

Wednesday, 28 January 2009

## MARKET ANNOUNCEMENT

### Investment Manager's December 2008 Report

The December 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) <sup>1</sup>

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. The Investment Manager is "style neutral" and invests in growth stocks, value stocks, stocks with maintainable dividend yields and special situations."

FSP Fund details as at 31 December 2008:

- The equity weighting was 76.2% (30 November: 71.6%);
- 97.1% of the equity portfolio is invested in companies contained within the S&P/ASX 200 Index (30 November: 96.6%) with the balance of 2.9% invested in companies outside of the S&P/ASX 200 Index (30 November: 3.4%); and
- The equity portfolio contained 43 holdings (30 November: 48 holdings).

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<sup>1</sup> Based on information provided by the Investment Manager, FSP Equities Management Limited.

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23 January 2009

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

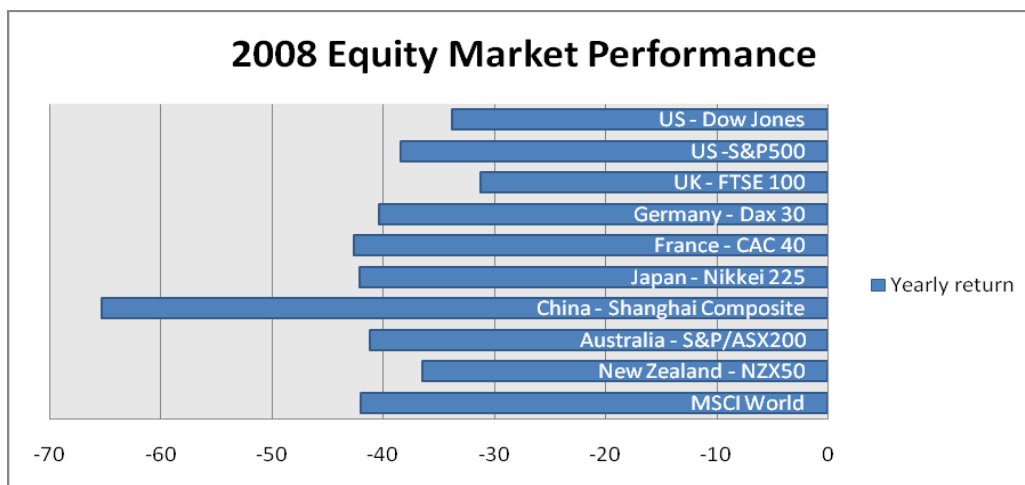
Our last letter in October 2008 was during an exceptionally tumultuous time in the financial markets. Equity markets were sold down heavily in October and the S&P/ASX 200 Index reached a low of 3218 on 21 November, 53.0% off its 1 November 2007 high of 6852, before rallying to a level of 3722 at the close of 31 December 2008. While massive government and central bank intervention has led to significant improvement in credit markets, ongoing concerns about the capital position of financial institutions has held back any sustained rally in equity markets.

Over the 12 months to 31 December 2008, the FSP Australian Equities Leaders Fund recorded a negative return of net -48.2%. Performance was impacted by an overweight position in materials and energy, while the Fund benefited from its underweight financials position and its holdings of gold and LNG exposed stocks. The Fund is defensively placed, with a 23.8% cash holding and a portfolio of high-quality equity positions.

### Performance History <sup>†</sup>

	Fund Net Return
<b>1 year to 31 December 2008</b>	<b>-48.2%</b>
<b>1 year to 31 December 2007</b>	<b>21.4%</b>
<b>1 year to 31 December 2006</b>	<b>35.5%</b>
<b>1 year to 31 December 2005</b>	<b>15.1%</b>
<b>1 year to 31 December 2004</b>	<b>31.2%</b>
<b>1 year to 31 December 2003</b>	<b>38.3%</b>
<b>Since Inception (9 April 2002) cumulative</b>	<b>66.4%</b>
<b>Since Inception (9 April 2002) annualised</b>	<b>7.9%</b>

The Australian market performed in line with global equity markets in 2008, as the MSCI World ex-Australia Index fell 41.7%. The chart below depicts the performance of major indices over the year.



Governments globally have now announced fiscal stimulus packages, invested fresh capital into financial institutions and guaranteed bank borrowing, while central banks have slashed interest rates and injected massive amounts of liquidity into their financial systems. The global response, which continues to develop, has so far amounted to commitments of more than US\$6 trillion<sup>1</sup>. Nonetheless, the global economy faces significant challenges in 2009. Action still needs to be taken to stabilise financial systems and improve the availability of credit, while housing markets around the world remain very weak. The US in particular is still facing an oversupply of houses for sale (as at 30 November 2008 there were 4.2 million unsold existing homes in the US<sup>2</sup>). Consumer and business confidence is low and tight credit markets together with falling asset values have prompted a large number of companies to come to the market for equity capital. Over \$20bn was raised by Australian listed companies in the last quarter of 2008. Economists are in broad agreement that the current economic conditions will lead to rising unemployment over the next 12 months.

On a positive note, governments and central banks have reacted promptly to bring in policies to deal with the crisis. From an Australian perspective, the Reserve Bank Governor Glenn Stevens noted in a December 2008 address<sup>3</sup> that the household sector's gross debt-servicing burden has dropped by almost three percent of household income as a result of the decline in interest rates to date. This is roughly equal to the effect of the cash rate reductions in the early 1990s, however in that case the change took place over two and a half years while this time it has been over four or five months. For the business sector, while the decline in borrowing costs has been smaller and slower to appear, a pass-through of changes in the cash rate has occurred in Australia.

Part of the reason for the falls experienced in equity markets has been an increase in the risk premium that investors apply in determining a valuation. Based on UBS's current earnings forecasts, the ASX 200 is trading on a one year forward PE of 9.6x<sup>4</sup> (or 11x for the All Industrials ex-Financials). The Deputy Reserve Bank Governor, Ric Battelino, points out that when the yield has risen to these levels in the past, equity markets have almost always recorded above average returns in the subsequent 10 years<sup>5</sup>. The chart overleaf highlights that the distribution of annual Australian share market returns has centred around the 0 – 10% and 10 – 20% brackets, while 2008 represents the extreme outlier.

<sup>1</sup> ABN Amro research

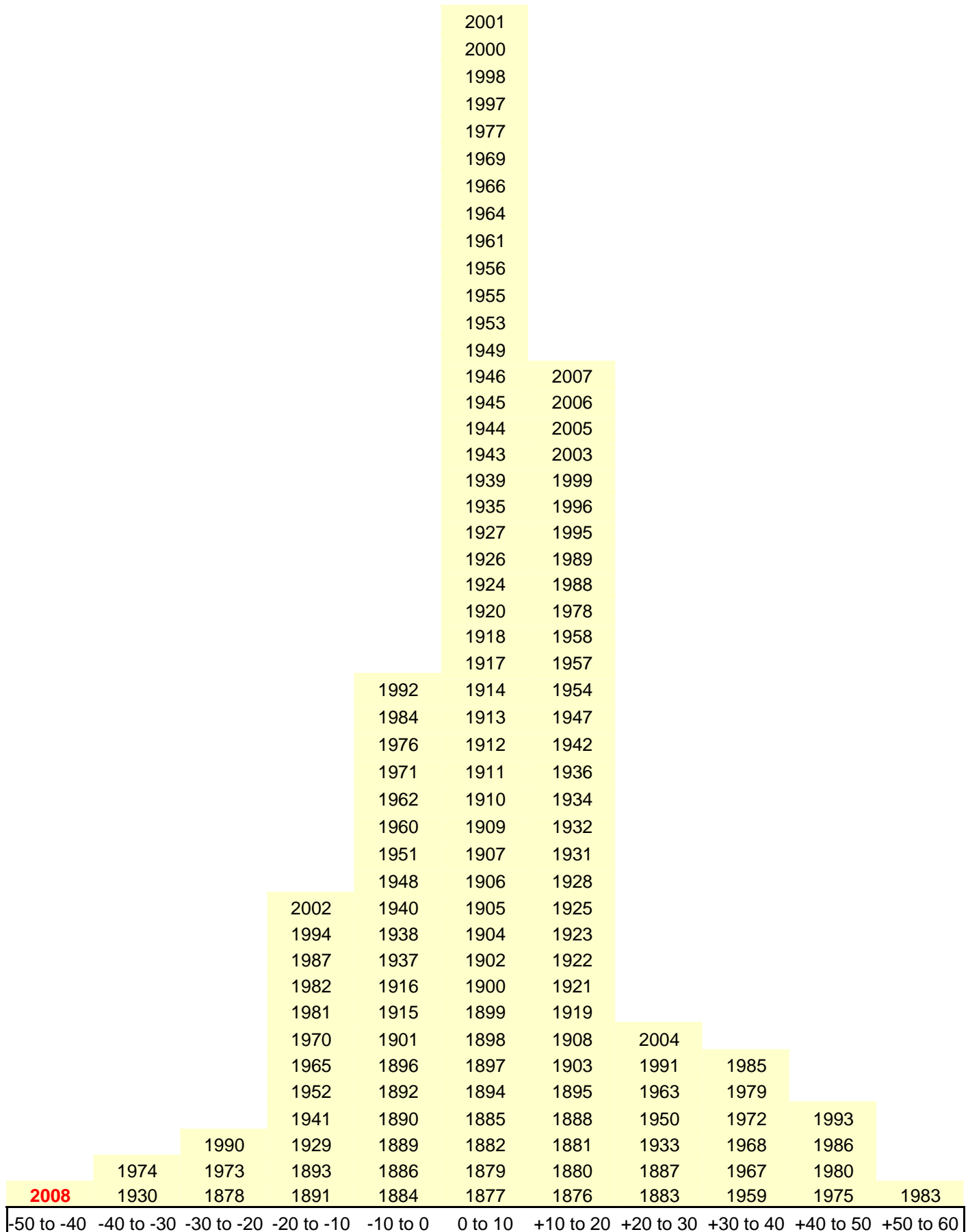
<sup>2</sup> National Association of Realtors

<sup>3</sup> [http://www.rba.gov.au/Speeches/2008/sp\\_gov\\_091208.html](http://www.rba.gov.au/Speeches/2008/sp_gov_091208.html)

<sup>4</sup> As at Monday 12 January

<sup>5</sup> 30 October 2008 address, [http://www.rba.gov.au/Speeches/2008/sp\\_dg\\_301008.html](http://www.rba.gov.au/Speeches/2008/sp_dg_301008.html)

## Australian Share Market Calendar Year Returns



Source: Mercer Consulting



## Global Indicators

Below are some important indicators for the global economy. The first table shows the most recent IMF forecasts for GDP growth in 2008 and 2009. The IMF cut its forecast for 2009 global growth by 0.75% in November and said that it is likely to make further downward revisions in its January report. The second chart shows the spread of the three month US\$ LIBOR contract over the expected cost of overnight funds, a preferred measure of credit market strains. This spread has improved significantly from the high of 3.6% reached in October 2008, while it is still around 10 times the level leading up to the credit crisis.

	2008 %	2009 %	2009 % change from October
World	3.7	2.2	-0.8
United States	1.4	-0.7	-0.8
Euro area	1.2	-0.5	-0.7
Japan	0.5	-0.2	-0.7
China	9.7	8.5	-0.8
United Kingdom	0.8	-1.3	-1.2
Newly industrialised Asia	3.9	2.1	-1.1
Russia	6.8	3.5	-2.0
Canada	0.6	0.3	-0.9
Brazil	5.2	3.0	-0.5
India	7.8	6.3	-0.6
ASEAN	5.4	4.2	-0.7
Australia	2.0	0.8	-1.4%*
New Zealand	0.3	1.1	-0.4%*

\*Australia and New Zealand based on forecasts published in *The Economist*, 9 January 2009

**LIBOR-OIS spread. A measure of credit market strains**



Source: UBS



## Stock Performances

Few companies' share prices withstood the turmoil in equity markets in 2008, however some of the Fund's long term holdings did produce notable performances. Metcash, which holds a strong market position in the independent grocery distribution sector, was able to increase both sales and margins in 2008 and finished the year up 5.8%. Ansell, which derives 40% of its income from defensive healthcare related sectors and maintained strong sales momentum in 2008, gained 6.0% for the year. This stock was sold in December after reaching our price target. Newcrest Mining, the Fund's sixth largest holding, secured a modest but positive return of 2.7% as it substantially reduced its gearing and benefited from the strong gold price. Coca-cola Amatil gained 1% in 2008 as the company was able to maintain its guidance of high single digit earnings growth through the year and received a takeover proposal from Lion Nathan in November.

## Portfolio

The guiding strategy of our portfolio management has been to identify high quality companies solid forecast earnings and undemanding valuation parameters. Based on consensus numbers we would expect the portfolio to return satisfactory long terms returns when equity markets stabilise. The Fund increased its cash weighting through 2008 as market volatility increased and downside risk to earnings forecasts became evident. We expect the upcoming reporting season to lead to further earnings downgrades, but will look to invest where value and earnings certainty are present.

### Top 15 Holdings (as at 31 December 2008)

	ASX Code	Stock Name	Fund Weight	Forward PE	Forecast Dividend Yield	Franking
1		CASH	23.8%			
2	BHP	BHP BILLITON	13.1%	10.5	3.7	100%
3	WBC	WESTPAC	8.4%	9.8	8.4	100%
4	WOW	WOOLWORTHS	5.8%	16.9	4.2	100%
5	WPL	WOODSIDE PETROLEUM	5.7%	19.0	3.3	100%
6	NCM	NEWCREST MINING	4.5%	24.2	0.4	100%
7	LGL	LIHIR GOLD	4.4%	19.4	0.0	
8	ORG	ORIGIN ENERGY	3.7%	19.1	3.7	100%
9	QBE	QBE INSURANCE	3.3%	11.4	5.3	20%
10	MTS	METCASH	2.5%	13.0	5.8	100%
11	STO	SANTOS LTD	2.4%	20.7	3.0	100%
12	CCL	COCA-COLA AMATIL	2.3%	16.4	4.6	100%
13	BEN	BENDIGO BANK	1.8%	10.4	6.7	100%
14	CBA	COMMONWEALTH BANK	1.6%	9.2	10.4	100%
15	SGX	SINO GOLD	1.4%	16.8	0.0	
<b>TOTAL</b>			<b>84.5%</b>			

All the best for 2009,

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.

<sup>†</sup>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.

