

Tuesday, 21 October 2008

MARKET ANNOUNCEMENT

Investment Manager's September 2008 Report

The September 2008 Newsletter from FSP Equities Management Limited (FSP) on the performance of its FSP Equities Leaders Fund (FSP Fund) is attached.

About The FSP Equities Leaders Fund (FSP Fund) ¹

The FSP Fund is a wholesale fund not open to retail investors. The investment management team is led by Mr Ronni Chalmers. The objective of the fund is to outperform the S&P/ASX 200 Accumulation Index over the medium term. There is no minimum equity weighting with the equity weighting as at 30 September 2008 being 91%.

Currently 91.2% of the equity portfolio is invested in companies contained within the S&P/ASX 200 index. The remaining 8.8% of the portfolio is invested in companies outside of the S&P/ASX 200 index. The equity portfolio contained approximately 90 holdings as at 30 September 2008. The Investment Manager is "style neutral" and invests in growth stocks, value stocks, stocks with maintainable dividend yields and special situations.

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¹ Based on information provided by the Investment Manager, FSP Equities Management Limited.

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13 October, 2008

The Directors of Scarborough Equities Limited
Suite 202, 30-36 Bay Street
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Dear Client

Fund Performance

Through the first two months of the September quarter the Australian equity market, as measured by the S&P/ASX 200 Index, traded around the 5000 level. An easing of inflationary pressures resulting from a significant fall in the oil price (down from its 30 June price of \$US140) and a moderation of domestic demand allowed the Reserve Bank to lower the official cash rate by 0.25% to 7.0% on September 3. The Australian market underperformed global markets in July and into August as the Australian market was impacted by broad falls in commodity prices given the relative importance of our materials and energy sectors.

Over the 12 months to 30 September 2008, the FSP Australian Equities Leaders Fund recorded a negative return of net -37.0%. While this period has been disappointing, we emphasise that this has followed five years of very strong returns, as shown in the table overleaf, and it is not indicative of the expected long term returns from Australian equities.

Most significantly in the quarter, tensions again escalated in credit markets after a respite following the March bail out of Bear Stearns. Concerns around solvency and an inability of financial institutions to access funding markets culminated in September with a number of significant financial market events. This included the placing of Fannie Mae and Freddie Mac into Federal conservatorship, the provision of a US\$85 billion secured line of credit to the world's largest insurer by assets, American International Group, the bankruptcy filing of Lehman Brothers and Washington Mutual, and a rapid consolidation or nationalisation of other investment banks and financial institutions. The scale of disruption to credit markets resulted in the US moving to enact a US\$700 billion authority to take troubled assets off US financial institution balance sheets to restore liquidity to the system. The UK took more comprehensive steps, announcing it will invest £50 billion to recapitalise key UK banks, provide £200 billion of additional short-term liquidity and commit £250 billion to guarantee medium term inter-bank debt. The US will also take equity stakes in financial institutions within its US\$700 billion authority, and there have been increasing moves towards global co-operation, including a co-ordinated interest rate cut at six central banks. Meetings of the G7, G20 and European leaders were conducted over the weekend as the emphasis on co-ordinated efforts increased. The 15 European nations announced agreement on measures similar to those of the UK, refinancing banks, guaranteeing interbank lending and ensuring that troubled banks do not fail.

The Australian market has been buffeted by these international developments but performed notably better than global markets over the period from mid-August to now. It is supported by the relative strength of the Australian financial system, where inter-bank liquidity has continued to operate normally. Australian banks have been able to continue to source overseas wholesale funding, albeit at raised interest rates, in addition to accessing new markets such as the Japanese samurai bond market and Canadian wholesale debt markets. Following moves by foreign governments to support their financial institutions, Kevin Rudd announced a guarantee on all Australian financial institution deposits for three years in addition to a guarantee on Australian banks' wholesale borrowing, which

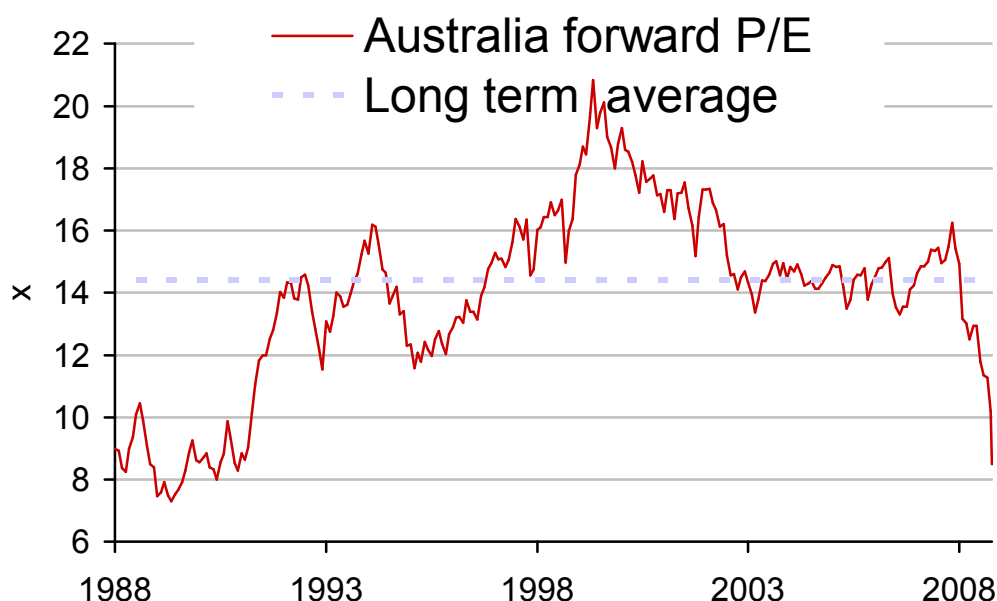
will ensure our banks remain internationally competitive. The Reserve Bank of Australia has taken further action, reducing the official cash rate target by 1% to 6.0% on 8 October.

Performance History †

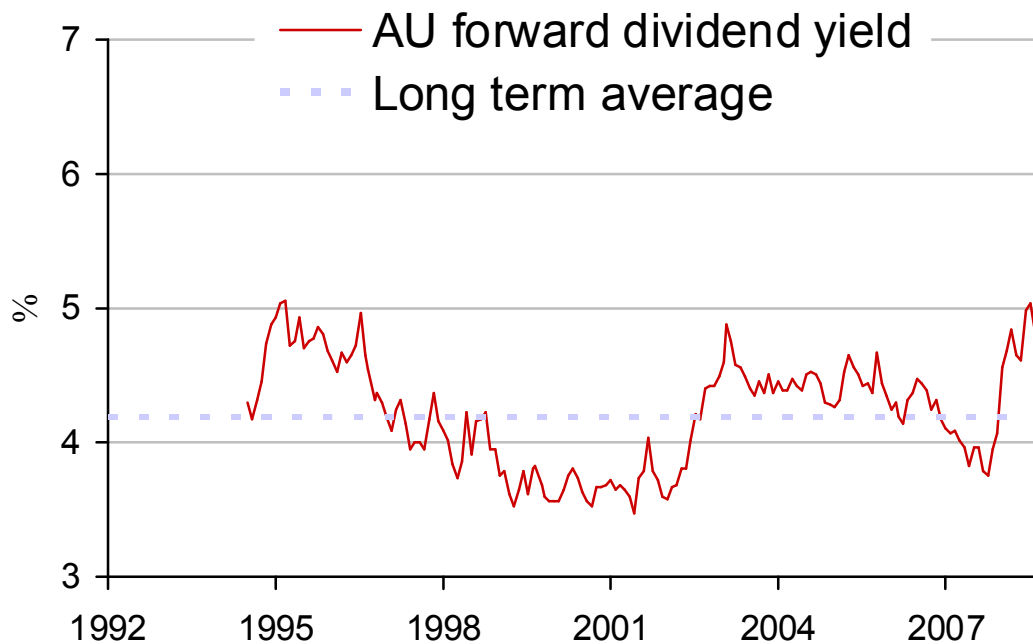
	Fund Net Return
1 year to 30th September 2008	-37.0%
1 year to 30th September 2007	42.6%
1 year to 30th September 2006	19.2%
1 year to 30th September 2005	29.7%
1 year to 30th September 2004	28.1%
1 year to 30th September 2003	24.0%
Since Inception (9 April 2002) cumulative	107.2%
Since Inception (9 April 2002) annualised	11.9%

Market Update

The Australian market is now trading on a PE multiple of approximately 8.5x forward earnings. This means that even if earnings fall by 20% over the next year, at current levels the market would still be trading at a 25% discount to its long-term average. Based on consensus forecasts, as shown in the chart below, this is the lowest PE multiple the market has traded at since 1989. The dividend yield of the market, shown overleaf, is now 6.6%, the highest forecast yield for the Australian market over the period back to the 1980s. Based on these traditional valuations compelling value is emerging in the Australian equity market. Throughout 2008 we have positioned the portfolio away from financial stocks and companies that are domestically focused in their earnings and we remain overweight resource stocks. We continue to favour coal and iron ore producers as well as energy/oil & gas companies. We have avoided stocks which are dependent on the US or European economies.



Source: UBS



Source: UBS

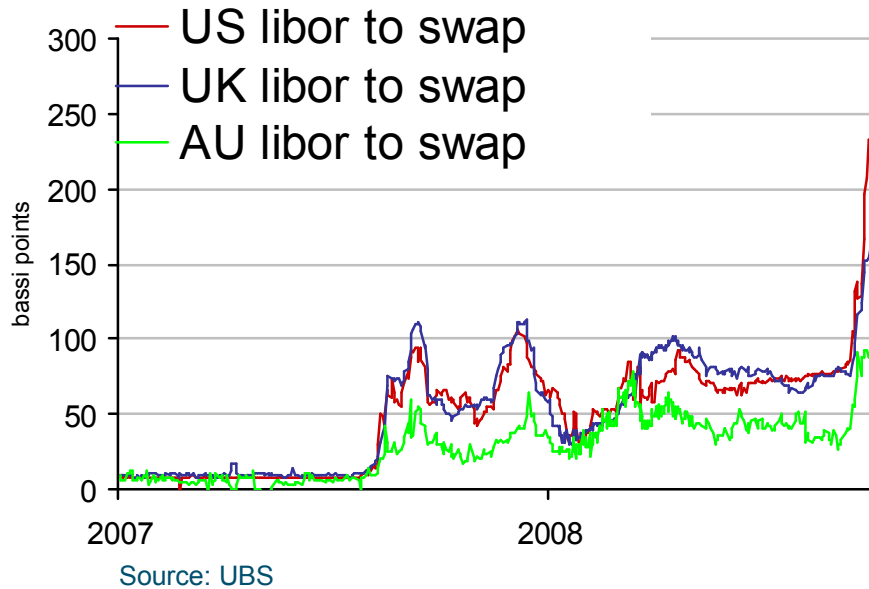
In regards to the domestic banks, our largest exposure is to Westpac Banking Corporation followed by a modest exposure to Commonwealth Bank. Westpac has come through the credit crisis so far in a very strong position with modest problem loans. Impaired assets represented 0.24% of Westpac's total book as at the end of June 2008. On 16th September, the day after Lehman Brothers filed for bankruptcy, all the big four Australian banks revealed their exposures to that entity. ANZ Bank disclosed exposure of US \$120m, CBA less than \$150m, National Bank less than \$100m, while Westpac's exposure was less than \$10m. In a subsequent meeting with FSP Westpac mentioned to us that their final exposure was less than \$2m.

The Australian banking system remains in a strong position, with Commonwealth Bank recently reporting its annual result for the year ending 30 June 2008. The result was a 5% increase in reported earnings to a record \$4.7billion. The recent weak position of HBOS has allowed Commonwealth Bank to reach agreement to buy Bank West and St Andrew's in Australia for 80% of the book value. The acquisition is "expected to be earnings per share accretive immediately".

The other three large banks (having 30th of September balance dates) will report in the next month. Despite the precarious positions of many overseas banks it is comforting to recognise that the big four Australian banks are all rated AA by the credit rating agencies. There are only 20 AA rated banks in the world.

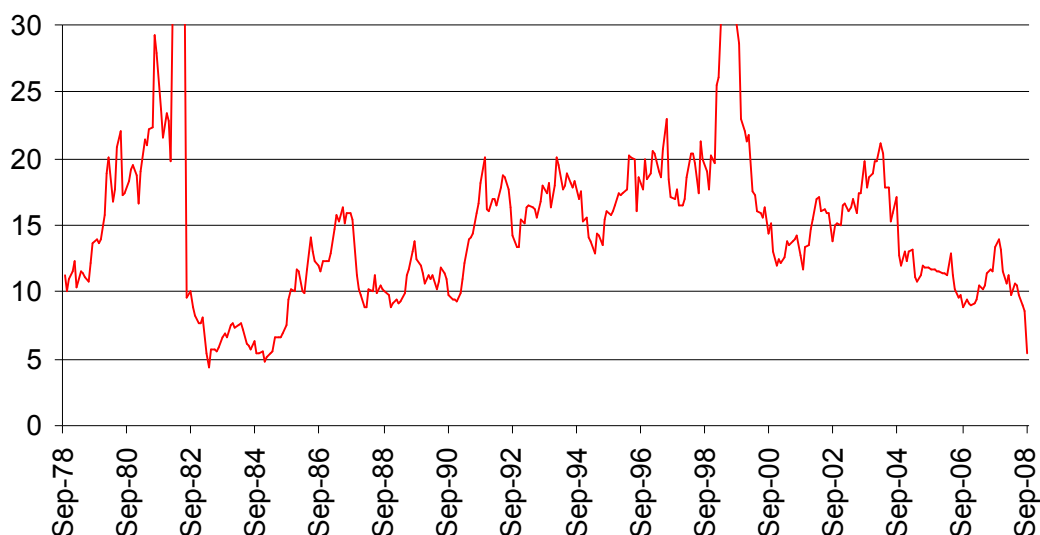


The graph below shows that inter-bank lending spreads (over the risk free rate) for Australian banks have “only” increased from 20 basis points in 2007 to the current level of about 75 basis points. This is substantially below comparable spreads for US & UK banks.



In regards to the portfolio’s largest position, BHP Billiton, the company recently released its annual result for the year ending 30 June 2008. The result was a 14% rise to a record \$US 15.4 billion profit. The company recorded EBIT margins of 48% and an EBIT return on capital of 38%. For the current year the company benefits from a 90% increase in iron ore prices and a 205% increase in hard coking coal prices effective until 31 March 2009. Analysts consequently anticipate a very strong profit result for the year ending June 2009. The consensus forecast is for a profit result of \$US 26 billion, implying a PE of under 6 times at the current share price. The company’s current gearing ratio is 18% and if the RIO takeover bid fails BHP Billiton will be virtually debt free in 12 months, allowing for a potentially very large buyback to be undertaken. The chart below shows that the PE ratio for BHP Billiton is now the lowest it has been since 1985. We would also argue that the quality of the company’s earnings, being diversified by both geography and commodity, further reiterates the attractiveness of the stock.

BHP Forward P/E



Source: Credit Suisse

Global economic outlook

As the IMF enunciated in its October 8th World Economic Outlook, “the immediate policy challenge is to stabilise financial conditions, while nursing economies through a period of slow activity and keeping inflation under control”. The financial crisis, in tandem with falling asset prices, has already engineered a significant slowing in global growth, with the IMF forecasting a recovery in late 2009. The slow down is expected to be most severe for the UK, US and EU countries, where growth for the full 2009 year is forecast at -0.1% , 0.1% and 0.2% respectively (providing scope for several quarters of negative growth).

Expansion in China slowed to 10.5% year on year in the first half of 2008, from 11.9% in 2007, and is projected to slow further to 9.3% in 2009. Thanks to capital account controls, Chinese banks have avoided investing in toxic US assets, and the build up of foreign reserves has meant that their financial system is awash with liquidity. The People’s Bank of China has recently relaxed some of the constraints it had implemented to control inflation.

Growth in Australia is forecast to slow to 2.2% in 2009, while a strong fiscal position provides scope for a discretionary stimulus if the outlook deteriorates further. While we cannot predict the market bottom, it is important to consider that the stock market generally leads the broad economy as has occurred in each of the last 6 US recessions. The IMF’s current forecasts for GDP growth rates are shown in the table below.



	2007	2008	2009
Australia	4.2	2.5	2.2
United States	2.0	1.6	0.1
Euro area	2.6	1.3	0.2
Japan	2.1	0.7	0.5
China	11.9	9.7	9.3
United Kingdom	3.0	1.0	-0.1
Newly industrialised Asia	5.6	4.0	3.2
Russia	8.1	7.0	5.5
Canada	2.7	0.7	1.2
Brazil	5.4	5.2	3.5
India	9.3	7.9	6.9
ASEAN	6.3	5.5	4.9
New Zealand	3.2	0.7	1.5

Portfolio

The guiding strategy of our portfolio management has been to try to identify high quality companies where we are comfortable with the forecast earnings and valuation parameters. By and large based on consensus numbers we would expect the portfolio to return satisfactory long term returns once equity markets stabilise.

Top 15 Holdings (as at 30 September 2008)

	ASX Code	Stock Name	Fund Weight	Forward PE	Dividend Yield	Franking
1	BHP	BHP BILLITON	17.0%	5.9	4.9%	100%
2		CASH	9.2%			
3	WBC	WESTPAC	8.5%	10.0	7.2%	100%
4	WPL	WOODSIDE PETROLEUM	5.9%	9.9	6.2%	100%
5	WES	WESFARMERS	4.0%	8.0	9.7%	100%
6	LGL	LIHIR GOLD	3.1%	15.4	0.0%	
7	NCM	NEWCREST MINING	2.7%	22.6	0.5%	100%
8	RIO	RIO TINTO	2.7%	5.9	3.2%	100%
9	STO	SANTOS	2.3%	10.8	3.7%	100%
10	FLX	FELIX RESOURCES	2.1%	4.2	12.2%	30%
11	IPL	INCITEC PIVOT	2.1%	5.2	12.2%	100%
12	ORG	ORIGIN ENERGY	1.8%	19.9	3.6%	100%
13	CBA	COMMONWEALTH BANK	1.7%	11.8	6.9%	100%
14	MTS	METCASH	1.7%	13.6	5.7%	100%
15	HVN	HARVEY NORMAN	1.7%	10.1	5.4%	100%
TOTAL			66.5%			

*PEs and dividend yields based on prices on 10 Oct. 08



Thank you for your ongoing support,
Yours sincerely,



Ronni Chalmers
Investment Director

Important information and disclaimer:

Performance is influenced by market volatility over time. Past performance is not necessarily indicative of future performance. Neither FSP Equities Management Pty Limited nor any related corporation guarantees the repayment of capital or the performance of the FSP Equities Leaders Fund.

The contents of this report have been prepared without taking into account your individual objectives, financial situation or needs. Because of that, before acting you should consider the appropriateness of what is included here, having regard to your own objectives, financial situation and needs and see your qualified financial adviser before making any investment decision.

This report may include statements (including opinions) about particular financial products or classes of financial products in which the FSP Equities Leaders Fund is or has invested – these statements are not intended to influence any person in making a decision in relation to these financial products or classes of financial products and hence do not constitute financial product advice.

[†]Performance calculations provided by White Outsourcing, a subsidiary of Moore Stephens Sydney, which is a member firm of Moore Stephens International Limited. The returns are net of all fees, pre-tax and assume DRP.

