

Kapstream Absolute Return Income Fund

Annual Report year ended 30 June 2011

Kapstream Absolute Return Income Fund
(ARSN 124 152 790)

Responsible Entity
Challenger Managed Investments Limited
(ABN 94 002 835 592)
(AFSL 234668)

KAPSTREAM

C A P I T A L

Kapstream Absolute Return Income Fund

ARSN 124 152 790

Annual report - 30 June 2011

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This financial report covers Kapstream Absolute Return Income Fund as an individual entity.

The Responsible Entity of Kapstream Absolute Return Income Fund is Challenger Managed Investments Limited (ABN 94 002 835 592). The Responsible Entity's registered office is Level 15, 255 Pitt Street, Sydney NSW 2000.

Financial highlights

Financial highlights for Kapstream Absolute Return Income Fund (the 'Trust') include the following:

Performance

The table below shows historical discrete annual return performance of the Trust since inception. Calculation of performance is after all fees, except any entry fees that have been deducted, and assumes that all distributions were reinvested during that period. The total return is aggregate of capital growth and distribution returns.

	2011 %	2010 %	2009 %	31/05/2007 to 30/06/2008 %
Seed (terminated 17 December 2009)				
Capital Growth	-	-	(1.70)	5.10
Distribution of income	-	-	8.72	-
Total return (%)	<u>-</u>	<u>-</u>	<u>7.02</u>	<u>5.10</u>

	2011 %	2010 %	2009 %	31/05/2007 to 30/06/2008 %
Premier				
Capital Growth	0.12	0.51	(1.62)	0.88
Distribution of income	6.05	7.01	8.70	4.47
Total return (%)	<u>6.17</u>	<u>7.52</u>	<u>7.08</u>	<u>5.35</u>

	2011 %	2010 %	2009 %	31/05/2007 to 30/06/2008 %
Wholesale				
Capital Growth	(0.13)	0.78	6.22	5.37
Distribution of income	5.99	5.96	-	-
Total return (%)	<u>5.86</u>	<u>6.74</u>	<u>6.22</u>	<u>5.37</u>

Consistent with the statements in the current product disclosure statement, future performance is not guaranteed. Investors should exercise care in using past performance as a predictor of future performance.

Indirect Cost Ratio (ICR)

The Indirect Cost Ratio (ICR) is the ratio of the Trust's management costs over the Trust's average net assets attributable for the year, expressed as a percentage. The ICR of the various classes of the Trust since inception has been:

	2011 %	2010 %	2009 %	31/05/2007 to 30/06/2008 %
Seed (terminated 17 December 2009)	-	0.30	0.30	0.30
Premier	0.40	0.40	-	-
Wholesale	0.70	0.73	0.60	0.60

Management costs include management fees and other expenses or reimbursements deducted in relation to the Trust, but do not include transactional and operational costs such as brokerage. Management costs are not paid directly by the unitholders of the Trust.

The above ICR for the Wholesale class for the year ended 30 June 2011 does not include a performance fee (2010: 0.03%).

Financial highlights (continued)

Unit redemption prices

Unit redemption prices (quoted ex-distribution and exclusive of exit fees) are shown as follows:

	2011 \$	2010 \$
Seed (terminated 17 December 2009)		
At 30 June	-	-
Year to 30 June:		
High	-	1.0208
Low	-	0.9892
	2011 \$	2010 \$
Premier		
At 30 June	0.9994	0.9982
Year to 30 June:		
High	1.0293	1.0321
Low	0.9984	0.9938
	2011 \$	2010 \$
Wholesale		
At 30 June	1.1413	1.1428
Year to 30 June:		
High	1.1741	1.1793
Low	1.1413	1.1347

Directors' report

The directors of Challenger Managed Investments Limited, the Responsible Entity of Kapstream Absolute Return Income Fund, present their report together with the financial statements of Kapstream Absolute Return Income Fund (the 'Trust') for the year ended 30 June 2011.

Directors

The following persons held office as directors of Challenger Managed Investments Limited during the year or since the end of the year and up to the date of this report:

BJ O'Connor
BR Benari
PD Rogan
RJ Woods
RW Adams (resigned 25 January 2011)
R Willis (appointed 25 January 2011)

Principal activities

The principal activity of the Trust during the year was to invest in corporate bonds, floating rate notes, mortgage backed securities and utilised derivative investments in accordance with the provisions of the Trust Constitution.

There were no significant changes in the nature of the Trust's activities during the year.

The Asset Manager of the Trust is Kapstream Capital Pty Limited.

Review and results of operations

During the year, the Trust continued to invest funds in accordance with target asset allocations as set out in the current product disclosure statement which continues to be adhered to. The Trust maintains its strategy of investing in high yielding, fixed interest, and hybrid (debt and equity) securities. The Trust make short sales in which borrowed money security is sold in anticipation of a decline in the market value of that security, or it may use short sales for various arbitrage transactions.

Results

The performance of the Trust, as represented by the results of its operations, was as follows:

	30 June 2011 \$'000	30 June 2010 \$'000
Net operating profit/(loss) after interest expense	<u>40,918</u>	34,200
Distribution paid and payable	<u>47,563</u>	30,878
Distribution (cents per unit) - Seed (terminated 17 December 2009)	<u>-</u>	0.44
Distribution (cents per unit) - Premier	<u>5.95</u>	6.86
Distribution (cents per unit) - Wholesale	<u>6.73</u>	6.68

Significant changes in state of affairs

In the opinion of the directors, there were no significant changes in the state of affairs of the Trust that occurred during the financial year.

Matters subsequent to the end of the financial year

No matter or circumstance has arisen since 30 June 2011 that has significantly affected, or may significantly affect:

- (i) the operations of the Trust in future financial years, or
- (ii) the results of those operations in future financial years, or
- (iii) the state of affairs of the Trust in future financial years.

Directors' report (continued)

Likely developments and expected results of operations

The Trust will continue to be managed in accordance with the investment objectives and guidelines as set out in the governing documents of the Trust and in accordance with the provisions of the Trust's Constitution.

Further information on likely developments in the operations of the Trust and the expected results of those operations have not been included in this report because the Responsible Entity believes it would be likely to result in unreasonable prejudice to the Trust.

Indemnity and insurance of officers

No insurance premiums are paid for out of the assets of the Trust in regards to insurance cover provided to the officers of Challenger Managed Investments Limited. So long as the officers of Challenger Managed Investments Limited act in accordance with the Trust's Constitution and the Law, the officers remain indemnified out of the assets of the Trust against losses incurred while acting on behalf of the Trust. The auditors of the Trust are in no way indemnified out of the assets of the Trust.

Fees paid to and interests held in the Trust by the Responsible Entity or its related entities

Fees paid to the Responsible Entity and its related entities out of Trust property during the year are disclosed in note 11 to the financial statements.

No fees were paid out of Trust property to the directors of the Responsible Entity during the year.

The number of interests in the Trust held by the Responsible Entity or its related entities as at the end of the financial year are disclosed in note 11 to the financial statements.

Interests in the Trust

The movement in units on issue in the Trust during the year is further disclosed in note 5 to the financial statements.

The movement in units on issue in the Trust during the year is set out below:

	30 June 2011 No. '000	30 June 2010 No. '000
Units on issue - 1 July	462,293	400,106
Units issued	468,525	315,211
Units redeemed	(163,138)	(253,024)
Units on issue - 30 June	<u>767,680</u>	<u>462,293</u>
Value of assets	\$'000	\$'000
Value of Trust assets at 30 June	<u>786,864</u>	<u>499,052</u>

The value of the Trust's assets and liabilities is disclosed in the statement of financial position and derived using the basis set out in note 2 to the financial statements.

Environmental regulation

The operations of the Trust are not subject to any particular or significant environmental regulations under a Commonwealth, State or Territory law.

Directors' report (continued)

Rounding of amounts to the nearest thousand dollars

The Trust is an entity of the kind referred to in Class Order 98/0100 (as amended) issued by the Australian Securities and Investments Commission relating to the "rounding off" of amounts in the directors' report. Amounts in the directors' report have been rounded to the nearest thousand dollars in accordance with that Class Order, unless otherwise indicated.

Auditor's independence declaration

A copy of the Auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 7.

This report is made in accordance with a resolution of the directors.



BJ O'Connor
Director

Sydney
16 September 2011

Auditor's Independence Declaration to the Directors of Kapstream Absolute Return Income Fund

In relation to our audit of the financial report of Kapstream Absolute Return Income Fund for the financial year ended 30 June 2011, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

A handwritten signature in cursive script that reads 'Ernst & Young'.

Ernst & Young

A handwritten signature in cursive script that reads 'Clare Sporle'.

Clare Sporle
Partner
16 September 2011

Statement of comprehensive income

	Notes	30 June 2011 \$'000	30 June 2010 \$'000
Income			
Interest income		37,088	27,114
Net gains/(losses) on financial instruments held at fair value through profit or loss	3	6,886	7,777
Other income		-	3
Total income		<u>43,974</u>	<u>34,894</u>
Expenses			
Responsible Entity's fees	11	2,914	606
Performance fees	11	-	7
Transaction costs		65	69
Other expenses		77	12
Total expenses		<u>3,056</u>	<u>694</u>
Net profit/(loss) before finance cost		<u>40,918</u>	<u>34,200</u>
Finance costs attributable to unitholders			
Distributions to unitholders	6	(47,563)	(30,878)
Interest expense		-	(3,591)
Change in net assets attributable to unitholders	5	6,645	269
Other comprehensive income for the year		-	-
Total comprehensive income for the year		<u>-</u>	<u>-</u>

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

Statement of financial position

	Notes	30 June 2011 \$'000	30 June 2010 \$'000
Assets			
Cash and cash equivalents	12(b)	61,994	116,557
Receivables		64,429	5,278
Cash on deposit		63,348	-
Financial assets held at fair value through profit or loss	7	<u>597,093</u>	<u>377,217</u>
Total assets		<u>786,864</u>	<u>499,052</u>
Liabilities			
Distributions payable	6	11,829	12,055
Payables		196	14,415
Financial liabilities held at fair value through profit or loss	8	<u>598</u>	<u>7,310</u>
Total liabilities (excluding net assets attributable to unitholders)		<u>12,623</u>	<u>33,780</u>
Net assets attributable to unitholders	5	<u>774,241</u>	<u>465,272</u>

The above statement of financial position should be read in conjunction with the accompanying notes.

Kapstream Absolute Return Income Fund
Statement of changes in net assets attributable to unitholders
For the year ended 30 June 2011

Statement of changes in net assets attributable to unitholders

	30 June	30 June
	2011	2010
	\$'000	\$'000
At 1 July - opening	465,272	396,496
Change in net assets attributable to unitholders	(6,645)	(269)
Application for units	482,367	330,111
Redemption of units	(166,753)	(261,066)
At 30 June - closing	<u>774,241</u>	<u>465,272</u>

The above statement of changes in net assets attributable to unitholders should be read in conjunction with note 5.

Statement of cash flows

	30 June 2011 \$'000	30 June 2010 \$'000
Notes		
Cash flows from operating activities		
Proceeds from sale of financial instruments held for trading	27,092	7,980
Interest received/(paid)	33,429	23,416
Other income received	1	3
Responsible Entity's fees paid	(2,800)	(465)
Payment of other expenses	(69)	(93)
Net cash inflow/(outflow) from operating activities	<u>12(a) 57,653</u>	<u>30,841</u>
Cash flows from investing activities		
Proceeds from sale of investments designated at fair value through profit or loss	607,773	516,467
Purchase of investments designated at fair value through profit or loss	<u>(922,909)</u>	<u>(525,862)</u>
Net cash inflow/(outflow) from investing activities	<u>(315,136)</u>	<u>(9,395)</u>
Cash flows from financing activities		
Proceeds from applications by unitholders	440,612	304,923
Payments for redemptions by unitholders	(166,753)	(261,066)
Distributions paid	(6,170)	(3,895)
Cash on deposit advanced	<u>(63,348)</u>	<u>-</u>
Net cash inflow/(outflow) from financing activities	<u>204,341</u>	<u>39,962</u>
Net increase/(decrease) in cash and cash equivalents	(53,142)	61,408
Cash and cash equivalents at the beginning of the year	116,557	53,752
Effects of foreign currency exchange rate changes on cash and cash equivalents	<u>(1,421)</u>	<u>1,397</u>
Cash and cash equivalents at the end of the year	<u>12(b) 61,994</u>	<u>116,557</u>

The above statement of cash flows should be read in conjunction with the accompanying notes.

1 General information

These financial statements cover Kapstream Absolute Return Income Fund (the 'Trust') as an individual entity. The Trust is an Australian registered scheme, and was constituted on 31 May 2007. The Trust will terminate on 31 May 2087 unless terminated earlier in accordance with the provisions of the Trust Constitution.

The financial statements were authorised for issue by the directors on 16 September 2011.

The nature of the operating and principal activities of the Trust are described in the Directors' report.

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated in the following text.

(a) Basis of preparation

These general purpose financial statements been prepared in accordance with the Trust's Constitution, Australian Accounting Standards, and the *Corporations Act 2001* in Australia.

The financial statements are presented in Australian dollars and are prepared on the basis of fair value measurement of assets and liabilities except where otherwise stated.

The statement of financial position is presented on a liquidity basis. Assets and liabilities are presented in decreasing order of liquidity and are not distinguished between current and non-current. All balances are expected to be recovered or settled within twelve months, except for investments in financial assets and net assets attributable to unitholders. The amount expected to be recovered or settled in relation to these balances cannot be reliably determined.

Statement of compliance

The financial statements have been prepared in accordance with the Australian Accounting Standards as issued by the Australian Accounting Standards Board and International Financial Reporting Standards as issued by the International Accounting Standards Board.

(b) Financial instruments

(i) Classification

The Trust's investments are classified as at fair value through profit or loss. They comprise:

- Financial instruments held for trading

Derivative financial instruments such as futures, forward contracts, options and interest rate swaps are included under this classification. The Trust does not designate any derivatives as hedges in a hedging relationship.

- Financial instruments designated at fair value through profit or loss upon initial recognition

These include financial assets and financial liabilities that are not held for trading purposes and which may be sold. These are investments in corporate bonds, mortgage backed securities, floating rate notes and discount securities.

(ii) Recognition/derecognition

The Trust recognises financial assets and financial liabilities on the date it becomes party to the contractual agreement (trade date) and recognises changes in fair value of the financial assets or financial liabilities from this date.

Investments are derecognised when the right to receive cashflows from the investments has expired or the Trust has transferred substantially all risks and rewards of ownership.

2 Summary of significant accounting policies (continued)

(b) Financial instruments (continued)

(iii) Measurement

Financial assets and liabilities held at fair value through profit or loss

Financial assets and liabilities held at fair value through profit and loss are measured initially at fair value excluding any transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately. Subsequent to initial recognition, all instruments held at fair value through profit or loss are measured at fair value with changes in their fair value recognised in the statement of comprehensive income.

- *Fair value in an active market*

The fair value of financial assets and liabilities traded in active markets is based on their quoted market prices at the reporting date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices at the close of statement of financial position date, while financial liabilities are priced at current offer prices.

- *Fair value in an inactive or unquoted market*

The fair value of financial assets and liabilities that are not traded in an active market is determined using valuation techniques. These include the use of recent arm's length market transactions, reference to the current fair value of a substantially similar instrument, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used in a market rate at the balance sheet date applicable for an instrument with similar terms and conditions.

For other pricing models, inputs are based on market data at the balance date. Fair values for unquoted equity investments are estimated, if possible, using applicable pricing/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Trust would receive or pay to terminate the contract at the balance date taking into account current market conditions (volatility and appropriate yield curve) and the current creditworthiness of the counterparties. The fair value of a forward contract is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at the valuation date. The fair value of an option contract is determined by applying the Black-Scholes option valuation model.

Investments in other unlisted unit trusts are recorded at the redemption value per unit as reported by the managers of such trusts.

(iv) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(c) Net assets attributable to unitholders

Units are redeemable at the unitholders' option and are classified as financial liabilities due to mandatory distributions. The units can be put back to the Trust at any time for cash based on the redemption price. The fair value of redeemable units is measured at the redemption amount that is payable (based on the redemption unit price) at the reporting date if unitholders exercised their right to redeem units in the Trust.

2 Summary of significant accounting policies (continued)

(d) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the statement of financial position.

Payments and receipts relating to the purchase and sale of investment securities held for trading are classified as cash flows from operating activities, as movements in the fair value of these securities represent the Trust's main income generating activity.

Payments and receipts relating to the purchase and sale of investment securities designated at fair value are classified as cash flows from investing activities, as movements in the fair value of these securities represent the Trust's investment activity.

(e) Cash on deposit

Cash on deposit accounts comprise deposits held with financial institutions with original maturities in excess of three months. These held to maturity investments are carried at amortised cost using the effective interest method.

(f) Investment income

Interest income and expenses are recognised in the statement of comprehensive income for all debt instruments that are not held at fair value through profit or loss using the effective interest method. Other changes in fair value for such instruments are recorded in accordance with the policies described in note 2(b).

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts throughout the expected life of the financial instrument, or a shorter period where appropriate, to the net carrying amount of the financial asset or liability. When calculating the effective interest rate, the Trust estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

(g) Expenses

All expenses, including Responsible Entity's fees are recognised in the statement of comprehensive income on an accruals basis.

(h) Income tax

Under current legislation, the Trust is not subject to income tax as unitholders are presently entitled to the income of the Trust.

Financial instruments held at fair value may include unrealised capital gains. Should such a gain be realised, that portion of the gain that is subject to capital gains tax will be distributed so that the Trust is not subject to capital gains tax.

Realised capital losses are not distributed to unitholders but are retained in the Trust to be offset against any realised capital gains. If realised capital gains exceed realised capital losses, the excess is distributed to unitholders.

The benefit of imputation credits and foreign tax paid are passed on to unitholders.

2 Summary of significant accounting policies (continued)

(h) Income tax (continued)

The Trust currently incurs withholding tax imposed by certain countries on investment income. Such income is recorded gross of withholding tax in the statement of comprehensive income.

(i) Distributions

In accordance with the Trust's Constitution, the Trust distributes income adjusted for amounts determined by the Responsible Entity, to unitholders by cash or reinvestment. The distributions are recognised in the statement of comprehensive income as finance costs attributable to unitholders.

(j) Change in net assets attributable to unitholders

Income not distributed is included in net assets attributable to unitholders. Movements in net assets attributable to unitholders are recognised in the statement of comprehensive income as finance costs.

(k) Goods and Services Tax (GST)

The GST incurred on the costs of various services provided to the Trust by third parties such as investment management fees have been passed onto the Trust. The Trust qualifies for Reduced Input Tax Credits (RITC) at a rate of 75% hence investment management fees and other expenses have been recognised in the statement of comprehensive income net of the amount of GST recoverable from the Australian Taxation Office (ATO). Accounts payable are inclusive of GST. The net amount of GST recoverable from the ATO is included in receivables in the statement of financial position. Cash flows relating to GST are included in the statement of cash flows on a gross basis.

(l) Receivables

Receivables may include amounts for dividends, interest and trust distributions. Dividends and trust distributions are accrued when the right to receive payment is established. Interest is accrued at the reporting date from the time of last payment in accordance with the policy set out in note 2(f) above. Amounts are generally received within 30 days of being recorded as receivables.

Receivables include such items as RITC and application monies receivable from unitholders.

(m) Payables

Payables include liabilities and accrued expenses owing by the Trust which are unpaid as at balance date.

Trades are recorded on trade date, and normally settled within three business days. Purchases of financial instruments that are unsettled at reporting date are included in payables.

The distribution amount payable to unitholders as at the reporting date is recognised separately on the statement of financial position when unitholders are presently entitled to the distributable income under the Trust's Constitution.

(n) Applications and redemptions

Applications received for units in the Trust are recorded net of any entry fees payable prior to the issue of units in the Trust. Redemptions from the Trust are recorded gross of any exit fees payable after the cancellation of units redeemed.

Unit redemption prices are determined by reference to the net assets of the Trust divided by the number of units on issue.

2 Summary of significant accounting policies (continued)

(o) Foreign currency

Transactions in foreign currencies are translated into presentation currency, Australian dollars, at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Australian dollars at the foreign exchange rate ruling at the reporting date.

Foreign exchange differences arising on translation are recognised in the Statement of Comprehensive Income. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the transaction. Non-monetary items measured at fair value in a foreign currency shall be translated to Australian dollars using the exchange rates ruling at the date when the fair value was determined.

(p) Use of estimates

For the majority of the Trust's financial instruments, quoted market prices are readily available. However, certain financial instruments, for example over-the-counter derivatives or unquoted securities, are fair valued using valuation techniques. Where valuation techniques (for example, pricing models) are used to determine fair values, they are validated and periodically reviewed by experienced personnel of the Responsible Entity, independent of the area that created them.

Models use observable data, to the extent practicable. However, areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments. Models are calibrated by back-testing to actual transactions to ensure that Trust outputs are reliable.

For certain other financial instruments, including amounts due from/to brokers and payables, the carrying amounts approximate fair value due to the short-term nature of these financial instruments.

(q) Unit prices

Unit prices are determined in accordance with the Trust's Constitution and are calculated as the net assets attributable to unitholders of the Trust, less estimated costs, divided by the number of units on issue, on a forward pricing basis, as determined by the Responsible Entity.

(r) Terms and conditions on units

Each unit issued confers upon the unitholder an equal interest in the Trust and is of equal value per class. A unit does not confer any interest in any particular asset or investment of the Trust. Unitholders have various rights under the Constitution and the Corporations Act 2001, including the right to:

- have their units redeemed;
- receive income distributions;
- attend and vote at meetings of unitholders; and
- participate in the termination and winding of the Trust.

The rights, obligations and restrictions attached to each unit are identical in all respects.

2 Summary of significant accounting policies (continued)

(s) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2011 reporting periods. The directors' assessment of the impact of these new standards (to the extent relevant to the Trust) and interpretations is set out below:

(i) AASB 9 *Financial Instruments* and AASB 2009-11 *Amendments to Australian Accounting Standards arising from AASB 9* and AASB 2010-7 *Amendments to Australian Accounting Standards arising from AASB 9 (effective from 1 January 2013)*

AASB 9 *Financial Instruments* addresses the classification and measurement of financial assets. The standard is not applicable until 1 January 2013. The current four categories of financial assets, stipulated in AASB 139 *Financial Instruments: Recognition and Measurement*, will be replaced with two measurement categories: fair value and amortised cost. AASB 9 only permits the recognition of fair value gains/(losses) in other comprehensive income if they relate to equity investments that are not held for trading. Fair value gains/(losses) on debt investments, for example, will therefore have to be recognised directly in profit or loss. The Trust does not expect any significant impact on the Trust's financial statements arising from an adoption of the Standard.

(ii) AASB 2010-6 *Amendments to Australian Accounting Standards - Disclosures on Transfers of Financial Assets (effective from 1 July 2011)*

In November 2010, the AASB made amendments to AASB 7 *Financial Instruments: Disclosures on Transfers of Financial Assets* which amends AASB 1 *First-time Adoption of Australian Accounting* and AASB 7 *Financial Instruments: Disclosures* to introduce additional disclosures in respect of risk exposures arising from transferred financial assets. The amendments will affect particularly entities that sell, factor, securitise, lend or otherwise transfer financial assets to other parties. The amendments will not have any impact on the Trust's disclosures. The Trust intends to apply the amendment from 1 July 2011.

(iii) *Amendments to AASB 2010-4 Further amendments to Australian Accounting Standards arising from the Annual Improvements Project (effective from 1 July 2010 / 1 January 2011)*

In June 2010, the AASB made a number of amendments to Australian Accounting Standards as a result of the IASB's annual improvements project. The Trust does not expect that any adjustments will be necessary as the result of applying the revised rules.

(iv) *IFRS 13 Fair value measurement (effective from 1 January 2013)*

In May 2011, the IASB issued IFRS 13 Fair value measurement, which establishes a single source of guidance under IFRS for determining the fair value of assets and liabilities. IFRS 13 does not change when an entity is required to use fair value, but rather, provides guidance on how to determine fair value under IFRS when fair value is required or permitted by IFRS. Application of this definition may result in different fair values being determined for the relevant assets. IFRS 13 also expands the disclosure requirements for all assets or liabilities carried at fair value, including information about the assumptions made and the qualitative impact of those assumptions on the fair value determined. The valuation of a financial instrument will be assessed based on the facts at the date of initial application. The AASB is yet to release the Australian equivalent standard, but the Trust is in the process of assessing the impact based on the international standards.

(t) Rounding of amounts

The Trust is an entity of the kind referred to in Class Order 98/0100 (as amended), issued by the Australian Securities and Investments Commission, relating to the "rounding off" of amounts in the financial report. Amounts in the financial report have been rounded off to the nearest thousand dollars in accordance with that Class Order, unless otherwise indicated.

3 Net gains/(losses) on financial instruments held at fair value through profit or loss

Net gains/(losses) recognised in relation to financial assets and liabilities held at fair value through profit or loss:

	30 June 2011 \$'000	30 June 2010 \$'000
Designated at fair value	(12,085)	(2,404)
Held for trading at fair value	18,971	10,181
Net gains/(losses) on financial instruments held at fair value through profit or loss	<u>6,886</u>	<u>7,777</u>

4 Auditor's remuneration

The cost incurred for auditing the financial report of the Trust is paid directly by the Responsible Entity. The audit fees paid/payable by the Responsible Entity for the year were \$5,500 (2010: \$5,500).

5 Net assets attributable to unitholders

Movements in number of units and net assets attributable to unitholders during the year were as follows:

As stipulated within the Trust Constitution, each unit represents a right to an individual share in the Trust and does not extend to a right to the underlying assets of the Trust. There are three classes of units and each unit has the same rights, preferences and restrictions attaching to it as all other units of the Trust.

	30 June 2011 No. '000	30 June 2010 No. '000	30 June 2011 \$'000	30 June 2010 \$'000
Net assets attributable to unitholders - Seed (terminated 17 December 2009)				
Opening balance	-	65,000	-	63,638
Applications	-	-	-	-
Redemptions	-	(65,000)	-	(65,473)
Change in net assets attributable to unitholders	-	-	-	1,835
Closing balance	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	30 June 2011 No. '000	30 June 2010 No. '000	30 June 2011 \$'000	30 June 2010 \$'000
Net assets attributable to unitholders - Premier				
Opening balance	427,400	335,062	425,502	332,808
Applications	434,314	249,104	442,899	253,213
Redemptions	(154,244)	(156,766)	(156,448)	(159,002)
Change in net assets attributable to unitholders	-	-	(6,297)	(1,517)
Closing balance	<u>707,470</u>	<u>427,400</u>	<u>705,656</u>	<u>425,502</u>

5 Net assets attributable to unitholders (continued)

	30 June 2011 No. '000	30 June 2010 No. '000	30 June 2011 \$'000	30 June 2010 \$'000
Net assets attributable to unitholders - Wholesale				
Opening balance	34,893	44	39,770	50
Applications	34,211	66,107	39,468	76,898
Redemptions	(8,894)	(31,258)	(10,305)	(36,591)
Change in net assets attributable to unitholders	-	-	(348)	(587)
Closing balance	<u>60,210</u>	<u>34,893</u>	<u>68,585</u>	<u>39,770</u>
			30 June 2011 \$'000	30 June 2010 \$'000
Total net assets attributable to unitholders			<u>774,241</u>	<u>465,272</u>

Capital risk management

Daily applications and redemptions are reviewed relative to the liquidity of the Trust's underlying assets on a daily basis by the Responsible Entity. Under the terms of the Trust's Constitution, the Responsible Entity has the discretion to reject an application for units and to defer or adjust a redemption of units if the exercise of such discretion is in the best interests of unitholders.

The Trust monitors the level of daily applications and redemptions relative to the liquid assets in the Trust. Sufficient liquid assets are maintained within the Trust. Liquid assets include cash and cash equivalents and listed securities such as corporate bonds, floating rate notes and discount securities.

6 Distributions to unitholders

Timing of distributions

The distributions for the year were as follows:

	30 June 2011 \$'000	30 June 2011 CPU	30 June 2010 \$'000	30 June 2010 CPU
Distributions - Seed (terminated 17 December 2009)				
30 September quarterly paid	-	-	199	0.44
31 December quarterly paid	-	-	-	-
31 March quarterly paid	-	-	-	-
30 June quarterly payable	-	-	-	-
	<u>-</u>	<u>-</u>	<u>199</u>	<u>-</u>

6 Distributions to unitholders (continued)

	30 June 2011 \$'000	30 June 2011 CPU	30 June 2010 \$'000	30 June 2010 CPU
Distributions - Premier				
30 September quarterly paid	835	0.18	1,714	0.48
31 December quarterly paid	10,314	1.36	6,892	1.76
31 March quarterly paid	21,846	2.87	8,821	2.03
30 June quarterly payable	<u>10,906</u>	<u>1.54</u>	<u>11,061</u>	<u>2.59</u>
	<u>43,901</u>		<u>28,488</u>	
	30 June 2011 \$'000	30 June 2011 CPU	30 June 2010 \$'000	30 June 2010 CPU
Distributions - Wholesale				
30 September quarterly paid	59	0.12	26	0.14
31 December quarterly paid	1,017	1.98	487	1.58
31 March quarterly paid	1,663	3.10	684	2.11
30 June quarterly payable	<u>923</u>	<u>1.53</u>	<u>994</u>	<u>2.85</u>
	<u>3,662</u>		<u>2,191</u>	

The component of the final distribution for the year which was unpaid at the reporting date is shown in the statement of financial position.

7 Financial assets held at fair value through profit or loss

	Notes	30 June 2011 \$'000	30 June 2010 \$'000
Held for trading			
Derivatives	9	<u>838</u>	31
Total held for trading		<u>838</u>	31
Designated at fair value through profit or loss			
Corporate bonds		231,667	132,634
Government bonds		15,906	-
Mortgage backed securities		86,647	93,263
Asset backed securities		25,324	-
Floating rate notes		<u>236,711</u>	<u>151,289</u>
Total designated at fair value through profit or loss		<u>596,255</u>	<u>377,186</u>
Total financial assets held at fair value through profit or loss		<u>597,093</u>	<u>377,217</u>

An overview of the risk exposures relating to financial assets at fair value through profit or loss is included in note 10.

8 Financial liabilities held at fair value through profit or loss

	Notes	30 June 2011 \$'000	30 June 2010 \$'000
Held for trading			
Derivatives	9	<u>598</u>	7,310
Total held for trading		<u>598</u>	<u>7,310</u>
Total financial liabilities held at fair value through profit or loss		<u>598</u>	<u>7,310</u>

An overview of the risk exposures relating to financial liabilities at fair value through profit or loss is included in note 10.

9 Derivative financial instruments

In the normal course of business the Trust enters into transactions in various derivative financial instruments which have certain risks. A derivative is a financial instrument or other contract which is settled at a future date and whose value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable.

Derivative financial instruments require no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

Derivative transactions include many different instruments, such as forwards, futures and options. Derivatives are considered to be part of the investment process and the use of derivatives is an essential part of the Trust's portfolio management. Derivatives are not managed in isolation. Consequently, the use of derivatives is multifaceted and includes:

- hedging to protect an asset or liability of the Trust against a fluctuation in market values or to reduce volatility;
- a substitution for trading of physical securities; and
- adjusting asset exposures within the parameters set in the investment strategy, and adjusting the duration of fixed interest portfolios or the weighted average maturity of cash portfolios.

While derivatives are used for trading purposes, they are not used to gear (leverage) a portfolio. Gearing a portfolio would occur if the level of exposure to the markets exceeds the underlying value of the Trust.

The Trust holds the following derivative instruments:

(a) Futures

Futures are contractual obligations to buy or sell commodity instruments on a future date at a specified price established in an organised market. The futures contracts are collateralised by cash or marketable securities. Changes in futures contracts' values are settled daily with the exchange. Interest rate futures are contractual obligations to receive or pay a net amount based on changes in interest rates at a future date at a specified price, established in an organised commodity market.

(b) Options

An option is a contractual arrangement under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of securities or a financial instrument at a predetermined price. The seller receives a premium from the purchaser in consideration for the assumption of future securities price risk. Options held by the Trust are exchange-traded. The Trust is exposed to credit risk on purchased options to the extent of their carrying amount, which is their fair value. Options are settled on a gross basis.

9 Derivative financial instruments (continued)

(c) Forward currency contracts

Forward currency contracts are primarily used by the Trust to hedge against foreign currency exchange rate risks on its non-Australian dollar denominated trading securities. The Trust agrees to receive or deliver a fixed quantity of foreign currency for an agreed upon price on an agreed future date. Forward currency contracts are valued at the prevailing bid price at the end of each reporting period. The Trust recognises a gain or loss equal to the change in fair value at the end of each reporting period.

(d) Credit default swaps

A credit default swap is a derivative, under which the party buying protection makes one or more payments to the party selling protection in exchange for an undertaking by the seller to make a payment to the buyer following a credit event (as defined in the contract) with respect to a third-party credit entity. Settlement following a credit event may be a net cash amount or cash in return for physical delivery of one of more obligations of the credit entity and is made regardless of whether the protection buyer has actually suffered a loss. After a credit event and settlement, the contract is terminated.

(e) Interest rate swaps

An interest rate swap is an agreement between two parties to exchange their interest obligations (payments) or receipts at set intervals on a notional principal amount over an agreed time period.

The fair value of interest rate swaps is the estimated amount that the entity would receive or pay to terminate the swap at the end of the reporting period, taking into account current interest rates and the current creditworthiness of the swap counterparties.

The Trust's derivative financial instruments at year-end are detailed below:

30 June 2011

	Contract/ notional \$'000	Fair Values	
		Assets \$'000	Liabilities \$'000
Buy			
Interest rate swaps	146,000	98	-
Options	16,813	165	-
Credit default swaps	37,362	-	233
Sell			
Futures	(113,380)	11	-
FX forwards	<u>(258,003)</u>	<u>564</u>	<u>365</u>
	<u>(171,208)</u>	<u>838</u>	<u>598</u>

30 June 2010

	Contract/ notional \$'000	Fair Values	
		Assets \$'000	Liabilities \$'000
Buy			
Options	(5)	31	-
Credit default swaps	(11)	-	11
Sell			
Interest rate futures	(62,657)	-	-
FX forwards	<u>(7,280)</u>	<u>-</u>	<u>7,299</u>
	<u>(69,953)</u>	<u>31</u>	<u>7,310</u>

An overview of the risk exposures relating to derivatives is included in note 10.

10 Financial risk management

(a) Overview

The Trust's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

The Trust's overall risk management programme focuses on ensuring compliance with the Trust's Product Disclosure Statement and seeks to maximise the returns derived for the level of risk to which the Trust is exposed. The Trust may use derivative financial instruments to alter certain risk exposures. The Responsible Entity is responsible for identifying and controlling the risks that arise from these financial instruments.

The allocation of assets between the various types of financial instruments is determined by the Trust's Fund Manager who manages the Trust's assets to achieve the Trust's investment objectives.

Divergence from target allocations and the composition of the assets is monitored on a regular basis.

The Responsible Entity of the Trust is aware of the risks associated with the business of investment management. A financial risk management framework has been established to ensure that procedures and controls adequately manage the risks arising from current business activities. Central control include (but are not limited to):

- clear policies and procedures covering operations;
- post-trade investment compliance monitoring;
- segregation of the dealing and investment management function from the administration and settlement function;
- an independent service provider for the valuation of securities; and
- a compliance function with a separate reporting line from the Funds Management team.

As part of the risk management framework, the Responsible Entity is subject to regular reporting and committee meetings regarding risk and compliance issues. The purpose is to facilitate a flow of information between the business and the Responsible Entity's Board and Committees. Any material matters identified are promptly investigated and reported.

As part of its risk management strategy, the Trust may use derivatives including Australian exchange traded derivatives such as index futures and warrants, to manage exposures resulting from changes in index prices, equity risks and exposures arising from forecast transactions.

There are no changes in the strategies used to manage the financial risks from previous reporting period.

(b) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Trust's income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Trust is exposed to market risks influencing investment valuations. The Trust may utilise derivatives to manage this risk.

(i) Price risk

Price risk is the risk that the value of an instrument will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market. Part (c) below sets out how this component of price risk is managed and measured. Investments are classified in the statement of financial position as at fair value through profit or loss. All securities investments present a risk of loss of capital. Except for equities sold short, the maximum risk resulting from financial instruments is determined by the fair value of the financial instruments. Possible losses from equities sold short can be unlimited.

As the majority of the Trust's investments are carried at fair value with fair value changes recognised in the statement of comprehensive income, all changes in market conditions will directly affect net investment income.

10 Financial risk management (continued)

(b) Market risk (continued)

(i) Price risk (continued)

The fund manager mitigates this price risk through diversification and a rigorous selection of securities and other financial instruments within specified limits set by the Board. Part (c) of this note summarise the impact of an increase/decrease of the RBA Cash Rate on the Trust's net assets attributable to unitholders at 30 June 2011. The analysis is based on the assumptions that the index increased by 10% (2010: 10%) and decreased by 10% (2010: 10%) with all other variables held constant and that the fair value of the Trust's portfolio of fixed interest securities and derivatives moved according to the historical correlation with the index.

Daily monitoring of trade restrictions and derivative exposure against limits is undertaken with any breach of these limit restrictions reported.

(ii) Foreign exchange risk

The Trust holds both monetary and non-monetary assets denominated in currencies other than the Australian dollar. The foreign exchange risk relating to non-monetary assets and liabilities is a component of price risk. Foreign exchange risk arises as the value of monetary securities denominated in other currencies will fluctuate due to changes in exchange rates. The risk is measured using sensitivity analysis.

Trusts that invest in international assets are exposed to foreign exchange risk. Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Fund managers may enter into derivatives contracts (such as forwards, swaps, options and futures) through approved foreign exchange dealers to minimise risk. However, the use of these contracts must be consistent with the investment strategy and restrictions of each Trust, and agreed acceptable level of foreign exchange risk.

The Trust actively monitors its foreign exchange exposure and enters into foreign currency forward contracts to minimise its foreign exchange risk.

The table below summarises the Trust's exposure to foreign exchange risk:

30 June 2011	Australian Dollars A\$'000	US Dollars A\$'000	Euro A\$'000	Norwegian Krone A\$'000	Other currencies A\$'000	Total A\$'000
Cash and cash equivalents	55,841	5,643	13	165	332	61,994
Receivables	5,297	58,874	274	-	(16)	64,429
Cash on deposit	63,348	-	-	-	-	63,348
Financial assets held at fair value through profit or loss	<u>439,320</u>	<u>147,702</u>	<u>9,981</u>	<u>46</u>	<u>(321)</u>	<u>596,728</u>
Total assets	<u>563,806</u>	<u>212,219</u>	<u>10,268</u>	<u>211</u>	<u>(5)</u>	<u>786,499</u>
Distributions payable	(11,829)	-	-	-	-	(11,829)
Financial liabilities held at fair value through profit or loss	-	(233)	-	-	-	(233)
Payables	<u>(196)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(196)</u>
Total liabilities (excluding net assets attributable to unitholders)	<u>(12,025)</u>	<u>(233)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(12,258)</u>
Net assets attributable to unitholders	<u>551,781</u>	<u>211,986</u>	<u>10,268</u>	<u>211</u>	<u>(5)</u>	<u>774,241</u>

10 Financial risk management (continued)

(b) Market risk (continued)

(ii) Foreign exchange risk (continued)

30 June 2010	Australian Dollars A\$'000	US Dollars A\$'000	Euro A\$'000	Japanese Yen A\$'000	Norwegian Krone A\$'000	Other currencies A\$'000	Total A\$'000
Cash and cash equivalents	115,980	316	198	90	-	(27)	116,557
Receivables	4,546	684	48	-	-	-	5,278
Financial assets held at fair value through profit or loss	<u>314,014</u>	<u>59,492</u>	<u>3,481</u>	<u>-</u>	<u>-</u>	<u>230</u>	<u>377,217</u>
Total assets	<u>434,540</u>	<u>60,492</u>	<u>3,727</u>	<u>90</u>	<u>-</u>	<u>203</u>	<u>499,052</u>
Distributions payable	(12,055)	-	-	-	-	-	(12,055)
Financial liabilities held at fair value through profit or loss	<u>(7,323)</u>	<u>(11)</u>	<u>-</u>	<u>24</u>	<u>-</u>	<u>-</u>	<u>(7,310)</u>
Payables	<u>(14,415)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(14,415)</u>
Total liabilities (excluding net assets attributable to unitholders)	<u>(33,793)</u>	<u>(11)</u>	<u>-</u>	<u>24</u>	<u>-</u>	<u>-</u>	<u>(33,780)</u>
Net assets attributable to unitholders	<u>400,747</u>	<u>60,481</u>	<u>3,727</u>	<u>114</u>	<u>-</u>	<u>203</u>	<u>465,272</u>

The table in part (c) summarises the Trust's assets and liabilities that are denominated in a currency other than the Australian dollar.

(iii) Cash flow and fair value interest rate risk

Interest rate risk is the risk that the fair value of future cashflows of a financial instrument will fluctuate because of changes in market interest rates.

The Trust has established limits on the total interest rate exposure, which are monitored on a daily basis. The Trust may use derivatives to hedge unexpected increases in interest rates.

The table in part (c) of this note demonstrates the sensitivity if the Trust's statement of comprehensive income to reasonably possible changes in interest rates, with all other variable held constant.

The sensitivity of the statement of comprehensive income is the effect of the assumed changes in interest rates on:

- the interest income for one year, based on the floating rate financial assets held at 30 June 2011; and
- changes in the fair value of investments for the year, based on revaluing fixed rate financial assets at 30 June 2011.

10 Financial risk management (continued)

(c) Summarised sensitivity analysis

The following table summarises the sensitivity of the Trust's operating profit and net assets attributable to unitholders to interest rate risk for financial assets and liabilities held at balance date, and foreign exchange risk. The reasonably possible movements in the risk variables have been determined based on management's best estimate, having regard to a number of factors, including historical correlation of the Trust's investments with the relevant benchmark, that is the RBA Cash Rate. However, actual movements in the risk variables may be greater or less than anticipated due to a number of factors, including unusually large market shocks resulting from changes in the performance of the economies, markets and securities in which the Trust invests. As a result, historic variations in risk variables are not a definitive indicator of future variations in the risk variables.

	Interest rate risk Impact on operating profit/Net assets attributable to unitholders	
	+100 bps \$'000	-100 bps \$'000
	30 June 2011	(5,275)
30 June 2010	(1,125)	1,122

	Foreign exchange risk Impact on operating profit/Net assets attributable to unitholders					
	-10% USD \$'000	+10% USD \$'000	-10% EURO \$'000	+10% EURO \$'000	-10% OTHER \$'000	+10% OTHER \$'000
	30 June 2011	(23,404)	19,149	(1,110)	909	(25)
30 June 2010	(7,102)	5,429	(445)	334	(21)	29

(d) Credit risk

Credit risk represents the risk that the counterparty to a financial instrument will fail to discharge an obligation and cause the Trust to incur a financial loss.

With respect to credit risk arising from the financial assets of the Trust, other than derivatives, the Trust's exposure to credit risk arises from default of the counterparty, with the current exposure equal to the fair value of these instruments as disclosed in the statement of financial position. This does not represent the maximum risk exposure that could arise in the future as a result of changes in values, but best represents the current maximum exposure at the reporting date.

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values.

The Trust holds no collateral as security or any other credit enhancements. There are no financial assets that are past due or impaired, or would otherwise be past due or impaired except for the terms having being renegotiated. The Trust minimises its exposure to credit risk on derivatives by only trading with top-tier financial institutions and has limits on the level of instruments that it holds with each counterparty.

The credit quality of financial assets is managed by the Trust using the Standard & Poor's rating categories, in accordance with the investment mandate of the Trust. The Trust's exposure in each grade is monitored on a regular basis. This review process allows the Responsible Entity to assess the potential loss as a result of risks and take corrective action.

The maximum exposure to credit risk at the reporting date is the carrying amount of the financial assets. An analysis of the financial assets by rating is set out in the table below:

10 Financial risk management (continued)

(d) Credit risk (continued)

	30 June 2011 \$'000	30 June 2010 \$'000
Australian fixed interest securities		
Rating		
AAA	111,372	117,328
AA+	23,617	10,025
AA	44,576	28,144
AA-	69,188	81,843
A+	7,044	-
A	41,541	21,238
A-	61,227	41,556
BBB+	26,040	8,457
BBB	39,542	10,078
BBB-	6,437	1,752
A-1+	594	18,068
A-2	-	6,139
Total	<u>431,178</u>	<u>344,628</u>
	30 June 2011 \$'000	30 June 2010 \$'000
International fixed interest securities		
Rating		
AAA	8,631	-
A+	30,632	6,024
AA	-	6,745
AA-	30,912	-
A	21,364	4,585
A-	50,671	8,625
BBB+	5,528	5,894
BBB	-	4,907
BB+	12,299	-
BB	5,513	-
Total	<u>165,550</u>	<u>36,780</u>

All transactions in listed securities are settled/paid for upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on purchase on the securities have been received by the broker. The trade will fail if either party fails to meet its obligations.

(e) Liquidity risk

Liquidity risk is the risk that the Trust will not be able to meet its financial obligations as they fall due.

The Trust's Product Disclosure Statement provides for daily redemption of units and it is therefore exposed to liquidity risk of meeting unitholders' redemption at any time.

The Trust's investments are considered to be readily realisable.

The investment management process includes the consideration of liquidity, both in terms of market quality and cash flow. In asset construction, securities/investments (including derivatives) are only purchased that meet investment criteria and this includes the assessment of saleability in different market conditions. Before entering into a transaction, consideration is given (among others):

- whether the purpose of the investment is consistent with the investment strategy of the Trust;
- the ease of selling the security should market conditions change unfavourably;

10 Financial risk management (continued)

(e) Liquidity risk (continued)

- whether there are sufficient assets to cover the underlying liabilities of that transaction; and
- the overall liquidity level for the Trust.

Under the terms of its Constitution, the Trust has the ability to manage liquidity risk by delaying redemptions to unitholders, if necessary, until the funds are available to pay them.

Maturity analysis for financial liabilities

Financial liabilities for the Trust comprise trade and other payables, distributions payable, and net assets attributable to unitholders. Trade and other payables and distributions payable have no contractual maturities but are typically settled within 30 days.

Net assets attributable to unitholders are entirely payable on demand.

(f) Fair value estimation

All financial assets and financial liabilities included in the statement of financial position are carried at fair value.

The carrying amounts of all the Trust's financial assets and financial liabilities at the reporting date approximated their fair values.

Financial assets and liabilities held at fair value through profit or loss are measured initially at fair value excluding any transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately. Subsequent to initial recognition, all instruments held at fair value through profit or loss are measured at fair value with changes in their fair value recognised in the statement of comprehensive income.

The Trust values its investments in accordance with the accounting policies set out in note 2. For the majority of its investments, the Trust relies on information provided by independent pricing services for the valuation of its investments.

The quoted market price used for financial assets held by the Trust is the current bid price; the appropriate quoted market price for financial liabilities is the current asking price. When the Trust holds derivatives with offsetting market risks, it uses mid-market prices as a basis for establishing fair value for the offsetting risk positions and applies this bid or asking price to the net open position, as appropriate.

(g) Fair value hierarchy

The Trust classifies fair value measurements using a fair value hierarchy that reflects the subjectivity of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

The determination of what constitutes 'observable' requires significant judgement by the Responsible Entity. The Responsible Entity considers observable data to be market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

10 Financial risk management (continued)

(g) Fair value hierarchy (continued)

The table below sets out the Trust's financial assets (by class) measured at fair value according to the fair value hierarchy.

As at 30 June 2011	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets				
Financial assets held for trading:				
Interest rate swaps	-	98	-	98
Futures	-	11	-	11
FX forwards	-	564	-	564
Options	-	165	-	165
Financial assets designated at fair value through profit or loss at inception:				
Corporate Bonds	27,170	204,497	-	231,667
Mortgage backed securities	590	86,057	-	86,647
Floating rate notes	-	236,711	-	236,711
Asset backed securities	-	25,324	-	25,324
Government bonds	-	15,906	-	15,906
Total	27,760	569,333	-	597,093
Financial liabilities				
Financial liabilities held for trading:				
Credit default swaps	-	233	-	233
FX forwards	-	365	-	365
Total	-	598	-	598

As at 30 June 2010	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets				
Financial assets held for trading:				
Interest rate swaps	-	31	-	31
Financial assets designated at fair value through profit or loss at inception:				
Corporate bonds	-	132,634	-	132,634
Mortgage backed securities	728	92,535	-	93,263
Floating rate notes	-	151,289	-	151,289
Total	728	376,489	-	377,217
Financial liabilities				
Financial liabilities held for trading:				
Credit default swaps	-	11	-	11
FX forwards	-	7,299	-	7,299
Total	-	7,310	-	7,310

Investments whose values are based on quoted market prices in active markets, and therefore classified within level 1, include active listed equities and exchange traded derivatives.

Financial instruments that trade in markets that are not considered to be active but are valued based on quoted market prices, dealer quotations or alternative pricing sources supported by observable inputs are classified within level 2. These include, investments in unlisted unit trusts and over-the-counter derivatives. As level 2 investments include positions that are not traded in active markets and/or are subject to transfer restrictions, valuations may be adjusted to reflect illiquidity and/or non-transferability, which are generally based on available market information.

11 Related party transactions

Responsible Entity

The Responsible Entity of Kapstream Absolute Return Income Fund is Challenger Managed Investments Limited whose immediate parent company is Challenger Funds Management Holdings Pty Limited and ultimate parent company is Challenger Limited.

Key management personnel

(a) Directors

Key management personnel includes persons who were directors of Challenger Managed Investments Limited at any time during the year and up to the date of the report as follows:

BJ O'Connor
BR Benari
PD Rogan
RJ Woods
RW Adams (resigned 25 January 2011)
R Willis (appointed 25 January 2011)

(b) Other key management personnel

In addition to the directors noted above, the Responsible Entity is considered to be key management personnel with authority for the strategic direction and management of the Trust.

The Asset Manager, Kapstream Capital, is a related party to the Trust by way of common director, Rob Adams until the 25th January 2011 then Rob Woods from this date onwards. Rob Adams was a director of both Challenger Managed Investments Limited and Kapstream Capital until he resigned from the board of Challenger Managed Investments Limited on 25 January 2011. Rob Adams has been replaced on the Kapstream Capital board by Rob Woods.

Key management personnel unitholdings

At 30 June 2011 no key management personnel held units in the Trust. Comparative information is as follows:

2010

Unitholder	Number of units held opening (Units)	Number of units held closing (Units)	Interest held (%)	Number of units acquired (Units)	Number of units disposed (Units)	Distributions paid/payable by the Trust (\$)
RW Adams	32	-	-	1	33	-
Total	32	-		1	33	-

Key management personnel compensation

No amount is paid by the Trust directly to the Directors of the Responsible Entity.

Compensation is paid to the Responsible Entity in the form of fees and is disclosed below.

Responsible Entity's fees and other transactions

Under the terms of the Trust's Deed, the Responsible Entity is entitled to receive management fees, calculated by reference to the average daily net assets (excluding net assets attributable to unitholders) of the Trust as follows:

- (i) nil% (2010: 0.30%) of the Seed class (terminated 17 December 2009), and
- (ii) 0.40% (2010: 0.40%) of the Premier class, and
- (iii) 0.70% (2010: 0.70%) of the Wholesale class.

11 Related party transactions (continued)

In addition to the Responsible Entity's fee, the Responsible Entity is also entitled to receive performance fees. The performance fees are calculated at 20% of the Fund's gross return above its benchmark which is RBA Cash Rate.

	30 June 2011	30 June 2010
	\$	\$
Management fees for the year paid directly to the Responsible Entity	<u>2,913,602</u>	<u>606,780</u>
Performance fees for the year paid directly to the Responsible Entity	<u>-</u>	<u>7,157</u>
Aggregate amounts payable to the Responsible Entity at the reporting date	<u>277,898</u>	<u>164,750</u>

Related party unitholdings

At 30 June 2011, parties related to the Trust (including Challenger Managed Investments Limited, its related parties and other schemes managed by Challenger Managed Investments Limited), held no units in the Trust. Comparative information is as follows:

2010

Unitholder	Number of units held opening (Units)	Number of units held closing (Units)	Interest held (%)	Number of units acquired (Units)	Number of units disposed (Units)	Distribu- tions paid/ payable by the Trust (\$)
Challenger Funds Management Holdings Pty limited	32	-	-	1	33	-
Challenger Life Company Limited	<u>65,000,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>65,000,000</u>	<u>198,495</u>
Total	<u>65,000,032</u>	<u>-</u>	<u>-</u>	<u>1</u>	<u>65,000,033</u>	<u>198,495</u>

12 Reconciliation of net profit/(loss) attributable to unitholders to net cash flows from operating activities

	30 June 2011 \$'000	30 June 2010 \$'000
(a) Reconciliation of net profit/(loss) attributable to unitholders to net cash flows from operating activities		
Net profit/(loss) attributable to unitholders	40,918	30,609
Proceeds from the sale of financial instruments held for trading	27,092	7,980
Changes in the fair value of financial assets	(6,886)	(7,777)
Net change in receivables and other assets	(3,657)	(106)
Net change in payables and other liabilities	186	135
Net cash inflow/(outflow) from operating activities	57,653	30,841
(b) Components of cash and cash equivalents		
Cash as at the end of the financial year as shown in the statement of cash flows is reconciled to the statement of financial position as follows:		
Cash at bank	61,669	116,733
Cash as collateral	325	(176)
Cash and cash equivalents	61,994	116,557
(c) Non-cash financing activities		
- reinvestment of unitholder distributions	41,755	25,188

13 Events occurring after the end of the reporting period

No significant events have occurred since the end of the reporting period which would impact on the financial position of the Trust as at 30 June 2011 or on the results and cash flows of the Trust for the year ended on that date.

14 Contingent assets and liabilities and commitments

There are no outstanding contingent assets, liabilities or commitments as at 30 June 2011 (2010: \$nil).

Directors' declaration

In accordance with the resolution of the Directors of Challenger Managed Investments Limited, I state that:

In the opinion of the Directors of the Responsible Entity:

- (a) the financial statements and notes set out on pages 8 to 32 are in accordance with the *Corporations Act 2001*, including:
 - (i) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and
 - (ii) giving a true and fair view of the Trust's financial position as at 30 June 2011 and of its performance for the financial year ended on that date;
- (b) the financial statements and notes also comply with International Financial Reporting Standards as disclosed in note 2(a); and
- (c) there are reasonable grounds to believe that the Trust will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors.

On behalf of the Board of Directors of Challenger Managed Investments Limited.



BJ O'Connor
Director

Sydney
16 September 2011

Independent auditor's report to the unitholders of Kapstream Absolute Return Income Fund

We have audited the accompanying financial report of Kapstream Absolute Return Income Fund, which comprises the statement of financial position as at 30 June 2011, the statement of comprehensive income, statement of changes in net assets attributable to unitholders and statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration.

Directors' responsibility for the financial report

The directors of the Responsible Entity are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 2(a), the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the Responsible Entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence


In conducting our audit we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the Responsible Entity a written Auditor's Independence Declaration, a copy of which is attached to the directors' report.

Opinion

In our opinion:

- a. the financial report of Kapstream Absolute Return Income Fund is in accordance with the *Corporations Act 2001*, including:
 - i giving a true and fair view of Kapstream Absolute Return Income Fund's financial position of as at 30 June 2011 and of its performance for the year ended on that date; and

- ii complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- b. the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 2(a).

A stylized, handwritten-style logo for Ernst & Young, with the text 'Ernst & Young' written below it in a simple, sans-serif font.A handwritten signature in black ink, appearing to read 'Clare Sporle'.

Clare Sporle
Partner
Sydney
16 September 2011

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Directory

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AFSL 234668

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