



K2 Market Comment & Outlook June 2007

Investment markets over the past 12 months have continued to exert a strong and positive momentum, though latterly we have seen a pick-up in volatility which is likely in our view to only increase with time. We were reminded in February of this year about volatility after the Chinese market in a single day sold off 9%, leading global markets to sell-off aggressively, albeit for what turned out to be only a short period.

Asia

Regional growth remains robust and we are strong believers in the long-term Asian growth story. However, the pace of expansion in China particularly has given rise to pressure points requiring tighter policy measures. In China particularly, inflation is rising both at the wholesale level and at the consumer level. Further, key indicators such as fixed asset growth and industrial production as well as GDP growth are all exceeding the government's targets. Hence, we are maintaining our view that further tightening measures will be imposed.

Separating economic growth from the stock market is important in our view and we expect that with the very buoyant Chinese stock market having run very hard that a pull-back is certainly an increasing risk. In China, the government has made clear its concerns regarding the over-heated state of the local (A share) market. Recently, it increased stamp duty which prompted a sharp downward reaction in the A-share market. However, as the market has already fully recovered from this loss, it is likely further cooling measures will be imposed.

We are finding in other Asian markets attractive investment opportunities. We have increased our position in Taiwan where the market offers investors good value. Uncertainty regarding the March 2008 election is abating with both the opposition leader and the incumbent party's nomination appeasing market concerns about Taiwan moving politically and economically away from China, an increasingly important trading partner for Taiwan Inc. In Taiwan we have maintained our weighting in the financial sector and we have increased our exposure to technology in the lead-up to the sector's seasonally stronger sales/earnings period. Technology stocks held and/or added typically are high margin, high return on capital companies with strong balance sheets.

Australia

The macro environment remains supportive with our central expectation being that economic growth as measured by GDP will expand by above 3% through the end of the year. The strong positive growth pressure that is being exerted from the resources sector we believe will continue for an extended period. At current estimates, new capital expenditure in Australia's mining industry is forecast to grow in real terms 23% in 2007 and 30% in 2008. (ABARE June 2007). We see the current rise in commodity demand and prices as a long-term secular story, with the rise of the Asian region an enduring force. We believe this backdrop is supportive for continued strengthening of the AUD. With the AUD having risen 60%+ against the USD over the past 3 years we do not discount the likelihood that we could see the AUD trading at parity to the USD over the next few years.

The Federal Budget announced a number of tax cuts to provide sweeteners ahead of the election in Q4. This should provide a mild economic stimulus going forward. However, we would not rule out more government spending initiatives nearing the election.

The employment picture in Australia remains robust with job creation up and unemployment continuing to fall across the economy. With Australia's rural economy in a drought induced



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recession, any improvement in this picture from the current winter rains could provide an additional economic stimulus to the economy.

The overall growth picture is likely to exert some inflationary pressure on the Australian economy and we believe the Reserve Bank will respond with higher interest rates over the next 12 months, most likely in the latter part of 2007. We do not view the risks from slightly higher interest rates as excessively problematic for the economy as a whole.

A feature which we expect in the Australian stock market is for leadership to shift to the high quality large-cap resource stocks and we are currently running a number of positions in this area.

North America

The US economy and particularly the consumer economy has been impacted by the rise in US interest rates from their lows of 1% in 2003; today US 30-year mortgage rates now over 6.50%. The impact has been worst felt by the sub-prime borrowing market, with low disposable income and a lesser ability to absorb rising interest costs.

Recent economic data, notably growth figures suggest that the US economy is however unlikely to slip into a housing led recession and as a consequence the markets may soon begin to price in improving economic conditions. Corporate balance sheets remain conservative and management focused on shareholder returns and a pick-up in investment spending may be an important driver for growth ahead.

The US equity market appears reasonably underpinned by valuation, with our investment focus on large-cap stocks that will be a beneficiary of an improving macro-economic picture over the coming quarters.

Europe

The European economic picture has been an improving one since 2003, with economic growth rising from 0.5% to 3% across the region in that time. A combination of benign inflation, rising productivity and falling unemployment have improved the regions fortunes with surveys pointing to economic optimism at multi-year highs.

The economy is benefiting from strong business led investment growth. European companies have been driving efficiency measures through their operations and we continue to find attractive investment opportunities.

The views expressed in this document are solely those of K2 and should not be relied upon as the basis for an investment decision and only expressed for the purposes of providing information.