

## What was the Question?

The last 18 months have seen a significant shock to global financial markets and the investing environment has changed substantially. In light of these events, the focus of this newsletter is to answer some of the questions we regularly receive from investors.

### What do Prime Value currently perceive as the biggest risks facing investors?

To state the obvious, the key risk for investors is that the market falls further and/or that the recovery, when it happens, is sluggish or drawn out. While this scenario is not our central case, there remains a great deal of uncertainty, and further bad news could quite easily see previous lows re-tested. Apart from the "shocks" associated with asset write-downs, bad debt charges and corporate collapses, a failure of Chinese growth to regain momentum would signal a dramatic shift in our global growth outlook and would be particularly detrimental for Australian investors.

### What risk management framework do Prime Value currently have in place to defend against current volatility?

We see the key to risk management as being our investment philosophy "the minimisation of mistakes". Everyone makes mistakes by investing in companies that under-perform or fall in value. However, by researching a potential investment thoroughly, preferring companies that are more transparent and avoiding companies with complicated and incomprehensible organisational structures, we automatically reduce the risk in the portfolio. Being index "unaware", we do not have to hold a stock just because it is part of the index.

In a market when virtually every company is experiencing price falls, avoiding mistakes will not fully protect against losses. In these times, having a defensively positioned portfolio, with stocks offering a stable and certain earnings stream, transparent balance sheet and good management, provides some stability. Our cash position has also provided protection in volatile times.

Other ways we manage risk (in all market conditions) involve maintaining a well-diversified portfolio, by the number, size and class of investments, and employing a highly qualified, experienced and stable team with a simple and well-understood investment philosophy.

### How has Prime Value managed to outperform its peers over the past 10 years?

The shareholders and investment managers of Prime Value are cornerstone investors, which means the culture of the business is focused on investment performance and stewardship. This alignment of interest with investors differentiates us from some of our peers from the very beginning of the investment process.

We recently produced a brochure explaining 10 good reasons for our 10 years of out-performance. Have a look at our website or ring us for a copy.

### What is the biggest risk associated with Prime Value relative to its peers?

Prime Value is a boutique funds manager. There are many advantages to being boutique, including flexibility, broad investment universe, more concentrated portfolio, potential for higher returns, more personalised service etc. But there are some risks as well. The key risk would relate to being index-unaware. This means that there is the potential for the deviation from index returns to be negative instead of positive. This could particularly be the case when we have used a sectoral tilt too early in the cycle, or had an investment in one or more stocks that underperformed.

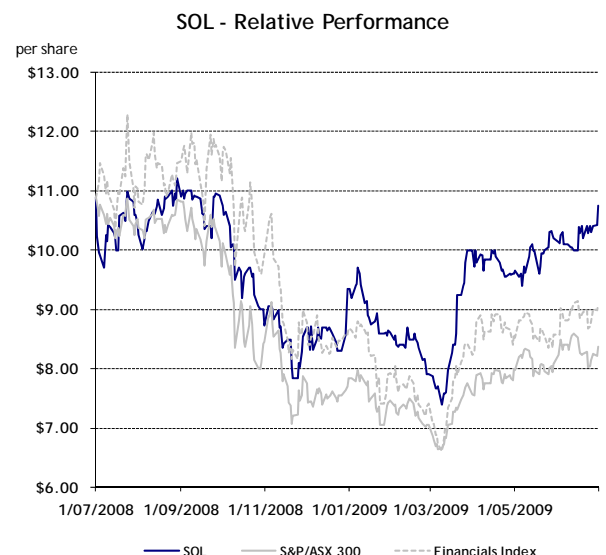
### Assuming the worst is over, how do you see the nature of its recovery - steady, steep, sector biased?

This is almost impossible to know as there are a number of conflicting issues affecting key market factors. However, our central scenario is that, following strong recent gains (of almost 30%) equities will range trade with a positive but generally lack-lustre trend. Investors should prepare themselves for modest returns over the next 2-3 years. See the outlook commentary of page 4 for more details.

### Could you tell us about a stock which you have bought or sold; and explain why?

During the half-year, we added Washington H Soul Pattinson and Co Limited (SOL) to the portfolios. SOL is an investment company with a myriad of holdings including coal mines, building materials, pharmacies and telecommunication. It is trading at some 30% discount to NTA (which has a ready market value) and is expected to pay a special dividend resulting from the sale of assets at very attractive prices.

We have also increased our holding in Westpac Bank (WBC), partially reducing our underweight position in the financial sector. Westpac is a solid, domestic focussed bank. It is well run and reasonably valued.



# PRIME VALUE GROWTH FUND

The Growth Fund aims to provide superior medium to long-term capital growth, with some income, by managing a portfolio of predominantly Australian equities.

For the six-months ended 30 June 2009, the Fund achieved a return of 9.8% compared with the benchmark S&P/ASX 300 Accumulation Index return of 9.4%.

Sectoral allocation (excluding cash) contributed to performance, with the Fund benefiting from underweight positions in the Telecommunications, Healthcare and Financials sectors. This benefit was partially offset by an overweight position in the Industrials sector. In addition, the Fund maintained higher than normal levels of cash due to our cautious outlook and this was a significant detractor from performance in a strong market. We are unrepentant for this

however, and feel this was the correct position in volatile market conditions.

Stock selection was also positive for the half-year. The biggest contributors to performance were in the mining and mining services industries, including Monadelphous, BHP Billiton, Orica and Worley Parsons. The companies which detracted from performance were QBE Insurance, Telstra and Australian Agricultural Company.

Average annual returns for 1, 3, 5 and 10 years are now -17.6% (benchmark -20.3%), 1.7%pa (-3.9%pa), 14.0%pa (6.8%pa) and 16.7%pa (7.1%pa) respectively.

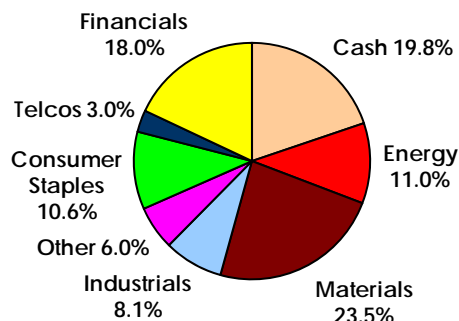
## Portfolio Outlook

While we feel more confident about the outlook for equities than we did 6 months ago, we retain a cautious stance. Subse-

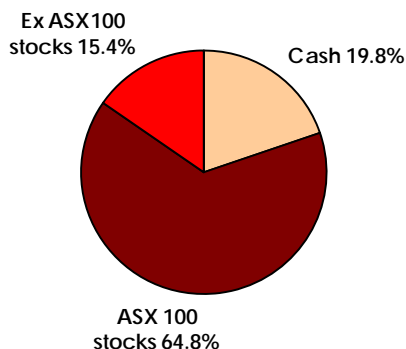
quently, we have lowered our cash position from around 30% to 20% currently. We believe the Australian banking sector is in a relatively healthy position, however conditions may remain difficult in the shorter term. We therefore maintain an, albeit reduced, underweight position in the Financial sector.

We remain positive towards companies which service the energy sector. We feel this period of uncertainty may provide some opportunities for smaller and mid-cap companies and we will be observing this sector closely. Our focus continues to be high quality defensive companies with a growth component and strong balance sheet.

## Holdings by Sectors



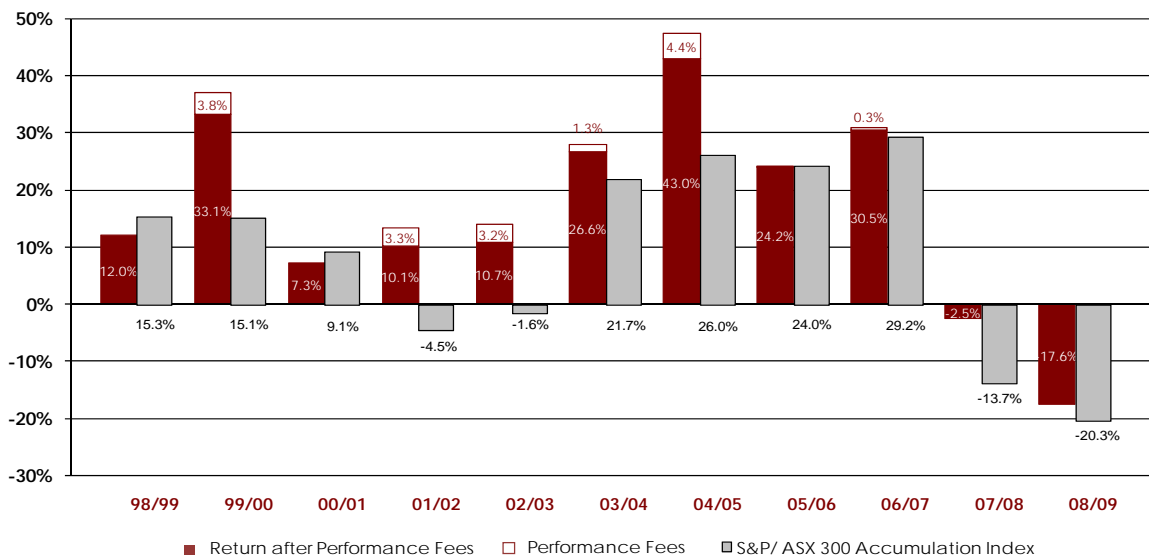
## Holdings by Market Cap



## Top Five Holdings

Name	Sector
BHP	Materials
National Australia Bank	Financials
Orica	Materials
Westpac	Financials
Woolworths	Consumer Staples

The portfolio is generally comprised of 30 - 60 stocks.



## Historical Performance (Class A Units)\*

Annual Return of PVGF and S&P/ASX Accumulation Index by Financial Year. This shows the performance of the PVGF for each discrete financial year, demonstrating consistently superior & positive returns. The Fund out-performed in 9 out of the last 11 financial years.

\* Past performance is not necessarily an indicator of future performance

## Distributions (Class A Units)

	2004/05	2005/06	2006/07	2007/08	2008/09
Distribution (per unit)	\$0.1586	\$0.1097	\$0.1632	\$0.1218	\$0.0635
Distribution (% of Unit Price)	7.2%	4.4%	5.4%	3.8%	2.8%
- Grossed-up (includes Imputation Credits)	7.8%	5.0%	6.1%	4.5%	3.9%
Imputation Credit (per unit)	\$0.0128	\$0.0143	\$0.0226	\$0.0223	\$0.0249
Franking Level (%)#	18.8%	30.4%	32.3%	42.8%	91.5%

# The "level of franking" is a measure of the grossed-up imputation credit relative to the total distribution made. Unlike the franking level of a company's dividend however, the "denominator" includes not just dividends, but realised capital gains as well. In times where capital growth is strong, distributions are likely to be higher, and the "level of franking" will be proportionately lower. This does not necessarily mean that dividends received were low or that they were not highly franked.

# PRIME VALUE IMPUTATION FUND

The Imputation Fund aims to provide capital growth over the medium to long term, combined with regular, tax-effective income, by managing a portfolio of assets comprised mainly of Australian equities.

For the six months ended 30 June 2009, the Fund achieved a return of 11.2%, outperforming the benchmark return of 9.4%. The Fund's sectoral tilt was mildly negative, as the Fund was overweight in Industrials and underweight in Materials. This was partially offset by underweight positions in the Telecommunications and Healthcare sectors. A significant detractor at a sectoral level was a higher than normal level of cash due to our cautious outlook. We are unrepentant for this however, and feel this was the correct position in volatile market conditions.

Stock selection more than offset the negative impact from sectoral allocation, adding almost 4% to relative performance. The biggest contributors to performance included Monadelphous, Wesfarmers and Westpac Bank. The detractors included QBE Insurance, Qantas and AGL Energy.

Average annual returns over 1, 3, 5 and 7 years are now -21.5% (benchmark -20.3%), -5.6%pa (-3.9%), 5.1%pa (6.8%pa) and 13.7% (7.5%pa).

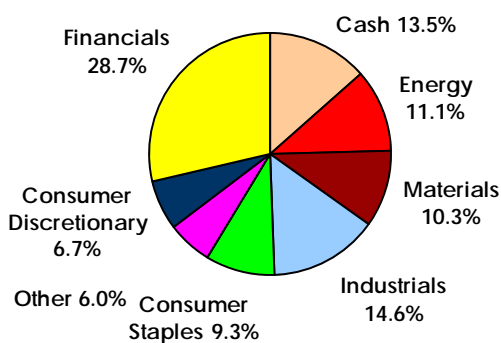
## Portfolio Outlook

The Imputation Fund will remain "true to label", meaning it will continue to focus on stocks offering a degree of both earnings certainty and dividend income certainty, with a bias towards a higher stream of tax effective income. These stocks should offer

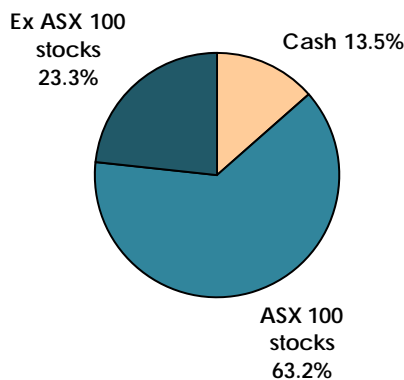
superior opportunities in a low interest rate, highly volatile environment. The portfolio currently favours the higher yielding energy and mining services companies and conservatively geared defensive industrials. While underweight relative to the benchmark, the Fund will maintain a core holding of quality banks due to the strong yield and high level of imputation.

We will continue to avoid domestic cyclical experiencing earnings pressure or with weak balance sheets, and will maintain an underweight position in low-yielding materials companies, which do not fit with the imputation fund mandate. Despite having a more positive outlook, we remain cautious over the short terms and cash holdings remain at higher than normal levels.

## Holdings by Sectors



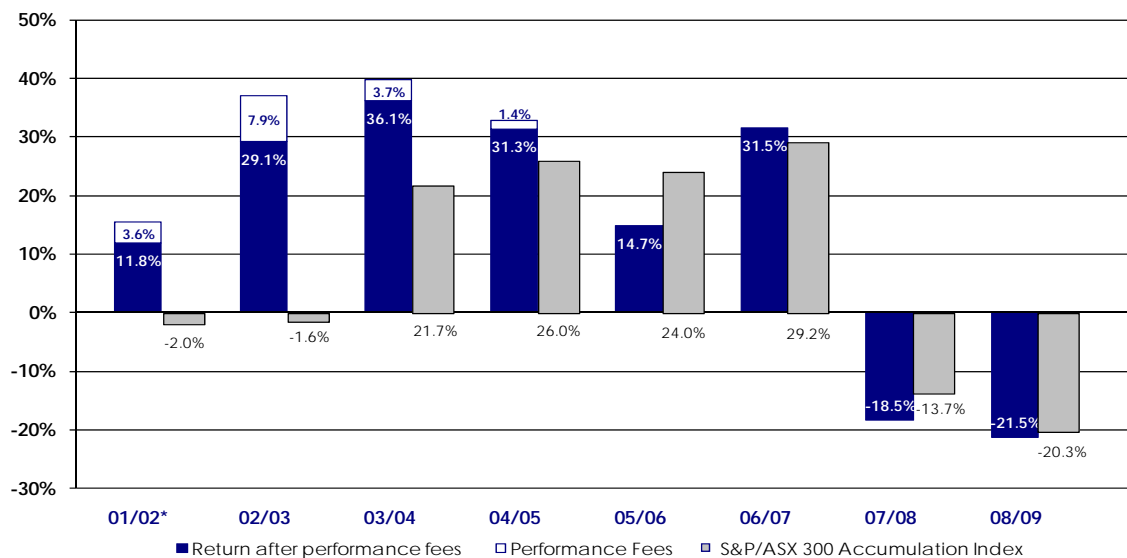
## Holdings by Market Cap



## Top Five Holdings

Name	Sector
Monadelphous	Industrials
National Australia Bank	Financials
Santos	Energy
Wesfarmers	Consumer Staples
Westpac	Financials

The portfolio is generally comprised of 30 - 60 stocks.



## Historical Performance (Class A Units)#

Annual Return of PVIF and S&P/ASX 300 Accumulation Index by Financial Year. This shows the performance of the PVIF for each discrete financial year and demonstrates the PVIF has consistently delivered superior, positive returns. The Fund out-performed in 5 out of the last 8 financial years.

# Past performance is not necessarily an indicator of future performance

\* The return for 2001/02 is for the period from 20 Dec 01 to 30 Jun 02

Distributions (Class A Units)	2004/05	2005/06	2006/07	2007/08	2008/09
Distribution (per unit)	\$0.1238	\$0.1536	\$0.1849	\$0.1527	\$0.0923
Income Distribution (% of Unit Price)	5.1%	5.9%	6.0%	5.3%	5.2%
- Grossed up (includes Imputation Credits)	6.1%	6.9%	7.4%	6.8%	7.6%
Imputation Credit (per unit)	\$0.0247	\$0.0273	\$0.0427	\$0.0410	\$0.0431
Franking Level (%)#	46.6%	41.5%	53.9%	62.7%	109.0%

# The "level of franking" is a measure of the grossed-up imputation credit relative to the total distribution made. Unlike the franking level of a company's dividend however, the "denominator" includes not just dividends, but realised capital gains as well. In times where capital growth is strong, distributions are likely to be higher, and the "level of franking" will be proportionately lower. This does not necessarily mean that dividends received were low or that they were not highly franked.

## Dear Investor, Company Update

The Prime Value team have been busy over the last six months. Andreas Rosenau, Senior Equity Analyst, completed his Chartered Financial Analyst course recently, while Fiona Clark, Senior Investment Analyst and Manager - Investor Relations, completed her Diploma in Financial Services (Financial Planning). Victoria Scholz, Client Services Officer, is also more than half way through completing her Diploma in Financial Services (Financial Planning). The management team congratulates Andreas, Fiona and Victoria on their achievements.

### Prime Value Growth Fund

The Growth Fund again out-performed for the full-year, despite a negative return. Performance for the 2008/09 financial year was -17.6% compared with the S&P/ASX 300 Accumulation Index (benchmark) return of -20.3%. This is the 8th consecutive year of outperformance.

The key reasons for the Fund's out-performance was superior stock selection, particularly amongst the mining and mining services companies.

### Prime Value Imputation Fund

The Imputation Fund had another disappointing full-year, achieving a return of -21.5% compared to the benchmark return of -20.3%. However, the Fund finished with very strong performance in the second half, with relative performance improving greatly.

The Fund also managed a very attractive average annual grossed-up distribution yield of approximately 7.0% over the last 5 years, testimony to its tax-effective focus.

### Investment Review 2008/2009

The Australian equity market experienced one of its worst downturns during 2007/08, with the S&P/ASX300 Accumulation Index falling by more than 20%. There were two distinct phases: initial increased weakness as a result of the deepening global financial crisis, followed by a strong rally of more than 30% after lows were reached in March. (Approx 60% in US\$ terms).

The year was characterised by a sharp economic downturn, high-profile corporate failures and a plethora of earnings downgrades as the deteriorating credit and economic conditions began to affect businesses. The financial crisis and resulting "real" economic fall-out was met with a global and co-ordinated response. Central banks cut interest rates (the Reserve Bank of Australia cut official interest rates from 7.25% to 3.0%) and governments increased spending and offered credit support measures to stimulate demand and improve confidence in the financial system.

The turning point, an acceptance that the financial system would not collapse, was accompanied by an apparent slowing in momentum in the deterioration of economic indicators. In other words, things were still getting worse, but they were getting worse at a slower rate. These "greenshoots" led to improving sentiment and a quick rebound in equities. At the end of the year, however, confidence in the rally was beginning to wane and the market rebound appeared to have stalled.

### Investment Outlook

The outlook for domestic and global economies and their respective markets remain extraordinarily uncertain. The turn-around in March was driven by relief that the global banking system was not going to collapse. This is not to say that the banks will return to strong profitability and recovery is imminent. The second wave of credit defaults, as the slowing economy hits businesses, is only starting to be felt. In addition, the willingness of consumers to borrow money, a major source of bank profits, has received a major structural blow. Despite this, there is universal acceptance that the system will not fail and the news on this

front, with bank sector profits surprising on the upside and "rescue" funds being repaid, continues to be encouraging. So we are confident the March low will remain the March low.

However the shape of any recovery (V, U, L or take your pick) is dependent on a multitude of conflicting "forces".

Firstly, the "good" or positive forces. These include

- the large efforts of governments and central banks around the world, using their respective weapons - lower interest rates and increased fiscal spending
  - growth from China and other developing countries, with massive populations aspiring to be in the middle-class
  - sentiment, which has shown a significant recovery now that the market appears to have bottomed
- Then we have the "bad" or negative forces
- reduced spending; by the growing number of unemployed, by the soon-to-be-unemployed or think-they-soon-may-be-unemployed
  - de-leveraging, where households set aside income as savings or payment of existing debt. The de-leveraging process is likely to be a multi-year rather than a short-lived phenomenon
  - capital raisings, with some \$42 billion raised so far this year. Companies don't need capital to expand due to strong economic conditions. More likely they are preparing for lean times ahead. The supply of shares, which will continue while the market is buoyant, may stifle market performance.

The sharemarket is a strange beast indeed. It is very difficult to draw a causal relationship between some forecasted economic scenario and the actions of the market (except with hindsight, of course!). Nevertheless, it seems reasonably clear that if the economy fails to show any sign of recovery in the next six months or so, shares are unlikely to do well.

The good and bad forces will battle on until one builds enough momentum but we won't know which one until the battle is well and truly over. For the next half-year, our view is that shares will range-trade with an upward trend and volatility will continue. It will likely be a "3 steps forward, 2 steps back" type of progression, where the emergence of bad news will create panic one day and a good economic statistic will create euphoria the next. The upcoming earnings season, for example, may see further downgrades and disappointments.

Since March, the rally has prompted a major rotation of performance, with the cyclicals (such as materials, energy and industrials) outperforming and defensives (such as healthcare and staples) lagging.

Strategically, Australia is in a good position to access the China growth story. Around 50% of the growth in Australia's real income in recent years has been due to China and other emerging markets in Asia. Our real income growth of 5-6% p.a. was much faster than in other countries due to the surge in commodity prices on the back of Chinese and Indian growth.

Furthermore, Australia has strong banks, a well regulated financial sector and a strong and well functioning public sector.

Both the Prime Value Growth Fund and Imputation Fund are well placed to take advantage of these positive factors.

We thank you for your continued patience and support and welcome any feedback or queries about your investment.

Han K Lee  
Managing Director

Y Yong Quek  
Executive Director