Long Tail ASSET MANAGEMENT PTY LTD
AFSL 341 474

Fund Positioning – 1st September, 2010

Since the last update in June, we have increased the fund's gross invested position from 23% to 34% (31% long and 3% short). The long exposure is invested in five discrete tenets (ideas) comprising nine individual investments. The fund also holds two short positions and two exposures in the "trading and other" category where the fund is risking approximately 2% of its capital on an annualised basis.

	Long (%)	Short (%)	Currency (%)
Australia	12.8%	-3.4%	82.3%
US	10.2%	0.0%	10.2%
UK / Europe	7.5%	0.0%	7.5%
Total	30.5%	-3.4%	100.0%
# investments	9	2	
# tenets (ideas)	5		
Trading & other	~2% annual risk		

We spent much of the last few weeks covering off on the recent reporting period. Our overriding impression was the "leveraging technology" idea we have previously written about was a common trait across results. This idea relates to our concern that a number of mature businesses locally appear to earn unsustainably high returns in the context of the goods and services they provide. Our sense is that at best these returns will be maintained, but more likely they will come under increasing pressure due to new competitors being able to attack incumbent business structures as a result of a shift in how we access and use technology. This issue is our primary concern when we look at investment opportunities locally.

Long Investments (30.5%)

The fund holds one large cap Australian investment tenet (9% position across two companies). The full year results of these businesses met or bettered our expectations. There was nothing to change our view that these investments will generate 12–14% type annual returns over the next three years with the potential for additional upside from asset consolidation.

Across the balance of the long exposure we have stayed out of trouble. We would describe the price action as the fund's holdings moved directionally with the broader markets but they have been less volatile (i.e. up less in rising markets, down less in falling markets). This price action combined with leaving the currency unhedged has delivered an essentially flat result in Australian dollar terms.

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Shorts (3.4%)

The fund has two short positions with both being ASX listed large cap companies:

1) Short A is an aggressively geared, acquisitive and asset heavy company. We are sceptical of their depreciation policies and perceive they have structurally underinvested in their asset base over recent years. We think this business will either raise equity now to reduce their gearing or they will make another scrip funded acquisition. We value this business about 35% below its current share price, but given the excessive gearing it is not difficult to envisage a scenario where the downside is much greater.

2) Short B is a market darling. It holds the dominant position in its sector and its business model and management are highly regarded. In our minds the valuation reflects all of these positives and then some. We think margins will rapidly contract as the business matures and they are forced to spend more to retain customers and try to fend off new entrants. As such we don't rate the model nearly as highly as the market. Moreover, we contacted the company through the results period to clear up our understanding of some recent changes to their accounting policies. We suspected there wasn't much to it, however, our curiosity was heightened when they were more than happy to return our calls around the results but the communication went dead when they knew what we were enquiring about. While we suspect there is probably nothing sinister to it, the sequence of calls / messages and then lack of follow up has perked our interest.

Trading and Other (Annual risk 2%)

1) Trade A (~1.5% annualised risk) - We have continued to buy out of the money put options on the Yen. Our fundamental basis for doing this was outlined in the "Japan" note dated May 31st 2010. We feel the fundamentals have continued to deteriorate, yet the Yen has aggressively appreciated. We are reasonably content to continue to spend the money on premiums. We are managing the exposure by consistently buying well out of the money options and limiting the annual investment to a predetermined level of the fund's capital. For this to be a profitable investment we need a big devaluation in the Yen over a short period of time. If this comes to fruition the returns to the fund would likely be very material.

2) Trade B (~0.5% annualised risk) - We recently bought some well out of the money call options in Australian general insurer IAG. We think there are a number of positives regarding the current investment merits of IAG, however, the one key negative we are struggling with is it seems to fit squarely in the sites of the leveraging technology theme we have written about. We see acquiring the call options as an effective way of gaining a material exposure to the potential upside while limiting the downside.

Cash and money market securities

The fund is approximately 69% in cash and similar investments. We probably got a bit lucky and this weighting has helped us protect the fund's capital against a falling market since opening on the 15th of April. The cash weighting is not a conscious defensive holding, rather it is an outcome of the ideas we are finding. Our preference is generally to be more fully invested.

Other comments

We have been feeling our way to an extent about what the right level of disclosure is for the investment activities of the fund. Ultimately, we want to be transparent in our communications and give stakeholders enough detail to make an informed assessment of the fund and our capabilities. The key area we will maintain a level of confidentiality is around the ideas we are considering for a mandate investment. To a lesser extent we also want to maintain some confidentiality around our shorting activities. We will detail the performance and rationale behind our core long positions as they are realised. We also expect to address our thought process behind existing holdings when we think this disclosure is useful from a governance perspective.

We have found a couple of ideas offshore that we think are worth pursuing. We plan to be away for a few weeks in October travelling through Germany, France and across America. The businesses we are looking at have simple models, the issues seem reasonably transparent and each of them operates in sectors we feel we know well. Curiously these companies seem to hold very little interest in the investment community; they are located in out of the way places, some aren't covered at all by broker research and often we get the feeling we are the only investors sitting on the conference calls. So rather than swanning through New York, LA, and London we will be off the beaten track; armed with a rent-a-car, GPS, couple of laptops and a heap of questions ... we can't wait.