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Dear shareholders,

The market correction we had been anticipating arrived during the second quarter. World stock markets fell by 1.3%. Vltava Fund's NAV rose by 0.9%. While these figures might suggest that the markets were not very lively during the past three months, in fact quite the opposite was true. As we indicated already in the previous quarterly report, we have adopted a relatively conservative stance with a greater emphasis on capital preservation. We reduced the proportion of cyclical shares in our portfolio by selling Canadian Natural Resources in March at a time of high oil prices during the Arab Spring. We had intended to retain a larger quantity of cash and wait for better opportunities, which we expected from the approaching drop in the market. Our expectation (and in fact our desire) was fulfilled. World markets reached their spring peak during April and then corrected rather markedly downward in the following two months. The correction bottomed out during June, with the markets roughly 10% lower.

After more than two years of significant gains, global stocks were simply expensive at the beginning of spring. While this in itself would be sufficient reason for the correction, two additional factors helped the markets to decline more substantially. The first was a slowing in the global economy, and the second the never-ending Greek tragedy.

The weakening of the global economy has several causes, the main one perhaps being the attempts by a number of countries, especially in Asia, to dampen the growth of inflation. High oil prices and the earthquake in Japan undoubtedly also played their roles. Even though it is hazardous to make predictions, especially about the future, we do not think we are witnessing the beginnings of a new recession. This is rather a slowing typical of the current phase in the business cycle, and perhaps we are also drawing nearer to the long-term growth trend, which will undoubtedly be less steep than what we have been accustomed to for the past 20 years.

Predicting the development in Greece is becoming ever more difficult. This is because that development is controlled by people who earn their livings by spending other people's money (otherwise known as politicians). Their motivations are not economic, but political. They stand ready to squander any amount of money in the name of political ideas and their re-elections. In this they should not be underestimated. What else is this so-called support of Greece than throwing money down the drain? A year after Greece received EUR 110 billion in support, its debt as a proportion of GDP is at least 15% higher, its budget in the same state of disintegration, and the need for further support so pressing that we're counting in days. The only difference a year has made is that a large part of the Greek debt has been shifted from private investors to the EU, ECB, IMF and the like, and hence, at the end of the day, to taxpayers in other countries. Our opinion remains the same. We anticipate that Greece will eventually have to default on a large part of its debt and probably introduce its own currency. No one knows when this will happen and how much more money will be squandered in the meantime. This uncertainty and dependence on the scarcely predictable steps of politicians rises to the surface from time to time and presses down stock markets.

The recent correction was to our liking, because it brought better opportunities to buy. Indeed, we would have liked to see prices drop even further. There is nothing worse for a long-term investor than high share prices. It is impossible to invest properly in such a market. When prices are high, opportunities are rare. On the contrary, low share prices are the dream of every long-term investor. In such an environment it is possible to invest with high expected returns. A relatively strong flow of dividends is constantly streaming into our fund, accumulating cash for further investments. If share prices are low, we can significantly boost the value of our shareholders' assets by reinvesting those dividends.

Of course, most investors feel better when their share prices are rising. It is a pleasant, sometimes even intoxicating feeling. But it is important to realise that short-term growth decreases long-term returns, and, vice versa, short-term decline in share prices increases their long-term returns. Prices and returns are communicating vessels, and the connection between them is the re-investment of dividends.

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If taken to the extreme, a long-term investor should rejoice with every significant drop in share prices. This is easily said, but such sentiments are rather uncommon. In any case, leaving emotions aside, three things are essential to success during significant drops in share prices: 1. Know what to buy. 2. Have the courage to do so. 3. Have the means to buy. All three requirements must be fulfilled simultaneously. If you have the courage and money but don't know what to buy, then it will end badly. If you have the money and knowledge but lack the courage, then you are wasting an opportunity. If you know what to buy and have the courage but lack the money, then it's maddening!

That's exactly what happened to us at the beginning of 2009. Prices were fantastically low, we knew what we wanted and were not lacking in courage, but at the time we did not have the funds. This was exasperating for us. This is also a reason why we now hold more cash in our portfolio. Even though cash has hardly any return, it does have its option value, which consists in the fact that it makes it possible to take advantage of opportunities that arise. The years have taught us not to invest in a rush, because with time opportunities will always turn up. And often quite unexpectedly. In the last report we wrote about how we invested in Japan two days after the tsunami, when the Japanese market was engulfed in panic. Today the value of that investment is higher by 60%.

Regarding specific transactions, we were relatively less active in the second quarter. We did not sell anything. When the market started falling more quickly, we temporarily boosted our short positions, thus profiting a little from the market downturn and obtaining cash for later purchases. We were more careful with the purchases themselves. Here and there, we bought additional shares in companies we already held when their prices were advantageous, and especially in the second half of June when markets appeared to be stabilising. At the end of June, we opened a new position – for the first time in the history of the fund entering the Brazilian market. Brazil is a large and attractive country. We found an inexpensive and attractive firm which is profiting from the rapidly growing consumption among the Brazilian middle class. Specifically, our fund will profit from nearly every second payment card transaction in Brazil.

So far this year has not been much inclined towards share price growth, and the majority of stock markets are on the minus side for the first six months. This also applies to our fund's portfolio. This does not mean, however, that the value of the shares we have in the fund also is falling. Value depends on profits, dividends, and future potential. As I repeat often and happily, value and price are two different things. They often differ fundamentally from one another, even in the long run. Our task is to buy shares at prices significantly lower than their values. Growth in share value and the adjustment of price to value then comprise a two-fold impetus for growth in our shareholders' assets.

How do we know that the value of our companies is rising? To this question there is a complex answer supported by numbers and calculations, and there is also a simple answer. The simple one goes like this: From the 24 companies we have in the portfolio, at least 20 will this year most likely record the largest profits of their entire existence, the dividends of all 21 companies that pay them will be at the highest levels in their histories, and the prospects of all 24 companies for the years to come are more than promising – otherwise we naturally would not own them. Hence, there is no doubt that the value of the shares we own is rising promisingly. Thanks also to transactions whereby we occasionally replace more expensive shares with less expensive ones, the value of the portfolio is increasing at a yearly rate of 15–20% according to our estimate. It is only a matter of time until this will be reflected in share prices.

Sometimes it takes a long time and it seems that nothing is moving and the waiting will never end. Investing is a little like watching a tree grow. No movement is apparent from day to day, but if a person returns to the same spot after 5 years he or she will be surprised how much the tree has grown. When we look back at three of the larger stock positions we have held for a longer time, the growth in value is apparent at first sight:

Asian Citrus. We first bought it in 2007 for HKD 3 per share (now it is priced at HKD 7.07). This year, Asian Citrus will have earnings per share of about HKD 1.2. This denotes a P/E of 2.5 relative to the initial purchase and a current earnings yield of 40% p.a. on the funds invested back then.

Universal Robina. We first bought these shares in 2007 for PHP 15 (now they cost PHP 41). This year, Universal Robina will have earnings per share of about PHP 3.65. This represents a P/E of 4.1 relative to the initial purchase and a current earnings yield of 24.4% p.a.

Humana. We first bought Humana in 2009 for USD 28.9 (today it is priced at USD 80.5). This year, Humana will have earnings per share of about USD 7.1. This denotes a P/E of 4 against the initial purchase and a current earnings yield of 24.5% p.a.

As so often happens, the prices of these three stocks went through several very wild periods. In retrospect, though, no signs remain of that volatility. What is important is that their prices are heading strongly upwards in pursuit of their values. We endeavour constantly to contribute to long-term growth in the portfolio's value in this fashion, by selecting appropriate shares and purchasing them at the right price. If we manage that, then the share prices will look after themselves.

Wishing you a pleasant and gainful summer…
Dan Gladiš, 30 June 2011

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The information contained in this letter to shareholders may include statements that, to the extent they are not recitations of historical fact, constitute "forward-looking statements" within the meaning of applicable foreign securities legislation. Forward-looking statements may include financial and other projections, as well as statements regarding our future plans, objectives or financial performance, or the estimates underlying any of the foregoing. Any such forward-looking statements are based on assumptions and analyses made by the fund in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. However, whether actual results and developments will conform to our expectations and predictions is subject to a number of risks, assumptions and uncertainties. In evaluating forward-looking statements, readers should specifically consider the various factors which could cause actual events or results to differ materially from those contained in such forward-looking statements. Unless otherwise required by applicable securities laws, we do not intend, nor do we undertake any obligation, to update or revise any forward-looking statements to reflect subsequent information, events, results or circumstances or otherwise.

This letter to shareholders does not constitute or form part of, and should not be construed as, any offer for sale or subscription of, or any invitation to offer to buy or subscribe for, the securities of the fund.

Before subscribing, prospective investors are urged to seek independent professional advice as regards both Maltese and any foreign legislation applicable to the acquisition, holding and repurchase of shares in the fund as well as payments to the shareholders.

The shares of the fund have not been and will not be registered under the United States Securities Act of 1933, as amended (the "1933 Act") or under any state securities law. The fund is not a registered investment company under the United States Investment Company Act of 1940 (the "1940 Act").

The shares in the fund shall not be offered to investors in the Czech Republic on the basis of a public offer (veřejná nabídka) as defined in Section 34 (1) of Act No. 256/2004 Coll., on Capital Market Undertakings.

Historical performance over any particular period will not necessarily be indicative of the results that may be expected in future periods.