

QUARTERLY REPORT

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Favourite quote for the quarter:

“The first of April is the day we remember what we are the other 364 days of the year”

Mark Twain

At PM CAPITAL, we are basically a group of individuals looking for opportunities to invest our capital at a satisfactory **after tax** rate of return. We emphasise tax, as in Australia, long term capital gains are taxed at half the rate of short term gains. Anyone who understands their compounding tables will be aware of how significant a difference this can be to one's wealth creation efforts over a long period of time.

Our objective is to find businesses that we believe are selling at a discount to their intrinsic worth, the price that a rational business person would pay under normal circumstances. Why a rational businessperson? Because in the end it is the businessperson, the real owner of a business, that will arbitrage any differential that persists between a stock market valuation and inherent business valuation. Over what period of time that value will be realised is hard to determine, but as long as the intrinsic worth of the business continues to compound at a satisfactory rate, one can afford to be patient.

Most of our efforts are focused on understanding the dynamics of how an individual business works, what makes it unique and thus what will determine the returns it will make and the valuation that one should be willing to pay for it. Management is an issue, but to demonstrate the significance of the qualities of the business versus the importance of management, we always like to refer to our favourite Warren Buffett quote;

"Find a business so simple an idiot could run it, because in all likelihood one day an idiot will be running it."

We believe that you can only value what you understand and thus, it is illogical to try and know everything. You will not find us invested in all markets and every industry sector. We try to avoid popular stocks (value is seldom found in popular stocks), and we do not follow the Noah's Ark approach to diversification i.e. buy two of everything and end up with a zoo not a portfolio.

We would also like to highlight a Peter Lynch quote with which we concur;

"I spend about fifteen minutes a year on economic analysis. I also spend fifteen minutes a year on where the stock market is going."

Above all, we remind ourselves that the stock market is far more volatile than the underlying businesses that it represents. Thus, it is our view that the key to successful investing is good business judgment in combination with the ability to control your emotion.

In our minds it is a simple story and a story that we have stuck to for over twenty years. We hope to stick to it for another twenty years.

The Funds at a glance

Fund Description	Fund Category	Inception Date	Volatility	Timeframe	Total Return Since Inception	
Absolute Performance Fund	Global Equity Fund (long/short)	28 October 1998	High	3 Years +	Fund 101.0%	MSCI -5.2%
Australian Opportunities Fund	Australian Equity Fund (long/short)	20 January 2000	High	3 Years +	Fund 206.9%	ASX 200 138.2%
Enhanced Yield Fund	Yield Fund (Multi Strategy)	11 February 2002	Low	1 Year +	Fund 74.6%	RBA 53.2%
Emerging Asia Fund	Asian Equity Fund (ex Japan)	1 July 2008	High	3 Years +	Fund 87.9%	MSCI Asia 5.1%

Annualised Returns	Unit Price	Mar Qtr	1 Yr	3 Yrs ₁	5 Yrs ₁	10 Yrs ₁	Inception _{1,2}
Absolute Performance Fund	\$1.1889	7.7%	59.0%	-11.9%	-2.9%	2.1%	6.3%
Australian Opportunities Fund	\$1.2712	2.1%	66.0%	-3.6%	6.3%	10.0%	12.2%
Enhanced Yield Fund	\$1.0881	1.4%	12.3%	5.8%	6.4%	-	7.1%
Emerging Asia Fund	\$1.4293	0.8%	35.1%	-	-	-	43.4%

Returns do not come in a straight line

Financial Year Returns	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 FYTD Jul-Mar
Absolute Performance Fund	46.8% ₃	14.9%	14.7%	-13.8%	8.6%	26.7%	0.6%	17.1%	8.5%	-38.0%	-14.0%	28.5%
Australian Opportunities Fund	N/A	31.0% ₃	18.5%	0.0%	-2.0%	33.9%	13.8%	25.2%	21.6%	-29.8%	-14.0%	43.8%
Enhanced Yield Fund	N/A	N/A	N/A	4.0% ₃	10.7%	6.9%	5.7%	7.2%	7.5%	3.0%	6.2%	6.4%
Emerging Asia Fund	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	66.3%	13.0%

1. Annualised return 2. Return since inception 3. Not a full year. Calculations are based on exit price to exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax and adviser service fees (if applicable). Past performance is no indication of future performance.

Introduction

Our basic investment premise for the last twelve months has been that *“March was a once in a lifetime opportunity to purchase debt, an extraordinary opportunity to purchase equities and that eventually the fiscal and monetary stimulus unleashed globally would overwhelm all else”*.

In June of 2009 we noted that:

“There is no doubt that day to day, the markets will be buffeted by economic indicators that point to either a positive or negative short term outlook for the economy. The reality is that the amount of artificial stimulus injected by governments and monetary authorities over recent times will make it impossible to truly judge the underlying economic trends over the medium term. There will be a cost to this stimulus and 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.”

And in September;

“Despite the magnitude of the moves of the last six months we still believe that valuations are reasonable e.g. banks, which are our largest invested position, appear to be on 5-7 times recovery earnings. In an environment where loan losses are behind them and with significantly higher capital ratios going forward, it would not be unreasonable for these businesses to sell on a multiple of future earnings in excess of 12. There is still significant upside return potential. On the debt side, which is our second largest invested position, the credit spread available to the benchmark borrowing rate is still above normal and thus worthy of continuing to hold...I would also be very surprised to see the end to the recovery in stock prices, over the medium term, in an environment where cash is still the most popular investment... the biggest danger at the moment is to succumb to the perception that one

always needs to be active when investing ones capital... Our intention is to be patient and allow our current invested positions to regress to what we think should be their normalised valuation ranges”.

Thus, we expected activity in our portfolios to be minimal and that has in fact been the case.

By the end of February / early March, markets started to move upwards again as it became obvious that the global economy, and more importantly the American economy, was not only gaining traction but would probably, in the short term, be a lot stronger than most had been previously anticipating. Economically sensitive businesses, most notably the banks, led the upward move. This has been further supported by strong first quarter earnings reports that have been released to the market over the past week or two.

Investor’s negative sentiment has definitely thawed but I suspect is still fragile and tested by news such as the rescue of Greece and the prosecution of Goldman Sachs by the US Securities and Exchange Commission. I suspect Goldman Sachs is noise, but Greece is definitely an issue longer term. I have always been skeptical of the European Union given the diverse nature, both cultural and economic, of the different countries that are operating under the one currency scheme. The Germans will want the Greeks to behave like they do and the Greeks will want the Germans to “chill out” and act like they do. It will be interesting to see the final outcome.

At some point the market will get ahead of itself and may be vulnerable to a correction. Over the medium term, however, given the strong correlation between all asset classes at the moment, my suspicion is that until the banks reach more appropriate valuations on recovery earnings (the banks are still at a significant discount to such valuations), we will continue to maintain our investment positions.

Absolute Performance Fund

Sector		Example	
Banking	52%		
Europe	25%	Lloyds	
USA	20%	Wells Fargo	
Asia	7%	ICBC	
Technology	30%		
Semi Equipment	15%	Novellus	
Analogue	9%	Maxim	
Software / Storage	7%	Oracle / EMC Corp	
Brewing	16%	Heineken	
Media	10%	Comcast	
Commodities	7%	Gazprom	
Other Longs	12%	Sotheby's	
Shorts and Derivatives	-16%		
Net effective exposure	112%		
Debt / hybrids	23%		
Cash	-35%		
Total exposure	100%		
Currency			
AUD	11%	GBP	14%
USD	53%	EURO	16%
		Other	6%

Portfolio holdings as at 31 March 2010
 Source: PM CAPITAL Limited

As alluded to in the introduction, activity has been minimal, and thus our comments will be brief. In late February, I travelled to California with the specific purpose of meeting with the new C.E.O. of Wells Fargo, the management of BB&T Bank, assessing the status of California and its recovery from the Global Financial Crisis, as well as meeting with a number of other companies.

Although both investors and managements were still very cautious, my overall conclusion was that my previous suspicions were in fact true i.e. the US economy would in fact surprise people with its short term recovery and this would be supportive of stock prices. One factor supporting the local economy was the fact that there have been big adjustments in the cost structure of businesses. Wages have been cut, bonuses eliminated and manufacturing labour costs are now below most western economies, including Australia. It was also clear that Americans were under no illusion that their position in the world had eroded, it was their own fault, and they wanted to do something about it. They were scathing of their politicians. If sustained, this should all be positive for the longer term outlook for markets. The below excerpt regarding Caterpillar is testimony to my comments:

“Caterpillar Inc. is considering relocating some heavy-equipment overseas production to a new U.S. plant, part of a growing movement among manufacturers to bring more operations back home—a shift that will likely spark fierce competition among states for new manufacturing jobs.

The trend, known as onshoring or reshoring, is gaining momentum as a weak U.S. dollar makes it costlier to import products from overseas. ...After a decade of rapid globalization, economists say companies are seeing disadvantages of offshore production, including shipping costs, complicated logistics, and quality issues. Political unrest and theft of intellectual property pose additional risks.”

Paul Moore, Chief Investment Officer

Bank results reflecting an improved economy

California home default cases plunge [Los Angeles Times] Wednesday, April 21, 2010

Apr. 21—The California foreclosure crisis appears to be abating, new data show, as the federal government and big lenders step up efforts to keep troubled borrowers in their homes.

Mortgage default notices – the first step toward foreclosure – plunged 40.2% statewide in the first three months of the year compared with the same period in 2009, according to San Diego research firm MDA DataQuick.

Foreclosure sales dropped 1.7% from a year earlier and 16.1% from the last three months of 2009, DataQuick said Tuesday.

The numbers suggest that the housing market won't be flooded by a fresh wave of bank repossessions, which had been seen as a major threat to the market's recovery.

"It is surprisingly good news," said Gerd-Ulf Krueger, principal economist at Housingecon.com. "There is still a lot of supply lurking out there, but at this point, it looks like it is pretty much under control."

Stuart A. Gabriel, director of UCLA's Ziman Center for Real Estate, said the declining foreclosure numbers are "consistent with a broad range of indicators that are suggestive of not only a healing economy but the beginning of healing in the housing market."

Southern California home prices jumped 14% in March from the same month a year ago, to a median \$285,000.

As a comparison, the median house price in Australia is \$A596,000 which adjusted into US dollars at 93 cents equates to \$US554,000, nearly twice that of a home in Southern California.

Wells Fargo earns \$2.55 billion, beats expectations [The Charlotte Observer, N.C.] Wednesday, April 21, 2010

Apr. 21—Wells Fargo earned \$2.55 billion in the first quarter, beating analyst expectations and trumpeting that credit has "turned a corner." Delinquencies across major consumer loan portfolios, including home equity, auto dealer services and credit cards improved.....Chief executive John Stumpf said in a statement that the bank is benefiting from improvements in the economy, a diversified business model and the 2008 purchase of Wachovia. But he cautioned that the economy "continued to present challenges, and we've yet to see consumers and businesses resume past levels of spending and borrowing."

Bank of America earns \$3.2 billion in first quarter [Los Angeles Times] Friday, April 16, 2010

Apr. 16—Bank of America began the year with unexpectedly strong profits, in another sign of the strong recovery being staged by the country's big banks.

The Charlotte, N.C.-based bank, the nation's largest, said on Friday morning that it booked a profit of \$3.2 billion in the first three months of 2010, or 28 cents a share. That was more than the 18 cents a share that analysts surveyed by Bloomberg had expected.

Like JPMorgan Chase & Co., which reported its earnings earlier in the week, Bank of America's strong results came primarily from the strength of its investment-bank and trading desks, large parts of which were acquired when Bank of America purchased Merrill Lynch in the midst of the financial crisis. But the results were also helped by the improving credit trends of retail borrowers.

"With each day that passes, the 2010 story appears to be one of continuing credit recovery, and our results reflect a gradually improving economy," the bank's chief executive, Brian T. Moynihan, said in a statement.

Australian Opportunities Fund

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Sector		Example
Banking	25%	ANZ Banking Group National Australia Bank
Commodities	18%	BHP Billiton Plc RIO Tinto Plc
Gaming	11%	Sky City Entertainment Tabcorp Holdings Ltd
Insurance	10%	IAG, Suncorp
Media	8%	News Corp
Brewing	7%	Foster's Group
Other	27%	Includes all other longs, shorts and derivatives
Net effective exposure	106%	
Debt / hybrids	21%	
Cash	-27%	
Total exposure	100%	

Portfolio holdings as at 31 March 2010
Source: PM CAPITAL Limited

The December reporting season was a little more positive than expected. Many companies across industry sectors suggested that the worst of the economic downturn has been cycled, although outlook comments remained cautious. Attention to balance sheet repair and tight cost control has left companies well positioned to leverage the economic recovery. The conversion of revenue growth to earnings growth in an environment of improving demand will be a key factor in sustaining the strong re-rating in equity markets.

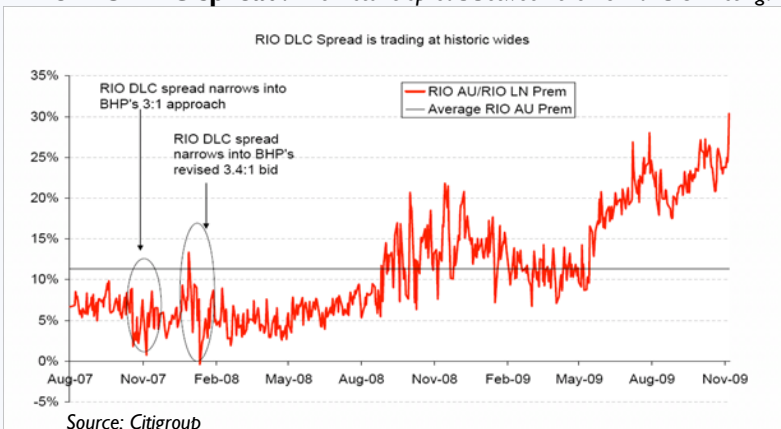
Mixed offshore economic data and local company news flow created periods of acute short term volatility over the quarter. This volatility provided opportunities to refine the Fund's portfolio positioning. It has allowed us to trim fully valued stocks and top up holdings in companies where we believe the risk/reward trade-off is more appealing.

Since we last reported in December, the Fund has added to existing holdings in ANZ, NAB, Harvey Norman, Crown and Suncorp Metway. We also trimmed the Fund's significant weightings in Alumina, BHP, Rio Tinto and Westpac into price strength late in the quarter.

We still retain holdings in the major diversified miners, BHP Billiton and Rio Tinto, reflecting their strong industry positioning, low cost production profile, long life reserves and favorable earnings outlook from more positive outcomes on iron ore/coal contract pricing. However, we have switched from holding the ASX listed stock to purchasing the UK-listed PLC stock. The UK listed stock, which is valued on AUD equivalent terms, was being offered at an abnormally large discount that we could not ignore. Historically, the UK listed stock discount has ranged between 5-10%, driven by a number of factors including dividend franking differences and the companies' larger index representation in the ASX. However, the UK listed discount versus the ASX listed price for BHP and RIO recently blew out to in excess of 20%, a level that we felt was extreme. By simply calling a broker in London

and not Sydney, we are able to buy the same entitlement to company profits and outlay 20% - 25% fewer dollars to do so. This is an arbitrage provided with courtesy by the institutional gate keepers who insist that Australian equity mandates restrict themselves to securities traded on the Australian Stock Exchange. It is an interesting phenomenon.

The RIO DLC spread: *The historic spread between the ASX and UK listing.*



On the sales side, the Fund exited holdings in Seek and RP Data during the quarter when share prices exceeded our assessed valuations. Seek remains a good quality company with a strong management team and solid earnings growth prospects. However, with the stock trading on a PE multiple in excess of 30x forward earnings, we felt that this future growth was being fully reflected in the share price.

Late in the quarter, our holding in Corporate Express was subject to a takeover bid from its majority shareholder Staples Inc.

Corporate Express board recommends Staples takeover bid

Dow Jones Newswires March 17, 2010

STAPLES launched a \$5.60-a-share takeover bid for office products supplier Corporate Express Australia today, valuing the target company at \$1 billion.

The board of the Sydney-based company has unanimously recommended the offer, subject to no superior offer emerging, and signed an implementation agreement, Staples said in a statement. Shareholders will still receive a 12.5 cent dividend announced on March 2, giving a total value of \$5.725 a share. Corporate Express Australia shares were suspended from trading earlier today after the group said it had received a takeover proposal.

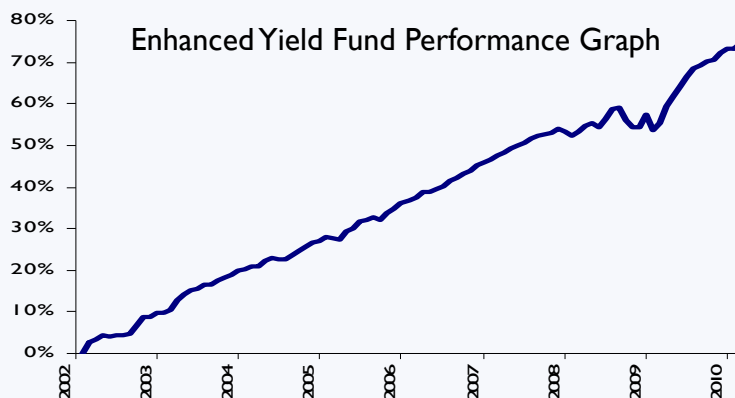
Its shares last traded at \$4.60, giving it a market capitalisation of \$773.4 million.

Operating in the office supplies market, Corporate Express is a relatively simple distribution business. It has been a relatively low growth business with revenue growth typically matching economic trends. Although the company is supplemented by “bolt on” acquisitions it generates reasonably predictable cash flow and earnings. Coincidentally, we had debated the merits of our investment in Corporate Express during our weekly investment team meeting only days before the announcement of the takeover bid. Our conclusion was that valuation appeared to be very reasonable for this low growth business and in all reality it should be a private company. We have accepted the takeover offer and now it is a private company.

Enhanced Yield Fund

As at 31 March 2010	%	Avg. Yield *	Avg. Spread to RBA
Cash	30	4.4%	0.4%
Corporate debt	42	6.0%	2.0%
Fixed	8		
Floating	34		
Hybrids	26	7.8%	3.8%
Fixed	7		
Floating	19		
Buy & writes	2		
Total (net) *	100	5.9%	1.9%

* The figures are net of management and performance fees. Net yields have increased since writing in line with RBA rate rise.



Graph as at 31 March 2010
Source: PM CAPITAL Limited

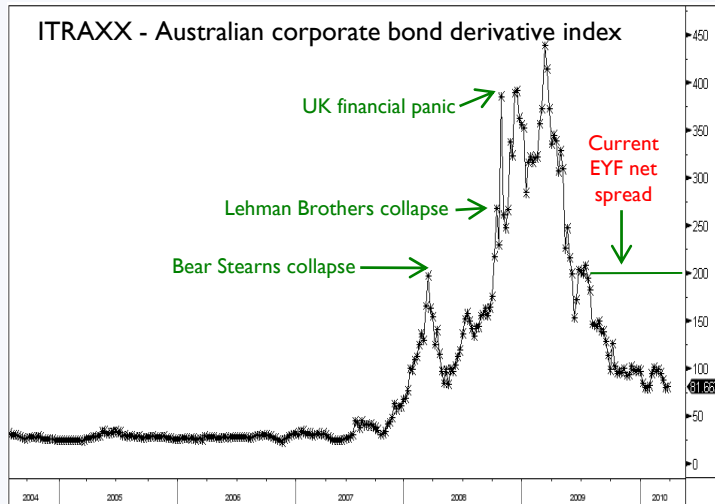
The Australian economy continued on its recovery path in the first quarter of 2010, with further indications that growth is returning to normalised levels. By far the most impressive part of the recovery to date has been the performance of the domestic housing market. Prices in most states are making new all time highs in what was already an expensive market by global standards, prompting the RBA to make specific mention of this issue in the monthly board minutes. In line with these concerns, they saw little alternative but to raise official rates by 0.25% to 4% in March (and subsequently to 4.25% in April).

The cash rate has now increased by 1.25% from the “emergency” levels used by the RBA in 2009. Whilst this is a significant move, it still leaves rates at relatively low levels by historical standards and with an improving macro backdrop, it is likely in our view that official rates have somewhat further to rise – potentially more than the approximately 1% that is priced into markets over the next 12 months.

Given our view on medium term interest rates, we think it prudent that the majority of the funds investments be held in floating rate instruments. Currently, approximately 80% of the funds investments are invested in floating rate assets and as a consequence of this, the Fund currently exhibits the interest rate sensitivity of a 5 month bank bill. This conservative positioning will ensure that the running yield of the Fund will ratchet up with any future unexpected increases in interest rates.

In light of the improvement in the macro environment, credit spreads continued to fall through the first quarter of 2010 with broad contractions evident across most sectors. With further domestic economic improvements predicted we expect this positive dynamic to continue over the longer term. However, given the sharp adjustment already witnessed over the previous year, it would not surprise us if credit spreads stabilised in the near term. We think it important to

Enhanced Yield Fund



Source: Bloomberg

remind investors that, whilst credit derivative index spreads (chart above) have contracted somewhat from their highs, the average net credit spread on the Funds investments is still reflective of the very alluring levels we witnessed during the Bear Stearns collapse back in 2008. We think this is still a significant market anomaly given the markedly improved macro environment we are operating in compared to 2008.

Whilst distressed selling is no longer present in credit markets, as you can see from the table opposite, we are having no trouble finding attractive opportunities to invest the Fund's capital. We think the debt investments purchased, whilst falling within different sectors of the economy, each share some of the key characteristics that we look for when buying yield securities. In particular, they have all improved their subordinated or equity capital positions and are committed to lower

Purchases	Position	Spread	Yield
AMP Senior Debt (1.5yr)	1.5%	Bills + 1.75%	6.00%
National Wealth Mgmt Senior Debt (3yrs)	0.75%	Bills + 1.95%	6.25%
Mirvac Senior Debt (5yrs)	0.5%	Bills + 2.65%	7.00%
Sale	Position	Purchased at	Sold at
JP Morgan Senior Debt (2.5yrs)	2% (was 4%)	Bills + 325bp	Bills + 90bp

gearing levels. Additionally, they are increasingly focused on their core businesses, having divested assets they had previously diversified into. Given the reduced gearing levels, the risks to these investments is low, yet the spreads are very appealing.

Going forward, we think more emphasis will need to be placed on individual stock picking, as valuation anomalies become less broad based and concentrated in certain sectors.

The current net running yield of the fund is just under 200bp above the RBA cash rate. The Fund is conservatively positioned with respect to interest rate movements and its credit investments exhibit a high degree of liquidity. For investors who require their cash at call, we think the Enhanced Yield fund is an attractive proposition.

Jarod Dawson, Enhanced Yield Portfolio Manager

Emerging Asia Fund

Sector		Example
Financials	24%	Bank of China ICBC
Infrastructure	19%	Dalian Port Co Tianjin Port Development
Commodities	17%	China Shenhua Energy CNOOC
Retail	12%	Wumart Glorious Sun Enterprises
Consumer	10%	China Resource Enterprise Hite Brewery Co
Conglomerates	3%	Hutchison Whampoa Ltd
Service	5%	JobStreet Corp
Gaming	4%	SJM Holdings
Net effective exposure	94%	
Cash	6%	
Total exposure	100%	

Portfolio holdings as at 31 March 2010
Source: PM CAPITAL Limited

Markets across the region experienced a volatile start to 2010 with investors reacting to the release of various pieces of conflicting economic data. The most widely critiqued remains the inflation, credit growth and fixed asset investment figures from China, which not only have implications on the domestic Chinese economy but the region as a whole. This data is very short term in focus, often monthly, and as a result can fluctuate considerably. This is also magnified during the first quarter of every year by the timing of Chinese New Year. We try not to place too much focus on this data in isolation, however every time you open the newspaper the headlines are sensationalised and it seems as if the market is placing an increasing amount of attention on these individual data points.

It is clear to most that look at China today that authorities have a big task ahead of them as they start to withdraw the economic stimulus and shift their focus towards managing some of the excesses that have arisen from the massive extension of credit needed to fund the program. What is being debated is how severe the slowdown will be, how big the excesses are and what impact these two will have on economic growth in China in the next 12-24 months.

We have seen a meaningful divergence in views towards China over the last few months. Since the start of the year we have observed the rise of the China bears, led by familiar names such as James Chanos and Marc Faber. The China bears rightly argue that the stimulus deployed over the last 12 months has led to substantial over-investment and overcapacity in a lot of sectors creating potential bubbles, most notably in property and infrastructure, which the economy needs to digest. On the opposing side we have resource majors like BHP and Rio Tinto. Both continue to see strong demand for their products in China and have aggressively pushed through a new pricing mechanism for iron ore shipments that sees them move to quarterly contracts, allowing them to better capture higher spot prices compared to the traditional annual contracts. We can also add to this the bullish sentiment here in Australia stemming from another round

of M&A activity in the resource sector which included a takeover offer of Arrow Energy from a Shell/PetroChina JV and the recent courting of Macarthur Coal.

[Click here to view](#) a recent commentary piece from GMO's Edward Chancellor ⁽¹⁾ that looks at the drivers of historical bubbles which are applicable to China today and we think is a worthwhile read. Internally, we continue to watch the drivers of potential inflation problems that may cause a quicker than expected slowdown by the Central Government and/or perpetuate some of these excess. Key areas in our view remain property prices, commodity prices and wages.

Despite the volatility experienced in the market, the Fund recorded positive performance for the quarter. This positive performance was driven by stock specific news flow as opposed to overall sector based performance. Positions in JobStreet, Dalian Ports and Wumart were the biggest contributors to positive performance. JobStreet rose after Seek Ltd. doubled its stake in the company, taking its holding to 22.2%, while Dalian's strong performance was driven by a solid annual results release which included upbeat guidance for 2010 and a significant increase in their dividend payment (increasing dividend yield to 7.8% vs. 2.8% in 2008). The majority of this positive performance was however offset by sector positioning in commodities (China Shenhua, PetroChina) and banks (ICBC, CCB) which were impacted by the growing concerns surrounding China.

In terms of portfolio positioning we continue to look for an opportunity to exit our investments in commodities, which have performed well since we entered into them in February and March of 2009. This decision is driven by our growing concern for the outlook of China over the medium term and the impact it will have on commodities.

As Paul mentioned in his commentary it looks like the US economy is gaining some traction and may well surprise to the upside over the coming 12 months. Consequently, we continue to see value in stocks which are correlated to this improvement and point to our position in the China ports as an example of this. We also think the underlying fundamentals for consumption related plays in the region remain sound despite the concerns surrounding China, however valuations are much less supportive compared to when we purchased these positions over 12 months ago.

Before signing off for another quarter we would like to refer back to last quarter's commentary where we spoke about the Chinese banking sector and concerns surrounding capital adequacy. It was our belief that the banks we owned did not need to raise capital. However, over the course of the quarter the majority of mainland Chinese banks announced plans to raise capital and this included the Fund's two biggest Chinese bank positions ICBC and CCB. We still believe additional capital is not needed and this view is supported by the fact that ICBC and CCB already have higher capital ratios compared to CMB and Bank of Communications, two other banks that announced capital raising plans, even after the latter's planned raisings. The timetable for these equity raising have not be finalised but they are relatively small in size and will result in less than 10% dilution and ensure that both ICBC and CCB each maintain a return on equity of above 20%. We continue to hold a meaningful position in the Chinese banks believing that recent performance has factored in the risk of non-performing loans arising from the stimulus and the dilution from potential rights issues, and we believe the sector will benefit from a rising yield curve going forward.

*(1) Edward Chancellor is member of GMO's asset allocation team and author of several books including *Crunch Time for Credit and Devil Take the Hindmost: A History of Financial Speculation**

Conclusion

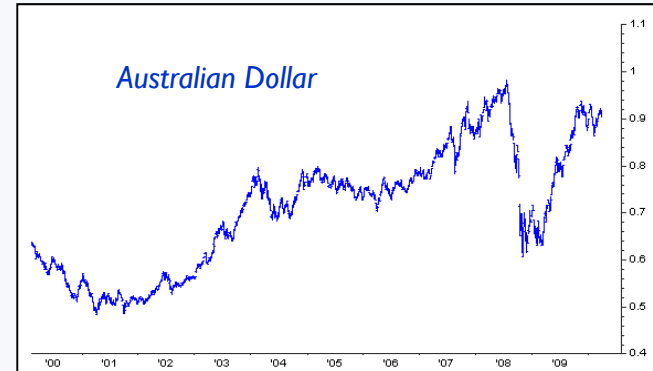
Following on from our Ben Graham quote in the December Quarterly Report, "For indeed, the investor's chief problem - and even his worst enemy - is likely to be himself", I thought this comment would be of interest; "You can almost guarantee what this years top selling mutual funds categories will be looking back to last year's top performers...It's a great source of frustration trying to get people to stop looking in the rear view mirror and start looking forward" - President of John Hancock Funds.

It is something to consider, especially given that investors will increasingly have to consider the debate that is raging on the ultimate path of the global economy post its GFC recovery. The sustainability of China's growth and the sustainability of Greece and other peripheral European economies are perfect examples.

It may also be worth considering that over the previous decade, in local currency terms, the global equity index started where it finished. I suspect that this decade the index will also be relatively unexciting, although I believe this will be enhanced by a depreciating currency as eventually the commodity rally will falter. One thing to be clear on with our funds is that they are not index proxies. If we ignore the allocation to short positions, Banking, Technology and Brewing investments make up 90% of our global fund assets. With the addition of our levered debt position, we are unlikely to behave in a similar manner to the generic index.

Yours Sincerely

Paul Moore



Source: Factset



Source: Factset

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