PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
30 September 2013

FOR PROFESSIONAL INVESTORS ONLY

3Q13 Review and Outlook

After highlighting our consistently good quarterly outperformance since inception in the last quarterly report, it is perhaps somewhat predictable that the fund meaningfully underperformed the market this quarter, rising 4.6% compared to the market's rise of 7.6%. The market has yet again provided a free lesson in the importance of humility.

It is always tiring to read fund manager reports that list a number of excuses for underperformance so we will *try* to avoid doing this or at the very least, we will keep the list short. The explanation is simple: we were overweight ASEAN and high quality stocks and underweight China and low quality stocks. This quarter ASEAN did badly and China did well and low quality stocks outperformed high quality stocks. Although we had reduced our ASEAN weight substantially and increased our China exposure over the past year this did not prove to be enough. Looking back on the quarter we don't think there is a huge amount we would have done differently though, even with the benefit of hindsight. The types of stocks that did well (highly geared Chinese cyclicals) are not the type of investments that we tend to focus on. We have benefited from a long period of favourable market conditions and it is expected that for some quarters we will be swimming against, rather than with, the tide.

Although one might imagine that the rise in long term interest rates would have been a significant factor in our underperformance it does not appear to have been so. Indeed the fund has actually outperformed the market since the US 10 year bond yield bottomed on 30th April. This is partly because we acted to remove a lot of the interest rate sensitivity in the portfolio during the first half of the year, but it is also because stock valuations are not always as dependent on interest rates as one might expect. My view is that the market never "believed" the low level of interest rates and so to an extent a rise in yields had already been priced in.

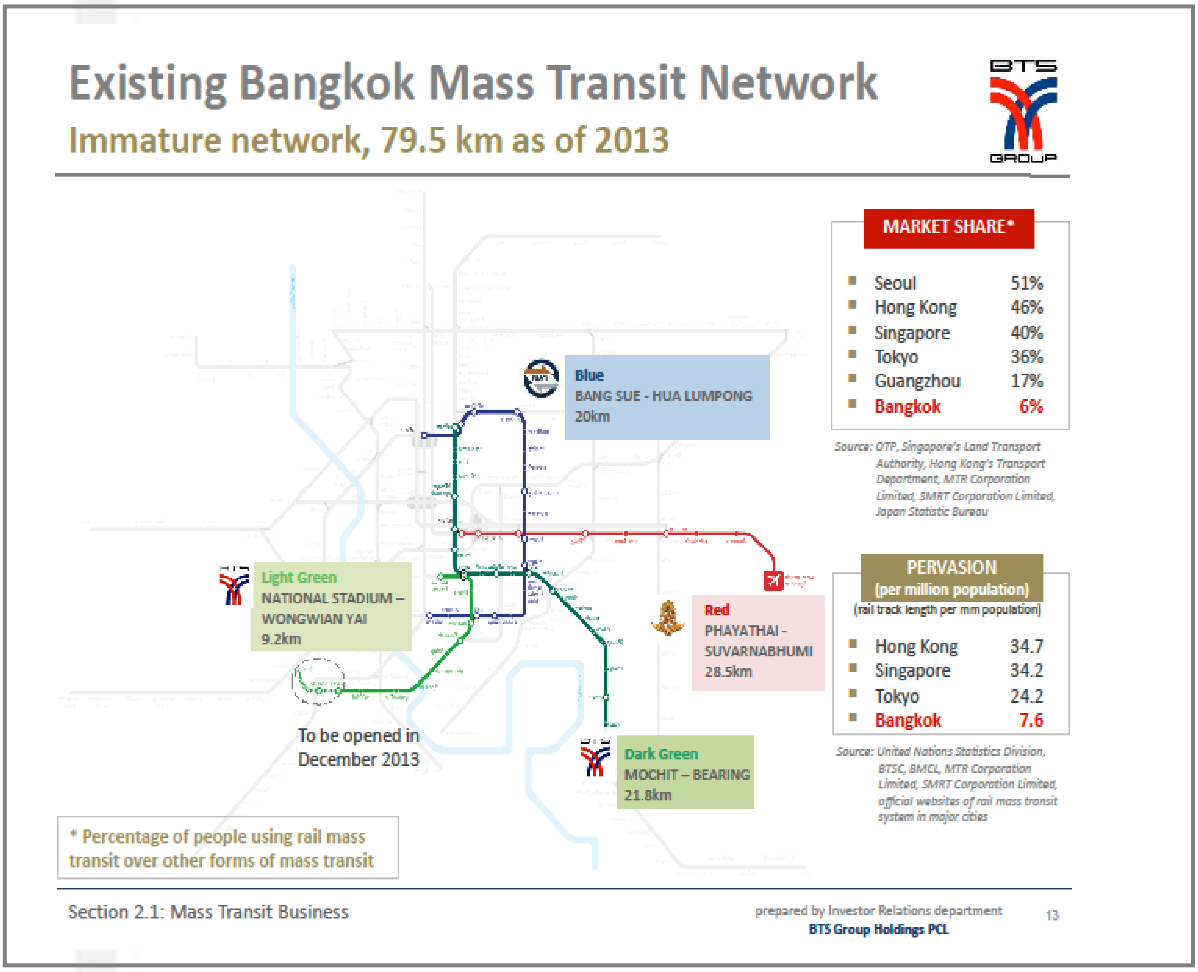
It is important to recall that we do not construct our portfolio with reference to the index. We buy stocks which we believe will generate attractive *absolute* returns over the long term regardless of the market performance. However, we do regard the market as being our "cost of capital" over time and believe that our process will generate above market returns over a full cycle.

Portfolio update

There was a reasonable amount of activity in the quarter, most of which took place in September. We exited a total of 12 positions which had either met our valuation target or which, after careful review, we felt did not meet our required return or quality objectives. We used the capital raised from these sales to fund 9 new positions. More colour on 3 out of these 9 positions is set out below.

BTS Growth Infrastructure Fund (BTSGIF)

BTSGIF is entitled to receive the revenues (minus direct costs) from certain Bangkok Skytrain lines. The concession has 17 years remaining and so it is a short duration stock (we assume a terminal value of zero when the concession ends) but with attractive prospects for revenue growth during this period. Since operations started, ridership on the lines, or volumes, has increased by 11% per year. We expect ridership to continue to grow at a healthy pace and this, plus future acquisitions of additional lines, should help drive revenue growth from here. Fares are linked to CPI and so the cash flows are protected from inflation. The chart below shows the current network and the planned network. The stock is currently yielding just below 7.0% and we expect the dividend to increase at around 5-10% in real terms over the next 17 years. On a nearer term basis the dividend growth rate is likely to be higher than this owing to new lines coming into operation. The company is debt free.



Great Eagle

Great Eagle is one of Hong Kong's largest landlords and hotel operators. It owns or manages the Citibank plaza office complex, The Langham Place shopping mall and the Langham Hotel chain worldwide. The attraction of the company, as outlined below, is the valuation.

Market capitalisation	US$2.2bn
Net cash	US$1.2bn
Holdings in listed REITs (at book value)	US$4.2bn
Other assets (Hong Kong office, overseas hotels)	US$1.7bn
Total assets	US$7.1bn

So in cents and dollars terms we are buying $1 of book value for 30c (or US$7.1bn worth of assets for a market capitalisation of US$2.2bn) which appears very cheap for a company with a net cash balance sheet and a track record of returning excess cash to shareholders after spinning off several of its assets into REITs (management have paid 3 special dividends in the last ten years). Now that management have listed the Hong Kong office and hotel businesses they will continue to collect management fees on 100% of the assets which generate a high margin annuity income stream of almost US$30m per year.

The ongoing yield is only 2.5-3.0% but **Great Eagle** has just paid a special dividend, which takes the yield this year to almost 6%, and we expect more repayments of capital to come. The company's track record in acquisitions is not quite as impeccable as that of its sales but the implied value destruction in the current share price is excessive. If the assets were sold on the open market they would likely achieve close to their book value of US$1 per share and, even in a distressed sale, would be likely to achieve 50c per share compared to a share price of 30c. It is always appealing to buy stocks where a bankruptcy can be viewed as one of the "bullish" scenarios.

Coal India

Coal India is one of the largest coal producers in the world and accounts for 81% of India's overall coal production. Where **Coal India** differs from normal coal companies is that its selling price is at a 40% discount to world coal prices. This means that not only does the company have virtually no volume risk, but also, arguably, the price risk is only to the upside. With **Coal India** selling its production at a 40% discount, it is more likely the company's prices converge with international prices rather than this discount widens. **Coal India** has a very long reserve life of over 100 years and is expected to have production growth in the mid-single digit range over the long term. The stock trades on 10.4x forward earnings, or 5x earnings stripping out the net cash, and has a dividend yield of 5.1%. We find the stock particularly interesting at the moment because the Indian government is under pressure to reduce imports in order to rein in the current account deficit which, in turn, might lead them to incentivise **Coal India** to develop domestic coal reserves to reduce the imported energy bill. Owing to the fact that the company is 90% owned by the government it is also possible that the dividend will be increased in order to extract some cash. Finally, a well known UK based hedge fund has attempted to improve corporate governance at the company, albeit without a great deal of obvious success to date. Any progress on this front, however, would be taken positively. As with any government linked company our holding in **Coal India** is not without the associated risks which come with this status.

PAEIF 2.0

Although we don't believe that the Prusik Asian Equity Income Fund's ability to generate superior investment returns has substantially deteriorated to date, we have written at length in previous quarterlies about how we are struggling to find new ideas that meet our stringent investment criteria. In our (unavoidably biased!) opinion, we believe that the portfolio we currently own is excellent; however, for the past 3-6 months we have struggled to uncover new ideas owing to these stringent investment criteria. We therefore have to make some decisions on how we react to this situation. There are some solutions which we do not think are appropriate. We do not believe that we should "chase" yield by owning lower quality stocks. We are not prepared to accept a lower alpha and we do not think praying for the market to collapse is a viable strategy. But there are things we can do to allow the fund to evolve whilst maintaining its focus and uniqueness.

In deciding which path to take, we return to the objective of the fund which is outlined in the first quarterly report (1Q11)

"**There are three main aims of the fund:**

- **To generate an attractive dividend yield that is higher than the market**
- **To grow that dividend in real terms over time**
- **To outperform the Asian market by 5-10% per year over a full cycle"**

The ultimate aim of the fund must be to generate attractive total returns - there is no point in generating a 5% yield if the fund is falling by 10% a year in capital terms. We aim to grow the fund value over time and compound at a rate which is higher than the market.

When we launched an equity income fund in 2007 at a previous firm it was a happy coincidence that the type of stocks that we tended to own, or would have liked to have own then, were also stocks that had good dividend yields. Owing to the fact that we look for franchise stocks with non-cyclical earnings, abundant free cash flow and limited capital requirements which trade at a discount to intrinsic value, it followed that many of those stocks had high dividend yields as it was this type of company which was able to distribute those earnings to shareholders. Even as recently as 2010, when the Prusik Asian Equity Income Fund was launched, the opportunities to buy great franchises AND receive a high up front yield were plentiful. However, our primary focus has always been to search for companies with strong franchises trading at a discount to intrinsic value. Having a dividend yield was a necessary but not sufficient condition. To invest successfully one has to value the entire business – it is no good just focusing on a relatively small component which is the proportion of one year's earnings which management decides, often arbitrarily, to distribute. When we value and purchase stocks, we consider the valuation without regard to the dividend yield. Only when the stock is cheap relative to intrinsic value and with limited downside risk do we invest. Whether the yield is 3.0% or 8.0% makes no difference to that decision.

Over the past couple of years, the market has become obsessed with stocks that have a safe, short term dividend yield but has ceased to consider how the company is generating that yield and whether the stock is cheap in a broader and more accurate sense. This has caused some sectors of the market to trade at very high valuations. We are therefore finding less value in the "traditional" high yield universe and more and more value in companies which have all of the characteristics we are looking for but do not have a high up front yield – often because management are able to reinvest that cash flow at high rates of return in the core business. The gap between the type of stocks that we think will generate superior returns and the universe of high yield stocks is growing and we are therefore being forced to make a decision. **Over the past several years, many investors have asked us what we would do if we could not find enough yield stocks. Would we buy lower quality stocks to maintain the yield or accept a lower yield but preserve quality? Our answer was always the latter**. Our skill and expertise is identifying these franchises that can compound at a high rate over time. **Yield without reference to valuation means nothing**. Given this situation, we would like to take this opportunity to alert investors to some subtle changes in our investment strategy that will help us maintain our investment performance whilst still keeping the unique attributes of the fund which are outlined below. We reiterate that the impact on the actual portfolio will be marginal (it affects perhaps 10-20% of the portfolio at most). The aim of the fund is still to generate an attractive yield which is stable and grows over time. Most of our key positions still offer a great combination of low valuation, high up front yield and superb franchise strength. But if we do nothing then the risk is that this portion of the portfolio will begin to decline as stocks reach our target prices and we are forced to sell them. In practical terms all this means is that we are selling 10-20 % of the portfolio that we think does not offer an attractive enough risk/return profile and replacing it with stocks that do. **The stocks we are selling tend to be at the low growth/low quality end of the portfolio and the stocks we are replacing them with are higher growth, higher quality and higher profitability.** The only thing we are giving up is the short term dividend yield. **In simple terms we are trading "tens of basis points" of yield for the potential of "hundreds of basis points" of potential total return**.

In light of this we are planning to introduce a degree of flexibility in three areas of the fund strategy:

1. **Decreasing the minimum yield of new positions from 3.0% to no minimum level**

   We believe that there is now more value in the market for franchise stocks that have many of the characteristics that we look for such as pricing power, high margins, stable earnings, but do not meet our threshold of a 3.0% dividend yield. We have decided to relax this criterion so that we can own some of these stocks. Of course we still prefer to receive a high dividend yield but we will no longer have an arbitrary cut off level in place.

2. **Increasing the maximum position size from 5% to 7.5% and in turn increasing portfolio concentration**

   We plan to increase slightly the maximum size for individual holdings in the fund from 5.0% to 7.5%. The rationale here is that given our lower number of investment ideas we believe we should not have to dilute our best stock ideas if we do not have to. In practice we do not intend to make many changes to position sizes in the short term but we believe on a longer term basis it is important to have greater flexibility in this regard. In the short term a few holding sizes will be increased to 5.5-6.0% rather than taking numerous positions to 7.5%.

3. **Increasing the maximum cash level of the fund from "0 -5%" to "10-15%"**

   Finally, we still intend to be fully invested but we are now more willing to see the cash level rise to 10-15% level in the very short term if we cannot find enough attractive ideas to invest in. It is important to note that this flexibility will never be used as a call on markets; we would not raise cash in anticipation of a market correction. The purpose of this amendment is that it allows us breathing room if we sell positions but do not have enough suitable investment candidates to reinvest that cash into immediately.

We are conscious that these changes might sound dramatic. They are not. We are merely giving ourselves the flexibility to continue to meet our overarching investment objectives. The actual impact of these changes will be minimal on the current fund. The fund's yield should remain well above the market.

We are trying to make the fund flexible enough so that we can meet our performance objectives whilst at the same time staying true to the fund's mission, which is to conservatively grow capital over time whilst generating a growing dividend and attempting to avoid permanent loss of capital. If markets change and more ideas present themselves then it is possible that we do not need to make use of these new limits. But we need to prepare for the fact that that does not happen.

It is possible to argue that changing these parameters could be construed as "style drift". However, we believe the opposite. It is vital for funds to adapt to meet the market environment. We have enjoyed 3 extremely strong years of outperformance and a portion of this came from a compression in yields which is unlikely to be repeated. We could always do nothing and simply accept future underperformance and hope to beat other Asian equity income funds within the context of that underperformance. But that is not the way a boutique operates, particularly one where the partners invest much of their capital in the funds. For us, running a fund is not an academic exercise. I have no other funds to fall back on if this one underperforms and we know that unless we generate good returns, we will not continue in business. So this is driven by a desire to generate high returns and keep performing.

Of course, we don't take these changes lightly. Any change in emphasis is examined very carefully and of course investors are free to draw their own conclusions. But in order to keep our integrity we must be open and honest. We believe the opportunity set for equity income investing in Asia in the "old" form has diminished substantially over the past 6-12 months. We have high conviction in our current portfolio but we are simply not able to find good candidates to replace the stocks that we are selling as they reach our valuation targets. Owing to this, the alpha of the fund is likely to decline in the future if we are forced to either buy lower quality companies or allow cash to build up on a longer term basis. In order to avoid this scenario we are purchasing businesses that have all the characteristics we look for but do not have a high upfront yield. As we have always said - dividend yields by themselves are meaningless. They are only important if supported by a business that has predictable, annuity like cash flows to support that payment.

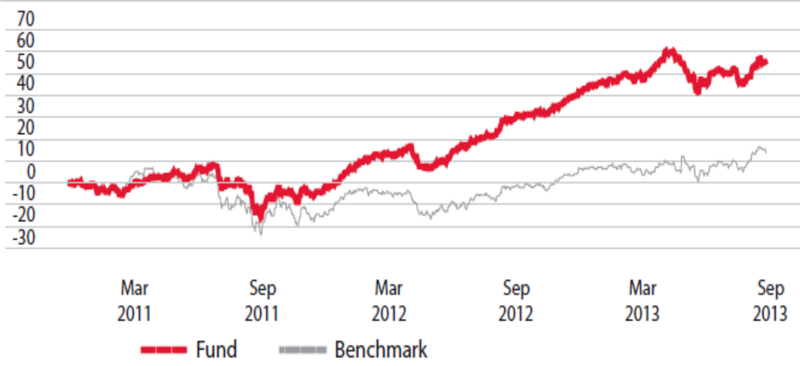
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.09.2013

Class 1*	B USD	Benchmark **
1 Month	5.07	6.00
3 Months	4.64	7.55
Year to Date	9.81	1.52
2012	45.90	22.96
2011	-3.96	-15.20
Since Launch+	53.88	6.28
Annualised since Inception	16.96	2.24

* Class 1 shares were closed to further investment on 30th November 2012
**MSCI Asia Pacific ex Japan
+ Launch date: B 31.12.2010,

Fund Performance - Class B USD (%)



Source: Bloomberg. Total return net income reinvested.

Class 1 B, USD Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
2013	3.93	1.78	0.35	4.57	-0.53	-4.95	1.87	-2.24	5.07			
2012	8.12	6.54	1.92	3.20	-7.67	3.84	6.72	1.92	6.36	1.97	2.76	3.63
2011	-2.68	-1.46	2.55	3.90	2.59	-0.60	3.56	-6.06	-12.80	10.62	-3.52	1.79

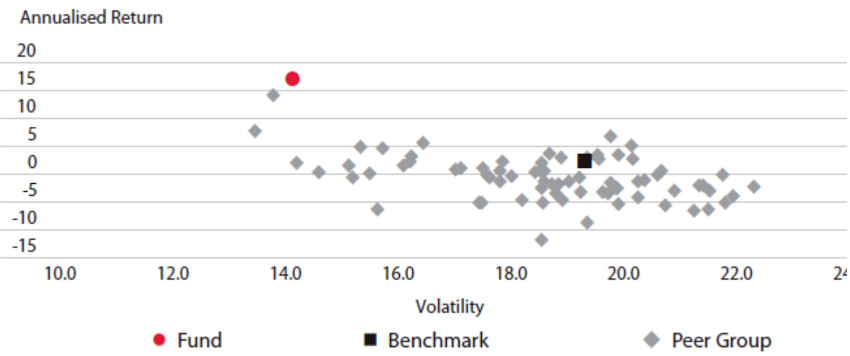
Source: Bloomberg

RISK ANALYSIS

Risk Metrics	Fund (%)
Tracking Error (% pa)	6.87
Beta	0.8
Alpha (%)	15.17
Volatility (%)	14.13

Source: Bloomberg
Since inception: B 31.12.2010

Risk Adjusted Performance - Class B USD (%)



Source: Bloomberg. Annualised return and 1 year volatility versus the peer group (op ended offshore Asia Pacific ex Japan Equity Fund Index), 31.12.10 to 30.09.13

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Cheung Kong Holdings	5.6
HSBC Holdings	5.3
Hutchison Whampoa Ltd	4.4
SK Telecom Co Ltd	3.7
KT Corporation	3.3
Total Number of Holdings	43

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	11.2x
Predicted Return on Equity (%)	16.7
Predicted Dividend Yield (%)	4.5

Thematic Breakdown (%)

Core Infrastructure	37.7
Asian Consumer	12.3
Quality Financials	11.4
Cash	10.6
Real Estate	8.2
Energy	6.7
Retail Shopping Mall	6.5
Asian Export Brand	4.5
Niche Tech	2.0

Geographical Breakdown (%)

Hong Kong	35.2
China	17.0
Korea	12.6
Cash	10.6
India	7.0
Singapore	4.9
Thailand	4.2
Australia	3.8
Indonesia	2.4
Malaysia	2.4

All data as at 30.09.13. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	810.2m
Launch Date	31st December 2010
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Management Fees

Annual Management Fee
1% p.a Paid monthly in arrears

Performance Fee
Class 1: None
Class 2 and Class U: 10% of the net out-performance of the MSCI Asia Pacific ex Japan Index with a high-water mark.

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Daily
Min. Initial Subscription	USD 10,000
Min. Subsequent Subscription	USD 5,000
Subscription Notice	1 Day
Redemption Notice	1 Day

Share Class Details

Class 1*			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B4MK5Q6	IE00B4MK5Q67	158.14
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	137.89
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	138.31
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	132.47

*Class 1 shares were closed to further investment on 30th November 2012

Class 2*			SEDOL	ISIN	Month end NAV
X USD	Unhedged	Distributing	B4PYCL9	IE00B4PYCL99	126.72
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	127.33
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	126.47

* Class 2 shares were soft closed to new investors as of 30th November 2012

Class U*			SEDOL	ISIN	Month end NAV
U GBP	Unhedged	Distributing	BBP6LK6	IE00BBP6LK66	98.77

* Class U shares are open to current investors only. Performance fee based on fund performance as a whole.

Dividend Dates

Dividends paid twice annually (January and July)

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