31/12/2010

We have used this note to reflect on 2010, provide an update on our progress and to highlight some of the key themes running through the fund. Within the note there are links to posts we have previously written; we thought this was a neat way to organise the background information regarding the themes and also to help you track how our thinking has evolved. We appreciate the time people have invested going through the detail on our website, meeting with us and providing feedback and questions to better understand our business. We hope you have a safe holiday period and productive 2011.

Yours Sincerely,

Miles Webster & Nigel Trewartha

The business has been operating for a year. We were granted our AFS Licence in January 2010 and opened the fund on the 15th of April. From the date of opening to the end of June the markets promptly fell 15%. Over the last six months they have mostly recovered these losses. We wouldn't describe the recovery as the markets grinding higher; rather there has been a reasonable amount of volatility caused by the well publicised structural undercurrents. We expect this high level of volatility to be a characteristic of the markets going forward; although we think this suits us in that when we find something we consider as a genuine investment proposition we feel it lets us be patient and wait for a period of uncertainty to accumulate the position.

The fund is 38% gross invested; 34% long and 4% short. Both our long and short stock investments have positively contributed to performance, the detractors have been the yen short which has cost the fund roughly 1.5% and leaving the currency exposures unhedged from the USD and Euro denominated equity investments, which has cost the fund an additional 1.5%.

The key themes shaping our thinking are broadly divided into two areas. The first relates to specific ideas which detail why we think an investment is mispriced. The second area includes a number of broader structural drivers which give us a framework or context around which we invest. Over the year we have alluded to these drivers in individual posts; we thought it would be useful to summarise the key points in a consolidated form which follows:

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1) Sovereign Risk:

We have taken a fundamental approach to quantifying sovereign risk through modelling various governments as we would a company. The key points we are focussed on are the government's debt position and their cash flow; their sources and uses of funds. We are trying to get a sense for where the government generates and consumes cash and where going forward there are likely to be opportunities to either generate more or consume less to service existing debt obligations (as opposed to printing money).

We are reasonably constructive on the sovereign risk profile of the major currency blocks and we consider the current mainstream attention to sovereign risk as being an enabler of change going forward. It is really because of this assessment that we have left the USD and Euro currency exposures from offshore investments unhedged within the fund. Japan is the exception, and why we have the position shorting the Yen.

Sovereign Risk Posts:

- 10/21/2010
- 22/09/2010
- 18/06/2010
- 31/05/2010
- 25/05/2010

2) Leveraging Technology:

Given how inexpensive, ubiquitous and accessible technology has become, we think this will have fundamental consequences for business formation and long term returns. If the content is unique, we feel you can get shelf space and distribution very cheaply. This view has multiple investment ramifications including the obvious old world new world shift – where the internet is a fundamentally better place to transact for certain goods and services. We are also wary of established domestic mature industries that seem to earn excess returns due to operating in a "concentrated local market structure". In a world where prices are transparent and easily comparable this has to increase pressure on businesses that are over earning. Taking this idea further, we perceive there are a few great online businesses with a unique proposition and IP, but most of them appear to us to be a generic concept with first mover advantages. The market tends to argue there are positive "network effects" within these businesses meaning effectively as they gain critical mass they will attract more "buyers and sellers" and this activity strengthens the business creating greater barriers to entry. We suspect that in most cases the online businesses that are currently going from strength to strength are gaining due to their distribution cost advantage vs the "old world" incumbents and early adoption of a generic idea. Extending the leveraging technology view makes us think as these same businesses mature they will have to increasingly spend on brand rebuilding and awareness to hold their existing customers.

Leveraging Technology Posts:

- 17/10/2010
- 06/04/2010
- 11/03/2010
- 24/02/2010

3) Interference Discount:

The idea relates to the concern that due to the increasing levels of government involvement investors could lose interest in equities as an investment class or that they need an excessive discount on valuations to be enticed to invest due to uncertainty around the investment landscape.

Interference Discount Posts:

- 20/12/2010
- 25/02/2010
- 09/02/2010

We feel we have an appropriate structure and resources in place to enable us to focus our efforts on seeking out compelling investments consistent with our investment process. The fund and mandate offerings enable us to reflect these ideas in an uncompromised manner and the website is a means to communicate what we are doing externally. Our success will be a function of the quality of ideas we develop and our ability to execute them effectively.