Dear Investors,

The Orange Capital Master Fund returned -1.9% in the second quarter. For the year the fund is up 2.12% net of fees and commissions. Since inception the Fund returned 45.1% cumulative or 19.33% annualized both net of fees and commissions.

Positions held as of June 30th 2010

L'Oreal	(the position made +5.39% since inception)
Air Liquide	(+1.12%)
Bancolombia	(+0.88%)
Banco Santander	(-0.88%)
BBVA	(+0.24%)
Bankinter	(+0.1%)
Monsanto	(-0.83%)
Africa Oil	(+0.33%)
EUR	(+0.43%)

Positions closed in the second quarter 2010

DD	(since inception flat)
Palladium/Gold	(+3.19%)
GBP/EUR	(+1.05)

The best opportunities arise when markets stop discriminating between quality and the rest. When everything trades in tandem and one piece of news can move asset prices across markets. The sell off in Europe in early May is a good example. Consensus is that the correction was driven by the sovereign debt crisis in Europe. We disagree. After looking at the situation and particularly focusing on Spain, which seemed to be the main issue, we concluded that the problems there could not have caused such a sell off.

But if it wasn't the government debt in Europe, then what else drove the markets down? The answer came from a different corner of the market. We looked at the major oil companies after the BP oil spill to see if there are opportunities arising from that situation. While talking to the oil industry we realized that the ripple effect from the BP oil spill was substantial. The industry was basically frozen, new projects postponed and the whole value chain was loosing a substantial amount of business. The economic value lost through all this could equal 10% of the value of the S&P 500 index. Hence we attributed the sell off to the oil spill rather than the macro situation in Europe.

This led us to believe that the banks in Spain are a great buying opportunity. Their business is very clear and transparent. We also took notice that the government was ready to restructure the local savings banks and that there were ready buyers for those assets. The main issue with the top banks is not the quality of assets or leverage but the access to very short term financing which is resolved by the ECB intervention. Santander and BBVA have two thirds of their businesses outside of Spain and are dominant players in Latin America where banks trade at top valuations. Given the compelling valuations of these banks we saw a comfortable 50% upside in the share prices within a short time frame.

Another position we took was going long the Euro after it fell below 1.2. At this level the exporters in Germany and France have a great competitive advantage which led us to believe that the currency had to recover alongside the markets in Europe.

The most interesting investment we made is in Bancolombia. The largest listed bank in Colombia is a good proxy for the improving macro situation in the country. After spending a few days visiting companies in Bogota and Medellin we feel even stronger about the opportunity. The country is in a virtuous circle with lower inflation, improving credit, lower cost of capital, strong corporate governance and stable policies. In addition to that there are large investments planned in infrastructure and natural resources such as oil and and hydro energy. This country reminds us of Chile with a very strong pension fund system that supports the local capital market.

We are keeping our investments in Air Liquide and L'Oreal. Both businesses are doing well and their stocks have outperformed the French market by a lot. The companies have one characteristic which we pay a lot of attention to; they are successful in China. They compete locally and make profits there. On top of that they have leading positions in other growth markets around the world. Recently the ownership saga of L'Oreal has been unfolding and our anticipated takeout of the company is becoming more imminent.

Ideas we are working on

We took a look at Argentina but concluded that the country is uninvestable. The country has no rule of law, the judiciary and the central bank are not independent, and the presidency is basically a license to steal. We will revisit after next year's election.

Other ideas we are working on are primarily M&A situations. The cycle is still early and the spreads are large enough but as usual with such events only a few deals are interesting enough to make it worthwhile.

We started looking at short ideas again. There are a few sectors which are under competitive pressure from China, such as trains and power equipment. Both areas are suffering because the Chinese are taking their business away in new markets. When we visited China last year we felt strong about their ability to build trains and power equipment. But the Chinese railway and construction stocks are not investable due to transparency issues. Instead of looking for a buying opportunity in China we decided to look for a competitor in the Western world to short.

Positions we closed

We closed our Dupont position because of the risk of pricing pressure from Monsanto in the seed business. We like Dupont as a company and their approach to their businesses. However, Monsanto has recently been under a lot of pressure and we are afraid that they might become irrational, in order to gain share, and destabilize the seed market.

Another position we got out of is long Palladium/ short Gold. This spread is a play on the global recovery in the auto market. The trade worked fine and reached our target so we decided to close the position.

We also closed our long GBP versus Euro position. We got involved shortly before the UK elections and we hoped that the GBP would outperform the Euro because the UK will be more efficient in tackling its issues. We were proven right and the GBP rallied versus the Euro. Even though the gain was less than we expected we were happy taking the profit and go on to new things.

Why we are comfortable with market risk

When it comes to market risk we pay attention to two variables. First, the yield curve, which is still steep and hence offers hope for a continuous market rally. Second, we look at the equity risk premium. If the equity risk premium was around 6% we would consider it fair. But currently our own estimates show an equity risk premium of the S&P 500 of 8.5% or higher. That is just too high and signals either the potential for a sharp stock market rally or a long and painful recession. We are still in the first camp and hence we are comfortable taking on market risk. Please note, this doesn't mean we are just long the market, it means that when we have a long idea we don't see the need to hedge all the market risk away. On the flip side we would want to hedge our shorts. Our thesis is also backed by the Fed which stated in the last FOMC meeting on June 22nd;

"The spread between the staff's estimate of the expected real return on equities over the next 10 years and an estimate of the expected real return on a 10-year Treasury note--a measure of the equity risk premium--increased from its already elevated level."

When it comes to listening to market participants we usually prefer to ignore them. But we do pay attention to what the Fed says.

Portoflio

We decided to concentrate the portfolio with our top ideas. Having this type of conviction helps navigate through volatile markets. So far it has paid off and we will keep it that way. For the rest of the year we find lots of opportunities to make money regardless of where the markets end up. As usual, please feel free to contact us if you want to discus more.

Krim Delko, New York, July 20nd 2010