



7 July 2009

PO Box R718
Royal Exchange
NSW 1225

Dear Investor,

**Smallco Investment Fund -
6 Monthly Newsletter to 30/06/09**

It is pleasing to report a positive return of 14.1% in the 6 months ended 30 June 2009. The closing unit price was \$1.3207, before the 7.83c distribution.

The first 9 months of the 2009 financial year were characterised by panic in world equity markets. Debt markets which were dysfunctional in late calendar 2008 have improved fairly steadily. Since March equity markets around the globe, including Australia, have improved significantly. This is despite the fact that profits in the Australian market will fall in financial year 2009 and are likely to fall again in 2010. A gradual improvement in economic data over the past 3 months has led the equity market to look through the negative short term earnings.

Smallco Investment Fund has outperformed the Small Industrials Accumulation Index over the past 6 months (14.1% versus 13.0%) and over the past 12 months (-20.3% versus -21.6%).

When we wrote to you 6 months ago, we mentioned that cash levels were higher than normal but our aim was to gradually build positions in quality companies that had been harshly dealt with. This has largely happened, although cash levels (15 to 20%) are still higher than normal. This provides a pool of liquidity to buy good stocks should they become available at the right price.

One company in which the fund has invested over the last 6 months is REA Group. It owns the dominant Australian web site for Australian real estate agents to display their listings - realestate.com.au. In common with most other internet businesses, it has low incremental costs so a high proportion of any increase in revenue goes to profit. Additionally, as the leading estate web site in Australia, it has good pricing power because it is such an important selling tool for agents. Our forecasts indicate that despite the difficult 2009 financial year the Australian business' profits will be up over 30%. We have followed REA for a number of years but it was last year's change in managing director and the historically very low share price over the last 6 months that provided our buying opportunity. Additionally, the company's recent announcement indicating an intention to exit its loss-making UK business has increased our confidence in its earnings outlook.

We have previously mentioned our investment in Seek, which owns the leading on-line employment classifieds business in Australia. While we expect profits in the 2009 financial year to fall by approximately 30%, the share price has already doubled from \$2 to around \$4. We are currently not a further buyer at this price but we maintain our positive view on Seek's medium term outlook.



Another recent development is that we have re-opened the fund to new investors, providing the ability to invest following a significant market fall. Historically we have strictly managed capacity to ensure that the size of funds-under-management does not hinder performance. We will continue to monitor this and will re-close the fund at a size that ensures it remains nimble.

Looking forward, while more uncertainty than normal prevails, we are cautiously optimistic about the outlook for the Australian economy and, more significantly, about the medium term earnings outlook of the portfolio of quality companies in which the Smallco Investment Fund is invested.

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.

Yours sincerely,

A handwritten signature in black ink that reads "Rob Hopkins". The signature is written in a cursive, slightly slanted style.

Rob Hopkins
Smallco Investment Manager