PRUSIK

Long Only Absolute Return Investing in Asia

Prusik Asian Equity Income Fund

Quarterly Investment Report 30 September 2011

FOR PROFESSIONAL INVESTORS ONLY

INVESTMENT OBJECTIVE

To select a portfolio of equity investments in the Asia Pacific ex Japan region with above average dividend yields and which have the ability to grow their dividends over the time. The fund aims to out-perform the MSCI Asia Pacific ex Japan index by 5-10% annually whilst growing its dividend overtime.

INVESTMENT PROCESS

The process is both quantitative and qualitative with the latter dominating. The universe is screened for those high dividend stocks which have the greatest ability to sustain and grow their dividends over time. A particular emphasis is placed on identifying those companies with exceptional franchises, annuity like cash flows and pricing power which are trading at significant discounts to intrinsic value.

FUND MANAGER

Tom Naughton -Partner
15 years experience in Asian fund management including 7 years spent in Hong Kong. Chief Investment Officer for the equity team at PMA, a US$1.7bn multi-strategy absolute return fund focused on Asia ex-Japan and built the equity business from zero to a peak of US$1.5bn in a assets. During this time he ran several equity income funds including the Sparx Asia Pacific Equity Income Fund (SPAIX). Previously was the Pacific Equities manager for Universities Superannuation Scheme Ltd where he worked from 1994 until 2002.

Performance Summary

The fund fell by 15.2% compared to a 20.4% fall in the market. The main detractors from returns were Anhui Expressway (China toll road), Macquarie Group (Australian based investment bank) and ARA Asset Management (Property fund manager). The main contributors were BEC World (Thai TV company), Dynapack (Apple battery supplier) and LPN Development (Thai property development).

We are disappointed by the performance but note that the fund is still outperforming the index by 7.2% year to date – in line with our stated target of 5-10% outperformance. In such a market we would prefer to have been down less than 10% given the quality, we believe, of our holdings. We attribute the greater participation in the downside to the following:

- **We do not hedge currency exposure**. During the quarter, currencies detracted 470bps from performance as the US dollar strengthened
- **Betas tending towards 1.0 as fear gripped markets**. Although this is not unusual, it was surprising how little the market distinguished between higher and lower quality companies

During the last few weeks we have analysed in some more detail the fundamentals of the stocks that we own in terms of dividend growth versus dividend risk, ability to withstand a global/Asian recession and other qualitative and quantitative factors. We have taken the opportunity of the turmoil to "upgrade" our portfolio – selling those positions that had more cyclicality or greater risk to dividends and recycling that capital into stocks that have greater security of earnings. Given that most stocks have been sold off aggressively, it is possible to do this without losing much potential upside should the markets rebound.

Investment Philosophy

Also it is important to reiterate that our strategy is built on finding stocks with two key characteristics:

- **Ability to sustain the current dividend payment even under difficult economic circumstances**
- **Ability to grow the dividend in real terms over time**

We believe that if we construct a diversified portfolio of stocks with these characteristics and have patience that we will achieve our two other objectives which we don't target explicitly but expect to achieve because of the two points above:

- **Outperform the index by 5 to 10% per annum**
- **Taken on less risk than the market (a beta of around 2/3 of the market)**

It is worth reiterating that the first two points are what we spend more of our time focusing on. We do not consider a stock's volatility when considering it for inclusion in the portfolio and of course, many of the greatest investment opportunities come when Mr Market starts panicking and offering to sell positions at sharply lower prices day after day, because he is fearful of the end of the world.

What we do pay attention to is the underlying risk of the company fundamentals. We are very wary of companies that have cut dividends sharply in the past. Whereas it is not possible to conclude that a company with an unbroken record of dividend increases will not grow dividends in the future, it is generally possible to conclude that a company that has cut its dividend in the past will do so again in the future. Of course there are exceptions to this rule but as a general rule of thumb it has served us well. We pay close attention to what companies have done in the past and what our assessment of their business risks are. We pay very little attention to what management thinks will happen in the future -or indeed what we think will happen in the future. In the words of the economist John Kenneth Galbraith:

> *"We have two classes of forecasters: Those who don't know – and those who don't know they don't know"*

By trying to ensure that we are invested in companies with strong balance sheets, high profitability, capable management and operating in businesses that are relatively secure, we hopefully will have a portfolio that will perform well regardless of the economic environment.

Dividend Sustainability

We have analysed for each of our holdings and the portfolio as a whole, the volatility of dividends and the number of times and by how much they have been cut in the past. For those companies that have cut their dividend by more than 20% in the past we have considered what the risk of that being repeated in the future. There are many flaws to this approach – limited operating histories, accounting for special dividends, changes in balance sheet etc can all lead to misleading results but, overall, we are comfortable that our portfolio has substantially lower risk than the market despite offering a yield that is almost 75% higher (6.4% compared to 3.7% for the market). **An example of this is that the average stock in our portfolio increased dividends in both 2008 and 2009 (by 5% and 1% respectively) whereas the market as a whole saw dividends cuts of 1% and 34% for these two years**. This does not of course mean that dividends cannot fall in the future but gives an idea of the defensiveness of the positions.

Portfolio Changes

In terms of changes to the portfolio in the past quarter, we have taken the opportunity given by the market to make some small changes at the margin. Some of the "!!!" dividend stocks in !sia are now trading at extremely high multiples and therefore, to us, do not offer sufficient upside. An example of this is **Parkway REIT** which owns a portfolio of hospital assets in Singapore which it leases back to the sponsor. Due to the extremely attractive rental agreement that the company has (effectively it has a 15 year rental agreement with the sponsor of the REIT which escalates at CPI +1%) the stock was exactly what the market wanted – a zero risk, inflation linked asset. Because of this, the stock had risen 23% since our initial purchase compared to the market falling 15% during the same period. The asset yield (stripping out the impact of gearing) had compressed from 5.0% to 3.9% and no longer offered sufficient upside – especially considering that Singapore is enjoying record low interest rates. We therefore exited the position and reinvested the proceeds in higher return positions.

!t the other end of the portfolio, we have “upgraded” the portfolio by switching capital from companies with more cyclical earnings into higher conviction positions with more defensive earnings. As the market sell down was so broad based, we are able to do this without compromising, in our view, the upside potential of the fund. So during the quarter we have exited positions such as **WT Micro Electronics** (Electronics distribution), **Dynapack** (iPad batteries) **and LPN Development** (Thai property developer) and introduced positions in **Giordano** (Hong Kong low end clothes retailer), **Berjaya Sports Toto** (Malaysian gaming company) and **Australian Stock Exchange** (which also owns the Sydney Futures exchange).

In very broad terms, we could characterise what we have done as selling our AAA positions as well as our BB and below rated positions and concentrating the portfolio in the AA, A and BBB section of the market, where we see extremely good value and low risk to dividends. This fits in with our view of the markets which is that although they are attractively valued, we are likely to see earnings and therefore dividend downgrades over the next 12 months. We therefore want to reduce the risk of dividend cuts but do not want to overpay for security by buying the well-known and highly rated defensive stocks.

New Theme

One of the themes in our portfolio at the moment that is of significance is **Free-To-Air TV broadcasting**. We own 3 companies in this sector which accounted for 8.6% of the portfolio in total. Free to air broadcasting in Asia is attractive for several reasons:

- In many markets in Asia – particularly the lower income ones – TV is still the only way of reaching mass audiences. Cable/Satellite TV is often not widely available and internet based advertising is still too small a market to be effective.
- As a result, these companies enjoy strong bargaining positions with customers wishing to advertise
- Capital spending requirements are limited – companies are normally able to distribute close to 100% of earnings as dividends
- Multinational consumer companies including Unilever and Nestle are often the biggest advertisers in these markets. Their efforts to increase their emerging market sales is leading to greater spending on advertising
- As consumer spending grows in Asia, spending on advertising will also increase
- _ecause they are perceived to be “boring” businesses, they trade at very attractive valuations

As a result, we believe that our portfolio of companies in this sector **TVB** (Hong Kong), **BEC World** (Thailand) and **Media Prima** (Malaysia)) **offer exceptional value with dividend yields of 5% and growing at a double digit rate.**

PORTFOLIO PERFORMANCE

Performance Summary (%)
Periods ending 30.09.2011

	USD	GBP	SGD	Benchmark *
1 Month	-12.80	-12.52	-13.13	-13.44
3 Months	-15.16	-15.02	-15.28	-20.42
Year to Date	-11.60	-11.26	-13.77	-18.84
Since Launch+	-11.60	-11.26	-13.77	-18.84
Annualised since Inception	-15.20	-13.64	-17.96	-24.35

Trip to the region

At the beginning of October, trips to Hong Kong, China, Singapore and Korea will be conducted. We are planning to travel the length of Jiangsu Expressway's Nanjing Highway (from Shanghai to Nanjing) with the purpose among other things to view the infrastructure development along this road. And then, assuming we survive the return journey on a high speed train back to Shanghai, we will travel to Hong Kong and visit several existing holdings and some potential new additions. Then on to Korea which is a market where there are relatively few dividend stocks available but the recent fall in the markets has presented some opportunities. Finally on to Singapore where we also see a number of potentially interesting high yield stocks. Expect more details in the 4Q report.

Outlook

In terms of our outlook for markets, there is little that we can add from a top down view to what has already been said. On a twelve month view, it is likely that equity markets will perform well if historical valuations are any guide however, on a one month view, it is perfectly possible for shares to be 10% higher or lower. Our portfolio is pricing in earnings DECLINES of 1-2% a year for the next 5 years which we believe is excessively pessimistic[1].

Although we believe our portfolio will be able to grow dividends in real terms over the next five years, it is clear that the market is extremely worried about the situation in Europe and the slow down in the _hinese economy. We won't dwell on the situation in Europe except to say that we would agree with the consensus that the most likely outcome is a long drawn out recession with GDP growth near zero for many years to come. With regards to China the situation, as always, is that there are two very strong themes which often are opposed to each other and lead investors to swing from extreme bullishness to extreme bearishness on the country. The positives in China are that the story of urbanisation and growing consumer spending are real and likely to continue. Unless China is different from almost every other country, it will follow a similar path to Japan, Korea and Taiwan which followed a fairly predictable "S curve" with consumer demand and urbanisation increasing as the economy grows. So far, so good. The negative is of course the risk that the level of overinvestment that has taken place over the past ten years will lead to a collapse in capital spending and a potential banking crisis that will override the positive structural story. This seems a real possibility but stocks in China and Hong Kong are already trading near record lows which reflect this concern.

Our view is that these two opposing views will continue to cause markets to oscillate from optimism to pessimism over the next several years and will give us the opportunity to purchase positions at steep discounts to intrinsic value as a result. For example, Jiangsu Expressway now trades on a dividend yield of 8.5% despite having grown dividends at a CAGR of 18% since listing 15 years ago and has seen a dividend cut. It would seem unlikely that traffic growth would be negative for any period of time in China even if the country entered a sharp recession and therefore that yield is relatively secure, even in dire economic circumstances.

[1] Source: Starmine Intrinsic Valuation Calculator. Essentially this is a DCF calculation which takes the most accurate analysts' forecasts and adjusts them for over-optimism.

Source: Bloomberg
+ Launch date: B 31.12.2010, C 21.01.2011, D 31.12.2010

Monthly Performance Summary (%)

Risk Metrics Fund

Source: Bloomberg Since inception: B 31.12.2010

PORTFOLIO PERFORMANCE

Performance Summary (%)
Periods ending 30.09.2011

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PORTFOLIO PERFORMANCE

Performance Summary (%)
Periods ending 30.09.2011

	USD	GBP	SGD	Benchmark *

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

PORTFOLIO PERFORMANCE

Performance Summary (%)
Periods ending 30.09.2011

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PORTFOLIO PERFORMANCE

Performance Summary (%)
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*MSCI Asia Pacific ex Japan

Fund Facts Share Class Details

Fund Size 22.68m **Codes**

31st

Launch Date December 2010 **Class 1 SEDOL ISIN NAV***

Fund Structure UCITS III A USD Unhedged Non Distributing B4MK5Q6 IE00B4MK5Q67 90.93

Domicile Dublin B USD Unhedged Distributing B4QVD94 IE00B4QVD949 88.40

Currencies USD (base), GDP, SGD C GBP Hedged Distributing 88.74

B4Q6DB1 IE00B4Q6DB12 D SGD Hedged Distributing 86.23

2011

Sourc

B4NFJT1 IE00B4NFJT16 **Management**

Fees *Month End 30.06.2011

Annual Management Fee 1% p.a Paid monthly in arrears Class 1 will remain open to investors until the fund reaches USD50m. It will then soft close (to Performance Fee new investors) remaining open for current investors until the fund is USD100m. A new share Class 1: None

class (Class 2) will be launched when Class 1 is approximately USD50m. This will carry a 1% AMC with a 10% performance fee relative to the index.

Dealing

PORTFOLIO PERFORMANCE

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Fund Manager

Tom Naughton

Tel: +44 (0)20 7493 1331 Email: tom.naughton@prusikim.com

Sales & Marketing

Mark Dwerryhouse

Tel: +44 (0)20 7297 6854 Mob: +44 (0)7831 856 066 Email: mark.dwerryhouse@prusikim.com

Prusik Investment Management LLP

1st Floor 46 Hays Mews London W1J 5QD

Email: enquiries@prusikim.com

PORTFOLIO PERFORMANCE

Performance Summary (%)
Periods ending 30.09.2011