

Greencape Wholesale High Conviction Fund

Fund report and commentary – 31 December 2008

Overview: The Greencape Wholesale High Conviction Fund (Fund), posted a return of -15.54% (after fees)* compared with the S&P/ASX 200 Accumulation Index (benchmark), which returned -18.25%.

Performance					
	Quarter (%)	1 year (%)	2 years (%) p.a.	3 years (%) p.a.	Inception (%)
Greencape Wholesale High Conviction Fund	-15.54	-33.78	-6.97	-	1.54
Growth return	-15.91	-37.81	-15.08	-	-6.21
Distribution return	0.37	4.03	8.11	-	7.76
S&P/ASX 200 Accumulation Index	-18.25	-38.44	-15.47	-	-8.50
Active return (net)	2.71	4.66	8.50	-	10.04

Returns are calculated after fees have been deducted, assuming reinvestment of distributions. No allowance is made for tax. Past performance is not a reliable indicator of future performance.

Investment objective

The Fund aims to provide capital growth over the long term through a highly concentrated portfolio of Australian shares, and provide returns above the benchmark, the S&P/ASX 200 Accumulation Index, over rolling three-year periods.

Investment manager

Greencape Capital Pty Ltd

Investment strategy

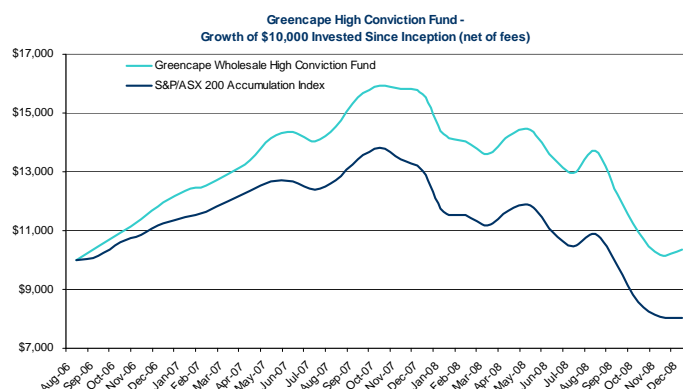
Greencape is an active, bottom-up stock picker. Whilst not targeting a specific investment style and investing in stocks displaying 'value' and 'growth' characteristics, Greencape's focus is on a company's qualitative attributes, which will generally lead to 'growth' oriented portfolios. This is an outcome of Greencape's bottom up process. As such, Greencape's investment style may be classified as 'growth at a reasonable price' (GARP).

Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years



Asset allocation		
	Current (%)	Range (%)
Securities	99	85 - 100
Cash	1	0 - 15

Fund facts	
Greencape Wholesale High Conviction Fund	
Inception date	11/09/2006
APIR code	HOW0035AU

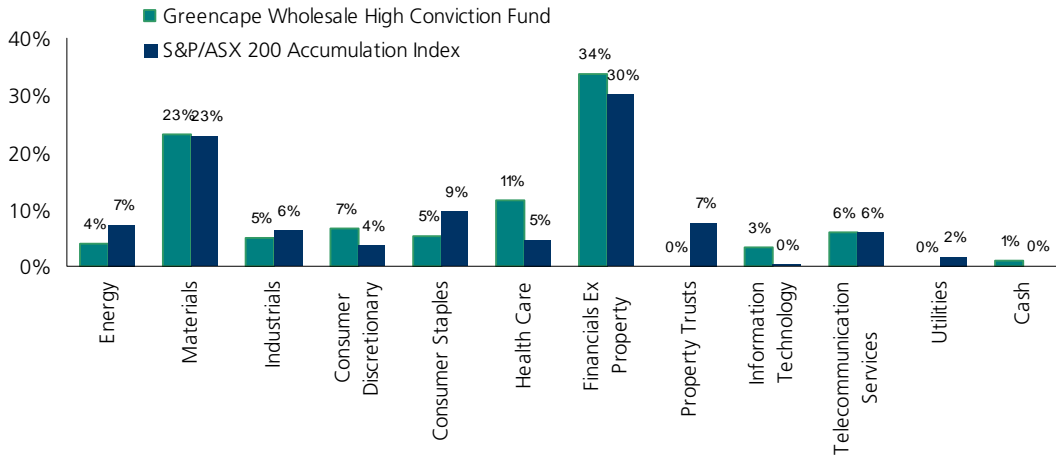
Fees	
Greencape Wholesale High Conviction Fund	
Entry fee	Nil
2007/08 ICR	0.90%
Management fee	0.90% p.a.
Performance fee	15% of the Fund's after management fee return above the Fund's benchmark.
Buy/sell spread	+0.30%/-0.30%

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Sector exposures as at 30 November 2008

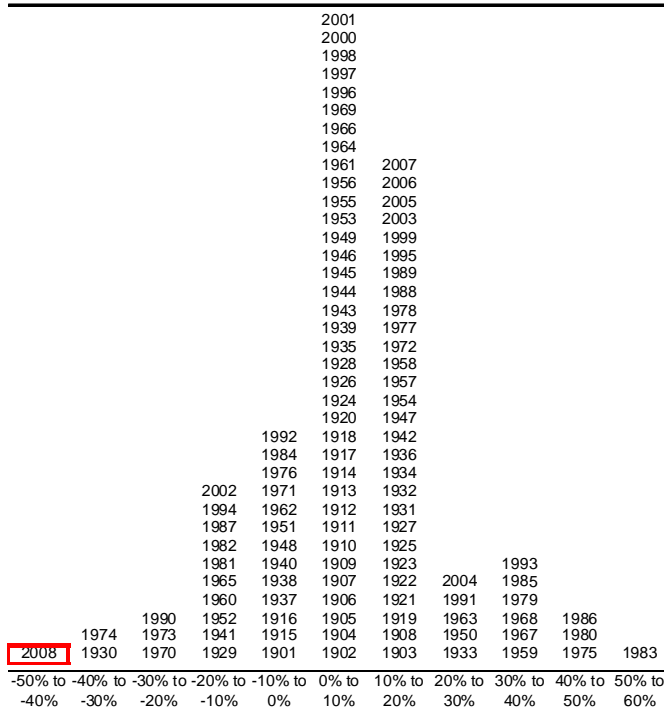


Market Review

In the December quarter the S&P/ASX 200 Accumulation Index dropped 18.3%, marking the 5th consecutive quarter of negative returns and the single largest annual fall (38.4%) on record, returning the market to levels last reached in 2004. This was only the 2nd time the Australian share market has experienced falls in five consecutive quarters, the previous occasion being the 1989/1990 “recession we had to have” when the market fell 29.4%.

The historical magnitude of the fall can be seen in the following chart:

All Ordinaries Annual Returns



Source: Global Financial Data, IRESS, Morgan Stanley Research



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The December quarter featured two particularly weak months, October down 12.6%, and November down a further 6.2%. October's weak performance was driven by the frequent release of poor and deteriorating economic data. In particular employment data in the US and Europe weakened considerably as did Chinese economic activity, illustrated by falling electricity generation. The deterioration in China's economic growth resulted in further falls in hard commodity stocks with particular weakness in mining contractor/service providers due to concerns lower commodity prices will lead to lower production volumes. Indeed, the December quarter saw a large list of mining and related infrastructure projects being delayed or cancelled.

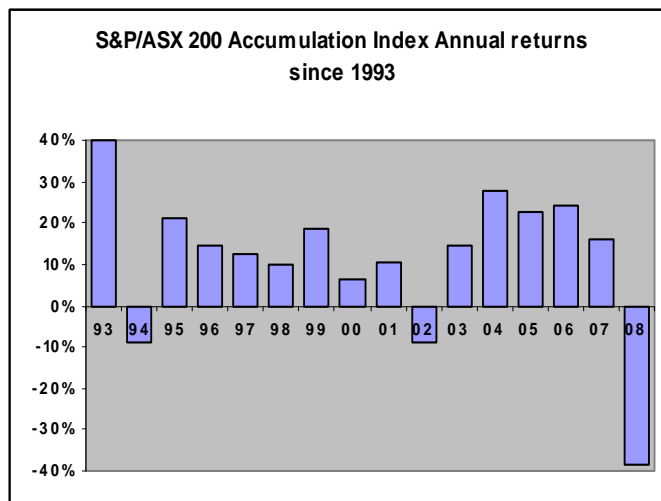
"I do know that the American economy, over a period of time, will do very well, and people who own a piece of it will do well. But they shouldn't own it on leverage. That's what people have learned in this period, that you've got to be able to play out your hand and it's a big mistake to let somebody else be in a position where they can sell you out."

**Warren Buffett CNN interview
24/09/08**

Michael Smith, CEO ANZ 18/02/08.

All sectors' returns were negative for the December quarter with the traditional defensive sectors outperforming, albeit because they declined the least!

	Dec Quarter	2008
Market (S&P/ASX 200 AI)	- 18.3%	- 38.4%
<u>Best performing sectors:</u>		
Utilities	- 4.8%	- 30.3%
Healthcare	- 7.3%	- 9.1%
Telecommunications	- 8.7%	- 17.5%
<u>Worst performing sectors:</u>		
Property Trusts	- 32.9%	- 54.0%
Industrials	- 25.1%	- 45.6%
Materials	- 25.1%	- 40.7%
Consumer Discretionary	- 24.6%	- 53.9%
Energy	- 21.3%	- 16.7%



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Investors punished any stock considered dependent on debt markets for further capital, particularly listed property trusts. There were a number of examples of banks refusing to refinance debts, resulting in corporates desperately relying on the equity market as a funding source.

The energy sector was weak with the oil price hitting multi year lows in December, despite OPEC jawboning about production cuts. October and November also included the bank reporting season which featured a continuing trend of growing bad debts, increased funding costs and an urgent desire to recapitalise balance sheets. The banks performed poorly during the quarter as all major banks, except for ANZ, raised equity through placements/rights issues.

“High risk and high leverage proved to be a fatal combination. It always does.”

Glen Stevens, RBA Governor, 17/09/08.

Globally interest rates continued to fall, and many governments announced substantial fiscal stimulus programs designed to restore consumer confidence. This has supported sentiment towards retailers in the short term.

Company Visits and Observations

- Retailers approached Christmas very cautiously, with evidence of deep discounting emerging early in this key shopping season. Whilst confidence from retailers has clearly been boosted by falling interest rates, falling petrol prices and government fiscal stimulus packages, it has been offset by low consumer confidence due to job security concerns.

“The timing is what the timing is”
Bob Every, Chairman Wesfarmers re Coles Acquisition. AFR 17/11/2008

- In November we visited the United States, during which we noted the following observations of US companies:
 - Companies are very focused on managing their balance sheets, including locking in debt funding or increasing free cash flow to repay debt (often via cutting growth capital expenditure).
 - Management of multinationals believe that emerging economies are better positioned compared to previous downturns. This should assist in rejuvenating global growth.
 - Cost pressures are now easing including input costs (commodities), labour (more workers now available) and rents (from rising vacancies).

“... the business cycle. It is not dead, even though it has been muted for the past two decades.” Alan Greenspan,
The Age of Turbulence 2007



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- Companies have very limited or no visibility on a recovery in US consumer spending.

- Almost all companies we spoke to during the quarter were reducing or delaying their capital expenditure where possible, including defensive businesses that are highly cash generative.

- Many companies we spoke to are increasingly focused on generating additional cash flow by reducing their working capital. To achieve this, companies are using a combination of delaying their own supplier payments whilst increasing their focus on timely debtor collection. Clearly this is a zero-sum game for the economy as a whole so there will be winners and losers, which we think will be determined largely by the relative bargaining powers of companies within their respective supply chains.

“During times of dislocation, market shares become more fluid”
Mark Joiner CFO NAB, 21/10/08

- Some companies with strong balance sheets are using this period of financial stress to position themselves to pick-up assets at large discounts to previously traded multiples, and as such we believe will be long term beneficiaries of this period of economic turmoil. QBE is one such company, recently acquiring a large US lender property insurer (November) and PMI Australia (August), which has a 40% market share of Australia’s residential mortgage insurance industry, along with other smaller acquisitions at favourable prices.

“AIG would be doing fine now, I think, if they'd never heard of the word derivative.”
Warren Buffett CNN interview 24/09/08

- Regulatory risk appears to have been underappreciated by the market with the recent example of Telstra being excluded from the federal government’s RFP process for the National Broadband Network.

- This follows on from the recent government regulatory changes which impacted Tattersalls (loss of gaming licence) and Healthscope (rise in the threshold of income level for the private health insurance rebate). Other regulatory changes witnessed during the quarter were the government’s guarantee on bank deposits, negatively impacting non-bank lenders including state governments, and a temporary ban on the short-selling of shares.

- The quarter saw huge drops in a number of commodities, some of which were:
 - The Baltic Dry Index (International shipping freight rates) declined 76% for the quarter and 93% from its high in May.



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- o Oil (WTI) dropped 61% for the quarter to US\$39 a barrel and was off 73% from its peak of US\$145 in July.

Fund Outlook

Markets currently provide compelling value but also considerable risk to earnings. This stems from the considerable uncertainty with respect to the global GDP growth trends, the role China and other emerging economies will play and how successful the globally co-ordinated monetary and fiscal stimuli is.

"It is possible that we are witnessing the early part of a new phase where the household spending and borrowing dynamic is different from the past decade and a half."
Glen Stevens, RBA Governor,
17/09/08.

The trade-off between valuation and earnings risk is also very much prevalent at the stock level and is central to our current focus and ensuing portfolio positioning.

Relative to our last quarterly report our portfolio is more balanced, having taken profits in certain defensive positions at full prices whilst selectively increasing our exposure to high quality companies offering compelling upside, but also short term earnings risk. We remain happy holders of defensive names such as CSL, Tatts Group and Healthscope that continue to offer solid valuation appeal. On the other side of the ledger we have been selling our position in Woolworths at levels above our fundamental valuation.

"It's nice to have a lot of money, but you don't want to keep it around forever. I prefer buying things. Otherwise it's a little like saving up sex for your old age."
Warren Buffett CNN interview
24/09/08

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