

THE DEVIL'S ADVOCATE REPORT COMPENDIUM

April 2010

Featured Companies:

Research In Motion
Dell Computer
Palm Inc.
Nokia Corp.

Horizon Research Group

Steven Bregman
Thérèse Byars
Peter Doyle
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Murray's Musings

Two Important Aspects Facing the Short Sale Community

The current *Musings* section has several aspects to it. The first pertains to the differences between fundamental shorting, and shorting for volatility control. The standard instrumentality for volatility control is to short the S&P SPDR which, as has been stated in previous publications, has the deficiency of a negative carry element to it inasmuch as the S&P 500, viewed as a conglomeration of companies, usually has a profit. Therefore, its book value is usually increasing. Of course, viewed as an agglomeration of companies, it has a certain dividend payout ratio, which in totality represents a negative carry from the point of view of the short seller.

Of course, the S&P can fluctuate wildly, but if one is going to have, as a matter of permanence, a given range of short sale positions, that average short sale position will necessarily have the negative cost of carry of the S&P itself. Given the depressed level of the S&P in March of 2009, that negative carry can be rather serious.

In contradistinction, the VIX contract has the feature that it's merely an algorithm and, therefore, its existence has no organic reality. The VIX is merely an abstraction. Ergo, as an abstraction, although its value fluctuates wildly, and in reality even more wildly than the S&P 500, there's no reason to believe that its average value is likely to be any different ten years from now than it is today. Therefore, in principle, the negative carry element is less important. It's also worthwhile noting that, even on a short-term basis, the VIX is much more sensitive than the S&P 500. For example, on Friday March 19, 2010, the VIX was trading at 16.97, which incidentally is below its long-term average of 19.43. In any event, on that day the S&P 500 declined by 51 basis points. The VIX was up .35, or 2.11%. That doesn't always happen, but it happens so frequently that the VIX appears to be much more sensitive than the S&P 500. As it pertains to short-selling, the world might change to favor the VIX.

Another element of shorting concerns leveraged balance sheets, which ultimately provide much of the material for the classical short seller. Currently, companies, in general, are deleveraging their balance sheets and building up cash. It's becoming increasingly difficult to find companies that are improperly leveraged to the point where it becomes dangerous. An improperly leveraged company facing a decline in cash flow could find that leverage creates corporate fatality, and that would be a major success in the short-sale realm. This position is becoming increasingly difficult to accomplish because the corporations are managed by people, and people, as a generalization, are terrified of what happened in 2008 and early 2009. Their general predilection is to be much more financially conservative. Therefore, from the point of view of finding securities to sell short, particularly those that are overleveraged, it's becoming increasingly more difficult.

The next aspect compares the NASDAQ 100, as it exists today, with the NASDAQ National Market as it existed in early 1983. In the following table, a sample set of

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companies from the NASDAQ National Market in January 20, 1983 is presented. It is worthwhile noting some interesting aspects of this table. For instance, many of these companies are no longer listed on NASDAQ because their business gradually deteriorated, which is very different from having a business which is structurally unsound in the balance sheet sense.

Select Listings of the Nasdaq National Market: January 20, 1983

Apple Computer	Intel Corp	People Express
Avantek	Intergraph Corp	Pick N Save
Cetus Corp	Jerrico Inc.	Pizza Time
ChiChis Inc.	MCI Communications	Price Company
Color Tile Inc.	Millipore Corp	Quotron Systems
CPT Corp	Morrison	Safeco Corp
Digital Switch	National Data	Seagate Tech
Godfather Pizza	Network Systems	Triad Systems
Graphic Scanning	Nike	US Bancorp
Hadson Petroleum	Pay N Save	US Surgical

Examples of these casualties would include Digital Switch, Graphic Scanning, Intergraph Corporation, Quotron, and MCI Communications, the latter of which might actually have been at one point in its life overleveraged. The common feature of most of these companies is that the businesses became exposed to intense competition because the product life cycle for emerging companies is becoming ever shorter with the ever-increasing pace of scientific discovery and social change. Having said that, the NASDAQ 100 today has a large number of reasonably well-established companies that are extraordinarily well-capitalized. They are capitalized better than most of the companies on the NASDAQ National Market were in 1983. We'll only cite nine examples of some that are less obvious. There are some that are very obvious and have no need to be cited.

For instance, Fiserv, Life Technologies, Paychex, Sigma Aldrich, PACCAR, eBay, Cintas, Starbuck's, and Joy Global all have a type of dominance in their own niches, and all have excellent balance sheets. It's difficult to see how those companies might be displaced by the changing pace of technology or by technological change. That is not to say that it couldn't happen. The mission of the short seller, it seems, is going to be not to find companies that have a structural defect in terms of their balance sheets or their accounting practices, but those that have some type of defect in terms of rising competition or social change that could dramatically reduce the demand for the goods or services produced by the company. Within the text of this report, some examples will be cited.

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Industry Thoughts

The Steel Industry

The present *Industry Thoughts* section will focus on the steel industry. The capacity utilization of the steel industry, as reported by the American Iron & Steel Institute in the most recent week, is 70.9%. This number is actually relatively low in the context of history. The capacity utilization of this industry during the last week of October 2008 was 67.3%. This would be the onset of what proved to be the great contraction. Nevertheless, 67.3% is a significant number because, according to the institute, there are only four times in the 20th Century that the capacity utilization figure was as low as that. Within this context, it's worthwhile noting that the steel industry, as calculated by the American Iron & Steel Institute, had capacity utilization in July of 2009 below 50%, but it didn't last long.

The four occasions in history are, first, the early 1920's in the Post World War I contraction, which was obvious given the decline in defense spending. Second, during the Great Depression of the 1930's, which is certainly not surprising either. Third, during the business recession of 1958-1962, which is rather surprising because that's generally thought to have been a rather mild recession as far as recessions are concerned, and it's generally recorded in American history as an otherwise prosperous era. The fourth occasion was during the rather severe recession of 1982, though even that was not as severe as the most recent recession.

Therefore, the capacity utilization rate has been rising virtually every week for months. One would think that in an industry like steel, the prime determinant of profitability is the capacity utilization rate, because almost all the costs are fixed, and proportionally the variable costs are relatively low. One would think that all of the steel companies would perform in a very narrow band. However, that's not happening. For example, we'll cite the relative year-to-date performance versus the S&P 500 of five steel companies.

Worthington Steel substantially outperformed the S&P. Yet, Nucor Steel, which is one of the better managed steel companies, some would say the best managed, has substantially underperformed the S&P. Commercial Metals, which is involved in steel recycling, is more or less a market performer. Posco Steel, which is the Pohang Steel of South Korea, substantially underperformed the S&P, even though Posco is emerging as one of the dominant steel producers of the world. Lastly, Arcelor Mittal, the Indian company, has substantially underperformed the S&P in what is clearly an improving steel environment.

Below, readers will find a table containing the P/E ratios of these five companies.

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	Forward Year P/E Ratio
Worthington Steel	13.9x
Nucor	12.5x
Posco	11.8x
Commercial Metals	10.3x
Arcelor Mittal	9.9x

While the P/E ratios are mostly in the 9x-12x range, Worthington Steel has a 13.9x multiple, such that the cause of its outperformance has been the acquisition of a much higher multiple than the others. The other companies trade in a relatively narrow multiple band and Worthington Steel trades out of that band, so one would look for something that's different about Worthington Steel. However, it doesn't appear to have a higher return on equity, nor does it appear to have a higher profit margin. Its earnings do not appear to be growing at a higher rate than those of the others. However, it has done more than any of the other companies to repay debt and, therefore, the P/E ratio viewed as a crude proxy for the risk premium on an individual equity is starting to reflect the investor preference for modest corporate leverage, or unleveraged companies over leveraged ones.

In this regard, Nucor has modestly reduced its net current assets, from \$7.9 billion to \$7.4 billion, so it's using less working capital. However, it has chosen not to use the funds to pay down any debt. Its debt in the last year viewed at December 31, is unchanged from the prior year. This will be viewed in comparison to Worthington, which has also modestly reduced its working capital. This is nothing other than logical inasmuch as demand for steel is reduced; however, Worthington's debt on December 31, 2008 was \$245 million relative to the current level of only \$100 million. Therefore, debt reduction appears to be a salient feature from the point of view of those who follow the steel industry.

	Nucor	Worthington
12/31/09:		
Current Assets	\$12.6	\$1.4
Current Liabilities	<u>5.2</u>	<u>0.7</u>
Net Current Assets	\$7.4	\$0.7
Debt	\$3.1	\$0.1
12/31/08:		
Current Assets	\$13.8	\$2.0
Current Liabilities	<u>5.9</u>	<u>1.1</u>
Net Current Assets	\$7.9	\$0.9
Debt	\$3.1	\$0.2

(\$ in billions)

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An interesting example of this phenomenon is Posco, which is Pohang Steel. Pohang Steel, in contradistinction to some of the other steel companies, increased its long-term liabilities. The company did this to expand its business. During the downturn, Posco was adding to plant equipment, or adding to the fixed asset base, which is very unusual for companies in the steel business. In reality, there's only one reason for doing this, which is that the company believes it can capture market share. As the rest of the steel industry retrenches, there's every reason to believe that Posco is right. As shown in the following table, Posco's net current assets have increased, and long-term liabilities are up about 33%. As an aside, the only American company one can find that's been expanding, albeit modestly, during the decline is Commercial Metals.

	<u>POSCO</u>
12/31/09:	
Current Assets	KRW12.4
Current Liabilities	<u>2.7</u>
Net Current Assets	10.2
Long-term liabilities	6.4
12/31/08:	
Current Assets	KRW13.7
Current Liabilities	<u>4.3</u>
Net Current Assets	9.4
Long-term liabilities	5.0

(in trillions of Korean Won)

If one believes in contrarian investing, the management of Posco is correct. If it is believed that as one's competitors are under pressure, one should retrench like one's competitors, then the management of Worthington is right. It seems much more reasonable to believe that ultimately the management of Posco will be proven right, and time will tell. The important distinction is that the companies that seem to be engaged in long-term investing are being disfavored, and the companies that are investing to please the investors that are concerned about leverage, although Worthington is by no stretch of the imagination a leveraged company, are acting otherwise.

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Facts & Figures

The Cyclical Manifestations of Exxon and Toll Brothers

This is a different *Facts & Figures* section, because it compares two companies that have no basis for being compared: Exxon and Toll Brothers. These companies have nothing in common. The following table provides a variety of financial figures on Exxon through the last ten years such as revenue, net profit, current assets, current liabilities, long-term debt and shares outstanding.

Year	Revenue	Net Income	Current Assets	Current Liabilities	Long-term Debt	Shares Outstanding
2009	\$301.5	\$19.3	\$233.3	\$122.7	\$7.1	4.7
2008	\$459.5	\$45.2	\$228.0	\$115.0	\$7.0	5.0
2007	\$390.3	\$40.6	\$240.0	\$120.3	\$7.2	5.4
2006	\$365.5	\$39.5	\$219.0	\$105.1	\$6.6	5.7
2005	\$358.9	\$36.1	\$208.3	\$97.1	\$6.2	6.1
2004	\$291.2	\$25.3	\$195.2	\$95.5	\$5.0	6.4
2003	\$237.0	\$20.9	\$174.3	\$84.3	\$4.7	6.6
2002	\$200.9	\$11.0	\$152.6	\$78.0	\$6.6	6.7
2001	\$208.7	\$15.0	\$143.1	\$70.0	\$7.1	6.8
2000	\$227.6	\$15.8	\$149.0	\$78.2	\$7.3	6.9

(\$ in billions)

The Exxon data is presented because it's fairly obvious that there are periods of time in a recessionary environment when Exxon's earnings are highly cyclical. Examples would include the earnings experiences during 2009 and 2002. In the 2009 experience, earnings declined by well over 50%; in the 2002 experience, the recession wasn't quite as severe, so earnings declined by about 30%.

Nevertheless, Exxon continued to buy back shares throughout the entire time period. Exxon did not repay any of its debt; it merely refunded its debt. Exxon continued to invest in its own business, as one can see from the current assets and current liability line, in that it's constantly adding to working capital. Exxon is constantly putting money to work. They're doing this at the same time as the equity base is being shrunk. Therefore, there is very little doubt, if one follows a policy like this, that the net asset value of a company will increase. In point of fact, as anyone can observe by looking at a chart of Exxon, its price has increased over the last decade, and has outperformed the S&P 500 by a reasonable quantity.

Despite its episodes of cyclicity, Exxon is not considered to be a very volatile stock. Therefore, a company like Exxon, even if one were to be able to forecast its periods of

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decline, would not be a wonderfully remunerative short sale candidate. It seems that the market, for a variety of reasons, either understands the ephemeral nature of the Exxon cyclicity or, being perhaps the most important constituent of the S&P 500, Exxon always has a natural constituency of buyers and, therefore, will always be owned. Even investors who run money on an active basis rarely wish to exclude the largest component of the S&P 500 from their portfolios, although they might choose to underweight it. Ergo, for those reasons, the existence of a natural buying constituency of Exxon mutes its volatility, such as it is.

Let us compare the Exxon situation to that of Toll Brothers. Toll Brothers, of course, is the higher-end home builder. There are a number of aspects of this company that might astonish people. Certainly, as one views the Toll Brothers data below, the losses the company experienced in 2008 and 2009, which is an October fiscal year, are not surprising. Toll Brothers experienced enormous cyclicity starting at the end of the fiscal 2006 time period. In reality, who is to say that the cyclicity has ended?

October Fiscal Year	Revenue	Net Income	Current Assets	Current Liabilities	Long-term Debt	Shares Outstanding
2009	\$1.7	(\$0.76)	\$5.6	\$3.1	\$2.1	0.17
2008	\$3.1	(\$0.30)	\$6.6	\$3.3	\$2.1	0.16
2007	\$4.6	\$0.04	\$7.2	\$3.7	\$2.2	0.16
2006	\$6.1	\$0.69	\$7.6	\$4.2	\$2.3	0.15
2005	\$5.8	\$0.81	\$6.3	\$3.6	\$1.8	0.16
2004	\$3.8	\$0.41	\$4.9	\$3.0	\$1.7	0.15
2003	\$2.8	\$0.26	\$3.8	\$2.3	\$1.5	0.15
2002	\$2.3	\$0.22	\$2.9	\$1.8	\$1.1	0.14
2001	\$2.2	\$0.21	\$2.5	\$1.6	\$1.0	0.14
2000	\$1.8	\$0.15	\$2.0	\$1.3	\$0.8	0.14

(\$ in billions)

It is interesting to observe that the major decline in the share price of Toll Brothers dates from July of 2005 to September 2007. In reading this phrase, one should consult the data table. There were nearly \$300 million of losses in the October 2008 year, and there were over \$755 million of losses in the October 2009 year. Moreover, demand for new homes has certainly not meaningfully increased since the end of October 2009. In any event, in September 2007 the stock was trading at slightly in excess of \$19 a share. It might be amazing, but it's nevertheless a fact, that in November of 2008, in the middle of what many described as the worst financial crisis of the last 100 years, inclusive of the Great Depression, Toll Brothers traded at slightly in excess of \$18. Therefore, had one bought Toll Brothers in September 2007 at its then trading price and held it, in November 2008 one would have had a modest loss, but one would have handily outperformed the S&P 500. This price behavior is true for some other homebuilders as well, though not necessarily all of them.

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Let us assume for the mere purposes of discussion that someone bought Toll Brothers in September 2007, held it until November 2008, and then forecasted the financial recovery that none in November of 2008 had dared forecast, but we now know actually happened. We know how much the S&P has increased in value from March of 2009 to the present time. Toll Brothers now sells, approximately 1-1/2 years later, for \$20 a share. So, the great irony is that the variability of the industry is beyond any question. However, the variability of the stock no longer reflects the variability of the industry. It's ironic, but nevertheless a documentable fact, that Toll Brothers is not a volatile security. One might call this beta, or volatility transformation, if there is such a need for a term of that type.

One can theorize why that is, and it has a lot of relevance to the prospective short seller. The decline of the industry was so blatantly obvious to so many people that anyone not interested in being a long-term investor in the housing industry would certainly not have been a holder. If one didn't know the dangers and variability of the housing industry in November of 2008, one probably wasn't a sentient human being. Therefore, anyone owning Toll Brothers in November of 2008 had to be, almost by definition, an investor who was willing to accept the intrinsic variability of the industry and, therefore, was not interested in trading the security with regard to its variability. Therefore, the variability of the industry is not reflected in the stock price, which means that the variability of the industry is really reflective of the passions of the investor¹.

¹ The short sale of Toll Brothers was originally recommended in a January 13, 2004 issue of the Devil's Advocate. Copies of this report are available through PCS Research Services.

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Featured Companies

As a brief preface, I'll discuss a topic that is normally not the largest aspect of short selling, which is the changes in competitive and social landscapes that take a very long period of time to take effect, perhaps a decade or more, but ultimately result in the evisceration or near evisceration of enterprises. That may be the most fertile ground for the short seller and, therefore, the following are not necessarily short sale recommendations, but are merely short sale possibilities that may turn into short sale recommendations in the not too distant future. It's important to stress that I don't necessarily recommend the short sale at this moment, though I might well recommend it in due course.

Research In Motion (RIMM)

The first company to discuss is Research In Motion, which is the manufacturer of the ubiquitous BlackBerry handheld communication device. There is no need to describe the BlackBerry device, since it's so ever-present that everyone understands what a BlackBerry is. According to December 2009 data published by comScore, BlackBerry has a 42% market share in devices of its type, but it recently lost a one percent share to iPhone.

iPhone, if the figures are accurate, as of the fourth quarter of 2009, has a 25% market share, which is up 1.2% from the prior quarter. This business is clearly becoming much more competitive and iPhone is not the only entry in the market. Another market entrant is the so-called Android. On February 16, 2010, Google announced that 60,000 Android phones are shipping per day. One would imagine that sooner or later that has to make an impression upon Research in Motion.

Importantly, Research in Motion has its own operating system for the BlackBerry. Yet, Android has the possible advantage of the Open Source Alliance. The Open Source Alliance is a consortium of a variety of companies that back Android, because it employs an open-sourced operating system. The idea of an open-sourced operating system is that people can readily write software for it. Android is based on the Linux operating system, which is itself an open-sourced operating system.

Among the members of the Open Source Alliance are Google, Motorola, Qualcomm, Texas Instruments, Samsung, LG, T-Mobile and Nvidia. Perhaps the most worrisome part, if one were the management of Research in Motion, is the number of mobile operators that are backing the Open Source Alliance. These are China Mobile, KDDI, NTT DoCoMo, T-Mobile, Sprint Nextel, Telecom Italia, Telefonica, Vodafone and China Unicom. One might well ask what all the companies listed have in common. As a generalization, the companies listed tend to have a heavy presence in the emerging market geographies. The emerging market geographies are very important because there

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is, first, a lower installed base of handheld devices and/or cellular phones. Second, to the extent there is an installed base, there is much less experience in using those handheld devices; therefore, almost by definition, there is much less customer brand loyalty. Since there is no long-term practice, in principle, it should be much easier to convince people to switch to an alternative, possibly the Google Android. As a result, one might think that would be worrisome for Research in Motion

Android is always introducing new features including an integrated camcorder and camera, a text-to-speech engine, Bluetooth, Google Maps, and SMS and MMS text messaging. In principle, there's nothing to limit BlackBerry from adding such features on its phones, but the difference is that, given the combined resources of all of the members of the Open Source Alliance, and all of the lesser parties that are willing to write software for Android, it's difficult to imagine how Research in Motion can fight a battle against this collectivity. It's a battle arguably fought from the vantage point of dominant market share that it is likely to lose. Therefore, it must be regarded as a company that, at the moment, is rather vulnerable and, consequently, is likely to be a suitable candidate for a short sale recommendation in the future.

Dell Computer (DELL)

Another company where this sort of dynamic is reasonably evident is Dell Computer. It's reasonably evident, but for not necessarily self-evident reasons. In the following table, Dell Computer's market share from 1997 to the most recently completed year of 2009 is presented.

<u>Year</u>	<u>Dell Global Market Share</u>	<u>Global PC Unit Sales</u>
		(in millions)
1997	5.5%	80.6
1998	7.9%	92.9
1999	9.8%	113.5
2000	10.8%	134.7
2001	13.3%	128.1
2002	15.2%	132.4
2003	15.0%	168.9
2004	16.4%	189.0
2005	16.8%	218.5
2006	15.9%	239.4
2007	14.3%	271.2
2008	12.2%	302.2
2009	11.5%	305.9

In 1997, Dell had only a 5.5% market share. Its peak market share was in 2005 at 16.8%, and it has been gradually losing market share ever since. The entire idea behind Dell Computer is to produce the cheapest possible computers and, therefore, unit volume and economy of scale are critical to that strategy. If the company is losing market share, for

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reasons that will be explored momentarily, that is a threat to the basic Dell business model.

The second column in the table above provides one with the global unit sales of PCs, which surprisingly has been growing, even during the recession. In 2009, global unit PC sales increased, albeit relatively modestly, by about 1%. The growth in PCs is clearly coming from the emerging markets and, in this case, much like the issue in handheld devices, there is not the same tradition of using computers and, therefore, not the same brand loyalty or the same installed base. Consequently, there is room for new entrants or even existing entrants who have a different market strategy, one of which is clearly Hewlett-Packard, another one of which is iMac or Apple Computer. Incidentally, iMac is growing at 8% a year.

Competition is not necessarily only from desktops. It's also from the handheld devices because, for many people, the purpose of having a computer is merely to have access to the Internet on a not very sophisticated basis. It seems nothing other than reasonable to assert that the purchase of a powerful computer with a very powerful microprocessor just for the purpose of looking up fairly pedestrian listings on the Internet is a waste of resources that can easily be accomplished by some type of handheld device. Therefore, as the handheld devices grow in power and sophistication, one would imagine that would be a threat to the entire PC market, and a threat to Dell in particular.

Dell's financials are very interesting. For a company as large as Dell, one can look at the following number in two ways. Dell has \$5.3 billion of net current assets. One might argue on the positive side that this reflects the efficiency of Dell—that it turns its working capital so frequently it doesn't need a lot of working capital. However, one can argue that it's not a lot of working capital resources to compete with the giant companies with which it wishes to compete. It's also worthy of note that Dell has \$3.4 billion in debt. The source of most of its working capital happens to be borrowings. It has a \$28.2 billion market capitalization. The market expectation of Dell's earnings is reasonable. The market expects Dell to earn \$2.82 billion in the coming year, assuming it can achieve a 12% market share of the 305 million PCs sold globally. Dell needs to sell 36.6 million PCs, and it needs to make a profit after taxes on those units of \$77 per unit, which is plausible.

Nevertheless, it's a very low margin business. These earnings, should they be achieved, would represent a 2.7% net profit margin. This is a very slender profit margin business, which means there's very little room for error. Interestingly enough, even with relatively little leverage, as a pure arithmetical property, Dell has a 4.3% return on assets and a 25.4% return on equity, which is not something one normally sees in this business. It means that they turn their inventory very rapidly. It's also worthwhile noting that Dell, which may come as a surprise to many people, has no tangible shareholders' equity. The entire company is an intangible.

One of the long-term threats to the PC in general, and one might argue to the Dell PC in particular, but I suppose it pertains to all PCs, is that the two irreducible costs for Dell are

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the cost of the operating system, which comes from Microsoft, and the cost of the microprocessor, which comes from Intel, because both companies are very loath to reduce prices. The emergence of the handheld device, which is based on a Linux operating system, and is essentially available for free, is a real threat to a company that has to pay the operating system cost. Ergo, Dell is rather vulnerable to slight margin erosion. This margin erosion might not come from price competition from other PCs, so much as it might come from relatively inexpensive handheld devices that could perform the same functions as the PC. Therefore, Dell is a potential short sale candidate.

Why is it not a recommended short sell candidate at the moment? For the simple reason that Dell and Research in Motion have in common the property that in the next several weeks the companies might actually achieve an earnings boost from the recent vigor of the economy. Moreover, it's worthwhile noting that the earnings of all these companies are depressed because of the economy and, therefore, the entry point is in dispute. The current environment, however, might not necessarily reflect the ultimate state of the company. As a result, this may well be a short sale recommendation in due course.

Palm Inc. (PALM)

Another company for which the problems are far more obvious is the company known as Palm. This company has many problems, and it's a \$4 stock. Of course, even the \$4 stock, were it to go to zero, would represent the maximal short seller's rate of return, by definition being 100%, since no security could possibly decline below a price of zero. It appears that Palm is shipping approximately two times as many Pre and Pixi Smartphones as the company is actually selling, which is a very serious problem and could potentially be fatal for the company. The net current assets, or working capital if one prefers, of Palm are a mere \$61 million. I think it's easily arguable that \$61 million in working capital is simply inadequate, and woefully inadequate to compete with the likes of the giants with which Palm must compete. Problematically, the competition is growing and it is absolutely ferocious.

It's also worthwhile noting that Palm not merely has negative tangible equity, but actually has negative equity. It has negative equity and it happens to have debt of \$388 million. It's clearly not well-capitalized, or at least inadequately capitalized for the business it is in. In addition, it has to maintain, with these rather slender resources, the Palm operating system, because it has its own operating system in a posture that competes with devices like the Android, the iPhone, and other much better capitalized companies in general. One can only wonder, how is this conceivable? But, the answer is it probably isn't conceivable.

Last but not least, the company is currently losing money and there seems very little prospect of making any money. In not very many quarters, it's likely to completely exhaust its financial resources and be unable to function as a company unless some enterprise wishing to enter the Smartphone business were to buy it. That's the only possibility of salvation. Therefore, this seems to be a reasonable short sale candidate. It

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doesn't appear likely that someone would wish to buy Palm merely to upgrade the Palm operating system to compete with the Open Source Alliance.

Nokia Corp. (NOK)

There's a much better capitalized company known as Nokia. Nokia is not only the leader in cell phones but, surprising as it may be to some readers, has a very large presence worldwide in Smartphones. In 2009, Nokia, according to the Gartner Group, sold 172 million Smartphones of varying versions. Nokia calculates that the Smartphone market is growing at 24%, which is one of the reasons why it attracts so many market participants. Nokia calculates that it has a 46.9% market share of the cell phone market. Thus, it has economy of scale, and it is certainly a dominant company.

One of Nokia's problems is that the demand for traditional cell phones may well be eroded by the rising market for Smartphones. Those users of cell phones who are likely to buy the more expensive higher margin product are likely users of the Smartphone. As likely users of the Smartphone, they aren't necessarily likely users of the Nokia Smartphone. Therefore, as the Smartphone market grows and begins to penetrate and erode the cell phone market, the market is Nokia's to lose.

Nokia does have its own open source initiative founded around Symbian, but Symbian doesn't have anything close to the number of adherents as has the Open Source Alliance. Therefore, one possible scenario is that this becomes a battle between two open source operating systems and Apple Computer. Ultimately, the world has a tendency to standardize on one system. It appears that there's a big risk associated with owning Nokia. Nokia has a long way to fall, since it has a \$56.4 billion market capitalization. Even with that market capitalization, this business represents a razor-thin profit margin of 2.9%. A 1% margin erosion, which in the world of market share battles is not unheard of, represents a decline of 33% in profits. Moreover, some of this business is likely to be competitive on a price basis.

On the positive side, Nokia does have \$8 billion of working capital, but it also has \$4.4 billion of debt. Obviously, Nokia is a reasonably well-capitalized company. Nokia, in its own forecast, asserts that it is likely to increase, ever so slightly, its market share in the current year. It appears, given all that it's developing in the Smartphones, that a market estimate founded on the presumption that Nokia is likely to increase, however slightly, its market share, is not necessarily a sound forecast, and might be vulnerable to negative revision.

Another worrisome feature for Nokia is the growth in mobile device volume. Mobile device volume embraces not merely traditional cell phones but also Smartphones. Mobile device volume by geographic area, as shown in the table below, appears problematic in some regards.

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Nokia Mobile Device Volume, 2009 vs. 2008

Europe	-1.2%
Middle East & Africa	33.5%
Greater China	36.4%
Asia/Pacific	15.4%
North America	-7.3%
Latin America	-6.8%

The above table only pertains to Nokia's phones, not necessarily the given market, although the market is probably reflective of this. There are three geographical areas in 2009 in which demand for mobile devices declined. These are Europe, North America and Latin America, and those represent, more or less, the saturated markets. The Middle East was very robust, as it grew over 33%, and greater China grew by 36%. The Asia/Pacific area, although less robust, still was strong, demonstrating a 15.4% growth rate. The growth in phones is clearly happening in the emerging areas, because those are the areas yet to be penetrated, and those are all the areas that have a relatively low installed base with no long history of brand loyalty. Therefore, the evolution of new and interesting products is likely to have a greater impact on those areas than we saw in the developed markets, where there is such a thing as brand loyalty.

Thusly, if Nokia does not reproduce its market share in the emerging markets as in the developed areas, it is likely vulnerable to a serious diminution of the consensus estimate earnings. Therefore, Nokia remains a possible short sell recommendation with the proviso that in the coming weeks and months, Nokia might well experience some boost in sales from a recovering economy, which might impede the progress the short seller is likely to make. The issue with Nokia is not necessarily one of validity of the investment thesis. Rather, it's more an issue of the appropriate entry point. One might wish to postpone this undertaking to a somewhat later date.

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From the Readers

Alexander & Baldwin (ALEX)

Q: Do you have a current opinion on Alexander & Baldwin?

A: Alexander & Baldwin, the shipping company, has many good features. First of all, it's an undervalued company because it happens to own a lot of real estate, not merely in Hawaii, but also in the Continental United States. At one point, Alexander & Baldwin had a virtual monopoly on Hawaiian shipping. In fact, it still has a virtual monopoly on Hawaiian shipping. Since it was active in shipping, it acquired some interesting waterfront properties, some of which have been developed; others have yet to be developed. It has this land position, which is intrinsically valuable. One can argue what the land might be worth, but it's unquestionably intrinsically valuable.

Second, over the years it acquired real estate in the United States. This real estate is not in any way unique, such as being distressed or exotic real estate. It's merely garden variety commercial space that earns a mundane cash-on-cash yield. As such, unlike most commercial space, because it's enclosed within the corporate structure of Alexander & Baldwin, it pays the corporate income tax. It would have a much greater valuation were it enclosed in its own REIT format. In order to accomplish that, Alexander & Baldwin would have to, in some way, spin off the conventional real estate assets into an REIT; however, the board has not been very progressive, and it has been loath to undertake many shareholder-friendly actions. Therefore, one could argue that the assets of Alexander & Baldwin, valuable though they be, have yet to achieve their maximal value, because the corporation has been indisposed to undertake the necessary actions.

In fairness to the corporation, the listing of yet another real estate security in the 2007-2009 time period might not have been the most judicious action inasmuch as there wasn't great demand for real estate securities in general. Moreover, maybe it's arguable that actions of that type should be pushed to a later date. Therefore, it's not inconceivable that the company might take those actions, but there's no question it's an undervalued security. Those are the actions necessary to provide for a higher valuation on the shares, and one day that might happen.

Incidentally, if one is interested in valuing the real estate, there's another real estate company that trades in Hawaii called Maui Land & Pineapple. That real estate is not necessarily comparable, but at least one would have a general idea. Hawaiian real estate is, generally speaking, pretty valuable. It's lush, beautiful, and scenic. The State of Hawaii itself has a lot of restrictions on building in various areas. For that reason, there was a decline in real estate values in Hawaii, but it was nothing like what was experienced on the mainland. Hawaiian real estate remains very valuable, since it's a commodity in relatively short supply, and Alexander & Baldwin is in a position to supply it.

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Chinese Currency

Q: The media recently has been talking about the inevitability of the Chinese government removing the yuan-dollar peg and allowing the depreciation of its currency. You've talked in the past about companies that have local revenue streams that are based in the Chinese Yuan, and the ability to capitalize on that as a U.S.-based investor. Given the inevitable appreciation, what are the ways in which investors can potentially profit from that without directly investing in the currency such as in the WisdomTree ETF?

A: Well, when buying the ETF, one doesn't hold yuan. The ETF owns forward contracts, exchangeable for yuan. Thus, it's in a position to profit from a change in the rate if one would occur. It's very difficult to actually own yuan. The standard way of doing it, other than buying an ETF, is to buy a Chinese company whose business can't possibly be exported and, therefore, must by definition be a Chinese currency earnings stream. One example would be the airports, of which there are two publicly traded ones. There's the Hainan Airport (357:HK) and the Beijing Airport (694:HK). Those are obvious candidates because, say what one will about the airports, it can't be exported.

Another possibility, though some might think it to be less desirable, would be to invest in the various property companies that exist in China itself. An example might be New World China Land (917:HK). The deficiency of property in China, many would argue, is that there is a bubble in Chinese property. In principle, then, if there were no bubble in Chinese property and the Chinese currency would appreciate, any owner of the property would enjoy that. Of course, if one takes the view that Chinese property is too expensive, one might be right in the currency but be wrong on the property. Therefore, I would argue that anyone having any doubt about the pricing of Chinese property might wish to find an alternative to Chinese property to express their yuan trade.

However, there are also the ports. There's COSCO Pacific (1199:HK), Tianjin Port Development Holdings (3382:HK), Dalian Port PDA (2880:HK), and Xiamen International Port Co (3378:HK). These ports mentioned are all publicly traded and they can't be exported. However, that's not to say there isn't an export element to it. One could argue that, were the Chinese currency to appreciate, one of the natural consequences might be less tonnage leaving China. Therefore, one might argue that the tonnage realized in the ports would be lower, and that, consequently, the port would be intrinsically less valuable. Of course, one could also argue that one of the objectives of changing the Chinese currency from the non-Chinese point of view is to make sure more imports flow into China and, therefore, in principle, the port would be carrying the same tonnage. In practice, my own view is that the Chinese in their own time will wish to raise the value of their currency, because the reserve currency of the world is the dollar. All commodities are priced in dollars, and China is commodity short. Raising the value of the currency actually means to lower the value of the commodities that China must buy to feed its own growth, and I believe it will do that.

If one wishes to avoid the aspect of the international ports, one can buy PYI Corporation, (498:HK), which is a local port. That's actually a river port and, therefore, it's not

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necessarily involved in international transit, although it is involved to some degree because one has to understand that goods that might ultimately be exported at the international ports are many times sent to the international ports via the rivers. Therefore, it's not without an international trade component, just somewhat less so.

Another way to gain exposure to the currency is to buy the casinos, because the Macau-based casinos are not possible to export. The casinos are SJM (880:HK), Wynn Macau (1128:HK), Sands China (1928:HK), Galaxy Entertainment (27:HK), and Melco (200:HK).

Then there's the question of the utilities. The utilities are a little bit more complicated. The reason is that, although they've been interesting investments, they haven't been marvelous investments like some other Chinese companies. The reason is because the Chinese government has been very reluctant to grant rate increases to the utilities when commodity prices increase, since they're very wary about furthering inflation. The Chinese government can intervene in that way because there isn't an established body of utility law, as is the case with American utilities. As a consequence, in principle, should the Chinese currency rise in value, although the companies themselves might not get a rate increase, they will experience lower commodity prices and, to that extent, their profit margins might be higher than what they otherwise would be. Examples of the Chinese utilities are Huaneng Power (902:HK), China Shenhua Energy (1088:HK), and Datang International Power Generation (991:HK).

Last, there's also the gas utility, which is the most interesting of all. The company is called Towngas China (1083:HK) and it is 45% owned by Hong Kong & China Gas (3:HK). Hong Kong & China Gas is currently in the process of engaging in a transaction with Towngas. Hong Kong & China Gas owns some gas properties, which are in the Liaoning and Zhejiang Province, which will be sold to Towngas in exchange for stock. At the conclusion of the transaction, the ownership by Hong Kong & China Gas of Towngas is going to rise from 45% to 54%. The gas industry is very interesting in China, because the gas utility industry is in its infancy. Virtually no district in China has a gas supply, which is in contradistinction to a developed country like the United States where virtually every district has a gas supply. In China, the gas industry is just starting, and the gas company is merely a common carrier. The gas company merely delivers gas. As a common carrier it gets a certain rate of return, and its life is a little bit easier than an electric company that, in essence, takes title to some type of fossil fuel, and then burns it and converts it to electric power. Therefore, the regulatory scheme of Towngas, from the point of view of the company itself, is less problematic, and also has much more growth ahead of it than the electric companies.

Most dwellings in China have access to electric power, but very few homes, and not even that many businesses, have access to gas. This is very different from the Western European and American experience. It's worthy of note that in the Western European and American experience the typical urban dwelling had access to gas before it had access to electric power, because gas, as strange as it may sound, was the modality by which homes were lighted. It's hard to believe that in the 19th Century many homes had an open

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gas flame serving as an alternative to a candle. Imagine how dangerous that was? China didn't go through that experience.

The existing gas utility network in the developed world was used to create the gas utility network as we see it today, primarily for heating and cooking. In China, it has yet to exist. As the cities are being modernized, the local gas distribution infrastructure is being installed, and Towngas is an interesting company. Obviously, one can't export the local gas distribution company; it must remain Chinese. Therefore, it is a mechanism for investing in the Chinese currency.

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Money Manager Index

From Jan 1983 to Jan 2010														Annualized return		
Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Yr. End	Index	Yearly return	(since inception)
1983								1.00	0.81	0.76	0.87	0.75	1983	0.75	(60.5)%	(50.2)%
1984	0.75	0.71	0.70	0.66	0.67	0.67	0.61	0.83	0.79	0.76	0.67	0.65	1984	0.65	(13.5)%	(26.5)%
1985	0.92	0.93	0.99	0.95	1.20	1.30	1.32	1.38	1.28	1.50	1.86	2.02	1985	2.02	211.8%	33.7%
1986	2.46	2.78	2.47	2.31	2.36	2.33	2.03	2.23	1.98	2.37	2.34	2.34	1986	2.34	15.9%	28.2%
1987	3.21	3.27	3.16	2.55	2.37	2.30	2.39	2.47	2.22	1.56	1.44	1.52	1987	1.52	(35.0)%	9.9%
1988	1.80	1.87	1.78	1.79	1.69	1.94	1.92	1.96	2.01	1.97	1.95	2.07	1988	2.07	36.0%	14.3%
1989	2.42	2.37	2.54	2.63	2.64	2.64	2.93	3.12	3.07	3.05	3.23	3.26	1989	3.26	57.8%	20.2%
1990	3.12	3.15	3.53	3.06	3.47	3.45	3.30	2.70	2.68	2.40	2.52	3.02	1990	3.02	(7.3)%	16.1%
1991	3.08	3.49	3.70	3.68	3.71	3.61	3.86	4.05	4.07	4.69	4.47	5.72	1991	5.72	89.4%	23.0%
1992	5.76	5.61	5.30	5.12	4.98	4.99	5.93	6.06	6.19	6.56	7.25	7.36	1992	7.36	28.6%	23.6%
1993	8.06	8.04	8.20	7.94	8.15	8.57	9.05	10.00	9.99	9.31	8.97	8.90	1993	8.90	21.0%	23.4%
1994	9.52	8.73	8.05	7.85	7.81	7.53	7.66	8.31	8.15	8.52	7.88	7.95	1994	7.95	(10.6)%	19.9%
1995	7.74	8.38	8.72	8.77	9.20	9.35	9.93	10.78	11.22	10.53	10.89	10.40	1995	10.40	30.8%	20.8%
1996	11.12	11.50	11.33	11.62	11.86	12.53	11.91	12.36	13.32	14.03	14.42	15.02	1996	15.02	44.4%	22.4%
1997	16.04	16.81	15.32	17.27	18.42	20.29	22.28	21.39	25.31	24.95	24.95	25.50	1997	25.50	69.8%	25.2%
1998	25.67	29.00	29.89	30.60	28.90	30.44	27.67	21.33	21.74	25.16	27.27	25.41	1998	25.41	(0.4)%	23.3%
1999	26.00	23.71	23.92	26.77	28.94	29.74	28.78	26.74	25.89	27.73	28.54	30.55	1999	30.55	20.2%	23.2%
2000	31.07	31.19	36.01	35.60	35.20	40.32	43.58	45.75	45.62	48.69	44.05	49.84	2000	49.84	63.1%	25.2%
2001	50.23	46.41	44.27	46.96	48.90	49.98	50.67	49.70	46.47	44.81	48.04	51.91	2001	51.91	4.2%	23.9%
2002	53.62	53.74	55.11	52.52	52.83	50.48	42.58	44.92	41.54	42.66	45.78	43.17	2002	43.17	(16.8)%	21.4%
2003	42.72	41.18	42.36	45.98	49.02	50.71	53.47	53.97	53.46	56.12	55.83	58.49	2003	58.49	35.5%	22.1%
2004	64.38	65.08	64.63	61.68	60.86	62.30	58.71	64.08	65.73	68.86	73.53	78.16	2004	78.16	33.6%	22.6%
2005	76.46	77.94	74.06	72.83	77.02	80.25	83.59	83.07	86.03	89.19	96.58	97.35	2005	97.35	24.6%	22.7%
2006	107.62	111.44	110.75	111.88	101.89	100.61	100.62	104.98	114.61	116.64	113.78	118.05	2006	118.05	21.3%	22.6%
2007	125.73	123.77	122.62	127.58	133.57	134.68	126.61	124.07	133.57	148.09	135.13	135.56	2007	135.56	14.8%	22.3%
2008	127.53	115.76	115.94	121.58	130.51	115.68	119.94	120.55	109.69	72.70	62.95	67.91	2008	67.91	(49.9)%	18.1%
2009	57.51	51.76	65.63	79.49	85.67	90.79	99.97	101.69	107.32	107.36	110.94	115.01	2009	115.01	69.4%	19.7%
2010	106.84	110.318	118.13											118.13	2.7%	19.6%

Name	Amount Invested	Name	Amount Invested
Affiliated Manager	\$ 22,947	Pzena Investment Mgt	\$ 122,426
Alliance	\$ 7,633		
BlackRock	\$ 23,205		
Waddell & Reed	\$ 27,513		
Eaton Vance	\$ 2,641		
T. Rowe Price	\$ 2,423		
Franklin resources	\$ 908		
Legg Mason	\$ 1,000		
Federated Inv	\$ 26,381		

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International Money Manager Index

From Jan 1983 to Dec 2009

														Annualized return		
Year	31-Jan	28-Feb	31-Mar	30-Apr	31-May	30-Jun	31-Jul	31-Aug	30-Sep	31-Oct	30-Nov	31-Dec	Yr. End	Index	Yearly return	(since inception)
1986											1.00	1.02	1986	1.02	10.0%	10.0%
1987	1.25	1.37	1.48	1.48	1.37	1.33	1.39	1.40	1.33	0.81	0.76	0.73	1987	0.73	(27.7)%	(23.3)%
1988	0.75	0.92	1.02	0.95	0.80	0.89	0.88	0.82	0.86	0.88	0.89	0.93	1988	0.93	26.4%	(3.4)%
1989	1.03	1.02	1.06	1.17	1.19	1.18	1.25	1.16	1.17	1.20	1.21	1.28	1989	1.28	37.8%	8.1%
1990	1.24	1.24	1.18	1.19	1.22	1.24	1.26	1.26	1.23	1.24	1.25	1.33	1990	1.33	3.7%	7.0%
1991	1.34	1.52	1.56	1.58	1.57	1.47	1.52	1.64	1.81	1.89	1.94	1.92	1991	1.92	44.8%	13.5%
1992	2.01	1.93	1.88	2.14	2.19	2.13	2.08	1.99	1.95	1.77	1.76	1.96	1992	1.96	1.9%	11.5%
1993	1.98	2.03	2.20	2.39	2.42	2.45	2.54	3.05	3.01	3.07	3.01	3.30	1993	3.30	68.7%	18.1%
1994	3.72	3.39	3.17	3.04	2.99	2.89	3.01	3.14	3.13	3.19	3.15	3.15	1994	3.15	(4.7)%	15.1%
1995	3.07	3.12	3.28	3.41	3.56	3.59	3.87	3.76	3.76	3.77	3.70	3.73	1995	3.73	18.6%	15.4%
1996	3.76	3.85	3.70	3.79	3.96	3.90	3.75	3.96	4.16	4.47	4.90	4.86	1996	4.86	30.3%	16.8%
1997	5.11	5.37	4.99	4.96	5.43	5.94	6.57	6.32	7.45	7.24	6.80	7.19	1997	7.19	47.9%	19.3%
1998	7.12	8.05	8.78	9.25	8.95	8.74	8.91	6.67	6.08	7.01	7.51	7.71	1998	7.71	7.3%	18.3%
1999	7.99	8.21	8.68	9.07	8.71	8.61	8.63	8.43	8.47	8.79	9.80	10.79	1999	10.79	39.9%	19.8%
2000	11.23	12.27	13.95	13.50	13.73	15.39	15.85	16.82	17.07	16.31	14.43	16.76	2000	14.43	33.8%	20.7%
2001	17.42	15.88	13.46	15.14	15.84	15.15	14.21	13.61	10.77	11.43	13.90	14.12	2001	14.12	(2.2)%	19.1%
2002	14.74	13.78	15.09	15.11	16.38	14.14	12.92	12.10	11.23	11.06	11.33	10.50	2002	10.50	(25.6)%	15.7%
2003	10.18	9.52	9.69	10.62	12.17	13.04	13.98	15.38	16.67	17.88	18.16	18.07	2003	18.07	72.1%	18.4%
2004	20.00	22.41	29.98	35.46	26.68	30.80	25.37	25.20	23.67	23.34	27.56	31.48	2004	31.48	74.2%	20.9%
2005	32.19	32.57	31.88	27.79	27.36	29.05	30.38	31.49	33.39	32.24	32.95	37.18	2005	37.18	18.1%	20.8%
2006	41.01	40.97	43.69	46.45	42.39	41.58	40.60	43.32	43.55	43.70	44.58	49.38	2006	49.38	32.8%	21.3%
2007	50.95	51.18	53.59	56.09	58.16	56.37	53.90	48.65	50.96	57.03	48.21	45.75	2007	45.75	(7.3)%	19.8%
2008	38.71	39.71	38.59	40.18	39.25	35.10	34.59	33.33	26.09	18.72	14.50	15.79	2008	15.79	(65.5)%	13.3%
2009	14.62	13.24	14.96	19.63	22.82	23.73	26.14	27.05	28.41	28.53	28.69	29.83	2009	29.83	89.0%	15.8%
2010	28.50	27.58	29.90											29.90	0.2%	15.6%

<u>Name</u>	<u>Amount Invested</u>	<u>Name</u>	<u>Amount Invested</u>
IGM FINANCIAL INC	\$1,000	HENDERSON GROUP PLC	\$14,447
F&C ASSET MANAGEMENT PLC	\$1,203	RAB CAPITAL PLC	\$24,603
INVESCO PLC (PREVIOUSLY AMVESC	\$1,357	AZIMUT HOLDING SPA	\$21,908
SCHROEDERS PLC	\$1,208	EVEREST FINANCIAL GROUP LIMITED	\$23,437
RATHBONE BROTHERS PLC	\$1,208	CHARLEMAGNE CAPITAL LTD	\$36,848
ABERDEEN ASSET MGMT PLC	\$1,208	PARTNERS GROUP-REG	\$36,848
CI FINANCIAL INCOME FUND	\$2,585	INVISTA REAL ESTATE INV MNGT	\$36,589
MAN GROUP PLC	\$2,862	ASHMORE GROUP PLC.	\$36,688
AGF MANAGEMENT LTD-CL B	\$3,343	BLUEBAY ASSET MANAGEMENT/UNI	\$37,469
SPARX GROUP CO LTD	\$11,762		