

Fund Positioning – 8th November, 2010

The fund is 36% gross invested (31% long / 5% short) in addition we have trading and other positions risking ~2.5% of the fund's capital. The invested position has not changed meaningfully since our last update on September 1st, however, there has been some change within the individual investments.

	Long (%)	Short (%)	Currency (%)
Australia	11.5%	-5.5%	77.7%
US	11.9%	0.0%	11.9%
UK / Europe	7.3%	0.0%	10.3%
Total	30.7%	-5.5%	100.0%
# investments	9	3	
# tenets (ideas)	5		
+ Trading & other			(2.5% annual)

In early October we visited companies in France, Germany and America. The meetings were focussed within industries we feel we have a strong background in: infrastructure and utilities in Europe and regional gaming businesses in America. Beyond having the benefit of freedom of thought travel time like this affords, the trip is also having an impact on investments in the fund. We sold at a small profit one investment we held in Germany and two of the other companies we met with we are pursuing as core investments.

Curiously, despite the strong Australian dollar, the US struck us as expensive. We travelled through out of the way places staying in mid range accommodation. Domestic airfares were a nominal cost but we were consistently surprised by the high (AUD) cost of hotels, petrol, food, groceries and rental cars.

Long Investments (30.7 %)

The fund holds one large cap Australian investment tenet (7.5% position invested in two companies). We described this position in the prior investment update as something we expect to deliver “12–14% type annual returns over the next three years with the potential for additional upside from asset consolidation.” Since September 1st the position has appreciated approximately 16%. Accordingly, we have trimmed the size of the investment as to an extent we have realised our first year of expected return from this position over the last two months.

The dynamics of the balance of the long investments have remained consistent. The individual companies have performed reasonably well; consistent with strong equity markets. The appreciation

of the AUD has somewhat muted this performance as we have been content to leave the Euro and US currency exposures unhedged.

Shorts (5.5%)

We have added a third short position since September, which is a large cap Australian company. We feel encouraged with our shorting endeavours and are showing a small profit from these holdings over the past two months.

Trading and Other (annual risk ~2.5%)

1) Trade A: Yen (~2 % annualised risk)

- We have maintained our activity of buying out of the money put options in the Yen. Our fundamental thesis for doing so is outlined in the “Japan” note dated May 31st 2010. We are maintaining this position in a manner that enables the fund to continue to have a material exposure to a sharp depreciation in the Yen. The cost of this position is the option cost which is the ~2 % annualised risk described above.

2) Trade B: IAG Call options (~0.25% risk)

- The share price of IAG has appreciated strongly since we bought these options. We sold half of the position recently at 27 cents (cost was 10 cents). At current prices the holding has contributed ~1% to performance.

3) Trade C: “Global growth proxy” put option (~0.25% risk)

- In the days leading up to the announcement of “QEII” we risked (and unfortunately have likely lost) 0.25% of the fund’s capital buying very short dated out of the money put options in a company we consider to be a proxy for global growth. Asset prices were aggressively appreciating coming into this announcement and our sense was there was a strong likelihood of markets selling off when the details were evident.

Other comments

Every position in the fund goes through the same rigorous fundamental research process regardless of asset class or geography. At our core we are fundamental based long term investors seeking opportunities in the large cap Australian equity space. Our preference is to find investments where we can just own them outright. These investments are held in the “long investment” portion of the fund and it is from this part of the fund that we expect to gain the majority of performance over time.

We are using the “trading and other” section of the fund to isolate exposure to a specific investment where we want either:

- The effective leverage in the position through buying options; or
- Exposure to a specific company where we think it has real investment merit but for whatever reason we are uncomfortable with the downside risk of making a direct investment.

We see the benefit of buying options in both of these cases as a risk control mechanism; effectively we can isolate a material exposure to the idea we think is mispriced while limiting the fund’s risk to the cost of the option.

Recent activity in the fund has involved trimming long holdings back to their core weights, selling the options held that are geared to a rising market and buying some short term protection across the fund.