

Five Oceans Wholesale World Fund

Fund report and commentary – 31 December 2011

Performance

	3 months (%)	6 months (%)	1 year (%)	3 years (% p.a.)	5 years (% p.a.)	Since inception (% p.a.) ¹
Fund return (gross) ²	1.2	-3.1	-3.3	2.9	1.2	1.8
Fund return (net) ³	0.8	-3.7	-4.5	1.6	-0.3	0.4
MSCI World Index Unhedged \$A	2.1	-6.1	-5.0	-1.7	-6.9	-5.2
Difference	-1.3	+2.4	+0.5	+3.3	+6.6	+5.6

Past performance is not a reliable indicator of future performance.

¹ Inception date is 3 July 2006

² Gross returns assume the reinvestment of distributions and exclude the impact of ongoing management fees. No allowance is made for tax when calculating these figures.

³ Net returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

Market review

Markets rebounded strongly in October, from depressed levels, but were then stuck in a volatile trading range for much of November and December. They ended the quarter up 7.9% (in local terms). The quarter was again marked by a relative strength of the US against all other major regions as economic indicators there struck a more positive note on a number of fronts including employment, construction and bank credit creation. This was in contrast to continued headwinds emanating from Europe and Asia.

In Europe, the sovereign debt crisis continues to evolve. A broad consensus had hoped for the European Central Bank to intervene in bond markets as was seen in the US. Rather the crisis appears to have been used to drive government fiscal consolidation. This is likely to have a negative impact on growth and expectations are now that Europe will enter recession in 2012. The ECB has stepped in to supply massive funding to European banks at cheap rates. Fears of a “hard-landing” in China continued to grow in main driven by falling property prices, induced by government curbs on bank lending. With inflation now slowing, there is greater scope for authorities to loosen policy conditions. Weakness in investment related industries have dampened China’s demand for commodities, highlighted by the fall in the spot iron ore price during the quarter. The Indian market also struggled as inflation remains stubbornly high in India in the face of a policy malaise. We saw pronounced weakness in the Indian Rupee during the quarter.

Fund performance

The Fund was up 1.2% over the quarter, underperforming the market, as measured by the MSCI World Index in \$A, which was up 2.1%. As mentioned, in local currency terms global markets were up 7.9% but the rebound in the Australian dollar masked part of this strength. The Fund was positioned cautiously at the beginning of the period given the scope of risks, though attractive valuations and the support of an increasingly proactive European Central Bank saw the Fund increase its net exposure to equities from approximately 62% to 75%, primarily by reducing the level of index hedging.

The biggest contributors to the Fund’s performance over the quarter were Varian Medical Systems, Coach, US Bancorp, Samsung Electronics and DR Horton.

Varian Medical Systems, the global leader in radiation therapy equipment, climbed strongly in the quarter after reporting better than expected quarterly numbers as well as the news that competitor Siemens AG, planned to selectively exit its radiation therapy business having been losing market share to Varian and key competitor Elekta for many years.

Leading American handbag and accessories maker, Coach, said it sees sales and earnings growing double digit in 2012, driven by the ongoing recovery in the US combined with continued strength internationally, especially in China where the company’s store rollout is in its early stages. The company also successfully listed in Hong Kong in December. US Bancorp benefited from both increasing signs of better loan growth, particularly lending to businesses, and evidence that it is taking market share. DR Horton moved higher in the quarter as it increasingly appears that housing activity is showing signs of life, 5 years after the peak. Samsung Electronics benefited from dramatic increases in smartphone shipments, with market share increasing from 12.2% in Q1 2011 to 23.4% in Q3 2011, briefly surpassing even Apple. Samsung’s valuation has historically been heavily influenced by their commodity semiconductor business, whose earnings can be vulnerable to economic weakness, despite Samsung being the dominant player in that market. However Samsung’s success in smartphones means their telecom division has now overtaken semiconductors to generate the majority of company profit.

Detracting from performance were Indian stocks ICICI Bank, Bharat Heavy and Bharti Airtel echoing current challenges facing India, and despite attractive valuations. Nervousness is high with regard to emerging market growth in general. Database software leader Oracle also performed poorly after the company produced a rare miss on earnings relative to guidance. We continue to see Oracle as well positioned for rapid growth trends in data and the valuation is very attractive here, with the company now trading on a prospective PER of 10.9x versus a five year average of 13.9x.

These stock stories highlight that companies with strong franchise positions such as Varian, Coach, and even Samsung are shaping their own success and delivering growth despite a challenging macro environment. We continue to hold these names as the valuation remains attractive. Economically exposed stocks such as Oracle, or oil service companies are trading on low valuations, but remain vulnerable to further weakness if there is more deterioration in the macro. On the other hand, more defensive names, such as Consumer Staples stocks, have done well, but now trade on less attractive valuations, in contrast to 2008-2009 when they sold down with the broader market.

Fund activity

There was a relatively low level of Fund activity during the quarter with core portfolio positions largely unchanged. The Fund did initiate a few new holdings, including technology behemoth Microsoft and Chinese consumer electronics retailer Gome. While facing some structural headwinds Microsoft looks very attractive on a range of valuation metrics and has almost \$50bn in net cash. We expect it to exhibit good earnings growth as it enters what looks to be a more positive phase in its product cycle with the approaching release of Windows 8. Importantly, we believe Windows 8 will work on ARM-based hardware and provide Microsoft with access to a wider range of portable devices including smartphones and tablets. The just announced Nokia Lumia 900 looks like a potentially attractive product for the US market, using Microsoft software. Microsoft is trading on a prospective PE of 9.7x highlighting attractive valuations, and how money has left the market. The Fund sold out of Standard Chartered over the quarter and took some profits on ladies' footwear retailer Daphne.

Strategy and outlook

As in the September quarter, the final quarter of 2011 saw the market heavily focused on Europe's sovereign debt situation and the global transmission risks. While there were some positive political developments over the quarter our view remains that there are still a myriad of uncertainties as to how this crisis is resolved. We await a more detailed policy response to get more positive on Europe's outlook as we continue to believe that austerity measures and tighter financial conditions, in part driven by bank deleveraging, will dampen growth in the eurozone and potentially elsewhere as evidenced by the decline in global PMIs over the last few months.

For now US economic growth is the standout and we expect this to remain the case near term though we are cognisant that continued growth is to some extent dependent on the eurozone. In Asia, there are signs that policy makers are providing support with China cutting its reserve requirement ratio for the first time in three years. There is little doubt that 2011 was a challenging year and we expect continued uncertainty as we head into 2012 but with this uncertainty comes opportunity and we continue to look for stocks that have attractive valuations and strong fundamentals.

Top ten long positions

	Region	Sector	Fund Weight (%)
Apple Inc.	United States	Information Technology	3.2
US Bancorp	United States	Financials	2.7
Coach Inc.	United States	Consumer Discretionary	2.4
Varian Medical Systems Inc.	United States	Health Care	2.3
Samsung Electronics Ltd	Korea	Information Technology	2.1
Danaher Corp	United States	Industrials	2.1
Wells Fargo & Co.	United States	Financials	2.0
Roche Holding	Switzerland	Health Care	1.9
Nestle	Switzerland	Consumer Staples	1.8
United Parcel Service	United States	Industrials	1.8

Country exposure summary

Country name	Long (%)	Short (%)	Net (%)
Asia ex Japan	9.4	-5.7	3.7
Japan	1.6	0.0	1.6
Europe	12.5	-0.4	12.1
United Kingdom	9.1	-0.2	9.0
United States	53.6	-9.7	43.9
Others	4.8	0.0	4.8
Grand total	91.0	-15.9	75.1

Portfolio exposure summary

	Fund Weight (%)
Long positions	91.0
Short positions	-15.9
Net equity exposure ¹	75.1

¹ Net equity exposure is short equity positions are deducted from long equity positions.

Sector exposure summary

Sector name	Long (%)	Short (%)	Net (%)
Consumer Discretionary	17.1	-1.7	15.4
Consumer Staples	6.9	0.0	6.9
Energy	9.1	-1.8	7.4
Financials	10.7	0.0	10.7
Health care	11.7	0.0	11.7
Industrials	12.1	-0.2	11.9
Information Technology	15.7	-0.1	15.7
Materials	3.6	0.0	3.6
Telecommunications	2.9	0.0	2.9
Utilities	0.0	0.0	0.0
Sector/Markets Hedges	1.2	-12.3	-11.1
Grand total	91.0	-15.9	75.1

Currency exposure summary

	Fund Weight (%)
AUD	11.4
USD	62.7
EUR	4.8
JPY	5.1
Other	16.0
Grand total	100.0

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