

CI GLOBAL EQUITIES FUND QUARTERLY REPORT



Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

SEPTEMBER 2010

“Public debt crises are always and everywhere a political phenomenon.” Niall Ferguson

“Everyone wants to live at the expense of the State... They forget that the state lives at the expense of everyone.” Frédéric Bastiat

Market and Fund Performance

CI Global Equities Fund - Hedged

	**FUND	BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	8.65%	9.75%	-1.10%
ROLLING 1 YEAR	12.75%	7.35%	5.40%
ROLLING 2 YEAR	1.19%	2.39%	-1.20%
ROLLING 3 YEAR	-5.32%	-7.92%	2.60%
ROLLING 5 YEAR	3.89%	0.88%	3.01%
SINCE INCEPTION*	8.38%	3.27%	5.11%
SINCE INCEPTION^	59.87%	20.65%	39.22%

*Annualised

^Cumulative (1 December 2004)

**Before fees and expenses

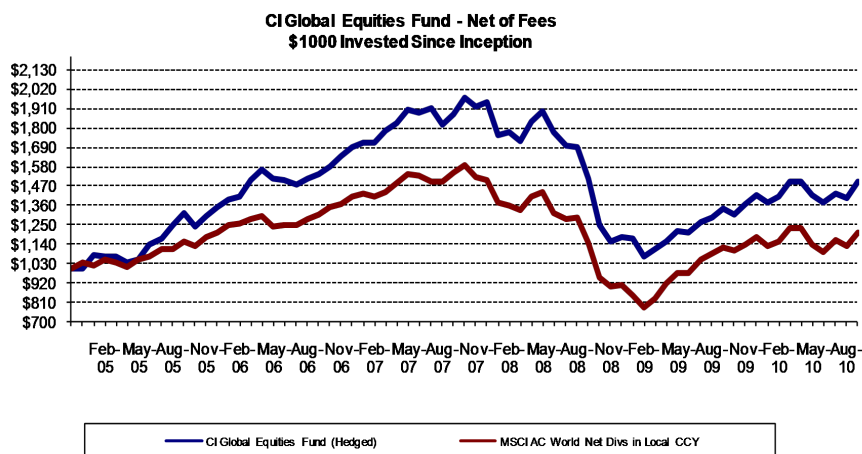
CI Global Equities Fund - Unhedged

	**FUND	BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	-0.78%	-0.26%	-0.52%
ROLLING 6 MONTH	-3.44%	-4.75%	1.31%
ROLLING 1 YEAR	1.45%	-1.18%	2.63%
ROLLING 2 YEAR	-5.53%	-6.07%	0.54%
SINCE INCEPTION*	-7.52%	-7.88%	0.36%
SINCE INCEPTION^	-15.01%	-15.71%	0.70%

*Annualised

^Cumulative (1 September 2008)

**Before fees and expenses



The CI Global Equities Fund (Unhedged) returned -0.78% for the July-September quarter of 2010. This is compared with -0.26% for the MSCI AC World Net Dividends in AUD. The CI Global Equities Fund (Hedged) returned 8.65% compared with the MSCI AC World Net Dividends in Local Currency which returned 9.75%. Top performers this quarter were Oracle Corp, Prosegur, Want Want, Itau Unibano and Shoprite. The worst performers were Roche, Colgate-Palmolive, Wells Fargo and Petrobras.

Currently, we hold 40 stocks in the portfolio and cash is around 4%. Our ten largest positions are Oracle Corp (4.5%), Itau Unibanco, Wells Fargo, Novo Nordisk, Standard Chartered, Shoprite Holdings, IBM, Tesco, SGS and

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Reckitt Benckiser (3.4%). Our smallest position is Apple with 1%. We made a few changes at the smaller end of the portfolio, primarily investing in a couple of smaller companies in Asia. We sold Hewlett-Packard this quarter, we had sold most of it just prior to the Mark Hurd debacle and, subsequently, we sold out entirely once it became clear the board of directors were plotting a radical new course for the enterprise hardware industry's equivalent of the Queen Mary. It remains to be seen whether Mr Apotheker has the right hands on deck to navigate successfully.

We are reasonably comfortable with the valuations of much of our portfolio. However it seems as though emerging market stocks are tending towards overvaluation levels. While we have not trimmed our positions on this yet, we are watching closely and in large part our actions will likely be influenced by any further easing on the part of central banks. If this does come to pass we feel it likely that valuations, in particularly the emerging markets, will remain strong.

This quarter we visited companies in Hong Kong and Japan. While we saw many excellent companies, Hong Kong seemed like the "thirty something show", that is price to earnings valuations of over 30 times. It did assuage our fears on China a little, at least in terms of contextualising near term weakness within longer term strength, particularly on the housing market and consumption patterns. We have not traded as a result of the trip though, mainly because valuations are a little high.

As a treat for readers this quarter we have included a picture of a stagecoach, so without further ado...

Wells Fargo – a homespun banking story

The name Wells Fargo has been in existence since 1852 when Henry Wells and William Fargo opened their bank and express stagecoach service in San Francisco during the gold rush. The modern Wells Fargo is a result of a takeover by Norwest, a Minneapolis bank which subsequently assumed the Wells Fargo brand and moved its head quarters south west to California. Throughout much of this decade Wells Fargo had strong presence in northern, western and middle America but none on the east coast. Wells got its chance to expand through acquisition onto the east coast when it trumped Citigroup to the purchase of Wachovia which had traditionally been a conservative east coast lender that had come unstuck with Golden West, a bank it had acquired in 2006. As the U.S. subprime crisis morphed into the global financial crisis the losses from the legacy Golden West subprime book brought Wachovia down and with it 200 years of banking lineage. Wells, whose market cap is \$135bn, is now coast to coast, has the largest branch network in the U.S. and is 4th in terms of size of assets and the largest retail mortgage originator. Total assets are 10% of the total industry's and loans are 8% of total credit in U.S.



In general Wells are renowned for being relatively conservative underwriters of loans. In the U.S. personal credit ratings are given what are known as FICO scores, the average in the U.S. is around the 690 mark according to Experian with sub-prime below 600 and the highest being 850. As an example going into the downturn the average FICO on Wells Home Equity lines was 750, well above the average. Wells strategy is to sell as many products to the customer as possible, and at the cross-sell they are clear industry leaders with 6.06 products per customer. This strategy is supported by what they consider to be relationship banking - in the sense of knowing the customer. Be this through their exhaustive use of data and I.T. to provide tailored products and offers – a method they pioneered - or from traditional customer facing relationships with their commercial customers. Just to hammer the point home, a

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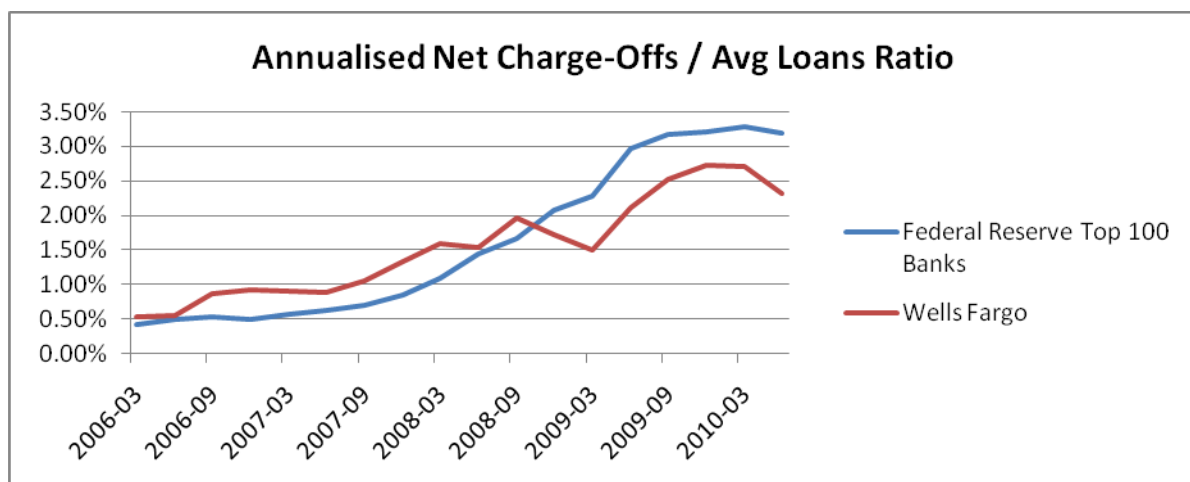
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word search on the transcript of their recent investor day shows “cross-sell” was mentioned 127 times. Their lines of business have, over time, been very conservative. They have not moved into proprietary trading or been stuck with large portfolios of toxic assets, unlike some of their peers. Wells’ management generally has traditional banking backgrounds as opposed to investment banking or otherwise and they are in a very different mould to their larger peers by way of focus and culture. Their funding base is largely from customer deposits and, importantly, a large portion is non-interest bearing. By avoiding those chasing yield, and focusing on stable, older, conservative customers through their community banking, they have a low cost funding base that is second to none. It is this that gives them an industry leading net interest margin of above 4% and often closer to 5%. This, their cross-sell of fee based products and the strong fee based product income, saw them consistently realise Return on Net Tangible Assets of over 25% prior to the financial crisis.

Our valuation on Wells suggests a fair price around the \$44 range. The stock is currently trading at \$26. So why the price discrepancy on one of the largest banks in the world, and certainly one of the best covered by analysts. On the face of it they have made all the right moves. They refrained from lowering their lending standards during the boom years and lost market share accordingly – market share they have subsequently regained in force. They took advantage of failed peers during a downturn to acquire assets cheaply. They’ve so far weathered the financial crisis, raised equity at appropriate times and come out looking stronger. The main reason for their lowly valuation is uncertainty. Uncertainty regarding a further leg down in the housing market, uncertainty regarding the regulatory environment, uncertainty over the Wachovia acquisition - in particular parts of the loan book and lastly uncertainty over the commercial real estate market and the funding of states and local municipals.

First, there are real concerns over the inventory yet to work its way through the housing market in the U.S. The current estimate is around 5.5m homes are either owned by banks, in foreclosure or 90 days past due payments. Currently annualised sales are 4.1m so it seems that this inventory will take a number of years to clear. If you include homes with payments 30 days past due, which have a cure rate of only 30% at the moment, then that would include another 1.3m. The 30 day delinquency rate is probably more appropriate to look at in terms of trends, as this is closely correlated to the initial employment claims, although down from its peak this remains stubbornly high at around 470,000 per month. It remains to be seen the effect of this shadow inventory on house prices, however it is safe to say it will apply significant downward pressure. While housing affordability is reaching its long term trends, the truth is that usually these trends overshoot. It is clear that it looks tough for the housing market. However Wells have seen marked improvement in their delinquency ratios for 6 months now and clearly they are writing off less loans than their comparable peers. This profile (see below) of charge-offs conforms to previous financial crises such as the Great Depression and Japan in the 1990s. If this is the case most previous charge-off ratios peaked around year 4, suggesting there is possibly a year to go which would be very containable with Wells’ earnings strength.



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Secondly, the regulatory environment in the U.S. could simply be described as in flux. Recently as new regulatory framework was passed in July under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Aside from the institutionalising of moral hazard (which we will leave for debate elsewhere) it places the Federal Reserve as the principal regulator of the systemically important banks with rules yet to be determined. It nominates any bank above \$50bn of assets as systemically important, including any non-bank holding companies that received TARP money also – known as the Hotel California rule. It limits absolute bank size and seeks to stop proprietary trading on banks' own capital. The key issue is the window of 18 months that the Fed, FDIC, SEC etc have to determine these prudential rules and how they will be affected by the incoming Basel 3. This leaves both the banks and investors in the dark about really what capital requirements and operational constraints there will be, until this is determined Wells may withhold dividend payments for longer. While this prolongs uncertainty, Wells are just shy of an 8% Tier 1 Common Capital ratio. Under Basel 3 6% is defined as "well capitalised". So this could be a sign dividends may not be far off. Further the evidence suggests that a banking system regulated by the Federal Reserve is likely to be pro-banks, although this may just be our cynical disposition.

Thirdly, at first glance when Wells acquired Wachovia, it appeared to many to be a shotgun wedding at the behest of the Treasury and Fed. Since then there has actually been nothing but relatively positive news coming from Wells regarding the matter. It is important to stress that Wachovia was of equal size to Wells, essentially Wells doubled their earnings power for \$15bn. As mentioned, Wachovia had a large portfolio of Option-ARM mortgages that reset after a specific period of teaser rates, usually causing the homeowner to then default. This however was marked down to cents on the dollar at the time of acquisition and subsequently has performed better than expected according to management. Of course, the damage from resetting of these rates has failed to transpire through abnormally low interest rates, and Japan's experience with balance sheet recessions would suggest that they will remain low for some time yet. Wachovia's branch and system integration has been successful and Wells has managed to retain both customers and staff which are big positives. Indeed Wachovia's customer base is cited as the big opportunity with only 4.9 products per customer currently and therefore potential for further cross-sell.

Lastly, there are issues regarding the commercial real estate market and also the balance sheets of the states and municipals. On the former, the concern is that \$1.4bn of commercial debt maturing over the next 4 years will flood an already weak system. It could be argued however that this is an opportunity for banks to lend at floating rates to good commercial clients. In the current environment banks have tightened consumer lending due to perceived risks, weak demand and also the fixed nature of residential mortgages in a low rate environment, leading to shrinking balance sheets. The issue around state and local government debt, however, is a serious one and the timeline for this playing out is unclear. Wells is exposed to these borrowers but it is less than 1.5% of total interest earning assets and they are mostly securities Wells underwrote themselves.

As with all opportunities, the biggest ones come in the face of uncertainty and worry. We think Wells Fargo stock is one of them currently. Disregarding external macro or industry issues, and solely focusing on what Wells management are saying, it seems that while business is difficult, there is a small chance balance sheet and provisioning issues may have turned a corner. There are two options, either it has or it hasn't. If it has then it's the home straight, if it hasn't then we are fairly confident that further future losses will not destroy Wells' longer term earnings power, in which case we will have to wait a little longer to realise our valuation.

Allan Says... Como pode-se impedir os bandidos?

"We only need to be lucky once. You need to be lucky every time." — The IRA to Margaret Thatcher, after a failed assassination attempt.

The Fund became shareholders in Prosegur in the first quarter of this year. After a number of meetings and phone calls with management we felt Prosegur was a compelling investment. With a workforce of more than 100,000 employees Prosegur is the leading security service company in Spain and Latin America and the 3rd largest

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worldwide. Listed in Spain, Prosegur has a market cap of USD \$3.5bn and operates across 13 countries in Europe and Latin America. Prosegur is the dominant player in these markets with 50% market share in Spain, 40% in Brazil and 50% in Argentina, its 3 biggest markets. After starting out as a pure Spanish player almost 35 years ago, Latin America has grown to be Prosegur's biggest and most important division contributing over 70% of profits in the first half of 2010. Prosegur's Latam footprint is extremely attractive given its size and growth profile, where they are beneficiaries of the growth in the Latin American economy and banking system. The company is owned and controlled by the founding Gut family who retains a 50% shareholding. The founder's son, Christian Gut Revoredo, is CEO and Helena Revoredo, the widow of the founder, is Chairman. The company is run for the long term and has the best returns and margins in the industry.

Prosegur provides two core security services – 1) man guarding and 2) cash in transit services (CIT), a more complex operation which involves transporting and handling the customer's cash as well as the management of ATM networks. Prosegur also has a small but growing Latam residential security business. The more commoditised man guarding business is Spain and Europe centric whereas the Latam operations are mainly CIT services. In Spain, Prosegur has scale in man guarding and the strict regulatory environment favours large established players. However, in Latam Prosegur is growing with its CIT operations as man guarding regulations are lax in these countries and many smaller companies underprice and cut corners. CIT is a more capital intensive business as it needs armoured trucks and cash handling centres but it is also much more profitable than man guarding with margins more than double those of man guarding. It is a business where scale matters as adding extra cash pickups on a route does not add any significant costs. As Prosegur averages 50% market share across Latam they are incredibly profitable with a group ROE of 25%.

Prosegur is benefiting from its early expansion into Latin America which it entered in 2001 with an acquisition in Brazil. In 2010 Prosegur will generate more than €1.1bn in revenues from Latam with Brazil the largest market contributing almost €600m. Prosegur is the largest CIT operator in Latam with a customer base of banks and large scale retailers. These markets are growing rapidly as more cash circulates through the economy. Prosegur is remunerated based on a combination of 1) the number of stops and pickups their armoured trucks make and 2) the amount of money being transported and handled. The Latam market is extremely valuable as the hostile environment means banks and retailers do not want to hold significant amounts of cash in branches and stores, leading to constant pickups of their cash. So too, high inflation and interest rates means banks and retailers don't want idle cash lying around. The Latam operations are growing in line with nominal GDP as organic sales have averaged double digit growth over the last 5 years. Business volumes move in line with real GDP and at the same time Prosegur and its peers are able to command yearly or 6 monthly price increases in line with CPI to combat wage inflation. As a result Prosegur will be a beneficiary of Latam inflation as long as the currencies hold.

In Latam Prosegur and Brinks dominate the market with a combined 90% market share. Except for Brazil, Prosegur does not see many more opportunities for acquisitions and substantial increases in market share. Brazil is the largest and most fragmented of the Latam security markets with 7 operators of significant size. Prosegur believes there is still room for consolidation in which it plans to take part. Prosegur has also signalled its interest in moving into new markets to ensure future growth. While moving into a new market poses new risks this strategy has been stated for some time and is likely to be a well thought out decision. With a strong balance containing only €170m of net debt, Prosegur has the resources to expand into new markets as it sees fit.

Prosegur is a well run company with a large exposure to emerging markets. The share price has quickly risen and it is up 25% since we became shareholders, reflecting recognition of its growth profile and strong market position. We continue to see value in Prosegur as it piggy backs off Latam growth. As the Latam operations generate 70% of profits, and are growing at double digits, Prosegur is an attractive long term holding at current valuations.

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