

NAOS ABSOLUTE RETURN FUND



MAY 2010

Fund Objective

Investment objective for the Naos Absolute Return Fund is to outperform the UBS Bank Bill Index over a rolling three year period in any market environment.

Market Overview

May was a volatile month for equity markets worldwide, with Macro-economic issues of Euro-zone sovereign debt and a potential 'European fiscal crisis' on the forefront of investors' minds. Any negative commentary sent stock prices tumbling as nervous investors resorted to safe-haven investments, with many believing a global financial crisis double dip is imminent. The sharp correction was exacerbated on May 6th when a computerised selloff triggered the biggest drop during a trading day in Wall Street history, closing down 300 points. Following this, markets trended downwards for the rest of the month with apprehension around whether the Greek bailout would be approved by the IMF and ECB.

Australian equity markets also endured the consequences of a proposed federal government 40% Resource Super Profit Tax (RSPT). Resource stocks plummeted following the news, which wiped significant value off the Australian equity market.

The ASX200 closed down 7.44% and the Small Ordinaries Index down 7.37% despite a late rally. At the lows on May 25, the ASX200 and the Small Ordinaries were down over 10% each. To highlight the negative effect of the RSPT; the Canadian S&P/TSX Composite Index (a similar resource economy to Australia) was down 6% in May. The ASX200 experienced its biggest correction since entering the post-GFC 'bull market' and from a 2010 high of 5024 on 15th April it was down 13% at its low on May 25th.

The Small Ordinaries Index told a similar story, down 17% at its May 25 low from its 2010 high of 2724 on January 11th.

In domestic economic news the RBA again raised interest rates by 25 basis points, to a level deemed 'neutral' in the current economic climate. Rates are expected to remain on hold in the short term but are tipped to reach 5% by the end of the year.

Investment Performance Net of Fees

	Three Months	One Year	Three Years	Five Years	Since Inception
Naos Absolute Return Fund	5.16%	3.73%	8.93%	3.12%pa	3.97%pa
UBS Bank Bill Index	1.07%	3.77%	5.60%pa	5.79%pa	5.78%pa
Value Added (NARF vs. Bank Bill Index)	-6.23%	-7.05%	-14.53%pa	-2.67%pa	-1.18%pa
ASX All Ordinaries	-3.33%	21.41%	-7.21%pa	6.20%pa	6.18%pa

Top 5 Holdings as at May 2010

CUDECO LIMITED (CDU)
LIHIR GOLD LIMITED (LGL)
QUBE LOGISTICS (QUB)
RIO TINTO LIMITED (RIO)
COMPUTERSHARE LIMITED (CPU)

Fund Performance

The NAOS Absolute Return Fund struggled to gain any traction in May falling by -9.03% compared to the All Ordinaries which fell -7.57%. Overall throughout May the funds positions have remained relatively unchanged and the view looking forward remains reasonably bullish based on valuation grounds.

The fund has built an overweight position in high quality resource companies such as BHP and RIO, as the risk of earnings surprises is very much to the upside when we take into account these stocks are trading below long term NPV, and the high possibility the Resource Super Profits Tax will be amended in the near future. The fund also positioned itself to take advantage of the expected upswing by investing in smaller resource stocks such as Gindalbe Metals and Lihir Gold.

The investment team continues to believe stock markets remain relatively undervalued on 12month view, with the ASX-200 trading as just a 12month forward P/E of 12 which is 30% below its historical average. Even though there are a number of Macro headwinds, as long as the fundamental valuations of these companies remain in tack, the All Ordinaries Index should find a base near term and push higher over the next 12 months. The key for many companies will be to take advantage of the cost cutting they have completed in the previous 12 months and look for ways to increase revenue and take advantage of the lower cost base.

Further Information - Sebastian Evans, Fund Manager

Thank you for your support and please feel free to contact a member of the NAOS team if you have any questions.