

Centre Capital Summary of PM Quarterly Update

At the time of writing this article, the PM Absolute Fund had returned 61.7% for the 6 month period as opposed to the 11.1% achieved by the MSCI World (\$A). As investors, you will note that over the last couple of years the size of movements in this fund have been quite large. The Manager, Paul Moore, has been forthcoming on where he sees the opportunity and refuses to be dictated to by the market. Furthermore, he says that the recent movements are only the beginning and that outstanding opportunities still exist for those with a 3-5 year view. “Despite the fear mongers reinforcing the rampant panic amongst investors, the best investment opportunities will always occur when visibility is at its worst. Our expectations have not changed and we continue to believe that hiding in term deposits is a big mistake”.

What About Recent Rebound?

“One should keep the rebound in perspective; it was from very depressed levels and one can continue to buy businesses at levels that are more than 50% below their peak level and/or in line with their nominal value (and thus 30% below their real value) of ten years ago. The returns available to the owners of a wide range of businesses and to those willing to lend to those businesses are very attractive, especially in relation to cash or government bond returns. In such an environment, it is likely that portfolio activity will be muted as the risk reward proposition of the individual stocks is such that we should be willing to hold these investments for a number of years”.

“The trick now is to be patient and accumulate the returns on offer for as long as possible”.

“I think the only thing we can say with certainty is that we are likely to endure a number of years of lower growth as both consumers and businesses reduce their exposure to borrowings and governments raise taxes to pay for theirs. But this is not a bad thing; it is actually a good thing for investors. It creates an environment of caution and thus elevated risk premiums, providing above normal returns for those willing to invest their capital”.

Irrational Pricing

Rather than be scared off by the market psychology, PM have held their nerve and continue to look for opportunities as they also know that traditionally “it is always darkest before the dawn”. When fear, or greed in happy days, is present then irrational pricing exists for investors to exploit.

“A perfect example of the irrational pricing and genuine arbitrage opportunities that were presenting themselves in the February/March period was our purchase of \$A denominated Morgan Stanley Fixed and Floating Rate Debt maturing in July 2010. At

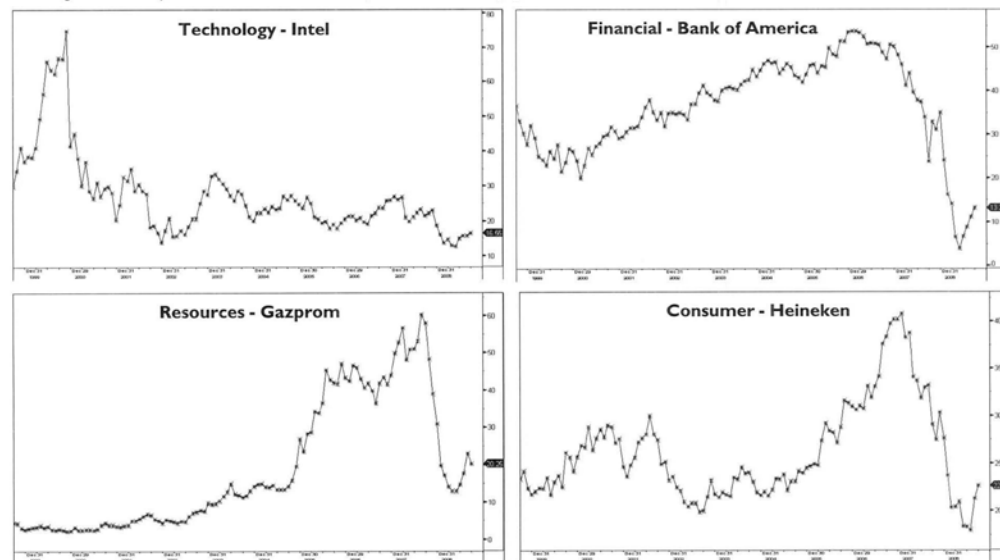
the time of purchase, the debt was offering a double digit yield and 8% in excess of the bank bill rate. This was extraordinary, as it was post Morgan Stanley being converted to a bank, raising significant capital and effectively being guaranteed by the Government; facts reflected in the doubling of it's share price. What was even more extraordinary was the fact that the identical \$US denominated debt was trading in London and New York at only 4% above the bank bill rate; a genuine arbitrage. This is very rare and was a function of the dislocation in markets”.

They also use an example of Westpac bank. You could put your money on term deposit with them for 3.7%. Given the bank debt is now guaranteed by the government the implication is that these are too big to fail. Therefore, why not own the bank and earn 16% yield based on the underlying profits? In any case, the large divergence in returns is not consistent with the incremental risks. This is the opportunity.



Consider stock prices in perspective.. PM CAPITAL QUARTERLY REPORT June 2009 6

Stocks generally across most sectors are still down 50% from their peak levels and/or are flat for ten years in terms of nominal valuation, which is effectively a 30% fall in real terms. While the recent rally since early March has been welcome, it needs to be considered against the last decade of de-rating across most parts of the market as shown by the charts on this page and the next.



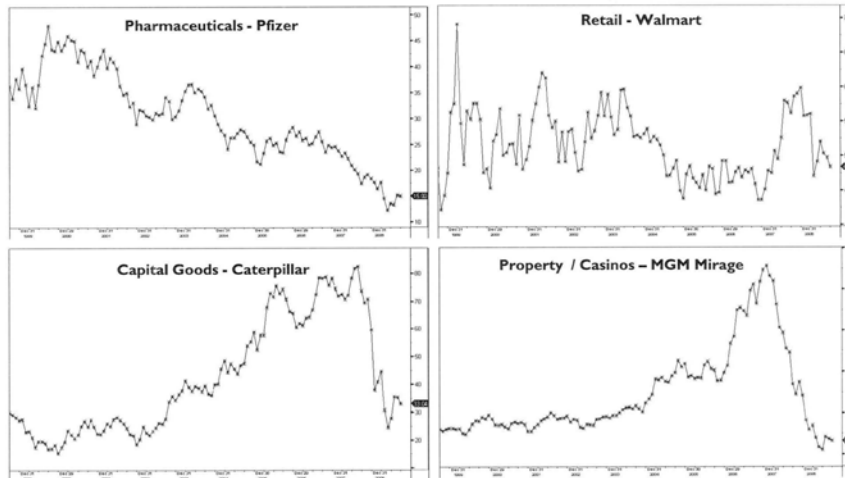
Note - The Absolute Performance Fund currently has a position in Bank of America, Gazprom and Heineken. Intel is not held in any of PM CAPITAL's portfolios.



Consider stock prices in perspective..

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We believe the world is entering a period where equities should provide investors with strong risk adjusted returns over a prolonged period....



Note The above stocks are not held in any of PM CAPITAL's portfolios, they are merely large cap representations of their industry.

Investors Sweet Spot

PM discussed valuations of the underlying businesses that are currently available and how it is an “investors sweet spot”. Valuations are the lowest they have been since the early 1980’s, however, importantly the earnings they use to calculate these valuations are based on the current depressed earnings.

When the market realises the world is not ending two things will happen;

- Valuations will expand as investors are willing to reinvest capital in expectation of future profits.
- Company earnings will increase, which means that the earnings figure being used to apply the above valuations will be larger.
- Both of these situations lead to higher share prices hence the sweet spot, common with this point in the cycle.

..plus valuations at their lowest in a generation..

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...and this view is reinforced by the chart below showing equity valuations having reached their lowest point (based on long-term P/E's) since the early 1980's, which happens to be the point at which global equity markets bottomed prior to entering their last secular bull run which lasted until early 2000. It is also worth noting that we are in the midst of a cyclical low in earnings, hence any recovery in stock prices from here should be a function of both expanding P/E's and a cyclical upswing in earnings.



Management and Capital Raisings

There is a lot to like about the way PM manage money on behalf of investors. I must admit that I really enjoy the candour of his presentations that we dial into each quarter. Paul Moore discusses what has been a big lesson for us at Centre Capital over the last couple of years and that is the incompetence (at best) or self interest (at worst) in the way management make decisions supposedly on behalf of shareholders.

“In our March 2009 Quarterly Report we made reference to the mania of corporate deleveraging and stated that “the drive to cash has been astonishing, not only amongst investors, but also amongst corporations. Investment banks are having a field day selling the easiest story in town; raise equity and reduce debt. The CEO’s, like investors, feel much more comfortable in a crowd and are blindly following the music much like the children followed the Pied Piper”.

“In reality, the majority of these equity raisings at deeply discounted prices and in some cases non-renounceable are a blight on our economic system. Management are basically holding a gun to the head of existing shareholders saying pay up or face significant dilution; the same management that raised gearing to levels that they now claim are inappropriate because “circumstances have changed”. Absolute ‘B.S’, the relevant Board of Directors and regulators should all be put in front of a firing squad for allowing individual shareholders, those that they supposedly represent, to be mugged in this way”.