

## K2 Asset Management

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# K2 Asian Fund Monthly Report - 30 September

## Asia Pacific Market Review

The K2 Asia Absolute Return Fund returned -8.97% for the month of September. The MSCI Asia Pacific ex. Japan (AUD) lost 4.7% or -7.4% in local terms. Asian and global markets endured yet another extremely volatile and difficult month. Asia, not only suffering from the fears of slowing EU and US economic performance and a corresponding withdrawal of funds from higher risk equity markets, but also from fear arising from the risk of a sharp slowdown in China's growth. As a result, the rapid deterioration in sentiment towards China led to China H-shares (-18.3%) and Hong Kong (-13.0%) being the hardest hit markets for the month. These markets have now lost 24.8% and 21.5% for the quarter respectively. Other poor performing markets over the month included Thailand (-14.0%) and the Philippines (-9.0%). Of the leading markets, none managed a positive return with India (-1.9%) being the best followed distantly by Australia (-5.3%) and South Korea (-5.3%).

## Outlook

Markets continue to sell off aggressively based on the fear that macro concerns facing Europe and the US will, in turn, cause Asia's growth to slow. Added fear is that policy measures targeting China's property, one of the drivers of growth, are now having an overly harsh effect. However, while we continue to believe that China will not suffer a hard landing, the risk to growth is clearly now the major concern for investors given the way Asian markets have behaved over the past few weeks. At this point, such concerns are showing no signs of improving. Despite this, there are some encouraging fundamental factors including China's PMI for September, released on the weekend, which came in at 51.2 vs 50.9 for August: an indication that the economy is still growing. Further, we believe that inflation in Asia is close to peaking and hence we should be close to an end in policy tightening. Any loosening of monetary policy, particularly in China, should be taken well. We spent two weeks in September visiting Taiwan, Hong Kong and Singapore. Whilst most talk was dominated by macro fears, the majority of companies we met were well placed to weather any downturn with strong balance sheets – low debt and in many cases, net cash holdings.

## Strategy

Net exposure at month-end was 56.9% having started the month at 70.3%. The change in exposure was via long positions which were reduced to 66.5% from 80.4%. Short positions were largely unchanged at -9.6%, down from -10.1% with these being in China and Australia. With sentiment so impaired at this point, extremely low valuations are being driven lower still by investors' diminishing confidence in the region's earnings outlook. This was reflected in the dramatic fall in Hong Kong and China equities and was the primary factor behind the fund's September fall. As such, despite our view that China is unlikely to suffer the hard landing the market is reflecting, the fund's exposure to China equities may be cut further. With regards to the fund's hedged position, the relative merits in the shorter term are weighing in favour of the USD and so may see some further reduction in the level of hedging. Given the benchmark index is unhedged and benefits from a fall in the AUD, the 9.4% fall in the AUD was the other major contributor to the fund's underperformance.

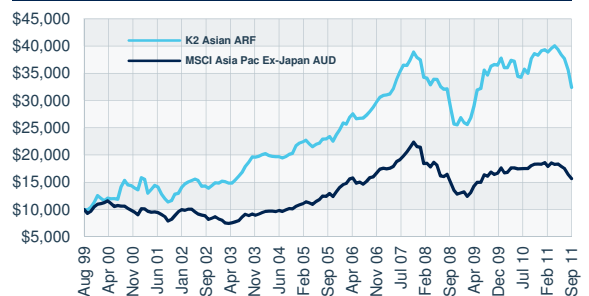
## Portfolio Realised Gains & Losses - September

Long Sales	Australia	Losses	BHP Billiton Ltd, Fortescue Metals Group Ltd, RIO Tinto Ltd, Stockland
Long Sales	HK/China	Profits	Galaxy Entertainment Group L, NVC Lighting Holdings Ltd
Long Sales	HK/China	Losses	Beijing Properties Holdings, China Everbright Ltd, China Railway Construction-H, China Railway Group Ltd-H, China Resources Land Ltd, China Yurun Food Group Ltd, Franshion Properties, Hutchison Whampoa Ltd, Ishares Ftse A50 China Index, Phoenix Satellite Television, Prada S.P.A., Samsonite International Sa
Long Sales	Singapore	Losses	Hongkong Land Holdings Ltd
Long Sales	Taiwan	Losses	Catcher Technology Co Ltd

Performance to 30 September 2011 (net of fees)	
1 Month	-8.97%
3 Months	-15.60%
6 Months	-18.09%
1 Year	-13.92%
3 Years (pa)	4.18%
5 Years (pa)	3.00%
10 Years (pa)	11.05%
Since Inception (pa)	10.22%

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:	A\$121.81
Distribution 30-Jun-2011:	A\$14.04
Start Date:	1-Sep-99
S&P Fund Rating:	★★★★

Top 5 Large Cap Holdings	Sector	%
AMP Ltd	Financial	3.4
Telstra Corp Ltd	Communication	3.3
Commonwealth Bank Of Austral	Financial	2.8
JB Hi-Fi Ltd	Cons. Cyclical	2.4
National Australia Bank Ltd	Financial	2.2

## Geographic Exposure %

	Long	Short	Net Equity
Australia	31.3	-7.4	23.9
China	16.0	-2.2	13.8
Hong Kong	9.9	-	9.9
Korea	4.9	-	4.9
New Zealand	1.2	-	1.2
Singapore	2.0	-	2.0
Taiwan	1.2	-	1.2
<b>Total Equity</b>	<b>66.5</b>	<b>-9.6</b>	<b>56.9</b>
<b>Total Cash</b>			<b>43.1</b>
<b>Total Equity and Cash Exposure</b>			<b>100.0</b>
<b>Net AUD Exposure AFTER Hedging</b>			<b>76.8%</b>

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