Fund Review

LONSEC

Five Oceans World Fund

Highly Recommended

About this Review	
Sector reviewed	**Hedge Funds - Global Equity Long/Short**
Total Funds rated	12
Date of this Sector Review	August 2009
About this Fund	
Fund reviewed	**Five Oceans World Fund**
Fund Size ($ million)	58 (March 2009)
Responsible Entity	Challenger Managed Investments Limited
Fund Commenced	July 2006
Wholesale Fee (p.a.)	Mgt fee: 1.25% (gross) Performance Fee: 20% (inc GST): 5% hurdle p/a
Structure Availability	Platforms, Wholesale
About the Fund Manager	
Fund Manager	Five Oceans Asset Management
Ownership	Majority owned by its executives (Challenger Financial Services Group has a 25% shareholding)
Assets managed this sector ($ million)	125 (March 2009)
Years managing this asset class	3.5
Investment Team	
Team size	10
Key Personnel	Christopher Selth, Ross Youngman
Number of Analysts/Portfolio Managers	9
Turnover/Team Ratio (past 2 yrs)	14%
Investment Process	
Style	Bottom-up
Targeted Value Add (p.a.)	No stated target, other than capital growth over the long term (at least 5 years)
Expected Volatility	Between 50% to 75% of MSCI World Unhedged Index
Typical Stock Numbers	50 core positions (including shorts)
Maximum % Short (gross)	130%
Typical Net Market Exposure	70% – 90%
Minimum Net Market Exposure	0% (i.e. can be 100% cash)
Use of Gearing	Allowable, cash, derivates and short selling up to max of 130% of portfolio NAV
Use of Derivatives	Yes (see comment re Gearing)
Currency	Hedged to $A or other currencies
Stock Bet Limits	Long: max 6% at purchase, with market movement to max of 25% Short: max of 4% at purchase, with market movement to max of 10%
Min Company Size	n/a
Sector Bet Limits	nil
Fund Rating History	
August 2009	Highly Recommended
August 2008	Initial Review - Recommended

What this Rating means

- The Highly Recommended rating indicates that Lonsec has high conviction that the fund or product can achieve its objectives and, if applicable, outperform peers over an appropriate investment timeframe. The manager or product has strong competitive advantages in people, process and product design and has no areas of material weakness. The investment is a preferred entry point to access this asset class or strategy.

Using this Fund

- **This is general advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.**
- The Fund is an absolute return style long/short global equities product and as such will generally sit within the growth assets component of an investor's portfolio. The Fund is suitable for higher risk profile investors with a five year plus time horizon. Lonsec's model portfolio asset allocation across relevant risk profiles (traditional assets only) is as follows: Conservative 4%, Balanced 7%, Growth 8%, and High Growth 16%.
- The Fund may utilize a broad range of strategies including short selling, gearing, derivatives and cash in order to adjust the Fund's net equity position in line with the investment manager's market outlook. At various stages through the market cycle, Fund performance may therefore have a low correlation with traditional equity benchmarks. Lonsec recommends that investors consider all relevant risks prior to investing.
- Lonsec notes the manager views currency as a separate asset class and incorporates active currency management to reduce risk and protect capital. Lonsec observes that, historically, adding consistent alpha from currency management is notoriously difficult, even for currency specialists using sophisticated tools and techniques. Accordingly, the Fund should only be considered for those investors (i) seeking a product which combines the active management of both global equities and currency exposures and (ii) who demonstrate sufficient tolerance for the potential additional volatility arising from active currency management.

Changes since Last Review

- In late 2008, Five Oceans launched a 130/30 fund – the Five Oceans Global Equity Extension Fund, managed by Kim Tracey. The Fund practically runs in parallel to the firm's flagship fund, the Five Oceans World Fund, although its currency positions are hedged to a lesser extent. Given the significant overlap between the funds, Lonsec does not believe this will have any detrimental affect on the level of resourcing dedicated to the Five Oceans World Fund.
- Investment team numbers have increased with the addition of several junior analysts.
- The Fund achieved its three year track record on 3 July 2009.

Lonsec Opinion of this Fund

Philosophy (Style)

- The Fund is a concentrated, long-biased long/short global equity product. The Fund is not managed relative to the MSCI Index, therefore its performance may differ significantly from that produced by 'benchmark aware' global equity funds.
- Currency is actively managed – to reduce risk and protect capital.
- Unlike most managers reviewed by Lonsec, Five Oceans does not adopt stated performance or volatility (risk) targets. Lonsec recognises the manager's focus is on generating absolute returns while preserving investor capital, however, Lonsec prefers managers to state a 'hard' return target (i.e. XX% pa - XX% pa) to provide potential investors with a guide as to what returns could reasonably be expected.

People and Resources

- Five Oceans was founded in 2005, and although has only been in business for a relatively short time, Lonsec believes the firm's structure and viability is sound. The firm is well capitalised, well managed and has considerable backing from Challenger Financial Services.
- Lonsec has met with a number of the Five Oceans' investment professionals and considers them to be suitability experienced and of high calibre, particularly CEO, Ross Youngman, and CIO, Christopher Selth.
- Selth has significant input at all stages of the investment process and therefore there is a high dependency upon the input of one individual. Although the other investment team members, and the portfolio managers in particular, have an intimate understanding of the process, ultimately Selth is the driver of the process.
- Key person risk in Youngman and Selth is high, although Lonsec believes that this risk is somewhat unavoidable in a boutique structure such as this, and is substantially mitigated by their significant equity ownership in the firm. While Lonsec notes this as a potential risk for investors, one of Lonsec's core beliefs is that, given sufficient conviction, key person risk is often a risk worth taking. We believe that in this case, this is clearly so given the calibre and capability of this team. That said, in the unlikely event that Youngman or Selth ceased to work within the organisation, the rating of the Fund would most likely be downgraded.
- While the investment team is smaller than many long-only global equity managers, Lonsec considers the team to be of high quality and experience and suitably resourced to implement its investment strategy. Lonsec believes the size of the team suits the decision-making process and high level of peer interaction demanded by the manager's investment style.
- Given the significant role Selth plays in all aspects of the investment process, Lonsec is pleased to see business and day-to-day operational issues are managed by CEO Youngman. Lonsec believes this arrangement successfully allows Selth to remain focused on investment management and research responsibilities.
- The investment team is centrally-located in Sydney, making Five Oceans one of very few (although this number is increasing) investment managers managing global equities from Australia. Lonsec believes Five Oceans manages the issue of distance adequately via extensive travel, the effective use of technology, and through the leveraging of multiple information sources such as industry contacts, experts in business, industry, academia, government etc. Of note is that Five Oceans specialises solely in global equities, and thus their focus is on one asset class rather than several (as is the case with many managers).
- Five Oceans personnel turnover over the last two years has been in line with expectations. The team has remained relatively stable, with experienced portfolio managers and analysts initially being added to the team, followed by several junior analysts more recently.
- Lonsec believes the alignment of interests between key investment professionals and investors is strong. This has been achieved via equity, co-investment and a bonus pool driven by performance fees.

Research and Portfolio Construction

- Five Oceans' research and portfolio construction process is based on leveraging the considerable investment knowledge, intuition and skills of the lead portfolio manager, and supporting key portfolio managers. Five Oceans' investment process focuses on bottom-up fundamental research with a strong emphasis on valuation.
- Given the small size of the team (relative to many other global fund managers), Five Oceans does not aim to research the entire universe of stocks. Five Oceans makes the initial universe more manageable by using a number of screens to filter down to a short list of stock candidates for more detailed research. Lonsec considers Five Oceans' investment process to be logical, thorough and well implemented.
- Lonsec has been provided with examples of the firm's research templates, models and analysis. Lonsec has been impressed by the depth of research and level of insight. Although the team is small versus peers, Lonsec believes the firm's research effort provides the firm with a competitive advantage.
- An important component of Five Oceans' research process is the focus on the identification of catalysts to release value. Lonsec believes this provides the firm with a strength, not only in terms of a robust sell discipline, but also with the timing of stock purchases (i.e. avoid buying too early).
- Five Oceans' portfolio construction process is highly intuitive and there are no portfolio construction rules to translate stock views into position sizes. Portfolios are constructed from a bottom-up perspective rather than relative to any benchmark. Essentially, Five Oceans believes preventing loss of capital is a far more relevant benchmark to investors, than a market index. This approach results in a portfolio that can vary significantly from the MSCI benchmark and which is focused on total returns rather than returns relative to an Index.

- Lonsec considers the level of accountability and clarity of decision making to be high. Portfolio construction is the responsibility of the CIO in conjunction with the portfolio manager / individual analyst.

- The manager does not target any specific regional exposures. In addition, the manager is able to maintain a large cash holding (up to 100% of the portfolio) if it is unable to identify sufficient attractive stock opportunities. Hence, there may be periods where investors pay active fees to sit in cash (which is not unusual for an absolute return style fund).

- As at June 2009 the net equity exposure (long and short) was approximately 79%, a considerable change from the net equity exposure (long and short) of approximately 39% in June 2008 when the Fund was positioned defensively based on the firm's concerns regarding the economic and investment outlook.

Risk Management

- Five Oceans has several hard limits in relation to stock positions on both the long and short side, however the risk limits in place are wide, and as such Lonsec does not believe the limits are particularly relevant in terms of the portfolio construction process. The firm's benchmark unaware approach also negates the relevance of 'active' weights.

- Five Oceans monitors individual holdings (in the portfolio and those that have previously been held in the portfolio) and the overall characteristics of the portfolio on a continuous basis. The manager uses mainstream risk monitoring tools and software, although given the 'benchmark unaware' style of the Fund, risk monitoring is not a benchmark driven exercise.

- The investment team meets formally on a weekly basis to review the relative merits of each existing holding and potential new holdings, in addition to the overall portfolio structure and its positioning.

- Lonsec believes that while formal risk management limits are broad, risk management is strongly imbedded in Five Oceans' investment process, being primarily undertaken at the individual stock level. Lonsec also believes Five Oceans' consideration of overall exposure to sectors / regions / countries and various economic scenarios to be thorough and prudent.

Performance

- Given the inception date of the Fund (July 2006) long term performance analysis is not possible.

- Performance for the Fund for the twelve months ending June 2009 was 0.7% p.a. While this is low in an absolute sense, in the context of very difficult market conditions, the Fund's positive performance results were strong, particularly on an index and peer relative basis. That is, over the twelve months ending June 2009, the Fund outperformed the MSCI World Ex Australia Index by 16.3% p.a. and outperformed the Lonsec assessed peer group by 14.8% p.a.

Overall

- As a result of this review, Lonsec has upgraded the Fund to "Highly Recommended", primarily based on Lonsec's increased conviction in Selth and Youngman, the depth and experience of the team, and the strength of the portfolio management effort. Lonsec believes that the Five Oceans World Fund is well placed to achieve it's objectives over the long term, and compares favourably to Lonsec's higher confidence fundamentally based global long short managers.

- Lonsec believes Five Oceans' investment team is ably managed by an impressive and experienced team of investment professionals, particularly Selth and Youngman. In addition, Lonsec believes the firm's culture, boutique nature and high alignment of interests, research, portfolio construction and risk management efforts are also strong. While the team is small, and the firm was only founded in 2005, Lonsec believes the principals of the firm have approached the venture in a logical and thorough manner, with Challenger providing services that enable the key investment professionals to remain focused.

People & Resources

Five Oceans was founded in 2005 by Christopher Selth, Chief Investment Officer and Lead Portfolio Manager and Ross Youngman, Chief Executive Officer. The firm is majority owned by its executives, with Challenger Financial Services Group holding a 25% share.

Challenger is the Responsible Entity for the Fund, and provides services to Five Oceans including: investment technology, administration, management accounting, marketing and client services and compliance.

Size and Experience

Youngman has over 25 years international experience in the finance industry covering asset management, financial planning and stockbroking. As CEO, Youngman is responsible for running the Five Oceans business. Prior to co-founding Five Oceans with Selth, Youngman was the CEO of Deutsche Asset Management in Australia.

The investment team is led by Selth. Selth has over 22 years investment experience, and prior to establishing Five Oceans was Head of International Equities at BT Funds Management (BT), including being the lead Portfolio Manger for the BT European Fund for over seven years.

The investment team consists of 10 members (including portfolio managers and investment analysts), many of whom have worked together previously at BT. Although the team is relatively small, the level and depth of experience of the majority of the team is strong. The portfolio management team has an average of 18 years investment experience and the analyst team has an average of 6 years experience.

Team Structure

The investment team is structured along regional and sector coverage lines, and all team members act as generalists. Selth is the lead portfolio manager, supported by portfolio managers: Kim Tracey, Piers Watson, Joe Kaderavek and Rob Nunley. All investment team personnel report to Selth on investment related issues, and to both Selth and Youngman on personnel/performance issues.

Remuneration / Alignment of Interests

Five Oceans is 75% owned by staff, with Youngman and Selth holding the majority of equity. Senior personnel and portfolio managers also have equity participation in the firm (20% excluding Youngman and Selth), have substantial holdings in the Five Ocean's Fund, and share in performance based fees.

Investment Style / Objectives

Philosophy and Style

Five Oceans' investment approach is based on the belief that investment opportunities are generated by change. The focus of the investment team is therefore on identifying existing trends, or the formation of new drivers that will bring about change, with the ultimate goal being to buy good businesses at attractive prices.

Five Oceans also believes that factors affecting long term corporate sustainability (including environmental, social and corporate governance factors (ESG)) are relevant, and are incorporated into the firm's fundamental research approach.

Research Approach

Screening of Stocks

The initial investment universe includes all global equities, including Australia, with a market capitalization of greater than $1 billion. There are no formal restrictions on countries or sectors. The broad investment universe is screened using a variety of techniques to generate a targeted universe of ideas that warrant in-depth fundamental research. Screens include: formalized screening of various databases (e.g. Factset) across multiple criteria; news flow screening; opportunities identified through team experience and contact networks; conferences and company visits, and ideas generated via external networks.

Information is gathered from various sources, such as broker reports, offshore newspapers, company visits, and annual reports. Tools such as Bloomberg and Factset are also utilised. Importantly, the focus is on internal research, with externally sourced research used as a secondary reference.

Research Focus

Each company identified by the screens is subject to detailed analysis. Five Oceans uses a standardized research template, to ensure all companies can be compared on a like for like basis, regardless of sector or location.

Five Oceans' template covers three main areas: 1. Fundamentals, 2. Valuation, and 3. Catalyst Identification.

Fundamental analysis is aimed at assessing a company's franchise, based on a "Porter Five Forces Model". The Porter Model provides a framework for assessing a company in terms of its industry by taking into account the following: barriers to entry, the threat of substitutes, buyer power, supplier power, and degree of rivalry or level of competitive advantage. In line with Five Oceans' ESG philosophy, sustainability has been added as a sixth element of the Porter analysis. Five Oceans believes that ESG factors have a material impact on a company's valuation, and are therefore considered within the firm's fundamental research effort.

Company visits, and meetings with management are important aspects of this work, with Five Oceans regularly travelling to meet companies under review, or to attend conferences etc.

Once a stock is deemed to be attractive from a fundamental and valuation stand point, the final step in the process is the identification of a catalyst(s) that will move the share price towards Five Oceans' valuation target. The identification of catalysts may include: an analysis of stock specific news, technical analysis, and a macroeconomic assessment.

A comprehensive report is presented to the team for peer review and scrutiny. Peer review forms a critical component of the risk control process by ensuring that all investments are scrutinised, by each member of the investment team, for flaws and reviewed in the context of limiting the loss of capital to the end investor. Importantly, this process focuses on debate and questioning rather than aiming to arrive at a consensus view and investment decision.

Valuation Approach

Five Oceans uses a flexible approach to valuation. That is, multiple methods and metrics are used as deemed appropriate to the situation, including discounted cash flow models, company specific, and industry and market relative measures. By using multiple valuation metrics, the risk associated with any single metric is significantly reduced.

The key outcome of the firm's valuation analysis is the determination of why a stock is cheap.

Portfolio Construction

Overview

The Fund will generally hold 50 core positions, including short positions, with position sizes reflecting the investment team's assessment of the following factors (rather than weighting the stock relative to its MSCI exposure): expected returns and risk adjusted potential upside and downside in an absolute sense and in the context of existing portfolio holdings; the strength of the investment case; expected timeframe for return to be achieved; key points of differentiation from market expectations, and why a stock is trading at a different price to what Five Oceans believes is fair value.

The portfolio will also often hold a 'tail' of smaller positions – which are generally either positions being built up, or sold from the portfolio.

Net regional exposures as at June 2009 and June 2008 were as follows:

Region	Net regional exposure June 2009	Net regional exposure June 2008
North America	40.0%	17.4%
Asia (ex Japan)	0.9%	-0.6%
Australia	1.1%	2.6%

Region	Net regional exposure June 2009	Net regional exposure June 2008
Europe	33.9	18.5%
Japan	2.3%	2.4%
South Africa	0.8%	0.8%
South America	0.0%	0.5%

Short selling is generally undertaken for the purposes of risk management; however it can also be utilised with the aim of enhancing returns. Portfolio construction therefore involves the determination of active 'long' positions as well as active 'short' positions. The same degree of research goes in to the decision to short sell a stock as it does in to the decision to purchase a stock.

Shorting can be implemented within the portfolio under several scenarios:

- Stand alone shorts: When the manager identifies a stock that is extremely over-valued the decision may be made to short sell the stock
- Stock Hedges or Pair position shorts: a short will be implemented to mitigate risk, or hedge a corresponding long position
- Futures and Options hedging: Will be applied to individual stocks, sub components of, or the overall portfolio in response to perceived stock or market risk issues

The level of portfolio turnover can be expected to vary depending on market conditions, although Five Oceans typically expects stock related portfolio turnover to be in the range of 80% - 100%.

Portfolio turnover for the Fund over the most recent 12 months was slightly higher (approximately 120%) due to the increase in market volatility.

Risk Limits

On the long side, positions are limited to 6% at purchase, but can then extend to a maximum of 25%. On the short side, positions are limited to a maximum of 4% at purchase, but can then extend to a maximum of 10%. Stock positions are generally increased as the level of conviction in a stock increases. For example, a typical initial position would be in the range of 1% to 2%, with a high conviction holding being greater than 3%.

There are no limits on Tracking Error, $A hedging or maximum cash weight within the Fund.

Total gross market exposure is limited to a maximum of 130% of the Fund's net asset value.

Currency Management

Currency is actively managed – to reduce risk and protect capital. Five Oceans can hedge the full gross exposure of the Fund back into $A or into other currencies that they believe offer better value. Five Oceans' currency approach involves the use of a combination of fundamental and technical analysis, with the starting point being the underlying currency exposures generated by the bottom up stock selection process.

Responsibility for the currency exposure decision rests with Selth. Selth was also responsible for currency related decisions in his various roles whilst at BT.

Derivatives

The manager typically utilises derivatives (on individual stocks, sectors and/or markets) for risk management purposes. Selth is ultimately responsible for determining derivative implementation.

Gearing

Use of cash borrowing, derivates and short selling will not exceed 130% of the portfolio's net asset value. Gearing will only be utilised when Five Oceans has identified a significant level of undervaluation in markets.

Unlisted Securities

The Fund will primarily be invested in shares of global companies; however the Fund's Trust Deed also permits investment in hybrid securities (for example, convertible notes, redeemable preference shares and partly-paid shares) and unlisted companies. Unlisted investments pose a greater liquidity risk than listed stocks, as there may not always be a readily available market to trade the security. That said, the manager has stated that the Fund will only invest up to 10% in unlisted companies provided they are expected to list within 18 months.

Risks

The Fund is exposed to a number of standard risks associated with investing, such as political and economic risks, risks associated with domestic and international markets, legal, tax and regulatory risks. The Fund is exposed to a number of specific risks, such as key person risk, risks associated with the use of derivatives and gearing, risks associated with short selling (losses from short selling are theoretically unlimited), currency risk, and company and sector specific risks. Risks associated with the Fund are further outlined in the Fund's Product Disclosure Statement (PDS) and should be read in full and understood by potential investors before investing.

Fees

Investors in the Fund will be charged a management fee of 1.25% and a performance based fee of 20% above a hurdle rate of 5.0% p.a. Performance based fees are accrued on a daily basis, and are paid quarterly.

Other

In line with Five Oceans' ESG commitment to sustainable investment principles, Five Oceans is a signatory to the United Nation's Principle of Responsible Investing; a signatory to the 2007 Carbon Disclosure Project; and a member of the Australian Investors Group for Climate Change.

Quantitative Performance Analysis Annualised after-fee % Returns as at 30 June 2009								
	1 Year		2 Years		3 Years		5 Years	
	Fund	Peer Group	Fund	Peer Group	Fund	Peer Group	Fund	Peer Group
Performance (% pa)	**0.7**	-14.1	**-8.2**	-19.5				
Standard Deviation (% pa)	**16.2**	23.9	**13.0**	19.6				
Excess Return (% pa)	**16.3**	1.6	**10.1**	-1.2				
Outperformance Ratio (%)	**75.0**	56.9	**62.5**	53.1				
Worst Drawdown (%)	**-12.8**	-26.5	**-17.7**	-37.0				
Time to Recovery (mths)	**na**	1.6	**na**	0.0				
Sharpe Ratio	**-0.3**	-0.7	**-1.1**	-1.3				
Information Ratio	**2.6**	0.8	**1.1**	0.2				
Tracking Error (% pa)	**6.3**	20.5	**9.1**	17.7				

Fund: Five Oceans World Fund
Benchmark: MSCI World ex Aus Acc Index Gross Div A$
Peer Group: Average among Lonsec rated Hedge Global Long/Short manager universe

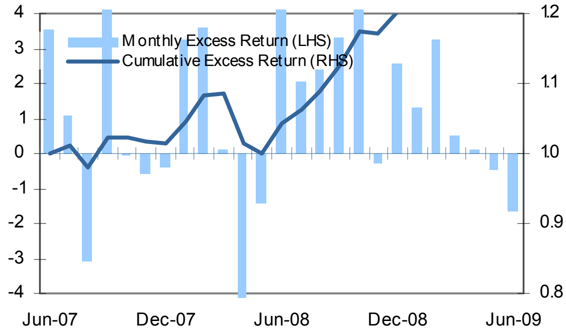
While the Fund is not managed against a specific benchmark, Lonsec sees the Fund as fitting into the global equity portion of an investor's portfolio. As such, for the purposes of quantitative performance analysis Lonsec has used the MSCI World ex Australia Accumulation Index with Gross Dividends A$ as the most appropriate benchmark, and the average among the Lonsec rated Hedge Global Long/Short manager universe as an indicative peer group.

It should be noted that Lonsec's Global long/short equity fund universe is a relatively broad universe, which includes both absolute return focus funds and beta 1 or 130/30 type products.

Given the inception date of the Fund (July 2006), limited performance history is available. Lonsec prefers to make a quantitative assessment over a period of at least three years; however, the cumulative performance chart for the two year period has been included for reference.

Lonsec uses the MSCI World ex-Australia Accumulation Index with Gross Dividends ($A) for comparison purposes for the global long/short equity universe. This index may not be the benchmark used by individual funds for performance targets.

Cumulative Performance over two years



Glossary

Absolute Return	'Top line' actual return, after fees
Excess Return (Alpha)	Return in excess of the benchmark return
Standard Deviation	Volatility of monthly Absolute Returns
Tracking Error	Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)
Sharpe Ratio	Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)
Information Ratio	Relative reward for relative risk taken (Excess Returns / Tracking Error)
Worst Drawdown	The worst cumulative loss ('peak to trough') experienced over the period assessed
Time to Recovery	The number of months taken to recover the Worst Drawdown

Analyst Disclosure & Certification

Analyst remuneration is not linked to the rating outcome. The Analyst(s) may hold the products(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst(s) holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the financial product(s) to which this document refers.

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