

## **Samuel Terry Absolute Return Fund – January 2011 monthly report**

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

<b>To 31 January 2011</b>	<b>STAR</b>	<b>All Ords</b>	<b>MSCI (\$A)</b>
1 month	-3.67%	0.07%	4.84%
3 months	5.32%	3.15%	6.35%
1 year	31.38%	9.80%	6.59%
3 years (%p.a.)	6.73%	-1.04%	-4.53%
Since inception on 1 November 2003 (%p.a.)	7.61%	9.94%	1.67%

The Fund's biggest loser was Australian gold miner **Saracen** (8.5% of the Fund) which fell 18% because of a 6% fall in the \$A gold price.

We were also hurt by sharp falls in several of our small Australian companies, such as insurer **Calliden** (4% of the Fund, down 14%) medical supplier **ITL** (2% of the Fund, down 16%) and finance company **Keybridge** (2% of the Fund, down 16%). I am not aware of any new reason for any of these falls and am not very worried about them.

3.4% of the Fund was invested in **Microsoft**, one of the world's highest quality businesses. Customers of the company will not be surprised to learn that it generates operating margins of about 40%, and returns on operating capital of over 100%. Despite the best efforts of competitors and regulators, it retains dominant market share in its two main markets, and it continues to grow both revenues and profits. In addition to these attributes, Microsoft has a bullet-proof balance sheet, with net cash and investments of about \$40bn, or 16% of its market capitalisation.

Other dominant technology companies such as Google and Apple have similar qualities. The unique attraction of Microsoft is that Bill Gates, its Chairman and largest shareholder has, in effect, been appointed by Warren Buffett as a key guardian of Buffett's legacy. This gives me a high degree of confidence that Microsoft will continue to be run, and its prodigious cash flow allocated, in an intelligent shareholder-friendly manner.

I also like the fact that Microsoft has recently been distributing about 100% of its earnings to shareholders, mostly by buying back shares. As the shares trade at only 10-12 times earnings, a ratio usually associated with uninspiring companies, share buybacks are a sensible use of Microsoft's cash flow.

Like all technology companies, Microsoft's prospects are hard to forecast and its dominance is potentially vulnerable. Nevertheless, Microsoft's financial strength and inexpensive valuation give us a considerable margin of safety if things go wrong, and the potential to make a good return if Microsoft continues to do well.

The Fund's net asset value per unit was \$A 1.2234 at the end of January. The Fund owned securities issued by 23 companies. 10.9% of the Fund was in \$A cash.

Fred Woollard  
15 February 2011

*Samuel Terry Asset Management Pty Limited (AFSL 278294) does not guarantee the repayment of capital or any particular rate of return from the Trust. Past performance is no guarantee or indication of future performance. The unit price can go down as well as up. Investment returns have been calculated in accordance with normal industry practice utilising movements in unit price and assuming reinvestment of all distribution of income and realized profits. The above report does not take into account a reader's investment objectives, particular needs or financial situation. It is general information only and should not be considered as investment advice and should not be relied on as an investment recommendation.*