



Nurturing Wealth Together

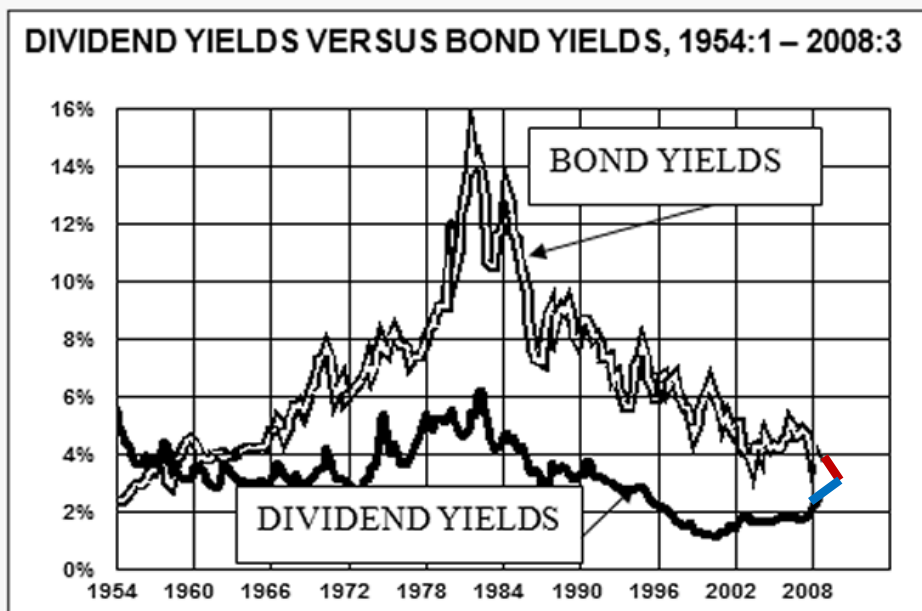
September 2010

Dear Investor,

Most global equity markets had an extremely strong September, with the S&P 500 in the US rising 8.8%, its largest rise for the month since 1939. The quarterly performance was also solid (but volatile) with the S&P 500 rising 10.7% and the FTSE100 in the UK rising 12.8%. Only Japan was down for the quarter as a strong currency weighed on exporters and economic indicators remained weak.

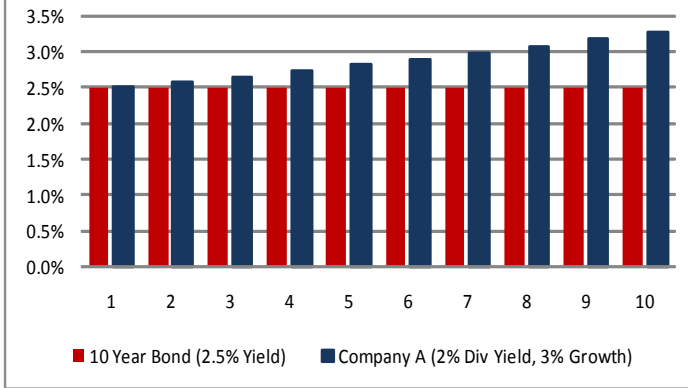
An investment with 613 Capital LLC rose more than 1.3% for the month net of fees. While the hedge portfolio detracted 5.3% (as one would expect in a strong market), the long portfolio contributed 6.7%. Overall net exposure (Long portfolio – hedge portfolio) remained low, averaging between 10-12% on a delta adjusted basis (taking risk into consideration). For the quarter an investment with 613 Capital LLC rose more than 2.1% net of all fees.

The graph below is extremely relevant as it is the first time since 1958 that equity dividend yields are once again higher than US government bond yields (10 year). Some 52 years ago, investors realised that receiving a growing dividend from a company as compared to a fixed yield on a government bond deserved a premium. While we acknowledge that not all companies are equal, and future dividends and growth are not a certainty, when investing in quality companies with long term predictability and sustainability, your opportunity as an investor to rely on this logic increases materially.



RISK IS WHAT YOU BUY RETURN IS WHAT YOU GET.

Return Profile Bond vs Dividend

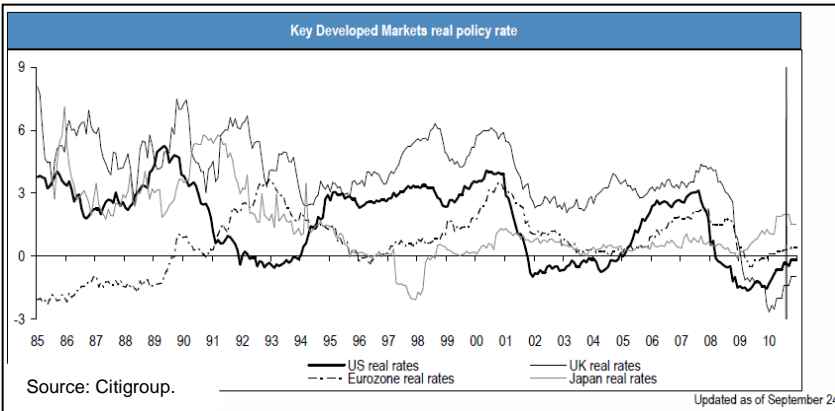


Source: 613 Capital LLC

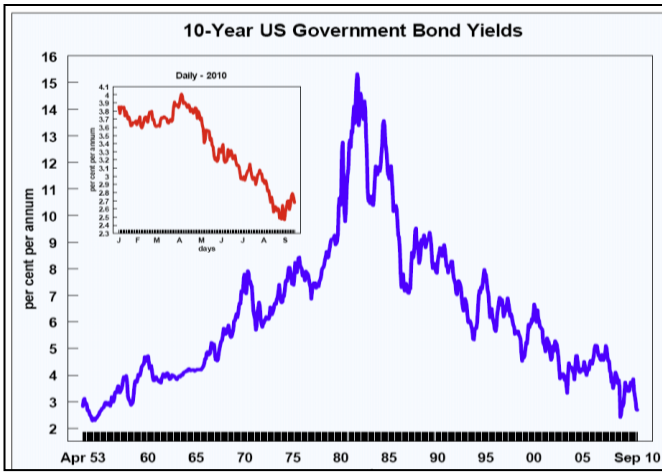
To put this in context, if you invested in a 10-year government bond (assume no reinvestment risk on coupons received) at a yield of 2.5% and invested in a company paying a 2.5% dividend growing at just 3% p.a. for the next 10 years, by end of the 10-year period the dividend yield of the company would be 3.3%. As an example Microsoft issued last month, three year notes at a 0.875% yield and 10-year notes at 3% yield. If you owned the stock instead, you would receive a 2.6% dividend, from a company that has over \$40 billion of cash on balance sheet, generates over \$15 billion a year in free cash flow and has paid out cash dividends of over \$54 billion in the past 8 years.

So why are investors behaving like this? Investors remained fearful, paralysed by the collapse caused by the GFC, the risk of deflation, and the potential that the current rise in equities off their lows, resembles the 1929's Dow Jones crash which saw markets fall 47%, then rally 48%. The market ultimately then continued to 'zig-zag' lower until it bottomed in 1932, down some 85% from its peak. At this stage, while this is possible, and risk management remains key, my sense is that it is bonds that are in a bubble, and where caution is required. Government bonds yields continue to fall, fuelled by fear and government's intervention in bond markets through quantitative easing (QE) policies. QE is the 'magical' creation of money from thin air, ex nullus, by central banks creating 'false' demand for bonds by purchasing them. The idea is to prevent deflation by increasing the supply of money and decreasing the returns one receives on cash with the hope of fuelling inflation, consumption and investment in higher returning (riskier) assets. A material consequence of QE is that it results in a devaluation of the respective currency due to oversupply. This can be seen as the US dollar continues to fall against most currencies. The fear of this devaluation drives investors into hard assets such as gold and other commodities, which once again feeds back into higher costs (inflation).

As consumption increases, company revenues and profits increase. This hopefully drives employment, which in turn drives further demand as more people have money to spend. This then loops back into increased revenues and profits and the cycle continues to spiral upwards. The positive outcome of QE is that, if successful, in the short term it leads to reflation, higher capacity utilisation, job creation and growth in nominal revenues and profits all of which are good for equities. The danger of QE is that it ultimately could result in hyper-inflation or higher than expected inflation which forces central banks to drain liquidity from markets by increasing interest rates and hence decreasing demand and corporate profits. This is bad for equities. To date the first round of QE may have prevented a great depression. The effects on the global bond market are clearly visible from the graph which shows negative real interest rates in the US, Japan and the Euro Zone, that is, investors after factoring in inflation lose purchasing



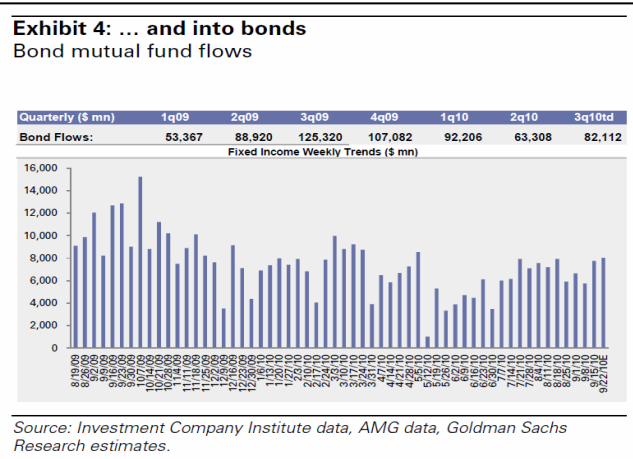
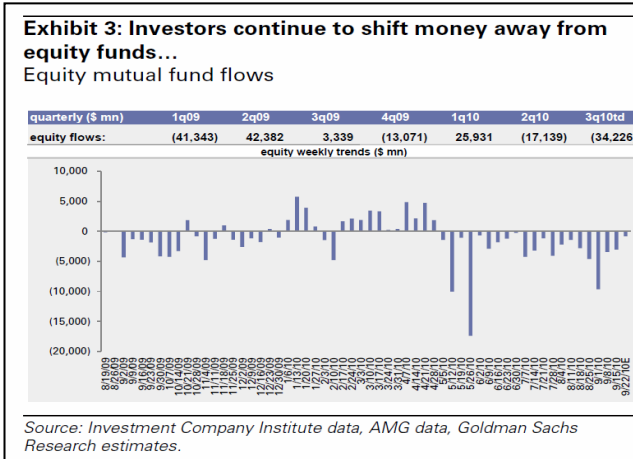
power. As the global economic growth slows after being boosted by stimulus packages and inventory restocking, central banks are now forced to implement further measures to help rekindle economic growth. QE 2 as it is being referred to is not far away.



Source: Bankwest

The graph to the left shows the US 10-year treasury bond yield from 1953. As shown, bond yields are now at 50 year lows, as fearful investors seek the 'safe haven' of government bonds. What is not well understood is that when 10-year bonds are at yields of 2.5%, every 1% increase in the yield results in a loss of over 6% in capital. So it would appear that this 'conservative' asset class offers very little yield protection from a large capital loss and is most certainly in a bubble, driven by central bank purchases and investor purchases, pushing yields lower and lower. The graphs that follow show just how material these flows have been.

For the past four quarters, investors withdrew \$40 billion from equity funds while purchasing over \$340 billion of government bonds. Investor fears of a double dip recession and the continued volatility of equity markets has exhausted the retail investor's appetite for risk. This is usually a strong contrarian signal showing that equity



markets have bottomed. I'm not suggesting that everything is rosy, but rather that an investment in 10-year government bonds is materially more riskier than investors acknowledge.

World	Trailing Dividend Yields			Cheaper / More Expensive
	Avg Div Yield			
	Current Div Yield	Since 1995		
Market	2.9	2.1	Cheaper	
Energy	3.2	2.7	More Expensive	
Materials	1.9	2.3	Cheaper	
Industrials	2.3	1.9	Cheaper	
Consumer Discretionary	1.8	1.5	Cheaper	
Consumer Staples	3.0	2.3	Cheaper	
Healthcare	2.8	1.7	Cheaper	
Financials	2.8	2.7	Cheaper	
IT	1.2	0.7	Cheaper	
Telco Services	5.5	3.1	Cheaper	
Utilities	4.7	3.8	Cheaper	

World	World 12 Month Forward P/E Ratios			Cheaper / More Expensive
	Historical			
	Current P/E Ratio	Since 1995		
Market	12.0	15.0	Cheaper	
Energy	10.3	13.5	Cheaper	
Materials	11.8	13.2	Cheaper	
Industrials	13.5	15.5	Cheaper	
Consumer Discretionary	13.7	16.8	Cheaper	
Consumer Staples	14.0	15.9	Cheaper	
Healthcare	11.0	17.3	Cheaper	
Financials	10.7	12.3	Cheaper	
IT	12.3	21.3	Cheaper	
Telco Services	12.2	15.5	Cheaper	
Utilities	11.7	12.9	Cheaper	

So what is an investor to do? As Warren Buffet says, "Be fearful when others are greedy and be greedy when others are fearful."

World	Price to Book Valuations			Cheaper / More Expensive
	Avg. Price / Book Ratio			
	Current Price / Book Ratio	Avg. Price / Book Ratio		
Market	1.8	2.6	Cheaper	
Energy	1.6	2.7	Cheaper	
Materials	1.8	2.1	Cheaper	
Industrials	1.9	2.6	Cheaper	
Consumer Discretionary	1.8	2.3	Cheaper	
Consumer Staples	2.8	4.1	Cheaper	
Healthcare	2.3	5	Cheaper	
Financials	1.0	2	Cheaper	
IT	1.6	4.4	Cheaper	
Telco Services	1.4	2.5	Cheaper	
Utilities	4.7	1.9	More Expensive	

World	Return on Equity			Higher / Lower than average
	Avg. Return on Equity			
	Current Return on Equity	Avg. Return on Equity		
Market	10.8	12.2	Lower	
Energy	11.6	16.9	Lower	
Materials	10.2	10.9	Lower	
Industrials	10.9	11.9	Lower	
Consumer Discretionary	9.9	9.3	Higher	
Consumer Staples	17.8	19.5	Lower	
Healthcare	18.8	20.3	Lower	
Financials	6.4	10.5	Lower	
IT	17.2	12.3	Higher	
Telco Services	11.8	11.3	Higher	
Utilities	11.2	11.8	Lower	

As discussed in last month's report, equities currently offer value as management teams have been able to right size their companies and maintain margins and profitability at lower levels of economic activity and revenues. While average Price/Earnings Ratios for the past two decades have averaged 17-20x's, the longer term norm is closer to 12-15x's earnings. Dividend yields are higher than their historical average and continue to rise, return on equity while lower than the average remain adequate in the sectors we look to invest in and cash flow generation remains high.

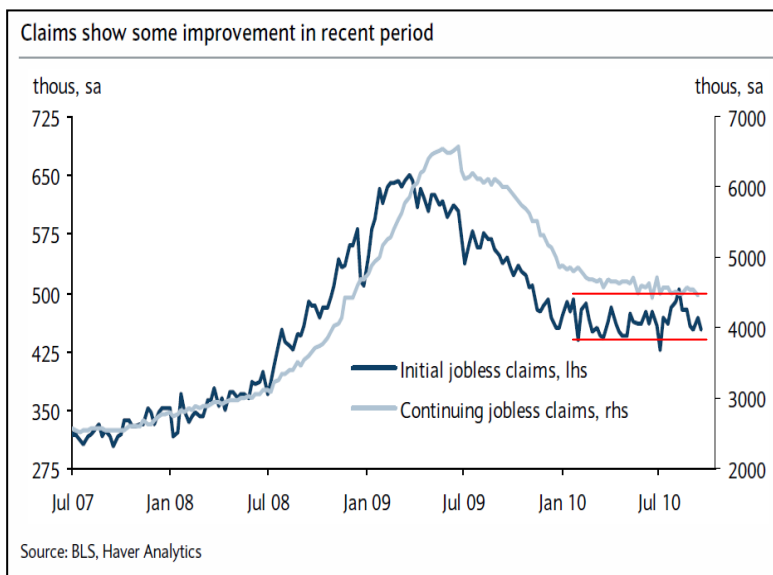
Source: I/B/E/S, MSCI, JP Morgan



So does this mean that we at 613 Capital are starting to get bullish after being bears for the past four years? Yes and no. Yes because we see value in many high quality names, and no because we remain respectful of volatility and for the current level of risks in the economy (more on this below). We continue to look to invest in great companies with tailwinds to support growth and cash generation. In summary we see an opportunity to add more risk to the portfolios because:

- Equities offer absolute and relative value and are cheap as compared to long term historical norms (pre 1990's);
- Corporate balance sheets are materially stronger, with cash hordes in excess of \$4 trillion including financials or \$2 trillion excluding financials;
- Profitability remains strong in the face of lower revenues and demand.
- Merger and acquisition activity has increased materially signalling management's confidence in the future;
- Dividend yields now exceed bond yields;
- Emerging market countries continue to grow due to improved domestic demand and exports. They are also running large current account surpluses and not involved in QE. The benefits to emerging market countries of not having to have implemented QE is that their currencies remain strong and continue to strengthen (unless you are China and peg your currency). The danger is that export driven growth in emerging markets stalls due to currency strength.

The risks for equities however remain:



High unemployment levels in developed markets remains a challenge and unlikely to improve to normalised levels in the next 12 months. However, any improvement will be seen as very positive. To date while the unemployment rate appears to have fallen in the US from 10.2% to 9.6%, as stated many time before, this has more to do with the participation rate (number of people still looking for employment) falling than any real improvement. Initial jobless claims and continuing claims have however improved and appear currently to be range bound. In order to create the 150,000 jobs per month required in the US, initial jobless claims will need to fall from its current 3 month average of 456,000 to below 400,000.

	Real GDP Growth (%Y/Y)				Change in Forecasts Past three months (%)			
	JPM		Consensus		JPM		Consensus	
	2010E	2011E	2010E	2011E	2010E	2011E	2010E	2011E
United States	2.6	2.4	2.7	2.5	-0.8	-0.7	-0.5	-0.4
Canada	3.1	2.2	3.4	2.7	-0.6	-0.6	-0.3	-0.4
Japan	3.0	1.1	3.4	1.6	-0.6	-1.2	1.3	-0.3
Euro area (12)	1.7	1.5	1.5	1.4	0.3	0.1	0.4	0.1
Germany	3.3	2.4	3.3	1.9	1.1	0.2	1.4	0.3
France	1.6	1.5	1.6	1.4	0.1	0.0	0.3	0.0
Italy	1.2	1.3	1.0	1.3	-0.1	0.0	0.1	0.2
Norway	1.5	2.3	1.5	2.8	0.0	-0.1	-0.4	0.0
Sweden	4.5	3.1	3.6	2.5	0.8	0.3	1.3	-0.1
Switzerland	2.9	2.0	2.1	1.8	0.6	-0.5	0.0	-0.3
United Kingdom	1.7	2.2	1.6	1.9	0.3	-0.3	0.4	-0.1
Australia	3.1	3.2	3.1	3.5	0.2	-0.3	-0.4	0.2
Hong Kong	6.6	4.1	5.9	4.3	-0.1	-0.1	0.2	-0.4
Singapore	14.8	4.2	10.8	5.0	4.4	-0.1	4.3	n.a.

Source: JP Morgan

The consumer remains over-leveraged and is currently in savings mode (increased from 0% to 6% over past 18 months). With the consumer making up between 60-70% of developed market GDP, economists have been lowering their expectations for 2010 and 2011 GDP.

Potential for exogenous shocks such as a debt crisis for PIIGS or a debt crisis for US state and municipal bodies remains possible.

Last month's economic data also raised a few red flags and appears to be signalling a slowing down of economic activity in the fourth quarter.

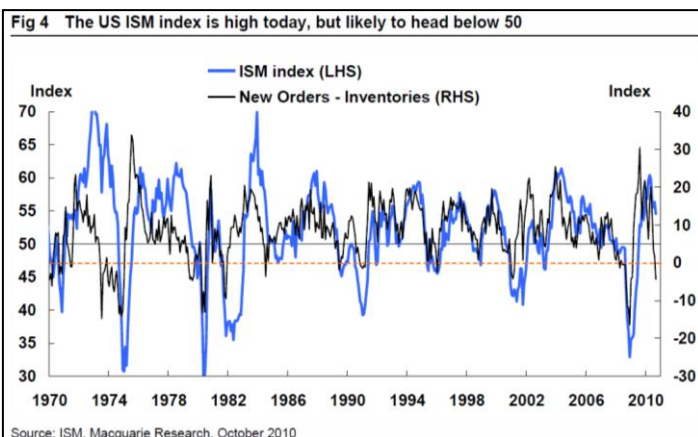
JPMorgan global manufacturing PMI summary						
	Apr	May	Jun	Jul	Aug	Sep
Global PMI	57.7	57.0	55.0	54.3	53.8	52.5
Output	60.9	59.3	56.9	55.6	55.5	53.8
New orders	60.2	58.9	55.7	54.0	52.5	51.4
Export orders	58.5	58.0	54.7	54.3	52.8	52.1
Employment	53.7	53.9	53.2	53.5	53.7	52.3
Input prices	70.1	68.6	58.9	56.9	58.5	62.6
Delivery times	41.3	41.3	42.7	42.5	43.8	46.0
Inventories	49.1	48.9	48.6	49.0	49.8	51.0
memo:						
Orders/inventory	1.23	1.20	1.15	1.10	1.05	1.01

Note. PMI is weighted average of component series: 30% new orders, 25% output, 20% employment, 15% delivery times, 10% inventories.

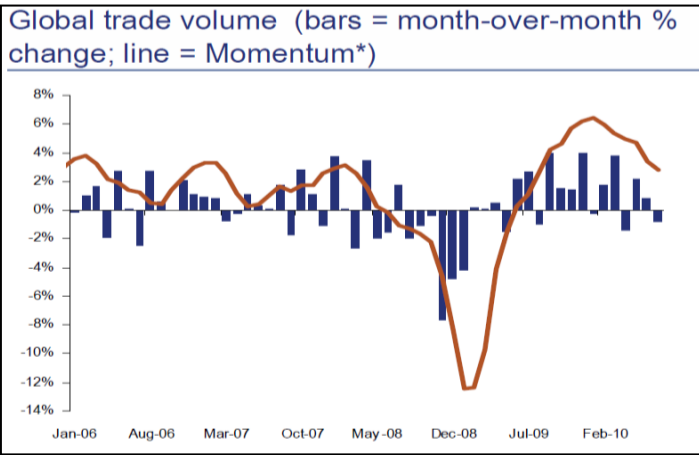
Source JP Morgan

Of the 23 countries that have released purchasing managers' indices (PMI) to date, 60% have been weaker as compared to last month, and are now at their lowest levels in the past six months. They do however remain in expansionary territory, albeit with softening momentum.

Of major concern however is the PMI's inventory and new-orders sub-indexes which showed inventories jumping back to levels last seen in 1998 (51.0) while new-orders fell. This is a good leading indicator of future sales level which appear to have stalled. Companies have responded by reducing orders. This has yet to be confirmed by retail sales statistics but appears to be leading to an inventory build at the manufacturing front and could portend to weaker demand. On the positive side is China. After negatively surprising the markets in the second and third quarter of this year saw their PMI stabilise and increase for the month.

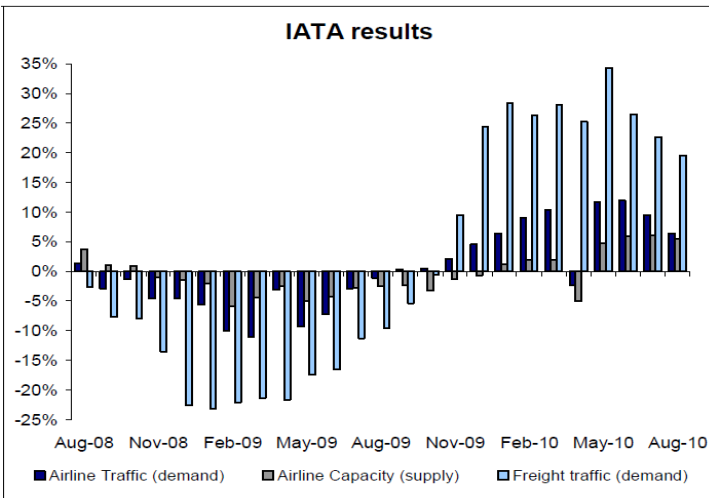


The headline US ISM index fell from 56.3 to 54.4. Like the PMI numbers, an analysis of the component parts showed new orders declining to 51.1 from 53.1 and only 39% of industries reporting rising orders. The employment components also showed a slow down, declining to 56.0 from 60.5, the lowest level since the first quarter of this year. This points to further volatility in the near future and will be monitored carefully.



Source: Bank Of America

Global trade also appears to have stalled with the chart showing a 0.8% drop for the month of August from July. Export data from China, Taiwan, and Korea also indicate a moderate slow down while Japan with its strong currencies appears to be bearing the brunt, seeing exports falling 2.3% in August to their softest annual growth rate since December 2009.



Source: IATA

The slowdown in global trade, as reflected above was confirmed by IATA data released for August which also showed a slowdown in freight and airline traffic.

In conclusion we remain cautious regarding the economic recovery in the near term and expect volatility will remain high. We however see value in certain equities on a 12 month forward looking basis and will take opportunities as they arise. The key will be to remain vigilant in managing risk and nimble enough to lock in gains when appropriate.

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 cyclical nature of oil, but also looks to a future where this cyclical nature 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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