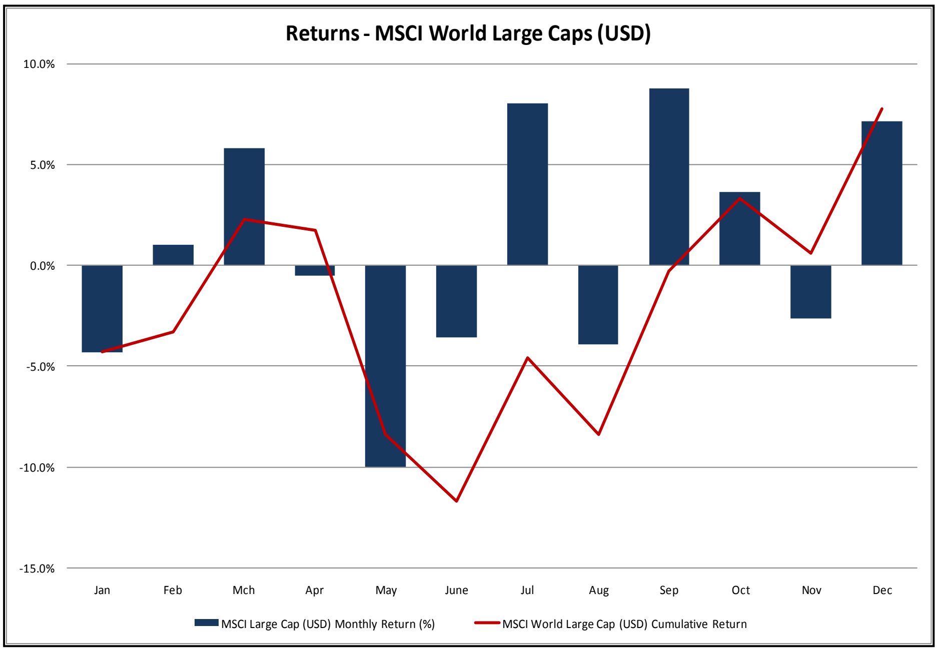
613 CAPITAL

Nurturing Wealth Together

December 2010

Dear Investor,

After having fallen more than 2.5% in November, the MSCI World Index (USD) rose 7.2% for December to end the year up 9.6%. The Christmas rally saw many equity markets now trade at levels above their pre-Lehman Brothers collapse levels as investor confidence slowly rebuilds. Notwithstanding the extreme volatility and uncertainty experienced over the past two years if you were "courageous when others were fearful – Warren Buffet", and bought shares at the lows, you would have seen your shares on average rise some 88%. Obviously with hindsight this is easy, but one does need to store these experiences in one's mind so that the next time something like this comes around (and it will) you are able to do what is uncomfortable.



Source: 613 Capital LLC

Back to the here and now, while equity markets in general were up for the year, performance was anything but smooth sailing. Returns were extremely volatile over the preceding twelve months as investor confidence waxed and waned on fears of a potential default by Greece in May and Ireland in November. These events were further exacerbated by the economic data points which started off strong but towards the middle of the year slowed materially to the point where the US Federal Reserve was forced to implement a second round of stimulus in the form of quantitative easing.

At its worst point during June this year, most equity markets were down over 10% from their 2009 close. While 2010 will go down in the record books as a year of positive returns, from a risk perspective, it recorded as an extremely volatile and challenging year where return of capital was more important than the return on capital.

For the month of December, an investment with 613 Capital LLC returned between 0.9% and 1.1% net of fees in USD terms. The long portfolio recovered well rising 5.1% for the month. Standout performers were our financial companies KKR (up 12.9%), JP Morgan (up 13.4%), and Citigroup (up 12.6%) as investors have started to look through the short term concerns and look to their longer term earnings potential. These companies currently fit into two medium term themes namely "Increased Mergers and Acquisitions" and "US cyclical recovery". As cash-rich companies continue to make strategic acquisitions, non-banking fees are likely to rise materially. In this regard, we are currently researching Goldman Sachs and Morgan Stanley as potential investments in the long portfolio. General Electric (up 16.4%) was also a star performer. The hedge portfolio lost 4% as expected in a strong market.

RISK IS WHAT YOU BUY RETURN IS WHAT YOU GET.

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So Where to From Here?

	Monthly Returns				Compound Annual Returns (p.a.)			
Country	**Month**	**3 Mth**	**6 Mth**	**YTD**	**1 yr**	**3 yr**	**5 yr**	**10 yr**
Developed (Local Cur)								
MSCI World Large Cap (USD)	7.1%	8.1%	22.0%	7.8%	7.8%	-7.5%	0.1%	-0.3%
MSCI World (USD)	7.2%	8.6%	22.9%	9.6%	9.6%	-6.9%	0.4%	0.5%
MSCI World (Local)	5.6%	7.9%	17.4%	7.8%	7.8%	-7.4%	-1.5%	-1.1%
Germany	3.4%	11.0%	15.9%	16.1%	16.1%	-5.0%	5.0%	0.7%
UK	8.0%	7.6%	21.4%	10.3%	10.3%	-2.6%	1.2%	-0.4%
France	6.7%	3.6%	11.8%	-2.2%	-2.2%	-11.8%	-4.0%	-4.2%
US (Dow)	5.1%	7.2%	18.4%	10.9%	10.9%	-4.5%	1.5%	0.7%
US (S&P 500)	6.6%	10.2%	22.0%	12.8%	12.8%	-5.0%	0.2%	-0.5%
Japan	2.9%	9.2%	9.0%	-3.0%	-3.0%	-12.6%	-8.7%	-2.9%
Hong Kong	0.0%	2.9%	14.3%	5.2%	5.2%	-6.1%	9.1%	4.3%
Singapore	2.2%	3.7%	13.3%	10.9%	10.9%	-2.7%	6.5%	5.2%
Australia	4.5%	5.4%	13.0%	0.1%	0.1%	-8.7%	0.7%	4.5%
Developing (Local Cur)								
India	4.4%	1.6%	15.2%	16.7%	16.7%	0.2%	16.8%	17.8%
China	-2.1%	3.9%	15.1%	-15.8%	-15.8%	-19.4%	18.9%	2.9%
Brazil	2.4%	-0.2%	13.7%	1.0%	1.0%	2.8%	15.7%	16.3%
Israel	6.2%	8.3%	23.3%	14.7%	14.7%	2.1%	8.2%	9.5%
Taiwan	6.4%	8.1%	21.5%	8.8%	8.8%	1.5%	6.3%	6.5%

Source: 613 Capital LLC

While most equity markets performed well during 2010, the shock performer was China, which fell 15.8% after the government increased interest rates and banking capital requirements in an effort to stave off rising inflation and a property bubble. Other developed markets put in a good performance, especially when you consider that markets were down more than 10% mid-way through the year. The Christmas rally gained momentum as positive economic data releases fuelled investor confidence for 2011. The low interest rate levels, extended personal tax cuts, and additional payroll tax incentives in the US, will provide continued support to this enthusiasm.

Our more positive view expressed since September 2010 on equity markets remains in place for 2011, but it is appropriate to emphasize that not all regions will be equal. Given the economic divergences taking place, it is our opinion that the US will lead the world out of the recent economic quagmire, followed by export-led Germany. Peripheral European countries are likely to continue to lag and although valuations look cheap, the risks are just too high. BRIC nations continue to perform well and as expected will provide fuel to commodity prices, notwithstanding the potential for a stronger US dollar. Supply constraints and increasing demand in metals such as copper and iron ore will keep pricing power in the hands of the producers, more on this below.

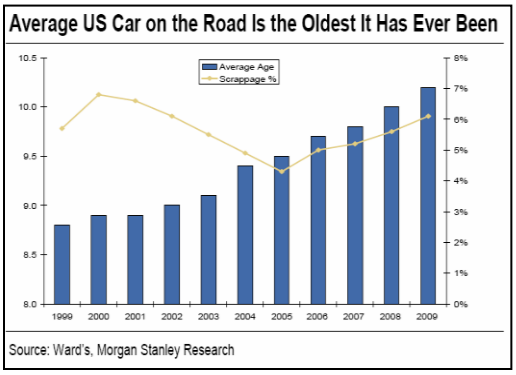
Key risks remain the same as detailed last month and have the potential to de-rail investor sentiment recovery as well as the economic recovery. These include:

- The risk of sovereign debt default spreading from Greece and Ireland to other European countries including Portugal and Spain.
- The risk of errors in Chinese fiscal policy in their fight to curb inflation and their property market. If Chinese growth slows too far, investor sentiment and global growth will rapidly fall.
- Threat of war.
- Failure of the European Central Bank to implement appropriate policy for fiscal sustainability and to put in place a mechanism to support failing member nations. This is a key risk and needs to be addressed soon.

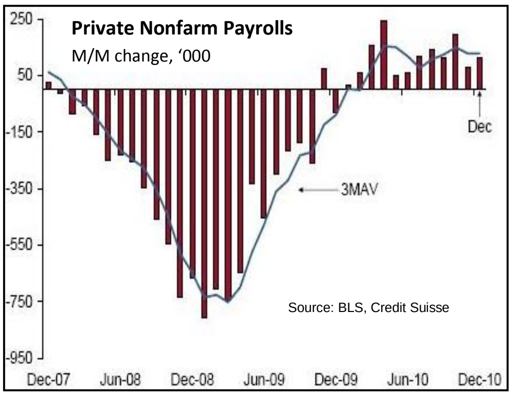
The economic data releases detailed below support our current level of optimism for 2011, although the usual lagging indicators have not yet turned sufficiently positive to justify a rip-roaring bull market.

Positive US economic releases in the US included:

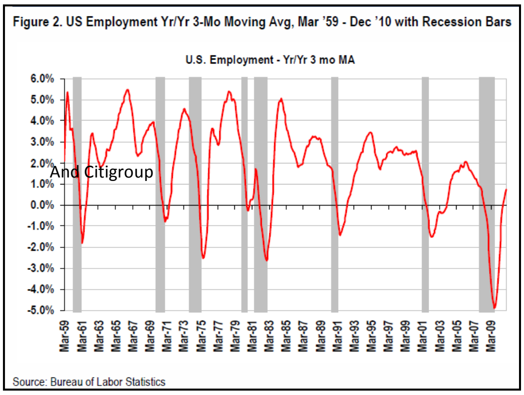
- An upward revision to third quarter GDP (2.6% from 2.5%).
- ISM non-manufacturing index edged up to 55.0 from prior 54.3 (the overall ISM index however fell marginally from 56.9 to 56.6)
- Retail sales which rose 0.8% after a 1.7% rise in October and;
- Industrial production rose 0.4%, beating expectations (+0.3%) after declining -0.2% in October.
- December new car and light truck sales hit a new high for the year of 12.5 million annualised units as compared to the previous quarter's average of 11.6 million units, despite severe snowstorms. This should be seen in the context of trough sales of below 10m units and peak sales in excess of 17.5m units. This recovery bodes well for US auto manufacturers which have materially restructured their businesses and balance sheets. While automakers are cyclical businesses, given their recent restructuring, the economic turnaround in the US and the huge growth opportunities from China and other emerging markets, we remain confident to invest in this sector over a two to three year period. This is further supported by our recent research on General Motors which shows the average age of a car in the US now exceeds 10 years with more than 120,000 miles on the clock. At some point in the future a replacement cycle will need to occur, although this remains dependant on job creation and the ability to get credit. Our view is that both of these will see improvement during 2011.



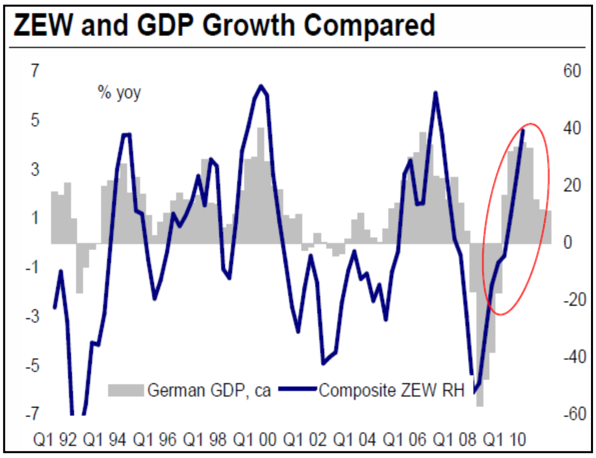
- Employment data was disappointing as non-farm payrolls added only 39,000 versus expectations of 172,000. These numbers however are notoriously prone to continuous revisions and during January 2011 they were revised upwards by 80,000 jobs.



Unemployment is always a lagging indicator as previously discussed in other reports. In the past our primary concern has been the impact of the current level of unemployment at a time where corporate and consumers were deleveraging and hence spending less. In that environment there is little incentive for management teams to look to add jobs. This will start to change in 2011 as the economic recovery gains momentum. Given the current level of savings and the amount on cash companies now have on balance sheet, it is reasonable to expect for things to improve from the lows of the credit crisis.



The key will be for the positive momentum to shift to one of job creation above the 250,000/month level. Once this occurs, the 'real' un-employment rate in the US will start to come down. When this occurs, equity markets will launch. As can be seen from the graph to the left however, the current level of job creation remains subdued relative to previous economic recoveries, where job growth year on year exceeded 3% - 4%. This will need to change for our view to come to fruition.



Source: Morgan Stanley

In Europe, economic data releases continued their positive trend as the manufacturing PMI increased to 56.8 from 55.3, although the services PMI slipped from 55.4 to 53.7. The ZEW survey of economic sentiment in Germany also increased, rising from 13.8 to 15.5. This is a highly correlated indicator to German GDP (see graph) and continues to point to stronger growth, notwithstanding that third quarter GDP remained unrevised at 1.9%. Also highly correlated to the ZEW survey is the German IFO business climate survey which increased from 109.3 to 109.9 (record high).

German industrial production also rose on a year to year basis by 6.9% although consumer confidence fell to -11.0 from -9.4, which appears to be at odds with retail sales which rose by 0.8%.

Government fiscal plans across the periphery

% oya for GDP and CPI, % of GDP for deficits and debt

	2009	2010	2011	2012	2013
Greece					
GDP	-2.3	-4.2	-3	1.1	2.1
CPI	1.3	4.6	2.2	0.5	0.7
Deficit	-15.4	-9.4	-7.4	-6.5	-4.9
Debt	126.8	142.7	154.7	158.4	159.2
Ireland					
GDP	-7.6	0.2	0.9	1.9	2.4
CPI	-1.7	-1.6	-0.5	0.2	1.3
Deficit	-11.8	-12.6	-10.5	-8.6	-7.5
Debt	65.5	98.9	112.8	120	124.5
Portugal					
GDP	-2.6	1.3	0.2	1.3	1.7
CPI	-0.9	1.3	2.2	1.9	2
Deficit	-9.3	-7.3	-4.6	-3	-2
Debt	76.1	82.1	86.6	86.6	85.5
Spain					
GDP	-3.7	-0.3	1.3	2.5	2.7
CPI	-0.2	1.7	1.8	2	2
Deficit	-11.1	-9.3	-6	-4.4	-3
Debt	53.2	62.8	68.7	70.2	70

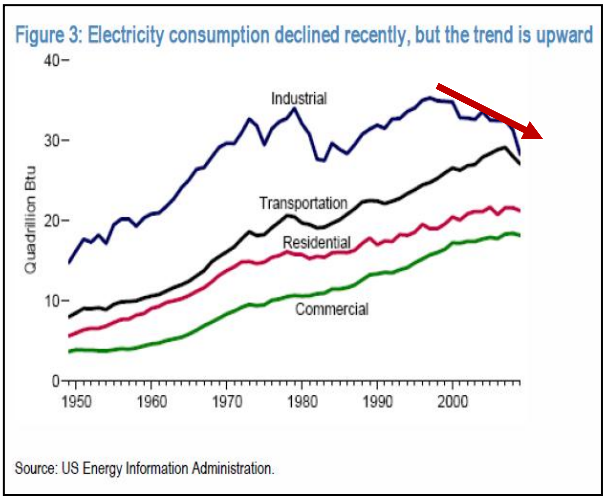
Note: IMF projections for Greece and Ireland.

The issues with Europe remain with peripheral countries like Greece, Portugal, Ireland and Spain. It is essential that the ECB implement the necessary structures and policies to ensure fiscal sustainability of the region if it is to persist in the future. While 2011 remains a challenging year economically for Portugal, Ireland, Greece and Spain, it will also be essential for the ECB to make available funding to these countries at subsidised rates in order to enable them to recover fully.

The role of China remains critical in this stage of the global economic recovery and any material slowdown in growth and demand from the region would have far-reaching consequences. Currently economic releases from China remain strong with exports rising 34.9% while imports jumped 37.7%. The increase in imports helped narrowing the trade surplus to US$23 billion from US$27 billion last month. The key focal point remains inflation, which exceeded expectations and saw the PBOC hike interest rates by a further 0.25% to 5.8% and also increased banking reserve requirements by an additional 0.5%.

Out The Box / Food for Thought

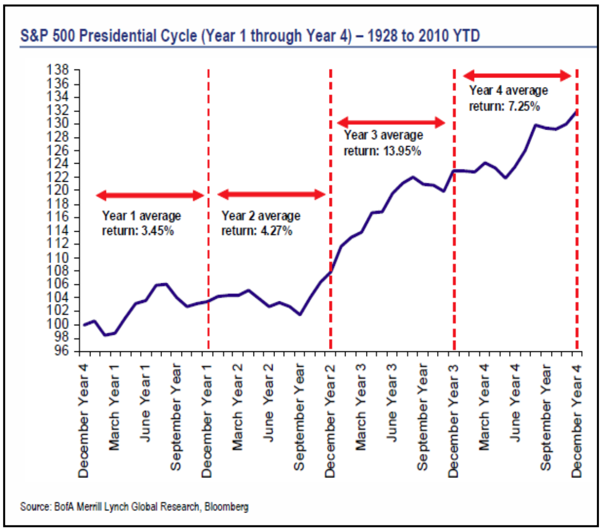
- **US Energy Consumption (Source: JP Morgan)**



The graph shows energy consumption in the US by different users. What is fascinating to note is the continuous decline in energy consumption since the mid 1990's for the industrial sector. While the other sector declines can be explained by more cyclical factors such as the recent global financial crisis, the industrial sector seems to be more secular.

The obvious cause of this secular downtrend in energy consumption in the industrial sector relates predominantly to the outsourcing of US manufacturing to China. This has some interesting infrastructural impacts such as the reduced need in the US and the increased need in China, to build power utilities. We see this in our General Electric research which shows strong demand from China and India for power generation plants.

- **US Presidential Cycle and Market Returns (Source: BofA Merrill Lynch)**

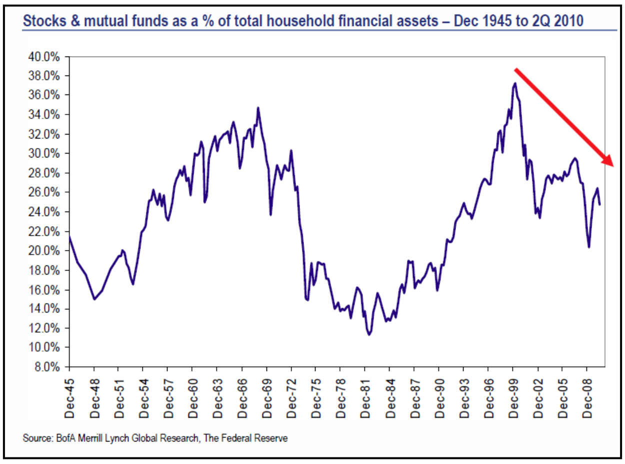


The US presidential cycle has a strange but relatively well known behavioural effect on S&P 500 returns. What the analysis by Merrill Lynch shows is that during the first two years of a president's term, market returns are usually below average while in the third year, market returns are well above average.

This can be seen from the graph to the left which shows the average returns for the S&P 500 from 1928 to 2010 for each year of the presidential term. It is clear from this graph that the first two years returns are way below the long term average of 9.8%. The third year market returns are however materially higher than the average. This is not voodoo but more about investor sentiment. If you think about it, this effect is relatively intuitive, and pertains predominantly to investor's need for certainty.

During the first two years of a presidential cycle, a new president tends to make many policy changes, creating an uncertain backdrop to invest in. During the third year, most presidents are in the implementation phase of their appointment and so very few changes are expected. Accordingly markets perform. The last year is always uncertain as the old president and the potential of a new president leads to a more tepid performance. If history is anything to go by, and given that this is Obama's third year, this should be a good year for equities. Since 1931 to 2007, third year performance has been positive 17 out of 20 years or 85% of the time. The average return over this period was 13.95%.

- **Average US Household Exposure to Stocks (Source: BofA Merrill Lynch)**



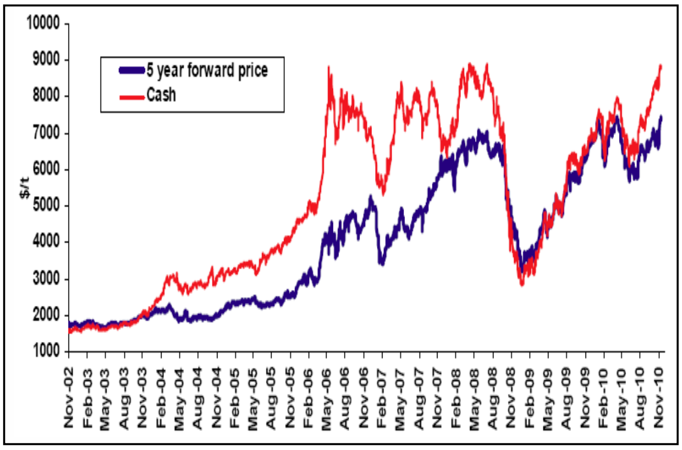
The graph to the left shows that the average household in the US has reduced their net exposure to equities since peaking in 1999 from 38% of assets to approximately 24%. This reduction is fully understandable given all the material events that have occurred in equity markets over the past decade (tech bubble bursts, 9/11, bear market that fell >35% until March 2003, the global financial crisis and the one-day 10% crash this year.)

While these events have justifiably damaged the investor psyche with respect to investing in equities, as economic growth starts to increase and employment improves, this will improve and provide an underpinning to the next decade of equity returns.

Thematic Research – Copper Supply Shortages

I want to end off this month's report by sharing a summary of some of our recent research and insights into the copper industry, a theme underpinned by growth prospects in emerging markets, especially China and India. Our view remains that it is better to invest in the companies that are providing the bricks and mortar to develop these nations than to invest in them directly. This view is supported by the tech boom and bust where investors who bought dotcom companies were left with nothing.

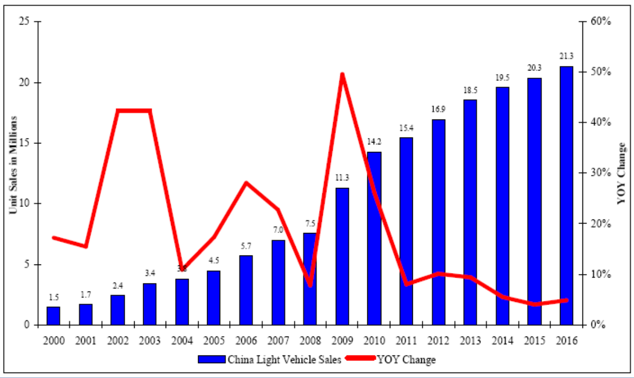
Copper Prices - Source: LME



Notwithstanding the dramatic price increase copper has experienced over the past eight years (see above graph), the investment in bringing on additional supply has not kept pace with the rapid rise in demand. Copper is an essential metal used in many industries such as building and construction (>50% of demand) (power cables, plumbing, air-conditioners), home appliances (>25% of demand) and the auto industry (>6% of demand). These industries have seen material increases in copper demand as China, and now India, have rolled out huge infrastructure projects. Furthermore, consistent with our 'Emerging Middle Class' theme, over the next decade an additional one billion middle class consumers will arise from emerging markets. This tailwind will fuel a material increase in home appliances and cars and thereby further increase the current levels of demand for Copper.

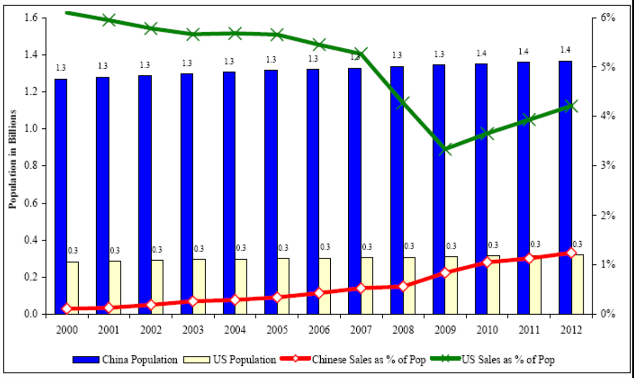
To put this in perspective, looking at the automotive industry, according to the ICA, a typical vehicle contains over 23kg of copper. Credit Suisse estimate that global light vehicle production for 2010 will be close to 70 million units implying demand of over 1.4Mtpa or 6% of supply. Looking at the opportunity in China the graphs below show that by 2013 the Chinese auto market will exceed the highest annual sales achieved in the US and will exceed Europe. While growth is expected to moderate from levels that have exceeded 10% p.a. for the past decade, vehicle sales in China have a long way to grow on an absolute level before they reach a level similar to the US when looking at it from a % of population basis (right hand graph – green (us) red (china) lines).

Figure 36: Chinese Light Vehicle Sales



Source: IHS Automotive (CSM Worldwide)

Figure 37: Sales as a Percent Population in China and U.S.



Source: IHS Automotive (CSM Worldwide)

Source: Buckingham Research Group

To further exacerbate the current supply shortages of copper, two large financial institutions are currently applying to list copper exchange traded funds. While the timing of this is uncertain due to regulatory issues, one institution has as of January, already purchased US$1 billion of Copper or some 107,000 tonnes (0.50% of supply).

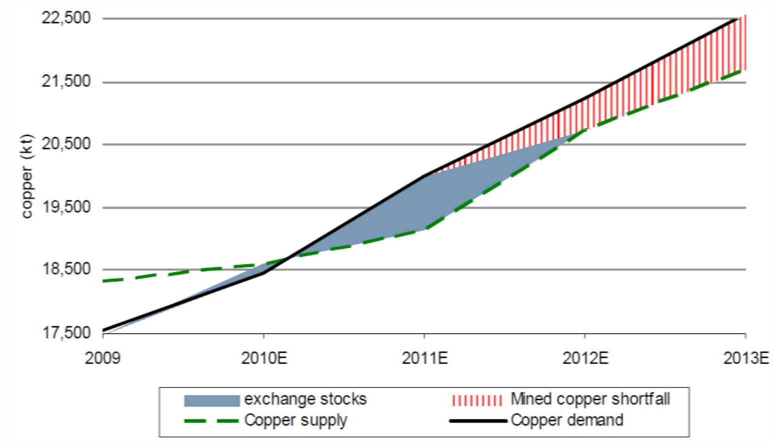
So just how bad is the current shortage? The table below details the current demand/supply expectations for the next four years by region. What is clear from the table is that demand and pricing is very dependent on China, which currently consumes close to 40% of annual copper production.

Refined Copper: Market Balance and Price Outlook		2009	2010E	2011E	2012E	2013E	2014E
Consumption:							
OECD Countries	('000t)	6,821	7,148	7,535	7,770	7,837	7,847
China	('000t)	6,137	6,843	7,424	8,018	8,580	9,137
Other Emerging Mkts	('000t)	3,832	4,368	4,614	4,826	5,046	5,272
Global	('000t)	16,790	18,359	19,573	20,614	21,462	22,256
% change		*-5.5*	*9.3*	*6.6*	*5.3*	*4.1*	*3.7*
Supply							
Global	('000t)	18,092	18,365	19,417	20,410	21,219	21,833
% change		*0.2*	*1.5*	*5.7*	*5.1*	*4.0*	*2.9*
Surplus/(deficit)	('000t)	**1,302**	**6**	**-155**	**-204**	**-243**	**-423**
Inventory / Consumption	(days)	21	21	17	15	13	12
Annual average price	(USc/lb)	**234**	**338**	**404**	**413**	**418**	**425**

Source: CRU International. GS&PA

While new mining production is forecast to come onboard over the next few years, the rate of growth in demand is likely to exceed this supply, thus maintaining the current supply/demand imbalance.

Figure 5: **Mined copper shortfall to be filled to prevent negative stock balances**



Source: Credit Suisse estimates

Another important swing factor is 'normal lost production' due to mine outages which is estimated at 750k tons for 2011. While this is higher than levels seen in the early 2000's, it is lower than that lost over the past 5 years (average over 1,000 tons) and could lead to shortages being higher than depicted above.

Looking at it graphically it is clear to see that the shortfall is expected to increase dramatically over the next 3 years (red shaded area) and hence provide a solid underpin to copper pricing and profitability for copper miners like Xstrata and Freeport McMoran.

We have decided to adjust the format of our monthly reporting so as to be able to share more information on the companies we invest in. The current format which tends to be economically focused will now shift to a format where the monthly report will provide detail on our thematic research ideas as well as provide information on the companies we are invested in.

In conclusion, our view is that 2011 will be a good year for investing in equities as the global economy finally stabilises after the severe turmoil created by the global financial credit crisis of 2008. We would not be surprised for equity returns to exceed 12% next year as earnings growth of 11-15% and reasonable valuations provide a solid catalyst for returns.

As always we welcome your feedback and questions.

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 cyclicality of oil, but also looks to a future where this cyclicality 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.