DDH Global Fixed Interest Alpha Fund

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DDH Graham Limited has issued a PDS offering a range of funds known as the DDH Investment Funds which provide access to investment in a number of underlying wholesale funds managed by QIC (Queensland Investment Corporation). DDH Global Fixed Interest Alpha Fund (the Fund) is one of the offered funds with DDH Graham Limited being the responsible entity and distributor and QIC the Investment Manager (manager). The DDH Global Fixed Interest Alpha Fund invests in the QIC Global Fixed Interest Alpha Fund (QIC GFIAF).

The DDH Global Fixed Interest Alpha Fund is a unique Fund within the absolute return "space". That is, while the Fund seeks to generate its high return objective of 10% p.a. above the UBS Bank Bill Index from investment in fixed interest markets, the Fund should be viewed and used as an absolute return fund and not an income fund. In order to achieve its return objective, the Fund is very actively managed and invests extensively in derivatives which provides significant exposure to leverage. Potential investors should be aware that leverage can amplify losses as well as gains and therefore the Fund is not recommended for conservative investors.

In addition, the active nature of the investment strategy used in the management of the Fund results in a large proportion of the return being distributed as income via realised capital gains. As these income distributions are likely to be unpredictable over time and returns volatile over shorter term periods, the Fund is most suitable for those investors seeking an absolute return investment with a medium to long term investment horizon. Given the Fund seeks to achieve its returns from investment in fixed interest markets and strategies, Zenith believes it provides excellent diversification characteristics when combined with equities based absolute return funds.

The QIC GFIAF is managed by QIC's internal fixed interest team which is not well known by the retail market but in Zenith's opinion is one of the most extensively resourced fixed interest teams within Australia. The team is headed by Susan Buckley and consists of 18 fixed interest professionals, which positions the group amongst the leading fixed interest teams in the country in terms of depth and resources. Importantly, there is an excellent level of experience across the investment team with an average of 9 years investment experience. The team is well structured and highly organised which Zenith views as critical for a team of this size.

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.

Zenith believes the investment process used in the management of the QIC GFIAF is well structured and disciplined and ensures that the positions in the portfolio are consistent with the manager's views. The QIC GFIAF is expected to deliver moderate to high levels of volatility over time. Overall, Zenith rates the investment team and process highly and has assigned a RECOMMENDED rating to the Fund.

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 10% p.a. above UBS Bank Bill Index
Recommended Investment Timeframe	3 + years
General Manager - Global Fixed Interest	Susan Buckley
Investment Team Size	18

Cumulative and Monthly Net Performance

Performance Analysis

Performance Statistics	*Since Inception*	*6 Mths (%)*	*3 Mths (%)*
Performance - Fund	10.05	7.62	0.67
Performance - Benchmark	6.01	3.28	1.64
Performance - Median Manager	-	3.02	0.67

Inception Date: Nov 2006

The Fund is approaching its first full year of performance and while it has generated attractive levels of return, it has not yet achieved its objective of achieving a return of 10% p.a. over the UBS Bank Bill Index. This return objective is targeted over a medium to longer term time frame and investors need to adopt a longer term (3+ years) investment horizon to maximise the potential to enjoy this level of returns over time.

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.

Investment Personnel

Name	*Title*	*Time with Manager*
Susan Buckley	General Manager - Global Fixed Interest	5 Yr(s)
Jeff Brunton	Head of Global Credit	14 Yr(s)
Kent Wilkes	Senior Global Manager	7 Yr(s)
Carolyn Martin	Senior Global Credit Analyst	2 Mth(s)
Andrew Morgan	Global Credit Manager	6 Yr(s)
Marayka Ward	Global Credit Manager	4 Yr(s)
Scott Rissman	Global Credit Portfolio Manager	4 Yr(s)
Richard Garland	Global Credit Portfolio Analyst	2 Yr(s)
Robert Jewell	Head of GFI Macro & Rates	5 Yr(s)
Beverley Morris	Global Macro Strategist	5 Yr(s)
Steven Smith	Global Macro Portfolio Manager	3 Yr(s)
Deborah Waters	Global Fixed Interest Analyst	1 Yr(s)
Benjamin Sanders	GFI Risk & Research Manager	2 Yr(s)
Peter Bogdanovic	Fixed Interest Analyst	2 Yr(s)
Lucy Austin	Business Analyst	7 Mth(s)
Bill Prendergast	Beta & Risk Manager	1 Mth(s)
Stephen Treanor	High Yield Consultant	7 Mth(s)
Katrina King	Head of GFI Alternative Investments	1 Yr(s)

QIC has one of the most extensively resourced and experienced fixed interest teams Zenith has reviewed. The team is headed by Susan Buckley, General Manager, Global Fixed Interest and consists of a further 18 fixed income investment professionals. There has been a further 7 additions to the team since our last review with only one departure (Bryce Lloyd) in this time. The team members, their positions and years with the manager are summarised in the table above.

As well as the addition of the new investment team members, the team structure and responsibilities has been further refined with the breakdown of the team into four distinct units. These units include Macro (4 people), Global Credit (6.5 people - Marayka Ward spends half of her time in this team and half in Alternative Fixed Interest), Beta and Risk Management (4 people) and Alternative Fixed Interest (1.5 people). The group has also employed Stephen Treanor as a consultant on high yield which has added further to group's capabilities in the high yield asset classes. We believe the evolution of the team to a more formal structure is both positive and necessary when dealing with such a large number of people. In Zenith's opinion, the QIC fixed interest team is very well resourced and compares favourably with many globally based fixed interest managers we have reviewed.

As General Manager, Global Fixed Interest, Susan Buckley is highly experienced with over 20 years experience in financial services and specifically, fixed interest investment roles. She has been in her current role at QIC since November 2001 and was specifically recruited for the head role. Prior to this she held positions as Head of Strategy, NRMA Asset Management, Senior Vice President, BT Funds Management and Manager, Suncorp Investment Management. Zenith has met with and interviewed Buckley on 3 occasions as part of its review process and believes she demonstrates the necessary knowledge, skills and experience to successfully lead the team and manage the group's fixed interest products effectively.

Buckley is ably supported by Jeff Brunton, Head of Global Credit, Robert Jewell, Head of GFI Macro and Rates, Bill Prendergast, Head of Beta and Risk Management and Katrina King, Head of GFI Alternative Investments. All of these heads of the fixed interest team units have over 13 years investment experience and represent a highly experienced team with vast and complimentary skill sets.

The Global Credit team consists of 6.5 people and is responsible for conducting issuer credit analysis research and security selection. Carolyn Martin has been recruited to this team since our last review and brings a wealth of knowledge and experience with over 16 years credit analyst experience including her last role at Fitch Ratings.

The Macro team consists of 4 people and is responsible for duration management, yield curve positioning and sector allocation. Beverley Morris has joined the Macro team as Global Macro Strategist. She has been recruited from within QIC where she was Chief Economist and Head of Economics. Morris has 13 years financial industry experience and provides specialist economic skills and knowledge which are invaluable in forming the macroeconomic views of the group.

The Beta and Risk Management team is a new unit within the global fixed interest team and is headed by Bill Prendergast who is also a new member of the team and has been recruited from AXA Investment Management in Tokyo specifically to head this team. Prendergast is another experienced addition to the team with over 11 years financial industry experience. This team is responsible for the management of over $15bn in long duration and inflation portfolios. The team's expertise in constructing and managing mandates is complemented by the strength of global relationships which are vital for accessing exposures in the inflation swap market. Zenith views this as a critical component of the fixed interest investment process and therefore considers the formation of a dedicated team in this area as a strong commitment to the management of risk and is a significant strength of the QIC team structure.

The Alternative Fixed Interest team is the smallest of the 4 global fixed interest units and consists of Katrina King with Marayka Ward spending half of her time in this area. The Alternative Fixed Interest team is responsible for the assessment of structured credit investments in the high yield segments of collateralised loan and debt obligations and in Zenith's opinion is a valuable addition and source of returns for the Fund.

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 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 in the absolute return "space" 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" macro economic 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 fundamentals 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 DataStream, 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.

The QIC GFIAF may also invest (via a mandate or pooled investment vehicle) in external managers. This has not occurred to date and is the responsibility of Susan Buckley who would leverage off the external manager research conducted by David Field (Head of Global Fixed Interest External Managers).

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) 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 (%)	-25% to 25%
Global High Yield - Absolute (%)	-50% to 50%
Emerging Markets & High Yield (%)	-50% to 50%
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 contraints 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 ensures 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. Since our last review, the risk management and portfolio management systems used by QIC are in the process of being further enhanced and consolidated into the Blackrock Solutions (BRS) risk process and portfolio management system. This will result in the day-to-day management and maintenance of risk attributes within the portfolio management of the QIC GFIAF being centralised in the one portfolio and risk platform. In Zenith's view, this is a sound enhancement and will result in more efficient portfolio management and risk management processes. QIC have also integrated reporting of further risk metrics including tracking error and Value at Risk (VAR). From this perspective, Zenith believes the manager is well resourced with risk management software and processes.

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 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.

Applications of the Fund

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 and therefore is not suitable for conservative investors.

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. Used in this way, Zenith believes an allocation of up to 10% of the fixed interest component of the portfolio would be optimal.

Investors should be aware that the Fund generates its returns through the use of derivatives in the QIC GFIAF which exposes the Fund to leverage and therefore this can act to amplify losses as well as gains. Investors should also be prepared for moderate to high levels of capital volatility particularly over short term time periods. For this reason, only those investors who are prepared to invest for the medium to longer term (3+ years) should consider an investment in the Fund.

Fees

The Fund has a base management fee of 1.5% p.a. which we believe is acceptable given the high return target of the QIC GFIAF. In addition, the Fund invests in the underlying QIC GFIAF from which a performance fee may be payable to QIC if the performance hurdles are met. The performance is equal to 20% of the returns of the Fund generated above the Fund's benchmark (UBS Bank Bill Index) after the base management fee has been paid subject to a high water mark. The fee is paid annually if applicable. Zenith believes that while the benchmark hurdle should be relatively easy for the manager to outperform, the performance fee structure is one of the "fairer" ones we have seen in recent times. The annual payment frequency is acceptable (rather than being more frequent) and the requirement for cumulative excess value of the QIC GFIAF to be higher than the last time the performance fee was paid is a sound feature of the fee structure. This effectively means, any previous underperformance needs to be made up before performance fees are payable.

Author: David Wright
Director
Email: david.wright@zenithpartners.com.au
Ph: (03)9642 3320
Fax: (03)9642 3319