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Keeping Your Capital Safe

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Client Newsletter for the period ended 31 December 2011

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1. Foreword

Fellow Investors,

Welcome to the Lighthouse Advisors newsletter for December 2011. We have passed the third anniversary of operations and are now in our fourth year.

We have recently moved to a new address; please take note when sending physical mail.

Discussions with service providers on setting up the fund are continuing. Your manager is sorry for the delay.

This newsletter follows the same format as previous issues. The special topic for this issue is **Counterparty Risk**.

2. Market Commentary

What a year it has been. Stock markets defied economic reality in Asia, while momentous political upheavals took place in Africa.

In 2011, the economies of China and India continued to outgrow those of the US and Europe. The respective stock market returns were rather different.

China's Shanghai Shenzhen CSI 300 Index finished the year 25% down, while Hong Kong's Hang Seng Index dropped 20%. India's Nifty Index fell 25%.

The US S&P 500 was almost exactly unchanged, while the Dow Jones Industrial Average gained 6%. In Europe, the UK FTSE 100 lost 6%, and Germany's DAX fell 15%.

In Europe, one could say the stock market paralleled the gloomy outlook, while in the US, markets seem to have priced in an economic recovery. But in China and India, a cloud of pessimism overhangs the growth being reported. Undoubtedly, this gloom will not last forever, and indeed in January there have already been sharp gains in Asian markets.

Japan's economy continued to tread water as it struggled to export its way out of the economic crisis; the Nikkei 225 reflected a no-confidence vote and fell 17% in 2011.

The US economy continues on its long, slow, bumpy road towards recovery. The latest news is encouraging, though a jobless rate of 8.3% is still nothing to write home about[1].

In contrast, the European crisis shows no signs of abating. While Italy and Spain have managed to get their recent bond sales off without paying too much[2], the Greek standoff continues.

That Greece will default is no longer in doubt; its 2-year debt trades below 25 cents on the dollar. Discussions now focus on the size of the "haircut" that bondholders will take. Originally set at 50%, this is increasingly seen as insufficient[3].

Japan remains mired in its long-term slump. For the first time since 1980, Japan slipped into an annual trade deficit[4]. While this is

[1] *The Employment Situation – January 2012*, **Bureau of Labor Statistics**, 3 February 2012

[2] *Spain and Italy raise €22bn in debt sales*, **Financial Times,** 12 January 2012

[3] *Greece needs a bigger debt 'haircut' - German adviser*, **Reuters**, 7 January 2012

[4] *Trade Statistics of Japan*, **Ministry of Finance,** 30 January 2012

easily blamed on energy imports in the wake of the Fukushima nuclear disaster, the long-term trend is undeniable. Japan's trade surplus peaked in 1998 at ¥14 tn. Since then, it has had a bumpy ride downwards, all the way to 2011's deficit of ¥2.5 tn.

The Daily Yomiuri soberly notes that "Japan's fiscal structure is distorted as tax revenues account for less than half of the central government's expenditures. Should interest rates increase, the current system could immediately collapse." [5] These are not inspiring words for investors hoping to find bargains in Japan.

China is seeing the beginnings of a slowdown. Tight credit has stoked fears of a hard landing, and perhaps a bad loan crisis after the credit binge in 2008. Too little credit could cause the economy could grind to a halt, but too much credit would fuel runaway inflation and foment social unrest. So far the authorities seem to be pulling off this balancing act.

With inflation down to 4.1% at the end of 2011, the authorities may ease off on credit. Indeed, given corporate commentaries that consumer demand growth is slowing, the authorities may soon try additional measures to boost consumer spending. In any case, the IMF's revised forecast is for China to grow at 8.25% in 2012[6]. This is still very strong by any reasonable measure, though it comes with the expected caveat excluding widespread contagion from the European crisis. The fallout could dent China's growth by up to 4%. Of course, China could still then be the best card in a bad hand, as it were.

India, too, faces problems. Even as 40% of fruit and vegetable production is wasted due to poor infrastructure[7], the government's latest attempt to liberalize the retail sector was blocked by vested interests hostile to foreign (read: efficient) competitors, to the detriment of Indian consumers[8]. The UN still expects India to grow 6.7% in 2012[9]. Presumably, this would be *in spite of*, and not because of, the Indian bureaucracy.

Africa has been hogging most of the political news lately, for all the wrong reasons. Tunisia, Egypt and Libya all saw a change of regime in 2011. The spotlight now shines on Syria, where 11 months of bloodshed have left thousands dead; the UN stopped counting after 5,000. A diplomatic solution looks extremely unlikely, as a UN resolution backing an Arab League plan for President Bashar al-Assad to step down was vetoed by China and Russia.[10].

What are we to make of the instability in the world today? Some speak of a "new normal" – that the world was abnormally stable and prosperous in the 1990s, and that the current chaos and implied slower growth are in fact "normal" as measured by the standards of modern history. Alan Greenspan's "Great Moderation" may eventually come to be seen as a modern myth, perpetuated by the accompanying bull market during his tenure.

The annals of history suggest, indeed, that the usual state of world affairs is not peace and prosperity, but crisis and war. A look in Wikipedia for a list of wars in the last 200 years shows that wars have occurred not just in every decade, but in almost every *year*. Similarly, a list of economic crises in the last 2 centuries shows one in almost every decade.

What does this all mean for investors? Simply put, investing has always been, and will always be, a bumpy ride. Investing is by nature a volatile affair, made even more so

[5] *Japan records 2.5 trillion yen deficit*, **The Daily Yomiuri**, 26 January 2012

[6] *China Economic Outlook*, **International Monetary Fund**, 6 February 2012

[7] *Speech of Pranab Mukherjee*, **Budget 2011-2012**, 28 February 2011

[8] *Market reform in India: Off their trolleys*, **The Economist**, 8 December 2011

[9] *World Economic Situation and Prospects 2012*, **United Nations**, 17 January 2012

[10] *Syria bombards Homs; West scrambles for new strategy,* **Reuters**, 6 February 2012

with today's communications technology that allows capital markets to react almost instantly to breaking news.

Public markets dance to the tunes of millions of buyers and sellers, each believing they are correct. Fundamentally, it is not possible to have a smooth outcome from investing in a volatile asset. Those who invested with Madoff thought they had found the best of all worlds – good returns with almost no volatility. We know how that turned out.

Today's depressed stock prices are clearly caused by fear as many companies continue to report stable or even improved results. For the long-term investor, low stock prices should be viewed as low-risk opportunities for good long-term profits.

It behooves investors to remember that price volatility is not the same as investment risk. Academic finance defines risk as price volatility, yet any sensible investor will acknowledge that a security that has declined in price (but not *value*) has in fact become *less* risky, even as the academic would insist that the same security is now *more* risky. Perhaps that is why very few academics are also successful investors, although successful investors do occasionally give a lecture or two in an academic setting.

Given the poor stock market performance in 2011, against the very decent corporate results actually recorded, the odds of a satisfactory result for 2012 are actually better than in 2011. Your manager will write again when the report for the quarter ended 31 March 2012 is ready.

Benjamin Koh
Investment Manager
Lighthouse Advisors
8 February 2012

3. Portfolio Review

As at 31 December 2011, the Reference Account Net Asset Value (NAV) was $186.42 per unit, net of all fees. The highwater mark was $228.60, and the total return for 2011, net of all fees, was -18.5%.

16 securities made up 76.0% of the Reference Account, with the balance in cash. A pie chart is in Annex I, while NAV values are tabled in Annex II.

As this is an annual review, in addition to divestments and new investments, mistakes made and lessons learnt will also be discussed.

Divestments

Hsu Fu Chi was acquired by Swiss food giant Nestlé. Your manager would have much preferred to continue owning the stock, but unfortunately we did not own enough shares to make a difference in the voting. The company will become a 60% subsidiary of Nestlé, with the Hsu brothers keeping a 40% stake. That is a good hint of how much more the founders believe the company can achieve. Hsu Chen will continue to helm the company after the acquisition.

As the stock was bought during mid-2009, at depressed prices, the final outcome was satisfactory. Including dividends, gains on divestment exceeded 200%.

Samson Holdings was sold after a string of disappointing financial results. The US housing market is recovering much more slowly than anticipated. Samson has been buying other brands out of bankruptcy in order to gain market share, but its growing share of a shrinking pie is still adding up to an absolute decline in sales and profits. Samson's multi-brand policy also requires it to retain the management teams of the brands it purchases, which results in persistently high staff costs.

Your manager believes that while Samson remains a well-managed company, market conditions have changed for the worse. In the past, Chinese wages were low, raw material prices were stable, and the USD/RMB exchange rate was stable. As a result, Samson

grew rapidly and displaced many local furniture suppliers in the US.

Today, the environment is not so benign. Chinese wages have more than doubled in the past 5 years, and the expectation is for a continued 15-20% annual increase for at least the next few years. Raw material prices have gone up significantly, yet the weak market has not allowed Samson to raise prices enough to compensate, impacting margins. Finally, the Chinese government is likely to let the RMB continue appreciating against the US dollar, which will raise costs and depress revenues for Samson over the long term.

None of this was new to your manager. But the speed at which these factors developed was underestimated. They were in fact anticipated successfully in the case of HTL, and for HTL divestment occurred at a profit. Unfortunately, your manager bought into Samson while selling out of HTL, thus keeping the "Chinese furniture maker exporting to weak Western economy" problem. Net of dividends, loss on sale was approximately 20% in local currency terms.

SUNeVision was sold as it became clear that the company is nearing a revenue/earnings plateau and will require significant investment to grow much more. Essentially, the company is a specialized landlord, renting space to companies looking for a secure location for their servers. Once its existing facilities are full, it will need to buy or build a new building. Like hotels, returns on equity are inflated because the buildings are carried at historical cost. If the buildings were to be revalued, like normal investment properties, return on equity would be much lower.

Recent results show continued growth, with an increase in the dividend. However, the payout ratio is now about 100% of adjusted net income, leaving little room for improvement, and occupancy is now 87%, so any meaningful growth must come from a new building – which means a large capital outlay. A new building will also take a few years to reach breakeven. Your manager decided to sell and put the money to better use elsewhere.

Unfortunately, the stock was bought at a high price (20 times earnings), and at divestment the stock had already re-rated downwards. Net of dividends, loss on divestment was about 20% in local currency terms.

New Investments

Sincere Watch HK is a distributor and retailer of luxury watches, in particular the *Franck Muller* brand. The parent company, Sincere Watch Limited, was set up in 1954 by Tay Boo Jiang. His son Tay Liam Wee joined in 1985, and became CEO in 1993. Sincere Watch was listed on the SGX that same year, and eventually grew to encompass 70 dealerships across 11 territories in Asia.

In 2005, Sincere Watch HK was listed in Hong Kong. It handles the watch business for Hong Kong, Macau and China. Tay Liam Wee is currently the executive chairman, and his cousin Tay Liam Wuan is the CEO.

Like many distributors of jewellery and fine watches, Sincere Watch HK has grown rapidly on the back of demand from newly minted Chinese millionaires. Sales more than doubled in the past 5 years. They plunged during the financial crisis, but have since recovered and are at record highs. Versus other distributors of jewellery and fine watches, the company has an important competitive edge: its relationship with the Franck Muller Group grants it extended payment terms.

While other distributors typically pay their principals within 30 days, the Group takes an average of 270 days to pay. This is a huge working capital advantage that allows the company to expand more rapidly. Because inventory turnover in the jewellery and watch business is slow, expansion is normally limited by the amount of capital a company can afford to sink into inventory at a new store. This is not an issue for the Group – it can expand as fast as the market demands. Typically, jewellers and watch distributors

will also carry some debt to help finance the inventory. The Group, on the other hand, is debt-free, since Franck Muller effectively provides the financing.

One other side effect of the extended payment terms is that the Group constantly reports unrealized foreign exchange losses or gains, depending on whether the Swiss franc, the currency in which the watches are bought, has appreciated or depreciated against the Hong Kong dollar, the reporting currency of the Group. The income statements therefore need to be adjusted for these unrealized gains and losses, as well as other non-cash allowances and write-backs.

Adjusted for non-cash items, the Group has earned an average of 24% on equity since IPO, with its worst year coming during the financial crisis, when it earned 14% in FY2009.

On a fully adjusted basis, the shares were purchased at about 8.5 times FY2011 earnings and just over 2 times book value. Dividend yield was about 4%.

Mistakes Made and Lessons Learnt

Samson Holdings was a mistake as your manager invested despite knowing the headwinds in terms of wages, market demand and currency mismatch. Essentially, it was a calculated bet that the US housing market would turn around before the effect of the headwinds kicked in. The bet was wrong. The lesson: **avoid foreseeable headwinds, as the future can come sooner than expected**.

SUNeVision was a mistake as your manager paid too high a price for the stock. There was nothing inherently wrong with the business – indeed it reported improved results throughout the period of ownership. The problem was that too much was paid for the stock, such that when the time came to sell, a loss was realized. Lesson learnt: **don't pay too much**.

4. Counterparty Risk

Counterparty risk refers to the risk of default by the other party (counterparty) to a contract that one has entered into.

One example might be a buyer walking away from a deal to purchase your house. In such a case you might sue the buyer to complete the deal, especially if the market value of the house has declined since the deal was struck.

Unfortunately, while people put a reasonable amount of thought about such risks into their daily business dealings, they seldom expend the same amount of effort when investing. This article will discuss some investment-related counterparty risks and what investors can do about them.

Business Counterparty Risk

At the company level, the same kind of "buyer walks" risk can be found. A customer can refuse to pay, which creates bad debts that hurt profits. A supplier can also refuse to deliver, which hurts profits by forcing a company to source for alternative supplies at the last minute, usually at higher costs. Any company that has been in business for a meaningful period of time should already have processes in place to avoid or mitigate such issues. Which is to say, if these become material, it suggests poor management of counterparty risk.

Noble is a supplier of commodities. It is active in both "soft" agricultural commodities like soybeans, palm oil, sugar, cocoa, cotton and coffee, as well as "hard" commodities like coal, aluminium, and iron ore.

Since Noble does not own all the fields that grow the crops, nor the mines that extract the minerals, it faces the risk that the growers and miners may fail to deliver. Noble does not own all the factories that process the crops, nor the plants that use the minerals, so it also faces the risk that customers will not take delivery. These twin risks were exactly what occurred in the quarter ended September 2011.

The backdrop to this is the volatile cotton prices of 2011. Prices rose sharply, at one point doubling versus the previous year, before falling some 40%. Noble was hurt initially when prices rose: farmers defaulted and refused to deliver, forcing Noble to purchase cotton in the spot market at high prices, to deliver to customers at much-lower previously contracted prices. Then, when prices fell, Noble was hurt again when *customers* refused to take delivery, leaving Noble stuck with high-cost inventory.

These losses combined to reduce Noble's agricultural division's operating income by some 70% from a year earlier, despite tonnage increasing 25% and revenues increasing 59%. Operating margin fell from 6.32% to 1.20%. Without the contribution of other commodities like soy, sugar, cocoa and coffee, the division's results would likely have shown a large loss. Indeed, after accounting for group expenses and financing costs, Noble reported its first quarterly loss in 14 years.

Noble's cotton business was clearly run in a risky fashion, dealing with dubious suppliers and customers alike. Such counterparty risks should have been dealt with either by avoiding such suppliers and customers in the first place, or by obtaining adequate insurance against defaults. It does not seem that either method was used.

Is the rest of Noble run in the same manner? Only the founder himself, Richard Elman, knows for sure. One hint that Richard's risk tolerance is lower than before: CEO Ricardo Leiman, who was appointed in 2010, quit for "personal reasons" hours after the September 2011 results announcement. Noble has since hired a new CEO: Yusuf Alireza, formerly of Goldman Sachs. While Goldman Sachs is generally acknowledged to have good risk management capabilities, how much of it rubbed off on Mr Alizera remains to be seen, for Goldman Sachs also produced Jon Corzine, of recent MF Global infamy. But more on MF Global later.

What can investors do about such risks? Simple – don't invest in a company that deals with questionable suppliers and customers. In a way, Noble was lucky. The losses in cotton were offset by earnings in other commodities. Next time, it could be different.

Financial Institution Counterparty Risk

MF Global is (or rather was) a stockbroker. It filed for bankruptcy on 31 October 2011 amid revelations that it had invested heavily into European government bonds. But the real problem is that in its final days, MF Global apparently used money belonging to customers for its own working capital needs[11]. As a result, some customers' money has disappeared[12].

Customer money held at a stockbroker is supposed to be separated from the stockbroker's own money. This allows customers to get their money back even if the stockbroker fails. This protection evidently failed at MF Global. Why?

The answer is that current laws do not require explicit *legal* segregation of the money. Regulators generally consider it sufficient that a stockbroker designates separate bank accounts for "house" money versus "customer" money. But since both accounts are still in the *name* of the stockbroker, it is a trivial matter to loot the customer account in times of duress. By the time this breach has been discovered, it is too late, as the beleaguered MF Global customers are now finding out.

What can investors do? The safest solution is to never leave any money at the stockbroker. But this is not workable in all but the simplest investment strategies, since many instruments and strategies require collateral to be posted. The next safest solution, then, would be to use a broker that is highly unlikely to run into

[11] *MF Global Is Said To Have Used Customer Cash Improperly*, **The New York Times**, 17 November 2011

[12] *MF Global Customer: $50M Commodity Account Gone*, **Bloomberg News**, 2 December 2011

liquidity issues that could tempt it into using customer money.

MF Global had two problems. First, as an independent stockbroker, there was no holding company to save it. Second, at the behest of CEO Jon Corzine, it was leveraged 40:1 on its proprietary trading positions. If the bets went the wrong way, or its lenders demanded repayment, it would be finished. As it turns out, its lenders did get nervous and demanded repayment, forcing bankruptcy.

Your manager currently uses **UOB Kay Hian** as the primary stockbroker. UOB Kay Hian is 39.4% owned by **United Overseas Bank** (UOB), and 19.8% owned by Wee Ee Chao, the chairman and managing director. Wee Ee Chao is also the son of UOB founder and chairman Wee Cho Yaw. While there is no explicit guarantee of support, it is very unlikely that Wee Cho Yaw would let UOB Kay Hian fail, given its use of the UOB brand.

UOB is one of only three local banks in Singapore, and its banking franchise is too valuable to the Wee family to risk damaging via a failure of UOB Kay Hian. So there is an unwritten lifeline that UOB Kay Hian can tap if it runs into trouble. UOB's shareholder equity is more than 20 times that of UOB Kay Hian's, so UOB will have no trouble bailing out UOB Kay Hian if it has to, though the elder Wee will of course first give his son a good dressing-down, to put it mildly.

As for leverage, in the last 8 quarters, UOB Kay Hian's debt-to-equity ratio ranged from 0.4x to 1.1x. There is no evidence of substantial proprietary trading, as cash and cash equivalents, contracts receivable and trade receivables form over 90% of all assets.

<u>Asset-Liability Mismatch</u>

Another form of counterparty risk comes in the form of an asset-liability mismatch. The most obvious mismatch, visible everyday, is in banks.

Banks have a **duration mismatch**. They borrow from depositors and lend to borrowers, but depositors can withdraw their money at any time, while borrowers need only repay their loans on a fixed schedule. So the loan assets are long-term, while the deposit liabilities are short-term. Should all the depositors decide to withdraw their money simultaneously, the bank will not be able to come up with the cash, and it will collapse. This is the "bank run" that every bank owner fears and which no bank can survive.

To assuage depositors' fears, governments typically guarantee some or all of the deposits. This helps reduce the risk of a bank run, and in turn keeps the bank alive – and the credit system functioning. But what if the bank sees more demand from borrowers than it has money to lend? It can run an advertising campaign to attract deposits with higher interest rates, but this takes time. It is easier and faster to borrow from other banks which have excess deposits. This is known as "wholesale" funding.

However, unlike retail deposits, wholesale funding is *not* guaranteed. This means that at the first sign of trouble, creditor banks will withdraw the wholesale funding. This creates the same effect as a run on the bank, and the borrowing bank collapses. **RBS** and **Dexia** were funded primarily by wholesale loans rather than retail deposits. Thus, when liquidity dried up, they could not refinance their loans, and needed government rescues.

How can a depositor avoid the risk of the bank collapsing and possibly losing his cash? This is not difficult: choose a bank that does not rely on wholesale financing! The key metric is the <u>loan-to-deposit ratio</u>. A ratio well above 100% means that a bank is using a lot of wholesale funding. A ratio well below 100% means the bank is funded mainly or even entirely by deposits.

Asset-liability mismatches are also seen in bonds. Bonds are commonly stereotyped as "safe" investments, on the basis that the bondholder is senior to shareholders and will

therefore be paid first. In the worst case, he can seize and sell the company's assets in order to reclaim the principal.

However, the bonds are often issued by the *holding company*, while the assets that could theoretically be seized and sold to repay the bond principal are held in the operating *subsidiaries*. So the bondholder would have to first seize control of the operating subsidiaries before selling off the assets. To make matters worse, the holding company is often incorporated in a different jurisdiction from the operating subsidiaries, which means the bondholder has to obtain the approval of the local courts before taking over the subsidiaries. There is no guarantee the local courts will support a legal judgment handed down elsewhere.

This **domicile mismatch** is common with Chinese companies, where the holding company is in an offshore jurisdiction like the Cayman Islands, while the actual operating subsidiaries are in China.

Many investors learnt about domicile mismatch the hard way when companies defaulted on their bonds and seizing assets proved impossible. On the Singapore Exchange (SGX), the defaulters' parade includes: **Bio-Treat**, **Celestial Nutrifoods**, **China Milk**, **China Sun Bio-Chem Tech**, **CHT**, **Sino-Environment**, and **Sunshine Holdings**. At the Toronto Stock Exchange, the recent default of **Sino-Forest** will likely also prove a total loss for bondholders. All of these, including Sino-Forest, are Chinese companies with a domicile mismatch.

Besides banks and bonds, another area of asset-liability mismatch is **variable interest entities** (VIEs). VIEs are often used in China when laws forbid foreign ownership of assets. Typically, the promoters will own the assets in their individual capacity, and then enter into a contract to transfer the benefits derived from operating the assets to a company. This company, or more usually, its holding company, is then listed on a stock exchange.

The counterparty risk here is that the promoters may not honour their commitments to transfer the benefits of the assets in question. The case of **Alibaba** illustrates this.

Alibaba is China's largest e-commerce company. Among its key products are *Alibaba.com*, an online business-to-business marketplace connecting suppliers and customers, *Taobao*, a consumer-to-consumer shopping platform, *China Yahoo!*, Yahoo Inc.'s business in China, and *Alipay*, a third-party online payment platform.

In 2009, Alibaba secretly transferred *Alipay* at a discount to a private company 80% owned by Alibaba founder Jack Ma. Despite owning 43% of Alibaba and having a seat on the board of directors, Yahoo claimed it did not learn about the transfer until March 2011. While the dispute was finally resolved in July 2011, the problems posed by the VIE structure of Alibaba remain.

Mr Ma owns a Chinese company whose economic returns are contracted to **Alibaba Group Holding**, a Cayman Islands entity. Alibaba's shareholders, in turn, own stakes in the Cayman Islands entity. They can sue if Mr Ma decides to keep some or all of the Chinese company's profits for himself. But, as a lawyer working in China has pointed out, it is *prohibited* for foreigners to own an Internet company of any sort in China[13]. Any attempt to enforce the VIE agreement in court would fail, as the contract would be voided. The investors are thus wholly dependent on Mr Ma's goodwill in adhering to the terms of the VIE agreement. This is not a good type of counterparty risk to take.

So how can investors protect themselves when faced with a domicile mismatch? The first rule of risk management is to avoid the risk if you can. So, where possible, avoid investments with a domicile mismatch. But what if one has to choose only from a pool of such

[13] *A Loophole Poses Risks to Investors in Chinese Companies*, **The New York Times**, 23 January 2012

mismatched investments? Then one should minimize the risk by looking for cases where the promoters have a reason *not* to default. One such example follows.

Among the SGX-listed Chinese companies, one stands out because it did *not* default on its bonds when they came due. This was **Sinomem Technologies**, led by Dr. Lan Weiguang. On 14 December 2009, Sinomem redeemed its outstanding convertible bonds in full, at par plus interest. *Why?*

Leaving aside integrity, there is one important factor that distinguishes Dr. Lan from the promoters of the defaulting companies: although he was born in China, Dr. Lan became a naturalized Singapore citizen in 1997, and now resides in Singapore.

Why is this important? Because Dr. Lan has *something to lose*: his citizenship and lifestyle in Singapore. Deliberately defaulting on the bonds would either subject him to criminal prosecution for fraud in Singapore, or force him to live in exile. Either way, he would be unable to enjoy the benefits of his citizenship.

Furthermore, under Article 129 of the Singapore Constitution, a person who acquires citizenship by registration or naturalization can also be deprived of it, for reasons such as a criminal conviction. If Dr. Lan wants to keep his citizenship, he will do his utmost to stay within the law. And anyway, as a matter of basic common sense, if he wants to live "happily ever after" in Singapore, it would be wise to avoid embarrassing the Singapore government with any corporate misbehaviour.

Convertible bond investors looking for bargains in 2008 and 2009 would have made a profit buying Sinomem's convertible bonds at a discount to par. They would have suffered a heavy loss doing the same with the bonds of any of the companies in the defaulters' parade. Paying attention to one small detail, the citizenship and residence of the promoter, made a big difference to the outcome.

Thus ends this discussion on counterparty risk, as applied to stock selection, stockbroker selection, and bond selection.

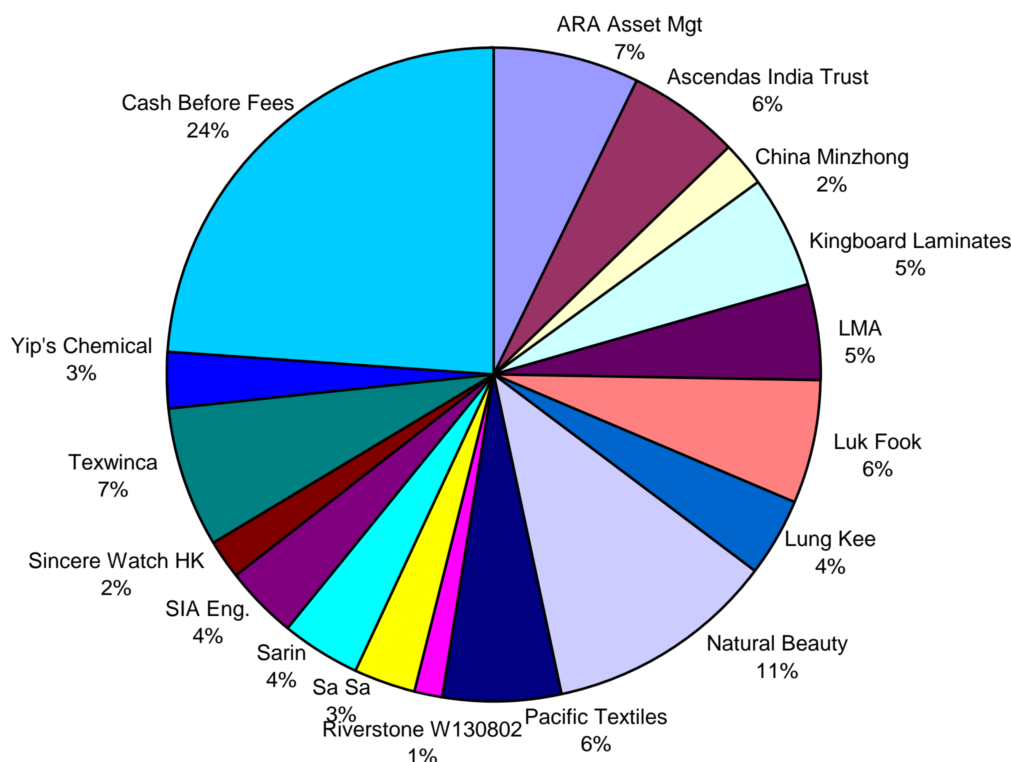
~ End ~

LIGHTHOUSE ADVISORS

Keeping Your Capital Safe

Annex I

Reference Account as of 31 December 2011



Annex II

Monthly Net Asset Values								
	2008		2009		2010		2011	
Date	**NAV**	**Invested (Gross)**	**NAV**	**Invested (Gross)**	**NAV**	**Invested (Gross)**	**NAV**	**Invested (Gross)**
31 Jan			$103.03	52.48%	$163.97	83.91%	$220.13	86.53%
28 Feb			$102.42	69.23%	$169.35	93.00%	$216.56	93.66%
31 Mar			$100.11	51.25%	$179.88	93.26%	$219.13	85.79%
30 Apr			$106.95	67.37%	$184.58	90.31%	$224.22	86.13%
31 May			$131.61	73.01%	$177.16	80.77%	$221.20	87.01%
30 Jun			$131.39	78.62%	$180.97	84.17%	$221.25	86.70%
31 Jul			$142.18	80.00%	$189.62	86.50%	$216.53	83.65%
31 Aug			$141.28	86.22%	$193.05	92.43%	$198.69	82.60%
30 Sep			$146.38	88.44%	$210.53	99.04%	$177.28	84.05%
31 Oct			$149.29	90.70%	$213.32	95.13%	$193.17	83.38%
30 Nov	$100.00	16.19%	$154.88	87.41%	$221.65	92.52%	$184.76	83.96%
31 Dec	$101.02	52.56%	$166.03	79.26%	$228.60	85.71%	$186.42	76.01%
YTD	**+1.0%**		**+64.4%**		**+37.7%**		**-18.5%**	

Updated 8 February 2012