

Kunlun Capital

Dear Investors:

The Fund fell 1.4% in the second quarter, but remains up 4.7% for the year. The portfolio's price to book ratio is 1.9x, PE is 10.4x, has a dividend yield of 4.7% and an ROE of 20%. The fund is 60% invested.

Mr. Market was euphoric in the first quarter and depressive in the second quarter. Stock markets were on a tear in the first three months, only to give back most of its gains in the subsequent quarter. While our returns fell slightly from March to June, we were fortunate to have sidestepped most of the carnage.

We used the opportunity to add 3 new positions to our portfolio. They have many of the characteristics that we treasure like excellent returns on capital, clean balance sheets, good cash flow, and growth potential. While not dirt cheap, we are hopeful that they will generate a very respectable return. The volatility has been gut wrenching, but has provided welcomed occasions to buy into excellent companies.

The current flight to safety did not happen as suddenly as in 2008, but over a longer period of time. There is a global chase for yield, particularly in safe havens/ stocks. For example, short term US Treasuries are practically returning 0% while US longer dated bonds are returning 1+ to 2+%. In many other perceived safe haven countries, yields are similarly low and unappetizing. Hence, dividend yielding stocks with predictable earnings and payouts are quite popular these days, and are being bid up. The desire to obtain a positive real interest rate is a rational response to the low interest rate environment.

As a general rule, we have always been partial to such stocks, but we were of the view that many of these stocks were already richly priced. Still they have continued to hold fast or appreciate in this turmoil. At current yields, however, we are not quite sure if the dividend returns adequately compensate for other risks like company specific risks, balance sheet risks, or (higher) interest rate risks. It is possible such stocks will continue to do well but the risk/ reward proposition is diminishing rapidly, and we would be very wary of entering into such positions.

Without a doubt, there is much to worry about: The problems in Europe are still not resolved and the global economy is slowing down. There is no clear direction. Uncertainty is in abundance. Yet, it is always wise to remember: Uncertainty creates opportunity.

Goh Yew Liang
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