**NAV Updates**

| *Series* | *Sept 2010* | *MTD* | *YTD* |
|---|---|---|---|
| Class A | 141.27 | 7.45% | 12.90 |
| Class B | 141.28 | 7.45% | 12.90 |
| Class C GBP | 74.43 | 7.33% | 13.81 |
| Class D SGD | 196.29 | 7.31% | |

Fund Size $68.8 m

**Performance**

| | |
|---|---|
| 2008 | - 21.06% |
| 2009 | +59.07% |
| 2010 (YTD) | +12.90% |

The Fund was up 11.3% over the quarter. The highlights included the ongoing performance of domestic demand related companies across the region as consumption, tourism, property purchases and internet spending all boomed. This was prompted by a background of very strong economic growth, a hint of inflation and a rush of liquidity exiting western economies in search of growth companies, strong currencies and possibly even dividend yield. TTK Prestige, a top Indian brand of kitchenware, Home pro, Thailand's DIY superstore chain, Manappuram, a microfinance company in India and gold miners Avoca, Medusa and Zhaojin all did notably well whilst the healthcare companies and REITS provided a steady performance. Currency gains were not as much as they might have been due to our large weighting in Hong Kong listed companies. However, with much of SE Asia now looking more stretched from a valuation and currency perspective we expect the final quarter to see assets in north Asia do better.

## Deja-vu all over, again?

The stock markets are beginning to look like 2007. Wide expectations of QE in November have sent assets and currencies soaring in Asia. The consensus view is that money printed in the West will make its way to Asia and other emerging countries, creating an obvious and exciting bubble. Indeed, the scale of capital inflows to emerging countries has already exceeded that of 2006/2007, with Asia inflows about 60% above that level.

We are viewing this headlong dash for inflation in the West as likely to succeed; indeed it is essential that it does, eventually. However, before the dangerous part of inflation where central banks raise rates there is usually a sweet spot and perhaps, we are enjoying that right now. There is even a chance that there will be an extraordinary 'aha' moment where investors all round the world wake up and realise that cash deposits sitting in bank accounts earning non-existent interest would be better off spent or invested somewhere, indeed anywhere. In short, we could find ourselves in a wild world of high western unemployment and yet rising consumption, higher risk tolerance, rising inflation expectations and thus greater investment in equities and other assets such as property.

In the meantime, companies can raise money at 3 or 4% in the corporate bond market and then buy cash flow in the equity markets at 7%. Individuals can borrow for 30 years fixed in the USA at 4.3%, surely the deal of a lifetime. Thus, with a return of confidence, economic activity should pick up, indeed could pick up significantly, increasing the velocity of the money being created by the western central banks and whipping up a storm.  Asian equities should do well in this environment but we also have to be aware of some risks.

Firstly, it is not inconceivable that foreign money inflows will put such upward pressure on the region's local currencies and assets, especially in areas causing social tensions such as house prices and food prices that local central banks will have to take action on. The problem is that simply raising interest rates to cool the domestic situation will exacerbate currency strength which is the very thing most central banks in Asia try to avoid. The risk is that a variety of capital control type measures to prevent inward investment might be introduced. If this does happen, it could happen very quickly and without much warning as once one country has acted; others will be forced to follow. History tells us very little about what to expect thereafter.

The second risk is that once money flows are under control the central banks in Asia may well be left with a residual inflation problem. If inflation does rise in western countries in a way that would ease the debt situation, then emerging country inflation could eventually find itself at uncomfortable levels.

The third risk is that both valuations and chart patterns are suggesting that Asia is not as well supported by value or underperformance as it might be. The chart below shows the Asia ex-Japan index ex companies over $75billion market cap. These mega caps have lagged hugely in the recent rally but when viewed without their inclusion, the regions index is in fact trading near its past highs and at 1 standard deviation above trend.

**Asia ex Japan - Price / Core Earnings (x) ex mega caps**


Source: CLSA

Finally, in June 2007 we sent you a Prusik Asia Fund monthly report containing stock price charts showing parabolic rises. These never end well albeit, we concede, the timing is hard to predict and in 2007 the rally did, after a short hiatus, continue powerfully into the final quarter despite an extraordinary turn for the worse in the macroeconomic environment which was eventually realised in 2008.  Here is one chart which is typical of the recent rally. Homepro is one of our holdings and sells home improvement and DIY products in Thailand. As a brand it is peerless in Thailand and is growing at 26% CAGR for the next 3 years with a ROE of 30%. We would therefore expect the company could reach a PE ratio of 25x, reflecting its one-of a–kind business position and strong fundamentals. However, this steep chart pattern is typical of many smaller domestic ‘bricks and mortar’ retail businesses across the region and illustrates well the likely future importance of timing, prudence over greed and being invested in companies where there is ample liquidity in proportion to ones position.

**Prusik Asia Smaller Companies Fund**

We believe it is important to remain largely invested as money flows continue to enter the region and may well take asset prices and currencies even higher. However, such ongoing strength in all assets increases the chance of policy risk and volatility, whether this comes in the form of the US FED deciding to delay QE or Asian central bankers acting against unmanageable capital inflows and currency strength. Therefore we have chosen to keep our exposure in a prudent mixture of high growth, under researched and still undervalued situations as well as companies supported by high dividend yield and excellent value. These include companies such as China lottery consultant AG Tech or China based advertising company Charm Communications as well as more defensive, all weather growth companies such as those in the healthcare sector including Faber Group; toll road operators such as Plus and property REITS which have a good dividend yield and/or value support.  These latter stocks will

<u>**Homepro**</u>


Source: Bloomberg

still do well if institutional money continues to buy Asia, but they will also be far more defensive if markets correct.

We would seriously council against large exposure to those areas of the region where liquidity can dry up very quickly and huge profits have been made. Both Indonesia in general and Chinese apparel/retail companies spring to mind. At the time of writing over 90% of our investments could be sold within 3 days, assuming we are occupying one third of the volume.

**Gold**

In the USA from next month it will be possible to withdraw gold from Gold ATM machines. There are already around 20 of these worldwide in places as diverse as Munich, Abu Dhabi and Madrid. These machines dispense small gold coins and bars weighing up to 8oz at prices updated every 10 minutes. Only time will tell if they herald the peak of the current gold bull market or will be just another milestone in an era where the consumers relationship with dollars and gold changes indelibly. In any event it is an interesting signpost in a world where powerful central banks are intent on creating inflation and also intent on buying back the gold they sold in the previous decade.

In recent weeks the gold price has continued to make new highs driven by a number of factors. The US dollar continues to depreciate against almost every currency, investors are switching out of cash accounts yielding zero into a currency that has a two thousand year history as a store of value and Chinese & Indian demand continues to be strong for the metal. Despite this, we are still able to buy shares in gold mining companies in Australia at attractive valuations. The Australian gold mining sector has shrunk in size since the acquisition of Lihir Gold and Andean which has forced investors to look at the smaller miners

Medusa mining is listed in Australia but its main asset is in the Philippines. It has a cash costs of US$200/oz due to the fact that the ore body they are mining contains 12g of gold per tonne of ore mined compared to a global average of 2g. Although the resource at their largest project is actually 5-7m oz in total, they have only proved up 500,000 oz as they are not willing to spend a vast sum in order to get it up to JORC standards (the rigorous standards used by Australian companies to account for mining reserves). This conservative attitude is a hallmark of the company which maintains a debt free balance sheet and therefore is not required to hedge any of its production. Trading on 6x 2011 earnings it is extremely undervalued and if the stock remains at this level and would be an attractive takeover target for a North American producer with highly rated stock.

**Chinese Tourist Boom**

Prusik recently met with someone who had just returned from a safari holiday in Africa and was staggered to have found a large group of mainland Chinese tourists in the middle of the Masai Mara. The local guides were equally surprised but were, rightly, warned that this was an event they should get used to. It can be instructive when shopping in any city, London included, to notice how many shops now display “Union Pay” signs. Union Pay is the card system Chinese shoppers mainly use when overseas.

In the 1990s it was hard for mainland Chinese to get a passport but these days that is easy; the harder part is getting a visa. Japan and now Korea have understood this and have opened wide inward visa applications for Chinese visitors. In Korea this is paying huge dividends already as Chinese visitor arrivals this summer soared over 85% up on last year, and now comprise the second largest tourist group after the Japanese. Korea targets there to be over 3 million visitor arrivals in Korea by 2012 and 9 million by later in the decade, representing 2% of China’s 400 million middle class. The good news is that the independent mainland travellers are large and spontaneous shoppers who spend 50% more than their Japanese counterparts do.

In Korea, as in the rest of the region, this is a trend which is beneficial not only to the major stores and brands. In Korea in particular cosmetics brands such as Amore are very popular in China as are airlines, hotels and casinos.

Grand Korea Leisure is a Korean casino operator. In Korea, the casino market is comprised of two very separate markets. There is a “domestic” casino sector which caters only to Korean gamblers and a “foreign” casino sector which is only open to non-Koreans. Grand Korea Leisure is one of two main operators in the “foreign” casino market which caters mainly to Japanese and, increasingly, Chinese visitors. It has a 49% market share of this market and their more established competitor Paradise has 41%.
Whereas Paradise has been hampered by poorly located casinos and an inability to generate profitable growth, Grand Korea Leisure is located in prime positions and has managed to capture almost half the market despite only having been in operation for 5 years – 45 years after Paradise opened their first casino. They operate 3 casinos with 2 of them located in Seoul and therefore highly convenient for business travellers to Korea. GKL is 70% owned by the Korean Tourist Authority which reduces the political risk given that the government effectively owns the casino. Although Japanese are the largest proportion of customers, Chinese gamblers now provide 25% of their revenue and that segment is growing rapidly. The stock is trading at an attractive multiple for several reasons. Firstly, it is a relatively new listing and therefore lacks the broker coverage of the other more well known casino operators in Korea. Secondly, the KTO has indicated that they wish to sell a 20% stake in the company which has pressured the price. Finally, the company saw margins fall this year due to higher employee costs and an increased use of junket operators to

build their Chinese business. This has now normalised and profitability is expected to improve in 2011. Trading at 13x 2011 earnings and generating a 5.0% dividend yield and with a 40%+ ROE now is a good opportunity to buy shares in what is a well managed business with high barriers to entry with an ability to capitalise on the growing Chinese tourism market.

**Dividend Investing**

*"It's quite clear that stocks are cheaper than bonds....I can't imagine anyone having bonds in their portfolio when they can own equities."*

Warren Buffett, 5 October 2010

Although long term returns from equities have caused many to wonder why they bother with this asset class, it is often interesting to examine from first principles the case for investment. When Prusik first investigated investing in Vietnam in 2001, we were surprised, and heartened, to hear that the Vietnamese equity market had a dividend yield higher than bonds as local investors did not see the point in investing in equities unless the dividend yield was higher than what they could get, risk free, from government bonds. This of course was how many investors in the UK and US viewed the equity market for most of its existence. In most equity markets, including Asia, it is now possible to buy many shares with dividend yields higher than the corresponding bond prices. With global bond yields of 2.5- 3.0% and real yields of 1-1.5%, an equity dividend yield of 4-5% seems extremely appealing as long as we do not enter a deflationary bust. Even if we do enter a Japan like scenario, it is possible to buy shares with very little cyclical risk which still offer a substantial risk premium to bonds. Of course if inflation does surprise on the upside, or we enter a hyperinflationary environment, then dividends have the inflation protection that cash and bonds do not. This is perhaps what explains Warren Buffett's aversion to fixed income securities.

With regards to Asia we believe that the current undervaluation of high dividend paying shares is particularly dramatic as the growth outlook for real dividends is higher in this region compared to the West. Although long term, real dividend growth in the US and UK has been between 1-2% over the past century we would see this growth level as being a floor for Asia with the possibility over the next five to ten years of real dividend growth in the high single digits. For many stocks of course it will be substantially more. This equity risk premium is extremely high at the moment and with careful stock selection we believe it is possible to buy a portfolio of stocks with high dividend yields, strong balance sheets and good ROE. If the market does not recognise this undervaluation then we will continue to collect a dividend stream which is far in excess of cash or bonds. However, we believe that the market is also likely to re-rate these stocks as cash rotates from other asset classes such as corporate bonds in order to generate an income stream with inflation protection.

There is another reason to favour high dividend yield stocks in Asia. In the ten years from 1999 to 2009, dividends accounted for more than 40% of total returns from Pacific ex-Japan equities. In addition, the top decile yield stocks produced an annualised USD return of 24.5% compared to market return of just 5.0%. One of the slightly counter-intuitive rules about investing in Asia is that high dividend stocks outperform high growth stocks even though investors often view Asia as a “growth” market. There are many reasons for this (value outperforms growth over time, high dividend stocks are sometimes “riskier” and so on) but another reason is perhaps more simple. In Asia where accounting can be murky and minority investors are often not well looked after, dividends are something that companies cannot fake (unlike Gucci handbags!). Additionally, when families own a large percentage of the company and pay a healthy dividend then it aligns the interests of both majority and minority investors.

Companies we like which also come under this theme include Amvig (Chinese cigarette packaging manufacturer) which is trading on a PE of 8.7x FY11, with a free cash flow yield of 7%, a dividend yield of 5% and ROE of 15%; Parkway Life REIT (invests in income generating real estate focusing in healthcare, consisting primarily of hospitals in Singapore and nursing homes in Japan) trading on a PE of 17x FY11 with a 6% dividend yield; and Mapletree Logistic Trust (owns S$3bn of logistic properties in Singapore, Hong Kong, China, Malaysia and Japan) trading on a PE of 14x FY11 and with a 7% dividend yield.

**Gambling**

The listed casino companies have been amongst the better performers this year, sparked by the hugely successful opening of two new casinos in Singapore earlier in the year and followed by some excellent numbers from the Macau and Korea based operators as the Chinese punters flood in. Meanwhile the four listed smaller companies which operate in the Chinese lottery segment have languished, owing to confusion surrounding the legality of gambling online and via mobile devices. However, we believe this is about to end.

In the recent Chinese language press it is clear that the government intends to continue cracking down on companies illegally using either the internet or mobile devices to sell lottery tickets. However, according to reports, the government itself intends to open up this market imminently by initiating a joint effort with a select few companies to access this potentially massive market. The final plans are, according to the companies involved in the discussion process, as close to fruition as the press suggests but we are yet to find out who the major players will be.

Once announced this will likely provide a huge fillip for the companies involved, and no doubt the sector as a whole. One company, AG Tech, has another joint venture with the government which is currently being launched which in itself offers a strong reason to consider an investment. AG Tech has very experienced and internationally connected senior management who came from Tabcorp in Australia. In conjunction with UK bookmaker Ladbrokes, AG Tech will roll out a synthetic motor race game, run with life-like graphics on a big screen every 10 minutes and this is planned eventually to run in every betting shop in China, of which there are 150,000 across 31 provinces, to date. These races will allow punters to make quick bets in between real races or matches and has already been successful in the UK, apparently providing about 20% of Ladbrokes revenue. The company conservatively estimates both revenue per day and also a modest rollout, starting in 14 major cities but the model does begin to look very exciting within a 3 year horizon. Despite taking all the companies' forecasts for revenue and number of shops and halving them, it is possible to envision a profit increase of over 5 fold from 2011 to 2014.

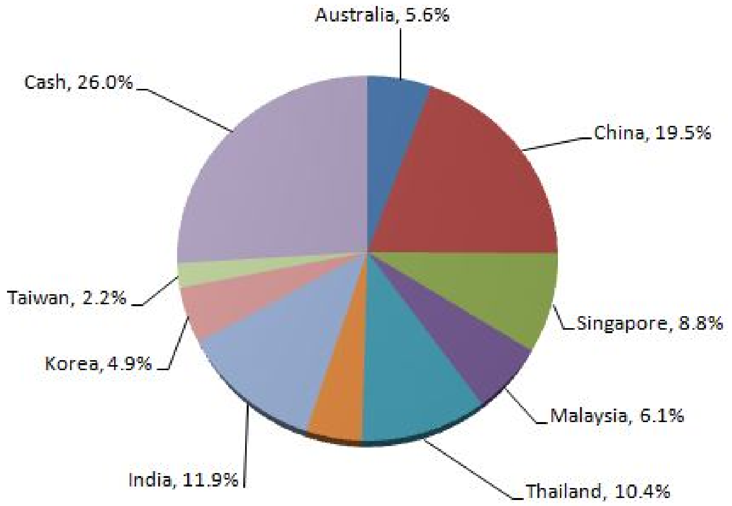
As if this is not enough AG Tech has also signed an exclusive contract with the government to operate all the ESports events in China. ESports is the relatively new phenomenon whereby people gather, rather as if at a rock concert, but to watch two or more national champions play video games against each other live, on a big screen. ESports is already a massive US$4billion per year industry in Korea and will be part of the Asian games in future. China, no doubt, will be looking to win gold. For AG Tech this is a Trojan horse for any future betting activity on these sports. No doubt it is also another plank in their relationship with the government. They say their joint venture partner in their bid for a slice of the online and mobile betting business is the Israeli private company Microstrategy. This company is quietly a giant, providing the software backbone of many major gambling networks in Europe and the US and claims to handle more transactions a day than the NYSE! As the Chinese will need foreign intellectual property to manage these projects, AG Tech does look well placed for more good news.

In the meantime AG Tech trades on 6x PE FY12 on extremely conservative earnings expectations.

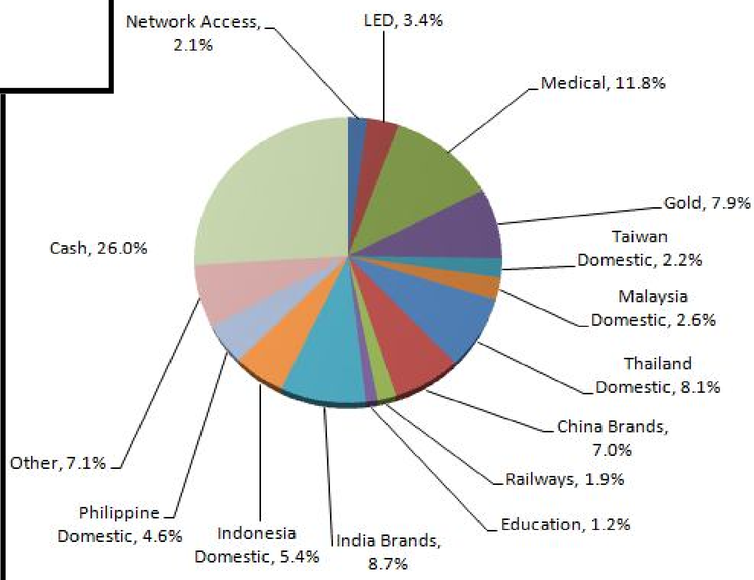
**Portfolio Valuation**

The portfolio trades at 13x 2011 PE, with estimates generating 20% earnings growth that year and an ROE of 18%.

# PRUSIK ASIA SMALLER COMPANIES FUND
# TOP LINE FIGURES — 3RD QUARTER 2010




| | |
|---|---|
| Number of holdings | 35 |
| Percentage of Fund invested | 74.01% |




| | Top 5 Holdings | % |
|---|---|---|
| 1 | AVOCA RESOURCES LTD | 3.0% |
| 2 | TTK PRESTIGE LTD | 2.8% |
| 3 | AMATA CORP PUBLIC CO LTD | 2.7% |
| 4 | JARDINE CYCLE & CARRIAGE LTD | 2.7% |
| 5 | FIRST PACIFIC CO | 2.7% |

## PASCF Monthly Performance

| Year | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2008 | - | - | -2.44 | 0.52 | 0.26 | -6.71 | -3.49 | -5.53 | -8.52 | -5.94 | 0.05 | 6.87 | -21.6 |
| 2009 | -3.6 | -2.1 | 5.6 | 16.7 | 17.7 | -3.7 | 8.9 | -2.01 | 5.48 | -2.16 | 4.42 | 4.81 | 59.7 |
| 2010 | -0.7 | -1.52 | 3.68 | 3.23 | -4.23 | 1.20 | 0.83 | 2.74 | 7.45 | | | | 12.90 |

**Key Parties to Fund**

| | |
|---|---|
| Investment Manager | Prusik Investment Management LLP |
| Administrator | Citi Hedge Fund Services (Dublin) |
| Custodian | Brown Brothers Harriman (Dublin) |
| Auditor | Ernst & Young |
| Legal Advisors | Dillon Eustace (Dublin)<br>Simmons & Simmons (London) |

**Key Terms**

| | |
|---|---|
| Denomination | USD |
| Dealing Day | Weekly (Friday) |
| Minimum Subscription | USD100,000 |
| Min Subsequent Subscription | USD10,000 |
| Subscription Notice Period | 2 business days |
| Redemption Notice Period | 2 business days |
| Dividends | |
| Class A | $ Non distributing |
| Class B | $ Distributing |
| Class C | £ Hedged Distributing |
| Class D | SGD Hedged Distributing |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**Manager Fees**

| | |
|---|---|
| Management Fee | 1.5% p.a. paid monthly in arrears. |
| Performance Fee | 10% of NAV appreciation. With a 6% hurdle. |

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