



# K2 SELECT INTERNATIONAL ARF

## MONTHLY REPORT - 31 January 2011

### Global Market Review

The K2 Select International Absolute Return Fund returned 0.43% for the month of January. The MSCI World AC Index (in AUD terms) returned 4.13%. World equity markets posted positive returns in January, led by developed markets, heavy rotation into last year's laggards, and a continued belief that the US economy is on track for a self sustaining recovery.

Most US economic data continues to point to an accelerating economy with lagging data such as car sales, consumption and housing all better than expected. The measure of real demand within the 4Q 2010 GDP report (final sales) hit a 25yr high of 7.1% , while the manufacturing PMI Index hit a 20 yr high and the employment sub component was the strongest since 1984. Coupled with 4Q earnings results from the 50% of the S&P having reported to date showing strong revenue acceleration (at 2% above expectations it's the strongest reading since 2008), it is clear to see why developed markets continue to lead world stock markets. Stockwise reactions to 4Q earnings have been mixed, with some strong but expected results being sold (Apple, Google), some being bought (CSX, IBM), misses being punished (F5 Networks, Ford), and big beats continuing to ramp (Netflix, Baker Hughes). Broadly disappointing results from the financials saw the year's early market leaders turn to laggards as energy stocks powered ahead driven by strong results from the service stocks and higher oil prices over erupting tensions in Egypt. A strong rotation away from last year's leaders saw many consensus trades underperform in January, such as emerging markets (India -10%, Brazil -2%), Gold (-6%), and resources stocks (-5%).

### Outlook

The coming of a new calendar year has seen a new wave of bullishness fall over equity markets, with a trail of equity market strategists publishing forecasts looking for 15% plus returns from global equity markets over 2011. While on the one hand it is a little concerning that consensus has now moved so far to the bullish camp, it is worth remembering that with global equities trading at just 14x forward earnings and US 10 year bonds still yielding just 3.4%, it is hard to argue that equities are the crowded asset class. As such, it looks as though 2011 will be a good year for equity market inflows with US mutual funds recently recording their highest 7 week inflows in 2 years (\$56bn), while bond funds conversely recorded their highest 7 week outflows for 2 years. Cumulative inflows to US equities over the last 3½ years have been zero while record bond inflows (\$800bn) exceeded equity flows around the Tech bubble (\$550bn), so in our view this trend towards equities could set in for some time. Rising bond yields on the back of an improving US economy and inflation concerns surrounding commodity prices is the main cause of the exodus out of bonds. But it is worth highlighting that higher commodity prices in themselves are creating a risk for emerging market equities in particular, as rising food costs are a major source of recent unrest in Tunisia and Egypt.

### Strategy

The K2 Select International ARF maintained net equity exposure within our recent band of 85%-100% over the month of January. Fund performance was relatively hurt versus the index due to the strong performance of developed markets over emerging markets, large caps over mid caps and also via the 2.5% depreciation in the AUD over the month. After a sustained period of outperformance from emerging markets, mid caps and multinationals, it appears that the combined effects of equity market inflows and commodity costs hurting emerging markets could see this trend reversed as fresh equity funds are deployed into developed markets and most likely to the large capitalisation stocks in those markets. Consequently, the fund has, and will continue to, bank some of the winners of the last 6 months and look to close underweight positions in developed markets going forward.

### Portfolio Realised Gains & Losses - January

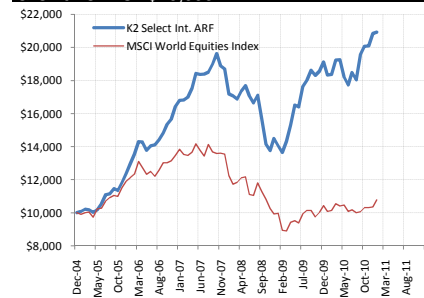
| Long Sales |               | Profits |   |
|------------|---------------|---------|---|
| Long Sales | Euroland      | Profits | Eurofins, Fiat Industrial, Koninklijke Vopak, Kontron, Fiat   |
| Long Sales | HK/China      | Profits | ASM Pacific Technology, China Merchants Holdings, Cnooc Ltd, Cosco Pacific, Galaxy Entertainment, Hutchison Whampoa Ltd., Rexlot Holdings |
| Long Sales | HK/China      | Losses  | Shun Tak Holdings Ltd   |
| Long Sales | Singapore     | Profits | Gallant Venture Ltd, Keppel Corporation Ltd   |
| Long Sales | Switzerland   | Profits | Swatch  |
| Long Sales | United States | Profits | Anadarko Petroleum, Apple, Frontier Oil, Noranda Aluminum, Patriot Coal, Titan International, Virgin Media, Williams Co                   |

### Performance to 31 January 2011

| (net of fees)        |        |
|----------------------|--------|
| 1 Month              | 0.43%  |
| 3 Months             | 4.24%  |
| 6 Months             | 13.19% |
| 1 Year               | 14.12% |
| 3 Years (pa)         | 6.79%  |
| 5 Years (pa)         | 10.04% |
| Since Inception (pa) | 12.91% |

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 (Cum): | A\$144.01 |
| Distribution 31-Dec-2010:       | A\$3.78   |
| Fund Size:                      | A\$217.6m |
| Start Date:                     | 1-Jan-05  |
| S&P Fund Rating:                | ★★★       |

### Top 5 Large Cap Holdings Country %

| Company              | Country       | %   |
|----------------------|---------------|-----|
| Apple                | United States | 3.3 |
| HTC Corporation      | Taiwan        | 1.9 |
| BHP Billiton Limited | Australia     | 1.7 |
| Yara International   | Norway        | 1.4 |
| RIO Tinto            | Australia     | 1.4 |

### Geographic Exposure %

|                                       | Long        | Short       | Net Equity   |
|---------------------------------------|-------------|-------------|--------------|
| Australia                             | 17.3        | -           | 17.3         |
| Canada                                | 1.2         | -           | 1.2          |
| China                                 | 12.4        | -           | 12.4         |
| Euroland                              | 8.0         | -           | 8.0          |
| Hong Kong                             | 4.6         | -           | 4.6          |
| Indonesia                             | 2.0         | -           | 2.0          |
| Japan                                 | 0.5         | -           | 0.5          |
| Korea                                 | 1.5         | -           | 1.5          |
| Malaysia                              | 0.7         | -           | 0.7          |
| Norway                                | 2.3         | -           | 2.3          |
| Russia                                | 0.9         | -           | 0.9          |
| Singapore                             | 2.1         | -           | 2.1          |
| South Africa                          | 0.1         | -           | 0.1          |
| Sweden                                | 0.2         | -           | 0.2          |
| Switzerland                           | 2.2         | -           | 2.2          |
| Taiwan                                | 3.0         | -           | 3.0          |
| Thailand                              | 0.9         | -           | 0.9          |
| United Kingdom                        | 7.4         | -           | 7.4          |
| United States                         | 22.8        | -0.9        | 21.9         |
| <b>Total Equity</b>                   | <b>90.1</b> | <b>-0.9</b> | <b>89.2</b>  |
| <b>Total Cash</b>                     |             |             | <b>10.8</b>  |
| <b>Total Equity and Cash Exposure</b> |             |             | <b>100.0</b> |
| <b>Net AUD Exposure AFTER Hedging</b> |             |             | <b>91.2%</b> |

# K2 Select International Fund

## Financial Year Returns



K2 ASSET MANAGEMENT

| K2 Select International Net Monthly Returns in AUD |      |      |      |      |      |      |      |      |      |      |      |      | MSCI (1) |         |
|--|------|------|------|------|------|------|------|------|------|------|------|------|----------|---------|
| Year   | Jul  | Aug  | Sep  | Oct  | Nov  | Dec  | Jan  | Feb  | Mar  | Apr  | May  | Jun  | Fin YTD  | Fin YTD |
| 2004/05  |      |      |      |      |      |      | 0.9  | 1.3  | -0.4 | -1.4 | 1.4  | 3.8  | 5.6      | 2.8     |
| 2005/06  | 4.9  | 0.7  | 2.6  | -1.0 | 4.2  | 4.4  | 5.1  | 4.4  | 5.7  | -0.1 | -3.7 | 2.0  | 33.2     | 21.7    |
| 2006/07  | 0.4  | 2.1  | 2.8  | 3.6  | 2.0  | 4.8  | 2.4  | 0.1  | 1.1  | 3.1  | 5.1  | -0.3 | 30.7     | 10.2    |
| 2007/08  | 0.1  | 0.6  | 2.6  | 3.4  | -3.7 | -1.1 | -8.0 | -0.6 | -1.2 | 3.0  | 1.8  | -3.5 | -7.0     | -19.4   |
| 2008/09  | -2.5 | 2.9  | -8.6 | -9.7 | -2.5 | 5.1  | -3.1 | -2.8 | 4.9  | 6.9  | 7.8  | -0.7 | -4.0     | -15.6   |
| 2009/10  | 7.6  | 2.1  | 3.3  | -1.7 | 1.4  | 3.0  | -4.1 | 0.2  | 4.7  | 0.2  | -5.4 | -2.7 | 8.1      | 7.5     |
| 2010/11  | 4.3  | -2.5 | 8.4  | 2.7  | 0.0  | 3.8  | 0.4  |      |      |      |      |      | 18.1     | 6.9     |
|  |      |      |      |      |      |      |      |      |      |      |      |      | 109.3    | 7.8     |

| Key Statistics           | Return (CAGR) | Standard Deviation (Annualised) | Alpha (Annualised) | Beta | Sharpe Ratio (6.0%) |
|--------------------------|---------------|---------------------------------|--------------------|------|---------------------|
| Since Inception          | 12.9          | 12.7                            | 12.3               | 0.69 | 0.6                 |
| MSCI (1) Since Inception | 1.2           | 12.1                            | NA                 | NA   | -0.3                |

NOTE: (1) MSCI AC World Index with Dividends, expressed in AUD