



K2 ASSET MANAGEMENT

K2 AUSTRALIAN ABSOLUTE RETURN FUND

MONTHLY REPORT - 30 September 2010

Australian Market Review

The K2 Australian Absolute Return Fund returned 4.72% for the month of September while the All Ordinaries Accumulation Index returned 5.02%.

Sentiments towards equity markets improved during September. Clarity surrounding Basel capital requirements for Banks, housing and manufacturing data from the US and clear signs that China's economy was stabilising, all contributed to a more positive outlook.

Domestically, the economic data flow remained strong; 2Q GDP exceeded expectations, employment trends remain positive and the outcome to the Federal Election was also finalised. The AUD continued its upward trend consistent the "risk on" trades dominating the markets and finished the month at 0.966c (+7.5c). Providing this backdrop, investors were happy to add risk into their portfolios; Small Caps (particularly Resources) outperformed +8.42%, Materials (6.25%) & Industrials (+6.28%). Investors funded this risk appetite from defensive sectors; Telco's (-4.45%), REITS (-1.08%) & Healthcare (+0.66%) all underperformed.

Outlook

The Reserve Bank of Australia (RBA) has consistently stated that its main task is to preserve the value of money over time and at the same time endeavor to keep the economy near its full employment potential. Given that the unemployment rate is just 5.1%, the RBA should be more focused inflation. As a result the September quarter CPI release on the 27th of October will be closely scrutinized. However, the RBA monetary policy meeting is next week. At face value it would appear that a rate hike is almost assured; during the month the Australian dollar surged 9% (2nd largest monthly gain in 15 years), the CRB Food index jumped 9% and the CRB Metal index rose 8%. Price signals would indicate that global growth is rapidly increasing and Australia's terms of trade will continue to swell. Why then is the Australian 10yr bond still yielding less than 5%? Maybe any renewed inflation fear is unwarranted.

Last month some of Australia's largest companies made public comments about current trading conditions. Marius Kloppers from BHP said "We believe that the recovery momentum of the major economies will remain uncertain as the impact of fiscal and monetary stimuli fades. Therefore, we are still cautious in our short-term view of the economy". The Chairman of Australia's largest employer, Wesfarmers, said "...we remain cognisant of the fragility of global markets and cautious of the negative impact that any sign of a potential downturn, or added pressure on household budgets, would have on the Australian retail environment." Even James Strong from Woolworths, who are in the process of buying back \$700m worth of shares, said that economic uncertainty was "...likely to continue in the near term". In addition the latest NAB Monthly Business Survey showed that the measure for Final Products Prices is still below its long run average. Accordingly we believe that the RBA should leave rates unchanged next week. We believe that households continue to endure high running costs and disposable income growth opportunities are limited. We also feel that trading conditions for Chinese and Japanese steel makers may have past their peak and hence spot iron ore and coal prices could endure some volatility in coming months.

We continue to run relatively high net exposure. We still believe that conditions favour equity market investments and that dividend income opportunities available are considerably more attractive than what is on offer in bond or residential property markets. However, we are starting to find the occasional shorting opportunity. As a result, our net exposure has declined from its recent high and will probably continue to do so near term.

Portfolio Realised Gains & Losses - September

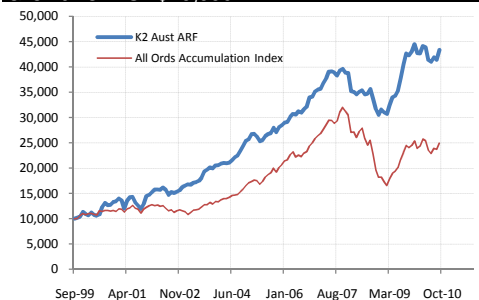
Long Sales	Australia	Profits	Alumina Ltd, BHP Billiton Limited, Brambles Industries Ltd., Carsales.Com, CSL Limited, CSR Ltd, Fortescue Metals Group Ltd, Macquarie Bank, Perseus Mining, Qantas Airways, RIO Tinto, Telstra, West Australian Newspaper Holdings Ltd
Long Sales	Australia	Losses	News Corporation, Paladin, Resmed Inc., Westpac Bank, Woodside Petroleum
Long Sales	New Zealand	Profits	Auckland Airports Ltd
Short Covers	Australia	Profits	Wesfarmers Ltd

Performance to 30 September 2010

1 Month	4.72%
3 Months	5.74%
6 Months	-1.68%
1 Year	1.61%
3 Years (pa)	3.35%
5 Years (pa)	9.16%
10 Years (pa)	13.07%
Since Inception (pa)	14.27%

The Fund's aim is to generate a 15%+ per annum return, net of fees and expenses, over an investment cycle.

Growth of AUD\$10,000



Returns are based on NAV per unit plus distributions reinvested net of management fee and performance fee accruals.

Fund Details (Unaudited)

Net Asset Value Per Unit (Ex):	A\$172.96
Distribution 30-Jun-2010:	A\$15.72
Fund Size:	A\$496.9m
Start Date:	1-Oct-99
S&P Fund Rating:	★★★★★

Top 5 Large Cap Holdings	Sector	%
National Australia Bank	Financial	9.8
RIO Tinto	Basic Materials	7.2
BHP Billiton Limited	Basic Materials	5.5
Westpac Bank	Financial	5.0
ANZ	Financial	4.4

Sector Exposure %

	Long	Short	Net Equity
Basic Materials	25.1	-1.5	23.6
Communication	5.5	-	5.5
Cons. Cyclical	9.8	-	9.8
Cons. Non-Cyc	5.4	-1.4	4.0
Diversified	0.7	-	0.7
Energy	3.1	-	3.1
Financial	33.6	-1.3	32.3
Funds	-	-	-
Industrial	11.4	-	11.4
Technology	-	-	-
Utilities	-	-	-
Total Equity	94.6	-4.2	90.4
Total Cash			9.6
Total Equity and Cash Exposure			100.0%

K2 Australian Fund

Financial Year Returns



K2 ASSET MANAGEMENT

K2 Australian Net Monthly Returns in AUD														All Ords (1)
Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin YTD	Fin YTD
1999/00				1.9	2.0	9.5	-3.9	-2.6	5.6	-4.0	-1.9	2.4	8.5	16.0
2000/01	13.1	6.8	-3.1	0.1	4.5	0.9	4.5	-2.9	-11.9	13.0	5.3	0.5	32.2	8.9
2001/02	-7.9	-4.8	-5.4	8.7	11.5	1.8	3.9	3.5	-0.2	-0.4	2.7	-2.7	9.5	-4.5
2002/03	-6.3	3.6	-0.9	1.7	1.6	4.3	1.8	1.2	-0.2	2.2	0.7	1.5	11.2	-1.1
2003/04	3.7	7.0	1.6	2.5	-1.2	2.9	0.4	1.4	0.5	-0.1	0.3	2.2	23.2	22.4
2004/05	3.1	1.4	4.2	4.5	3.7	1.4	3.8	0.3	-2.0	-3.4	0.8	3.2	22.6	24.8
2005/06	1.3	0.7	3.9	-3.2	3.7	1.4	1.7	0.5	3.5	1.9	-0.4	2.0	18.3	24.2
2006/07	-0.9	2.3	1.5	5.8	0.4	3.0	1.0	0.5	3.0	2.7	3.5	0.2	25.3	30.3
2007/08	-0.6	-1.5	2.6	0.9	-1.9	-0.3	-9.3	-0.4	-1.5	1.6	0.9	-2.3	-11.6	-12.1
2008/09	0.3	2.8	-5.8	-5.6	-3.8	3.4	-1.7	-1.2	5.8	4.7	0.9	2.9	1.9	-22.2
2009/10	7.2	7.4	5.1	-1.0	1.8	3.5	-4.0	-0.2	3.5	-0.6	-5.7	-0.9	16.3	13.8
2010/11	2.1	-1.1	4.7										5.7	8.7
													333.9	149.2

Key Statistics	Return (CAGR)	Standard Deviation (Annualised)	Alpha (Annualised)	Beta	Sharpe Ratio (6.0%)
Since Inception	14.3	13.3	8.2	0.69	0.6
All Ords (1) Since Inception	8.7	13.6	NA	NA	0.3
Since Inception to Restructuring	13.2	21.7	4.8	1.11	0.4
All Ords (1) Since Inception to Restructuring	8.6	12.6	NA	NA	0.3
Since Oct 2001 Restructuring	15.4	10.9	8.8	0.64	0.8
All Ords (1) Since Oct 2001 Restructuring	9.4	14.1	NA	NA	0.2

NOTE: (1) All Ordinaries Accumulation Index