PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Smaller Companies Fund

Quarterly Investment Report

30 June 2011

FOR PROFESSIONAL INVESTORS ONLY

INVESTMENT OBJECTIVE

To preserve capital and generate absolute returns over a full economic cycle by investing primarily in Small Cap companies in Asia Pacific Ex-Japan, whilst maintaining portfolio volatility significantly below the peer group.

INVESTMENT PROCESS

With anomalies as a start point, the investment process seeks to identify and invest in key 'themes' in the Pacific region. Our themes are driven by factors outside of normal economic cycle and are not yet discounted by the market. Companies are identified and chosen via rigorous bottom-up analysis with emphasis on traditional value and high ROCE. Cash and Index Futures are used when opportunities are few and to reduce portfolio volatility.

FUND MANAGER

Heather Manners - Partner
Appointed Head of Henderson Asia and GEM team in 1996 after which FUM tripled to USD5bn. Her flagship product was the S&P 3 Star rated Pacific Capital Growth Fund (long only) which she ran from 1990. The two main features of this fund were sub market risk for superior market returns. On the back of this fund she designed and launched the Henderson Asia Absolute Return Fund in 2000 (long/short) and managed it until 2002.

Heather has been running money in Asia for over 25 years. At some stage during her career she managed every type of asset class offered by Henderson, including short list portfolios and assets for a 5 star Morningstar rated Small Companies Fund.

Prusik Asian Smaller Companies Fund

The Fund was up 1.88% over the quarter. The stock markets were very volatile over the period; the Asian Index (MXAPJ) touched on a high point in early May of a quarterly gain of 4.6% and troughed in mid-June some 9.8% below the high. The quarter end saw a dramatic rally over the final two weeks, erasing most of the losses and catching many unawares.

We were certainly pleased with our ability to ‘hedge’, or at least partially protect holdings, using index futures. These futures positions contributed strongly in May, when the fund had about 25% futures cover across various markets and their removal in early June proved timely. This cover allowed us to leave the underlying holdings largely unchanged and, importantly, in place for the rally at quarter end.

We were also comfortable with the performance of our themes and underlying stocks. The Taiwan Domestic theme (Shining Building, Hung Poo), internet services (Daum Communications), branded consumer goods (Emperor Watch and Jewellery, Biostime, TTK Prestige) and healthcare (Mesoblast, Starpharma and KPJ Healthcare) were amongst the strongest contributors for the quarter.

Few significant changes were made to the fund. For much of the period the futures and cash position were defensively placed until June when, as many of the charts, valuations, statistics and bearish sentiment started to suggest an extremely oversold situation, the futures were removed and some of the cash was deployed to top up existing holdings and add to some new ones. Old favourites revisited included Skyworth (TVs in China), Hung Poo (Taiwan domestic) and Robinson Department Store (Thailand upcountry consumption). New additions included Alliance Global (financial services in Malaysia), Biostime (baby food and clothes in China), HSIL (bathrooms in India) and Jasa Marga (toll roads in Indonesia). In Thailand we retained the futures cover until after the month end uncertainty surrounding the election had passed.

Thematically there has also not been much change to the fund. We have kept a strong and growing exposure to our favourite domestic themes including, domestic consumption, Taiwan domestic, healthcare and ASEAN linkage. Automation of factories has also been a successful area. Asia, when viewed from an index perspective has made disappointing returns over the half year under review when compared even with stock markets in Europe or the US but this seems at odds with the underlying fundamentals and value that can be found in Asia. In practice there has been a huge divergence in performance between sectors and countries in the region. This can be broadly described as outperformance from ASEAN and domestic consumption themes everywhere, whilst cyclicals, exporters, banks and property in North Asia have languished. It is no surprise that the latter categories dominate the regional index and this underlines the importance of a thematic, non-index related, approach.

Outlook

We stand by our contention made in last quarter's report that 2011 is year 3 in a four year economic cycle and that year 3 is generally characterised by rising inflation and interest rates but also strong earnings growth. Across Asia this is indeed currently the fairly typical experience and as such the stock markets should be expected to perform in line with earnings this year. Conservatively this means returns of at least 10-12% are achievable and given the index (MXAPJ) has finished the first half of the year broadly flat, the upside is yet to come. We suspect the (temporary?) resolution of issues in Greece and elsewhere in Europe will be the catalyst for global markets to bounce. In addition, Asia has recently triggered most of the usual quantitative signals we see before a good rally. Credit Suisse has one of the most reliable models for predicting such turns and their data now shows Asia ex-Japan at similar to the levels of undervaluation to that which we saw at the lows in 2004 and 2010.

Yet again we all travelled to Asia during the second quarter and our findings also support the view that the region's equities could deliver some worthwhile upside before the year is over. Companies remain on the whole very upbeat and inflation far less malevolent on the ground than is presented in economists reports. The strength of the domestic consumer is impressive and sentiment is good. The most negative pressures are emanating from China and the western world. On China we believe this will change in coming months, on which more below.

As for the rest of the world; we are concerned. The short term appears set to offer some respite and recovery but the medium term future looks likely to be characterised by inhuman volatility and intermittent grave risk.

China – Economy

The one question we are asked constantly is whether China has inflation under control? The answer is that we do think so, and so does President Wen who went to the English press and declared this to be the case in the Financial Times recently. We expected the June CPI number to shock people, as it did, but believe that pressures will ease over the rest of the year. Hog prices which fell 20% since January until the sharp rebound in June now mean farmers can get good returns from rearing pigs. As a result by year end there should be pigs a plenty. Furthermore, manufacturing input prices fell in June for the third consecutive month in a row.

Perhaps more concerning is the rising evidence of real pressure at SME level. This is partly owing to lack of funding availability but also partly a squeeze on costs. In Wenzhou a recent study showed that as many as 25% of SMEs were operating at a loss although our anecdotal research suggests this could be understating the problem. That the Chinese government is prepared to stand by and let its precious private economy run aground in such as way seems anomalous.

We can only conclude therefore that the second half will see much more accommodative measures and more concessions to economic growth, which would be good for the stock market. This move perhaps started with two announcements made as the quarter ended. Firstly, the threshold for tax will be increased from CNY2000 (the equivalent of US$350 per month) to CNY3500 (US$540) per month. This will benefit the lower income earners but gives everyone a boost. (It also throws into deep relief the difference in the economic situation between East and West, where tax cuts will remain an elusive dream for a while!) The second announcement was from the Beijing government that they are setting aside CNY10billion for 1 million units of social housing to be built between now and 2015. This paves the way for similar announcements from other regional governments over coming days. We also think it is likely that we may see further measures coming soon including a possible cut in VAT or a widening of the trading band of the RMB.

China has been a poor performer in the last three months and now ranks amongst the very cheapest stock markets in the region. We have slowly in the past few weeks been re-building our exposure here. Consumption related businesses, such as Biostime (baby goods) and Trinity (luxury men's retail) will do well.

Milan Station

No, we have not taken a geographic wrong turn. Milan Station is the name of a company which recently had an IPO in Hong Kong and enjoys a current market capitalisation of some US$175million. The business buys and sells *second hand* designer handbags via shops in Hong Kong, Beijing, Macau and Taipei and the share issue was oversubscribed by 2,100 times, a record for Hong Kong! We have for several months resisted the urge to write about handbags being the new hard currency, but suffice to say it is not hard to fall into thinking that this, or the more recent Prada issue, also in Hong Kong, could mark the top for luxury goods consumption in China. But the extraordinary demand continues.

Emperor Watch and Jewellery

Emperor Watch & Jewellery is a Hong Kong-based and China-focused retailer of Swiss luxury watches and self-designed fine jewellery. It has an extensive network of 68 retail outlets at prime locations in Hong Kong (17 stores), Macau (4 stores) and China (47 stores). Its target customers are middle-to-high income mainland Chinese. In 2010, Hong Kong contributes 82% of revenue for geographical breakdown and the watch business accounts for 85% of revenue (vs. jewellery 15%) with higher gross margin on jewellery business 40% (vs. Watch 25%).

Emperor Watch & Jewellery has strong long-term partnerships with numerous Swiss watch brands, now established for nearly 70 years. It is a dealer of 21 luxury watch brands in Hong Kong and Macau, and 30 in China, with an extensive brand mix and full categories for most brands. Top 5 sales brands Cartier, Omega, Rolex, Patek Philippe and Jaeger-LeCoultre contribute around 50% of revenue in 2010.

EWJ sells both International brands and its Emperor brand. It offers tailor-made jewellery for customers who wish to create their own exclusive jewellery products with in-house design and outsourcing production. EWJ plans to expand its higher margin jewellery business to enhance overall profit margin. By the end of 2011 it anticipates to have opened 2-3 new stores in Hong Kong and 10-20 new stores in China.

According to management, two thirds of the new stores in China will be jewellery stores. Management believes lower-tier cities will be the main growth drivers of the jewellery business, and targets to achieve 50% sales from its jewellery business in 5 years (vs. 15% in 2010), lifting overall company gross profit margin via the product mix shift.

We think luxury goods will become the fastest growth segment in the retail sector in China. According to Euro monitor, luxury goods consumption in China will realise a CAGR of 25% in the next five years. Given an 11-20% import duty on luxury goods in China, duty-free Hong Kong has become the prime luxury goods shopping centre for high-income Chinese visitors. According to management, over 80% of its sales in Hong Kong and about 100% in Macau are from mainland Chinese visitors. During the past five years, the number of Chinese visitors and overall spending surged, and we expect this momentum to continue. The fast-growing high-income class in China and additional purchasing power due to renminbi appreciation will underpin the growth of China's luxury consumption.

The stock market consensus is that Emperor is trading on a 30% discount to its peers on 13x 2010 earning and will achieve earnings CAGR of 35% over the coming 3 years.

Oil Services

In the offshore oil drilling sector there is looming the mother of all investment cycles. At the moment it is rumbling like distant thunder. The majority of oil services companies in Asia are still dusting themselves off after the beating their businesses took on 2008/9 and oversupply of some vessels in the tugs and barges segment has not aided recovery much. However, the recent pain is masking some fairly bald statistics. The world has about 6,500 fixed offshore drilling platforms of which 3,600 are in the Asia Pacific, Africa and Middle East areas. Of the 3,600 rigs in these areas over 2000 are over 20 years old! Worse, they have not been treated well by their owners. It is not uncommon to find Indonesian owned rigs which were decommissioned 5- 10 years ago but have not been maintained at all. Anecdotally their owners are now looking to recommision these rigs and, thanks to the neglect, the work to be done is huge.

The key to this theme will be not to try to run before we can walk. This will be a multiyear story in Asia as new rigs are built and old ones are brought back into service. These efforts take years with many processes, such as laying undersea cables in preparation for a rig taking months at a time. Moreover, a shortage of boats and equipment will keep progress slow. The key will be to invest in those companies who are offering solutions to these bottlenecks.

Ezion

Ezion develops, builds and charters Liftboats of the most sophisticated class in the world and was the first to introduce Liftboats to Asia and the Middle East. Liftboats are used in the repair, maintenance and operational support of offshore platforms. In short they are the most efficient and safe way of transferring equipment and personnel onto a platform. Until recently Asian rigs used work boats for this purpose, often in the process having to deal with 20 foot height differentials in high seas. There is still an acute shortage of Liftboats in Asia, the Middle East and Africa. In North America there is roughly one Liftboat per 14 rigs but in Asia, Middle East and Africa there are less than 1 Liftboat per 60 rigs.

Apart from the ongoing demand for Liftboats, Ezion also provides sleeping accommodation vessels for workers which are more suited to the regions demands (for this read more cramped!). In sum, its main businesses are poised right at the point where spending is now picking up sharply and indeed demand is robust. Net profit CAGR of over 30% is achievable in the coming 3 years and the company currently trades on a PE of 6.9x 2011.

Vietnam – an 'amuse bouche' – Feast later.

We have just returned from a short visit to Vietnam, our first foray since 2007 which was a major stock market peak. Thankfully we only bought a painting as since then, the stock market has fallen some 65.3% from the top, including losing another 20%+ this year to date. So we felt it was time to reassess, and we were not disappointed.

Vietnam has had plenty to deal with this year. In crude terms there has been a currency devaluation of 9% (thus eliminating the black market differential), a removal of fuel subsidies resulting in oil prices rising 18%, a deregulation in electricity pricing which is pushing electricity prices up 15% and a clamp down on bank lending. In 2010 bank lending was up 30% but this year the government reduced loan growth for all banks to 20% and stipulated all loans must be made to 'productive' businesses, thus ruling out property and most other non-manufacturing enterprises. The upshot of this has been inflation of 23%. Food is 45% of CPI and energy is a further 25%. Deposit rates at the banks are about 14% and lending rates have soared to over 20%.

In addition, the trade deficit is 10% GDP and is made worse by the fact that Vietnam has to import nearly all the equipment is needs to make goods. Therefore a machine imported today for US$100 that produces US$20 of goods for export tomorrow results in a trade deficit of US$80.

Another structural problem is that State Owned Enterprises dominate the economy. They take over half of Vietnam's investment but only produce a quarter of all the industrial output. A Vietnamese SOE consumes US$12 of investment to produce US$1 of output. In China the comparable number was US$3.

To put Vietnam in perspective it is about 15 years behind China. Labour costs 50% of what it does in China and annual GDP is about US$100bn, which is the expected revenue of Apple this year! The stock market is tiny, some 289 stocks listed in Saigon (and about the same again in Hanoi but they are much smaller) and the stock market cap is US$20bn. For foreigners there is an additional frustration which is that many of the better companies have reached their foreign ownership limits at 49%.

So the question is whether we have now seen the worst? It is certainly difficult to deregulate energy twice, but timing will be difficult. There is nearly 5 years of bear market mentality now hardwired into local investor's minds and it will be the locals not foreigners who will need to get this stock market moving again. But we have to say we are very taken with the opportunities Vietnam offers any investor with a 3 to 5+ year horizon. Here are the main reasons:

Firstly, this is a resource rich country with more food, water, coastline, resources than it needs. It sits on the doorstep of China and India and in the midst of the ASEAN peninsula about which we have already written extensively.

Secondly, it has a population of 90 million people and the average age is 26. Indeed two thirds of the population are under 35, meaning that demographics will be supportive until mid century. Furthermore they are a very cohesive nation having fought together in recent history. Corruption is still very minor owing to the fact that a large percentage of the population are police! (This is hard to judge exactly as nobody had clear statistics and most are plain clothed!)

Thirdly, the country does not look or feel like a country which has been in economic crisis over the last 5 years. Since my last visit there are fewer mopeds and more cars in District 1 (the main business area) and everyone now wears a helmet (albeit more decorative than functional, we suspect). There is also a skyscraper! We went to visit blue chip dairy products company Vinamilk in their new offices in District 7 which last time we were there was a swamp, but now resembles the newer outskirts of Taipei. We have since learnt it was indeed conceived by a Taiwanese architect and was quite complete with tree lined roads and sedate traffic. The point here is that economic progress is ongoing, there is no rupture.

Fourthly, Vietnam receives about 10x the annual Foreign Direct Investment than the Philippines. Indeed this was the main reason we went to Vietnam again as so many of our companies were looking to set up there. Honda, for example, plans to make 64% of all their motorbikes globally in Vietnam! Other companies, such as Lock and Lock, see Vietnam as the start point for an ASEAN customer base as well as good cheap manufacturing.

Finally, the stock market looks very cheap. The average PE is 8x this year but the median company is on 5x. A good example is FTP, the country's leading IT conglomerate which has a market cap of US$464m and annual sales of US$1bn. It trades on 7x earnings and is likely to see earnings grow 20% this year.

In conclusion we think Vietnam will regain its stock market poise, possibly as soon as the coming 6 months but certainly it offers one of the more interesting counter cyclical investments in Asia in coming years, especially if the SOEs begin to make headway into better efficiencies. The stock market is very illiquid and small so latecomers will be disappointed in the next cycle.

Red China

A year ago an anomaly appeared in Chongqing which has since spread like wildfire across the country and possibly suggests a state of public mind which is important not to ignore. The new fashion is for red-songs, red-movies, red-dance and red-books. Anecdotally it is not uncommon to hear red-songs being played in the lobby of hotels or in karaoke bars or even on singing shows on TV. Even China Eastern Airlines has a red-movie month promotion this July. The most popular movie nationally currently is called 'Beginning of the Great Revival' and tells the story of the founding of the Communist Party.

In short, this is nostalgia for the 'good old days' when everyone was equal economically, housing was provided by the state and corruption was rare. The question is how deep does this feeling go and to what extent does it carry anti-existing order and anti-elites undertones? Some of our contacts who are close to Chinas government are separately but interestingly making the point that the incoming new leadership next year are far more pro central planning and that we should expect to see a lot more power returning to the party centre. Moreover they even go so far as to suggest that the current demise of so many small businesses will aid and hasten their takeover by large SOEs (State Owned Enterprises). Meanwhile the current predicament for so many foreign businesses that are entrenched in huge operations in China but unable to make money there will be solved in a similar way, presumably for cents on the dollar.

This latter point raises the hairs on ones neck. Of the 31 Chinese IPOs which have listed in the US, 26 are below the issue price and several, such as Longtop Financial are being investigated for fraud. Into this boiling cauldron of investor outrage Peter Navarro, economics professor at the University of California, Irvine and Greg Autry have written a book entitled ‘Death by China’. To give you some idea of the tone, some reviewers have likened the authors to Paul Rivere, the man who rang the Liberty Bell which sparked the American revolution against the British. The book lists, in great detail, threats made by the Chinese to the US. These include issues around currency rigging, destruction of the US manufacturing base, harmful Chinese imports such as dangerous toys and the considerable threat posed to US industries due to industrial espionage.

The conclusion here is that it’s too early to tell whether the red-fever is important or a bit of nostalgia but remaining open minded to either possibility will help next year. The anti-China sentiment is currently very extreme and at the very least suggests that probably China is due a rally in the near future! Cynical and short term opinions aside there does seem to be a risk that extreme geopolitics or, as somebody recently described it to us, ‘modern warfare’ becomes an even more powerful force that dominates our economic world for a while.

Grimsvotn

On 20th May, another Icelandic volcano erupted but with very little press coverage as it didn’t cause a huge disruption to air traffic. However, this one was way more important than the one which stopped all the aeroplanes last year. In volcano ranking terms this was a ‘4’ volcano, where the maximum is 5. It was throwing out between 100 and 1000 times more debris per second than last year’s volcano and in 48 hours had exceeded all of last year’s eruptions. Crucially, the ash was thrown 15-20kms up into the stratosphere but because of the location of the volcano and the prevailing winds for the time of year the ash has stayed mainly over the Arctic Circle. This has meant there has been very little impact so far on global weather but the risk is that this will change as summer ends.

In order to understand the magnitude of the impact it is important to remember that in 2009 there were 2 massive volcanic eruptions, one in Alaska and one in Russia. Both of these volcanoes were huge and have been a significant part of the cause of the last 2 years of cool and disrupted weather as the debris cleared. This year should have seen a return to normal but this new eruption will add another 2 years before the ash has worked through. In 1991 Pinatubo erupted causing clouds 10 miles thick and cooling the globe by 0.5°C is. This had a massive impact as for every 1°C drop in temperature the freeze zone moves south by 1000km. After Pinatubo, Canada lost 30-40% of its harvest and there was 1ft of snow on the grain in August.

Back to this year, the risk once again is that winter arrives early and is extremely harsh. It is also very likely to generate another LA Nina which will continue to create colder conditions and much disrupted weather. The US harvest is especially at risk as planting has come so late thanks to the flooding. No matter what your views on commodities medium term, this winter could be tough and soft commodities and energy prices could be firm.

SOME INTERNET TRENDS

Gamefication

Social gaming (eg Farmville or Pet Society) is poised to become a billion dollar industry in the US this year with nearly a third of internet users likely to play at least one game per month, a rise of 15% on last year. To be clear, over 60% of those billion dollars is money spent on *virtual items*.

Gaming is fast becoming a huge part of our lives so it should be no surprise that in the coming year we should see some dramatic new games designed to help educate us or make us healthy. New technologies such as 3D, accelerometers and gesture control will be at the core of these new products. In old parlance, 'sprinting' will become 'tag' and health and learning will become a lot more fun.

Daum Communications, listed in Korea, is a key beneficiary of increased usage of hand held devices as a regular means of access to the internet and the gaming boom that is coming with it. Daum is more innovative than its larger peer NHN in the mobile arena and is picking up good market share with its mobile search, casual games and *free* (yes, free!) calls service over the *3G network* (yes, that is correct!)

Tablets and Education

A new report by the Pearson Foundation suggests that 70% of those bound for university or college would like to own a tablet compared with only 7% of current students who actually do. Of those tablet users 9 out of 10 say it helps make their studies more efficient and to perform better in class.

Social learning platform Xplana has been analysing the digital textbook market and has concluded that it is reaching a tipping point which means that in 5 years over 25% of textbooks will be digital and that in 7 years the digital format will be dominant. These forecasts have been revised up dramatically from a year ago with the advent of the iPad. Although tablets will be the main driver of this revolution, better e reader sales, a booming textbook rental market, the rise of the Epub3digital book standard and new advances on 'open source' and open-rights textbooks all combine to make this a very low cost and attractive option for school boards.

Internet ready TV

The other area which is about to explode onto the market in China is internet ready TVs. Buyers will purchase TVs with numerous apps already preloaded, both from the traditional TV side, such as cable options and from the internet side such as search engines, movie download sites (such as Youku), music, home shopping, the weather and gaming sites and so on. Moreover these will be simply operated TVs and the remote control will be replaced with a Smartphone or tablet. For many households this new TV option could be the entry level purchase for getting online at all. What is interesting is that although they have announced the arrival of a TV product soon, TVs remain the one area not yet dominated by Apple.

3D Printing

A 3D printer, which has nothing to do with paper printers, creates an object by stacking one layer of material, typically plastic or metal-on top of another, much the same way as a pastry chef makes baklava with sheets of phyllo dough. Ten years ago this technology was hidden away at Nasa and in the design labs of companies like Boeing where they were used to design and make prototypes. Today we are seeing 3D printing technology being pushed to the limits from making bespoke prosthetic limbs to building houses! What is clear is that 'handcraft' and 'bespoke' are going digital, meaning that the cost will fall. Small runs of home designed items such as door handles or jewellery are feasible. This technology is part of a wider trend which looks as though it might turn manufacturing into a business not dependent on scale. Ideals and requirements such as locally sourced, small batches, quick turnaround, flexible and one offs will no longer be so hard to achieve. Furthermore, waste and inventories could become irritations of the past.

Crowd sourcing

If you have not yet looked at the website "Kick Starter' we urge you to do so. Here anyone can post a business idea and users can pledge start up money to the ideas they like. Those whose ideas generate to sums needed then get funding. The crowd gets to help pick the winning ideas and influence them.

There's more. The crowd is also now closing in on manufacturing in a way which will bring about transformative change. Manufacturing is being democratised. One way to put this is that global supply chains have become scale free, serving both the garage inventor and Sony, and the two forces driving this are a) the explosion in cheap and powerful prototyping tools and b) factories becoming more web centric, flexible and open to custom work, thanks to the global slowdown.

When industries democratise they are ripped from the sole domain of companies, governments or other institutions and handed to the crowd. It has already happened in the music industry, newspapers, broadcasting and communications and the consequence was a massive increase in the range of both participation and participants. Instead of 'General Motors' type companies there will be thousands of small innovators, like krill, operating in the realms of peer production, open source, crowd sourcing and user generated content. In short, manufacturing is about to discover its long tails.

One major factor behind this change is how the Chinese manufacturers have evolved to manage more efficiently small orders. Alibaba is the largest aggregator of 'open access' factories allowing customers to access makers in China, facilitating real time translation online and allowing replies within minutes. Chairman Jack Ma calls it 'C to B' – consumer to business and the trend is expanding very fast. China is at its epicentre thanks to its traditional 'shanzai' industries. Shanzai literally translates as 'bandit'. These are the fast and flexible knock off merchants but their hair trigger survival kit and networked approach has resulted in innovative products and business models.

The next decade will be interesting for manufacturing.

Big Government, complexity and inhuman volatility

The future is difficult, but not impossible if we keep our heads.

Big government is not a new idea for those of us investing in Asia but it has gathered popularity everywhere since the crisis. Passing time with an old Asia hand recently we noted what a large portion of the China and Hong Kong indices are now made up of sectors not in control of their own destiny. These include banking, real estate, oil and gas, coal, utilities, telecoms to name but a few although 'moral suasion' has even crept into the hallowed consumer sector via guidance on pricing of basic consumer products and department store gift voucher systems. It demonstrates how important it is not to invest in line with the index, unless, of course, the government wants the stock market to go up!

As scientists show clearly, the more complex a system, the more unstable it is which includes an increased inability to predict when change will occur. When Steve Jobs introduced the new Apple iCloud service the two loudest cheers were heard when he said there would be nothing new to learn and there would be no ads. Jobs has nailed the major problem of the 21st century which is that human bandwidth is miniscule. Indeed scientists have shown that the conscious mind can take in about 7 to 70 bits which is about a millionth of the data streaming into our senses. Fund managers have always had to jettison the majority of information they receive but quant funds, algorithmic trading and computer generated screening means that events in the stock market are unfolding at inhuman levels of complexity and information density. It could be important that the best way to manage risk is not to add complexity.

Dichotomy is something fund managers learn about at the knee of their first boss. The process of making a decision and maintaining that decision whilst constantly questioning if it's correct and examining with open mind any and all reasons why it might be wrong may be the kind of behaviour that drives family members up the wall, but is the basic survival kit in investing. The current state of the western world means that any locally made decisions are subject to additional layers of disproportionately high global risk which is not only changing but must be factored into decisions. The stakes are therefore significantly higher and the weight of dichotomy in every decision that much greater. As a character said in X-Files 'no matter how paranoid you are, you can never be paranoid enough'. He must have been talking about the current investing environment.

Paranoia, dichotomy, complexity and government intervention have conjoined to create the current era of extreme volatility. The major contributing factors are the deterioration of western demographics, huge debt to GDP levels, risk of debt defaults at sovereign level, inflation, China and , as a result of this concoction, a willingness by governments to do anything to keep the 'show on the road'. Recent events in the commodities sector underline this. In April the CME raised margin requirements on silver by a spectacular 84% and soon thereafter raised margins on oil and gasoline by 20%. Recent panic selling in grain began with a new CFTC requirement to large holders to reduce positions to 600 contracts or less by June 29th. Very recently the oil stockpile release in the US has flummoxed observers leaving experienced operators in that market to call it a 'psychological mechanism' and an 'act of desperation'.

This new geopolitical rationale and, crucially, the loss of predictability that comes with government intervention will ultimately be very serious for stock markets. This is illustrated by a simple experiment carried out by Seligman in 1968. He presented electric shocks to two sets of rats as they pressed a bar to get food. In one set the shock was always preceded by a flash of light, but with the other set the light and the shock were delivered separately and at random. Needless to say the rats in the predictable shock cage learned when to expect the shocks and continued to press the bar for food remained healthy. However, the rats in the random shock cage exhibited signs of extreme distress and stopped pressing the bar for food. After 45 days all the rats were dissected and those which had been subjected to the random shocks were found to have badly ulcerated stomachs.

Lessons in experimental neurosis may be learned the hard way in stock markets. Volumes are already very low as is courage and holding power. Whilst mathematically or even geopolitically governments may well believe they are doing right and are indeed rational in their thinking, they are either not caring or not aware of the psychological damage they could be inflicting and the subsequent risks they are introducing to the system itself.

Where does Prusik stand in all this? We think we have some strong advantages. Firstly, we are small and nimble. We are able to liquidate our positions within hours if needed and our thematic approach not only allows us to avoid great areas of the index where governments like to play but our thematic approach actively seeks out companies which remain too small, or areas which are too new to have lost control of their destiny. Furthermore, we have built our track record on fending off volatility. The Prusik Asian Smaller Companies Fund has volatility in the lowest decile of the entire peer group (open ended offshore Asia Pacific ex Japan Equity Fund Index) but performance and Sharp Ratio in the top decile.

Our prediction is that risk will increasingly matter, and when it does, simplicity, real ability to return to cash, transparency and low volatility will all be at the forefront of investor's requirements.

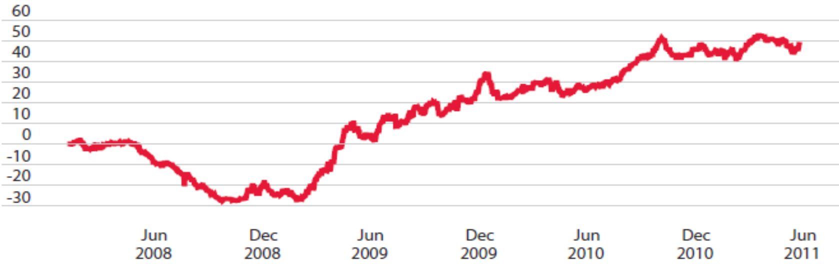
PORTFOLIO PERFORMANCE

Performance Summary (%)
Periods ending 30.06.2011

	USD	GBP	SGD
1 Month	-1.22	-0.99	-1.25
3 Months	1.88	2.37	1.73
Year to Date	2.48	1.83	2.20
Since Launch+	49.31	56.22	10.24
2010	16.43	16.90	7.90
2009	59.70	56.10	-
2008	-21.60	-18.40	-
Annualised 3 years	16.92	18.12	-
Annualised Since Inception	12.56	14.64	6.93

Source: Bloomberg
+ Launch date: A: 08.02.08, C: 25.03.08, D: 15.01.10

Fund Performance - Class A USD (%)



Source: Bloomberg. Total return net of fees. Since launch: 08.02.08.

Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
2011	-2.15	0.43	2.35	3.75	-0.57	-1.22						
2010	-0.70	-1.52	3.68	3.23	-4.23	1.20	0.83	2.74	7.45	3.62	-2.11	1.67
2009	-3.55	-2.02	-5.64	16.67	17.71	-3.66	8.91	-2.01	5.48	-2.16	4.42	4.81
2008			-2.44	0.52	0.26	-6.71	-3.49	-5.53	-8.52	-5.94	0.05	6.87

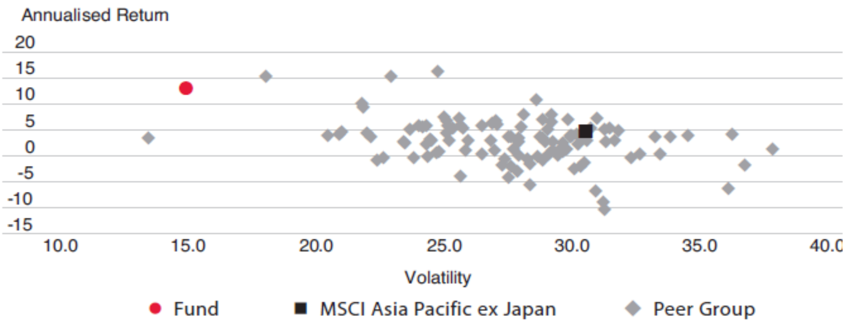
Source: Bloomberg

RISK ANALYSIS

Risk Metrics	**Fund**
Beta	0.54
Alpha	10.2
Sharpe Ratio	0.84
Volatility (%)	15.0
% of the portfolio – which could be sold in 2 business days	78%

Source: Bloomberg
Since Inception: A: 08.02.08

Risk Adjusted Performance - Class A USD (%)



Source: Bloomberg. Annualised return and 1 year volatility versus the peer group, 8.02.08 to 30.06.11.

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Emperor Watch & Jewellery	3.1
Ezion Holdings	2.8
Huaku Development	2.8
TTK Prestige	2.7
Daum Communications	2.6
Total Number of Holdings	39

Futures (%)

SET50 Future (Sep 2011)	-7.4

Portfolio Financial Ratios*

Predicted Price/Earings Ratio	10.3x
Predicted Return on Equity (%)	21.0
Predicted Earnings Growth (%)	23.0

*Fiscal year periods

Thematic Breakdown (%)

Domestic Consumption Services	25.2
Cash	21.5
Healthcare	12.4
ASEAN Linkage/Domestic Growth	9.2
Taiwan Cross Straits	7.1
Oil Services	5.2
Gold	4.1
Automation	3.9
Network Access	3.4
Smartphones/Tablets	2.9
Singapore Office	2.6
Other	2.0
IT Services	0.5

Geographical Breakdown (%)

Cash	21.5
Hong Kong/China	20.1
Singapore	14.8
Taiwan	12.3
Thailand	11.6
Australia	5.5
India	5.5
Korea	4.4
Malaysia	2.3
Philippines	2.0

All data as at 30.06.11. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size	87.4m
Launch Date	8 February 2008
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GBP, SGD

Dealing

Dealing Line	+353 1 4367 200
Administrator	Citi Hedge Fund Services (Dublin)
Dealing Frequency	Weekly, Friday
Min. Initial Subscription	USD 100,000
Min. Subsequent Subscription	USD 10,000
Subscription Notice	2 business days
Redemption Notice	2 business days

Share Class Details

Codes

Class 1			SEDOL	ISIN	NAV*
A USD	Unhedged	Non Distributing	B2PKN21	IE00B2PKN210	149.31
B USD	Unhedged	Distributing	B2PKN32	IE00B2PKN327	149.31
C GBP	Hedged	Distributing	B2PKN43	IE00B2PKN434	77.83
D SGD	Hedged	Distributing	B3M3HJ5	IE00B3M3HJ55	206.66

*Month End 30.06.2011

Management Fees

Annual Management Fee
1.5% p.a Paid monthly in arrears
Performance Fee
10% of NAV appreciation conditional on a 6% hurdle

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