To the Investors of the Kunlun K-10 Fund:

The fund launched in Sep 2009 and rose 1.8 % during the period for Sep till Dec. When the fund was launched in September, Asian indices had risen by over 50% from the bottom. Many of the names we had hoped to position in the fund had also gone up. Unfortunately, the economic outlook had not improved correspondingly. As such, we decided to take a prudent approach and opted to invest cautiously, and in some cases chose not to enter in. Hence the fund is currently about 35% invested with about 70% of the investments in Singapore and the remainder in Hong Kong.

The portfolio has a trailing PE of 10x for the invested portion. Its price to book is 1.5x. The dividend yield is 5.5% and ROE is 16%. Our portfolio consists of companies with sustainable business models. Most have sterling balance sheets and in many cases, they are net cash. Whilst their stock prices have gone up along with the market, most of the positions are still undervalued in my view with 5-7x forward earnings. The one caveat is that they are relatively illiquid and we will continue to add to these positions gradually in the coming months.

From our perspective, the current economic situation is feeble, the outlook is tentative and valuations are starting to look stretched. Many of the problems which created the crisis have not been rectified partly because of the lack of political will and powerful entrenched interests. It was finally comforting to see the "Volcker Rule" being proposed. Whether it passes through Congress is another matter. The practicality of the rule will also depend on the major financial centers, around the world, adopting it. Proprietary trading did not cause of this debacle, and many more reforms need to be enacted. Notably the Volcker rule does not address the effect derivatives and CDS' had on the markets. John Hussman has written a very good article on what needs to be done in addition to the Volcker Rule.

China is on everybody's investment radar today. The investment thesis is clear: A large, hardworking population that has its latent entrepreneurial zeal unleashed, and will provide the next big engine of growth for the world. It remains one of the few lights in the current economic gloom. We intend to tap on this theme for our investments. Investors should, however, remember though that events rarely occur in a linear pattern contrary to what we would like. We wonder if most of the good news has already been priced in…

The flip side to the bull story is that China's export growth model is now in question, given the US's anemic recovery. It remains to be seen if domestic consumption can take up all of the slack. China also faces many challenges. One challenge which is rarely highlighted is the severe lack of water in China. China's water per capita is 25% of the world's average and is also very unevenly distributed. The government has proposed many projects to alleviate the lack of water but the fundamental shortage will not be easy to solve. Other things to consider include the increasing rivalry with India (the border rivalry is another underreported event), the growing divide between rural and urban citizens and the environmental damage caused by China's rapid growth. The bull story will have many speed bumps and investors should not be compelled to rush in.

Going forward, we will be increasing our current weightings of our existing positions. We hope to add a few names which we are currently researching, assuming they meet our standards. Once again, the caveat is that they are not very liquid counters. If the markets continue to run, which I expect them to, and reach "silly valuations", we will reevaluate the portfolio. It would be apt at this juncture to remind investors that while we seek to maximize our returns, we will only do so without permanent loss of capital. It would not be appropriate for us to invest in stocks we deem expensive.

Thank you all for your encouragement and well wishes. I would appreciate any feedback.

Goh Yew Liang
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