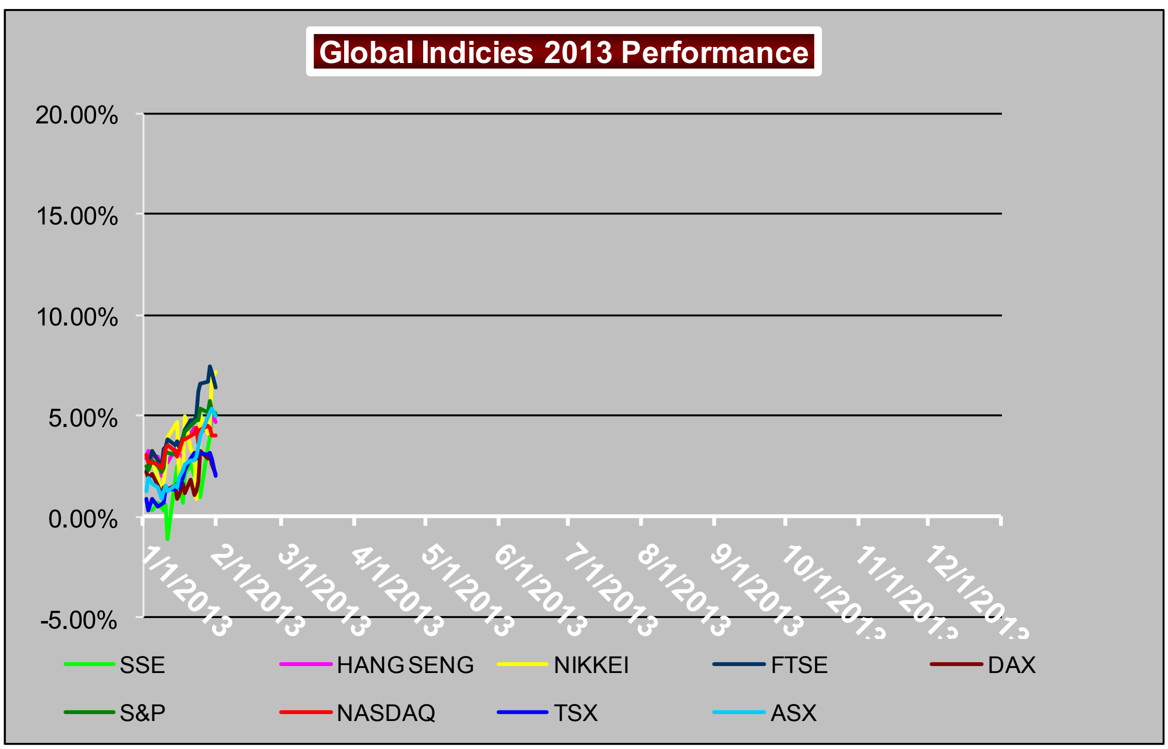
GDB Capital Inc.

GDB February 2013 Newsletter

Monthly Market Summary:

2013 January Market Activity		
SSE COMPOSITE	***2,385.42***	+116.29 (+5.12%)
HANG SENG	***23,729.53***	+1,072.61 (+4.73%)
NIKKEI 225	***11,138.66***	+743.48 (+7.15%)
FTSE 100	***6,276.90***	+379.10 (+6.43%)
DAX	***7,776.05***	+163.66 (+2.15%)
DOW	***13,860.58***	+756.44 (+5.77%)
S&P 500	***1,498.11***	+71.92 (+5.04%)
NASDAQ COMPOSITE	***3,142.13***	+122.62 (+4.06%)
ASX 200	***4,878.80***	+229.80 (+4.94%)
TSX COMPOSITE	***12,685.20***	+251.70 (+2.02%)
TSX VENTURE	***1,221.71***	+0.41 (+0.03%)



Investment Themes:

Investors around the world have been enjoying buoyant returns in global equities from a bout of sanguine optimism in January. The rotation to risky assets is ostensible by the irrepressible rise of major equity indices around the world. While for many economies, the rise in stocks is supported by improving fundamentals, the soaring Japanese equities should raise some eyebrows. The Nikkei 225 has been stellar over the past three months, soaring 29% from November 13, 2012.

Much of Nikkei's rise is attributed to the depreciating Yen. Over the same period, the Japanese Yen has declined 13% against the USD. Currency experts are predicting further declines in 2013.

A weaker Yen makes Japanese exports cheaper, and tilts the balance of trade in favor of Japan and benefit the country's exporters, of which, many are listed on the Tokyo Stock Exchange. This is the prevailing notion why investors have been piling onto Japanese equities.

To some degrees, the above notion holds true. The equity market almost always rally on the backdrop of a weaker exchange rate. In a very crude explanation, if Yen declines by 13%, ceteris paribus, demand for Japanese exports will increase by the same percentage which translates to 13% increase in revenue, earnings and rise in stock price. For Japanese companies that manufacture overseas, assuming foreign price consumers pay remain unchanged, thus no change in demand, a cheaper Yen would increase the amount these Japanese companies repatriate when foreign profits are brought home domestically. In either case, a 13% declining in Yen should boost Japanese exporter's bottom line by a similar magnitude by a back of the envelope calculation. However, at more than 2% rise for every 1% fall in the Yen, we believe the Nikkei is exuberantly distorted and could head for a reversal if there are no real economical improvements in the Japanese economy.

While a cheaper currency supports exports, it also increases the costs of Japan's imports. Input costs from energy to raw materials become more expensive in nominal terms, which in turn, cause margin compression for Japanese companies. Since the March 2011 earthquake, Japan has relied more on conventional energy such as oil and natural gas imports. Compounding the demand increase with rising energy prices and a weaker Yen, the costs of running factories and purchasing raw materials increase and have to be absorbed by the Japanese exporters; and with a limited ability to pass these costs onto the consumers given the abundance of foreign competition, the Japanese exporters are operating in an environment where they are constantly challenged by shrinking margins. The table below is December 2012's Principal of Commodity Report published by Trade Statistics of Japan Ministry of Finance. As we can see, the values of energy imports from petroleum, to LNG, to LPG have been rising steadily.

	Petroleum		Liquified Natural Gas		Liquified Petroleum Gas	
	TKL	Value	TMT	Value	TMT	Value
2010	214,618	9,405,875,538	70,008	3,471,846,720	12,144	779,654,285
2011	208,872	11,414,740,691	78,532	4,787,162,723	12,474	891,531,692
2012	213,033	12,247,883,589	87,314	6,001,493,752	13,200	1,021,091,421

Source: Trade Statistics of Japan Ministry of Finance

Japan Co. also imports a lot of components for its final products from other Asian countries such as Korea, Taiwan, and China. Let's take a look at the performance of the Japanese Yen against these other currencies:

As the chart illustrates, the Yen is down 12.6% against the Korean Won, down 11.5% against the Taiwan Dollar, and down 12.8% against the Chinese Yen. Therefore, the import components that go into many of the Japanese export products have increased by an average of 12% for Japanese manufacturers. Again this poses as headwind to firm's profitability.

Lastly, in addition to the above elements which may negatively impact Japanese companies, the political friction over the island dispute with China is causing Japanese firms to lose market share drastically in one of its largest growth markets. The impact may be prolonged depending on how the situation resolves.

The rise of the Nikkei is not sustainable based on currency devaluation alone. For this reason, we believe the rise in Japanese equities is at its later innings and will run out of momentum soon. To hedge this bet against the Nikkei, we would put on a short position on the Yen to mitigate the impact of further monetary easing by the BOJ. In the event that Yen continues its downward trend and inflates the Japanese equities, our net P&L will offset.

Investment Opportunities:

1. **Sino-GDB Fund**
   Fund managed by GDB Capital. Event-driven investments using hedging strategies and combinations of long/short positions in equities, futures, and commodities and their derivatives. Fund targets gross pre-tax IRR of 20% per annum, minimum investment US$100,000. GDB will insure against investment losses up to 5% of investor's original investment.