# Five Oceans Wholesale World Fund

## Fund report and commentary – 31 December 2009

**Performance**

| | 3 months (%) | 6 months (%) | 1 year (%) | 2 years p.a. (%) | 3 years p.a. (%) | Inception[1] p.a. (%) |
|---|---|---|---|---|---|---|
| Fund return gross ^ | 1.13 | 12.86 | 7.54 | -0.65 | 1.54 | 2.43 |
| Fund return net # | 0.81 | 12.16 | 6.21 | -1.89 | -0.02 | 0.95 |
| MSCI World Index Unhedged $A | 2.23 | 10.10 | 1.39 | -12.71 | -9.17 | -6.28 |
| Difference | -1.42 | 2.06 | 4.82 | 10.82 | 9.15 | 7.23 |

[1] Inception date: 03 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.
Past performance is not a reliable indicator of future performance.

### Fund performance

The Fund was up 0.81% for the quarter, underperforming the average move of global equity markets, as measured by the MSCI World Index in $A, which was up 2.2%. Over the six months to the end of December the fund is up 12.16% after fees versus 10.10% for the index. We commenced the quarter with a net exposure to equities of 91.40% and ended the period with our exposure at 90.29%.

The Fund benefited from its positioning in consumer-related stocks during the quarter, specifically News Corp, Next PLC, Coach Inc, Estee Lauder and Beiersdorf AG. Pharmaceutical companies in the portfolio rebounded during the quarter, notably Medicis Pharmaceutical, United Health Group and Aetna.

Banks and insurance companies in general were weak during the quarter and holdings in European based ING, AXA and Barclays detracted from performance. In addition, our decision to reduce the Fund´s weighting to mining companies affected its relative performance. To some degree, this was compensated for by the strong performance of the Fund’s energy stocks, including Devon Energy and Schlumberger. Other portfolio detractors included German pay TV operator, Sky Deutschland, and South African telecommunications company, MTN Group.

### Portfolio positioning and strategy

Our bottom-up company analysis continues to drive sector and portfolio positioning. We continue to have significant exposure to the Consumer Discretionary and Consumer Staples, Energy, Financials, Technology and Healthcare sectors.

Our strategy is to continue to target a range of businesses that we believe have attractive prospects relative to the price we are prepared to pay for them. We are particularly focussed on stock selection as we continue to move further away from the depths of the crisis. We incorporate analysis into environmental, social and corporate governance (ESG) factors in our company research which we believe is important to both manage company risk and understand future opportunities.

We have been particularly focussed on Asia recently and have introduced a number of stocks to the portfolio from the region. We introduced new positions in Indian companies, Reliance Industries, whose activities cover a range of areas including energy and petrochemicals, and Axis Bank, one of India’s big four banks. We also took a position in US homebuilder, DR Horton, based on its specific regional positioning and expectations for a gradual recovery in the US property market as well as adding new positions in US discount retailers, Wal-Mart and BJ's Wholesale Club.

Our overall levels of hedging remain low at present notwithstanding that risks remain as evidenced by the recent news that Dubai World was seeking a ‘standstill agreement’ from creditors as it sought to extend the maturities on its debt.

Additionally, concerns over the fiscal position in Greece were heightened by downgrades from some of the major credit rating agencies in the quarter. Markets began to fret that the country might go bust. Greek public debt is expected to rise to 125% of GDP from 113% this year and the country has to raise substantial amounts from a jittery bond market in order to refinance debt falling due over the next 12 months.

### Asia

Asian markets, were strong over the quarter with macroeconomic data and, perhaps more importantly, liquidity conditions continuing to support equity markets across the region. However, there was something of a change in leadership towards the end of the year as Taiwan and, to a lesser extent, South Korea, led by the technology sector, started to outperform the previously favoured markets of China, India, and Indonesia.

The Fund’s positions in Taiwanese based computer maker, Acer, was buoyed by growing expectations of an improvement in the Personal Computer (PC) cycle during 2010 given the number of new product launches and expectations of a recovery in corporate PC replacement rates (the current average age of corporate desktop PC's is towards all-time highs at 5.6 years). Another portfolio holding in Samsung Electronics was supported by the continuing recovery in DRAM and NAND semiconductor prices which will also benefit from an improvement in the PC cycle. Both companies also seem to be market share 'winners' in their respective markets given Acer's sales are skewed towards the faster growing emerging markets and lower priced products and Samsung remains the lowest cost producer globally of both DRAM and NAND Flash.

The Chinese market again generated plenty of interest and comment during the quarter. The PRC Government at its Central Economic Work Conference in early December reiterated its 'proactive' fiscal policy and 'moderately' loose monetary policy for 2010. Both China's macro data for November and PMI data for December confirmed that the upbeat momentum in industrial activity is continuing. However, an increasing number of market commentators believe global as well as local monetary policy settings and resultant excess liquidity is increasing the likelihood of a dangerous 'asset bubble' forming in the region's equity and property markets, primarily centred around China.

December saw the first sign of the authorities taking action to head off the growing 'bubble risk' by increasing property sales taxes and increasing initial deposits on all land purchases of land from around 20-30% to 50%. Further policy announcements, especially within the property sector, seem likely as the Government implements sector-specific tightening measures to address the growing asset inflation concerns.

### Energy and Materials

Commodities continued to rally into the December quarter, capping off a strong rebound over 2009, with expectations continuing for strong demand from emerging markets, and lately a stronger than expected US demand recovery.

Within minerals, aluminium, copper, iron ore and thermal coal all posted strong but volatile price increases over the quarter. We were also aware of continued Chinese buying into late 2009, front-running the upcoming Chinese New Year and its associated supply disturbances. We significantly reduced our materials positions in mid-November as signs of overheated prices started to emerge. This was mainly undertaken through the sale of Rio Tinto from the portfolio. Given the continuing strength of the sector right through the quarter, this cost the Fund relative performance.

Although the inventory build-up in metals and bulk commodities remains problematic, the exception was the US coal and gas market. This sub market had previously lagged the overall China-driven commodities markets. Operationally leveraged companies in this sector benefited substantially through the December quarter. US gas prices rebounded sharply off their September lows, exhibiting an astonishing 200% price increase in under 12 weeks. Not surprisingly, a number of US energy companies benefited, with portfolio holdings Devon Energy and Schlumberger performing strongly. We continue to believe in the sustainability of a rally in US and global energy companies and added to our sector weightings through the fourth quarter.

### Financials

Financials was the only major sector to finish the quarter in negative territory, significantly underperforming the broader market amid lower investor expectations for the sector. The major detractors to portfolio performance were Barclays and AXA, while a number of the portfolio's Financial positions finished the quarter slightly ahead, including Nomura, Prudential and US Bancorp.

Barclays was hit by investor concerns over the bank's Middle East loan exposure, given problems in Dubai, as well as the risk of downgrades to the UK's sovereign credit rating, and most importantly, the lack of clarity on how the recently announced UK regulatory proposals may change Barclays' capital requirements. We slightly trimmed our position because of the increased uncertainty but feel that the market remains too pessimistic here.

We added a position in Axis Bank, the third largest private bank in India. We are wary of the risks of paying too much for Asian Financials, however, we believe that Axis is an attractive company that will still benefit significantly from strong Indian growth in a very under-banked market.

Despite the under performance of the sector, we see some signs of improving fundamentals for our Financials holdings. Credit spreads continue to come down from historically high levels, increasing signs that credit costs will be peaking soon, while early signs are that commercial loan growth is picking up.

Historically, the Financials are generally not expensive, and this point in the economic cycle has generally been an attractive time to buy credit sensitive stocks so we remain positive, albeit still monitoring the risk of increased regulation and its impact on the sector's future returns.

### Technology

Technology had a strong quarter capping an overall strong calendar 2009. Early fears in the quarter about sales volumes in segments such as PCs and TVs after China's Golden week celebrations, and questions surrounding year end holiday demand were allayed, allowing a general rally for tech stocks towards the end of the year.

New product cycles remained a focus of attention within the technology space, with Google announcing its entry into the smart phone market scheduled for the first week of 2010. Additionally, many new products, such as Tablet PCs and 3D TVs, are expected to be launched at the Las Vegas Consumer Electronics Show in early January 2010.

Through the quarter we sold Micron after a strong run, given its valuation was no longer looking compelling, and built an initial position in Google on the back of stronger expected mobile search volumes. Apple had a good quarter and reported better than expected earnings as we continue to forecast strong iPhone sales.

### Healthcare

The Healthcare sector had a strong quarter benefiting from renewed investor interest as concerns over US healthcare reform began to subside.  As we have previously noted, the sector has been very out of favour with investors. The fund has remained overweight the US health insurers which rebounded strongly in the quarter as it became evident that it was unlikely that the companies would face strong competition from a government sponsored health insurer.

US based companies, United Health and Aetna, were stand-out performers and we believe the stocks will continue to rebound from historic low valuations back to more normal levels as perceptions of regulatory risk dampen. Democrat leaders are targeting late January to early February for the final passage of healthcare legislation. US companies, Varian Inc, world leader in radiotherapy equipment, and Medicis Pharmaceuticals, also performed strongly.

### Consumer Discretionary and Staples

Both Consumer Discretionary and Consumer Staples had strong quarters to finish 2009. Next, Newscorp, Peugeot, Coach and Inditex all performed strongly. Against this, European Pay TV operator, Sky Deutschland, detracted from performance on below market net subscriber additions and the resignation of the relatively newly appointed CEO. We trimmed the position after this news but remain convinced that the turnaround story is intact. Overall, the fund moderately reduced the size of the Consumer Discretionary position through the quarter as stocks reached our valuation.

Under new CEO Mike Duke, Wal-Mart continues to reduce its cost base and widen the price gap, giving consumers a better value offering. We believe this will drive favourable traffic trends, which combined with reduced headwinds from grocery deflation and improved operating leverage, bodes well for an acceleration of earnings growth at the retail giant this year.

### Outlook

It's impossible to not feel relief as the calendar ticks over to a new year. Although clichéd, 2009 was a rollercoaster year ending in a strong bull market rally across the developed and, particularly, the emerging markets. While many risks remain and volatility continues to be above trend, there is now an increasing amount of evidence supportive of improved economic conditions and strengthening company earnings. Given historically low interest rates worldwide and a view that US and European interest rates, in particular, will remain lower for longer, equities are likely to perform well in 2010. However, a key difference from recent years is that stock selection will be critical in identifying those companies that have emerged from the crisis intact and with strong prospects for cash generation in the period ahead.

## Top five long positions

| | Region | Sector | Weight (%) |
|---|---|---|---|
| Devon Energy Corp | United States | Energy | 3.96 |
| Arch Coal | United States | Energy | 2.73 |
| Wells Fargo & Co | United States | Financials | 2.53 |
| Procter & Gamble Co | United States | Consumer Staples | 2.44 |
| Varian Medical Systems Inc | United States | Health Care | 2.36 |

## Country exposure summary

| Country name | Long (%) | Short (%) | Net (%) |
|---|---|---|---|
| Australia | 0.00 | -0.54 | -0.54 |
| China | 0.50 | 0.00 | 0.50 |
| Eurozone | 0.34 | 0.00 | 0.34 |
| France | 7.01 | 0.00 | 7.01 |
| Germany | 4.77 | 0.00 | 4.77 |
| Hong Kong | 2.52 | 0.00 | 2.52 |
| India | 0.99 | 0.00 | 0.99 |
| Japan | 1.40 | 0.00 | 1.40 |
| Korea, Republic of | 0.98 | 0.00 | 0.98 |
| Netherlands | 3.80 | 0.00 | 3.80 |
| Singapore | 0.81 | 0.00 | 0.81 |
| South Africa | 0.62 | 0.00 | 0.62 |
| Spain | 2.13 | 0.00 | 2.13 |
| Sweden | 0.00 | -0.46 | -0.46 |
| Switzerland | 1.52 | 0.00 | 1.52 |
| Taiwan | 1.08 | 0.00 | 1.08 |
| Thailand | 0.59 | 0.00 | 0.59 |
| United Kingdom | 8.04 | -0.42 | 7.63 |
| United States | 58.08 | -3.48 | 54.61 |
| **Grand Total** | 95.18 | -4.89 | 90.29 |

## Portfolio exposure summary

| | Weight (%) |
|---|---|
| Long positions | 95.18 |
| Short positions | -4.89 |
| Net equity exposure★ | 90.29 |
| Gross equity exposure▲ | 100.07 |

## Sector exposure summary

| Sector name | Long (%) | Short (%) | Net (%) |
|---|---|---|---|
| Consumer Discretionary | 16.01 | -1.76 | 14.25 |
| Consumer Staples | 9.50 | 0.00 | 9.50 |
| Energy | 17.06 | -0.54 | 16.52 |
| Financials | 16.38 | -0.84 | 15.55 |
| Health care | 11.65 | 0.00 | 11.65 |
| Industrials | 5.46 | 0.00 | 5.46 |
| Information Technology | 11.89 | 0.00 | 11.89 |
| Materials | 1.71 | 0.00 | 1.71 |
| Sector/Markets Hedges | 2.22 | -1.76 | 0.46 |
| Telecommunications | 3.29 | 0.00 | 3.29 |
| **Grand total** | 95.18 | -4.89 | 90.29 |

## Currency exposure summary

| | Weight (%)* |
|---|---|
| AUD | 48.29 |
| USD | 27.04 |
| EUR | 12.00 |
| JPY | 4.63 |
| Other | 8.03 |
| **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.