

FAT UPDATE

Investment Manager Insight

August Review 2010

Dear Investor,

The market was confined to a trading range throughout much of August and will probably continue to be so until a final outcome is known with regard to the election. Investors are also concerned over the economic recovery in the US and the potential for a double dip. Much uncommitted cash remains on the sidelines as we head into September, a month with a long history of being volatile.

Despite widespread pervading bearish sentiment (not dissimilar to March 2009), we are nearly fully committed in terms of our cash levels, and see attractive value in the market at present. It is our view that the market could rally strongly into the end of the year. There are bullish factors which are supportive of this, such as the continuing strong economic data surrounding the Australian economy, the sharp uptick in the mergers and acquisitions cycle, and the fact that most investors now appear to be underinvested. The gloom appears to be more than in the price so to speak.

Fat Prophets Mining and Resources – Model Portfolio

Gold continues to play a major theme in this portfolio despite us recently having taken some profits. We believe the precious metal will continue to rally alongside recovering stock markets as long as public debt remains elevated. Debt monetisation is likely to remain a feature of the global economy for many years to come and this underpins our thesis on gold. We have recently added Azumah Resources to the model. Azumah Resources is an emerging gold play in West Africa that in our view ‘ticks all the boxes’. We are not only attracted to the size and quality of resource but also the value proposition in terms of market cap relative to resource size versus its peers. We suspect that we may be seeing a world class project in the making, plus it certainly has some ‘nearology’ as well, with its close proximity to known world class gold deposits.

Fat Prophets Concentrated Australian Share – Model Portfolio

This portfolio has benefited recently from its strategic exposure to soft commodities. There are surprisingly few options in the listed space to gain exposure to these commodities; the funds’ exposure is via Graincorp and the less well known Maryborough Sugar. Recent floods in Pakistan and widespread fire damage to crops in Russia has prompted a rally in the soft commodity prices. This has taken place alongside increasing M&A activity with AWB being bid for by Canadian giants Agrium Inc and as a result a withdrawal of its’ merger proposal with Graincorp. We continue to like this space longer term. Elsewhere, M2 Telecommunications has been an excellent performer of late despite Telstra having slashed its prices on many of its products; this will not affect M2 as they are a reseller of both Telstra and Optus. We see more growth to come, along with a 7% dividend yield and a low double digit earnings multiple.

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Fat Prophets Australian Share Income – Model Portfolio

Our focus on value and yield has drawn our attention recently to the infrastructure space. Many companies in this area possess world class assets and post the GFC have significantly improved capital structures. We look for dividends that are covered by operating cash flow and not debt as being the key to sustainability. Although in many cases these are regulated assets such as gas pipelines, they do provide some growth over and above inflation. Moreover the multiples we are paying for these unique assets are in our view very reasonable. We have recently added to positions in APA and MAP, and maintain our existing overweight position in Transurban, which recently benefited from takeover activity in the sector by Canadian pension funds. Cash levels are temporarily high in the model as a result of Westpac Office takeover by Mirvac.

Angus Geddes and Steve O'Hanna

Fat Prophets Fund Management Australia

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