<u>Martin Raymond Real Return Fund</u> – September 2004 monthly report

NAV/unit rose by 1.1% during September, and since the fund's inception on 1st November 2003, the NAV/unit has gained 15.4%. At the end of September, the fund owned securities in fifteen companies and 45% of the fund was in cash.

The fund underperformed the booming Australian market, which rose 3.8% during the month, but outperformed the world index, which fell 1.4% in $A terms. The main reason for this was our high cash weighting, kept in $A.

I have found several new potential investments during the month, and added four new names to the portfolio. Unfortunately, most of the securities I would like to buy are illiquid, and I am having trouble buying as quickly as I would like. The fund has buying orders with brokers worth over 25% of the portfolio.

The main stock-specific events during the month were:

Bangkok Land bonds (7.9% of the fund) rose from 32.5% to 36% of face value for no obvious new reason.

MCI (7.4% of the fund) fell 2.7% after Leucadia National Corp sold its 5% stake for a small profit. The sale disappointed me and I was surprised that the share price fell as little as it did.

Petrosea rose 34% during the month, and has now doubled in two months. The reason for this month's rise was the announcement of a special dividend. Early in the month I bought some more and after the rise sold a few to reduce the weighting back to 5.2%. Even now, the shares are on an EV/EBIT(1) ratio of about four, which is not expensive considering that the company has considerable growth prospects and its shares are still trading at only 70% of its net asset value.

The fund bought more **Central Exchange**, an investment company, whose principal attribute is that it trades at a 40% discount to its net cash. The fund now has a 3.6% weighting, and I am attempting to buy more of these shares.

Molins fell 14% after a first half loss that was even worse than the market had expected. If the company can be turned around the shares could potentially rise substantially but the high debt and operational uncertainty make the shares riskier than I first thought. Accordingly, I am not planning to add to the fund's current 3.2% weighting.

0.4% of the fund was invested in **option positions** on Rio Tinto and the Commonwealth Bank. I bought equal numbers of put and call options on each company. The reason I did this is that the price of volatility (as reflected in the options markets) in the US and Australia is now very low, relative to historic volatility. I believe that both Rio Tinto and the Australian banks are considerably riskier than current option prices imply.

If volatility remains low, then I intend to buy more options over the next few months. My objective is to buy options covering a range of different equities and with a range of expiry dates. I plan to buy at a rate that costs no more than a few percent per annum of the fund, assuming that all the options expire worthless. This is a worst case scenario, as it is unlikely that all the options will expire worthless.

Fred Woollard
6th October 2004

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(1) The EV/EBIT ratio is the ratio of Enterprise Value (i.e. the Market Capitalisation of the shares, less the net cash in the company) divided by the company's Earnings before Interest and Tax.