

THRIVE

STRIVING TO PRESERVE CAPITAL AND CREATE WEALTH YEAR ON YEAR

MARKET REPORT

RISK AVERSION RETURNS TO MARKETS

Risk aversion was back in May as global markets retreated sharply and volatility spiked. The MSCI World equity index was down 9.82%, while the All Share Index fell 5.11%. The All Share's drop was cushioned by a Rand that fell sharply by 3.74% against the US Dollar. The Euro suffered a large decline, losing 7.5% of its value against the US Dollar.

The change in market sentiment has been building for a number of months now and has centred around sovereign debt risk. First we had the Dubai World scare, and then Greece and the other Southern European countries came into the spotlight. Bailout packages were announced and for a while markets seemed to accept these and be willing to move ahead. But then markets started asking more questions about the details of what the bailouts actually meant for these countries and how they were going to solve the problems. The result was that what was a €110 million bailout package for Greece last month, ballooned into a nearly \$1 trillion package covering whichever European countries needed it in the course of a matter of days as markets were spiraling out of control. While there was an initial positive reaction to this package, markets have started to realise that you can't solve a debt problem simply by adding more debt to the system or simply shifting it around. At some stage, one has to face the day of reckoning.

A number of events helped to compound the sovereign debt problem. Firstly Australia spoke about a massive tax increase on miners. Then there was a slowdown in Chinese manufacturing. The British election saw a hung parliament and eventual coalition government formed, while Chancellor Merkel announced a ban on naked shorting without consulting any of her European colleagues. There were also tensions rising on the Korean peninsula, a massive oil spill in the gulf of Mexico and US regulators passing certain financial reforms that are likely to completely revamp the banking sector going forward. All of these helped to increase the uncertainty in markets.

Economic data however, continued to improve in both the US and South Africa, giving investors hope that macro events at the moment are simply leading to a pull-back in a bull market. Time will tell whether this view is correct, though one would be inclined to think that with many of the leading indicators having rolled over from their peaks, upward momentum in the markets from here is going to be tough.

The ray of hope for investors is that if one can protect capital through these volatile events, a multitude of excellent investment opportunities normally present themselves. ■

The Blue Ink funds produced the following performance to 31 May 2010

	1 Month	3 Months	6 Months	12 Months	2 Years	3 Years
Big Oak	1.10%	1.69%	6.34%	19.43%	7.64%	15.10%
Blue Ink-ubator	1.07%	3.97%	7.70%	15.42%	36.14%	45.99%
Blue Sky	-0.19%	1.35%	3.51%	8.94%	-5.19%	2.66%
Evergreen	0.10%	2.42%	5.32%	11.65%	20.18%	29.98%
Redwood	0.10%	1.96%	4.61%	9.94%	6.71%	14.28%
ALSI	-5.11%	2.30%	1.98%	21.93%	-9.65%	3.07%

Dear Clients



Brrr – winter has arrived...and along with it, more than 456,000 soccer visitors to celebrate the beautiful game. Lets unite behind our team and country and show our visitors our warm African hospitality!

Hedge funds are an interesting concept – Finweek asked South Africans this month what they thought of hedge funds and responses included “evil bankers” and “reckless traders”. In reality however, South African hedge funds have low volatility relative to South African equities. The Blue Ink All South African Hedge Fund Composite tracks the performance of around 100 funds in SA and shows that hedge funds continue to offer significant protection from volatility. Our investment team uses a world class proprietary risk management system to contain risk in our portfolios and our CIO, Thomas Schlebusch writes this month on understanding the concept of risk.

We profile Rowan Williams of i capital this month, who forecasts better investment opportunities in emerging, rather than developed markets in the medium term. Blue Ink have been investing in Rowan's i capital Nitrogen Fund since late 2007.

The Blue Ink funds performed well in May in an environment where local equities continued to erode investor confidence, with the JSE All Share Index losing more than 5% for the month. The funds continue to add more value at lower volatility levels than SA equities in both the short and longer terms.

Until next month!

Esmarie Strydom

Chief Executive Officer, Blue Ink Investments



Understanding the concept of risk...

Opinion piece by Thomas Schlebusch - Chief Investment Officer, Blue Ink Investments



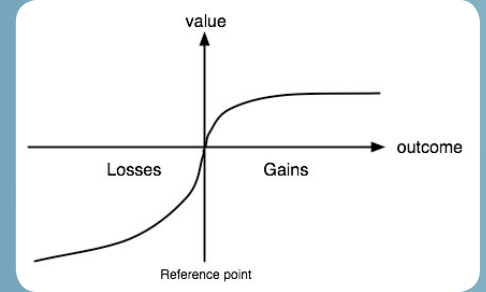
widely accepted measure of portfolio risk is the volatility of returns. In other words, by how much does the performance of a portfolio vary upwards and downwards over a measured period of time. In statistical talk, we commonly refer to this as the standard deviation of a portfolio's returns.

One may question why the variation in returns would be important if one was to be invested for the longer term? Surely absolute loss would be the only important factor? The problem is that the "long term" or the time period over which an investment is held, is a very subjective thing. The timing of investments is less "practical" in reality however, as very few of us know exactly when we will need to withdraw capital from an investment. Withdrawing capital at the peak of an investment cycle, makes the investment period and volatility less significant to an investor than if they were to withdraw capital at the bottom of a bear market. A case in point would be pensioners who wanted to retire at the end of 2008 during the bear market.

The reality is that the "long term" is an ambiguous term. Markets move in cycles and investment values do fall from time to time. If we were to believe the current thinking about the future, i.e. "the new normal" proposed by Pimco and other larger investment houses, then the future investment environment would seem to be one characterised by lower returns and lots of volatility.

Although outside the scope of this discussion, another problem with risk is the fact that investors have a psychologically biased experience of losses vs gains, as proven by Kahneman & Tversky in their Nobel winning research on *Prospect Theory*. In their work they showed that investors feel a relatively higher utility (pain) for every unit of loss than for every unit of gain (pleasure). In other words,

investors perceive loss differently than what they do with gains.

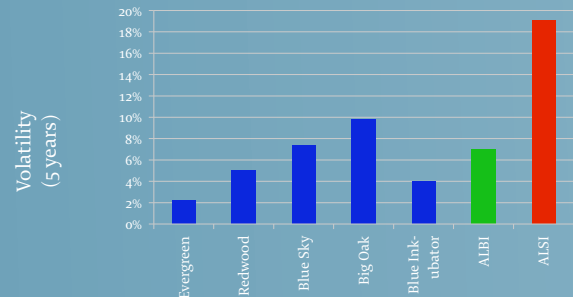
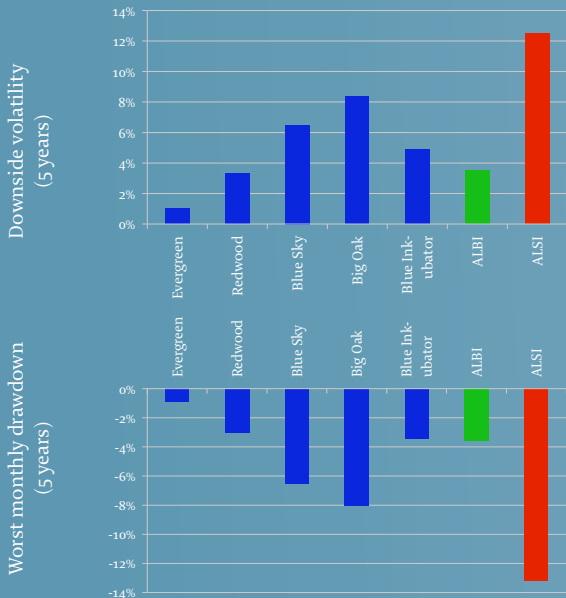


So, getting back to our definition of risk, we know that we don't want a volatile investment profile. We also know that we seek consistent positive returns and that we want to avoid losses. For this reason, other risk measures have evolved. Whilst volatility or return deviation is important, we should be less concerned about upside deviation. Rather, it is the downside deviation that is of concern i.e. the magnitude of the downside swings. In considering the consistency of the Blue Ink returns, managers now also monitor things like the distribution of the returns - the skewness and the kurtosis of the return distributions. These two measures identify how many of the returns are skewed to the positive side and how many are skewed to the negative side. Kurtosis measures whether the distribution of returns is bulky around a certain number or whether they are spread across a wide spectrum of outcomes i.e. more or less sure around a specific return number.

The graphics below show how the different Blue Ink portfolios have performed against the market in terms of the worst monthly loss, volatility and downside variation (volatility) over the past 5 years. In all cases, one can rest assured in the knowledge that we try to contain our risks - whatever the measure used! ■

I recently had the privilege of addressing the client base of one of our larger Independent Financial Advisors in Rustenburg, Northern Gauteng. During the presentation, I spoke about risk measurement and the value that hedge funds add to a balanced portfolio in terms of their risk reduction characteristics. During question time, I was asked about the Blue Ink definition of risk, whether this was an accepted measure of risk and whether the measure had changed over time. A very good question indeed! And one I would like to spend some time reflecting on in this month's publication.

The definitions of risk vary greatly. An outstanding book on the topic, its history and the development of the understanding of risk, is very eloquently laid out by Peter Bernstein, in a book called "Against the Gods". While Bernstein addresses the history, right from the development of statistical techniques which gave us the capability to measure the odds of certain events happening, the most



“...hedge funds add value to a balanced portfolio in terms of their risk reduction characteristics...”



How long has i capital been investing in the hedge fund industry?

i capital has been managing the i capital Nitrogen Fund since 2007, prior to which we managed a closed end private equity fund for eight years and were also involved in proprietary equity trading and investing. We also have extensive corporate finance advisory experience, as part of the i capital group's broader activities.

Where did you gain your investment/hedge fund experience and how long have you been in the industry?

We gained substantial investment experience through the management of our private equity fund, the i capital Growth Fund I Trust, which we managed from 1998 to 2007. We undertook a number of investments in smaller businesses in various sectors, including investments in listed companies. This gave us insight into the drivers of business success and the translation into sound investment opportunities. When we consider an investment, we think of owning a piece of a business and whether the business offers an attractive investment opportunity over the medium term. We gained arbitrage trading experience through our proprietary trading before rolling these activities into the Nitrogen Fund.

What motivates you about the hedge fund industry?

The hedge fund industry is largely a meritocracy. Fund management skills and superior return are recognised by investors and rewarded with increased assets under management. The industry is also very Darwinian in that it is constantly evolving and is very much about survival of the fittest. Managing a hedge fund is very stimulating

and is a constant challenge involving both quantitative skills and a high level of individual judgement. The industry attracts a diverse set of individuals and skill sets making it an interesting and exciting to be part of.

What is the i capital strategy or motto for investing?

Our motto is "stick to the fundamentals and have thorough insight". The direction of the stock market is random and unpredictable in the short term and the investor's knowledge and insight into the fundamentals of a share or particular trade provides the conviction to make an investment or trading decision. In the longer term, fundamentals will be borne out and a strong grasp of such provides a guide to sound investment decisions which are the foundation of delivering strong risk adjusted returns. We also make use of the Kelly system, which is a methodology for weighting investments to achieve optimal risk adjusted returns or simply, a framework for allocating capital to the most attractive risk adjusted investment opportunities, based on the manager's knowledge of the fundamentals of the investment situation.

What does i capital do to differentiate itself from competitors?

We have a fairly unique skill set with a background in private equity and corporate finance, providing strong insight into long term fundamental investing and shorter-term arbitrage trading opportunities. Our corporate finance experience allows us to trade corporate actions and other arbitrage opportunities with a high degree of conviction and insight. Our experience has also given us a wide business network, which provides a good base of knowledge for fundamental analysis.

Would you invest your own money in the hedge fund industry?

The industry delivers attractive risk adjusted returns with a good level of capital preservation. Hedge funds should be included in any diversified investment portfolio as they provide attractive non-correlated risk return characteristics - as such I would definitely invest (and have invested) in the hedge fund industry.

How do you view hedge fund regulation?

A certain level of regulation is important. The industry has a strong culture of self-regulation with investors requiring high levels of standards, administrative capacity

and transparency from fund managers. This has resulted in a high degree of professionalism amongst managers. Managers are also specifically regulated by the FSB in terms of the FAIS Act, which places further onus on the managers to comply with the relevant regulations in terms administration, disclosure and level of expertise and experience. This enhances the credibility of the industry. There are moves to regulate the hedge funds themselves, which currently are not specifically regulated - we believe this needs to be carefully considered as the current level of regulation has resulted in a very credible industry. Product regulation should not impact the flexibility that fund managers have to deliver superior returns. Sensible product regulation may open up hedge fund investment opportunities to a broader range of investors, thereby helping to grow the industry.

How does the SA hedge fund industry compare with offshore peers?

We believe that the industry compares well with its offshore peers. By and large there have not been any large hedge fund failures, proving that the current level of regulation has been effective in safeguarding investors. The returns delivered have been sound, proving that we have a group of skilled managers. We believe local managers are prejudiced by exchange controls as these managers certainly have the ability to apply their investment skills to offshore markets with good success. One negative is the size of the industry compared to offshore markets. The market size is impacted by the restrictive nature of institutional investor prudential investment limits.

What advice do you have for investors?

Uncertainty has returned as investors attempt to interpret the impact of the current sovereign credit of the global economy and hence the outlook for growth. We remain cautious, as the high levels of fiscal stimulus as a result of the credit crisis, have left a number of countries with weak balance sheets. We forecast below trend global growth for a number of years with significantly better investment opportunities in emerging economies, including South Africa, in the medium term. We advise investors to seek out experienced conservative managers who can take advantage of the current market environment to deliver market-beating returns with limited volatility. ■



WHO'S WHO AT BLUE INK



Narieman Kassiem Assistant Accountant at Blue Ink Investments

Tell us about your position at Blue Ink.

I'm part of the accounts team, and my role is assistant accountant.

How long have you been with the company?

I have been with Blue Ink for three years.

Run us through some of your responsibilities and tasks.

I ensure that our accounts processing runs smoothly so that we're able to meet all our deadlines timeously.

What are the challenges you face in this industry?

Keeping updated with current legislation is always a challenge, as is meeting tight deadlines.

What do you enjoy most about your job?

The dynamic environment within which we operate ensures that things are never dull.

Tell us about your working environment at Blue Ink.

We tend to be very flexible in the accounts department, adapting to the needs of work, to ensure that the job gets done well.

Tell us about your past experience and jobs.

I served my articles at a small firm of chartered accountants, gaining well rounded experience in accounting, auditing, company secretarial work; estate administration and tax.

After completing my articles, I moved to the commercial industry as an assistant accountant where I worked for two years, accounting for the various segments of the company within a group. I then moved over to the retail industry, where I worked for a little under a year before being contacted about a position at Blue Ink Investments.

What do you like about the finance / accounting line of work?

Finance plays a key role to improving the performance of a business.

What is your philosophy?

To keep things simple. It was Leonardo da Vinci who said, "simplicity is the ultimate sophistication."

What have been your key lessons in life?

To be grateful for all the simple pleasures.

What is your greatest achievement?

Performing pilgrimage to Mecca with people from all walks of life, from all nationalities across the world.

How do you spend your time on weekends?

I try to spend as much time as I can with my family and friends, hiking, fishing and going on scenic drives around our beautiful country.

What big decision are you currently wrestling with?

When to take my cousins bungee jumping!

What are your favourite activities outside of work?

I enjoy attending live shows, watching movies, reading, and trying different activities (within reason).

What are your extra mural interests/activities?

Getting involved with family and friends to run various charity projects such as offering meals to the elderly, orphans and the destitute. I derive much satisfaction in knowing that I have helped to make someone's life a little easier. ■

TAKE A CLOSER LOOK

Message from Esmarie Strydom - Chief Executive Officer

Over the past few months, there have been several unfavourable reports in the media about a financial services company operating in South Africa, Blue Financial Services.

Due to the similarities between the name of that company and ours, some confusion might arise about possible links between the two entities.

I assure you that Blue Ink Investments has no affiliation or link to Blue Financial Services. Blue Financial Services operates in an entirely different segment of the market to Blue Ink Investments, which as you know, manages fund of hedge funds, providing investment services to retail and institutional clients.

Besides being in excellent financial health, Blue Ink Investments is supported by our major shareholders, Sanlam Investments, one of South Africa's leading investment and wealth management companies, and Ubuntu-Botho Investment Holdings (UBIH), a broad based empowerment group.

I trust that this clarifies any misconceptions that you may have about the Blue Ink Investments brand. Should you have any concerns or require any additional information, please do not hesitate to contact me.

Esmarie Strydom

Tel: +27 (21) 673 3333

