

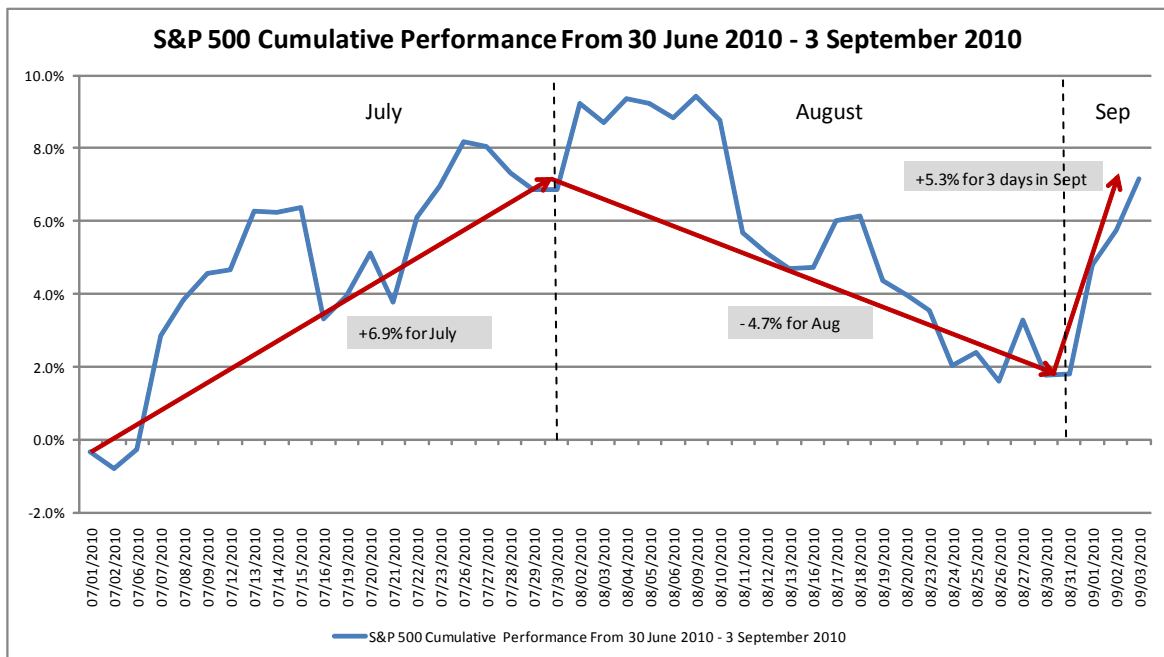


Nurturing Wealth Together

August 2010

Dear Investor,

After having risen some 6.9% during July, the S&P 500 did an about turn and fell 4.7% during August. What makes investors so confident one month and so unsure the next, can only be described as short-term speculation rather than long-term investing. This is one seriously confused market!! Poor economic data from the US and slower production numbers out of China plagued investors.



Equity markets were choppy during August as most major equity indices gave up their July gains and moved into negative territory for the year to date. Risk aversion prevailed as investors were surprised by poor economic data, and fear of a potential double-dip recession dominated.

Most global economic releases were poor. While we have been warning of an economic slowdown for some time, economists have only recently (towards the end of August) capitulated and lowered their 2010 and 2011 GDP forecasts after second quarter US GDP numbers were revised downwards from 2.4% to 1.6%.

The issues at hand are simple. The stimulus packages that have now been spent and have expired have neither resulted in a permanent up-tick in economic activity nor in job creation. With banks and consumers still de-leveraging from peak levels, and uncertainty on the employment front, the growth seen earlier on in the year has now stalled. Paraphrasing Nouriel Roubini (Dr. Doom), the second half of the year is going to be difficult from an economic perspective, as the tailwinds of the first half become headwinds. The base effect from the massive inventory restocking in the first half which fuelled GDP growth, as well as the expired home buyers tax credit, and cash for clunkers programmes, will result in a tough second half for 2010 and slower growth in 2011. Another interesting development during the month came from Moody's who warned that they would review the US's AAA rating unless an appropriate solution was found to the level of federal debt.



So Where To From Here?

	Monthly Returns				Compound Annual Returns (p.a.)			
	Month	3 Mth	6 Mth	YTD	1 yr	3 yr	5 yr	10 yr
Developed (Local Cur)								
Germany	-3.6%	-0.4%	5.6%	-0.5%	8.6%	-8.1%	4.2%	-2.0%
UK	-0.6%	0.7%	0.7%	-3.5%	6.4%	-6.1%	-0.3%	-2.4%
France	-4.2%	-0.7%	-6.6%	-11.3%	-4.5%	-14.9%	-4.5%	-6.2%
US (Dow)	-4.3%	-1.2%	-0.5%	-4.0%	5.5%	-9.2%	-0.9%	-1.1%
US (S&P 500)	-4.7%	-3.7%	-2.3%	-5.9%	2.8%	-10.7%	-3.0%	-3.6%
Japan	-7.5%	-9.6%	-13.5%	-16.3%	-15.9%	-18.9%	-6.6%	-6.3%
Hong Kong	-2.3%	3.9%	2.1%	-6.1%	4.1%	-5.0%	6.6%	1.8%
Singapore	-1.3%	7.7%	7.5%	1.8%	13.8%	-4.6%	5.3%	3.2%
Australia	-1.5%	-0.9%	-3.4%	-9.1%	-1.0%	-10.8%	0.1%	3.1%
Developed (Local Cur)								
India	0.6%	6.6%	9.9%	2.9%	14.7%	5.5%	18.2%	14.9%
China	0.0%	-0.6%	-11.7%	-19.5%	-1.1%	-20.3%	17.8%	2.7%
Brazil	-3.5%	5.2%	-0.4%	-5.0%	15.3%	6.0%	18.4%	14.1%
Israel	1.1%	1.7%	-1.8%	-2.1%	18.0%	0.0%	7.9%	6.2%
Taiwan	-1.9%	4.4%	-0.3%	-7.0%	11.6%	-5.3%	4.8%	0.0%

Source: 613 Capital LLC

Table 1: Global growth slowing
(index level)

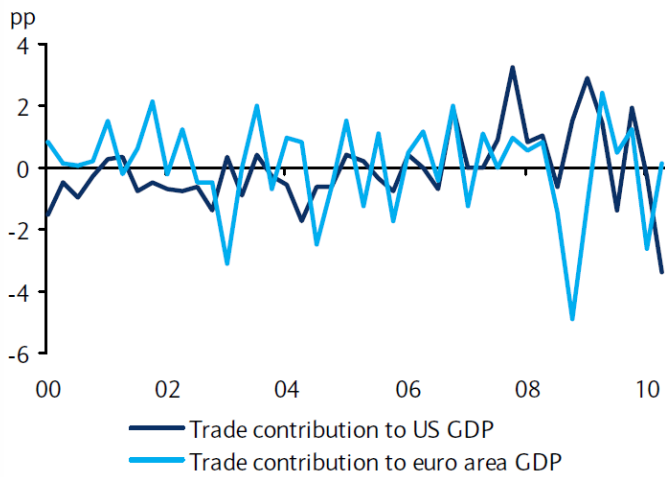
	August	July	MoM Change
Australia	51.7	54.4	-2.7
Austria	55.9	58.9	-3.0
China	51.2	52.1	-0.9
Czech Republic	57.4	56.8	0.5
France	55.1	53.9	1.2
Germany	58.2	61.2	-3.0
Greece	43.0	45.3	-2.3
Hungary	53.5	49.5	4.0
India	57.3	57.6	-0.3
Ireland	51.1	51.4	-0.3
Italy	52.8	54.4	-1.6
Japan	50.1	52.8	-2.7
Korea	50.9	53.2	-2.4
Netherlands	54.3	55.7	-1.3
Norway	54.9	52.0	2.9
Poland	53.8	52.1	1.7
South Africa	49.5	49.5	0.0
Spain	51.2	51.6	-0.4
Sweden	64.2	62.4	1.8
Switzerland	61.4	66.9	-5.5
Taiwan	50.5	53.8	-3.3
Turkey	52.8	53.2	-0.4
UK	54.3	53.2	1.1
US	56.3	55.5	0.8

Source: Bloomberg, BofA Merrill Lynch Global Research

The table to the left shows 15/24 countries with slowing purchasing managers' indices. The Purchasing Managers Index (PMI) is an indicator for economic activity. Roughly speaking it reflects the percentage of purchasing managers in a certain economic sector that reported better business conditions than in the previous month. Of most concern was China which really spooked investors.

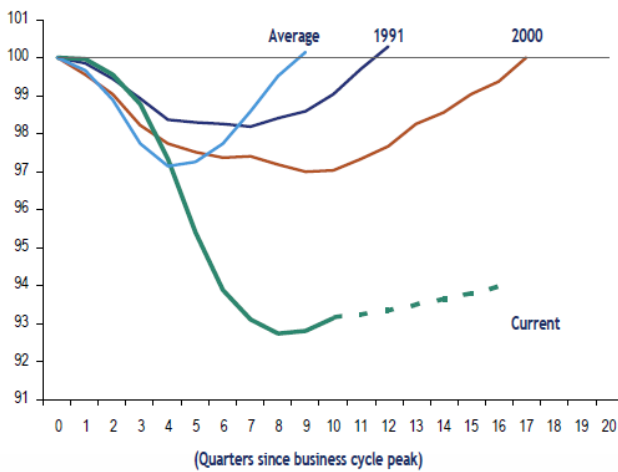
From a US PMI perspective, most sub-sector categories were weak. Most notable was the Inventories number, which fell to 46.5 in August from 50.8 in July in a sign that inventories will not be as significant a contributor to growth as it was earlier in the recovery. With weak orders and inventories, production was also down from 64.6 to 55.0. The marginal ray of light was employment which was slightly down to 55.5 compared with 56.6, but was most likely supported by 25,000 jobs created by GM in the auto sector.

Figure 2: Trade drag was very large in the US in Q2 10



Source: BEA, Eurostat, Haver Analytics

In the US, while investors took solace in the fact that second quarter GDP was only revised down to 1.6% (expectations were to 1.3%) from 2.4%, it still left little to be positive about. A large detraction from growth was a strong US dollar which impacted on trade as shown in the graph to the left. Overall it is estimated that trade detracted some 3.7% from US GDP during Q2, while the Euro region benefited from a weaker currency. This is likely to be volatile going forward.



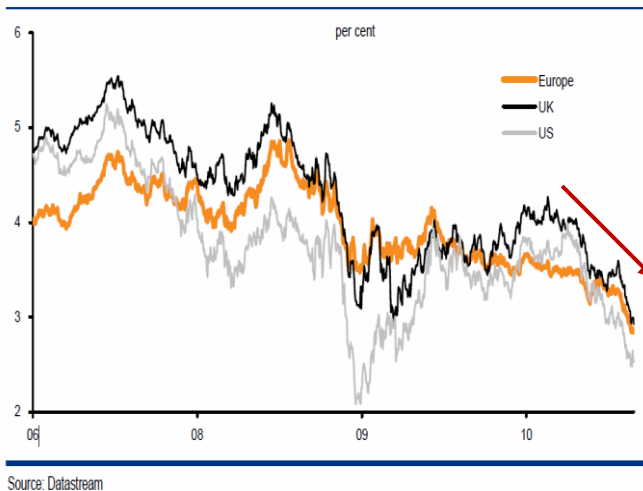
*Indexed to 100 at the previous business cycle peak. Average includes all recessions after 1950 excluding the 1980 and current recessions.
Source: Bureau of Economic Analysis, BofA Merrill Lynch Global Research

Focusing on unemployment, it is not surprising to expect the economy to continue to grow at a sub-par level as job creation continues to lag. Not only is the magnitude of job losses during the 'great recession' much larger than the past, but the length of recovery remains much longer, a natural hangover after the debt party of the 1990's and 2000's.

In order for the unemployment rate to reduce, the US economy will need to create a minimum of 125,000 jobs a month. With the current rate of private payroll increasing at some seventy thousand new jobs, it is expected that the disclosed unemployment rate will be above 10% by year-end.

On the positive front, tax receipts from wages, are now only some 4% below levels seen in 2007.

Chart 6 : 10-year yields for the euro area, the UK and the US



Source: Datastream

Investor fear was best demonstrated by the material fall in global bond yields as investors sold equities and bought bonds. Deflationary fears fuelled by the fear of a double-dip recession have now moved government bonds in my opinion into bubble territory and investors who see this as a risk-free asset class are likely to experience material capital losses within the next 18 months. I could be wrong, but I think it is very unlikely that the central banks of the world will allow deflation. What can they do to prevent it? Spend more money, implement more stimulus packages and incur more debt. Remember, inflation is the friend of the indebted, deflation its enemy. In this regard, I would not be surprised to see a further stimulus package announced should the economic data continue to be weak during September, irrespective of the current level of government indebtedness.

So with all this negative news, why is the team at 613 Capital starting to become more positive. The primary reason is that the factors we are concerned about have finally become broadly accepted by the wider market and equities have sold off. With global GDP forecasts being revised down, the final shoe to fall will be for analysts to downgrade their earnings expectations for 2011 which currently sit at +14% for the US. Most importantly, while we still see some further downside in equities in the near term from the abovementioned, there are many great investment opportunities that exists in the market today, barring a double-dip recession.

We continue to position the portfolio defensively but for the first time see medium-term value in some of the more high quality cyclical companies. We will not however deviate from our core philosophy of predictability (backwards looking – historical DNA of a company) and sustainability (future growth from secular trends). We expect to implement this cautiously and slowly. We still see the remainder of 2010 and the first half of 2011 as being tough from an economic perspective and could see markets move lower in the short term.

RISK IS WHAT YOU BUY RETURN IS WHAT YOU GET

APPENDIX

Thematic Research Background

'Ageing Demographics' focuses on the global ageing population and the industries that will benefit from this. This includes the healthcare sector (pharmaceuticals, medical equipments manufacturers, laboratory testing, age care facilities etc.). We are particularly excited about this theme in the pharmaceutical industry where a second theme 'patent expirations' will also be a strong tail wind for generic drug manufacturers. Drug patent expirations will exceed \$150bn over the next 5 years. It also provides the opportunity to invest in large drug manufacturers who, while losing revenues to patent expirations, (until replaced by new drugs) are trading at low valuations and high dividend yields for those patient investors.

'Peak Oil' acknowledges the current cyclicity of oil, but also looks to a future where this cyclicity will reduce materially as demand exceeds supply. At current estimates, discovered reserves are around 1.3 trillion barrels, with current annual consumption around 36 billion barrels per annum. This equates to approximately 36 years left of oil at current levels of demand (will be less as China and India come on board). While there are other discovered reserves, they require a higher oil price to make them economically viable, so either oil prices rise and remain high or the supply of oil continues to fall. A risk to this theme and ultimately where the future lies is substitution. The world has reached a tipping point with respect to high oil prices and will seek to employ new technologies that can replace oil. These include natural gas, electrification of motorised travel, and nuclear power generation. Ironically, coal will also be a material beneficiary of Peak Oil, although environmental pressures will force cleaner technologies to be invented. Part of this theme is to look at global utility companies, which are likely to be the future petrol companies as people 'fill-up' by plugging in.

'Technology Giant Cash Machines' while a more risky and cyclical theme, this focuses on quality technology companies that dominate their market position and have material cash on balance sheet and continue to produce huge amounts of cash annually as compared to their market capitalisation. Many of these companies are trading at cash yields above 8% and continue to grow cash earnings at greater than 10% per annum. As it is always difficult to predict when a new technology can become disruptive and materially damage the market position of a technology company we will manage this risk through appropriate position size while remaining focused on quality.

'Legalised Addiction' focuses on consumer monopolies in the carbonated-beverages, coffee, tobacco, telecommunications and gambling industries. We continue to search for companies that are strongly cash generative, have high return on shareholder's equity and can protect their competitive market positioning. With the exception of gambling (too cyclical and which we are not invested in) and a material economic slowdown, these companies will continue to grow ahead of developed world population growth rates and GDP, and represent a conservative way to invest in the long term growth prospects of a rapidly growing emerging market middle class.

'Emerging Middle Class' focuses on the huge surge in the number of middle income earners coming from emerging markets over the next 40 years. As the economic growth of Brazil, Russia, India, China, South Korea and Vietnam continues to outstrip the developed world by a factor of 2-3x's, GDP per capita is expected to follow.

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