



## Currency Hedging as at 1<sup>st</sup> August 2008 K2 Asian & K2 Select International Funds

On 1st August K2 Asset Management further reduced our currency hedge.

This has resulted in K2's level of AUD currency exposure declining as indicated below:

	1/8/2008	24/7/2008	23/7/2008
K2 Asian ARF	58.0%	75.0%	100.0%
K2 Select Int'l ARF	49.0%	71.0%	100.0%

### Investment Rationale

On 27 February 2008, I mentioned six potential triggers for K2 to reduce hedging back into the AUD, namely:

1. Weaker Australia domestic economy
2. Slowing Australian inflationary pressures
3. Slowing new world growth (China, India, Middle East, Latin America & E.Europe)
4. Falling commodity prices
5. Accelerating US economic growth & therefore rising US interest rates
6. Recapitalisation of the US financial sector.

In my view 5 out of 6 potential triggers have eventuated. The only trigger not working is that the US economy is still decelerating and is likely to stay in that mode until 2H2009.

1. The Australian domestic economy has weakened, as indicated by slower mortgage approvals, significant declines in consumer and business confidence, tighter advertising spending and declining growth rates in retail spending.
2. Oil prices have retreated from their highs, food prices have moderated and heat has been removed from the building sector and labor market, all of which is mitigating inflationary risks. Further, bank interest rate rises above RBA targets has dented demand for credit and is moderating investment intentions. Wholesale price inflation was recently reported below market expectations.
3. China's July PMI at 48.4 was the lowest reading since 2005. Weaker export demand from the US & Europe is likely to see China's trade and current account surpluses narrow. India is also suffering from higher interest rates and more subdued domestic demand.
4. **The CRB Index fell more than 10% in July, the largest fall in 22 years.**
5. The US economy is the only trigger failing to fire at the moment, as the economy continues to decelerate.
6. While not totally recapitalized, the US financial sector received further significant financial support from the Federal Reserve and Congress in July.

In Australia, the Federal Government and RBA have both acknowledged the weaker domestic economic conditions. The consensus on interest rates is now moving towards a cut in 2008. All of the aforementioned factors I believe will place short term pressure on the AUD.

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