

**BAOBAB**  
GLOBAL FUND



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		Other currency equivalent				
		USD	EUR	GBP	BWP	ZAR
<i>LONG TERM TRACK RECORD</i>						
11.7 years-compounded (22 Apr 1997 - 31 Dec 2008)	Investment officer (full service track record - <u>net</u> to investors)	6.8%	5.4%	7.7%	13.5%	12.4%
	Index*	-0.5%				
	NAV	\$97.06				
<i>SHORT TERM TRACK RECORD</i>						
12 months	Net to investors	-47.4%	-43.0%	-11.4%	-21.1%	-8.9%
	Index*	-40.5%				

\*Weighted index, according to the percentage of assets invested in specific markets. Currently the index comprises the S&P500, FTSE100, TSE300, Nikkei 225, Hang Seng and Dow Jones Commodity Indices.

Letter to shareholders:

### Mistakes

#### Getting off the track (when you know the train is coming)

The most significant mistake and disappointment for 2008 is that I did not sidestep the looming problems effectively. I thought the following prepared us sufficiently, but it did not.

- We had a significant short position of more than 10% of our assets and it was concentrated in financial stocks, the NASDAQ and the S&P500.
- We transferred the money that we received from shorting out of the USD and invested it in Asian, European and UK equities. So I was creating a liability in the USD, because I believed this liability was going to get smaller in future as the USD depreciates against the currencies of the equities in which we invested. It turned out that we were right.
- We held a sizeable cash position that averaged 12% of net assets for the year.

Yet, despite all these protections put in place, I still did not manage to sidestep all the problems of 2008.

With the benefit of hindsight, the main reason for this mistake is that I shifted too much on the quality spectrum. If you study the performance of stocks during the depression then you will find that the more expensive and higher quality companies outperformed the cheaper and lower quality companies during the downturn. One important, and obvious, reason for this is that a lot of the weaker companies ended up in bankruptcy. So ultimately I was seduced by the low prices of less than stellar companies. The discussion on ScS Upholstery in the following section is a case in point.

It would be interesting to know how many good investors made the same mistake of shifting too much on the quality spectrum. One would have expected those with outstanding long term records to have fared better last year. The following table, which I recently showed you, bar the last column, is illuminating.

Ranking	Entity	My career's rate of compounding compared to the best track records over the same time. (1 Apr 1997 - 31 Dec 2008) US\$	Performance in 2008
1	KEELEY Small Cap Value Fund - Cl A	9.6%	-40.2%
2	Berkshire Hathaway (Share price)	8.8%	-31.8%
3	Chou Associates Fund	8.5%	-47.7%
4	Baobab Global Fund	6.9%	-47.2%
5	Oakmark Select Fund (The) Cl I	6.3%	-37.2%
6	Bruce Fund, Inc.	5.7%	-31.6%
7	Davis New York Venture Fund A	4.6%	-41.0%
8	Third Avenue Value Fund	3.7%	-45.9%
9	JSE (Johannesburg stock exchange)	3.5%	-45.2%
10	American Funds Growth Fd of America A	2.9%	-39.8%
11	Franklin Mutual Discovery Fund, Class A	2.7%	-30.5%
12	First Eagle Global Fund Class A	1.7%	-26.5%
13	S&P 500	1.5%	-38.5%
14	Dodge & Cox Stock Fund	0.7%	-46.2%
15	The Weitz Funds, Value Fund	0.7%	-41.2%
16	Legg Mason Value Trust Inc.	-0.2%	-58.0%
17	Baobab Benchmark INDEX	-0.5%	-40.5%
18	Meridian Growth Fund	-1.4%	-33.5%
19	Longleaf Partners Fund	-2.3%	-52.7%
20	FPA Capital Fund	-2.9%	-41.2%

### ScS Upholstery

Accounting for *operating leases* presents one of the few remaining ways to keep a significant liability off the balance sheet. The popular argument goes that *retailers* should not act as pseudo landlords, but should focus on retailing. Therefore, they should not own the property, but they should lease it. Yet, because location is so important in retailing, the retailer usually secures the premises for a long time by entering into lengthy contracts. If I contract to pay you, a set amount for a very long time then that qualifies as a liability. The accountants disagree and allow you to simply make a footnote of it, instead of showing it on the balance sheet. If you capitalise the payments and add it to the balance sheet and/or treat the annual lease payments as you would interest on regular bank debt then suddenly the whole picture changes. This liability was significant for ScS Upholstery, it could not meet its rental bills in 2008, filed for bankruptcy and we had a permanent loss of capital. It was a horrible mistake and the cost was material. This also happens to be the biggest investment mistake of commission in my career....so far.

### Update

#### "Falling Down" article

I think it is pretty clear now that all the following "shoddy hamburger" problems of the US we identified in 2004 are broadly recognised (see the "Falling Down" article in the *News* section of our website),

1. Net external debt,
2. Social- and Medicare deficits,
3. Derivatives, and
4. Increase in the money supply.

These topics have reached the mainstream now, so it is time for us to move on.

Before I continue, be warned that this will turn out to be a predominantly negative letter in the sense that I am going to talk a lot more about problems than anything else. Do not mistake that for my mood. This is a great time to invest; there are endless bargains to be had in every asset class. My Dad used to say that *there is a reason the good Lord gave us 10 fingers, because you will never have more than 10 good friends in your lifetime. Even if you are very lucky, you will most likely still be able to count your good friends only on your one hand.*

Benjamin Graham taught us that Mr Market is a manic-depressive and to stretch that a bit; the one day he is your friend and the other he is your enemy.

If you marry, Graham's thinking with what my Dad said then it tells you that one will be lucky to see a proliferation of bargains on this scale more than five times in your life; you will find very few occasions in life where Mr Market is a better friend than he is now.

So what are the issues, the traps and the time bombs that we see as disruptive forces when we ponder the future?

Time bombs

#### Short fuse-Operating leases

We discussed the nature of operating leases under a previous section. However, I want to make a separate and important point. This is a significant risk in a broad sector of the market, most notably retail, and generally speaking, the current accounting treatment does not sufficiently assist one to identify this risk. Both equity and fixed income investors need to pay attention to this.

#### Long fuse-Pension Liabilities

*"Always be nice to bankers. Always be nice to pension fund managers. Always be nice to the media. In that order" -John Gotti (1940-2002)*

Just like operating leases, pension liabilities are liabilities that will play an increasingly important role in the demise of companies. One reason being, that there is significant risk that the pension issue will become heavily politicised. It will be an effective tool in winning or keeping votes at little cost to the politicians. Although, there is nothing wrong with forcing companies to keep its promises I venture that the politicians will abuse the process.

Against this background, let us now turn to the pension issue's financial ramifications specifically. Long gone are the days that a pension fund invested in safe investments, which mainly consisted of government and some corporate bonds. For example, consider the following from a *Citi Investment Research* report, which shows some companies with large pension fund obligations as listed in the UK market's FTSE 100. Note: This is not a problem that is limited to the UK; it is a global problem.

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**Figure 2. Large schemes with high equity pension asset allocation – FTSE 100**

Company	Equity exposure	Assets / Market Cap	FY end
FIRST GROUP	70.1%	97.7%	31-Mar-07
ROLLS-ROYCE GROUP	68.1%	71.7%	31-Dec-06
BAE SYSTEMS	67.0%	89.2%	31-Dec-06
LLOYDS TSB GROUP	63.4%	72.4%	31-Dec-06
ITV	61.0%	86.9%	31-Dec-06
AVIVA	58.2%	63.8%	31-Dec-06
WHITBREAD	56.9%	69.0%	1-Mar-07
SMITHS GROUP	55.2%	64.5%	31-Jul-07
BT GROUP	55.0%	186.8%	31-Mar-07
SAINSBURY (J)	52.0%	65.9%	24-Mar-07
NATIONAL GRID	49.8%	76.7%	31-Mar-07
REXAM	48.0%	90.9%	31-Dec-06
BRITISH AIRWAYS	46.2%	413.6%	31-Mar-07
ROYAL & SUN ALL.IN.	45.0%	119.8%	31-Dec-06
MARKS & SPENCER GROUP	43.0%	77.0%	31-Mar-07

Source: Citi Investment Research, Datastream

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This report was dated 22 January 2008 and since then the FTSE 100 has dropped more than 30%. As if this was not bad enough, the future returns for equities will prove to be nowhere close to the assumptions these pension fund actuaries and trustees use. In addition, the assumptions feed into the discount rate that is used to discount the liabilities. The net result is that pension funds, which are already underfunded, will have considerably less assets and more liabilities than currently expected.

The scale of the problem is substantial with an early 2009 total deficit of £242Bn for UK pension funds according to the *Pension Protection Fund*. The increase in the deficit from a year ago was 165% and the current assets of the *Pension Protection Fund* of less than £6Bn are inadequate. To fix the problem will not be easy, mainly because there is every incentive to get it wrong and none to get it right.

For those of you that are relying on future pension payments for your retirement the following might turn out to be literally true.

*"My NFL pension can barely pay my son's tuition. You know, it's very little money." -O. J. Simpson*

Of course, Simpson's pension does pay about \$30,000/month.

#### Long fuse - The rise of Islam

*"Europe is no longer Europe, it is Eurabia, a colony of Islam, where the Islamic invasion does not proceed only in a physical sense, but also in a mental and cultural sense." Oriana Fallaci (1929-2006)*

There are two important facts you have to recognize when it comes to mainstream Islam. Firstly, it is dramatically different in almost every way when compared to the Western world, which is based in Judeo Christian values. It is dramatically different on issues such as business, law, human rights, freedom of speech, freedom to practice religion, etc. Secondly, it is embedding itself in Western society, Europe in particular, and both the speed and severity is totally underappreciated by the West.

If one looks at the five elements of national power; military, judicial, diplomatic, economic and informational and you spend the time to research these issues then it is clear that Islam is extremely successful on all fronts. This forum is too limited to go into the details, but the following will give you some idea of the scale of the change at hand.

The majority of the discussions on the Islamification of the West I have come across misses a crucial factor; demographics and in particular not only the numbers, but the age profile. For example, London has a permanent population of 7.5m and an estimated 1m of those are Muslim of which, and this is very important, more than half is estimated to be under 25 years old. Although, almost 60% of Londoners claim to be Christian it is the Muslims that is about to build the biggest house of worship in the UK and the Christians that are converting churches into houses and flats. The *London Markaz* will hold about 70,000 worshippers and you can gain some perspective about the issue when you compare it with the UK's largest Christian house of worship (Anglican Cathedral in Liverpool), which I understand hold some 3,000 people. Research compiled for a 30 Jan 2009 article in *The Times of London* showed that Britain's Muslim population grew by 500,000 to 2.4m in the last 4 years and that the Muslim population multiplied 10 times faster than the rest of society. A recent UK Department of Labour survey found that the majority of Christians in the UK is around 70 years old and for Muslims it is under 40, so the one group is heading off a cliff and the other is just hitting its prime. Some symbolic changes have already taken place like in 2005 the *Chief Inspector of Prisons* in the UK banned the flying of the *Rose of England* over *British prisons*, because it is offensive to Muslims, so has the *Drivers and Vehicles Licensing Agency* and *Heathrow Airport*.

Did you know that the largest voting bloc in the UN Human Rights Council is the *Organization of the Islamic Conference* (Association of 56 Islamic states promoting Muslim solidarity in economic, social, and political affairs)?

Let us take another country, France. In France, about 10% of her total population and 30% of her cities are Muslim, but more importantly of the 25 and under age group about 30% are Muslim and in the cities, it is about 45%. Generally, in Europe the Muslim birth rate is estimated to be 3 times higher than the non-Muslim rate.

The above should give you enough indication of whether you should take this seriously as a disruptive force. You must also appreciate that this is not the type of issue that you will research for a couple of hours and come up with a nicely packaged answer. However, for me this is akin to the issues I raised in 2004 regarding the US and its problems with *net external debt, social and Medicare deficits, derivatives, and the increase in the money supply*. You will recall I started my one article at the time with "*Macro-economics is not my forte, but then again I don't have to be an expert on the machinery of a train to appreciate that it's big, it's heavy, and it's going to hurt like hell if I get in front of it.*" My research into the Islamification of the West leaves me with no doubt that the *Islamic Tsunami* has hit the shores of Europe and the UK and is flooding the place.

Do not make the mistake of being caught up in the emotive and religious issues. When you look at the facts, focus on the demographics and then try to see the picture 10 years hence. Bear in mind that at the core, these are two very different worlds colliding and the fervour and *youthfulness*, no pun intended, of the two sides is not an even match. The only question is whether you are prepared to deal with the disruption, irrespective of whether the tide is eventually turned or not.

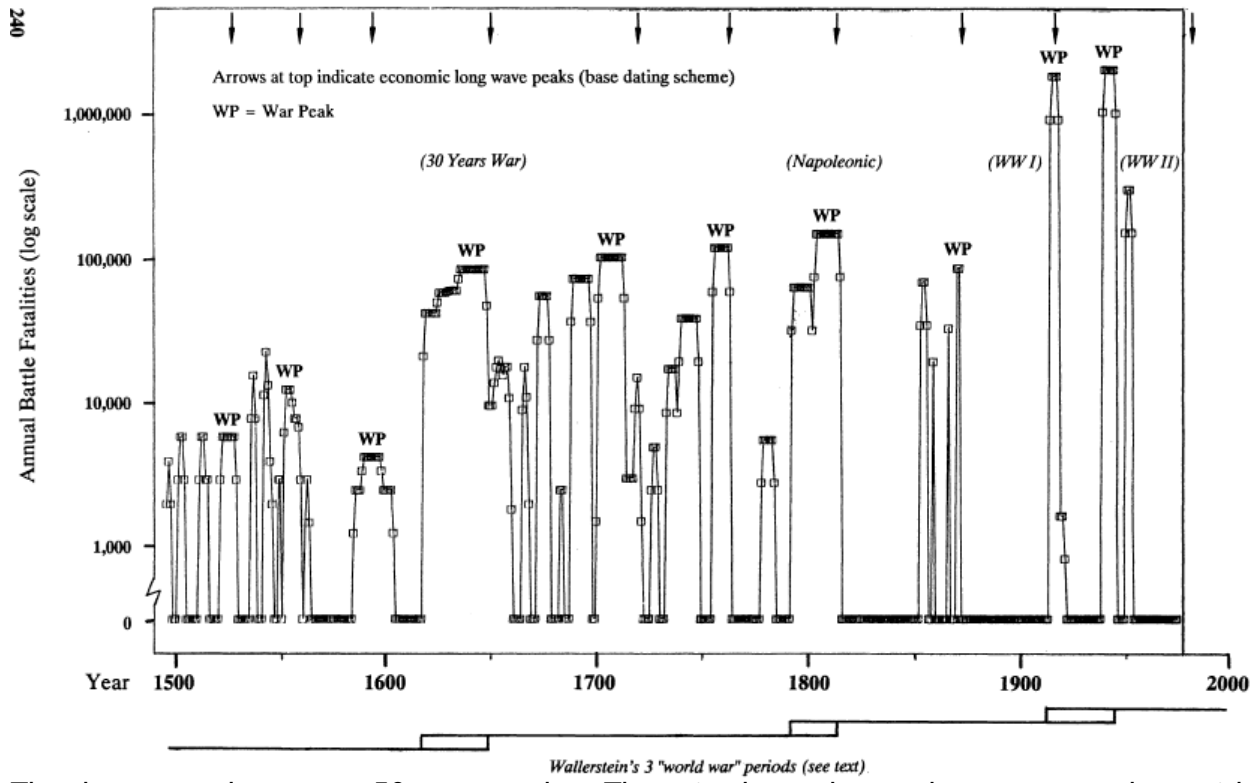
To tie this in with our existing investments; we have been invested in the Guoco Group Ltd for several years, which have been steadily increasing its investment in Islamic banking and Sharia compliant financial services. Also, we hold a large investment in a Turkish based insurance company and bank; Turkey is an Islamic state. One of the long-term drivers of value will be Turkey's inclusion in the European Union (EU). Currently, the biggest opponent in the EU to Turkey's inclusion is France. If I consider the rise of Islam in France then I suspect that France's opposition will likely wane.

Not sure how long fuse - The war curve or/and a nuclear event

*"Everyone's a pacifist between wars. It's like being a vegetarian between meals."* -Colman McCarthy

The following graph illustrates the significant wars (classed according to severity as measured in battle fatalities) fought by great powers from 1495 to 1975.

Figure 11.1. Great Power War Severity, 1495-1975



The data strongly suggest 50 years cycles. There is also a theory that wars correlate with economic long wave cycles and the following illustration was quite surprising to me. Row 10 of the following indicates that a major war is overdue.

**Table 11.3. Dating of Long War Cycles, 1495-1975**

Cycle	Starting date of war cycle	Peak war years	Length (years)	Ending date of corresponding long wave phase period
1	(1495)	1521-1529	(35)	1528
2	1530	1552-1556	28	1558
3	1558	1593-1604	47	1594
4	1605	1635-1648	44	1649
5	1649	1701-1713	65	1719
6	1714	1755-1763	50	1761
7	1764	1803-1815	52	1813
8	1816	1870-1871	56	1871
9	1872	1914-1918	47	1917
10	1919	1939-1945?	(27)	(1968/80?)

*“He who joyfully marches to music in rank and file has already earned my contempt. He has been given a large brain by mistake, since for him the spinal cord would suffice.” -Albert Einstein*

In my view the odds of a major conflict has risen considerably, since early 2000 when you consider the above together with the following major macro global disruptions;

- The beginning of a shift of global power from the West to the East, which has not occurred for centuries,
- The Islamification of Europe and the culture clash it causes,
- The global economic crisis, and
- The global nuclear threat.

Well if I failed to get you all depressed in the previous section then I definitely have you now. Although, I am not depressed I do worry about these issues, because that is my job. I am not saying the above is a foregone conclusion and I do not have a fatalistic approach. I have the same approach to these problems as I had with those the US faced back in 2004; I said then and I say now that things are aligning in a certain way and it seems to be reaching critical mass. Either the risk is that it might eventually reach a tipping point, which causes a flood that topples Baobab or it might result in the long term erosion of the soil in which our “little” tree, Baobab, stands. Rest assured though that I do incorporate these issues into my thinking and try to ensure that we are aware of the investment risk it poses and profit from the opportunities it presents.

#### Look east

If you compile a list of the net external debt of countries, it makes for some interesting reading. The list below shows the top 20 (highest external debt/GDP ratio) and the bottom 10 (lowest ratio, the negative ratio means the country has negative debt and is a net creditor). What is striking is the number of Asian and developing countries that make up the creditor nations of this world. Many will push the argument that it is somehow better to invest in a country that is a net debtor nation, but have a large economy as opposed to a smaller or developing economy, but is a net creditor nation. I increasingly feel more comfortable with the latter. I favour net creditor nations like China, Hong Kong, Singapore, etc over heavily indebted countries like Ireland, the UK and the US. However, all these choices present significant risk, but if I look 10 to 20 years down the road then the former

gives me a longer runway with potentially more upside. Not all the creditor nations are *investor friendly*, but there is ample to work with.

### Highest

USD m	Reserves of foreign exchange and gold	Debt - external	Current account balance	GDP	Current Account /GDP	(Net External Debt)/GDP
Ireland	926	1,841,000	-8,621	285,000	-3%	646%
United Kingdom	57,300	10,450,000	-72,540	2,787,000	-3%	373%
Switzerland	75,370	1,340,000	40,810	492,600	8%	257%
Netherlands	26,980	2,277,000	47,000	909,500	5%	247%
Belgium	16,510	1,313,000	3,972	530,600	1%	244%
Portugal	11,550	461,200	-23,970	255,500	-9%	176%
Austria	18,220	752,500	10,630	432,400	2%	170%
France	115,700	4,396,000	-47,270	2,978,000	-2%	144%
Seychelles	59	1,161	-307	779	-39%	141%
Denmark	34,320	492,600	4,333	369,600	1%	124%
Burundi	134	1,200	-120	903	-13%	118%
Germany	136,200	4,489,000	267,100	3,818,000	7%	114%
Zimbabwe	100	5,255	-597	4,548	-13%	113%
Sweden	31,040	598,200	35,220	512,900	7%	111%
Cyprus	1,476	28,840	-2,609	25,590	-10%	107%
Estonia	3,657	29,500	-3,037	25,210	-12%	103%
Latvia	5,660	39,470	-5,126	33,900	-15%	100%
Australia	25,750	1,032,000	-43,840	1,069,000	-4%	94%
Finland	8,535	271,200	10,630	287,600	4%	91%
United States	70,570	12,250,000	-568,800	14,330,000	-4%	85%

### Lowest

Malaysia	104,400	54,110	27,440	214,700	13%	-23%
Nigeria	72,040	9,132	7,722	220,300	4%	-29%
Hong Kong	161,400	78,840	22,440	223,800	10%	-37%
China	2,033,000	420,800	368,200	4,222,000	9%	-38%
Malta	4,150	189	-538	8,584	-6%	-46%
Taiwan	280,900	98,990	23,950	393,200	6%	-46%
Botswana	10,280	395	1,611	13,810	12%	-72%
Singapore	170,100	25,540	32,120	192,800	17%	-75%
Algeria	150,500	2,913	35,800	171,300	21%	-86%
Libya	99,450	5,521	43,330	108,500	40%	-87%

### Divestments

We continue the sobering exercise of following our divestments for three years. We try to keep things simple. Therefore we only record the date and market value or per share value at date of sale and compare it with the value at yearend. As soon as three years has passed then it is dropped from the list. We calculate the average of the change in value and compare that with the historical compound growth rate of Baobab.

Please note that you should not deduce from the following that we only had eight sales during 2008. We only show the first transaction of every holding and then we only include

sales of our core holdings; workouts are not included and some other minor adjustments are made.

Divestment	Date Sold	Valuation at sale (Local currency)	Yearend valuation	% Compound growth
Krispy Kreme	Feb-06	6.66	1.68	-38%
Humboldt Wedag Int	Jun-06	26.95	11.17	-29%
Markel Corp	Jun-06	337.00	299.00	-5%
Mercury General Corp	Jun-06	55.75	45.99	-7%
JJB Sports Plc	Jul-06	1.80	0.04	-78%
Glorious Sun Enterprises	Sep-06	3.80	1.91	-26%
Caldwell Partners	Jan-07	1.60	0.72	-33%
Gold Bullion Securities	Mar-07	24.00	20.03	-9%
Dewhurst Plc	May-07	2.00	1.84	-5%
YGM Trading	Jun-07	6.16	2.95	-37%
Chung Tai Print	Jul-07	2.25	0.05	-92%
Punch Graphix Plc	Aug-07	1.20	1.80	33%
Telecom Corp of New Zealand	Oct-07	17.35	6.70	-53%
Abbeycrest PLC	Mar-08	0.15	0.11	-35%
Mass Financial Corp.	Apr-08	5.50	4.25	-29%
Delta PLC	Jul-08	1.14	0.83	-47%
BioScrip Inc.	Aug-08	4.00	2.22	-69%
Liquidation World Inc.	Oct-08	0.94	0.78	-53%
office2office PLC	Oct-08	0.81	0.66	-57%
China-Hong Kong Photo Products Holdings Ltd.	Nov-08	0.37	0.37	-8%
Air Transport Services Group Inc.	Dec-08	0.27	0.18	-56%
Average				-34.85%

#### Why will we continue to do well?

We have an above average long term investment track record, simply because we follow a proven investment approach. We did not invent anything new; we are simply riding on the coat tails of people like Benjamin Graham, Warren Buffett, Francis Chou and Prem Watsa. I am just trying to learn as much as I can from these people, in particular their mistakes and then I try my best not to make them.

We do not spend any time to try and figure out the way the market is going and we do not try to project what our returns are going to be, because I do not know. All I know is that if we invest in a certain way by focussing firstly on surviving and secondly on earning a decent return then we will be ok. Anything more than that is a plus and anything less is unacceptable.

The point being that we are focussed on the process, not the outcome. It harks back to something that has served me very well in life; *you have to distinguish between the things you can control and those you cannot. Then focus 100% on what you can control.* We cannot control the outcome, but we have 100% control over the process and if focus on the process then the results will take care of itself.

*"Learn the art of patience. Apply discipline to your thoughts when they become anxious over the outcome of a goal. Impatience breeds anxiety, fear, discouragement and failure. Patience creates confidence, decisiveness, and a rational outlook, which eventually leads to success."* -Brian Adams

#### View on the market

Last year we continued our 100% success rate in predicting the markets. Our prediction for this year is the same and we expect to be right once more.

*The markets will go up or down*

#### Thank you

As always, I would like to thank to Rob and my family, but I think most praise should be reserved for our investors. Despite my dismal performance in 2008, not one investor pulled funds from Baobab and we had meaningful contributions. It makes my job so much easier and your vote of confidence is appreciated.

God Speed,

A handwritten signature in black ink, appearing to read 'M. van Blerk', written in a cursive style.

Martin van Blerk  
1 March 2009

Note: Audited Financial statements are presented separately and only to investors.