Overseas Asset Management

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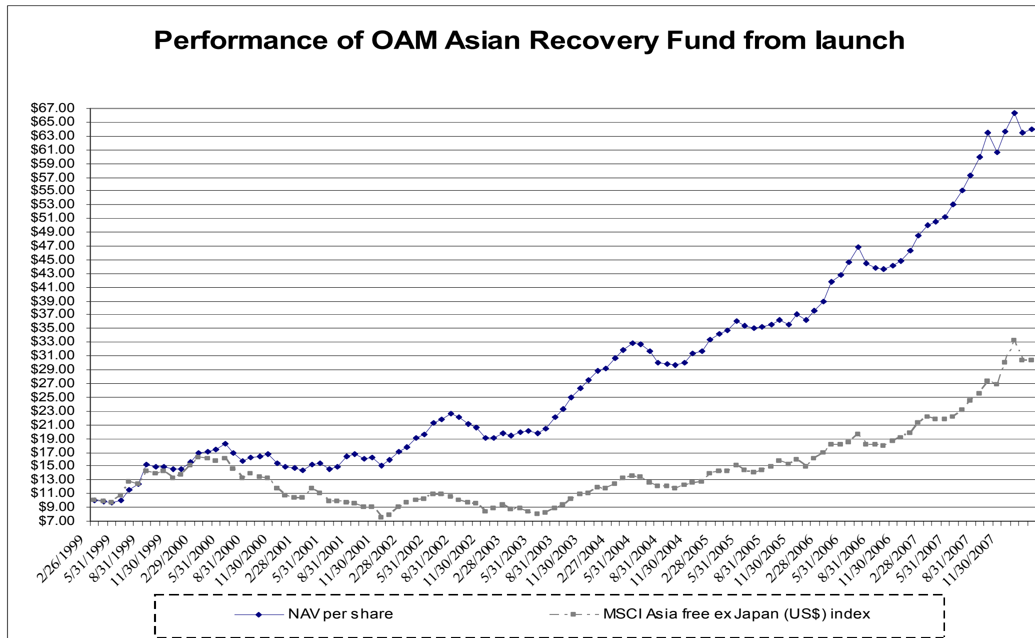
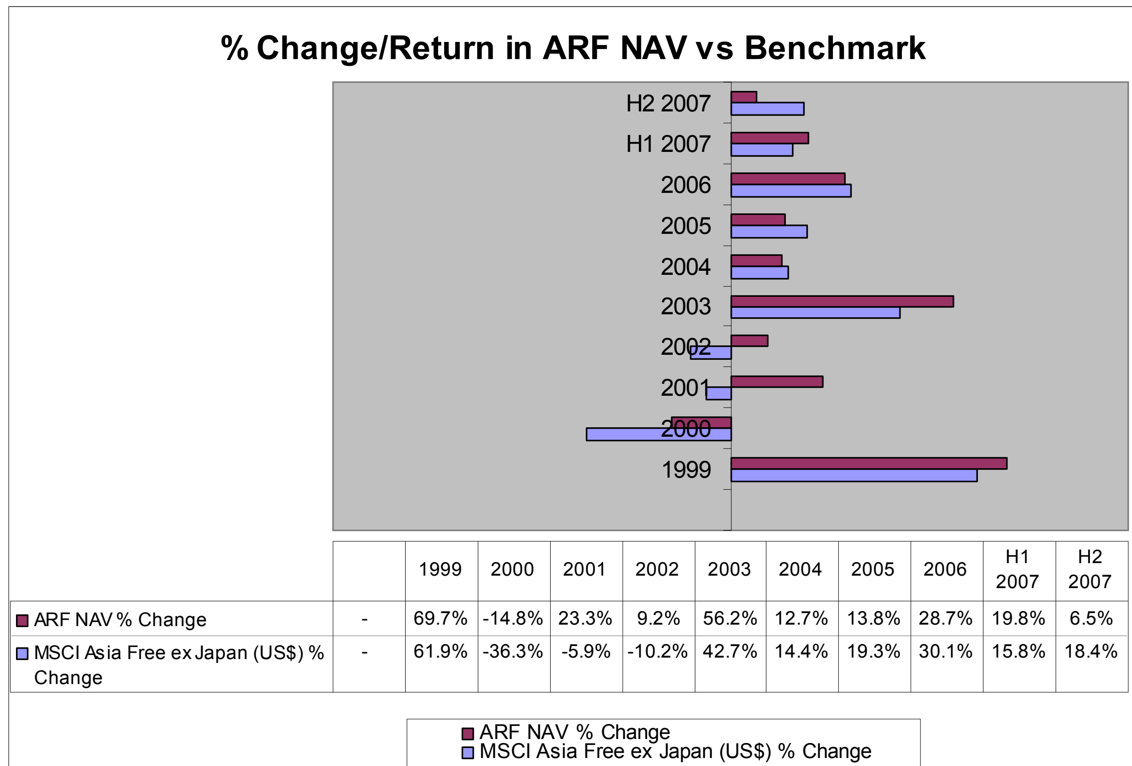
12th January, 2008 **OAM Asian Recovery Fund**

Dear fellow shareholder,

Last year, OAM Asian Recovery Fund's NAV increased by 27.6%. Whilst this was a decent return in absolute terms, it paled next to the 37.1% return of the Fund's benchmark, the MSCI Asia free ex Japan (US$) Index. Since inception however, the Fund's NAV has handily beaten its benchmark, increasing by 539.2% versus 202.8% for the MSCI Asia free ex Japan (US$) Index. The Fund's compound annual return over the past nine years has been 22.9% per annum. By comparison, the benchmark index has returned 13.1% per annum. The Fund's net assets ended the year at US$194 million.



As I have pointed out to shareholders in the past, in years like this past year when Asian markets rise strongly, OAM Asian Recovery Fund is likely to slightly lag the market. However, in weak markets, the NAV per share of our Fund is likely to hold up better. This was strongly illustrated in the 2000-2002 bear market. This year, the Fund's relative performance was particularly disappointing. An analysis shows that the Fund's underperformance was entirely a second half affair – the bar chart below clearly illustrates this point.



		1999	2000	2001	2002	2003	2004	2005	2006	H1 2007	H2 2007
ARF NAV % Change	-	69.7%	-14.8%	23.3%	9.2%	56.2%	12.7%	13.8%	28.7%	19.8%	6.5%
MSCI Asia Free ex Japan (US$) % Change	-	61.9%	-36.3%	-5.9%	-10.2%	42.7%	14.4%	19.3%	30.1%	15.8%	18.4%

The reason for our underperformance in the second half was because we were hugely underweight China and India which were the two heavyweight performers from a geographic standpoint and we had no exposure to the large index constituents that seemed to attract most of the hot foreign money to the region. As the sub-prime crisis caused Western markets to unravel, investors quickly reached the conclusion that Asia will be immune and will decouple from the west. We are dubious about the decoupling argument. We therefore took advantage of what we feel are high valuations of Hong Kong/China equities and raised about $19 million in October, mostly from funds that invest primarily in Hong Kong/China equities. Some of this cash was invested by making an additional subscription to a long/short Asian technology fund, with a particular focus on Taiwan, and by purchasing shares in Scottish Oriental Smaller Companies Investment Trust, a UK-listed investment trust that invests in smaller Asia ex Japan companies. Currently, the Fund has about US$18.5 million in cash or 9.5% of net asset value.

As I explained to clients in last month's newsletter, the risks of investing in the region have increased. To quote from that newsletter, "3 ½ years ago, the P/E ratio of the MSCI Asia free ex-Japan index was 35% lower than the P/E of the MSCI World Index. Today, the Asian ex-Japan P/E is 10% above the world average." I went on to say: "This aggregate measure of valuations in the region masks the huge divergence in valuations throughout the region. During the past four years, India's stock market has risen fivefold in USD while China's stock market has risen fivefold in the past two years. The rest of Asia in contrast has, for the most part, quite attractively valued stock markets and corporate balance sheets are very strong." While the focus remains firmly on India, China and large market capitalisation heavyweights, sentiment is very negative towards traditional "value" managers and Asian smaller companies. Our style of investing is very much out of favour in this momentum-driven market.

Though this is painful in the short-term, we have taken advantage of current sentiment to accumulate a 4% shareholding in Scottish Oriental Smaller Companies Investment Trust currently worth US$7 million or 3.5% of the Fund's NAV. As the chart below shows, Scottish Oriental has hugely and consistently outperformed the MSCI Asia free ex Japan (US$) Index, returning 27.1% per annum since the end of 1998 versus 13.1% for the benchmark index.

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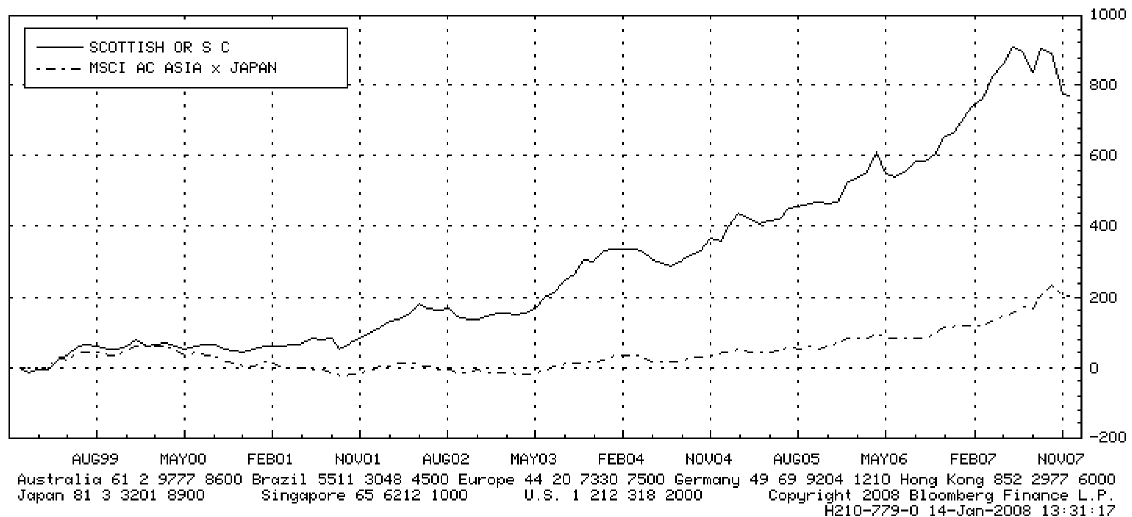
COMPARATIVE RETURNS Page 1/ 9

Range 12/31/98 - 12/31/07 Period M Monthly 108 Mo. Period

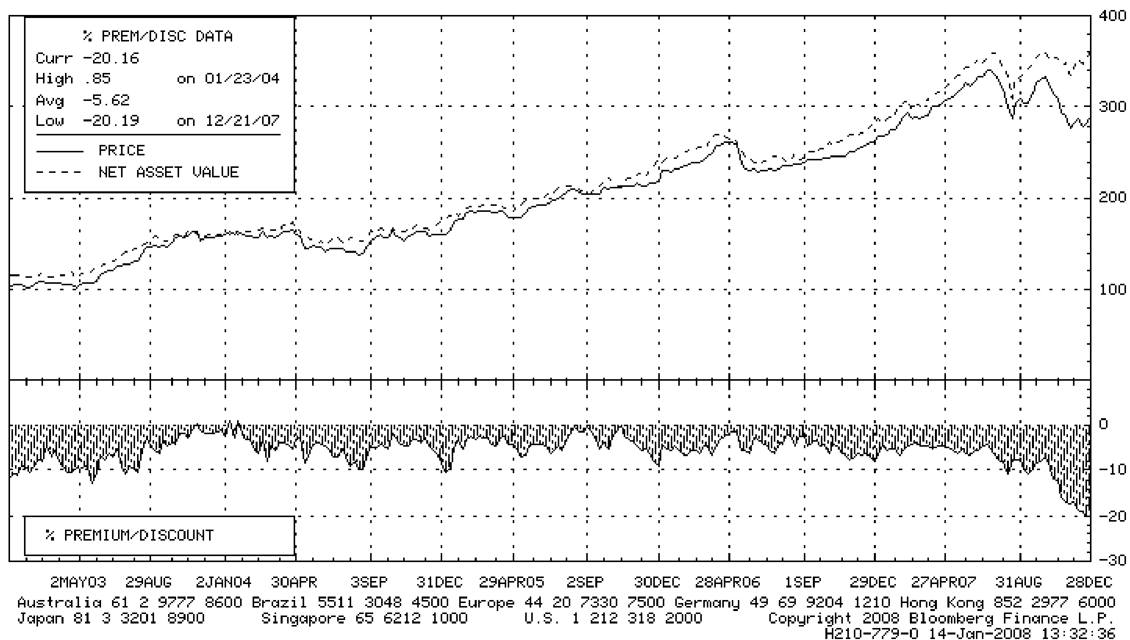
	Securities	Crncy	Prc Appr	Total Ret	Difference	Annual Eq
1	SST LN Equity	USD	661.23 %	769.71 %	566.89 %	27.15 %
2	MXASJ Index	USD	202.82 %	202.82 %*		13.09 %
3						

(* = No dividends or coupons)



Given this fantastic long-term performance track record combined with low management fees, it would be reasonable to assume that this investment trust would be trading at a small premium to NAV. Instead, as the chart below shows, it is trading at a 20% discount to NAV which is the widest discount to NAV at which it has traded in the past

five years. This is because Scottish Oriental has had a tough past six months, mirroring our experience. In the six months ended 30th November, 2007, the Trust's NAV per share returned 0% while its share price declined 12.2% versus an increase of 21.5% for the MSCI Asia ex Japan (£) index and 10.0% for the Nomura Asia Small Cap (£) index. The Trust attributed its underperformance to its underweight position in China, Hong Kong and India as well as the underperformance of smaller companies compared to larger counterparts, particularly in Taiwan and Korea. As an active investor in closed-end funds for more than 15 years, I know from experience that when sentiment is most negative, it usually coincides with lows or relative lows in prices and record high discounts to NAV. In other words, investors are usually most negative near the bottom and most positive near the top.



Today, the five original boutique managers currently manage just over half the Fund's net assets. One of these no longer takes new money; three only take new money on a restricted basis from existing shareholders (two of them only once a year); and the one manager who still takes money from new clients no longer offers the lower fee class of shares in their flagship fund that we own in the Fund. These five core managers continue to produce good returns. They have each increased their assets under managements from a range of US$10-200 million when we first invested with them nine years ago to US$800 million-US$6 billion today. One of these managers has even taken the management company public this year with a market value of US$1.5 billion! These managers have so much money under management today that they are arguably no longer boutique managers. While they remain excellent investors, it is fair to conclude that they are unlikely to trump the index by a wide margin as they did from 1999-2003 given that they have so much money to put to work.

Consequently, we have allocated money to new up-and-coming managers that have been recommended to us by other managers we respect – currently representing about 30% of the Fund's NAV - and on an opportunistic basis have invested in closed-end funds trading at a discount to NAV - currently representing about 10% of the Fund's NAV. The Fund remains an Asian fund-of-funds that invests on an underlying basis predominantly in smaller and medium-sized Asian companies with a bias towards companies serving the burgeoning Asian consumer. Whilst the MSCI Asia free ex Japan (US$) index currently stands on a P/E valuation of more than 15 times 2008 estimated earnings, there is far better value to be found in Asian smaller companies. For instance, we are completing due diligence on an Asian smaller companies fund where the portfolio P/E is less than 9 times 2008 estimated earnings.

While we feel comfortable with the valuation of our holdings, we think this year is likely to be a more volatile and less rewarding year for equities in the region. This could be particularly unpleasant for shareholders in some of the highfliers that have had huge gains over relatively short periods of time. We are prepared for such unpleasant volatility. We do not own shares in companies that sport valuations that can not be justified by current knowledge of fundamentals. We, as well as several of our managers, have ample cash to take advantage of any bargains that might result. It is encouraging that our conservative stance served us well in November & December which were dire months for stock markets globally. In November & December, the Fund's benchmark, the MSCI Asia free ex Japan (US$) Index fell 9.0% while the Fund's NAV fell by 3.6%.

The Fund has had an incredible run over the past five years, more than tripling its NAV per share and providing shareholders with a compound annual return of 26.9% per annum. The next five years is highly unlikely to be as rewarding, but I remain confident that the Fund will continue to provide shareholders with an attractive return relative to both cash deposits and most equity indices. Given the huge current account surpluses in the region and the undervaluation of the region's currencies on a purchasing power parity basis, we think that currency will continue to be a positive contributor to the Fund's USD return.

Desmond Kinch
Chairman