Pangolin Investment Management

Pangolin Asia Fund First Quarter 2006 Report

The Net Asset Value of the A shares was U$106.09 at the end of the period. Please note that the fund has a November year end, thus the first quarter ended on February the 28th.

At the quarter's end the fund was approximately 99% invested.

The year has started reasonably well and the fund has been helped by the increase in ASEAN currencies relative to the US$, as well as strong global stock markets. We seem to be at a point where the correlation between Asian and US markets remains close while we may also be finally arriving at a juncture where the currencies are diverging, with the correlation being closer to the Yuan henceforth. If the latter continues then this could be the (much anticipated by some) trigger that will finally cause the stampede out of the dollar and, given the lack of alternatives, into gold. Investors in the Pangolin Asia Fund should be hoping for a break in the correlation between ASEAN and Western stock markets, assuming they share the manager's view that Wall Street in particular does not represent particularly good value.

Most of the companies in the portfolio have recently announced results (they require a bit more time in Indonesia) with no nasty surprises. In some cases results have helpfully exceeded expectations; good news for the companies we hold which are liquid enough to be of interest to others.

Review

I recently concluded a brief cricket-watching trip to **India** (the game, not the insects for any American readers) which was my first visit there for six years. Much has been written about India's economic boom elsewhere, but I will add that it is tangible and impressive, and that at long last, in certain respects (not just the traffic in Chennai) the place feels like other parts of Asia. Indonesia springs to mind. Where the two countries differ from an investor's perspective is in equity valuations (although both markets are at new highs). It is my belief that in general the Indonesian market is cheap, while in India I read an article in a business paper explaining why high PEs were not a worry. I think I used to spout similar stuff as a broker in the mid-nineties….

The fund does not currently invest in the sub-continent, partly due to valuations but mainly due to a lack of expertise there. There are other ways of getting exposure which may entail less risk such as Singaporean property or selected Malaysian construction companies for example.

What has changed in India is the politics. The gradual switch away from protectionist socialist policies is unshackling those with some kind of entrepreneurial spirit and bearing fruit. There is still unbelievable poverty but there is change. Politics are fickle and the risk is that anti-reform parties win a future election (the present government has communist coalition partners) or just that the normal boom-bust cycle will kill things for a while.

Politically things in **Indonesia** seem to be moving in the right direction. The government gives the impression that they understand what is required to attract FDIs and are moving at the fastest pace possible, not that this will result in any speeding tickets. Major issues are changes in the labour laws making it easier to fire people (are you watching Chirac?), the resolution finally of the CEPU dispute between Exxon and Pertamina and whether to allow Playboy to publish. The latter has been a useful red herring to distract attention away from rising prices and high interest rates but has again reminded many of the strengthening Islamic lobby, especially during the debate surrounding the anti-pornography bill which will probably render Playboy more readable than viewable.

The real political action is in **Thailand** and surrounds Prime Minister Thaksin who has fallen foul of the urban elite but not the rural majority who voted him in. The expectation, I am told, is that he will stand down although no-one seems to have informed him and he is busily campaigning and organising rallies of support. Democracy in Thailand had seemed to be alive and well but if a minority forces the PM to resign (however valid their reasons may be) then it follows the precedents set by Indonesia and the Philippines in recent times. Tourism has apparently been affected by these so far peaceful rallies but the one company the fund owns in Thailand (LPN Development) still seems to be selling flats at an impressive rate. Its share price leapt following the results but has since fallen back again ahead of possible zoning changes; given a positive view on the management and the lower end of Bangkok's apartment market I am assuming that the organisation will be able to respond to any changes and that the long term prospects of the company will not be diminished.

The insurrection in the South still continues with an average of two deaths a day; not very nice if you live there and something to keep an eye on.

In **Malaysia** the Grand Prix was preceded by all the drivers being paraded around the circuit in vintage sports cars. The leading two cars contained the Prime Minister and his deputy. Can you imagine the reception Tony Blair and John Prescott would receive in England if they tried the same at Silverstone?

Malaysia benefits by having stable politics. However bear in mind that this is a country where civil servants hide their political affiliations (if anti-government) and students can lose their university places if caught campaigning for the opposition. Add in media control and you can see why the opposition is so ineffectual. As long as the economy remains strong that is fine but if a recession ever comes along then the largest opposition party is the Islamic PAS. This highlights the weakness of the restricted democracy system in that there is no viable opposition and therefore only an extreme alternative.

The current F1-loving prime minister promised open tenders for government contracts when he came to power, something that seems to have been forgotten. Recently the brother of the deputy and almost certainly next prime minister led a successful takeover by CIMB of Southern Bank. Given that there was intervention by the central bank many are not convinced that the decision to sell by Southern Bank's owners was not politically influenced.

It is no secret that the government implements policies to favour the ethnic Malays and most Malaysians would agree that if it results in the avoidance of periodical Indonesian style racial tension and violence, it is not a bad thing, although they might not like the way the policy is implemented. It is of course proving harder to protect racial interests in a globalised market, but new rules relating to Malay ownership of restaurants and supermarkets show that they have not stopped trying. Recently Digi, a 61% subsidiary of Norway's Telenor, had its application for a 3G licence rejected because it was not Malaysian enough. Not all that surprising but better things were hoped for from the present political leadership.

At the end of last week the authorities announced that short selling will be reintroduced and that stock futures will be launched. This will bring the market into the sights of hedge funds and prop. traders which can only be good news for the market. A step forward at last.

In **Singapore** they have virtually done away with all noticeable politics, and seem fine for it. Perhaps not the best long term solution but it has worked pretty well so far. There is an election expected soon but given the strength of the current government an upset is unimaginable.

In the meantime the managements of the companies in the fund will hopefully remain detached from everything above and continue to find ways to sell more of their product than the competition. After all, politics in Asia is a game for the poor and the mega-rich, and is of limited interest to those in the middle.

Shareholders in the fund are reminded that the minimum additional subscription is U$5,000 and that periodic additions will smooth out any shorter term market movements.

Investors are encouraged to suggest ideas, comment or interrogate as they see fit.

James Hay

27th March 2006

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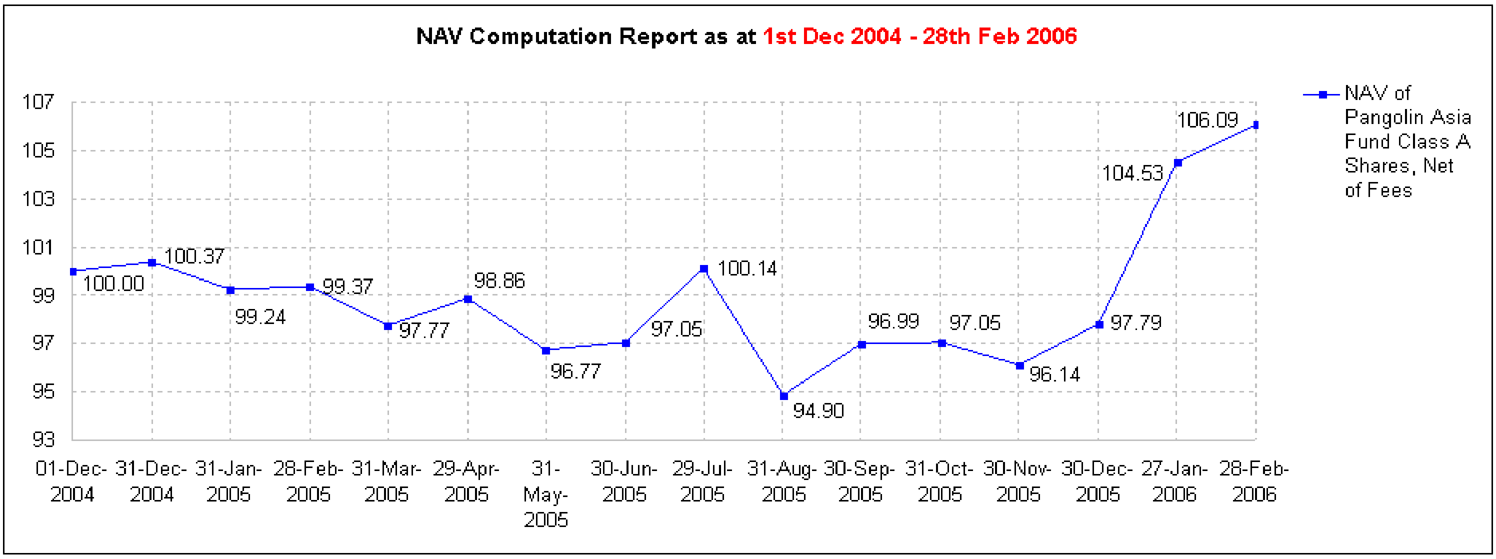

Month	NAV	% change
01-Dec-2004	100.00	
31-Dec-2004	100.37	0.37%
31-Jan-2005	99.24	-1.13%
28-Feb-2005	99.37	0.13%
31-Mar-2005	97.77	-1.61%
29-Apr-2005	98.86	1.11%
31-May-2005	96.77	-2.11%
30-Jun-2005	97.05	0.29%
29-Jul-2005	100.14	3.18%
31-Aug-2005	94.90	-5.23%
30-Sep-2005	96.99	2.20%
31-Oct-2005	97.05	0.06%
30-Nov-2005	96.14	-0.94%
30-Dec-2005	97.79	1.72%
27-Jan-2006	104.53	6.89%
28-Feb-2006	106.09	1.49%
	2005 return	-2.57%
	2006 return	8.49%