

Monthly Investment Report

Antares Lodestar Absolute Return Trust Australian Shares

Market Review

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- The ASX 200 Accumulation Index (XJOAI) declined by 2.08% in October which was the first negative return for the index since February 2009. The Australian market performed in line with the US S&P 500 (-2%), outperformed the DJ Euro Stoxx which declined by 4.5% but underperformed the Nikkei 225 (-1%).
- Volatility increased in the latter part of October as concerns about the durability of the US recovery took hold. US stocks declined despite the earnings reporting season delivering better than expected results, as mixed economic signals eroded confidence.
- US consumer sentiment indicators remain benign – consumer sentiment, unemployment and personal income growth all remained weak during October. US new home sales for September fell much further than expected and government rhetoric regarding increased regulation of capital requirements of financial institutions weighed further on sentiment. Investors focused on the slow consumer recovery rather than the strength of the economy overall, as October US GDP (3.5% annualised Q309 growth) exceeded expectations. This was the first quarter of growth seen in the US for over a year. US manufacturing PMI data rose 18% to 54.2 while Case-Schiller housing data indicated that the pace of declines had peaked.
- The highlights of the Australian equity market performance in October were the defensives, i.e. consumer staples (+1.4%), utilities (+0.6%) and telcos (+0.4%) were the best performers. October is traditionally a poor month for equity market returns but after 8 successive months of recovery, the defensives led and the cyclicals lagged during this historically weak period. Despite its defensive nature, the healthcare sector was down 3.8%, as the strong AUD impacted healthcare stock performances after analysts adjusted their earnings forecasts to accommodate the strong AUD.
- Australian banks (-1.4%) held up a little better than average as the September reporting season kicked off. Resources declined by 1.2% and Energy was down 5.3%, taking little comfort from the oil price (WTI) rallying to \$81. The REITs (-9%) underperformed due to profit taking and also in response to a tightening bias by the Reserve Bank (RBA) who raised cash rates by 25bp in October.
- Bond yields edged higher in October with the Australian 10 yr benchmark gaining 18bp while its US counterpart edged higher by 8bp. The earlier than expected increase in cash rates by the RBA contributed to bond market weakness however bonds retraced later in the month as equities weakened.
- Despite the interest rate tightening, consumer sentiment recorded its fifth consecutive monthly improvement in October, and the unemployment rate fell to 5.7% as full time employment rose. The Australian dollar rallied strongly to 93 US cents on declining risk aversion, rising commodity prices and rising interest rate differentials, before easing towards the end of October to 89.7 US cents.
- Commodities delivered the best returns in October compared to other major asset classes. Gold took out the March 2008 high and rallied to US \$1067 an ounce as investors favoured gold over a weakening USD. Spot iron ore prices stayed firm throughout October as Chinese import data for September indicated record levels in line with rapidly recovering steel production.
- Base metals also had a good month (CRB Index+5.3%) in anticipation of an economic recovery and reflective of the weaker USD. Zinc was the standout performer, up 9.8%.
- China reported real GDP growth of 8.9% yoy for Q3 which exceeded expectations. Fixed investment was the main driver and reflected the strong stimulus policies. Although two PMI series diverged they both still remained above the expansionary threshold of 50.

Portfolio Activity

- During October the Fund continued to decrease its net exposure. The portfolio had a net exposure of 60% as at the end of the month. The gross exposure is higher due to the Fund selling call options and buying put options against selected core long positions and maintaining some short positions.
- There was no material change to the Fund's sectoral exposure. The preference for industrials over resources was retained, specifically via significant exposure to the major banks and consumer discretionary stocks. Large positions in the financials were largely retained, however, in light of selected significant share price appreciations and as most of the major banks go ex dividend in early November, it was deemed prudent to buy put options (which provides the right but not the obligation to sell at a pre-determined price in the future) over the majority of these financials. As a consequence, the Fund reduced its net exposure.

Fund Performance

Period ending 31.10.09	1m %	3m %	1yr %	2yr % p.a.	Since Inception % p.a.
Total Return	-0.78	12.08	15.49	-2.21	0.68
Benchmark *	0.28	0.82	4.05	5.87	6.08
ASX200 Accum. ^	-2.08	10.86	21.39	-13.10	-3.93

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 returned -0.78% (post fees) in October vs. the ASX 200 Accumulation Index (XJOAI) return of -2.08%, hence it was pleasing to significantly outperform the market. However, this is tempered somewhat as the Fund lost money over the month. The fund's performance was mainly attributed to defensive stock holdings, e.g. Coca Cola Amatil (CCL) and domestic cyclicals, such as Village Roadshow (VRLPA) and Downer EDI (DOW).

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Positive Influences

Company	October Return %	Fund Position %
Village Roadshow Prefs	18.8	1.4
Coca Cola Amatil	8.1	1.8
Downer EDI	5.2	2.8

- Village Roadshow (+18.8%) announced its intention to buy back up to 10% of ordinary shares and 46% of the preference shares on issue. This suggests that Village management and Board share Lodestar's view that their shares were mispriced by the market and is an encouraging outcome for the Fund.
- Coca Cola Amatil (+8.1%) performed strongly as it is a beneficiary of the strong AUD. Also, at a recent investor conference management noted that operational momentum continues to be strong.
- Downer EDI (+5.2%) held its AGM in October. The company's commentary was generally upbeat and management reiterated its expectations of 5% profit growth for 2010. Some companies in the capital goods space were sold down over the month as foreign earnings were being diluted by the stronger AUD, but as Downer has very little foreign earnings exposure it benefited from investors switching to stocks with a domestic earnings bias.

Negative Influences

Company	October Return %	Fund Position %
Fleetwood	-14.5	1.7
ANZ Bank	-5.6	3.7
Graincorp	-9.3	2.6

- ANZ (-5.6%) was lower despite reporting a strong 2009 result in which it exceeded cash profit consensus estimates at \$3.38bn and also reported better than expected margins. The post result share price depreciation indicates that the banks in general had reached valuations where even good news was not enough to sustain the rally in the short term.
- Graincorp (GNC) (-9.3%) bought United Malt Holdings, the world's 4th largest commercial malt producer for USD666m which was funded with both equity and debt. GNC shares fell mainly as a result of the dilutive effect of the large (9:10) capital raising at \$5.65, a considerable discount to the prevailing share price. The acquisition essentially doubles the market capitalisation of GNC.

Outlook

- After a sharp rally of almost 32% between mid July and late October the market was beginning to run ahead of the macroeconomic conditions as articulated by company

managements (at numerous Annual General Meetings) and official global economic data.

- The major themes currently dominating the market are: the strength of the AUD, some fairly full stock/sector valuations, the Reserve Bank's interest rate tightening cycle and most importantly, the pace and durability of the economic recovery.
- The AUD has rallied nearly 15% since the end of the financial year. As many companies have foreign earnings they are at risk of underperforming the broader market if their respective earnings growth rates do not match the pace of the currency's devaluation of the foreign earnings stream. Meanwhile, the Australian economy continues to surprise with its resilience and upgraded growth profile. It is for this reason that the Fund's exposure has been tilted towards companies with predominantly domestic earnings. Lodestar perceives that a superior risk-return proposition at this stage of the recovery involves favouring stocks with clean leverage to the Australian economy over those deriving foreign earnings from weaker economies.
- The Reserve Bank (RBA) recently upgraded its CY10 GDP forecast from 2.25% to 3.25%. But interestingly, the RBA left its 2011 forecast at 3.25%. This suggests a mild recovery cycle is predicted by the organisation that controls monetary policy.
- It is also interesting to note that the combined market capitalisation of the major banks in October was equal to that achieved at the peak of the bull market in 2007. It should be pointed out that the credit growth is now considerably less than it was in the middle of 2007 (combined business and consumer borrowing rates). The strong implication is that the banks have rallied strongly after the bad debt cycle has proven to be much more benign than initially anticipated and now credit growth needs to resume a "normal" re-acceleration from both consumers and business customers alike. Apart from first home buyers this has yet to occur. The ASX 200 Accumulation Index is now trading on about 16.5x FY10 earnings. This is somewhere between fair value and expensive depending on FY11 earnings assumptions. The market is no longer cheap which means it is vulnerable to sell offs whenever the sustainability of local and/or global economic recovery is threatened.
- The RBA has increased official interest rates twice in two months to 3.5%. It is still in the "emergency" setting range below 4.00%. It is hard to see the economic recovery being derailed by moderate rate rises to remove the "emergency" settings. The issue of monetary policy tightenings may be more relevant this time next year when the impact of recent rates rises is likely to be known. However, the current tightening bias is a very strong indicator of the health of the Australian economy, a scenario that most G20 nations would be envious of.
- The dominant feature of the reporting season was cost cutting and sets up a powerful configuration for earnings leverage when a more synchronised recovery occurs. The sharemarket appreciation to date now needs ongoing good news in order to continue its rally. This may be provided by improvements in the revenue line of many companies as the economic recovery matures. Annual General Meeting season is underway and is proving to be the forum by which investors are sourcing updated

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information flow. This AGM period has been optimistic as corporate conditions have stabilised.

- The market has reached a point where stock selection is now more important than ever. The companies that will continue to rally are those that can execute well and deliver at or near expectations. Those companies that have economic tailwinds such as a stronger currency or

are exposed to a segment of the economy that is performing well, or experiencing above general economic growth rates are likely to be well supported but those companies that are fully valued but vulnerable to industry specific or macroeconomic glitches are likely to suffer share price falls.

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