PENDO LLC

THE VALUE INVESTOR

International Core Value Strategy
Quarterly Commentary Q3 2009

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STIMULUS, CURRENCY, AND BEARS. OH, MY…

We remain optimistic for the long-term prospects of the international investor. Unlike our beloved homeland (where we are decidedly bearish), whose green shoots of spring were covered by the early-fall foliage (and shambolic economic reports), we are fortunate to find sound, under-valued companies in growing, sound economies. Domestically, the “stimulus” package is financed by a gargantuan debt and printing presses (the physical supply of our currency has more than doubled in less than a year). Emerging economies such as China and Brazil also rely on the greenback to spur their (already recovered and thriving) economies. The difference is that they don’t need to print dollars; just these two combined have a supply of approximately $2.2 trillion dollars of foreign reserves that we handed to them freely during the last bull market, in exchange for goods. In return for our rapacious appetite for foreign goods, we have been repaid with a decrease in net financial inflows from abroad of approximately 40% since 2006, bringing us back to the same level as 2002 (source: U.S. Bureau of Economic Analysis/U.S. Department of Commerce, www.bea.com). We will leave judgment to you, as to whether or not this (spending one’s self out of debt) is a viable business model.

Along the same lines, we (are happy to) receive many questions from our clients, and would like to include a recent email exchange here, as we find it to be quite relevant. A client asks:

Question: *What happens to the HK dollar? Will it float and appreciate against the USD at the same rate as the Chinese Yuan? Will the hate for the USD slow down?*

> Hello [Client]-
>
> I apologize in advance for being so wordy, but I thought it would be helpful to explain our thought process.
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> While it is difficult to give a definitive answer, due to constant ‘romancing’ by their government (as opposed to the ever-constant, by-the-book approach to fiscal policy we have here…), there do seem to be some valid presumptions we can make. The Yuan is “officially” not pegged to the USD, but actively managed by the PRC via a floating exchange rate, pegged to an undefined

basket of international currencies, of unknown origin, weight, etc. Somehow, it manages to remain fairly stable vs. the USD. The HKD is "officially" pegged to the USD, generally at between 7.75-7.85HKD to 1USD. Therefore, the HKD should remain in sync with the USD within ~1%. The fluctuation risks would be in comparison with other un-pegged world currencies. In other words, both would seem to face risks associated with the USD (as an aside, when you factor in the devaluation of the dollar vs. gold or the euro, the rally in the S&P 500 disintegrates).

According to a recent [9/21/09] article in the "Shanghai Daily" (which should be interpreted as endorsed by the State), "As the global economy appears headed toward recovery, concerns are growing that the United States' addiction to massive fiscal stimulus as an economic panacea could eventually lead to an even bigger crisis - a loss of confidence in the US dollar." This could hasten the drumbeat for a new reserve currency, and regional trading has already broken out along these lines (China, Brazil, S. Africa, Australia).

What we at Pendo have been speaking about since our inception is also gaining wider traction, as articulated in a recent [9/20/09] "Telegraph UK" article ["HSBC Bids Farewell to Dollar Supremacy"]: "A monetary policy of near zero rates – further juiced by quantitative easing – is completely incompatible with circumstances in most of Asia, the Middle East, Latin America, and Africa. Divorce is inevitable. The US is expected to hold rates near zero through 2010 to tackle its own crisis." In other words, a de-pegging is looking more and more like a matter of when, rather than if. This in effect gives us a free [long-term] call option on the securities affected, and could result in significant additional upside.

As far as reaction to the USD, as an American I still have a hard time saying "hate." I prefer "prudently averse." This is most likely to continue without a slowdown for the near term at least, since we seem intent on printing our way out of the recession, devaluing the dollar. We've more than doubled the physical supply of money in less than a year, and currently there is no stop in sight. The lower it goes, the more we have to pay a third (foreign) party in order for them to assume this debt, the more we pay in debt service, and the spiral continues. The choice is to either print more money, or raise taxes. Since we are now talking trillions of debt, printing that much money could have a Zimbabwe effect. None of this would seem to encourage any great 'love' toward the dollar.
I hope this longer than expected reply effectively answered your question[s]; please feel free to contact us directly for any clarifications or further questions.

Sincerely,

Mark J. Foley
President
Pendo LLC

Pendo International Core Value Portfolio

The holdings that contributed the most to this quarter's performance were Cresud, JSE Ltd., Telenorte, Turkcell, and Canadian Natural Resources. Prior to the third quarter, these companies were among those we believed to be trading at the largest discount to their respective normalized earnings or book values. We believe that this recent performance is quite significant (and encouraging), and that it indicates that markets are becoming less irrational; deeply-discounted companies are starting to be recognized, and bid up closer to fair value. For the majority of late 2007 to April 2009, most markets were highly correlated, and thus irrational, as companies traded up or (mostly) down regardless of their valuations or correlations, industry, sector, or geography.

One could easily assume that with quarterly returns in excess of 28%, the aforementioned group of companies has now reached fair value. However, in our opinion this is not the case. We believe that although these companies now trade at their 52 week highs, they trade well below their fair values. With the exception of Cresud, which trades at 20x trailing earnings the others trade at 14-16x trailing earnings. Based on 2009 and 2010 earnings estimates, they trade at even lower valuations.

- As for Cresud's valuation, it currently trades at 1.3x stated book value, which in itself is highly understated because it records farmland at cost as opposed to fair value. We believe that Cresud's fair value is at least 30% above the current stated book value based on recent farmland prices. This is before taking into account a growing worldwide demand for foodstuff.
- JSE (Johannesburg Stock Exchange) remains undervalued not only on an absolute basis, but also on a relative basis versus other publicly traded exchanges, and especially versus exchanges operating in emerging markets. The company is debt free, grows at double digit annual rates, and pays a 3% dividend yield. In addition, it should be a natural beneficiary of South Africa's growth, in which China Investment Corp. recently made a commitment to make major capital investments.
- Telenorte continues to rebrand its merged telephone brands into one, close redundant outlets, reorganize and cut costs, while delivering continued high levels of free cash flow. The company plans to use its cash flow to repay the debt it took on to buy out its competitors. We believe that as the company with the government's support to be Brazil's only nation-wide fixed, broadband, and wireless provider, it will benefit from scale. It will also benefit from the country's growing economy and continuing strong recovery from the economic crisis. We believe that the company should provide double-digit returns while likely paying a 5% dividend yield.
- Turkcell trades at 14x trailing earnings and pays a 4% dividend yield. With its roll-out of 3G and Turkey's growing economy, we expect that Turkcell will continue to provide investors with double-digit returns despite the Turkish cell phone market approaching a 90% penetration rate. This company is well financed with a net cash positions.

- Earlier this year, Canadian Natural Resources started production of its new development which nearly doubled its reserves. After several years of capital expenditures that resulted in high debt levels, the company is now benefitting from cash flows from increased production. As a result of the increased oil reserves, the company's earnings are expected to provide enough cash flow to reduce debt significantly, while providing investors with a double-digit earnings growth-rate.

We at Pendo LLC hope that this review is helpful to you, and will better enable you to understand our thinking and strategy.

Sincerely,

Tina Larsson	Mark J. Foley
CIO	President
Lead Portfolio Manager	Pendo LLC
Pendo International Core Value Strategy	Pendo Capital LLC