



5 January 2009
PO Box R718
Royal Exchange
NSW 1225

**Smallco Investment Fund -
6 Monthly Newsletter to 31/12/08**

As you would be aware, equity markets globally have posted further heavy losses in the past 6 months, driven by continued dysfunctional debt markets and the realisation that the global economic slowdown will be worse than many initially thought. This has resulted in heavy falls in the prices of many Australian small companies with the Small Ordinaries Accumulation Index falling 42.0% for the half year and falling 19.1% for the preceding 6 month period. These two periods have been the worst two 6 month declines in this index's 19 year history.

In the 6 months to 31 December 2008 Smallco Investment Fund returned -30.2%. While this is better than the small company indices, it is nevertheless disappointing. The unit price ended the year at \$1.1571 and the performance for the calendar year was -53.7%.

Despite central banks trying to push liquidity into the system, the debt markets remain very fragile. Equity markets are now very concerned about the earnings outlook as the economy slows. Additionally, any company that does not have a strong balance sheet and is due to refinance over the next couple of years is being treated very harshly, perhaps overly so in many cases.

In this environment where valuations are generally attractive but near term earnings risks are high, we have held higher than normal cash levels with the aim of gradually building positions in quality companies that have been harshly dealt with. Our strategy is to reduce cash levels once our confidence in the outlook starts to improve.

Our focus continues to be on fundamental stock selection with an aim to buy high quality businesses (generally those with a strong competitive position) which we expect to have strong profit and earning per share (EPS) growth over the medium term. The reason for this is that as long as a company continues to increase profits and EPS, we believe that in due course the market will recognise this and it will be reflected in the share price.

In our last letter we spoke of the fund taking advantage of price weakness to purchase shares in Wotif.com and Primary Health Care. Both of these companies continue to grow and expectations are for EPS growth in excess of 20% in FY09 despite the economic slowdown.

Another company of interest is Seek, the leading on-line employment classifieds provider in Australia. Since listing in 2005, Seek has reported EPS growth in excess of 30% per annum. Due to the slowing employment market, our forecast is for a decline in profit in FY09 and again in FY10. However, Seek is a very strong cash generator and has a dominant position in a long term growth market. Consequently, now that the stock has fallen 65% from its high we have cautiously started building a position.

On behalf of the Smallco team, I would like to take this opportunity to thank you for your support of the fund. We will continue to work diligently over the coming period to achieve a satisfactory return and I look forward to giving you an update in 6 months.



Please note that along with providing regular 6 Monthly Newsletters we are also available during business hours to further discuss any relevant issues or to provide ongoing fund updates. Please feel free to contact our Business Manager Craig Miller on 02 8256 1000.

Rob Hopkins

Yours sincerely,
Rob Hopkins
Smallco Investment Manager