CADENCE
CAPITAL LIMITED

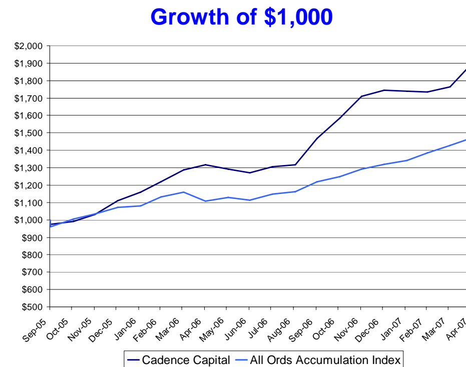
INVESTMENT UPDATE AND NTA - May 2007

FUND PERFORMANCE*

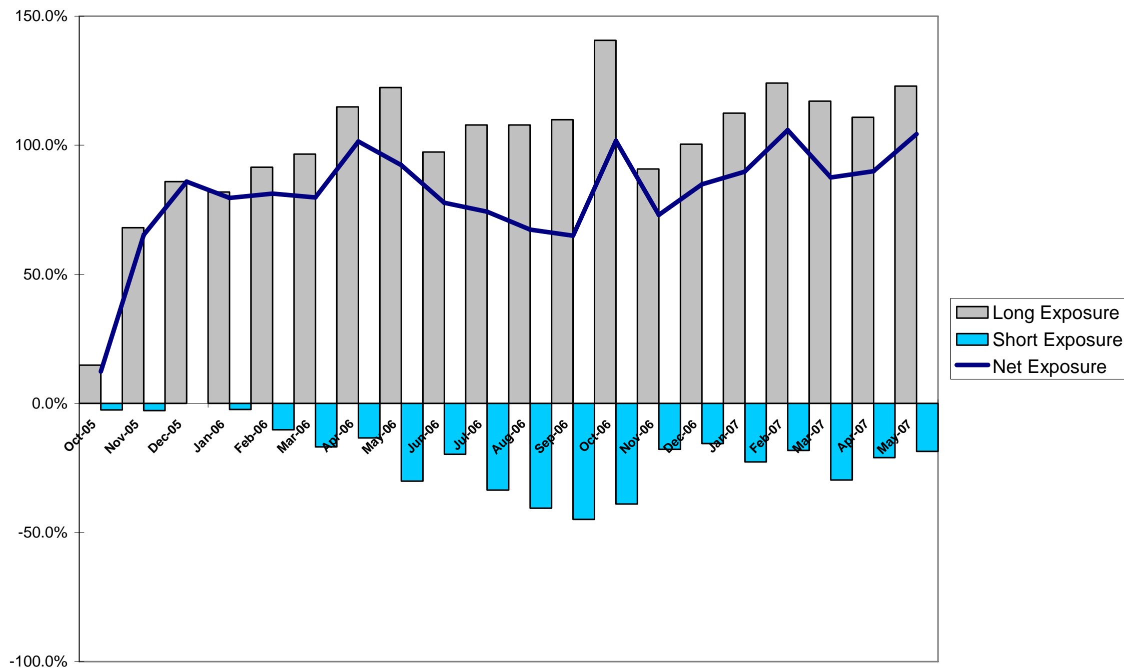
Performance to 31st May 2007	CCL	All Ords
1 Month	7.56%	3.19%
3 Months	9.02%	9.87%
6 Months	19.65%	17.99%
1 Year	44.15%	32.81%
2 Years (% per Annum)		
3 Years (% per Annum)		
Inception to date accumulated return	**95.21%**	**47.24%**

* Before Management and Performance Fees

Growth of $1,000



PORTFOLIO EXPOSURE ANALYSIS



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PORTFOLIO SECTOR ANALYSIS

Sector	Long	Short	Total
Diversified Financials	33.82%		33.82%
Software & Services	17.71%	-4.36%	13.35%
Commercial Services & Supplies	11.77%		11.77%
Materials	17.14%	-5.96%	11.18%
Capital Goods	9.60%	-0.94%	8.65%
Telecommunication Services	6.69%		6.69%
Media	6.80%	-0.44%	6.35%
Insurance	4.82%	-0.96%	3.86%
Banks	3.49%		3.49%
Other	2.52%		2.52%
Retailing	2.46%		2.46%
Real Estate	2.65%	-0.77%	1.88%
Automobile & Components	1.10%		1.10%
Health Care Equipment & Services	1.04%		1.04%
Food Beverage & Tobacco	1.03%	-0.31%	0.71%
Pharmaceuticals, Biotechnology & Life Sciences	0.33%	-0.44%	-0.11%
Transportation		-1.06%	-1.06%
Energy		-1.64%	-1.64%
Consumer Services		-1.71%	-1.71%
Gross Exposure	**122.96%**	**-18.60%**	**104.35%**
Net Cash / (Debt)			**-4.35%**

MARKET AND COMMENTARY

Cadence Capital Limited NTA estimates as at 31st May 2007:

Gross NTA	$1.48187
Pre Tax NTA	$1.40172
Post Tax NTA	$1.30046

To get weekly estimates of the NTA for Cadence Capital Limited please visit www.cadencecapital.com.au

During the month of April, Cadence Capital Limited returned a gross performance of 7.56% compared to a rise in the All Ordinaries Accumulation Index of 3.19 % and a rise in the Small Ordinaries Accumulation Index of 5.43%. For the past 12 month period, Cadence Capital Limited returned a gross performance of 44.15% compared to a rise in the All Ordinaries Accumulation Index of 32.81 %. The fund finished the month 123.0 % long, 18.6 % short and with a net long exposure of 104.4 %. The net exposure for April 2007 was 89.9%.

Are Resource Companies Really that Cheap?

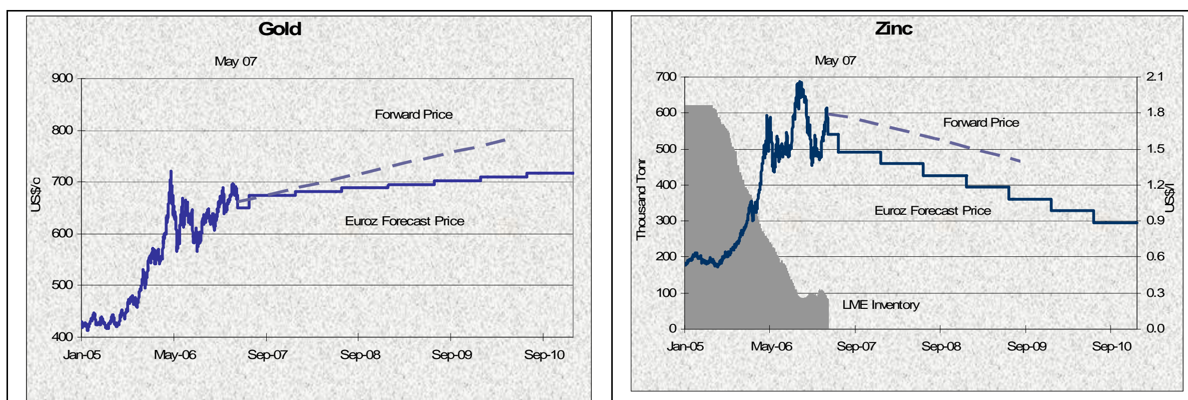
Paraphrasing Ed Sekota (one of the world's great investors) from a book called Market Wizards; 'Commodities represent the purest form of trading in the world and resource companies are a leveraged version of this type of trading'.

I believe he was trying to explain that commodity speculation centres largely around the demand and supply of an underlying commodity and that price is affected depending on demand and supply. When you speculate on commodities you are speculating on the future demand and supply of that commodity and hence, the future price of that commodity.

In the case of a resource company you are not only speculating on the price of the commodity produced but also the volume of the commodity you expect that company to produce. In simple terms the Revenue = Price x Volume. The variable cost of mining a commodity is: Variable Cost = Cost x Volume. The margin earned can be represented as follows: (Price of Commodity - Cost of mining the commodity) x Volume of the commodity produced.
Presuming a resource company producing constant volume, the profit of a resource company is more sensitive to commodity price moves than the profit on a direct commodity position. I.e. The profit of a resource company is usually more volatile (or leveraged) than the movement in the underlying commodity price.

When valuing a company we tend to look at current year earnings and earnings two years into the future. In the case of a resources company this means: (the price of a commodity less the cost of mining the commodity) x volume produced. Using the logic outlined above this formula is very sensitive to the future price of a commodity. This illustrates the problem in a nutshell. For someone to say that commodities are cheap (based on say a P/E multiple or Cash Flow multiple) – they need to be confident that the price of the commodity is not going to fall significantly in the future.

Below are a set of charts showing the current forward price curves for a number of commodities.



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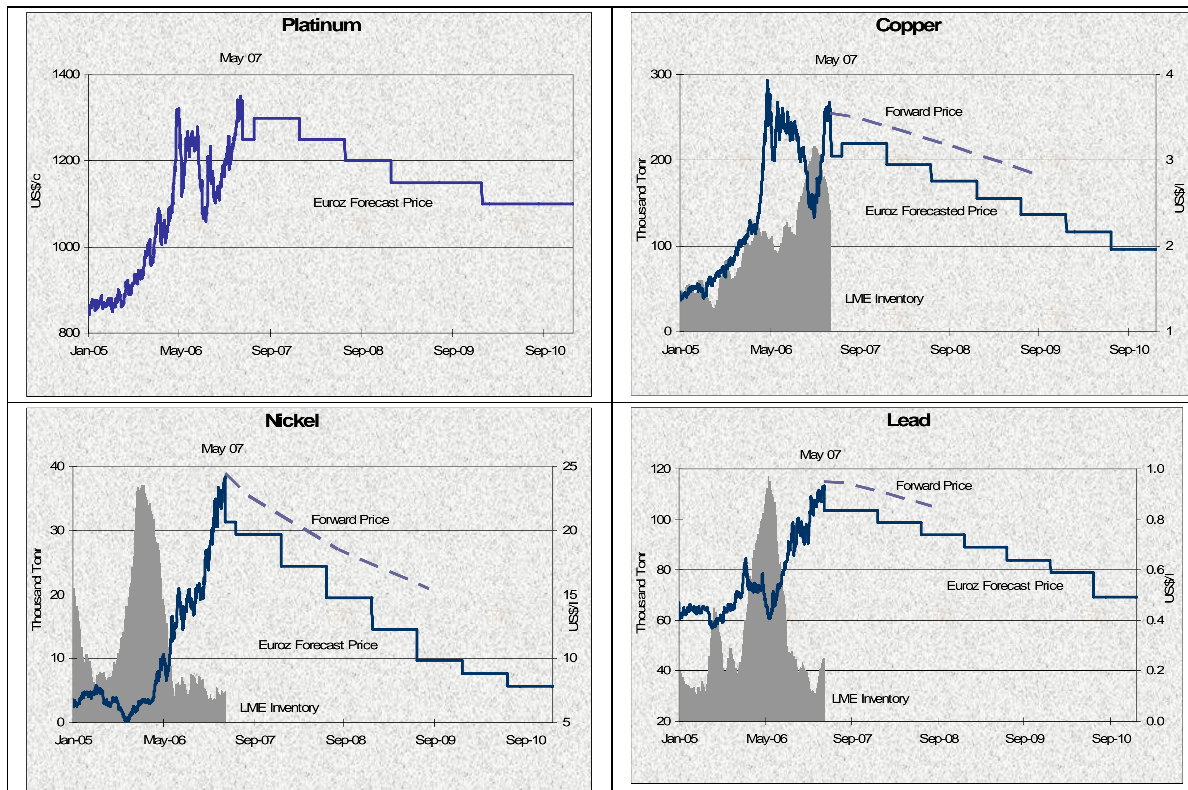

In the case of copper, nickel and zinc companies, resource companies we made good gains on as commodity prices rose over the previous two years, the forward price curves are showing a significant fall in price. Should the forward market be correct and prices of these commodities fall, this will have an even greater effect on the profitability of resource companies producing these commodities (as outlined above).

We should be looking at future commodity prices and future profitability in order to conclude that resource companies are cheap. Around 18 months ago we concluded that many resources companies were indeed cheap since forward prices (the price the market was predicting these metals would trade at in the future) were higher than spot prices (current prices) at the time. This was due to the fact that the supply side for these commodities was constrained and stockpiles (or the amount of stock on hand) were falling. Prices did indeed rise as a result of falling stock piles and in hindsight this was a good investment decision. Interestingly enough if you used current/spot prices, at the time, to determine earnings for these resource companies, they did not appear particularly cheap.

This leads to the anecdotal conclusion, ‘buy resource companies when they look expensive and sell them when they look cheap’. This statement is not strictly speaking correct but does serve as a warning that the best time to buy resource companies is when the forward price curve is indicating prices are going up and sell again when the forward price curve is going down.

To date heavy metal prices have risen significantly due to the demand-supply imbalance that has developed in the world over the last two years in particular. However, we need to be aware that as more supply comes on i.e. more resources are found, or it becomes economic to mine old resources at higher prices, the demand-supply equation will eventually come back into equilibrium.

The first clue of a reversion to equilibrium may be a forward curve showing falling prices. This forward price curve is a summary of the best estimates of all market participants expectations as to where future commodity prices are likely to go.

DISCLAIMER

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