

Five Oceans World Fund - Wholesale

Fund report and commentary – 31 December 2008

Performance						
	1 month (%)	3 months (%)	6 months (%)	1 year (%)	2 years (%) p.a	Inception ¹ (%) p.a
Fund return (gross) [^]	-0.93	-4.70	6.93	-8.22	-1.33	0.45
Fund return (net) [†]	-1.03	-5.01	6.27	-9.38	-3.00	-1.08
MSCI Unhedged \$A	-3.55	-11.36	-8.50	-24.86	-14.02	-9.19
Difference	+2.52	+6.35	+14.77	+15.48	+11.02	+8.11

¹Inception date: 3 July 2006.

[^]Gross returns assume the reinvestment of distributions and exclude the impact of ongoing management fees. No allowance is made for tax.

[†]Net fund returns are calculated after fees have been deducted, assuming reinvestment of distributions. No allowance is made for tax.

Market review

What had already been a tough year got a whole lot worse over the last quarter of 2008. The “bear savaging” continued through the quarter as it became obvious that we are entering a global recession, most likely “the most serious downturn since the Second World War”.

The US S&P 500, Japanese Nikkei and EuroStoxx Index were all down over 20% for the quarter. The Dow Jones Industrial Average finished its third worst year throughout history and the worst year since 1931 with a negative return of -35%. The Australian dollar lost 11% of its value versus the USD.

Just when we thought we had seen it all, New York based investment manager Bernard Madoff allegedly confessed to running a US \$50 billion “ponzi” scheme. Those affected read like a who’s who of the financial services industry including HSBC, Banco Santander and Royal Bank of Scotland.

The slew of negative news and government and central bank responses came thick and fast. In summary, the National Bureau of Economic Research announced in the first days of December that the US was officially in recession and had been since December 2007! The European Commission rolled out a stimulus package in late November totalling 200 billion that Eurozone member nations could use as they desired, while the Eurozone unemployment rate hit 7.7% in October – the highest in almost two years, but no doubt going higher!

Manufacturing readings in Britain and Eurozone fell to record lows in November while China recorded the sharpest contraction in manufacturing activity on record. Japan’s central bank follows suit and cuts rates from 0.3% to 0.1%. The government says the world’s second largest economy will not grow in 2009.

The US House of Representatives passed a \$700bn government plan to rescue the US financial sector known as TARP (Troubled Assets Relief Program). On top of this, the US government unveiled a \$250bn plan to purchase stakes in a wide variety of banks in an effort to restore confidence in the sector. Troubled banking giant Citibank received a \$20bn rescue plan after its shares plunge by more than 60% in a week. The US Federal Reserve slashes its key interest rate from 1% to a range of zero to 0.25% - the lowest since records began.

President George W Bush committed the US government to use up to \$17.4bn of TARP funds to help the big three US carmakers, General Motors, Ford and Chrysler.

Additionally, the UK government announced plans to pump billions of pounds of taxpayers’ money into three UK banks in one of the UK’s biggest nationalisations. Royal Bank of Scotland (RBS), Lloyds TSB and HBOS will have a total of £37bn injected into them.

The G7 nations issued a five-point plan of “decisive action” to unfreeze credit markets, after a meeting in Leaders of the G20 developed and emerging economies gather in Washington to discuss ways to contain the financial crisis and agree on longer-term reforms.

Illiquidity reigns supreme across many asset classes and the combination of waves of mutual and hedge fund redemptions and “on edge” investors has created levels of extreme volatility. Historically a daily move of plus or minus 3% has been a 1 in a 100 day event. In the last twelve months, 1 in every 10 days on average has been up or down by 3% or more, while in October the S&P500 index gained or lost 3% or more every second day!

Fund Performance

The fund was down -5.3% during the quarter giving a calendar 2008 return of -9.4%. This compares to the average move of global equity markets, as measured by the MSCI World Index in \$A, which were down -14.7% in the quarter and -24.9% for the year. We commenced the quarter with the portfolio conservatively positioned but with higher equity exposure than we had had earlier in the year. We finished the year with a net exposure to equities of 64%.

Our defensive positioning, including cash holdings and our prudent use of hedging, assisted in mitigating losses through the quarter. Additionally being underweight financials, energy, resources and real estate helped the portfolio avoid the most troublesome areas, although in reality utilities and telecommunications were the only sectors to avoid double-digit falls over the period. Our low exposure to the AUD during the quarter also benefited the portfolio.

Contributors to performance included IAM Gold, Lihir Gold, Vodafone Group, Vivendi and Natura Cosmetics. Detractors included Harley Davidson, AXA, Alumina and Estee lauder.

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Portfolio Positioning and Strategy

Looking forward it is not clear that we are over the worst. Notwithstanding this, there is some evidence that equities markets are in the process of establishing a bottoming formation. We increased our equity exposure during the quarter from 56% to 64% buying into the weakness. We continue to remain cautious and keep significant "powder dry" as we work through the current economic issues.

Financial institutions still appear likely to take massive write downs and require more capital. The financial system, at least in the US and UK, is essentially government controlled and it is unclear what the rules are. That being said sentiment is extremely negative, broad company valuations are more attractive than they have been for many years and it is clear that there are many opportunities.

We continue to seek quality franchises at attractive prices for the fund. Some of the companies introduced during the quarter included French luxury goods company LVMH, Mexican telecom company America Movil, Apple Inc and Babcock and Brown Wind Partners.

Asia

Japanese and Korean industrial output fell significantly during the quarter as consumer spending diminished. Some pundits are now forecasting Chinese growth to fall to 6% over the next year. The Chinese government announced a significant stimulus package that created some short-term regional euphoria. We have been spending significant amounts of time travelling to China and analysing what is happening in the region given its global importance.

We added a long position in Hong Kong based, Hutchison Whampoa during the month. The company is a diversified conglomerate with a Telco exposure through its 3G business. The company is cheap on a price to book value and cash-flow is now starting to improve which should continue to support the current dividend yield of over 5%.

Energy and Minerals

The quarter was characterised by significant deterioration in global energy demand as OECD consumption slumped. In conjunction, emerging market demand was also disappointing, particularly as Chinese economic growth was below evolving expectations. The call on OPEC was thus significantly reduced, prompting the cartel to hold two extraordinary meetings during which OPEC pledged to cut 5.5% of global production causing spot oil price to flirt with US\$30 per barrel, down from US\$110 per barrel at the beginning of the quarter.

Likewise commodity prices, (with the exception of gold, which was up 8% over the quarter), came under intense pressure as global growth screeched to a halt. Copper Nickel and Aluminium prices were down 58%, 43% and 39% respectively over the quarter.

We introduced a long position in Gold producer Lihir Gold during the quarter driven by the companies low cash costs, large reserve backing, and 11% compound production growth over the past 3 years.

Our overall exposure to materials and energy was reduced further during the quarter in the face of evidence that both global and Chinese growth were slowing faster than had been previously anticipated.

Financials

The financials continue to represent an exercise in estimating the unknowable. The extent to which bank balance sheets are impaired is unclear even to the banks themselves. The amount of capital required to support these assets is greater than the current amount, but unknown until the extent of write-downs are determined. This in itself is a function of the extent of the

housing downturn and recession, which is affected by consumer's ability to rebuild their own personal balance sheets and spend, which in turn comes back to the issue of banks own willingness to lend.

To all intents and purposes this is a vicious circle. While we acknowledge that valuations are extremely low, we struggle with determining what the banking model will look like going forward. Only when this is determined can we have confidence in the multiple we are prepared to pay for the earnings stream. That being said there are some institutions that are trading at significant discounts to what seems to be a defensible book value and supported by sufficient capital. We aim to own these names.

Autos

The big three autos did themselves no favours in the battle of the hearts and minds for the voting public, as they flew to DC in private jets to request a hand-out to ensure their survival. It appears that in general the US public don't want to see these companies fail but the operational *status quo* cannot continue. The latest news appears that although the senate has scuppered any bailout deal, the Government through the TARP has indicated it would fill the breach. The debate continues over the desire to avoid a collapse and the resulting dislocation to employment, the finance sector and overall economy versus whether there should be a pre-organized "chapter 11" type strategic restructuring.

We have no exposure to US autos but maintain a minimal exposure to European autos through BMW and Peugeot.

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Top five long positions

	Region	Sector	Weight (%)
Yum! Brands	United States	Consumer Discretionary	3.48
AXA SA	France	Financials	2.84
Johnson & Johnson	United States	Healthcare	2.69
Inditex SA	Spain	Consumer Discretionary	2.52
Carrefour SA	France	Consumer Staples	2.47

Regional exposures

Country Name	Long	Short	Net weight* (%)
Australia	0.82%	-0.48%	0.35%
Canada	2.02%	0.00%	2.02%
Finland	0.65%	0.00%	0.65%
France	9.71%	-1.70%	8.01%
Germany	6.23%	-1.92%	4.31%
Hong Kong	0.73%	0.00%	0.73%
Japan	3.02%	0.00%	3.02%
Netherlands	4.11%	0.00%	4.11%
Norway	0.60%	0.00%	0.60%
Spain	2.52%	0.00%	2.52%
Sweden	0.42%	-0.54%	-0.12%
United Kingdom	10.28%	-0.61%	9.67%
United States	32.98%	-6.70%	26.28%
South Africa	0.78%	0.00%	0.78%
Switzerland	1.12%	0.00%	1.12%
Grand Total	75.98%	-11.94%	64.03%

Sector exposure summary

Sector Name	Long	Short	Net weight* (%)
Consumer Discretionary	16.61%	-3.94%	12.67%
Consumer Staples	7.87%	0.00%	7.87%
Energy	4.02%	-0.02%	4.00%
Financials	10.03%	0.00%	10.03%
Health Care	9.92%	0.00%	9.92%
Industrials	5.80%	0.00%	5.80%
Information Technology	11.75%	-1.14%	10.61%
Materials	3.72%	-1.16%	2.56%
Sector/Market Hedges	0.00%	-4.04%	-4.04%
Telecommunication Services	5.59%	-1.64%	3.95%
Utilities	0.66%	0.00%	0.66%
Grand Total	75.98%	-11.94%	64.03%

Portfolio exposure summary

	Weight (%)
Long positions	75.98
Short positions	-11.94
Net equity exposure★	64.03
Gross equity exposure●	87.92

Currency summary exposure

	Weight (%)
AUD	20.40
GBP	1.52
USD	47.94
EUR	15.81
JPY	13.34
Other	0.99
Grand Total	100.00%

*May not add to 100% due to rounding.

★Net equity exposure is the net equity exposure of the portfolio after short equity positions are deducted from long equity positions. ●Gross weight is the percentage of the gross equity exposure of the portfolio. Gross equity exposure is the total of the long and short equity positions in the portfolio.

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