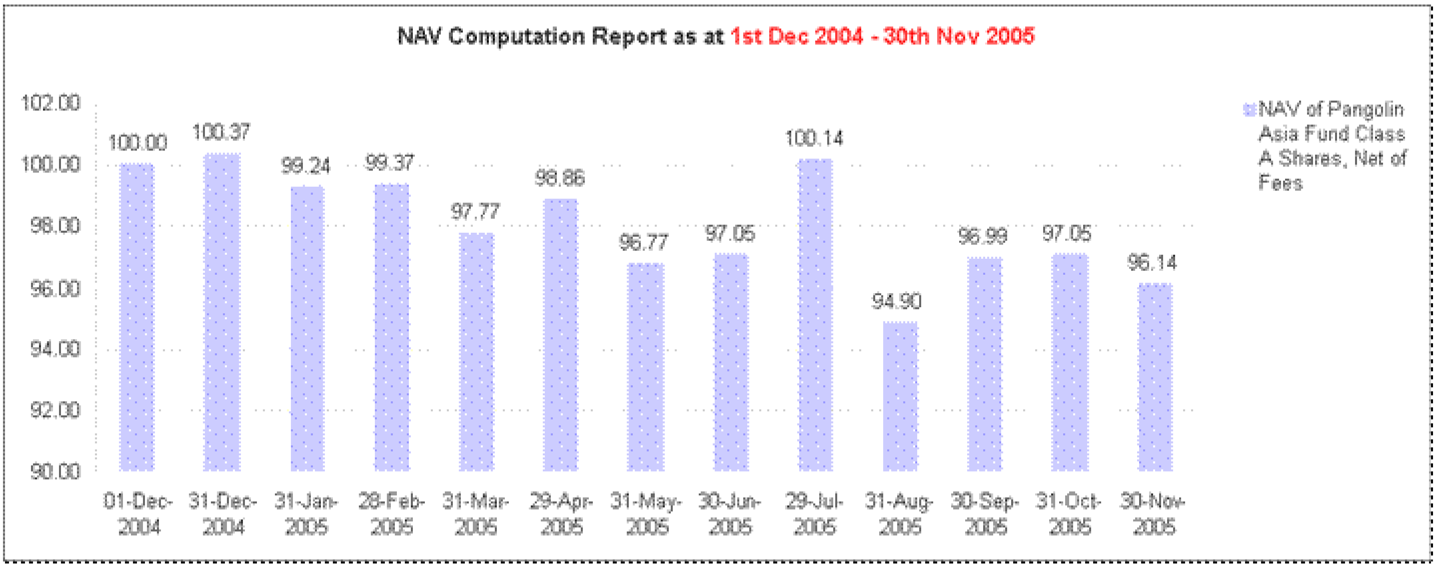
Full Year Report 2005

Dear Investors,

I was assured by all service providers when setting up the fund that it would be much better not to have a December year end if possible. Thus this is the report to investors for the fund's first year which ended on 30th November 2005. The value of the Class A shares was down 3.86% for the year finishing with a final NAV of U$96.14. This is not the audited number but the value calculated by the fund's administrator, HSBC, as are all the monthly values. The audit should be complete some time in January (by PWC) and it shouldn't differ – but it might – and the final report and accounts will be sent out thereafter.



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%
	YTD return	-4.21%

At the year end the fund was approximately 96% invested and this is closer to 100% at the time of writing.

Pangolin Investment Management

Review

When assessed over one year the performance can only be described as disappointing. Even the longest term investors like some imminent recognition for their strategy but please recall that the fund's objective is to acquire assets believed to be undervalued in the expectation that at some point the markets will recognise this value. In theory this "value" should also offer downside protection but in reality if the market is weak and the sellers outnumber the buyers then no share price is immune. However equity prices are regarded by the manager as being no different to other asset prices and price declines are seen as an opportunity to acquire more. The fund has been reinvesting its dividends and this will continue for as long as there is the opportunity to do so. The fact that the fund is virtually fully invested implies that your manager is still optimistic.

Now for the excuses:

The fund is not hedged and therefore does not benefit from declining markets, other than by using them as a buying opportunity as described above. The focus of the fund is ASEAN-centric although companies as far away as Hong Kong have been visited. The mandate is to invest anywhere in Asia with the proviso that there is a strong understanding of the investment being considered, as well as some feel for the market and macro forces in each country. Sadly that currently rules out Korea, Japan, Vietnam and India which happen to have been 2005's best performing markets. Managements of all the companies held have been met with at least once in the past 12 months and in many cases the relationship goes back much further.

Good businesses with dubious management abound everywhere and the focus remains on trying to identify strong cash generators without dodgy directors. As company managements don't wear labels categorising them as I would like, some luck is always required especially as the best conmen seem the most honest. Although the fund is not actively traded it is actively managed with all investments being constantly reviewed.

The fund's small size counts against it to a certain extent. The value of the investments declined approximately 1.6% over the year. Hopefully as the fund grows the expense ratio will decline. It is a double-edged sword in that the small size does enable the fund to take some positions that a larger one could not.

Investments by country:

Indonesia

At the year end about 27% of the fund was invested in Indonesia and this has subsequently been raised with a small investment into Tempo Scan Pacific, a pharmaceuticals company. The other investments are Buana Finance, a scrap of Duta Pertiwi Nusantara, Mandom Indonesia and Sepatu Bata, the activities of which were all covered in earlier newsletters (see www.pangolinfund.com).

Indonesia's economy has been hit hard by the increase in oil and other raw material prices. The problem is that the fuel subsidy was so large that it was unsustainable. The government has recently more than doubled retail fuel prices without totally removing the subsidies. This has led to a sharp jump in inflation, and interest rates in order to stop money fleeing. We are now experiencing a year end rally in the Rupiah. It doesn't happen often so enjoy it while it lasts.

Indonesia is of course a large producer and exporter of commodities (despite being OPEC's only net oil importer) and the rural economy (most of it) has thus been strong this year. However the rise in interest rates has hit the consumer hard, a double whammy for our consumption plays when combined with their raw material induced margin squeeze. However valuations remain cheap and the government generally is making some progress in restructuring the economy (16 steps back for every 17 forward) and the legal system in an attempt to woo foreign investment. It is possible to get quite excited and argue that interest rates have peaked, FDI is rising and corruption is falling; and then one reads that in a country that imports manufactured items from China, the minimum wage is being increased by 15% in line with inflation. All the same, fingers crossed, things might get better and it is still a fascinating place to visit.

Malaysia

I've owned stocks that have gone down before. As a broker I recommended many terrible performers. But it is sod's law that it is not until I launched a fund that one of my investments has halved in value, as has been the case with Silver Bird in Malaysia. This is both a function of a poor market for second line Malaysian companies coupled with the business not hitting its targets; over-optimism, competition and higher raw material prices being largely to blame.

YTL Power warrants have doubled and LITRAK (toll road operator) is up a bit while Public Bank has been affected by concerns over interest rate rises and the impending opening up of the Malaysian banking sector to foreign competition in 2007.

Malaysia floated its currency two hours after China in July. Since then disappointed speculative money has been leaving the country to take advantage of higher US interest rates leaving the market soggy at best. Second line stocks have had a terrible year. If the government were to discontinue its practice of aggressively ramping the closing prices of index component stocks in the last few minutes of daily trade, then the headline index numbers would surely also look a lot worse.

Malaysia politically has structural problems which exasperate the leadership but not enough to cause it to do much about them. Some progress has been made but there is a lot of management speak and not so much action emanating from Putrajaya (every emerging nation needs a brand new purpose built capital). All the same valuations are low and a change in liquidity circumstances should get investors smiling again, when it happens. Malaysian investments account for about 39% of the fund.

Singapore

I generally find it hard to say much about Singapore. However the openness of the economy is still a huge benefit and those who doubt its raison d'être as an investment haven given the opening of China and India underestimate the value of stability to emerging market investors. Malaysia has been open for years yet Singapore's economy has massively outperformed.

The fund has two investments (20% of the fund) in Singapore: Boardroom, a regional company secretarial business should do well and generates pots of cash. Koda manufactures furniture in Vietnam for export to the US and Europe. In theory it could be hit by a US recession or housing market slowdown. Currently it is on a PE of 5x, is growing fast, and I would imagine that in the event of an economic downturn the consumer is probably going to stop buying western made furniture first.

Thailand

A year is an aeon in Thai politics. Thaksin, the first prime minister ever to secure an outright parliamentary majority (twice even) is now massively unpopular and there has even been talk of a coup. Of course it all boils down to interest rates being on the up as well as fuel and other prices. Behind the headlines Thailand continues to make progress in attracting FDI, especially in automobile manufacturing, and the economy doesn't look too bad. The fund holds LPN Development (10% of the NAV) which shot up 17% immediately after we bought it and then has fallen and remained annoyingly below our entry price. All the same, its cheap and cheerful apartments continue to sell well, the company is inexpensive and we like the management.

The Moslem insurrection in the South remains nasty, bloody and off the front pages. It is quite possible that its proponents will try and change that by attacking targets in Bangkok or Phuket at some point which could stifle a market rally or even FDI. Let's hope not.

Other

Overall improving politics are leading to improving economics in Asia, although in China it is maybe the other way round. As India and China open for trade the smaller nations, largely willingly, seem happy to get dragged along with this process. There are structural issues to be addressed but the labour markets remain largely unimpeded and the more nominally socialist the government, the less the restrictions on pay, hours, safety etc. The demographics are positive too and the masses are assuming middle class tastes. The darkest cloud on the Asian horizon remains its politicians, but there is still plenty to be optimistic about.

Shorter term worries include the whole world's monetary system (according to Gold Bugs), an impending US recession (maybe), terrorism and the world ending. Investors worried about these issues should make appropriate arrangements.

As mentioned earlier, India, Korea, Vietnam and Japan were the places to be in 2005. Perhaps ASEAN will come back into vogue in 2006 or perhaps some of the above-mentioned events will also occur, but with the exception of the world ending well-managed businesses with low costs should still do better than most. Anywhere.

I would like to thank the directors of the fund and management companies for their support and congratulate Gerry Ambrose on his recent appointment as Managing Director of Aberdeen Asset Management's new Kuala Lumpur office. I would also like to thank Vinchel Budihardjo who does most of the work and Joann Low for handling much of the administration.

Merry Christmas and Happy New Year,

James Hay.

23rd December 2005.