<u>Samuel Terry Absolute Return Fund</u> – December 2009 monthly report

The Fund's performance, and those of the Australian All Ordinaries Accumulation Index and the MSCI World Equities Index, are as follow:

To 31 Dec 2009	STAR	All Ords	MSCI ($A)
1 month	4.15%	3.69%	4.24%
3 months	6.33%	3.71%	3.21%
1 year	24.27%	39.58%	2.55%
3 years (%p.a.)	-6.87%	-0.62%	-9.39%
Since inception on 1 November 2003 (%p.a.)	4.03%	11.18%	1.37%

The Fund had an eventful month. **Challenger Kenedix**, a Japanese property trust, (2.8% of the Fund last month) rose 47% after it received a takeover bid from its major shareholder. The Fund sold most of its shares at the bid price.

We were also helped by the emergence from bankruptcy of **CIT**, an American bank and finance company. You may recall that we invested in CIT's bonds at 55% of face value in July. CIT has completed a deal with bondholder, in which bondholders gave up 30% of the face value of their bonds, in return for being given almost all the shares in CIT. Last month, 5.2% of the Fund was in CIT bonds, which were then trading at 64% of face value. In terms of the old bonds, the price rose to 80% by the end of December, which now comprises a mixture of new shares and new bonds.

Following the emergence from bankruptcy, we bought some more CIT shares. The Fund's exposure to CIT shares is now 5.2%, in addition to our 4.9% weighting in CIT's new bonds. The attraction of the new bonds is that they yield over 9%, which is too high a yield for one of America's best capitalised banks. CIT now has tangible equity of over 14% of total assets. Just as important, it has extended its debt maturities to match its assets, significantly reducing the probability of another liquidity squeeze. I expect that as time passes, the yield on the bonds will fall and their price rise, meaning we should expect a good return for little risk.

The new shares offer higher risk but potentially higher rewards. They are trading at a discount to NAV[1] of about 40%, but CIT has a history of earning high returns on equity and should be able to do so again. If so, I expect CIT shares will be trading at a significant premium to NAV within 2-3 years.

The Fund was also helped by rises in three of our Australian holdings. **Domino's Pizza** (5.8% of the Fund) rose 20%, debt in poker machine maker **Ainsworth Gaming** (4.2% of the Fund) rose 22%, and publisher **Commstrat** (3% of the Fund) rose 33%.

[1] Net Asset Value

One of our companies, **Hamilton Securities**, (3.1% of the Fund) has launched a takeover bid for **Timbercorp Orchard Trust debentures** (2.6% of the Fund). I believe that the bid will be very beneficial for the holders of both Hamilton and the debentures.

After a meeting with the company, we more than doubled our holding in **J-Rep**, a Japanese property company, now 2.5% of the Fund. J-Rep shares are speculative because of its high debt level, but I regard the shares as a good gamble for three reasons:

1) J-Rep's controlling shareholders, Macquarie and Goodman, are smart, successful Australian investors. They have the capacity to provide extra capital to J-Rep if it becomes necessary.
2) J-Rep has no significant debt repayment due until 2013, and its assets are worth almost twice its debts.
3) J-Rep shares trade at an 87% discount to NAV. If one could buy all of J-Rep at the current share price, the net rental yield would be 8-9%, compared to Japanese government bond yields of less than 2%.

We have added two new names to the fund. One is an Australian mining investment trust trading at about half of NAV. So far, we have only invested 1% of the Fund in this company and I hope to buy more.

The other is an Australian engineering company called **Logicamms**, where we participated in an issue of new shares. Logicamms has a good history of growth and is debt free. We bought the shares at a P/E of 6x and a 6.5% dividend yield. Unfortunately, we did not receive as many shares as I had requested, and it is only 1.5% of the Fund.

Finally, ANZ Bank has announced that it is selling its custody business to JP Morgan. The effect of this is that some time in 2010 our custodian will change from ANZ to JP Morgan. I will let you know when this happens.

The Fund's net asset value per unit was $A 0.9276 at the end of December. 3.2% of the Fund was in $A cash. The Fund owned securities issued by 24 companies.

Fred Woollard
15 January 2010