

Monthly Investment Report

Antares Lodestar Absolute Return Trust Australian Shares

Market Review

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- The Australian sharemarket fell 12.75% over October. This was the worst month since the bear market commenced last November. The sharemarket is now down 37.8% over the last twelve months.
- The poor performance, like September, was lead by dysfunctional global money markets which literally seized up during the first half of October. This lead to increasingly dramatic support from governments to ensure the liquidity of global banking systems. This resulted in very significant volatility in global currency, commodity and equity markets. To put this into perspective, the U.S. S&P500 had nine days with moves greater than 4%. There were no days with such a move from 2003 to 2007, three throughout the 1950's and two in the 1960's.
- It was the worst month for the U.S market since the 1987 crash falling 16.8% and Japan's Nikkei 225 Index hit 26 year lows. Iceland's exchange crashed 81% for the month.
- The month saw the continuation of the divergence in performance between Resources (down 18% for the month and more than 36% since the end of August) and Industrials (down 5% for the month and 15% since the end of August). Small companies have experienced their worst two months since the Index was created in 1992. The Small Ordinaries fell 24.9% in October after falling 15.7% in September.
- The Banks reporting season brought no big surprises as most results were well flagged by management with Nab actually releasing their report a week early - as a result banks were down just 4%. AGM season is now also under way with a number of profit warnings occurring to date with CSR, Boral and Aristocrat being the more prominent examples.
- Global central banks, in concert with their respective governments, have aggressively stimulated economies in an effort to now avoid deflation and deep recessions. Fears of the inflationary impact of such initiatives have taken a back seat. The Australian Reserve Bank was no exception, easing official interest rates from 7% to 6%. The size of this move surprised the market which was only expecting 50 basis points. The U.S Fed Reserve cut twice over the month, by 50 basis points each time.
- Australian ten year Bonds continued to firm as the expectations of a slower economy grew with yields falling 24 basis points to 5.15%. The AUD lost 15.8% against the USD to close at USD0.667, at one stage falling to USD0.60 – its lowest level since April 2003.
- Commodity prices continued to support concern of global economic weakness with the CRB Metals Index down 22.2%, now down 45% from its May highs. Copper was down 31.1%, Aluminium 12.1%, Zinc 28.1% and Nickel fell 20.6%. The oil price fell 32.4% to \$68.10 and Gold fell 15.7% to \$739.

Portfolio Activity

- With the sharemarket falling over 20% since the end of August, valuations improved dramatically despite the economic environment deteriorating. In this environment the Fund gradually increased its net exposure to the market as some selling was determined to be driven by fear and not fundamentals.
- As a result the net exposure was increased from 39% to 74% over the month of October. This was achieved by a combination of increasing long positions (56% to 69%) and reducing shorts (from minus 17% to minus 3%). The balance of the increase came from buying call options on mainly the Index and some specific large cap stocks. The reason for purchasing call options on the Index was to give the Fund additional exposure to the market in the event of a rally without risking additional capital. Also, the volatility on the Index (which is made up largely of Banks and Resources stocks) was cheaper than individual stocks. Also valuations on both these sectors have become undemanding and if the market was to rally both these sectors could conceivably rally.

Fund Performance

Period ending 31.10.08	1m %	3m %	6m %	1yr %	Since Inception % p.a.
Total Return	-13.18	-16.16	-17.46	-17.20	-7.25
Benchmark *	0.59	1.90	3.92	3.92	7.30

Performance returns are calculated net of management fees and 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 (Benchmark) is used for the purposes of calculating the performance fee. Inception date 1 March 2007.

- The Fund declined 13.18% over October. While disappointing we view the last two months, in particular the month of October, as a possible capitulation period in the market. It has the classic hallmarks with large falls and volatility spiking the new highs.
- The CBOE VIX Index (the global measure of share volatility) went to a new all time high at 89.5 during October and has since fallen to 56 (still high historically). The three month LIBOR (the London Inter-Bank Lending Rate) rose to a high of 4.6% in October (it was 5.1% in December 2007) and is currently at 2.3% - the lowest since November 2004. Both these indicate the fear factor in the market is gradually abating.

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Positive Influences

Company	Oct Return %	Fund Position %
GPT Group	24.0	0.8
QGC Queensland Gas	42.0	0.6
Commonwealth Bank	6.1	2.8

- GPT raised \$1.6 billion through a 1 for 1 entitlement issued at a 45% discount to their trading price (i.e. at 60 cents per share) - its lowest price in decades. The Fund participated in this capital raising.
- QGC Queensland Gas was taken over by British Gas during the month resulting in a positive return.
- CBA announced the acquisition of Bankwest from HBOS Group. The total cost of the deal was \$2.1 billion, which is 0.8 times book value. Management expects the deal to be positive immediately. The deal will make the combined CBA/Bankwest the number one player in retail and SME markets across most products in Australian banking. The bank raised capital at \$38.00 a share and the Fund participated. The historic yield at that price is 7.0%.

Negative Influences

Company	Oct Return %	Fund Position %
Imdex limited	-60.0	1.8
Clough Limited	-41.0	2.4
Bradken Limited	-43.0	2.2

- Imdex fell 60% over the month. At its AGM the company stated that the first quarter was in line with expectations and that they expected to meet full year guidance of earnings. The company said that the financial and equity market turmoil should have limited impact on them, as the group was not highly geared and had limited exposure to junior explorers, who are more likely to be affected in the current environment. There were some earnings downgrades by brokers and on current expectations the FY09 Price Earnings ratio is 3 times.
- Clough fell 41% when the company announced that its subsidiary Petrosea had suspended work on contracts to develop and ultimately operate the Pakar coal mine in Indonesia. Work was suspended due to the client requiring additional funding to complete the contract as a consequence of scope changes. In the current environment, this funding has been delayed. When forecasted earnings assume this contract does not continue, the FY 09 Price Earnings ratio is at 7.2 times. The company is debt free and at 1.2 times Net Tangible Assets.
- Bradken fell 43% during the month and revealed at its AGM that first quarter trading was in line with expectations, with customer orders remaining high. Management has yet to determine how the financial crisis will affect its customers such as Rio Tinto, however the stock's FY09 PE multiple was 6.9 times at month end and their dividend yield is above 9%.

Outlook

- We are of the opinion that the de-leveraging process and historically large mutual funds redemptions, have caused selling in global equities beyond what could be considered normal, fundamental levels. It remains to be seen if economic and corporate conditions will back the move placed on valuations. What is clear is that an extremely bad scenario has been already factored into current share valuations and this scenario has yet to become reality. What is most likely to occur, in what is an incredibly volatile market, is that earnings downgrades will persist in the coming months. This could result in price earnings multiple expansion. There is a high likelihood that individual companies could keep falling dramatically in cases where earnings declines are significant.
- This occurs as investors gather economic and corporate earnings data and gradually determine the gradient and likely duration of the economic downturn. To date, significant dislocation has occurred in financial equities and those companies that have arrived into this cycle with too much debt almost regardless of the industry they are participating in (i.e. Babcock and Brown, GPT Group) have been heavily penalised by the market. Profit warnings are beginning to spread to other sectors.
- The U.S economy has avoided a technical recession remarkably well to date. After ten consecutive months of increased job losses and the loss of a low currency, the US appears to be now entering this phase with Japan, the UK and Europe following in kind. The world thus seems to be on the verge of recession.
- Chinese growth is also slowing very sharply with exports and its property markets under pressure. Its very encouraging to see that the State Council of China announce a two year stimulus package of \$US586 billion. This equates to about 15% of its GDP and is much larger than any stimulus program currently in place in either Europe or the U.S in terms of GDP. It is unclear at this stage whether these programs for housing, rural infrastructure, water, electricity, transportation, the environment, technical innovation and rebuilding from several disasters are all new funds or represents some previously announced initiatives. Regardless it is good news for the Chinese economy which has slipped quickly post the Beijing Olympics.
- In Australia, the RBA has recently downgraded its GDP assumptions for the next two years and its new estimates do not include a recession. This is after factoring in 200 basis points in rate cuts, a large fiscal package and a very accommodative shift in the exchange rate. Thus the RBA is likely to keep lowering interest rates which should help the sharemarket.
- There have been some encouraging signs that the peak of the credit gridlock may be passing with the LIBOR (London Inter-Bank Offered Rate) falling to a four year low. Also, activity in the U.S. commercial paper market seems to have been kick started by the actions of the Federal Reserve recently. However, what has transpired in Australia recently is that the level of equity raisings is increasing. This could be a sign that corporates are unable to borrow effectively and are now coming to the equity market even while their respective share prices are low. This may belie the positive ratios from the money market.

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- Lodestar's investment process suggests that although markets still have risks, on balance, valuations have become cheap and with the world's governments now underwriting the banking system and central banks stimulating economies with lower interest rates, now is the time to be selectively increasing the Fund's equity exposure. We are doing this as cautiously as possible. We are favouring large cap stocks, as they have become almost as cheap as small caps and also via options in order to limit the capital at risk given the tough environment that is currently prevailing.

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