PRUSIK ASIAN SMALLER COMPANIES FUND PLC
PRUSIK INVESTMENT MANAGEMENT LLP

PRUSIK

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An Independent, Asian Specialist, Investment Management Team

NAV Updates

Series	*Sept '09*	*QTD*	*YTD*
Class A	116.50	+12.6%	+48.67%
Class B	116.50	+12.6%	+48.67%
Class C GBP	60.86	+13.1%	+45.22%

Fund Size $33.6 m

NAV Update	**Sept 09**
Class A USD Non distributing	USD 116.50
Class B USD Distributing*	USD 116.50
Class C GBP Distributing*	GBP 60.86

The fund rose 12.6% over the quarter, bringing the year-to-date rise to nearly 50%. It is refreshing to see, also, that the fund has punched through and held levels well above its high water mark, which in reality was set since inception at the beginning of last year. We believe it is one of the few funds in the industry to have achieved this. Since inception the fund has risen 18% and the index has fallen 16%. Over the quarter we added four new holdings in Hong Kong / China and reduced our exposure to Korea after some strong performance. We also added some new holdings in Taiwan, more of which below. The PE of the portfolio is 12.5x FY 2010, earnings growth is forecast to rise 45% that year. This would suggest, on our assessment, that the overall portfolio is still undervalued by 25% which provides some comfort.

Thematically, the fund is now heavily tilted towards domestic Asian growth, bar some of the network access manufacturing companies. However, the dynamics driving demand in, for example, "the low cost internet device" market seem to be coming as much, or if not more, from China than anywhere else in the world.

We have written in previous reports on the likelihood of significant "growth premiums" being paid for companies who can engineer good earnings growth in the current sluggish global economic environment. With Asian economies in arguably the best health for 40 years, currencies undervalued, and broader equity valuations only neutral we would argue these premiums are still to come. In fact, we feel that Asia currently is as attractive a universe to invest in, relative to the West, as it has ever been. The risk is that a fresh bout of instability comes as a result of poor economic management in the West. Should we escape without further crisis into a long period of convalescence and sub-par global growth, then Asia will see both its currencies and assets revalued upwards versus western assets, and the domestically oriented businesses will stand out.

Portfolio updates

LED

LED wafer shortages in the global market place are acute. Vico and Aixtron cannot manufacture enough wafer making MOCVD machines to satisfy demand, whilst the Korean electronics sector, which has been caught out by the phenomenal demand for flat screen TV's this year, has had to turn to Taiwan in desperation for supply. Pricing is improving and earnings are, we believe, set to exceed current expectations. We have added Harvatek and OptoTech, both listed in Taiwan, whose earnings are set to rise by 50% and 100% respectively in 2010.

Taiwan

Sticking with Taiwan, cross straits relations are thawing fast. Wen Jianbao the Chinese PM has offered to “crawl” to Taipei, China President Hu Jiantao has offered to sign a peace treaty with President Ma of Taiwan. We are also expecting the imminent signing of a MOU regarding closer ties in banking, broking and insurance. We added to our existing property holdings in Taiwan over the quarter. We have 14% of the fund in Taiwan and are looking at further opportunities on the domestic front.

Sugar

Food has performed well, with Khon Kaen Sugar in Thailand rising 40% over the quarter. In India United Phosphorous (a fertilizer manufacturer) met our expectations and we exited as we did ABB after the Viterra takeover. Food remains a theme for us, but a frustratingly difficult one to invest in, with the ultimate raw commodities still probably the best way.

Power Transmission and Distribution

We visited India over the summer and made some changes to our power transmission investments. Though we still remain very positive on the T & D space in India, we learnt that over capacity and competition from Korean suppliers would put pressure on margins for the transformer companies, and limit their growth opportunity. That said, India plans to add 60,000 MW of generation capacity over the next 3 years. For every $1 spent on generation, $0.5 needs to be spent on transmission and $0.5 on distribution. However, India has a much bigger investment backlog on the T & D side and addressing that will lead to huge investment. With this scale of investment, we feel that the companies that are focused in the construction arena, for the laying of the transmission and distribution network, would be better leveraged to benefit. Overseas players cannot compete on cost, knowledge or relationships. Having met with the management of the companies in this space we added Kalpataru alongside our existing holding, KEC.

We trimmed back Wasion, the funds largest holding, over the quarter having visited it in Hong Kong. We felt there was some uncertainty over Wasion’s order book outside China and, secondly, some delays in the new Government tender programme in China. Wasion is still a company we like long-term, however, we just felt it prudent to have below 2% in the company as we navigate these issues rather than nearly 5%. We hope to build the position again as the market digests this news.

Education

Education is another theme that we have been very positive about in India. However, we have struggled with valuations of market leader Educomp and have found it difficult to justify the levels of growth they were suggesting they might achieve. We have, however, met another company which is also focused on the Indian education space and is currently not researched by any international houses. Navneet Publications has two core businesses, namely curriculum publication and stationary. FY08 saw them also foray into the e-learning segment which we expect to be a huge growth driver for the company. We think that the significant difference between Navneet and Educomp is Navneet’s e-learning business, which is based on the current state curriculum, which will make it easier for teachers to transition from text book based teaching to their e-learning platform. This is in contrast to Educomp's business model, where they provide their own content which does not necessarily mirror the curriculum. At present this business segment is a negligible portion of the company's earnings, but we expect that, if the company executes well, the next 3 years will see this business becoming a very material portion of revenues and earnings. Navneet is trading on a FY11 PE of 11x compared to Educomp on 28x so there is still substantial room for both earnings growth and multiple rerating.

Telecom equipment

Readers of the Prusik Asia Fund reports will be familiar with our enthusiasm for the huge opportunities open to those companies involved in the Chinese mobile telecom network, whether building it, accessing it or trading on it. ZTE has been one of the better performers in the large fund, and so we added Comba Telecom to this fund which supplies antennae and base stations to the Chinese Telecom industry. Comba has been a strong performer over the quarter rising over 70%.

Gambling in China

Rexlot is also one of our larger holdings and a unique way of gaining access to the lottery and state betting systems in China. Post results we remain extremely confident in the company and expect more exciting news related to single match betting in China over the New Year. This is a huge industry, currently in the hands of the illegals and likely to become bigger driven by the World Cup football tournament next year. We still feel Rexlot, which has tripled from our purchase price, could triple again as the profitability of mobile phone single match betting becomes clearer.

Railways and Nuclear

In the rail and nuclear development theme we have added Hollysis Automation to our existing long term favourites China Automation and Zhuzhou CSR . Hollysis is a NASDAQ listed company based in Beijing and we have met with management twice in recent weeks. Like China Automation it focuses on control and safety systems for rail networks and industrial plant, but also has a joint venture with the Guangdong Nuclear Power Development Agency, where Hollysis is responsible for the IP for nuclear plant control and safety systems. Guangdong Nuclear power is to list next year and this may crystallize the value in Hollysis' joint venture. We saw one broker initiated cover of the company late last month after which the shares rose 50%! We feel these are still early days.

China Stimulus update

Given the tremendous stimulus we have seen, exemplified by the extraordinary bank lending increases, the key from here on is whether the private sector has shown any signs of improvement and whether areas which are not so easily "ramped" by the Government have been revitalised. Capital expenditure is probably the most important barometer of confidence within small and medium sized businesses. Over the summer, surveys show 29% of companies now expect an increase in capital expenditure this year versus 18% in January. This is a recovery, but, nowhere near the boom time figures of nearly 70% in 2007, or 40% in 2008. Likewise, top line or order growth has stabilized from within China and is now growing year on year, but remains in sharp comparison with overseas orders which are still declining, albeit at a slower pace.

Our conclusion is that there is some

recovery, but nothing like the rebound we would expect to see to necessitate major policy changes.

The news from the consumer is a little more bouyant. Flash reports from last week's Golden Week holiday in China suggest that shoppers have been busy. Top selling items are HD TVs, Fridges and 3G handsets. Suning Store reported that its Beijing shop saw sales leap 91.7% yoy on 2nd October and 25.8% for the first three days of the holiday. Meanwhile, the city's top gold jewellery store reported daily sales increases of over 90% year on year which were exceeded in Shanghai Department Store where gold jewellery sales rose 150%yoy! Tourism has also been strong. Initial surveys of 119 sightseeing destinations show tourist visits up 26.8% yoy whilst between 1st and 8th October 45,000 international holiday trips were taken, an increase of 107.4% yoy.

Despite such a healthy snapshot of the Chinese consumer, we believe at present the biggest threat to the equity rebound remains a withdrawal of any stimulus whether in the East or West. China's leadership knows how fragile the recovery still is and how dominated by Fixed Asset Investment (by the Government) it is. Additionally the leadership remains paranoid about unemployment. Without any inflation to worry about we expect continued stimulus and easy monetary policy as China faces the challenges of still weak export markets and high unemployment. We therefore expect, over time, more infrastructure launches, new tax policies, new incentives to boost private investment and consumer spending, and an acceleration of the urbanization program.

History tells us that China has always stimulated her economy until inflation forces a change of tack. Looking at past cycles we would probably need to see 4% inflation before we see a change in policy and we remain some way off this at present. The likely explanation of the disconnection between PPI (recovering) and CPI (declining) in China is overcapacity. Higher input prices usually manifest themselves in lower corporate profits rather than higher prices and inflation, especially when demand is weak. This profitless growth is being addressed by the Government via its "empty the cage, change the birds" policy, whereby higher value added industry is being strongly encouraged at the expense of the traditional low cost manufacturer. Recently in Dongguan we came across old style toy makers actually short of staff with local Government unwilling to help as the industry was deemed "sunset" or too low value added. This is an interesting anomaly set against unemployment of over 30m people!

Looking at the bank lending numbers again, CBRC & PBOC have indicated that they would expect loans to expand by 15% in 2010 vs 33% in 2009. In absolute terms that would mean lending an incremental RMB6trn as against the RMB10trn targeted for this year. We estimate the lion's share of credit growth in 2009 was directed at infrastructure and ailing state entities. Perhaps by Easter next year the infrastructure roll out (which is 75% debt financed) will have drawn down the bulk of necessary funds and it will be then that we can really see whether the private sector has any material appetite for credit. Without a pick up in private sector loan demand the Government would be forced to "restimulate" to achieve that loan growth figure for 2010. At some point the market will have to start to differentiate between the two types of credit growth, and we hope come next summer to report that the Chinese economy is being weaned off the State sponsored drip by a resurgent private sector.

Its always difficult to gauge China as one country, but, having visited in September our conclusions were that the Government is doing a good job of balancing the export pain, with a domestic stimulus yet to really kick in.

Valuations are neutral, stock picking is more important than ever as the overall relief rally is probably now priced in. We hold a number of retailers in the fund who are growing with the ever more affluent Chinese consumer. Daphne and Xtep are the larger positions. Daphne is a leading ladies footwear retailer in China with over 3,600 retail outlets. Daphne has 5 footwear brands and is also a non-exclusive sportswear distributor for Adidas and Nike. The company's focus is on the mass market in tier II and III cities, an area which, we believe, is still significantly underpenetrated and affluence levels are rising fast. By the end of the year Daphne will have sold their loss making Nike/Adidas division, which should help improve margins going forward. In addition, they are also manufacturing more of their own brands in-house which should also be positive for margins. We expect ASP's to trend upwards from next year and drive same-store sales growth from 2010. Trading on 14x 2010 PE versus peers on 20x plus, we feel that there is significant room for multiple rerating and with higher growth prospects see no reason why it can't trade at least on par. Xtep is a fast expanding fashion sportswear brand in China with about 4% market share in the sportswear market. Their Xtep brand targets the domestic mass market, whereas the Disney Sport brand targets fashion sportswear. Again we like Xtep as it is a strong player in the lower tier cities. Xtep recorded 22% order growth by value in 1Q 2010 at trade fairs, which is the strongest among its sportswear peers. We expect a strong 2nd half same-store sales growth and expect this to continue into 2010. Again trading on 10x 2010 PE, we believe the market is not crediting Xtep with the value it deserves.

Land values in China.

We have written in the past about a pilot scheme in Tianjin which enabled farmers to borrow against or in fact trade their land. We were excited, therefore, to spend some time in Hong Kong with Roy Prosterman of the Rural Development Institute (RDI) to update ourselves about land tenure in China.

The RDI have surveyed a wide sample of Chinese farmers to estimate the impact of the 1998 ruling which granted farmers a 30 year lease on their land. They found that 32% of farmers have both the key land-rights documents and 60% have at least one. 24% of farmers have made one or more long term investments in their land using their own savings and that farms comprising over 10% of China's arable land have assigned or transferred their land rights for economic benefit. Interestingly, in 2008 the average income per hectare was USD 538 which prices a hectare at US$10,000 (£2653 an acre). This values China's 120million agricultural hectares at 1.2 trillion dollars!

Land reform thus has begun and is likely to accelerate from here. What is the significance of this? In Taiwan during the decade following land reform, average rice yields rose 60%, farm incomes rose by 160% and diversification ruled with fruit and vegetables replacing the dominant crop of rice. Crucially, annual purchases of consumer goods soared. The RDI advise the Chinese government to extend land rights beyond 30 years and step up the publicity. This could be an extraordinary next move should the current economic stimulus falter. Indeed ultimately the pace of rural income growth in China may, therefore, exceed that of coastal urban areas for a period.

As an aside on the subject, India lags far behind; with half the rural population having no land tenure at all. This is an issue India is trying to address by handing out micro plots. Nevertheless, as it stands grain yields in China are 5433kg per hectare, India 2595kg per hectare, whilst the US reaps 7000kg per hectare. There is, therefore, plenty of future upside to farm yields in India too as land reform takes hold.

Taiwan Domestic – update

With no fanfare Taiwan is quietly one of the better performing stocks markets in Asia this year. We ask you to show us where else in the world have you seen property prices double this year? And yet in a somewhat unedifying suburb of Taipei residential prices have indeed risen from 2000 TWD /sq foot to 4000 TWD /sq foot! However, if you ask a local whether they are thinking of buying property they will probably say: yes but not yet, but they will when it falls by another 10% in value!

Taiwan is interesting for many different reasons.

Firstly, they are a master class in how to live with deflation. This is a country which enjoys global leadership in the manufacture of a myriad of technologies all of which are subject to Moores Law. They can live off the smell of an oily rag and make profits. This means companies are in fact extremely leanly managed. For example, cement in Taiwan is produced at a GP per tonne 30% higher than in China as there has been no demand for cement in Taiwan. However, it means their whole mentality is geared to expecting more of the same which is why reversing consumption habits of the past decade will take time.
Secondly, as a result of the point above and partly also due to living for decades in constant political fear of China, the Taiwanese live spectacularly below their means. As we have written about extensively before, huge savings are kept offshore, both private and corporate, which could change the landscape of Taiwan in a generation if brought home and spent. Meanwhile, the average car in Taiwan is between 13 and 14 years old! In Taiwan everyone eats a lunchbox, the usual cost of which is 50 TWD (US$ 1.51!) but a 60 TWD lunchbox is considered to be 'gold dusted' to cost so much!

Thirdly, as a result of such modest consumption many of the key sectors are hugely consolidated. For example, only two department stores comprise 80% of all department store sales, the top three hypermarkets have 75% combined market share, whilst 80% of cement demand is satisfied by the two main players. As a result, when the consumer finally gets moving, the stock market will be a truly extraordinary place.

Fourthly, Taiwan money supply, M2, as a percentage of GDP stands at a whopping 2.25x compared with 1.2x in Hong Kong and 1.5x in Singapore. Fixed asset investment has remained below 20% of GDP since 1995 and banks are offering 1% teaser rates for mortgages. Meanwhile the tax rate is still 40%, but this could fall, whilst the government for the first time in a decade is beginning some major infrastructure projects.

We note that the Chinese signing of the MOU with Taiwan is still to come later this autumn. It is widely anticipated, but, should nonetheless keep the tone positive. Further to that, we expect a steady trickle of related news flow as China shops for assets in Taiwan.

Finally, all of the above adds up to a very positive outlook for Taiwan on a multi-year basis. Taiwan proved in the 1989 boom that it can march to the sound of its own tune and anyone living there will tell you how little attention is often paid to world events. We are a long way from even starting to repeat that heady period of the 80's, but, we do think that Taiwan has a strong chance to become a remarkable outperformer in a world with fewer uncorrelated opportunities.

Gold

Since its low in March 2001 at $250, gold has quadrupled in value. It has, since late 2001, been part of our portfolios, both professional and personal, and has been a very defensive store of wealth over the recent turbulent times. We believe the bull market in gold is far from over. Indeed at the time of writing, gold stands at an all time high.
But what of the fundamentals? In the first instance many argue that the future of gold depends on an inflationary outcome to the current economic crisis. Without delving in to the guts of that argument here, although we have sympathy to that view, we prefer to note that other factors are adding up fast to suggest gold prices will go higher from here – perhaps even giving us a sneak preview as to the outcome of the inflation/deflation debate?

Our arguments are very simply about supply and demand, combined with the very real likelihood that somebody somewhere (we think China, probably) will initiate a new currency backed to a greater or lesser degree with gold.

Firstly, on supply, global central bank net sales of gold fell 83% yoy in the first half of 2009, with purchases actually rising more recently turning central bankers into net buyers! Indeed in 1H09 purchases were already nearly double the same period in 08. It is suggested that by the end of 2009 central bank gold sales will fall to the lowest level since 1994 or 71% below the average of the last decade. What is more, there is no indication that sales will recover again next year. This leaves the IMF as the last remaining major seller of gold, with another round of selling due to commence next year, but aside from this, the 488 tons per year of sales we have become used to looks set to dry up.

Secondly, South Africa's gold production has fallen for 20 years, falling 75% from its peak to the lowest level since 1922 due to a combination of chronic energy shortages, terrible labour problems and declining ore grades. China is now the world's largest producer of gold. However, China's supply of gold seems likely to dwindle in the coming decade. Some data suggests that China's reserves of economically viable gold will last only 4 years whilst the total reserve base would only last 14 years at the current extraction rates.

Thirdly, and perhaps more profoundly, it is possible we have seen 'peak gold' production for the world. According to the United States Geological Survey over two thirds of all gold ever extracted has been mined in the past 50 years and it would seem that we have now mined over 60% of all the gold available. Indeed recently, despite exploration spending increasing by 6 fold since 2001, the actual increase of gold resources from new discoveries has fallen sharply. Although new resources have been opened by the large miners, the depletion at smaller mines has meant that overall resources have depleted at double the rate of new openings. Furthermore, this has been taking place against a backdrop of rising gold prices where more expensively extracted gold deposits are becoming viable once more. The raw statistics from the major gold producing countries are quite shocking. US production peaked in 1998 and has since fallen 37%, Australia peaked in 1997 and has fallen 30% since, in Canada the peak was 1991 and since production has dropped 43% while Indonesia and Peru have both seen more recent peaks followed by declines. These countries comprise nearly half of all global output.

Finally, it would seem that we have also sold ahead of our ability to ramp up production as prices increase. The old mining adage of 'worst grade first, best grade last' was ignored in the bear market decades of low priced gold and the desperate need to stay in business, so any hope of being able to ramp up new supply to meet rising prices is likely to be in vain.

On demand, China is also the world's largest consumer of gold. Last year, despite the crisis, per capita consumption of gold rose 8% yoy although, as with many consumption statistics, China's average consumption of gold remains 85% below the world average.

Jewellery demand is still the largest source of global gold demand, accounting for 57% last year. Although it has fallen 35% since the peak in 1997, gold prices have continued to rise fuelled by investment demand. Coin minting rose 40% last year to a 20 year high whilst bar hoarding rose 62%. ETFs and online trading have also widened the availability of gold to investors. In total therefore, gold demand rose 7% last year and was up 35% YOY in 1Q09. Supply has been met in part by recycling and destocking from jewellery makers, but this has fallen away nearly 40% in the past quarter.

In summary, gold supply will struggle to match ongoing demand. Should demand increase, and certainly the evidence suggests this will be the case from the average investor to the possible backing of a new currency, the price could move sharply higher from here.

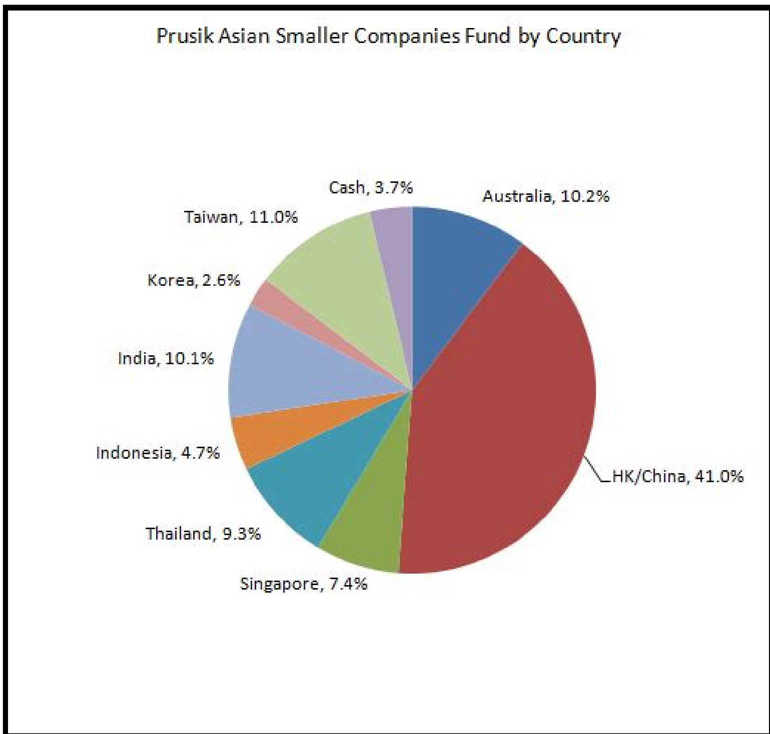
We have recently added to our holdings in gold adding mainly to our list of Australian miners. Not surprisingly we have seen the beginnings of M&A which means the apparently cheap levels we think the fund's holdings trade at will not last long. Of the 10% the fund holds in Australia all of it is in gold mining companies, one of which, (Sino Gold) was bid for by a Chinese company. We expect this will be a takeover the Australian Government might actually let go through!

The PE of the portfolio is 12.5x FY 2010, earnings growth is forecast to rise 45% that year and will generate a ROE of 16.6%.

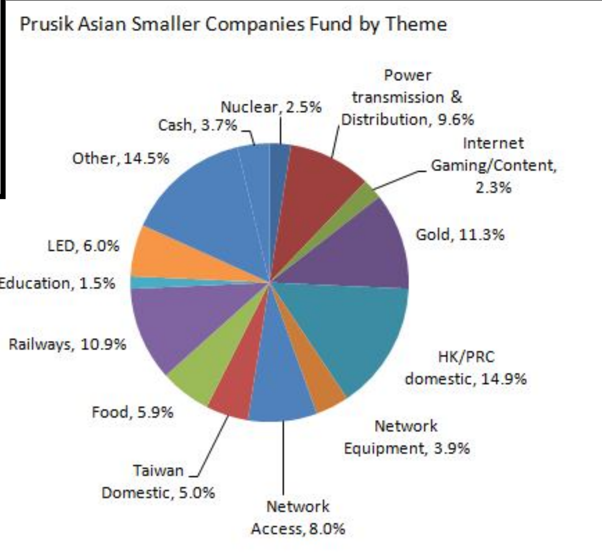
Prusik

We are delighted to announce that Richard Atkinson has joined Prusik as non-executive Chairman, to help us with our business development plans. Richard has 30 years experience in the investment world both as an investment banker, fund manager and fund of funds manager. We are confident that Richard's extensive experience will prove invaluable in the years to come.

Prusik Asian Small Companies Fund
Top Line Figures—3rd Quarter 2009



Number of holdings	39
Percentage of Fund invested	96.3%



Top 5 Holdings	%
Ju Teng	4.2%
LPN	4.2%
Comba	3.9%
Sino Gold	3.6%
Daphne	3.5%

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	-	-	-	48.7

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) Simmons & Simmons (London)

Key Terms

Denomination	USD
Dealing Day	Every Two Weeks
Minimum Subscription	USD100,000
Min Subsequent Subscription	USD10,000
Subscription Notice Period	10 business days
Redemption Notice Period	10 business days
Dividends	
Class A	$ Non distributing
Class B	$ Distributing
Class C	£ 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.