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K2 Australian Fund
Monthly Report - 31 October 2011

Australian Market Review

The K2 Australian Fund rose 3.69% in October in what was another month of extreme volatility dominated by macro news flow emanating from Europe. The All Ordinaries Accumulation Index finished up 7.17% recording its strongest monthly rise since July 2009. Markets across the globe rallied extremely strongly on expectations of an EU rescue package, which was announced on the 26th October, including a Greek debt restructure, planned bank recapitalisations and a leveraged EFSF. Economic data remained on the soft side but the key release for the month was the CPI inflation data. The year-on-year CPI on a RBA trimmed mean was 2.3% which was considerably lower than market expectations and paves the way for future interest rate cuts from the Reserve Bank. Lower rates are much needed and will provide an impetus to a weakening domestic economy and aid in restoring confidence to consumers to spend.

The best performing sectors for the month were Energy (+12.4%), Financials (+9.2%) and Materials (7.9%) as it was clearly “risk on” as investors chased beta. Other strong performers were: Consumer Discretionary (+7.5%), Industrials (+7.2%) and Property (+3.7%), all direct beneficiaries of potential RBA rate cuts. The lagging sectors were all the defensive sectors reflecting investor positioning and included: Telecoms (-0.2%), Consumer Staples (0.3%), Healthcare (+0.93%) and Utilities (+2.6%).

Outlook

During the month the Australian share market had a trading range of 14%. Despite this volatility, we progressively lifted our net exposure. It appeared that European leaders had finally agreed on a program to address the debt crisis. However, we were subsequently surprised to learn that the Prime Minister of Greece aimed to hold a referendum to consider the merits of the bail-out package. The pending G-20 summit may alleviate some of the concerns about coordinated action but clearly volatility in asset markets will continue for some time yet.

On a brighter note we were pleased to see the Reserve Bank of Australia (RBA) cut interest rates. This important move is hopefully the first step towards an improvement in consumer confidence. Given that nearly 90% of Australian mortgages are on variable interest rates, monetary reductions can led directly into greater household discretionary expenditure. Now that inflationary concerns are rapidly diminishing we can foresee more interest rate cuts in the months ahead. Accordingly, we believe that the probability of a cyclical improvement in consumer activity is increasing.

One of the consequences of the Global Financial Crisis (GFC) is that the volume of money in Australian bank deposits is greater than the entire market capitalisation of the equity market. As trading conditions in Australia start to normalise, we would expect listed companies to increase their dividend pay-out ratios back towards 65%. It is also likely that dilutive equity raisings will be less of a feature in the year ahead. As a result, we anticipate that listed companies will deliver double digit growth in dividends per share next year. Moving into 2012, dividend income will become increasingly competitive to fixed income.

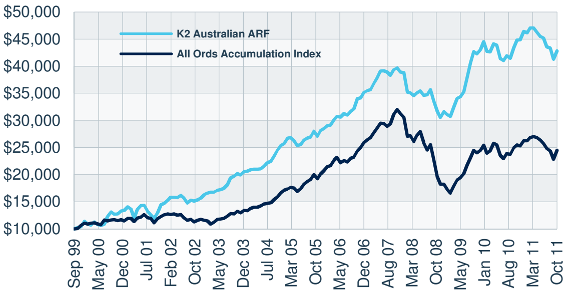
Portfolio Realised Gains & Losses - October

Long Sales	Australia	**Profits**	Caltex Australia Ltd, Cochlear Ltd, National Australia
			Bank Ltd, Qantas Airways Ltd, Treasury Wine Estates
			Ltd
Long Sales	Australia	**Losses**	AMP Ltd, Aust and NZ Banking Group, Boart Longyear
			Ltd, Commonwealth Bank Of Austral, Incitec Pivot Ltd,
			Myer Holdings Ltd, RIO Tinto Ltd, Stockland, Telecom
			Corp Of New Zealand
Short Covers	Australia	**Losses**	Amcor Limited, CFS Retail Property Trust, Coca-Cola
			Amatil Ltd, QBE Insurance Group Ltd, Wesfarmers Ltd,
			Westpac Banking Corp

Performance to 31 October 2011 (net of fees)	
1 Month	**3.69%**
3 Months	**-1.82%**
6 Months	**-7.53%**
1 Year	**-4.48%**
3 Years (pa)	**10.48%**
5 Years (pa)	**4.71%**
10 Years (pa)	**12.71%**
Since Inception (pa)	**12.79%**

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)	
Exit Price Per Unit:	**A$166.13**
Distribution 30-Jun-2011:	**A$3.62**
Fund Size:	**A$469.7m**
Start Date:	**1-Oct-99**
S&P Fund Rating:	★★★★★

Top 5 Large Cap Holdings	Sector	%
BHP Billiton Ltd	Basic Materials	**8.1**
National Australia Bank Ltd	Financial	**7.6**
Westfield Group	Financial	**7.3**
Aust and NZ Banking Group	Financial	**5.4**
Telstra Corp Ltd	Communications	**5.2**

Sector Exposure %	Long	Short	Net Equity
Basic Materials	17.2	-	**17.2**
Communication	7.0	-	**7.0**
Cons. Cyclical	12.0	-	**12.0**
Cons. Non-Cyc	8.6	-	**8.6**
Diversified	-	-	**-**
Energy	2.4	-	**2.4**
Financial	34.4	-3.6	**30.8**
Funds	-	-	**-**
Industrial	8.1	-	**8.1**
Technology	-	-	**-**
Utilities	-	-	**-**
Total Equity	**89.7**	**-3.6**	**86.1**
Total Cash			**13.9**
Total Equity and Cash Exposure			**100.0**