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January 2009 NTA Release

1. Details of Performance and Net Asset Backing at Month end

The net asset backing (“NTA”) of Fat Prophets Australia Fund Limited (“**Fat Fund**”) as at 30 January 2009 was **\$0.7532 per share** on a before tax basis, calculated in accordance with ASX Listing Rule 19:12, and represents a decrease of 5.68% over the month. By comparison, the Fat Fund’s benchmark, the S&P/ASX 300 Accumulation Index declined by 4.84% in January 2009.

After adjusting for the impact of taxation on both realised and unrealised gains, the Fat Fund’s after tax NTA at the end of January 2009 was **\$0.8481 per share**.

2. Performance Commentary

The major influences on the Fat Fund’s performance versus the benchmark during the month of January 2009 were as follows (* denotes acquired during month):

Positive Influences			Negative Influences		
<i>Company</i>	<i>% move</i>	<i>Position</i>	<i>Company</i>	<i>% move</i>	<i>Position</i>
Allco Equity Partners	18%	Overweight	CSL Limited	11%	Underweight
SP Telemedia	28%	Overweight	Beach Petroleum	-19%	Overweight
Alt Invest Trust	9%	Overweight	Mundo Minerals	-31%	Overweight
Ambition Group	59%	Overweight	GPT Group	-17%	Overweight
Origin Energy	-13%	Underweight	Guinness Peat Group	-21%	Overweight

One of the downsides of living in a country of only twenty million people, concentrated in a few cities, is that it leads to in-breeds. Rarely of the less palatable type, but more frequently, folk who all think the same. The best example, in financial market circles, are of course, economists – a group who very rarely deviate from a view espoused from Martin Place, for fear of having its access to rubber chicken and cheap wine brutally removed. Plus a quick call to the boss to “bring one back into line”. Hence, the almost universally incorrect views of interest rates through the first seven months of 2008.

Now we have a consensus that the world is about to end economically over the next year, despite the 4% cut in interest rates in less than six months, and the Federal Government’s assortment of packages and incentives. Moreover, in the same way that the Australian economy started to tank because ordinary folk couldn’t afford high interest rate mortgages and \$1.80/litre petrol, now that rates are far lower, petrol is just above \$1.10/litre and there is a positive gross yield gap on residential properties in the western parts of Sydney, people are acting more positively. Real estate agents in this part of the world are having record January’s (normally a slow month) – a fact now seen in the latest housing approval data. Hardly surprising, when this has been one of the lousier sub-regions of the worst performing major city property market in Australia over the past seven years.



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Hence, whilst times are certainly tougher than they were, it's clear the consensus view from Vaucluse and Mosman probably reflects the state of their immediate property market, private school and delicatessen owner rather than parts of the greater world out there.

Which, of course, leads to another sort of in-bred thinking – “the money will run out and we have to raise money, no matter what the cost, before the institutions close their doors.” Can't wait to go to the next briefings of one of the money raisers who wheels out a WACC chart or some EVA stuff; the cost of these raisings for a number of companies is astronomical. It probably explains why the raisings fall into three camps – the one's where there is a genuine refinancing reason – Wesfarmers, Suncorp – which the market laps up. A second category is where there is a degree of opportunism, but the pricing is so low, that the market gorges on it – let's call that Tabcorp. And a third basket of others who figure they just have to be there because it's “prudent”. We didn't buy any of those.

There's also an intriguing obsession with what could be classed as largely “theoretical values” of a number of non liquid assets – notably property and intangibles in the current environment, especially where banking covenants are involved. In many cases, the analyst forgets to go back to the basic question – if the loan is performing i.e. the company is paying interest at a suitable rate, including an adequate risk premium – why would you foreclose? We all know that banks tend to be poor sellers of assets, mainly because they have inbuilt LVR security. In the short term, there has been an excessive price to pay for companies who the market perceives must have capital; this will continue a little while but is likely to come to an end once the transaction market gets partly liquid. The problem for investors will be that many of these companies geared on the way down – and then ungeared in the upcycle. Not a good recipe. This, of course, has hurt the Fat Fund in its A-REIT holdings over the past 9-10 months. We are hopeful that after the indigestion of the Westfield issue, the sector starts to move closer to a bottom with share prices now predicting 35-40% valuation declines in prime property for many of the larger players.

However, the most fascinating event in the past month to the Fat Fund managers was the Commonwealth Bank result. For all of the astounding detail now required of these institutions, investing in Australian bank equity really only comes down two things – assuming a continuation of strong cost management which now seems a cultural given amongst these companies. The two things are interest margin – or spread – and bad debts. We accept that volume growth helps, but it's really only setting up the whole loan book for whatever repricing can be wrought upon it at any given time.

The CBA results do show the increasing cost of wholesale funds but also show the margin expansion that was possible despite this – partly in the interest lines, but also in the loan service fee line. Remember, a 9bp shift on a \$400billion book is \$360million per annum. So underlying profits – profits before bad debt charges and tax excluding the “investment experience line” - were **up 24%** over the corresponding six month period a year ago. It's called a strengthening oligopoly. For sure, the bank had to put up with some big name exposures which forgot to pay back what they owed, but the scale of this is not even close to the 1990-92 experience; in any event, many of these big names have fallen over already, very early in the cycle – a vast difference to the early 90's experience. It's hardly surprising to see that CBA management are downplaying returns to shareholders, because it is very clear that whatever the difficulties which may lay ahead in the next 6-12 months, this bank – and we suspect at least three others – are going to emerge from this downturn in amazing shape in respect of cost, margin and probably capital too. Whilst there are clear CBA specifics in the numbers, we think there are clear bullish observations for the rest of the sector.



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Being very overweight Australian banks goes against the grain for a number of investors due to the banks' obvious reliance on capital markets – certainly wholesale (foreign supplied) debt and even equity; but with the Australian Government guarantee providing a major funding assistance, it would appear this cycle will be a very mild one for the "Big Four" - with probably few major distinguishing features between them – except NAB in the UK. That's why we're overweight all of them, in a portfolio which is also overweight major resources securities, notably BHP, and gold shares. A portfolio we suspect, that's a way off consensus. In January 2009, the bank holdings cost a little in terms of performance, as did our oil exposure leading to a modest underperformance against benchmark.

In the past month, we have subscribed to the Tabcorp, Westfield and Suncorp placements, as well as increasing our gold exposure through the purchase of Kingsgate Consolidated, funded by elimination of some smaller holdings.

3. Top 15 Holdings at 30 January 2009

Company	Symbol	% Weighting
BHP Billiton	BHP	16.05
Westpac	WBC	9.56
National Aust. Bank	NAB	8.49
Commonwealth Bank	CBA	6.29
QBE Insurance	QBE	6.13
Woolworths	WOW	5.77
ANZ Bank	ANZ	5.13
Washington H Soul Pattinson & Co LT	SOL	3.06
Beach Petroleum	BPT	2.87
GPT Group	GPT	2.56
Insurance Australia Group	IAG	2.48
Wesfarmers	WES	2.38
ALLCO Equity Partners	AEP	1.84
Rio Tinto	RIO	1.78
Seven Network	SEV	1.75

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a: Andrew Brown and Steve O'Hanna are employees of Tidewater Investments Limited. A controlled entity of Tidewater Investments Limited, Tidewater Asset Management P/L (AFSL# 302802) currently manages the Fat Fund under a sub-contract agreement dated 24 May 2007 with fat Prophets Funds Management Australia P/L.

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