

Monthly Investment Report

Antares Lodestar Absolute Return Trust Australian Shares

Market Review

John Morgan, Chief Investment Officer
Lodestar Capital Partners

- The Australian sharemarket recommenced its downward trend after global events overwhelmed the recent rally seen over the FY08 reporting season in August. The S&P200 Accumulation Index was down a significant 9.9%.
- There was a continuation in the divergence of performance between the Resources (down 22% for the month) and Industrials (down 5.1%) as the credit crisis and economic data from the developed nations indicated a recession was looming and the perceived growth rates of developing nations come into question.
- The major influence over the month was the collapse of confidence in US financial markets. The US S&P500 fell 9.2% with historic announcements made on an almost daily basis.
- The US Government bailed out mortgage providers Freddie Mac and Fannie Mae. It then effectively nationalised America's largest insurance company AIG by taking an 80% equity stake in it. Lehman Brothers filed for bankruptcy. Towards the end of the month, a US\$700 billion relief package was proposed, only to be rejected by the US House of Representatives. All S&P500 sectors were down, with Materials and Energy the worst, down 17% and 12% respectively.
- Combined with the growing certainty of a slowing of globally and domestic growth, there was a flight to safety into government bonds. Australia's ten year yield dropped 35bp to 5.39%, back to 2005 lows.
- Australia's currency continued falling against most currencies and actually accelerated downwards to close at US79.2c, a fall of 8% over the month. It actually fell more against the Yen (down 10%) to 84.1. Falling commodity prices, a reduction of 25bp in official interest rates (with the expectation of more to come), caused significant pressure on our dollar. The Australian dollar is the fourth most traded currency in the world and investors use it as a proxy for world growth, hence the aggressive selling.
- Commodity prices fell across the board. Oil fell to a seven month low and was down 13% to US\$100.7 and is now down 31% from its July high of US\$145. The CRB Metals Index lost 8% in September, with the Index down 30% from its June highs and is now back to February 2007 levels. Gold was the exception, closing up 4% at US\$870. This belies the volatility in the gold price with September seeing a price range from US\$741 to US\$901.

Portfolio Activity

- The Fund's net equity exposure was reduced from 81% to 39%, with the majority of the move made in the first week of September. Expectations of a reasonable domestic reporting season were met during August and the Fund had its best month ever.
- Attention quickly focussed on the upcoming US 3Q08 reporting season, which was expected to be critical for any continuation of Australia's sharemarket rally. Events in America overtook these corporate earnings announcements, with major dislocation of credit markets occurring and the collapse and forthcoming Government

bailout of several household names in the US financial community.

- The gross exposure of the fund declined from 105% to 76%. This indicates that the reduction in the Fund's net exposure was not only a function of selling long positions. The Fund took the opportunity to add short positions. The number of short positions was raised from 15 to 20, increasing the Fund's exposure to 17%. The Fund's long exposure went from 82% to 56%. This action was amongst the swiftest the Fund has executed, with the exception of August 2007 and January 2008 and was fortuitous as the markets have corrected significantly.

Fund Performance

Period ending 30.09.08	1m %	3m %	6m %	1yr %	Since Inception %
Total Return	-8.73	-3.33	-1.48	-2.12	1.56
Benchmark *	0.64	1.97	3.98	7.72	11.84

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 Australian sharemarket declined -9.85% over September. Although the fund outperformed the broader market by 1.12% the fund posted a negative return of -8.73% (post fees).

Positive Influences

Company	September Return %	Fund Position %
Bank of Queensland	-17.1	-1.0
Austbrokers Holdings	14.7	1.0
Macmahons Holdings	-6.3	-1.0

- The Bank of Queensland underperformed the banking sector during the month. This was to be expected as this bank does not have the depositor base of the majors (although it is growing it rapidly) and as a result is at a funding disadvantage. As the credit crisis went to a new level, this disadvantage became more stark and with a premium rating versus the sector, it received a de-rating. The share price subsequently hit our Buy price target and the short was removed in October.
- Austbrokers achieved a solid result during reporting season and given its reliability of earnings and relative defensiveness it actually rose over 14% in a very weak equity market. The stock continues to be a favoured small cap in the portfolio.

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Negative Influences

Company	September Return %	Fund Position %
Imdex limited	-35.7	2.6
BHP Billiton Ltd	-24.0	3.5
Centennial Coal	-32.7	2.3

- Imdex, Centennial Coal and Macmahon Holdings were all caught in the same headwinds of hedge fund redemptions of Global Cyclical and concern over the levels of global growth. The PERs of these stocks fell from 11x to 7x for Imdex (nearly debt free); 9x to 6x for Centennial Coal (debt free – actually gave a return of capital earlier in the year) and 16x to 15x for Macmahons (the fund was short on a relative valuation thesis). All three companies upgraded earnings guidance over the past two months.
- While many stocks held in the portfolio, have little or no debt and have PER multiples in the single digits, some of these companies suffered falls between 20% to 32%. Not only was there radical PER contraction, but it came swiftly after most had produced excellent FY08 results and many upgraded earnings guidance. For example, BHP had an excellent result and earnings per share forecasts have been rising since the result, now standing at A\$6.00ps. The share price of BHP fell 24% over September. This means the PER of BHP fell from 6.9x to 5.2x in one month, whilst receiving earnings upgrades.
- Many of the stocks detracting from performance are tied to Chinese and Indian growth or Australian infrastructure spending. We are of the view that these areas are slowing but the market has over reacted to the degree of slowing. This situation has been exacerbated by massive repatriation of funds back to the USA.
- A confluence of events caused the large contraction in the valuation of Global Cyclical companies. Firstly, the heightened level of the credit crisis has led to a squeeze on the USD. At the same time US hedge funds are de-gearing due to higher short term borrowing rates from their prime brokers as these same brokers are being put under massive financial stress, coupled with large redemption requests. Many of these funds have been traditionally long Global Cyclical/short Financials.
- In addition, Chinese economic data is slowing however it has been clouded by the “Beijing Olympic effect”. This is where many sectors of the Chinese economy were temporarily shut for pollution issues over the Olympic period. Thus money flows and not totally fundamentals have caused a valuation “shock” to Global Cyclical stocks.
- The Fund reduced these stocks but not totally, and as a result the Fund’s performance suffered. We are of the view that once these pressures abate, there is likely to be a re-rating of many of these companies. The Fund’s investment process has firmly guided us to retain and in some instances add to these positions in recent days.

- The de-leveraging of hedge funds has been great and there are some tentative signs that it is coming to an end. These money flow issues will abate - it is simply a matter of time. The slowdown of China and other BRIC nations is another question. There is definitely a slowing of these economies, with Russia leading the way. However China did take delivery of significant amounts of iron ore and coal over the Olympic period when industry was idle and let stockpiles build in time for price negotiations with iron ore and coal suppliers next month.

Outlook

- Post September, there was a continuation of the extreme nervousness associated with the stresses on the financial system, not only in America but globally. The issue of bad mortgages in California and Florida has turned into a global credit crisis, the degree of which the world has not seen since the Great Depression. The US House of Representatives began to understand the seriousness of the issue only after they saw the US sharemarket shed US\$1 trillion after they voted down the US\$700 billion TARP package. Their decision was thankfully reversed as the bill was submitted a second time.
- This did not stop the momentum of what can only be described as fear and mistrust in the financial viability of international banks. The interbank lending market nearly completely seized up in early October. As a result not only the world’s central banks, but the governments of the G7 and eventually G20 nations swung into a combined effort with a coordinated lowering of official interest rates and stimulus packages that could not have been envisaged in August 2007.
- Importantly the derivative positions of Fannie Mae, Freddie Mac and most importantly the bankrupted Lehman Brother’s have now settled without catastrophe.
- What has transpired is the effective part nationalisation of the financial industries of the USA, the UK and Europe. This has led to a significant dilution to common stockholders for the benefit of future financial viability and importantly the removal of the uncertainty of counterparty risk.
- So far this has led to some stability. Though at the time of writing, the TED spread (the effective interbank lending rate) had yet to come down. This has been clouded by the Columbus Day holiday where the US bond market is closed. Sharemarkets have started to rally, however we are only talking of one or two days of trading at this stage.
- This level of turmoil usually occurs two or three instance in a lifetime. At this stage of the cycle, fear usually tends to dominate and fundamentals take a backseat. It is times like now that a strong investment process is extremely useful - a tried and tested process that acts as a guidemap when volatility can unbalance markets for a period. Our investment process is viewing the current market as a buying opportunity.



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- The selling of shares in Australia's market has been erratic and not necessarily fundamentally based. It has not been until very recently with governments stating they are basically prepared to spend any amount to ensure the functioning of the financial markets, that market participants have started to return to fundamentals. Eventually fundamentals rule the day.
- Lodestar's investment process strongly 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.
- In Australia, there has been a further development with the Federal Government announcing fiscal stimulation. Our Federal Government has the great luxury of a strong balance sheet and can continue to fund additional packages if required. The structure of Australia's banking system has proven to be amongst the best in the world.
- There are indications and expectations of further interest rate cuts in Australia (futures are pricing in 1% by Xmas) and the Reserve Bank of Australia has plenty of capacity for further easings to monetary policy (cash is still relatively high at 6%). Lastly the Australian dollar has fallen to the same levels that cushioned our economy while most of our trading partners suffered severe recessions during the Asian crisis in the mid 1990s.
- The Fund will always act dynamically to changing circumstances, however at the moment our process suggests strongly that during this volatile time, opportunities are present and as a result most of the Fund's short positions have been bought back and those stocks with quality businesses and strong balance sheets have been purchased.

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