August 2009 NTA Release

1. Details of Performance and Net Asset Backing at Month end

The net asset backing ("**NTA**") of Fat Prophets Australia Fund Limited ("**Fat Fund**") as at 31 August 2009 was **$1.0618 per share** on a before tax basis, calculated in accordance with ASX Listing Rule 19:12, and represents an **increase of 7.34%** over the month. By comparison, the Fat Fund's benchmark, the S&P/ASX 300 Accumulation Index firmed 6.64% over the month.

After adjusting for the impact of taxation on both realised and unrealised gains, the Fat Fund's after tax NTA at the end of August 2009 was **$1.0607 per share**.

2. Performance Commentary

The major influences on the Fat Fund's performance versus the benchmark during the month of August 2009 were as follows (* denotes acquired during month):

Positive Influences			**Negative Influences**		
Company	***% move***	***Position***	***Company***	***% move***	***Position***
SP Telemedia	61%	Overweight	Beach Petroleum	-5%	Overweight
National Aust. Bank	17%	Overweight	Brambles	24%	Underweight
Telstra	-8%	Underweight	Mundo	-9%	Overweight
Westpac	12%	Overweight	Macquarie Grp.	15%	Underweight
QBE Insurance	17%	Overweight	Integrated Research	-6%	Overweight

August was categorically the month of the "financial". Banks (+13% on an accumulation basis) despite yet more dilutive equity raisings, and REIT's (up 17% as a sector over the month) were standout features of an exceptionally buoyant domestic equity market. What's mystifying is that in all cases, there is no real news – just perception that the worst is over and that all will be sweetness and light from this point forward. That may be true, but in all cases, the dilutionary impact of necessary – but now arguably excessive – equity raisings has left many of these securities at far less of a valuation gap than might otherwise have pertained. The banks clearly are something of a "coiled spring" with solid underlying earnings growth from margin expansion likely to be overlaid on top of significant reductions in bad debt charges in 2011 (and probably sooner); REIT's do not have this luxury. All have lost their lustre of cheapness.

Indeed, the market has rallied so far in companies reliant on economic turnaround that it has forsaken numerous steady growth companies who benefit from long term structural and demographic shifts, and now price them at <u>discounts</u> to these rust-belt exposures a couple of years out. For example, healthcare, as a grouping, traditionally the preserve of the growth investor, is starting to exhibit strong value stock characteristics, particularly examined on a 2011 basis when many of the cyclical will have recovered to a fair degree.

The counter-argument is the level of upside postulated for operating margins, which on many measures fell to levels at or below those of the last "real" recession in Australia – 1990/1. What will be different on the upside this time are several factors:

- the level of oligopoly control of distribution (another word for retail) in many industries which will prevent manufacturers from recovering to previous levels – in many cases, distributors are becoming de-facto brand-owners;
- if China is going to recover so strongly, and with the A$ at current levels, distributors have a double benefit – and manufacturers are pushing up a very steep hill;
- the upside benefit in many traditional cyclical industries – notably media – is being scattered by changed habits and generational change;
- global change means your competitor is a state/government subsidised corporation; and
- from the last recession, Australia was deregulating- now it's re-regulating.

The past six successive months of gains in the Fat Fund benchmark have seen a cumulative benchmark return of close to 38%. For industrial shares only, in capital terms, the uplift has been around 36%. The average bull market in Australia since 1936 has been of a three year duration, with an average uplift of about 80% in capital value. Whilst taking averages of averages is fraught with danger, it could be reasonably perceived that we are not far short of half way there with only six months gone, suggesting more moderate 10-11% per annum returns (plus dividends) to come over the next couple of years or so. These returns have to be eked out in an environment of likely sharp interest rate rises over the next two years from decade lows.

On this basis, there is clear justification for a "buy and hold" type strategy for equities in general, but the sort of paranoid FOMO (fear of missing out) which has characterised many investors stock choices in recent times – partly dictated by placements - should now be looked at as FOMU – fear of mucking up. What appears not to be perceived, from a corporate strategy viewpoint, is that the chances of the latter have heightened significantly, as global shifts weigh proportionately on local companies and markets.

In the past month, the Fat Fund has acquired new positions in Sonic Healthcare and Healthscope, further reduced its underweight position in Telstra (at this rate we'll soon be at index…) whilst reducing its exposure to certain well-performed "micro" cap securities, and eliminating some smaller positions. We are still cautious about taking aggressive base metal and bulk resources positions, since product and share prices appear to discount a brighter environment than yet prevails; however, we are still overweight gold shares. Our own shares, at close to a 22% discount to NTA, also have appeal given the estimated 9.6% outperformance of the benchmark over the past year prior to taxes and fees, the vast bulk of which has arisen from pure security selection rather than cash/market timing.

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3. Top 15 Holdings at 31 August 2009

Company	Symbol	% Weighting
BHP Billiton	BHP	12.14
Westpac	WBC	10.8
National Aust. Bank	NAB	8.15
Commonwealth Bank	CBA	7.80
ANZ Bank	ANZ	5.89
QBE Insurance	QBE	4.23
Woolworths	WOW	3.33
Wesfarmers	WES	2.82
CSL	CSL	2.8
Rio Tinto	RIO	2.61
Beach Petroleum	BPT	1.99
Oceana Capital	OCP	1.95
Telstra	TLS	1.65
Westfield Group	WDC	1.54
Premier Investments	PMV	1.59

Andrew Brown[a] & Steve O'Hanna[a] 14 September 2009

a: Andrew Brown and Steve O'Hanna are employees of Tidewater Investments Limited. A controlled entity of Tidewater Investments Limited, Tidewater Asset Management P/L (AFSL# 302802) currently manages the Fat Fund under a sub-contract agreement dated 24 May 2007 with Fat Prophets Funds Management Australia P/L.

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