

# Due Diligence

Enhanced Yield Fund

June 2010

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# **A** Why invest in the Enhanced Yield Fund?

**As at 30 June 2010**

## **1. The fund is positioned with rising interest rates in mind**

Regarding interest rates, it is our view and the consensus view in the market that interest rates will rise, and most predict by at least one percent. The Fund is positioned with this in mind. In fact, more than three quarters of the Funds assets are invested in issuances that are floating rate.

The fixed rate assets in the Fund equate to around 20% of the Fund. We have not avoided fixed rate assets altogether, despite our view that interest rates will rise, because we have invested in quality fixed rate issuances offered at high fixed yields that provide a return buffer well in excess of our outer expectation on rising interest rate moves.

### **So how will the fund behave if rates were to move higher by a couple of percent?**

In simple terms, if interest rates were to increase from 4.5% to 5% by mid 2011 (as currently implied by the futures market) all other things being equal, the forward yield of the Enhanced Yield Fund would increase by roughly the same amount. The risk for fixed income funds is that the RBA moves interest rates higher than the current market expectation.

The interest rate duration of the Enhanced Yield Fund is 0.4 years which means that if the RBA raises interest rates higher than the market expects by 1% then the Fund will lose 0.4%. In other words, the Enhanced Yield Fund exhibits the interest rate sensitivity of a 5 month bank bill.

In contrast, the UBS Composite Bond Index (which many yield funds are managed against) has an interest rate duration of 3.5 years. So if interest rates were to move higher than expected by 1% then funds managed in line with the UBS Composite Bond Index would lose 3.5%. This is worth remembering when considering the relative "safety" of fixed income funds.

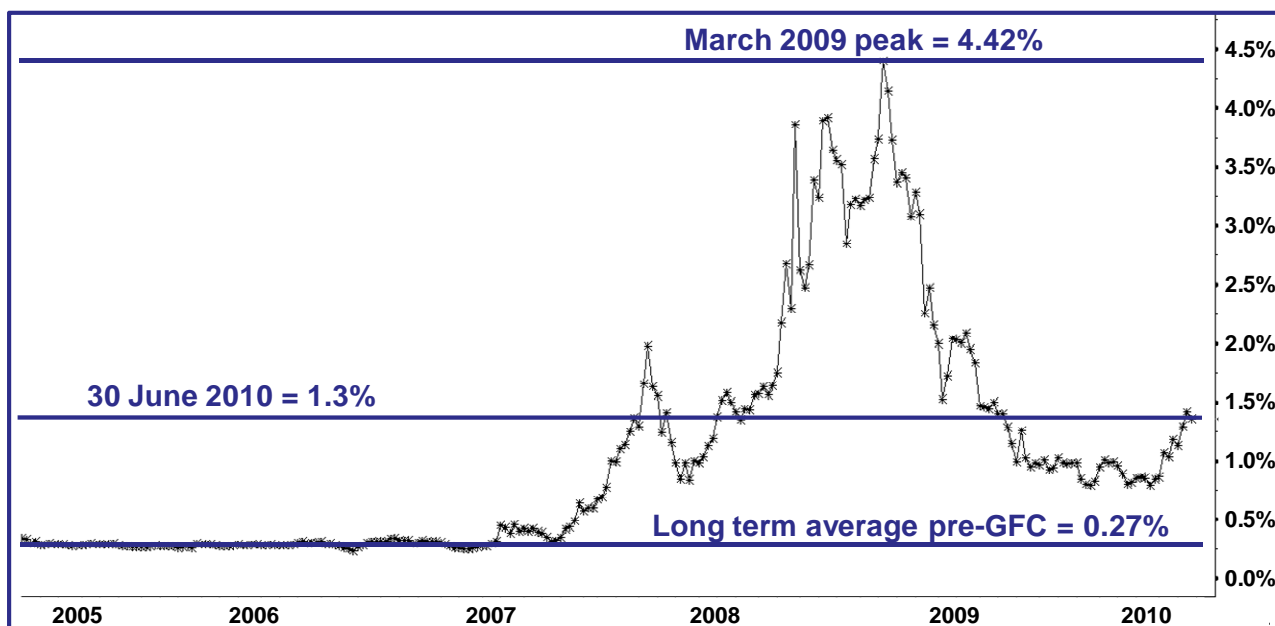
## **2. Credit spreads are at high levels**

A credit spread is the amount over and above the government bond rate (i.e. the 'risk free' rate) that investors receive when they invest in the debt of a company. This amount acts as compensation for taking on that extra risk.

Credit spreads rose sharply from July 2007 resulting in the value of yield securities in the market falling and creating 'mark-to-market' losses. Whilst credit spreads have now contracted quite markedly from the all time highs we saw early in 2009, we believe that there is a substantial amount of value yet to be realised from the yield assets we own. Indeed, we are still seeing a large number of attractive opportunities to invest the Fund's capital.

At this point is it worth reminding investors about the objectives of the Fund. While it is tempting to ramp up the risk profile of the Fund and purchase the highest yielding and longest duration securities, this is not what the Fund is about. The Fund should be viewed as a cash-plus type product and investors should not expect an equity-like risk and return profile. The blowout in risk premiums across the board has meant that the Fund is expected to be able to achieve its objectives without placing investors capital at undue risk.

The chart on the following page shows the recent history of credit spreads in Australia. For a number of years leading up to the Global Financial Crisis (GFC), the average credit spread was around one quarter of one percent. During the GFC that spread blew out to nearly 4.5%. This spread has since come in to around 1.3% which still represents some four times the historical average leading up to the crisis.



Source: Bloomberg

### 3. You can rely on PM CAPITAL to be forthright about the opportunity

PM CAPITAL are investors in the same funds offered to clients. As such, we have an alignment of interest and we are acutely honest about the risk / reward opportunities for investors. For example, for approximately 2 years from June 2005 we had been alerting investors to the fact that the risk / reward was not in favour of the yield investor. This can be seen from some excerpts from our quarterly reports:

**June 05:** *“it has been a difficult year to add much value above the cash return without taking risks that we are not prepared to take.”*

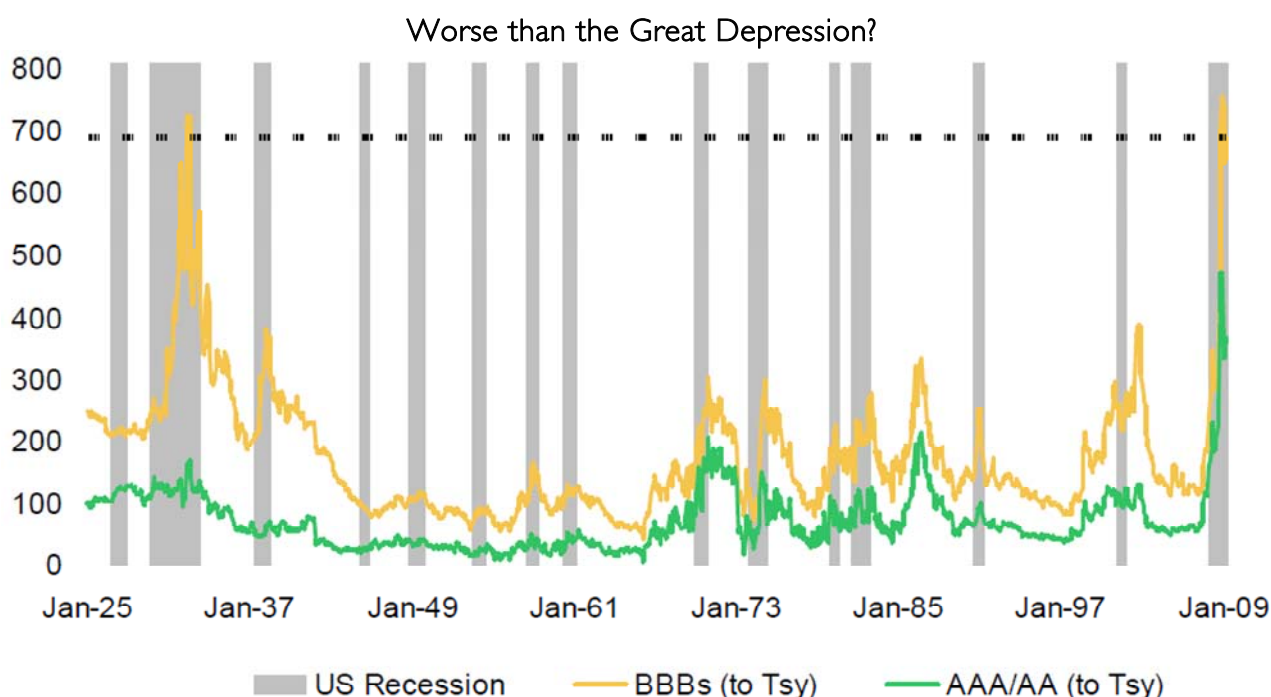
**March 06:** *“...in most cases there is no longer adequate compensation for the risks being taken on many yield securities.”*

**March 07:** *“...the market is not currently being driven by traditional credit fundamentals, but rather the old adage of ‘too much money chasing too few assets’ and so we intend to maintain our relatively conservative portfolio structure.”*

Given the risk of credit spreads increasing, our primary concern during that period was the protection of capital. As a result, we held up to 50% of the Fund’s assets in cash and the remainder in high quality, short-dated securities. During this period, many competitor funds were achieving much stronger returns through either leverage or investing in higher risk securities. We were often criticised for having such conservative positioning, and having a significant ‘cash drag’ on the performance of the portfolio.

As can be seen above from the chart, the period from mid 2007 to March 2009 produced an unprecedented blowout in credit spreads to levels never seen before. The result for funds that employed such leverage or invested in higher risk securities in order to generate higher returns (when spreads were low) has been disastrous, with investors in those funds losing significant amounts of capital. Our conservative approach during the 2005-07 period meant that we were able to protect capital by holding cash, and then when securities were

priced with higher and more attractive yields we had significant capital to invest. During this time many of our competitors had liquidity issues and minimal access to cash, forcing many to close their funds to redemptions.



Source: Moody's, Yield Book, NBER, Morgan Stanley Research

If we fast forward to the peak of the credit crisis where we saw credit spreads at levels above even those witnessed in the Great Depression (see above), our comments to investors predictably changed as seen below:

**December 08:** ***“We believe that yield security assets now represent excellent value... the decision to purchase the yield securities of high quality banks and investment grade corporates at distressed prices will prove to be a valuable strategy”.***

**March 09:** ***“We genuinely believe that we will look back on this environment (i.e. where assets are being sold for reasons of necessity rather than inherent valuation) as a once in a generation opportunity to invest in yield securities.”***

#### **4. The risk / reward profile of the fund is compelling**

Historically financial advisers have timed their allocation to the 'yield' sector poorly.

The period of 2005-2007 was characterised by rising interest rates (from an initial low base) and credit spreads that were at historically low levels (the average Australian corporate bond spread through this period was just 27 basis points). Investors were not being compensated for taking on risk. As our commentary indicated, the risk / reward was not appealing and investment opportunities were scarce. Despite this scenario, investors appeared to be optimistic about the sector and money was pouring into yield funds.

Whilst credit spreads have now contracted quite markedly from the all time highs we saw early in calendar 2009, we believe that there is a substantial amount of value yet to be realised from yield security assets. Indeed, we are still seeing a large number of attractive opportunities to invest the Fund's capital.

## B Fund Overview

### Investor Profile

The Enhanced Yield Fund is suited to investors who wish to invest in a fund which seeks a return in excess of the RBA cash rate with a low degree of volatility.

### Investment Objectives

To provide investment returns in excess of the RBA cash rate by investing in a combination of cash, yield securities and low volatility equity strategies on globally listed companies. The Fund targets a return to investors above the RBA cash rate with limited volatility and low risk of capital loss.

### Investment Strategy

The Fund will be managed using the same investment philosophy and process that PM CAPITAL employs for all of its investment funds. The Fund will aim to invest the majority of its assets in cash and interest bearing securities, including any securities which pay franked dividends and/or high yield. Using a 'buy & write' strategy the Fund has generally had a net exposure to equities of around 5% of the portfolio's net asset value (NAV).

### The Manager

PM CAPITAL is recognised as one of Australia's leading boutique fund managers and is majority owned by its staff.

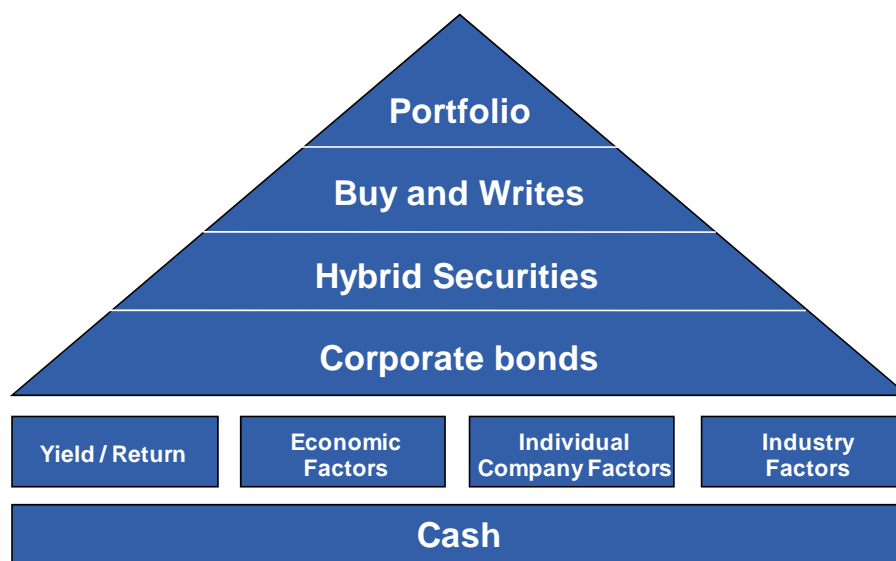
### Fund Details

- **Minimum investment:** \$20,000 via PDS (\$1,000 via Wrap and Mastertrusts);
- **Entry/Exit Fee:** Nil
- **Adviser Service Fee:** Additional 0.25% (optional);
- **Buy / sell spread:** +/- 0.2% (0.4% round trip);
- **Pricing / applications and redemptions:** Daily;
- **Management fee:** 0.55%p.a;
- **Performance fee:** 25% of the excess above the RBA cash rate (subject to a high-water mark);
- **Custodian:** UBS Nominees Pty Ltd;
- **Reporting:** Monthly reporting for advisers / quarterly investment report

### Portfolio Structure

- The Fund will aim to hold a minimum cash weighting of 20% of the Fund's net asset value. If the Fund cannot find suitable low risk investments it will let the cash levels build up. If appropriate the Fund may be 100% invested in cash
- The Fund has had a historical average of around 5% exposure to equity securities. The maximum allowable is 10% net exposure to equities;
- Derivatives may be used for hedging purposes or to replicate underlying positions;
- Any offshore currency will be substantially hedged back to Australian Dollars;
- A net limit of 5% exposure at acquisition to any single issuer (excluding cash & cash equivalents);
- BBB, or lower rated debt is limited to 30% of the Fund;
- Unrated or sub investment grade paper limited to 15%.

## C Portfolio Construction



THE PORTFOLIO IS CONSTRUCTED FROM THE BOTTOM UP

### Cash

The cash allocation of the Fund seeks a yield above the cash rate via investments in bank bills, negotiable certificates of deposit, bonds with less than one year to maturity and I I AM cash.

### Corporate Bonds

Floating Rate Notes (FRN's) pay a fixed margin over the bank bill reference rate, usually on a quarterly basis with a typical maturity between 1 and 5 years from issue date. They have very low interest rate risk and typically their prices are very stable. The buyer is exposed to the credit worthiness of the issuer. We target shorter maturity FRN's typically with an investment grade credit rating and above. Fixed Rate Bonds pay a fixed coupon and so have greater interest rate exposure than a FRN. Where we think there is a risk of rising interest rates, we will use derivatives (such as bond futures) to hedge out the risk.

### Hybrid Securities

The hybrid securities that the Fund may invest in include listed and unlisted converting/convertible preference shares and income securities. These securities typically sit further down in a company's capital structure and so pay a higher yield but can also carry greater credit risk. We aim to purchase securities whose yields provide us with what we believe to be an appropriate risk premium over the risk free rate, given the underlying credit quality of the issuer.

### Buy & Write Strategy

Where our research process identifies an undervalued business, we can buy the stock and write a call option against these holdings which allows us to earn a return that is well in excess of the cash rate, while at the same time hedging a significant portion of our exposure to any downside in share price movements.

## D Exposures

Enhanced Yield Fund – Historical and Current Exposures (Effective)				
Quarter	Cash	Yield Securities	Net Equity Exposure	Net Exposure
Jun-10	33.0%	65.1%	1.9%	100.0%
Mar-10	30.4%	68.0%	1.6%	100.0%
Dec-09	30.1%	68.3%	1.6%	100.0%
Sep-09	30.8%	67.4%	1.8%	100.0%
Jun-09	22.5%	74.8%	2.7%	100.0%
Mar-09	25.0%	71.7%	3.3%	100.0%
Dec-08	30.5%	66.6%	2.9%	100.0%
Sep-08	24.8%	71.2%	4.0%	100.0%
Jun-08	31.1%	65.4%	3.5%	100.0%
Mar-08	37.7%	58.8%	3.5%	100.0%
Dec-07	46.9%	49.3%	3.8%	100.0%
Sep-07	42.9%	52.4%	4.7%	100.0%
Jun-07	44.3%	54.0%	1.7%	100.0%
Mar-07	39.4%	58.0%	2.6%	100.0%
Dec-06	37.4%	59.1%	3.5%	100.0%
Sep-06	40.6%	55.5%	3.9%	100.0%
Jun-06	37.6%	57.2%	5.2%	100.0%
Mar-06	33.8%	63.2%	3.0%	100.0%
Dec-05	36.5%	55.4%	8.1%	100.0%
Sep-05	37.9%	54.4%	7.7%	100.0%
Jun-05	41.3%	50.1%	8.6%	100.0%
Mar-05	39.6%	52.5%	7.9%	100.0%
Dec-04	46.8%	45.7%	7.5%	100.0%
Sep-04	51.7%	41.3%	7.0%	100.0%
Jun-04	54.2%	39.5%	6.3%	100.0%
Mar-04	59.8%	35.4%	4.8%	100.0%
Dec-03	52.5%	44.6%	2.9%	100.0%
Sep-03	53.0%	43.2%	3.8%	100.0%
Jun-03	61.7%	32.0%	6.3%	100.0%
Mar-03	63.9%	28.0%	8.1%	100.0%
Dec-02	61.3%	29.1%	9.6%	100.0%
Sep-02	78.3%	12.9%	8.8%	100.0%
Jun-02	81.4%	13.5%	5.1%	100.0%
Minimum	22.5%	12.9%	1.6%	100.0%
Maximum	81.4%	74.8%	9.6%	100.0%
Average	43.6%	51.6%	4.8%	100.0%

Source: PM CAPITAL Limited

## E Performance

Financial Year	EYF	RBA Cash Rate
2010	7.9%	3.4%
2009	6.2%	5.2%
2008	3.0%	7.0%
2007	7.5%	6.3%
2006	7.2%	5.7%
2005	5.7%	5.5%
2004	6.9%	5.2%
2003	10.7%	4.9%
2002	4.0%	1.5%
<b>Total Return</b>	<b>76.9%</b>	<b>54.9%</b>
<b>Annualised Return Since Inception</b>	<b>7.1%</b>	<b>5.4%</b>

Quarter ending	EYF	RBA Cash Rate
Jun-10	1.4%	1.1%
Mar-10	1.4%	0.9%
Dec-09	1.8%	0.8%
Sep-09	3.1%	0.8%
Jun-09	5.6%	0.8%
Mar-09	0.1%	1.0%
Dec-08	-2.4%	1.5%
Sep-08	2.9%	1.8%
Jun-08	0.8%	1.8%
Mar-08	-0.4%	1.8%
Dec-07	1.1%	1.7%
Sep-07	1.5%	1.6%
Jun-07	1.7%	1.6%
Mar-07	1.6%	1.6%
Dec-06	2.0%	1.5%
Sep-06	1.9%	1.5%
Jun-06	1.5%	1.4%
Mar-06	2.1%	1.4%
Dec-05	1.5%	1.4%
Sep-05	1.9%	1.4%
Jun-05	1.9%	1.4%
Mar-05	0.8%	1.3%
Dec-04	2.5%	1.3%
Sep-04	0.5%	1.3%
Jun-04	1.9%	1.3%
Mar-04	1.5%	1.3%
Dec-03	2.3%	1.2%
Sep-03	1.1%	1.1%
Jun-03	4.2%	1.2%
Mar-03	1.6%	1.2%
Dec-02	3.9%	1.2%
Sep-02	0.6%	1.2%
Jun-02	1.3%	1.1%

Source: PM CAPITAL Limited

This table contains PM CAPITAL Limited investment performance after taking into account fees but before taxes.

## Monthly Returns

Month	EYF	RBA Cash Rate
<b>Mar-02</b>	2.6%	0.4%
<b>Apr-02</b>	0.9%	0.4%
<b>May-02</b>	1.0%	0.4%
<b>Jun-02</b>	-0.5%	0.4%
<b>Jul-02</b>	0.4%	0.4%
<b>Aug-02</b>	0.0%	0.4%
<b>Sep-02</b>	0.2%	0.4%
<b>Oct-02</b>	2.2%	0.4%
<b>Nov-02</b>	1.7%	0.4%
<b>Dec-02</b>	0.0%	0.4%
<b>Jan-03</b>	1.0%	0.4%
<b>Feb-03</b>	0.0%	0.4%
<b>Mar-03</b>	0.6%	0.4%
<b>Apr-03</b>	2.1%	0.4%
<b>May-03</b>	1.2%	0.4%
<b>Jun-03</b>	0.8%	0.4%
<b>Jul-03</b>	0.5%	0.4%
<b>Aug-03</b>	0.7%	0.4%
<b>Sep-03</b>	0.0%	0.4%
<b>Oct-03</b>	1.1%	0.4%
<b>Nov-03</b>	0.6%	0.4%
<b>Dec-03</b>	0.6%	0.4%
<b>Jan-04</b>	0.8%	0.4%
<b>Feb-04</b>	0.4%	0.4%
<b>Mar-04</b>	0.3%	0.4%
<b>Apr-04</b>	0.1%	0.4%
<b>May-04</b>	1.1%	0.4%
<b>Jun-04</b>	0.7%	0.4%
<b>Jul-04</b>	-0.4%	0.4%
<b>Aug-04</b>	0.2%	0.4%
<b>Sep-04</b>	0.7%	0.4%
<b>Oct-04</b>	0.8%	0.4%
<b>Nov-04</b>	0.9%	0.4%
<b>Dec-04</b>	0.8%	0.4%

Month	EYF	RBA Cash Rate
<b>Jan-05</b>	0.3%	0.4%
<b>Feb-05</b>	0.6%	0.4%
<b>Mar-05</b>	-0.1%	0.5%
<b>Apr-05</b>	-0.4%	0.5%
<b>May-05</b>	1.7%	0.5%
<b>Jun-05</b>	0.5%	0.5%
<b>Jul-05</b>	1.3%	0.5%
<b>Aug-05</b>	0.2%	0.5%
<b>Sep-05</b>	0.4%	0.5%
<b>Oct-05</b>	-0.3%	0.5%
<b>Nov-05</b>	1.3%	0.5%
<b>Dec-05</b>	0.6%	0.5%
<b>Jan-06</b>	1.0%	0.5%
<b>Feb-06</b>	0.4%	0.5%
<b>Mar-06</b>	0.6%	0.5%
<b>Apr-06</b>	0.8%	0.5%
<b>May-06</b>	0.2%	0.5%
<b>Jun-06</b>	0.5%	0.5%
<b>Jul-06</b>	0.4%	0.5%
<b>Aug-06</b>	0.9%	0.5%
<b>Sep-06</b>	0.5%	0.5%
<b>Oct-06</b>	0.6%	0.5%
<b>Nov-06</b>	0.6%	0.5%
<b>Dec-06</b>	0.8%	0.5%
<b>Jan-07</b>	0.6%	0.5%
<b>Feb-07</b>	0.5%	0.5%
<b>Mar-07</b>	0.5%	0.5%
<b>Apr-07</b>	0.6%	0.5%
<b>May-07</b>	0.6%	0.5%
<b>Jun-07</b>	0.5%	0.5%
<b>Jul-07</b>	0.5%	0.5%
<b>Aug-07</b>	0.6%	0.5%
<b>Sep-07</b>	0.4%	0.5%
<b>Oct-07</b>	0.4%	0.6%

Month	EYF	RBA Cash Rate
<b>Nov-07</b>	0.1%	0.5%
<b>Dec-07</b>	0.6%	0.6%
<b>Jan-08</b>	-0.4%	0.6%
<b>Feb-08</b>	-0.6%	0.6%
<b>Mar-08</b>	0.6%	0.6%
<b>Apr-08</b>	1.0%	0.6%
<b>May-08</b>	0.5%	0.6%
<b>Jun-08</b>	-0.7%	0.6%
<b>Jul-08</b>	1.3%	0.6%
<b>Aug-08</b>	1.4%	0.6%
<b>Sep-08</b>	0.2%	0.6%
<b>Oct-08</b>	-2.0%	0.5%
<b>Nov-08</b>	-1.0%	0.4%
<b>Dec-08</b>	0.5%	0.4%
<b>Jan-09</b>	1.5%	0.4%
<b>Feb-09</b>	-2.3%	0.3%
<b>Mar-09</b>	1.0%	0.3%
<b>Apr-09</b>	2.5%	0.3%
<b>May-09</b>	1.5%	0.3%
<b>Jun-09</b>	1.4%	0.2%
<b>Jul-09</b>	1.6%	0.3%
<b>Aug-09</b>	1.1%	0.2%
<b>Sep-09</b>	0.3%	0.2%
<b>Oct-09</b>	0.6%	0.3%
<b>Nov-09</b>	0.2%	0.3%
<b>Dec-09</b>	1.0%	0.3%
<b>Jan-10</b>	0.5%	0.3%
<b>Feb-10</b>	0.0%	0.3%
<b>Mar-10</b>	0.9%	0.3%
<b>Apr-10</b>	0.8%	0.3%
<b>May-10</b>	0.0%	0.3%
<b>June-10</b>	0.6%	0.4%

Source: PM CAPITAL Limited

This table contains PM CAPITAL Limited investment performance after taking into account fees but before taxes.

# F Frequently Asked Questions

## Why our Enhanced Yield Fund?

- The Fund has a low risk, absolute return objective;
- The objective is to provide investment returns in excess of the RBA cash rate.
- It is a low volatility fund; aiming to avoid the risk of capital losses, including those risks associated with interest rate movements;
- The Fund's returns should not be cyclical with any single asset class.
- The Fund is an alternative to fixed interest and balanced funds.
- The Fund is not dependent on or restricted to yield securities;
- The minimum cash weighting is 20%
- Securities are sourced globally – including buy & writes
- The Fund will be substantially hedged back into Australian Dollars.

## What are the types of risks involved with the Enhanced Yield Fund? How does the investment team assess and deal with these risks?

The Fund has three separate components each with different types and levels of risk. The three components are:

- Cash;
- Yield securities and;
- Equities (buy and writes).

### Cash

This component will include investments in bank bills, negotiable certificates of deposit (NCD's), bonds with less than one year to maturity, and I I am cash. There is typically minimal credit and interest rate risk associated with these instruments.

### Yield Securities

We will hold a portfolio of interest bearing securities. An example of the typical security type that we will be holding is a corporate bond. The primary risks involved in this type of security are interest rate risk and credit risk.

The interest rate risk lies predominantly with fixed rate bonds and their potential for falling capital values in a rising interest rate environment. We will employ less fixed rate and more floating rate notes in this scenario. We will also employ derivative hedges to protect the value of our portfolio if we perceive a significant risk of sharply higher yields.

These securities will typically contain credit risk. If the credit profile of the issuer should worsen, the price of the instrument will fall. We use our in-depth investment analysis to screen out those companies whose credit profile we believe to be deteriorating. PM CAPITAL's team of equity analysts is fundamental to this part of the process. Each of the issuers of credit securities are reviewed in great detail by the relevant analyst covering the stock whilst Jarod Dawson performs the credit overlay. As such, PM Capital feels it is in a better position to understand the true strength of the business than a team of pure credit analysts.

PM CAPITAL's equity analysis looks at a business from the perspective of how much a rational business person would pay to buy the company in its entirety (i.e. to privatise the business), which means buying both the debt and the equity. The primary valuation metric used to arrive at the privatisation value of a company is the Free Cash Flow (FCF) yield. Given the major driving factor behind a company's ability to service its debt burden is FCF, PM CAPITAL believes it is ideally positioned to more comprehensively understand a company's debt servicing capacity (and therefore the likelihood of default or ratings downgrade) than a team of analysts who are focused entirely on credit markets.

### **Equities**

Equities are higher risk assets and may experience periods of significant volatility, as has been the case in the last few years. The Fund's exposure to equities will therefore be limited (to an absolute maximum net exposure of 10% FUM) and carefully managed. Investors should expect equity exposure during normal market conditions to be around 3-5%. Equity exposure will be via 'buy and write' structures, an example of which appears on the following page. The buy and write strategy affords downside protection, in exchange for capping the potential upside of the underlying equity. The risk profile of buy and write structures is lower than direct equity investments.

We gain insights from our research where the team identifies undervalued businesses that we would like to own outright over a 2-3 year period. In the Enhanced Yield Fund we further reduce our risk by writing call options. Typically we are buying these securities when short term issues are impacting the stock price, therefore providing us with a good entry point.

## Can you provide an example of a buy & write strategy?

### Example

Buy Company XYZ: + \$20  
 Sell XYZ 2 Year \$20 Call Option: - \$8

24 months to expiry of option

**Scenario 1:** If the stock is < \$20 at the time of expiry: we keep the \$8 and this offsets losses on the shares. The share price would have to fall by 40% before we incur a net loss.

**Scenario 2:** If the stock is = \$20 at the time of expiry: we keep the \$8 (premium received) and our return is  $8/20 = 40\%$  over two years.

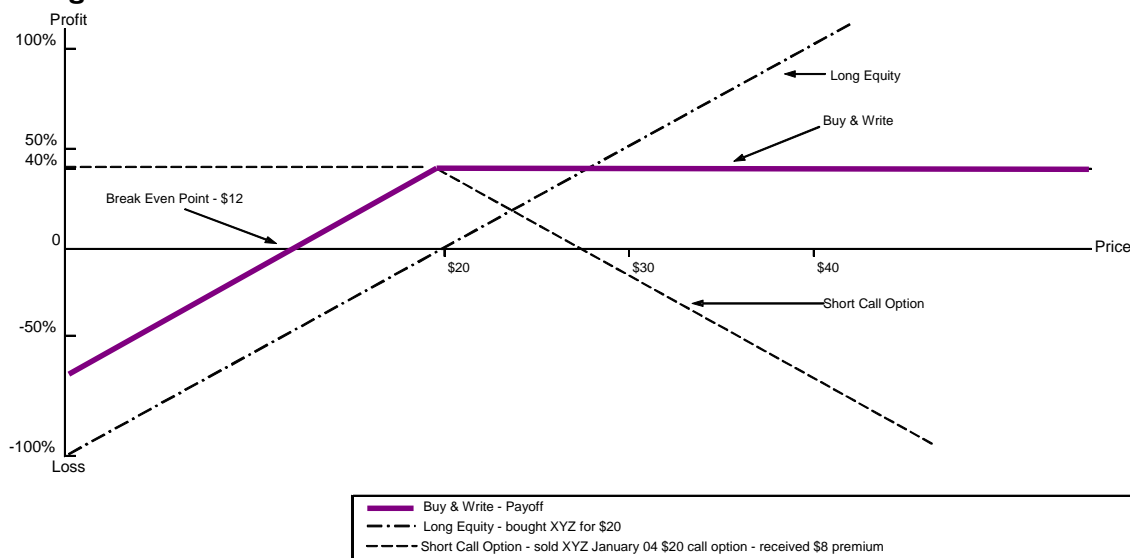
**Scenario 3:** If the stock is > \$20 at the time of expiry: we sell the stock to the option holder for \$20 and we keep the \$8 premium received. Return is  $8/20 = 40\%$  over 2 years

**Summary:** At expiry of the options in 2 years  
 Maximum gain 40% and downside protection of 40%.

Stock Price	\$12	\$20	\$28	\$36
	0%	+40%	+40%	+40%

There is a risk of loss of capital below \$12 and thus, it is critical that our research process identifies businesses that we would be willing to own outright in our equity funds, including those stocks that have solid downside support; for example they hold high cash reserves.

### Pay off diagram



### Exposure:

The maximum effective exposure that the Fund will put at risk in buy and writes is 10%. Below is an example of how effective exposure is calculated.

Gross Exposure	Sold Options	Delta <sup>1</sup>	Impact of option on exposure	Effective Exposure <sup>2</sup>
20%	-20%	0.635	-12.7%	6.3%

1. In theory a 1% movement in the share price will be offset by a 0.63% movement in the option price.

2. Effective exposure to movements in underlying share price.

### What is the maximum net exposure to equities in the Fund?

The Fund is restricted to a maximum net exposure to equity securities of 10%, with a historical average of around 5%. An example exposure might be:

	<b>Gross</b>	<b>Net</b>
Long shares	7%	7%
Sold calls on long shares	-5%	-2% (Delta 0.4)
<b>Effective Exposure</b>		<b>5%</b>

This equity component can invest in Australian or international markets: wherever the best opportunities exist.

### Does the Fund use fixed interest type securities?

Yes. We use the term yield securities rather than fixed interest as we intend to invest in hybrid securities as well as conventional fixed interest.

### How are the performance attributes likely to vary over different stages of the market cycle?

The Fund aims to be non-cyclical, unlike a conventional equity or hybrid fund. We try to avoid the usual strong negative correlation between fixed income funds to the interest rate cycle via our diversified fund composition of equity, cash and yield securities. Our philosophy of absolute returns means we will not allow ourselves to be tied to a cycle and we will reduce exposure to a particular asset class if we feel that the cycle is turning down. However, the performance attribution may vary over cycles with the obvious examples of a strong equity market allowing the buy and writes to increase their contribution and a declining interest rate environment potentially favouring the yield securities.

### When are you likely to perform better than the RBA cash rate?

Our benchmark is the cash rate. The following conditions would be conducive to our outperformance:

- A positively sloped yield curve
- A period of falling interest rates and stable credit spreads
- A period of credit spread contraction and stable interest rates

### Describe your ability to assess and manage the interest rate risk in the Enhanced Yield Fund.

The Enhanced Yield Fund has a dedicated Portfolio Manager in Jarod Dawson. Jarod has 12 years experience in fixed income and interest rate products within funds management. Jarod is supported in credit analysis by John Whelan and Uday Cheruvu, both of whom have prior experience in credit markets. He is also supported by Tim McGowen who analyses the buy and write component of the fund.

In addition to our credit analysts, our equity analysts have many years of experience in assessing economic cycles within the framework of their equity analysis. It is not possible to be ignorant of interest rate cycles and be an investor, regardless of the asset class you are investing in.

## **Describe your ability to assess the credit risk in the Enhanced Yield Fund. Are not equity and debt analysis quite different disciplines?**

Our equity analysts approach a company from the perspective of a buyer of the whole business, i.e. a buyer of the equity and debt. As a buyer of the whole business, we need to be sure the business can provide a return to both equity and debt holders. Hence, we are very concerned with typical credit issues, for example cash-flow, capital expenditure cycles and clarity of the balance sheet.

Equity and credit analysis are to an extent different disciplines, but our approach to valuing a company combines both. The fixed income team performs detailed credit analysis but also utilises the in-depth company analysis of the equities team.

In addition, the portfolio managers use their experience to advise on the macro and market factors driving trends in aggregate credit spreads.

## **Provide biographies of the key investment personnel involved in the credit analysis**

### **Jarod Dawson – Enhanced Yield Fund Portfolio Manager**

Jarod is responsible for analysing the cash and fixed income components as well as overall portfolio construction of the Enhanced Yield Fund. Prior to joining PM CAPITAL in September 2004, Jarod spent 6 years with UBS Global Asset Management, the last 4 years of which he held the title of Fixed Income Portfolio Manager and was responsible for managing and growing their Credit Enhanced product suite. Before his time at UBS, Jarod spent 2 years at ING Funds Management where he was responsible for managing relationships with key national firms & financial advisory groups. Jarod has a Bachelor of Commerce from Macquarie University, and a Graduate Diploma in Applied Finance & Investment from the FINSIA.

### **John Whelan, CFA – Investment Analyst**

John joined PM CAPITAL in April 2009 and will be working with Jarod Dawson analysing the cash and fixed income components of the Enhanced Yield Fund and Global equity funds. John is a CFA Charterholder and holds a Masters of Business from the Smurfit School of Business, University College Dublin and a Bachelor of Business and Finance from Dublin City University. John has six years financial markets experience primarily analysing and implementing currency and interest rate strategies, as well as managing multi currency fixed income / credit portfolios.

### **Tim McGowen – Options and Protection Strategist**

Tim joined PM CAPITAL as an 'Options and Protection Strategist' in August 2009. His primary responsibilities are to formulate option strategies for portfolio protection & income generation. His skills are applied across all of the equity funds, plus he manages the buy & write component of the Enhanced Yield Fund. Tim has 22 years of investment experience and was the founder and CEO of Fortitude Capital, which has received numerous elite industry awards, including most recently 'The AIMA 2008 and 2009 Australian Hedge Fund of the Year'.

### **Uday Cheruvu – Investment Analyst**

Uday joined PM CAPITAL in 2008 as an equity and credit analyst. He holds a Bachelor of Engineering and a Bachelor of Commerce, both with Honours, from the University of Melbourne, as well as a Master of Applied Finance from Macquarie University. Uday has a background in both private equity and investment banking in equity and credit analysis. Uday also has experience in financial modelling and creating financial (credit based) models for hybrid instruments in the Australian market. From an industry perspective at PM CAPITAL, Uday works under Paul Moore analysing global financial stocks and their credit profile. From a fund perspective Uday works with Jarod Dawson analysing opportunities for the Enhanced Yield Fund.

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