Greencape Wholesale Broadcap Fund

Fund report and commentary – December quarter 2010

Performance	Quarter (%)	1 year (%)	2 years (%) p.a.	3 years (%) p.a.	Inception (%) p.a.
Greencape Wholesale Broadcap Fund	**6.47**	**5.41**	**23.79**	**–1.10**	**8.98**
Growth return	5.34	2.78	20.59	–4.18	4.39
Distribution return	1.13	2.64	3.20	3.08	4.60
S&P/ASX 300 Accumulation Index	4.65	1.90	18.41	–5.04	3.02
Active return (net)	**1.82**	**3.51**	**5.38**	**3.94**	**5.96**

Returns are calculated after fees have been deducted, assuming reinvestment of distributions. No allowance is made for tax. Past performance is not a reliable indicator of future performance.

Investment objective

The Fund aims to provide capital growth over the medium to long term through a diversified portfolio of large, mid and small capitalisation Australian shares and provide returns above the benchmark, the S&P/ASX 300 Accumulation Index, over rolling three-year periods.

Investment manager

Greencape Capital Pty Ltd

Investment strategy

Greencape is an active, bottom-up stock picker. Whilst not targeting a specific investment style and investing in stocks displaying 'value' and 'growth' characteristics, Greencape's focus is on a company's qualitative attributes, which will generally lead to 'growth' oriented portfolios. This is an outcome of Greencape's bottom up process. As such, Greencape's investment style may be classified as 'growth at a reasonable price' (GARP).

Distribution frequency

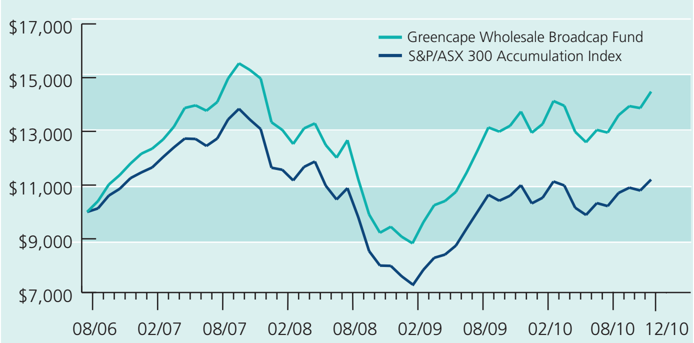
Quarterly

Suggested minimum investment timeframe

At least five years

Greencape Broadcap Fund

Growth of $10,000 invested since inception (net of fees)

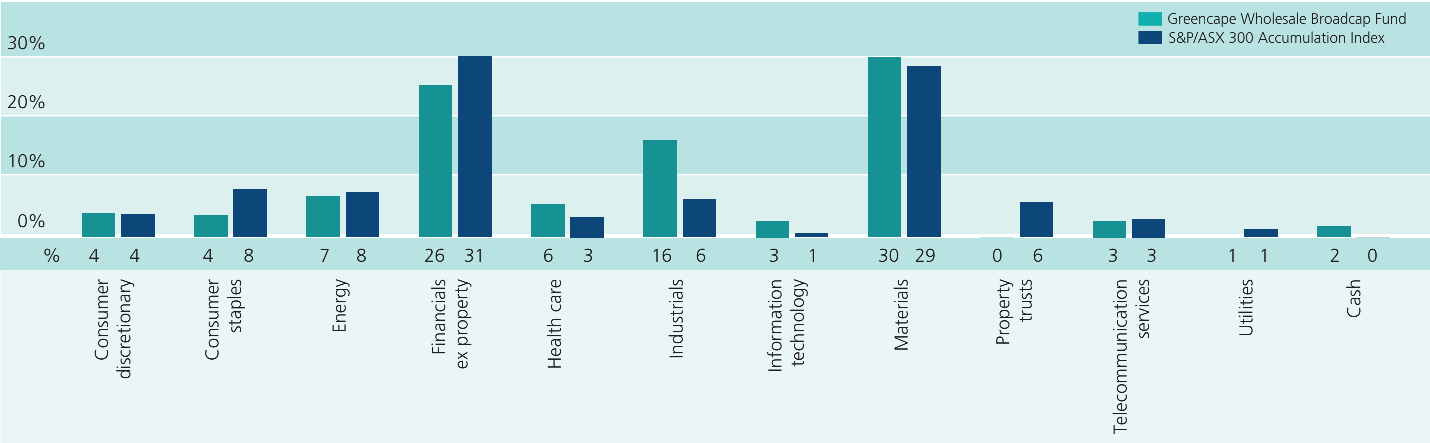


Asset allocation	Current (%)	Range (%)
Securities	98.18	85–100
Cash	1.82	0–15

Fund facts	Greencape Wholesale Broadcap Fund
Inception date	11/09/2006
APIR code	HOW0034AU

Fees	Greencape Wholesale Broadcap Fund
Entry fee	Nil
2009/10 ICR	1.25%
Management fee	0.95%p.a.
Performance fee	15% of the Fund's after management fee return above the Fund's benchmark.
Buy/sell spread	+0.30%/-0.30%

Sector exposures as at 31 December 2010



Market review

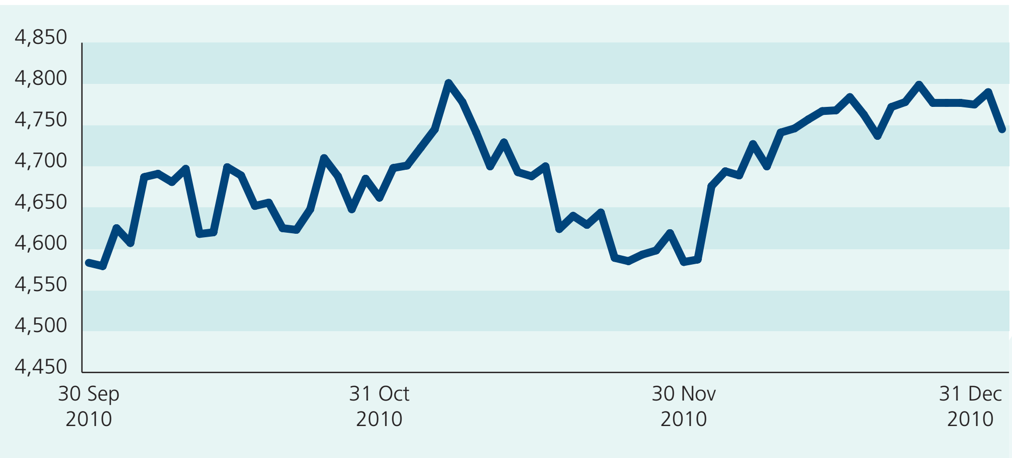
The S&P/ASX 300 Accumulation Index gained 4.65% for the quarter but was only up 1.90% for 2010. The Greencape Broadcap Fund outperformed the market and delivered a 6.47% return over the quarter.

The market was up in October and into early November on the back of rising commodity prices and the expectation of further US quantitative easing being taken positively by the market, which also saw the Australian dollar reach parity with the US dollar for the first time since 1983. Singapore Exchange made a bid for the Australian Securities Exchange, which subsequently traded below the bid price on concern that the deal may not be approved by the Australian Parliament. The Reserve Bank of Australia (RBA) raised the cash rate by 25 basis points (bps) to 4.75% on Melbourne Cup day, followed by additional increases by the Big Four banks and then the regionals and credit unions followed.

Equities sold off in late November as sovereign debt fears re-emerged with Ireland taking a bailout from the European Union, and China tightened its monetary policy by lifting its bank reserve ratio by 50bps to an all-time high. November also saw the largest initial public offering in Australia for 13 years with Queensland Rail being listed at the lower end of its indicative range.

The market was up in December as the RBA held the cash rate flat and the US Government announced it would extend both the Bush-era income tax cuts and long-term unemployment benefits for at least the next two years. Late in the year downgrades by some companies as a result of the Queensland floods saw some tempering of the market's gains.

S&P/ASX 200 Index



Materials was the standout sector for the quarter, as they were for the year, with BHP up 16% (47% of the materials index) after the Canadian Government rejected their bid for PotashCorp in November and BHP reactivated their share buyback. Fortescue Metals rose 26% after refinancing their debt which allows their next leg of iron ore production expansion to proceed, and Iluka was up 52% on higher mineral sands prices.

Healthcare was driven by CSL (54% of the sector) being up 10% after a large European competitor announced its withdrawal from the plasma market following product quality concerns, which should expediate the transition from trough cycle conditions currently being experienced. Cochlear was up 15% following a competitor announcing a worldwide recall and Ramsay Healthcare gained 16% after it upgraded earnings guidance in December.

The energy sector's gains were broad-based with Riverside Mining gaining 63% following Rio Tinto's acquisition bid. Paladin Energy was up 37% on the back of improving fundamentals for uranium and Worley Parsons was up 20% following project wins and a higher oil price. Woodside Petroleum (31% of the sector) offset these gains to some extent, falling 3% after Shell sold its shareholding.

	December quarter	1 year
Market (S&P/ASX 200 Accumulation Index)	4.4%	1.6%
Best performing sectors:		
Materials	13.4%	12.5%
Healthcare	8.3%	5.0%
Energy	7.5%	2.3%
Worst performing sectors:		
Consumer staples	–4.7%	3.0%
Consumer discretionary	–2.0%	–4.8%
Industrials	1.5%	–3.4%

The consumer staples sector was down, driven by Coca-Cola Amatil falling 9% after modestly downgrading second half earnings. Woolworths was also down 6% after posting soft Q1 sales with signs of price deflation, and Fosters was down 5% with the strong Australian dollar hurting foreign earnings and weak beer volumes sold.

Consumer discretionary was down modestly following earnings guidance downgrades from The Reject Shop (down 22%) and Aristocrat (down 15%), strong price deflation, particularly in electronic products, and a shift in consumer consumption habits hurting Harvey Norman (down 20%), JB Hi-Fi (down 13%), David Jones (down 7%) and Myer (down 6%).

Industrials' weak performance was broad-based and weighed down by the larger stocks such as Toll Holdings (down 11%) following Paul Little's retirement announcement, Qantas (down 9%) following A380 engine issues and bad weather in Europe, and Leighton Holdings (down 7%) after they downgraded earnings guidance due to cost overruns and foreign exchange headwinds.

'In my experience it's very unusual to see a significant anomaly and at the same time the catalyst that will correct it.'

Anthony Bolton, former Fidelity fund manager

'The prevailing view has been that the market will earn a high rate of return if the holding period is long enough, but entry point is what really matters.'

Seth Klarman, 19/05/10

'Sometimes risk and reward are correlated in a positive fashion… The exact opposite is true with value investing. If you buy a dollar bill for 60 cents, it's riskier than if you buy a dollar bill for 40 cents, but the expectation of reward is greater in the latter case. The greater the potential for reward in the value portfolio, the less risk there is.'

Warren Buffett, 1984

Company visits and observations

China:

In November we travelled to China, Hong Kong (HK), and Singapore to ascertain how economic growth is unfolding and what the implications might be on the Australian economy and listed companies. We met with a wide range of private companies (banks, manufacturers, mining, construction, shipping, retail, automotive, property and commodity traders) as well as government officials involved in monetary policy, energy policy development and trade. Some of our key take outs were:

- Wages inflation is running at 10 to 15% p.a. and will continue to rise faster than GDP growth. The magnitude is greater for English speaking workers which is a key challenge for most corporates, particularly in low margin industries.
- Food inflation: People we spoke to weren't personally concerned with the hike in food costs and see it as largely temporary.
- Steel demand:
  - Most corporates believe long steel (50% of demand, used for construction) grows more modestly from here but flat steel (50% of demand, machinery, auto, appliances etc.) will continue to grow strongly.
  - New infrastructure investment spend should grow for the next two to three years given plans in place for road/rail.
  - Private ownership of cars is still in its infancy, with huge growth still to come. Passenger car sales will outstrip commercial vehicles going forward.
- Coal (thermal):
  - Supply: Government's five year plan is for 4% compound annual growth, but this may prove conservative.
  - Price: There is a chance government may try to restrict domestic coal prices rising given inflation concerns.
- China property market:
  - Major bank view: Whilst housing affordability is decreasing, first home buyers are supported by their parents/grandparents who are debt free.
  - Central bank view: 'Bubbles evident within housing market and very hot in parts'.
  - Some developers are switching from residential to commercial developments, therefore some risk of future oversupply in parts of the commercial market.
  - No signs of industrial companies speculating on property (like those in Japan in the 1980s).
- Banking in China/SE Asia:
  - Rational industry.
  - Property exposure: Total property lending is relatively low. Low loan to value ratios (LVR) against housing is a large buffer (e.g. post the 1997 Asian crisis HK property prices fell 70% but HSBC's delinquency rate stayed less than 2%).
  - Bad debts: Five to ten years ago there was poor risk management in the banking system but regulators did a good job of cleaning up.
  - System liquidity is very high – greater than prior to the GFC. Everyone we spoke to blames US Quantative Easing 2 (QE2), and all banks were worried about the future impact.

'China's progress over the past three decades is a successful variation on the East Asian growth model that stems from the initial conditions bequeathed by a planned socialist economy. That model has now almost exhausted its potential. So China has reached a crucial juncture: without painful structural adjustment, its economic growth momentum can suddenly be lost.'

Yu Yongdin, China Society of World Economics, 10/01/11

'Given that bank credit is 130% of GDP and fiscal spending only 20%, monetary and credit policy is by far the most important policy tool.'

UBS, 12/11/11

- China consumption:
  - Consumer leverage is still low, e.g. 94% of one major bank's mortgages go to first home buyers at 60% LVR.
  - Increase in interest rates has little impact on consumption demand, since 'they spend from income, not from debt'.
  - Middle market consumption patterns are changing, consumers are moving up product price points.
- Corporates (general):
  - Manufacturing moving further inland in China.
  - Going global: Almost all we spoke to have global ambitions (underway) and are well supported by banks.
  - Return on equity: All quote targets of 14 to 15% but we question how strict this is.
  - More businesses relocating to Shanghai away from HK.
  - Increasing hiring of locals versus expats.
- Chinese Government:
  - Policy makers are well aware of risks.
  - Government bodies appear more innovative than in the West (e.g. in energy the Government is actively involved in technical aspects of coal-seam methane and shale gas).
  - China floating the Renminbi? Another consideration for the Government is the risk that high net worth individuals could send funds offshore if they were concerned about political unrest (and the currency was floating), and such individuals' combined wealth is greater than China's foreign currency reserves.
  - 'Chinese politics is a black box'.
  - Transition from a planned to a market-based economy is real but there are challengers, e.g. want to increase energy efficiency, but don't want to hurt consumers with significantly higher energy prices.
- Intra-Asia trade: Growing c 15% p.a. post China/ASEAN trade agreement.
- Excess capacity is an issue in many industries, particularly:
  - Aluminium: minimal upside to domestic prices in next two to three years.
  - Shipping: new ones still being built, so international freight rates should stay low for next two or more years.

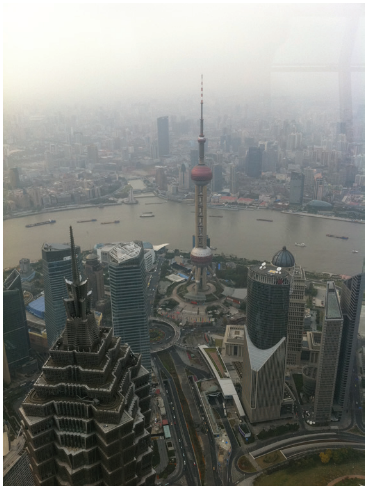
'Today Chinese consumer spending is just 3% of world economic activity, in contrast to Europe and the US's 36% share.'

Gordon Brown, former British PM, 22/12/10

'20 years ago, it was argued that "Japan is different" and that Tokyo's economic policies were better than the West's.'

Edward Chancellor, GMO, March 2010

View from top of Marina Sands, Singapore's new casino



Shanghai – Looking across Yangtze River and view from the 101st floor of the Financial Centre building

Australian companies borrowing from US:

- Increasingly we are seeing Australian mid and large sized corporates bypassing the Australian banks and going direct to the US private placement market for their borrowing requirements, given low US interest rates at present. An example is Campbell Brothers (CPB, market cap $2.6 billion) who recently sold senior unsecured notes with a face value of US$165m into the US, the first time they had accessed that market. We understand that CPB originally planned to issue US$100m of debt but received offers for $900m with a 15 year tenor. The fixed interest rates offered were 3.2% in the US, 4% for Canadian debt and the tenor of the debt was mostly 10 years. The fixed debt was then entered into a variable-rate swap with the current rate being 1.6% p.a.

Australian retail:

- Retail is tough. Some retailers were planning on an 'ok' Christmas trading period after a very tough November which saw total retail sales up only 1.4% on pcp[1] with electrical, clothing and department stores all experiencing negative growth, following the RBA's and banks' additional rate rise on Melbourne Cup day. This in part may be due to consumers on average shifting down to lower priced items which anecdotally appears to have carried into the Christmas shopping period. An example of this is Dymocks who saw the average value of their gift cards fall by 12%, whilst the volume of cards was up.
- Other headwinds facing retailers:
  - Price deflation, particularly in electronics where retailers have reported price deflation of 30% for televisions, which has swamped any increase in volume growth.
  - The recent and planned arrival of international competitors (e.g. Costco, GAP, Zara, Lowes).

[1] *ABS data (original data basis): Total retail for November 2010 + 1.4%, electrical goods -5.8%, clothing –2.7%, department stores –1.8%*

- Wet weather along the east coast, particularly in Queensland, during the busy Christmas and post-Christmas sales periods.
- Online retail taking a bigger share of wallet (see below).
- Several retailers have being rolling out new stores in recent years (e.g. JB Hi Fi, The Reject Shop, Myer, David Jones).

- Online retailing: Whilst coming from a low base of around 3 to 5% of total retail sales[2] versus 8% in the US and 10% in the UK, the recent strength of the Australian dollar has, at least anecdotally, seen a strong increase in online purchases. The shift to online has been around for longer, and is more pronounced, in certain categories such as music (think iTunes) and books (Amazon), but is growing in categories such as apparel, where even the author of this report has shifted 100% of his work shirt purchases to UK websites! The impact of online offshore purchases on retailers was evidenced by the creation of the 'Coalition against GST exemption for online shopping' which was backed by several retailers, including David Jones, Myer and Harvey Norman.

  We perceive the risk as more a medium-term structural shift story, however a related risk for David Jones and Myer is that they are not the ultimate owner/controller of the brands they sell (although Myer has several of its own brands). Brands are selling more online from their own websites (e.g. Witchery, Country Road) and this trend appears set to continue. Overall the best execution model may be a multichannel one which combines traditional retail brand awareness & shopping optionality with a lower cost to serve via online.

[2] *JP Morgan estimate, 24/12/10 'Online Retailing – Reviewing the Competition Threats posed by Technology and the Web'*

'Australia Post said there was a 24 per cent increase in overseas packages shipped into the country in the three months to October.'

The Age, 16/11/10

'… the campaign appears to be having the opposite effect to that intended: it is highlighting the fact that Australian consumers pay much higher prices for comparable items than shoppers just about anywhere else in the world.'

AFR, 07/01/11

Macro observations

US QE2:

- On 3 November 2010 the US Federal Reserve (Fed) announced that it would expand its holdings of longer-term Treasury securities by a further US$600bn by Q2 2011 in an attempt to keep interest rates low. In the release documents we note the following excerpts, which show that the Fed is having to change its own rules in order to accommodate the size of the program as well as internal opposition to the move, both of which may hamper the Fed's ability for any future QE3 if QE2 was ultimately ineffective:
  - Federal Reserve Bank of New York: 'To provide operational flexibility and to ensure that it is able to purchase the most attractive securities on a relative-value basis, the Desk is temporarily relaxing the 35% per-issue limit on System Open Market Account (SOMA) holdings under which it has been operating. However, SOMA holdings of an individual security will be allowed to rise above the 35% threshold only in modest increments.'
  - US Federal Reserve: 'Voting against the policy was Thomas M. Hoenig. Mr. Hoenig believed the risks of additional securities purchases outweighed the benefits. Mr. Hoenig also was concerned that this continued high level of monetary accommodation increased the risks of future financial imbalances and, over time, would cause an increase in long-term inflation expectations that could destabilize the economy.'

Ben Bernake was interviewed on 60 Minutes on 5 December 2010 in relation to QE2, with an excerpt of the transcript below:

Interviewer: 'You have what degree of confidence in your ability to control this [inflation]?'

Bernake: '100%'.

Interviewer: 'Do you anticipate a scenario in which you would commit to more than $600 billion?'

Bernake: 'Oh, it's certainly possible. And again, it depends on the efficacy of the program. It depends on inflation. And finally it depends on how the economy looks.'

'Our current policy of QE2 is merely the last desperate step of an ineffective plan to stimulate the economy through higher asset prices regardless of any future costs.'

Jeremy Grantham, October 2010

'At the moment, from a European viewpoint, one could get the impression that the US is doing through other means what it is reproaching China for…. With all due respect, my impression is that the US is helpless. The problem of the US is not a lack of liquidity and the decision by the Fed to add some $600 billion will not solve the problem.'

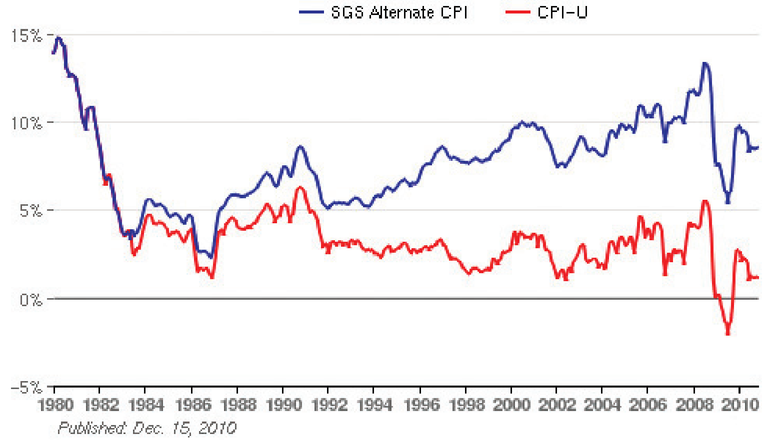
Wolfgang Schaeuble, Germany Finance Minister, 05/11/10

Alternative inflation measure (US):

- The chart below shows the official Consumer Price Index (CPI) as published by the Bureau of Labour Statistics (red line) versus what it would look like if it was calculated using the same methodology that was used in 1980 (blue line). According to Shadowstats.com.
  - 'In general terms, methodological shifts in government reporting have depressed reported inflation, moving the concept of the CPI away from being a measure of the cost of living needed to maintain a constant standard of living.'
  - 'Geometric weighting was introduced to the CPI reporting methodology, which had the effect of mimicking a substitution basis' (i.e. assumes people consume less of a good as its price goes up relative to a cheaper alternative).
  - 'Artificially reducing reported CPI inflation would have a variety of benefits, beginning with reduction of the budget deficit due to the cutting of cost-of-living adjustments for Social Security payments.'

Annual consumer inflation – CPI vs SGS alternate

Year to year change through Nov. 2010 (BLS, SGS)

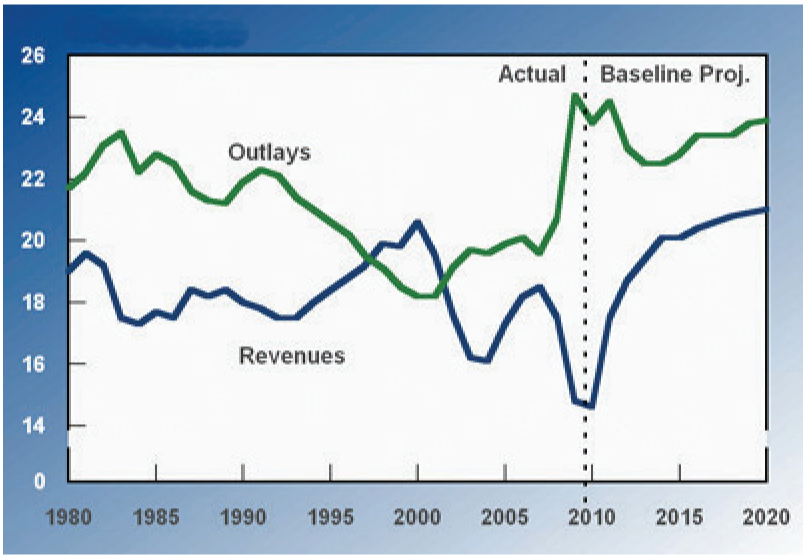


Source: shadowstats.com

US Federal deficit:

- The chart below from the US Congressional Budget Office (CBO) shows the drivers of the historical and forecast US Federal budgets. This was produced in August 2010 and therefore excludes the proposed extension of the Bush-era income tax cuts and long-term unemployment benefits for the next two years.

Percentage of GDP



Source: US Congressional Budget Office

'There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.'

John M Keynes

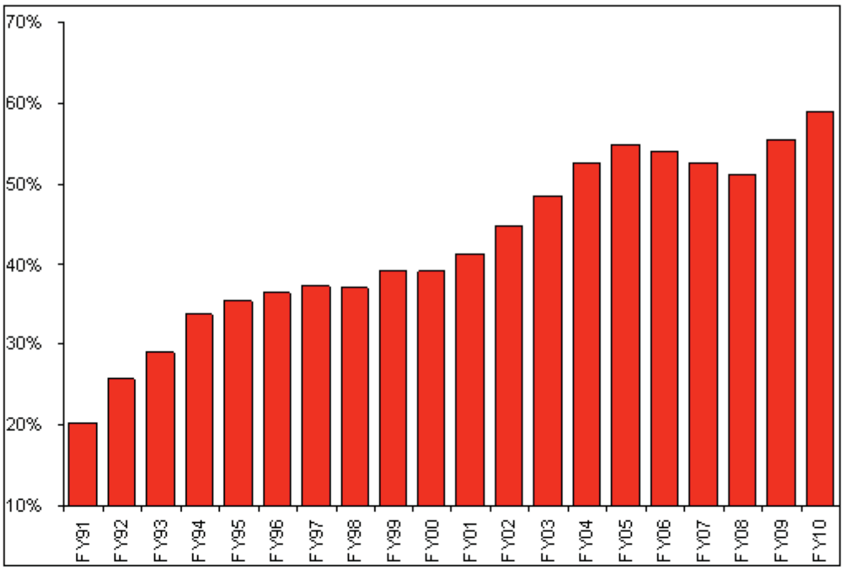
We note the following with respect to the CBO forecasts:

- A budget deficit is forecast for every year out to 2020 (2020 deficit is US$685bn versus 2010's $1.3 trillion) but for the second half of the decade assumed rates of GDP growth means total debt stabilises as a proportion of total GDP.
- Net interest expense is forecast to go from $200bn in 2010 to $780bn in 2020 (assumes an average interest rate of between 5 and 6%).
- But the biggest swing factor appears to be their revenue forecasts. For example, in 2010 total individual income taxes collected were $890bn, yet its forecast is $1.4 trillion in 2012 (which would be $240m higher than any other year on record) and then $2.6bn in 2020. This would require a compound average growth rate in income tax collections of 11.3% p.a. over the decade. This appears optimistic to us.

Australian banks wholesale funding:

- Australian banks currently have 62% of their lending exposed to housing, up from 58% a year ago. The chart below shows how this exposure has grown over the last 20 years.

Percentage housing of Australian bank loans: FY91 – FY10



Source: Morgan Stanley

- This lending is funded significantly by international wholesale sources – largely bond investors. The banks are very secretive when it comes to which entities are the key providers of their wholesale funding. We've observed that the appetite (and hence funding cost) for funding Australian banks is heavily influenced by bond investors' views towards Australian house prices. Recently views towards Australian house prices have become increasingly polarised with a growing (vocal) camp making a case that housing is over-priced, whilst others like the RBA and Commonwealth Bank (CBA) have defended affordability (refer to our reports for September 2009, March 2010 and June 2010 where Australian house prices and bank offshore funding requirements were discussed in more detail).

  We note banks have made some progress recently in increasing the proportion of funding from deposits, yet the wholesale funding requirement remains large. In light of this, and given the increasingly polarised view towards house prices, we consider it important to understand the concentration risk of wholesale bank funding providers. Very little is publically disclosed by banks as to who their key bond holders are, however we commissioned research to explore the geographic concentration of Australian bank wholesale lenders (see following table). Interestingly it highlights National Australia Bank (NAB) as an outlier with a much higher dependence on Europe. This may be significant given European sovereign risk remains a key influence on funding pricing and availability.

'US state [governments] face a cumulative deficit of US$144 billion for fiscal 2011.'

John Rubino, CFA Magazine, November 2010

'… in 2010, Japan's nominal GDP is equal to its 1993 GDP.'

American Enterprise Institute for Public Policy Research, July 2010

'… when a sector reaches the bubble or manic phase, it accounts for a very large percentage of the economy, or of the stock market capitalisation, and usually also of the total credit (this certainly is the case of real estate bubbles).'

Marc Faber, January 2010

'Property prices and leverage are probably the two best indicators that you have a problem.'

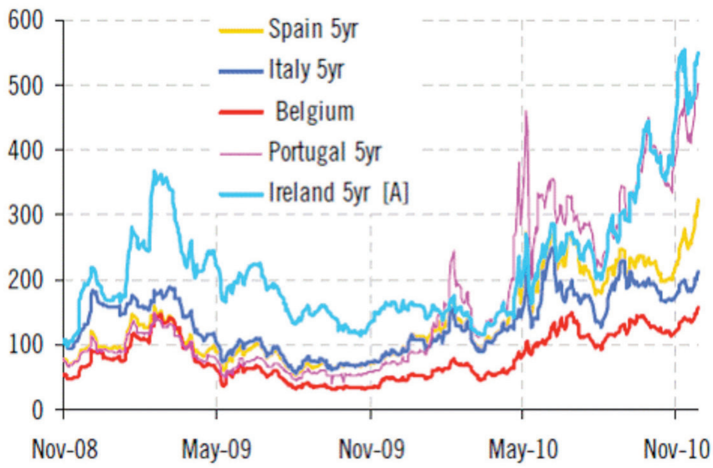
Kenneth Rogoff, prof Harvard, 06/07/10

Bond investor location	ANZ	CBA	NAB	WBC
Australia	30%	36%	24%	33%
Asia	16%	10%	18%	4%
USA	24%	30%	20%	30%
Europe and UK	24%	18%	38%	26%
Japan	6%	6%		7%

Source: Estimate based on Appendix 4E and Investor presentations

Below is a chart showing the latest credit default swap (CDS) spreads, which highlights the market's increasing concern about Ireland and Portugal.

Selected EMY 5 year CDS levels



Source: Citi Investment Research and Analysis

'… with sovereign debt, we are talking about tipping points – we don't know how much is too much… A tipping point is invisible, as we just saw in Greece. In most situations, everything appears fine until it's not fine, until, for example, no one shows up at a Treasury auction.'

Seth Klarman, 19/05/10

Australian Government inquiry into bank competition:

- After much anticipation, the Federal Government announced a package of 13 reforms in December to 'promote a competitive and sustainable banking system' in Australia. The reforms are around the following three areas:
  - Empowering consumers to get a better deal: banning mortgage exit fees, study into account number portability, etc.
  - Support smaller lenders to compete with big banks: supporting mutual sector to create a fifth pillar, making deposit insurance permanent, increasing support for the securitisation market.
  - Expanding bank funding sources: introducing covered bonds, encouraging a liquid corporate bond market.

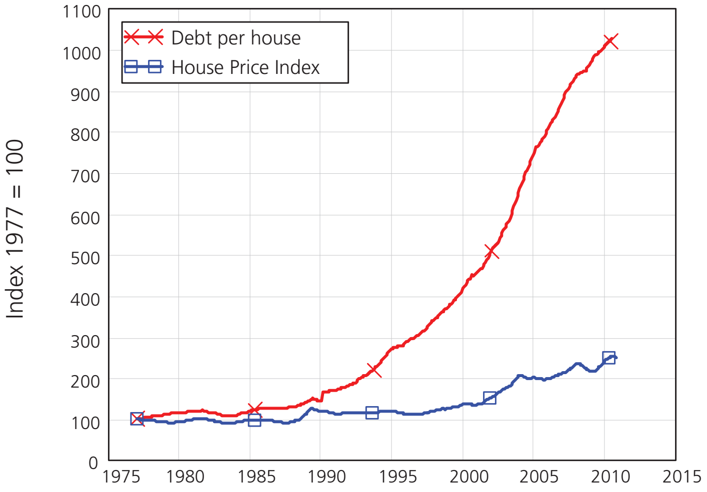
  Our view is that these reforms will have a limited impact on the Big Four banks, with the first group of reforms hurting smaller banks more. We are sceptical about the likelihood of success of a mutual taking significant share and the reforms in the third group above should prove favourable. However the fact that the Government has gone to such lengths to appease the public's perception of big banks 'ripping off' consumers, is perhaps an indication of just how reliant our economy has become on credit and how large a part the banks are of our economy. A couple of metrics that highlight this are the fact that the combined market cap of the listed banks is $270 billion, or 21% of GDP (or 23% of the value of the S&P/ASX 300 index)[3] and the chart following from Professor Steven Keen highlighting the increasing household debt burden over the past 30 years.

'If increased competition had unintended deleterious consequences on previous occasions [mid 1980's], what might be the consequences of enhancing competition again now, in the aftermath of a financial crisis? Is competition the panacea, as conventional economic analysis argues, or is it to some extent the problem in the financial sector?'

Professor Steven Keen, 30/11/10

[3] *Includes ANZ, CBA, NAB, WBC, BEN, BOQ but excludes MQG and SUN. Although it should be noted that these banks include offshore investments as well as wealth management related earnings.*

CPI -deflated debt and house prices

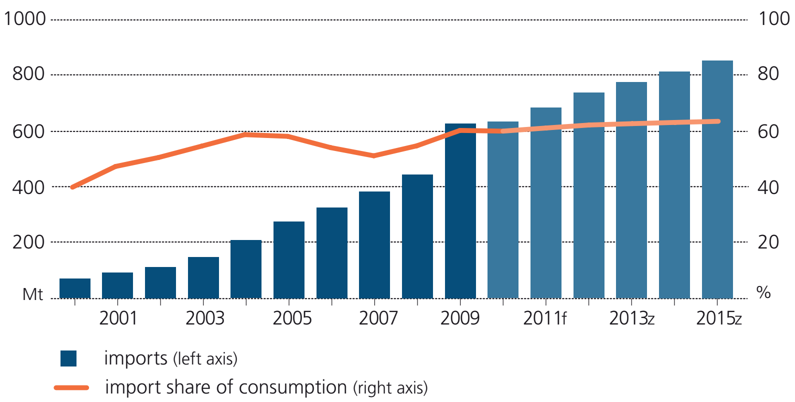


Source: Professor Steven Keen

China's iron ore imports:

- In 2009 China consumed 66% of the world's seaborne iron ore market. If the forecasts below are correct, in 2015 China will consume more iron ore than the entire world did in 2005.

China's iron ore imports



Source: Australian Bureau of Agricultural and Resource Economics (ABARE)

Copper:

- In the US, people aren't just giving up their fixed copper lines, they are stealing them. The Federal Bureau of Investigation has reported a sharp rise in the last four years of fixed line infrastructure theft. AT&T is reportedly offering a $3,000 reward for information leading to the arrest of local copper thieves after nearly 7,000 customers lost local phone service during a three-day stretch of thievery, according to local reports.[4]

'A British 2p coin is now worth 5p in copper!'

Greencape

[4] *Source: Networkworld*

Outlook

As bottom-up investors, we remain cognisant of our, and everyone else's, inability to accurately predict future macro-economic outcomes. Rather we take a highly disciplined bottom up approach and have consideration for possible macro scenarios which may not be reflected in stock prices.

At the time of writing, uncertainties abound as we look to the year ahead and beyond, some of which are:

- The impact of the Queensland floods on the economy, our currency and the market.
- China's outlook for commodity demand as it tries to cool parts of its economy.
- To what degree sovereign debt issues and fiscal austerity programs in Europe will impact investor and consumer sentiment.
- Whether the USA's improving economic data will be self-sustaining if federal and monetary stimulus are unwound and what pressure, if any, will the next vote by Congress have to approve the 81st increase[5] in the statutory debt limit have on future federal budgets.

In 2010 the materials sector (29% of the index) outperformed the market by 11% with most other sectors modestly outperforming or underperforming (excluding telecommunications and utilities which are both relatively small). In 2011 we are more circumspect about the potential for similar outperformance for materials to outperform by such a magnitude, given the outperformance of some of those stocks, particularly in the December quarter, balanced against some of the macro risks that we have highlighted.

Whilst we've identified a number of macro risks is this report, including parts of the global economic recovery that may occur at the expense of future tax payers (e.g. huge US fiscal stimulus), it's impossible to predict when such imbalances may 'come home to to roost'. As such we remain balanced in our portfolio construction and continue to focus our hunt for bottom up value in higher quality companies, rather than pursuing any macro or sectoral themes. The combination of uncertain times and generally strong corporate balance sheets should continue to reward quality companies with established track records of adding value through all points in an economic cycle.

[5] *The next increase will be the 81st since 1940. Since 1917 a statutory limit on the amount of US federal government debt outstanding has been in place. The current limit is US$14.294 trillion which is forecast by Morgan Stanley to be reached sometime in mid 2011.*

'The whole problem with the world is that fools and fanatics are always so certain of themselves, and wiser people so full of doubts.'

Bertrand Russell

'I have to say, I feel deeply troubled by the current investment environment. Asset prices are going up, not because of sustainable and sound fundamental economic factors, but because of unsustainable fiscal deficits and loose monetary policies are practically everywhere in the world.'

Marc Faber, January 2010

'The monetary history of the last 400 years has been replete with financial crises… financial failure has been more extensive and pervasive in the last 30 years than in any previous period … the likelihood of escaping economic and financial crises in the years ahead seems small.'

Book: Manias, Panics and Crashes – Kindleberger/Aliber (2005)

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