March 2010

Monthly Investment Report

Antares Lodestar Absolute Return Trust Australian Shares

Market Review

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- Global equity markets were strong in March, shrugging off rising bond yields and macro concerns, ranging from Greek debt to Chinese monetary tightening.
- The ASX200 index (+5.8%) had its best month since September and came within a whisker of the 12-month high struck in January. Helped by a rally in the AUD, the Aussie market was one of the world's strongest in common currency terms.
- The market lifted the barbell during March with both of the two major sectors outperforming: Banks gained 6.8%, while the Resources index rose 8.4% with the help of strong iron ore pricing and a recovery in the Energy sector (+8.9%). A weak bond market hit yield-sensitive sectors, notably Utilities (+1.6%) and REITs (-0.2%).
- BHP announced that it had reached agreement with a number of Asian customers to move iron ore contracts from an annual benchmark price (a decades old system) to a quarterly reference price based on spot. National Australia Bank and AXA SA formalised terms for NAB's takeover of AXA Asia-Pacific. Arrow Energy's board recommended acceptance of a takeover offer for its Australian operations from Royal Dutch Shell and PetroChina.
- The Reserve Bank raised the cash rate target by 25 basis points to 4.25% at its March meeting, marking the fourth hike in the current tightening cycle. Australian economic data was, on balance, softer than expected with employment, retail sales and housing finance coming in short of forecasts. US data continued to be distorted by weather effects, with housing indicators particularly weak, though the decline in February payrolls was smaller than expected.
- Bond markets came under pressure in March from concerns about high supply. The Australian dollar gained on most crosses as expectations for both bulk commodity prices and interest rates firmed. The US dollar gained ground for the fourth successive month on a trade-weighted basis and concerns over Greek debt continued to overshadow the euro. The yen was also weak.
- The Australian dollar gained against the USD in March (+2.4%), as markets priced a stronger trajectory for short term rates and bulk commodity prices. However on most major crosses, the US dollar was up and the Euro (-0.9% against the USD) continued to struggle with concerns over the fiscal problems of some of its members. A joint Eurozone-IMF deal to offer support to Greece provided some clarity.
- Oil was stronger in March (+5.1%), breaking through $82/bbl mid-month, taking cues from signs of economic recovery in the US, strong Asian growth and higher demand forecasts from OPEC and the US Energy Information Administration. Gold fell 0.3% with USD strength and an interest rate hike in India weighing on the price.
- Spot iron ore prices were strong in March (Tianjin 62% fines +16.5%), posting their seventh consecutive monthly gain. The annual benchmark pricing system appeared to be coming to an end as BHP and Vale agreed with a number of customers to shift contracts to a quarterly pricing system using spot as a reference. Based on spot prices in the March quarter, this implies an increase of more than 100% on the previous benchmark price. Base metals built on February's recovery, aluminium (+11.6%) being particularly strong.

Portfolio Activity

- The net market exposure was lifted from 45% to 62% in the month of March. This was driven by higher commodity prices, in particular iron ore and coal. The domestic reporting season went well and reflected a buoyant economy.
- Due to the improved outlook for commodity prices, the global cyclical exposure was increased from 15% to 27%.
- Some of the increased exposure came through the change in derivative positions. As the market rallied, the leverage through the options positions increased.

Fund Performance

Period ending 31.03.10	1m %	3m %	1yr %	2yr % p.a.	Since Inception % p.a.
Total Return	2.17	-0.48	25.18	0.61	1.39
Benchmark *	0.36	1.06	3.53	5.17	5.79
ASX200 Accum. ^	5.75	1.36	41.71	-0.06	-1.26

Performance returns are calculated net of management and performance fees and are pre tax. Past performance is not a reliable indicator of future performance, the value of your investment can go up and down. * 90 day Bank Bill rate resets quarterly (Benchmark) and is used for the purposes of calculating the performance fee. ^S&P/ASX 200 Australian Shares Accumulation Index is provided for comparison purposes due to the Australian Share investment focus of this Fund. It is not the Fund's benchmark. Inception date 1 March 2007.

- The Fund produced a return of 2.2% in March. The Fund maintained a defensive stance, given that the current view is one of caution. A protective stance was taken via derivatives and as a result the Fund did not match the share market over the month as it has done over the last nine months.

Positive Influences

Company	March Return %	Fund Position %
Westpac	6.3	6.7
ANZ	9.2	3.7
NAB	7.8	4.3

- **Westpac Banking Corporation (WBC):** A trading update indicated that 1Q10 cash profits are up 33% to $1.6bn, largely driven by lower provisioning charges. WBC also noted improved conditions, revenue momentum and flat margins. Westpac's Tier One capital position remains strong at 8.5%. The other major banks all posted good returns for the month on the same theme of indications of robust profit growth with the lowering of provisions off the back of a better than expected economy and better trading conditions.

- **National Australia Bank (NAB) :** NAB's 1Q10 update highlighted cash profit growth of 18% to $1.1bn. NAB flagged flat revenue growth and numerous headwinds remain (eg. further fee cuts, competition and funding cuts). Bad and doubtful debts improved with management noting 3Q09 appeared to be the peak of the bad debt cycle. NAB's Tier One capital position remains strong at 9.3%.

Negative Influences

Company	March Return %	Fund Position %
Sigma Pharmaceutical	-66.0	0.4
ASX	-4.6	0.8
Downer EDI	-2.7	0.8

- **Sigma Pharmaceuticals (SIP):** Sigma reported a surprise full year net loss of $389m due to $424m of writedowns. This compared to an $80.1m net profit in the previous year. Sigma said that breaches of banking facility covenants have been waived and its debt facilities have been renegotiated with reset covenants. Sigma's troubles have stemmed from competitive pressures in the generic drugs market.
- **ASX Limited (ASX):** Financial Services Minister Chris Bowen announced in-principal support for Chi-X to launch a rival exchange market. This follows Senate approval of laws that will strip ASX of its regulatory function. The Australian Securities and Investments Commission will take over real time supervision of the country's financial markets from the third quarter of this year.
- **Downer EDI (DOW):** Moody's noted that Downer EDI's subsidiary, Reliance Rail Finance, could be exposed to a funding gap of $357m from early 2012, or higher funding costs, or both, if the consortium's guarantors were to go bankrupt. Downer commented that any possible equity contribution to Reliance Rail "would not be material to Downer" and "absolutely would not involve an equity raising".

Outlook

- The risk profile of global growth forecasts have risen since December. Generally, economic statistics are mixed but continue to point to recovery. However developments in China and especially Europe give the progress of this recovery a fragility that exacerbates the already unsteady configuration of the government stimulated US economy.
- Growth from the already strong economies of China and India remains excellent, albeit the momentum of recovery is maturing. Australia, the beacon of economic stability within the OECD, just produced annual GDP growth of 2.7%. This growth rate was assisted by Government stimulus (both fiscal and monetary). This stimulus tailwind will remain in place in the form of fiscal policy, however the Australian Central Bank has now removed its emergency settings and is progressing towards actually slowing the economy down through higher official interest rates. Nearly all economic data is robust and consumer and business sentiment remains at very buoyant levels.
- The European economy continues to lag other regions with the level of government stimulus below other economic zones. This may change with the potential bail out of Greece. At the time of writing, there is a growing expectation an EU package will be forthcoming with obligations attached to the Greek Government to reign in debt levels. It remains to be seen if this dilemma spreads to other regions in Eurozone. ECB monetary policy has maintained its historic conservatism relative to other regions.
- The US economy is staging a recovery, though at a muted pace versus the recovery seen from other severe post war economic contractions. Activity reports (ISM Manufacturing and Services), GDP and corporate profits are all improving. Housing (activity and pricing), consumer borrowing and unemployment remain at historically extremely poor levels.
- The current valuations of equity markets such as USA, UK and Australia are all approximately at fair value. This holds for the absolute forward Price Earnings multiples or relative to ten year bonds. However the quantum of earnings growth expected is large. For example the earnings per share growth required to meet this "fair value" statistic in the US market is 30%, 33% for UK and 27% for the Australian market.
- Australia's reporting season has just concluded with the vast majority (85%) of companies reporting "in line" with market consensus. The number of companies that exceeded expectations or disappointed was evenly weighted. This hides the fact that there were upgrades prior to reporting season which actually makes this statistic more robust. In this context it is an encouraging sign to see that the sharemarket received upgrades to consensus earnings for financial years 2010, 2011 and 2012. This is particularly important given the high hurdle the market has set for current valuations to be justified.
- At this stage the market expects earnings growth of 27% for FY2011. The sectors expected to produce the highest growth are Energy, Metals and Mining, and Financials. The sectors that are expected to produce the most modest growth (not one sector is expected to produce negative growth at this stage) are Telecommunications, REITS and Insurance, in that order. The key to this year will be having exposure to those stocks delivering the best relative growth on a risk adjusted basis so as not to compromise the valuation settings.
- The fragile nature of the global recovery and the high earnings hurdle are likely to create an environment where if doubts of the projection of the economic recovery come into play (and thus the level of earnings), then equity markets will correct as they did in January and early February. If the recovery continues as anticipated, equities will be supported. Therefore the action of equity markets will be likely to be saw-tothed as the cycle unfolds. The likelihood of the flow of both positive and negative news is very high given the current economic

and political settings. This has been highlighted recently with the significant swings in currencies such as the Euro and Sterling, which have become volatile on the back of unsystematic risks (potential Greek default and hung Parliament respectively). Not only active stock picking but active allocation and protection of capital will be a feature of this year.

- This view of markets is largely unchanged from prior months yet the market is almost 6% higher than last month and back to where the market was prior to the announcement from the Chinese authorities on credit supply and the Greek turmoil. The market has responded to a robust reporting season, strong guidance from the banks and higher bulk commodity prices. The economy has received higher official interest rates from the Reserve Bank of Australia. Credit growth remains muted versus historic growth rates and OECD growth rates have fallen in the March quarter (+1.9%) versus the December quarter 2009 (+3.7%) with a “number of factors expected to bear down on activity in the very near term”. (OECD chief economist Pier Carlo Paodan). China and India have kept producing very solid growth figures. As a result we remain cautious and have a strong bias to companies leveraged to the strong economies such as Australia, China and India and very little exposure to the rest of the OECD.

Important Notice