

# DDH Global Fixed Interest Alpha Fund

31 Dec 2009

The DDH Global Fixed Interest Alpha Fund (QIC GFIAF) provides a unique fixed interest investment opportunity, offering investors an absolute return focused strategy that invests broadly across global interest rate and credit derivative strategies. DDH Graham Limited is the responsible entity and distributor of DDH Global Fixed Interest Alpha Fund and QIC is the Investment Manager.

During 2009, QIC undertook an independent review of its future strategy, organisational structure, and remuneration structure, which culminated in the firm moving to establish a 'house of boutiques' model within the firm in August 2009. The new structure is intended to allow investment teams and key investment professionals to fully focus on investment management. Zenith is broadly supportive of the restructure overall, which should assist the firm address its previous difficulty in retaining key staff, whom can now be offered an equity like economic interest in their relevant boutique.

QIC's Fixed Interest investment team is headed by Susan Buckley, Managing Director, who has over 23 years of industry experience, over 8 of which have been with QIC. Buckley is well supported by a number of senior professionals, including Peter Scobie, Head of Credit, and Andrew Ticehurst, Senior Portfolio Manager within the Macro unit, both of whom have over 20 years of industry experience. Overall, Zenith believes QIC Fixed Interest Team of 19 investment professionals is extensively resourced with a high level of experience throughout the group in their areas of specialisation.

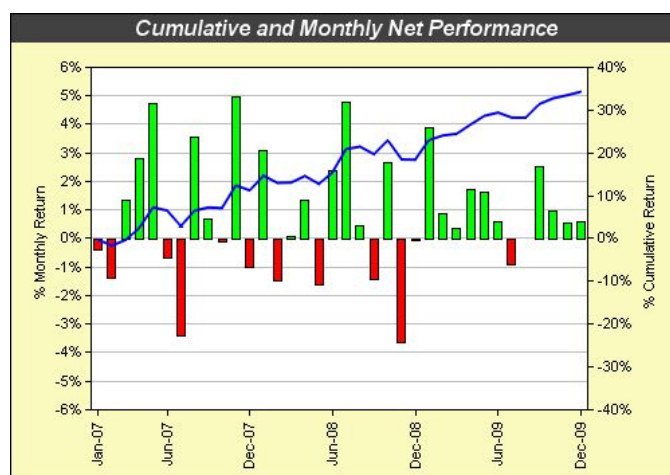
QIC GFIAF aims to provide a return of 5-10% p.a. over the UBS Bank Bill Index. The underlying investment process leverages off the manager's broader fixed interest approach and is essentially a portfolio of innovative absolute return strategies capturing the global fixed interest process "best ideas". The approach seeks to generate returns from a highly diversified portfolio of strategies which also assists in controlling exposure risk within the QIC GFIAF. Despite this, the manager expects that the QIC GFIAF is likely to produce a negative return 1 in every 4 years on average and therefore investors need to adopt a medium to long term (3+ years) investment horizon when investing in the Fund.

The Manager seeks to control risk by diversifying across a wide number of investment strategies and positions. The risk management and portfolio management systems used by QIC are underpinned by the use of BlackRock Solutions' Aladdin Package, which provides highly sophisticated systems for day-to-day management and maintenance of risk attributes within the QIC GFIAF portfolio. In addition to these quantitative tools, analysts from BlackRock's Risk and Quantitative Analysis team (RQA) provide continual qualitative feedback on risks in the portfolio. Zenith has reviewed RQA's systems and met with member's of its team and consider their approach to risk management to be best practice.

QIC GFIAF's highly active investment process, extensive use of derivatives and high return objective of the Fund is likely to lead to medium to high levels of volatility in returns. Therefore, although the Fund has daily liquidity, Zenith does not advocate QIC GFIAF being used by investors requiring short term liquidity from their investment, due to the risk of realising a negative capital return. As a result, we believe the Fund is most appropriate for those investors who have a moderate to high risk profile and are seeking high returns from an absolute return focused investment.

Overall, Zenith rates the investment team and process highly and has assigned QIC GFIAF a RECOMMENDED rating.

Key Features	Description
APIR Code	DDH0007AU
Asset Class	International Fixed Interest
Sub-Asset Class	Specialist
Investment Style	Active
Benchmark	UBS Bank Bill Index
Return Objective	Objective is 5-10% p.a. above UBS Bank Bill Index
Recommended Investment Timeframe	3 + years
Managing Director, QIC Global Fixed Interest	Susan Buckley
Investment Team Size	19



### Performance Analysis

Performance Statistics	3 Yrs (% p.a.)	2 Yrs (% p.a.)	1 Yr (% p.a.)
Performance - Fund	10.29	9.88	13.43
Performance - Benchmark	5.93	5.53	3.47
Performance - Median Manager	5.75	8.61	13.51

QIC GFIAF's investment objective is to deliver 5-10% p.a. (net of fees) in excess of the UBS Bank Bill Index. Pleasingly, the Fund has achieved strong performance numbers in what has been a challenging market environment.

### Income / Growth Returns

QIC GFIAF's income / growth returns over the past 3 years to 30 November 2009 are shown below:

- 30/11/08 - 30/11/09: Growth -3.95%, Income 16.65%, Total Return 12.70%
- 30/11/07 - 30/11/08: Growth -7.32%, Income 12.92%, Total Return 5.40%
- 30/11/06 - 30/11/07: Growth 4.38%, Income 11.03%, Total Return 15.41%

Although the Fund should be viewed more as an absolute return fund rather than an income focused investment, the Manager's very active management approach to the management of the Fund results in a high level of portfolio turnover of positions. In turn, this results in the majority of the Fund's return being delivered as income via realised capital gains. Despite the majority of returns from the Fund being income, it is not suitable for those investors seeking income as distribution levels are likely to be highly volatile from quarter to quarter based on the Fund's investment process.

### Consistency Analysis

Consistency Statistics	3 Yrs	2 Yrs	1 Yr
History of Monthly Excess Return (%)	58.33	62.50	83.33
History of Monthly Excess Return (Rising Mkts %)	58.33	62.50	83.33
History of Monthly Excess Return (Falling Mkts %)	0.00	0.00	0.00

Although QIC GFIAF has satisfactorily achieved outperformance over 50% since inception, Zenith expects this statistic to further increase should credit markets continue their recovery post the global financial crisis.

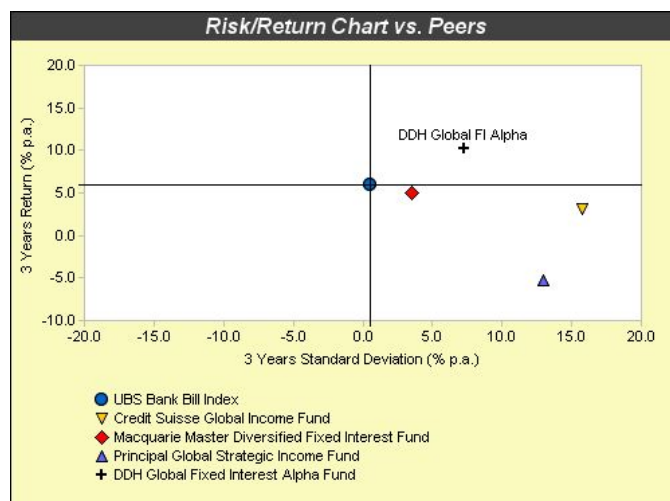
### Risk / Return Analysis

Risk / Return Statistics	3 Yrs	2 Yrs	1 Yr
Information Ratio - Fund	0.60	0.68	2.45
Information Ratio - Median Manager	0.17	0.22	2.32
Sharpe Ratio - Fund	0.60	0.68	2.40
Sharpe Ratio - Median Manager	0.16	1.16	2.79
Standard Deviation (% p.a.) - Fund	7.24	6.42	4.15
Standard Deviation (% p.a.) - Median Manager	12.21	5.46	3.94
Tracking Error (% p.a.) - Fund	7.24	6.43	4.07
Tracking Error (% p.a.) - Median Manager	12.32	4.96	3.69

Reflecting GFIAF's high performance objective, risk levels as measured by standard deviation are typically at the upper end of the spectrum in comparison with the peer universe of fixed interest funds.

Investors should be aware the Fund has the ability to maintain up to 20% standard deviation over a rolling 3 years, which potentially allows volatility to trend significantly that of the Median Manager in this sector.

The risk / return chart below highlights the Fund's risk adjusted performance standing relative to other managers in the universe.



## Investment Personnel

Name	Title	Time with Manager
Susan Buckley	Managing Director, QIC Global Fixed Interest	8 Yr(s)
Peter Scobie	Director, Credit	1 Yr(s)
Carolyn Martin	Senior Portfolio Manager, Global Credit	2 Yr(s)
Marayka Ward	Portfolio Manager, Credit	7 Yr(s)
Richard Garland	Portfolio Manager, Credit	4 Yr(s)
Stephen Holmes	Senior Analyst, Credit	1 Yr(s)
Katrina King	Credit Strategist	4 Yr(s)
Beverley Morris	Macro Strategist	7 Yr(s)
Kent Wilkes	Senior Portfolio Manager, Inflation	11 Yr(s)
Debbie Waters	Portfolio Manager, Macro	4 Yr(s)
Ben Sanders	Senior Portfolio Manager, Macro	4 Yr(s)
Peter Bogdanovic	Analyst	5 Yr(s)
Andrew Ticehurst	Macro Strategist	5 Mth(s)
Andy Lin	Macro Analyst	4 Yr(s)
Andrew Morgan	Director, Cash & Beta Management	6 Yr(s)
Scott Rissman	Senior Portfolio Manager, Cash & Beta Management	6 Yr(s)
Andrew Whittaker	Analyst	2 Yr(s)
Ben Fisher	Analyst	3 Yr(s)
Thanula Wijeratne	Analyst	1 Yr(s)

### Organisation:

Previously known as Queensland Investment Corporation, QIC Limited (QIC) is a fully commercial organisation owned by the Queensland Government, with offices in Brisbane, London, Sydney and Melbourne. QIC commenced operations in 1989, and has grown to be one of the largest institutional investment managers in Australia, with approximately \$65 billion in funds under management as of 30 September 2009. Of this amount, QIC manage ~\$47 billion in global fixed interest exposures. The majority of this figure is in cash/enhanced cash and global beta mandates, with approximately \$170 million currently being managed in this Fund and \$1 billion in this strategy.

During 2009, QIC undertook an independent review of its future strategy, organisational structure, and remuneration structure, which culminated in the firm moving to establish a 'house of boutiques' model within the firm in August 2009. As part of the review, each existing investment team was critically evaluated in terms of future outperformance and profitability potential. This resulted in the closure of two investment

businesses - Implemented Solutions and Global Tactical Asset Allocation.

The new structure is intended to allow investment teams and key investment professionals to fully focus on investment management. Each boutique has the backing and support of the centralised resources of QIC, including finance, systems, compliance, risk management and investment support services. In November 2009, Hazel McNeillage was appointed as QIC's Head of Funds Management. Zenith believes she is a valuable addition to the team, given her 25 years of experience which includes a proven track record in managing a multi-boutique investment structure. Zenith is broadly supportive of the restructure overall, which should assist the firm address its previous difficulty in retaining key staff, whom can now be offered an equity like economic interest in their relevant boutique.

### Investment Team:

QIC has a well resourced and experienced team of 19 investment professionals, which has been organised into 3 units according to research responsibility. These units are: Macro (7 people); Credit - Investment Grade and High Yield (6 people); and Beta and Cash (5 people). Although the team has experienced above average turnover it has gradually grown in size.

The team is headed by Susan Buckley, Managing Director, QIC Global Fixed Interest, who has over 23 years of industry experience, over 8 of which have been with QIC. Prior to her current role with QIC, Buckley held positions as Head of Strategy, NRMA Asset Management, Senior Vice President, BT Funds Management and Manager, Suncorp Investment Management. Zenith believes Buckley demonstrates the necessary knowledge, skills and experience to successfully lead the team and manage the groups fixed interest products effectively.

As well as having overall responsibility for the QIC Global Fixed Interest boutique, Buckley leads the Macro team. Buckley is well supported by a number of senior professionals, including Peter Scobie, Director, Credit, and Andrew Ticehurst, Macro Strategist, within the Macro unit, both of whom have over 20 years of industry experience. In addition, there are a further 5 analysts within the Credit and Macro units that possess over 10 years of industry experience, further highlighting the calibre of the team overall.

The Credit Team is responsible for conducting issuer credit analysis research and security selection in Investment Grade and High Yield securities. The Macro Team is responsible for duration management, yield curve positioning and sector allocation. The Cash Management team is led by Andrew Morgan, who is the senior portfolio manager within the Beta and Cash Management team.

Zenith believes the team structure is well organized and logical and is consistent with the manager's objective to generate returns from a broad range of sources. In summary, we believe the QIC Fixed Interest Team is extensively resourced with a high level of experience throughout the group in their areas of specialisation. The team is well lead by Susan Buckley and as a result we rate their investment capabilities highly.

### Investment Process

#### Investment Objective

The objective of the QIC GFIAF is to generate high risk adjusted returns from interest rate and credit management strategies. The QIC GFIAF aims to provide a return of 5-10% p.a. over the UBS Bank Bill Index. From this perspective Zenith believes the Fund should be viewed as an absolute return fund rather than a traditional fixed interest fund. Zenith believes that the Fund is relatively uniquely positioned as an absolute return focused fund, given it aims to achieve the high return objective from investment in fixed interest markets rather than the growth asset classes of Australian or international equities.

In order to achieve this level of returns the manager seeks to apply an innovative absolute return strategy which aims to construct a portfolio capturing the investment team's best ideas.

### Investment Philosophy

The manager's investment philosophy is based on:

- Fundamental factors drive markets towards fair value;
- Transitory influences cause market values to deviate from fair value in the short term; and
- Diversified sources of active return across interest rates and credit sources;

The fixed interest sectors utilised within the product are extremely broad encompassing all segments of fixed interest markets including but not limited to:

- Global Government bond markets;
- Global corporate bond markets;
- Global structured credit markets; and
- Global derivative markets including futures, swaps, credit derivatives and other synthetically created instruments.

### Investment Strategy

The sources of potential return for the QIC GFIAF are broad and are categorised into Interest Rate Strategies and Credit Strategies as follows:

#### Interest Rate Strategies

The objective of the interest rate research is to determine the relative country positions, duration exposures and yield curve positions. The interest rate strategies sources of return include:

- Duration - this is the management of the maturity profile of the portfolio and its ability to add returns through bond yield movements both up and down;
- Yield Curve - what part of the yield curve provides the best value and return potential;
- Country Spreads - this strategy reviews bond yields of different countries versus each other, versus their fair value and versus their historical yield levels;
- Security selection - the purchase of the most attractively valued securities;
- Inflation Linked; and
- Volatility

#### Credit Strategies

The objective of the credit research is to determine the credit allocation, industry allocation, individual corporate security selection and to manage the QIC GFIAF's overall credit risk. The credit strategies sources of return include:

- Allocation to credit (versus government bonds);
- Sector / Industry Allocation - the use of both the "top-down" macroeconomic views and bottom up issue research to tilt the portfolio to those sectors / industries that are likely to provide the best returns;
- Issuer Selection - this involves leveraging off the research of the credit analysts to identify and invest in the strongest issuers;
- Country Credit Spreads - this involves the comparison of corporate bond yields across different countries and allocating to those countries offering the best risk / return potential;
- Swap Spreads strategies;
- Credit Yield Curve - this strategy combines the macro view with the bottom-up security analysis in order to select securities in the optimal maturity band of the yield curve; and
- Long / short strategies - buying undervalued markets or securities and selling overvalued markets or securities.

### Investment Process

The investment process follows a structured and disciplined 5 step approach. The first stage of the process is the research approach which involves the development of a fundamental based, global macro research framework for interest rate analysis. The manager has developed proprietary 10 year valuation models for Australia and the US and short end valuation models for G7 and Australia. In addition to these models QIC have developed proprietary econometric models that provide research based valuation signals to support the interest rate strategies, credit and swap strategies.

The research is internally generated and supplemented by external sources such as Factset, Bloomberg and the manager's contact with global brokers / counterparties and the research and information they provide. Information will also be drawn from the QIC group's economists and other asset classes to ensure all key variables are identified and assessed.

The manager then uses this information to complete scores (from -5 to +5) for both global interest rates (2yr & 10 yr bonds) and the Global Credit environment. Different members of the investment team are responsible for scoring their areas of responsibility which results in a total of 24 scorecards across global markets being completed. This scorecard approach is completed on a weekly basis or more frequently if conditions require. This scoring process is used for valuation, transitory risks and technical and market positioning factors and is used as a measure of the strength of the view. The scorecards then drive the "best ideas" in terms of country spreads and yield curve positions.

Transitory factors are key economic variables and upcoming releases that could influence bond and / or credit markets. Technical factors focus on trend and sentiment indicators such as price momentum. The valuation score tends to be largely automated by the output of the valuation models, whereas the transitory risks and technical and market positioning factors are more subjectively scored. While these factors are more subjective, the underlying factors in each category are formally identified and scored which we believe provides sound rigour to the derivation of the overall score.

In practice, the investment approach is ongoing which involves monitoring and evaluation on a continual basis. Zenith believes the manager's scoring approach provides a sound investment

framework by ensuring that all key drivers are formally assessed and reviewed and portfolio positions reflect the views of the team. It also provides the manager with an audit "trail" of historical decisions and how these have performed and what improvements could be made to the process.

## Security Selection

### Universe of Securities

The QIC GFIAF invests in a broad range of global interest rate and credit derivatives and physical fixed interest securities. The QIC GFIAF may also hold cash and deposits for portfolio management purposes along with foreign currency deposits for the management of foreign currency denominated futures contracts.

The QIC GFIAF may purchase or sell Australian or International:

- Interest rate futures contracts, including foreign bond futures;
- Bank bill and government bond, exchange traded and over-the-counter options contracts;
- Interest rate swap agreements, index swaps, CPI swaps or interest rate swap futures;
- Forward rate agreements;
- Other synthetically created interest rate instruments;
- FX spot and forward rate contracts used to establish foreign currency deposits, and to hedge those deposits back into AUD;
- Credit derivatives or other synthetically created credit instruments, including emerging market credit derivatives, and options on credit derivatives;
- Currency spot and forward exchange contracts; and
- Other synthetically created instruments.

## Portfolio Construction

It is the output of the scoring process that drives the positioning of the portfolio within both the interest rate strategies and credit strategies. The strength of each score effectively determines the size of each position. The manager then implements these views through derivatives which involves the use of leverage (up to 3 times net asset value) to enhance position sizes and ability to generate returns.

The philosophy behind the manager's portfolio construction process is to construct a diversified portfolio with strategies across the broadest possible interest rate and credit market opportunity set. The manager expects that different strategies will contribute to performance at different times.

Cash is used in the QIC GFIAF for the purposes of covering any unrealised losses and to manage the liquidity and collateral requirements of the fund. Annual turnover of exposures is expected to be high which is consistent with the manager's active approach to the management of this fund.

## Risk Management

Portfolio Constraints	Description
Emerging Markets Debt - Absolute (%)	-125% to 125%
Global High Yield - Absolute (%)	-250% to 250%
Emerging Markets & High Yield (%)	-250% to 250%
Inflation Linked Bonds (%)	-50% to 50%
Duration ( Yrs )	-7 Yrs to 7 Yrs
Gross Leverage	Will not exceed 15 times the NAV of the Fund
Net Leverage	Will not exceed 3 times the NAV of the Fund
Value at Risk Limits (%)	3% of NAV on daily basis and 20% on monthly basis

The Manager seeks to control risk by diversifying across a wide number of investment strategies and positions. The QIC GFIAF's holdings are closely monitored to ensure unwanted concentrations do not occur. As a further risk management tool, the QIC GFIAF operates under a wide number of constraints as detailed in the table above. While these investment constraints are numerous, they are deliberately wide in order to provide the Manager with the necessary flexibility to achieve the Fund's high target returns. Zenith believes these risk management constraints are appropriate and consistent with the Fund's return objective however, can expose the Fund to moderate to high levels of investment risk.

The Manager uses daily profit and loss statements for all active positions which ensure each position is being actively monitored and managed. Every position in the portfolio has a target return and the manager actively uses stop-loss orders to limit downside risk if positions do not work out as intended. Daily portfolio performance attribution is also undertaken on the portfolio to ensure the portfolio manager is kept up-to-date with where returns are being made or lost and which strategies are working and which may need review.

From a trading perspective, a senior manager must authorise every trade which in Zenith's experience is consistent with industry best practice.

The risk management and portfolio management systems used by QIC are underpinned by the use of BlackRock Solutions' Aladdin Package, which provides highly sophisticated systems for day-to-day management and maintenance of risk attributes within the QIC GFIAF portfolio. In addition to these quantitative tools, analysts from BlackRock's Risk and Quantitative Analysis team (RQA) provide continual qualitative feedback on risks in the portfolio. Zenith has reviewed RQA's systems and met with member's of its team and consider their approach to risk management to be best practice.

## Leverage

Taken in isolation the QIC GFIAF can hold derivative exposures greater than the capital allocated to the QIC GFIAF. The QIC GFIAF will not be levered by direct borrowing. That is, the net cash exposure of the QIC GFIAF will always be

positive. The particular leverage limits are set with references to the Net Asset Value of the QIC GFIAF.

### Derivatives

All positions in the QIC GFIAF are enacted through derivatives. The manager also actively utilises credit derivatives including credit default swaps and credit indices. In order to do this, the manager has established agreements with 15 different counterparties. In Zenith's experience this is a large number of counterparties and provides excellent diversity and choice when seeking pricing on derivatives. While the manager does not formally restrict their exposure to any one counterparty, exposure is actively monitored. Counterparties must have a minimum rating of A- or the equivalent by the international rating agencies Standard & Poors, Moodys or Fitch.

### Currency

Foreign currency exposures stemming from offshore investments are hedged back into Australian dollars (AUD) with no active currency management.

### Risks of the Fund

The QIC GFIAF has a high return objective and employs extensive use of derivatives which exposes the fund to leverage. Investors should be aware that leverage can amplify investment losses as well as gains from the Fund's investment positions. As derivatives contracts must be honoured by the party on the opposing side of the trade, the Fund is also exposed to counterparty risk, ie - the counterparty may default on their obligations. In this regard, Zenith believes having 15 different counterparties reduces investors' exposure to this risk significantly.

As an indication of the level of risk associated with an investment in the QIC GFIAF, the manager expects that, on average, it is likely to deliver a negative return 1 in every 4 years. The highly active investment approach adopted by the manager and leveraged exposure via derivatives means that fund returns are likely to be volatile and therefore the QIC GFIAF is not appropriate for those investors with a conservative risk profile.

The manager seeks to control the risk of the QIC GFIAF by maintaining a highly diversified portfolio across both interest rate and credit strategies and this should assist in limiting both exposure and volatility risk for those investors adopting a long term investment approach.

As at end November 2009, QIC had Funds Under Management (FUM) of approximately \$1 billion invested in this strategy. The Manager has committed to reviewing the Fund's capacity once FUM reaches \$2.5 billion. Given the derivatives markets that the Fund invests in are highly liquid, Zenith is comfortable with the manager's current policy.

Zenith considers Buckley to be a key contributor to the Fund's investment process, and therefore would view her departure as a significant loss, that would trigger a review of the Fund's current rating. This being said, Zenith acknowledges the high level of experience among the team overall, with several analysts also currently having portfolio management responsibilities. Over time, Zenith believes the continuing development of the team will further negate key person risk surrounding Buckley.

### Applications of the Fund

3 years Excess Correlation Table	
Fund Name	Excess Correlation
Credit Suisse Global Income Fund	0.11
Macquarie Master Diversified Fixed Interest Fund	0.05
Principal Global Strategic Income Fund	0.25

While Zenith has categorised the Fund as a specialist international fixed interest fund, the Fund should be viewed as an absolute return fund and is therefore not suitable for those investors seeking a consistent income generating investment. In addition, the highly active investment process, extensive use of derivatives and high return objective of the Fund is likely to lead to medium to high levels of volatility in returns. Therefore, although the Fund has daily liquidity, Zenith does not advocate QIC GFIAF being used by investors requiring short term liquidity from their investment, due to the risk of realising a negative capital loss.

As a result, we believe the Fund is most appropriate for those investors who have a moderate to high risk profile and are seeking high returns from an absolute return focused investment. As the Fund seeks to generate its returns from fixed interest strategies rather than the growth assets of Australian or international equities, we believe it provides excellent diversification qualities for a high returning diversified portfolio. Alternatively, the Fund's aggressive return target lends itself to being used as a "satellite" overlay exposure to more traditional fixed interest investments as a way of enhancing the returns of the portfolio.

### Fees

The Manager charges a base management fee of 1.5% p.a. In addition, there is a Performance Fee of 20% of returns above benchmark (UBSA Bank Bill Index), subject to a high watermark. Although the Fund is expensive relative to other managers in this sector, Zenith views the fee structure to be in line with the high absolute performance objectives of the Fund.

### Author: Graeme Miller Investment Analyst

Email: [graeme.miller@zenithpartners.com.au](mailto:graeme.miller@zenithpartners.com.au)  
Ph: (03)9642 3320  
Fax: (03)9642 3319

**DISCLAIMER:** This report is prepared exclusively for clients of Zenith Investment Partners (Zenith). The report contains recommendations and advice of a general nature and does not have regard to the particular circumstances or needs of any specific person who may read it. Each client should assess either personally or with the assistance of a licensed financial adviser whether the Zenith recommendation or advice is appropriate to their situation before making an investment decision. The information contained in the report is believed to be reliable, but its completeness and accuracy is not guaranteed. Opinions expressed may change without notice. Zenith accepts no liability, whether direct or indirect arising from the use of information contained in this report. No part of this document is to be construed as a solicitation to buy or sell any investment. The performance of the investment in this report is not a representation as to future performance or likely return. The material contained in this report is subject to copyright and may not be reproduced without the consent of the copyright owner. Zenith usually receives a fee for assessing the fund manager and product(s) described in this

*document against accepted criteria considered comprehensive and objective.*