

FAT UPDATE

FAT PROPHETS MINING & RESOURCES MODEL PORTFOLIO – JUNE QUARTER 2010

Investment Objective

The Fat Prophets Mining & Resources Model Portfolio (the 'Model') seeks to outperform the total return (both income and capital growth) of the S&P/ASX 300 Resources Accumulation Index, before taking into account Model fees and expenses.

Performance

Performance as at 30/06/2010	Gross	S&P/ASX 300 Resources Accumulation Index	Outperformance*
1 Month	0.00%	-1.28%	1.28%
3 Months	-5.84%	-11.06%	5.22%
6 Months	-5.14%	-10.11%	4.96%
1 Year	14.28%	9.79%	4.49%
2 Year (%pa)	-7.53%	-12.58%	5.05%
3 Year (%pa)	1.68%	-0.81%	2.49%
Since Inception (pa)^	4.70%	1.76%	2.94%

*Shows the difference between Portfolio Gross Return and Benchmark Return

^Model Performance inception date 27/5/2007

Top 10 Stocks as at 30/06/10

1. BHP Billiton
2. Rio Tinto
3. Woodside Petroleum
4. Catalpa Resources
5. Lihir Gold
6. Oil Search
7. Andean Resources
8. Newcrest Mining
9. Eldorado Gold
10. Macarthur Coal

Fund Managers Report

Dear Investor,

Equity markets over the last quarter were best described as nervous and volatile with the convergence of a number of headwinds creating the 'perfect storm' for equity markets.

Consider the following;

- A European debt crisis saw sovereign risks increase sharply, firstly with Greece being downgraded and subsequently subjected to a €750bn rescue plan by the EU. Then rating agency Fitch downgraded Spain - a far more significant member of the Euro-zone.
- The Euro hitting a four year low versus the USD, having declined circa 14% to end June.
- Fears regarding the strength of the recovery in the US, as reflected in recent sluggish US payroll numbers and other economic data. Private sector jobs growth has yet to ramp up and the prospect of stimulus fade weighed heavily on investors' minds.
- Chinese economic data also exhibited signs of slowing, largely as a result of tighter credit controls on banks, leading the markets to readjust GDP growth closer to 10% than the previous expectation of as much as 14%, albeit still a very strong number.
- Commodity prices also fell sharply, especially base metals, which have declined between 12-20% peak to trough over the period.
- The proposed introduction of RSPT on the mining industry cast a pall over the sector and the AUD fell sharply as uncertainty over the implications for valuations prompted foreign investors to flee with the AUD falling 11% in less than a week. Timing of this proposal certainly did not help.

The end result was that the ASX 200 sank just over 11% over the period and the combined effect of these events meant that risk aversion reached extreme levels. However, there was some relief towards the end of the quarter as foreign exchange markets stabilised and the disastrous RSPT was withdrawn and replaced with a more palatable alternative. With the Australian dollar rebounding resource stocks outperformed their industrial counterparts by a margin of more than 2% in June.

The banks were hardest hit, falling 5% over the closing weeks of the quarter, on concerns about rising wholesale funding costs, which in some part offset the benefit of improving debt impairment levels. Looking forward, we are increasingly of the view that returns for banks will be modest when compared to the stellar returns of 2009 as bank returns tend to be strongly correlated to credit growth and we struggle to see how households can increase their debt levels further at this point in the interest rate cycle.

In the run up to the end of the review period investor attention did return once more to Europe, with rising fears of 'deflation' surfacing over the recent introductions of fiscal austerity measures and the resulting negative economic impact of tightening expenditure prematurely before the recovery in the Eurozone gains traction. The fear being that the world would maybe witness similar historic parallels with the 1930s when following the 1929 crash the authorities reigned in spending early, balanced budgets and increased interest rates. This had the effect of stifling the recovery and was one of the factors that caused the Great Depression. We believe that these fears are being somewhat overplayed at present. With too much pessimism and negative rhetoric having emerged in recent weeks this leads us to believe that the lows for this particular correction were set in June.

Whilst real risks do remain for the global recovery, it would appear that both equity and bond markets have adequately discounted these dangers for the time being. Bonds are pricing in a severe recession and possibly the onset of deflation in the US with 2 year Treasury yields at around 0.6% and the 10 year at around 2.9%. Markets appear to be signalling not only nil expectation for rates to rise in the US anytime

soon but moreover, little in the way of economic growth. With risk aversion back on the table, investors seem to be clearly more concerned about return of capital than return on capital!

However, in our view Australian equities presently represent good relative value. Historically, a yield gap between bonds and equities at levels of less than 400 basis points has tended to be a bullish indicator for stocks. In March of 2003 this gap had shrunk to around 150 basis points and in the 3 years that followed the All Ordinaries Index rallied more than 60% excluding dividends. Current spreads are now below that level, giving what appears to us to be a clear relative value signal that at the very least equity markets are oversold.

Although forex markets have stabilised, we continue to believe the US dollar will come under further sustained pressure, with significant structural headwinds lying ahead for the currency. The economic numbers are staggering when one considers that the \$3.5 trillion of Obama administration spending over the last 12 months accounts for one in four dollars of US GDP over the same period. Even more worrisome is total spending exceeds the Federal Government tax take of \$2.1 trillion by a massive \$1.4 trillion. At the State level, California has 12% unemployment and a budget gap of \$US19bn, which is far greater than Greece, Portugal, Ireland, Hungary and Romania combined!

The US Government faces a difficult time ahead, balancing economic recovery (and the ongoing threat of deflation) against rising debt levels and the attendant growing risks for the US dollar. Fortunately, there now appears to be a genuine resolve amongst US lawmakers to tackle the debt problem in the US, however it will require much political will and bi-partisanship to bring current spending (and future spending obligations) under control.

Despite a growing chorus calling a double dip recession in the US history suggests that it would take a substantial shock to bring about the second leg of economic contraction. One obvious cushion is provided by strengthening US corporate balance sheets, which are increasingly able to support investment growth as confidence in the economy rebuilds. The US reporting season has been quite robust and underpins our thinking that notwithstanding the very significant public debt issues in the US the economic recovery is intact. Second quarter earnings expectations were 12% ahead of pre-reporting consensus. Importantly profit growth in 2Q10 was stronger compared to both 2Q09 (+53%) and 1Q10 (+17%). Earnings growth expectations for the S&P500 in the 3Q2010 are in the double digits. Our own reporting season is looking equally robust. What also gives us confidence that the recovery is underway is that we are seeing a pick-up in M&A activity globally. Locally we have seen a raft of activity, particularly in the coal sector. This is now moving into the soft commodity space with AWB/Agrium and, what is likely to be biggest one of the year, BHP/Potash Corp.

The absence of a clear majority win by either major party in the federal election over the weekend is a clear negative for Australian equities. A lack of policy direction on a raft of reforms will increase the level of uncertainty for the foreseeable future. Regardless of whichever political party do manage to form government it will be a minority one and therefore somewhat ineffective versus an absolute majority. One of the major issues is the Minerals Resource Rent tax which now clearly hangs in the balance. Notwithstanding this, given the overall positive tone of reporting season, we expect equities to start finding more positive traction looking ahead to the second half of 2010, especially in light of compelling valuations and an improving global backdrop.

Mining and Resources Model Portfolio

Positive Influences			Negative Influences		
<i>Company</i>	<i>% Move</i>	<i>Position</i>	<i>Company</i>	<i>% Move</i>	<i>Position</i>
Eldorado	21%	Overweight	Newcrest	7%	Underweight
Catalpa	7%	Overweight	Cape Lambert	-34%	Overweight
Andean Res.	4%	Overweight	Aurora Mineral	-54%	Overweight
Avoca Res.	38%	Overweight	Platinum Aust.	-28%	Overweight
Coeur D'Alene	18%	Overweight	AWE	-34%	Overweight

The main highlight for the portfolio over the period was a very significant overweight position in precious metals, specifically gold, which exceeded the benchmark by around 13%. A rising gold price helped the portfolio significantly during the quarter, which outperformed its benchmark by approximately 5%. Recently we took some profits within the sector, however we are starting to see risk appetite return, supported by recovering base metal and bulk commodity pricing. We remain bullish of gold, which in our view will continue to benefit from its quasi-monetary status as the major global economies monetise debt in an effort to reflate.

Copper is our favourite among the base metals with the supply demand equation increasingly supportive of higher prices over the next few years as demand potentially doubles by 2015. Chile, the largest producer of copper globally is on track to add only 56,000 tonnes to global supply whilst China will add 830,000 tonnes to demand. In this environment it is not difficult to see copper prices heading back to the highs seen in 2007.

Recent major changes to the portfolio include Orocobre and Nkwe Platinum.

Orocobre is a company focused on development of several lithium projects in Argentina. The demand for lithium is increasing as a result of the proliferation of electronic devices, mobile phones, laptops etc and importantly, hybrid cars and the emergence of pure battery powered electric cars. We believe this is an exciting area and we are encouraged by the fact that Toyota has the option to take a 25% equity stake in the company. Our confidence emanates from the fact that despite the prolific nature of lithium in South America, what is of critical importance is the chemistry of the deposit, specifically, the level of magnesium and sulphates. Chemistry effectively drives the cost curve and Orocobre has very low levels of both these contaminants whereas the majority of the deposits in the region have very challenging chemistry. The company is not without execution risk, as production is not expected before 2012. However, having given consideration to the quality of the project, the discount to NPV, the part funding of feasibility study by Toyota and potential equity stake, we find the Orocobre story compelling.

Nkwe Platinum was bought and sold for a profit during the quarter. The company is the owner of a significant stake in an undeveloped platinum asset (Platinum group metals) in South Africa. We await some certainty around Xstrata's plans for this asset before possibly reinvesting on behalf of the model.

Overall, we will continue to retain a significant overweight to gold and the precious metals. The supply constraints in some of the base metals, particularly copper, indicate that current prices will remain well supported for the foreseeable future. Further supporting this will be any more quantitative easing measures in the US, which is likely to place further pressure on the USD, thereby helping to underpin commodity prices across the board.

Angus Geddes and Steve O'Hanna

Fat Prophets Fund Management Australia

FAT PROPHETS MINING AND RESOURCES MODEL PORTFOLIO

Model Portfolio name	Fat Prophets Mining & Resources Share
Code	FP0002
Model inception date	25/5/07
Principle investment objective	To invest in a sample of mining and resources securities listed on the ASX
Can derivatives be used?	No
Indicative number of stocks	10-40
Minimum Model investment	\$20,000
Model Provider fees*	
Investment fee	0.75%
Performance fee applicable?	Yes
Brief description	10% of any outperformance of the benchmark index
Benchmark Index	S&P/ASX 300 Resources Accumulation Index

*Please refer to the Fat Prophets Separately Managed Account Product Disclosure Statement for further details

IMPORTANT INFORMATION

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