

Colonial First State Hedge Funds

InvestorInfo Hedge Fund Seminar - June 2002

Damien Hatfield
Head of Hedge Funds

Agenda

- Evolution of the industry
- What are Hedge Funds?
- Common misconceptions
- Why are Hedge Funds included in portfolio construction?
- Our approach to Hedge Fund investing - the Global Diversified Strategies Fund
- Summary

Evolution of the industry

- Started in 1949 by an Australian, Alfred Winslow Jones with a US long-short portfolio
- Slowly built recognition through 70's, 80's and 1990's
- Growing in importance amongst global pension funds
- Industry now over US\$500 billion
- 6,000-8,000 Hedge Funds worldwide

What are Hedge Funds?

- Investment professionals who invest in shares, fixed interest and other instruments
- Aiming to profit in rising and falling markets
- Using a variety of investment techniques:
 - Most use some level of leverage
 - Some use derivatives
 - Long and short exposures
- Most Hedge Fund managers have a significant personal stake in their own funds

A Long-Short trade (example only)

Assume as at December 31 2001, BHP Billiton is expected to rise, News Corporation is expected to fall:

Dec 31:

Long only manager:
Zero weight in News
Buy BHP at \$10.50

Long-Short manager:
Sell News short at \$15.62
Buy BHP at \$10.50

March 31:

Sell BHP at \$11.40

Buy News at \$13.12
Sell BHP at \$11.40

Profit = \$0.90

Profit = \$3.40

(Excluding borrowing costs, brokerage)

Common misconceptions

- “Hedge Funds are risky”
- “All Hedge Funds are highly leveraged”
- “Hedge Funds are not transparent”
- “Hedge Funds are not liquid”

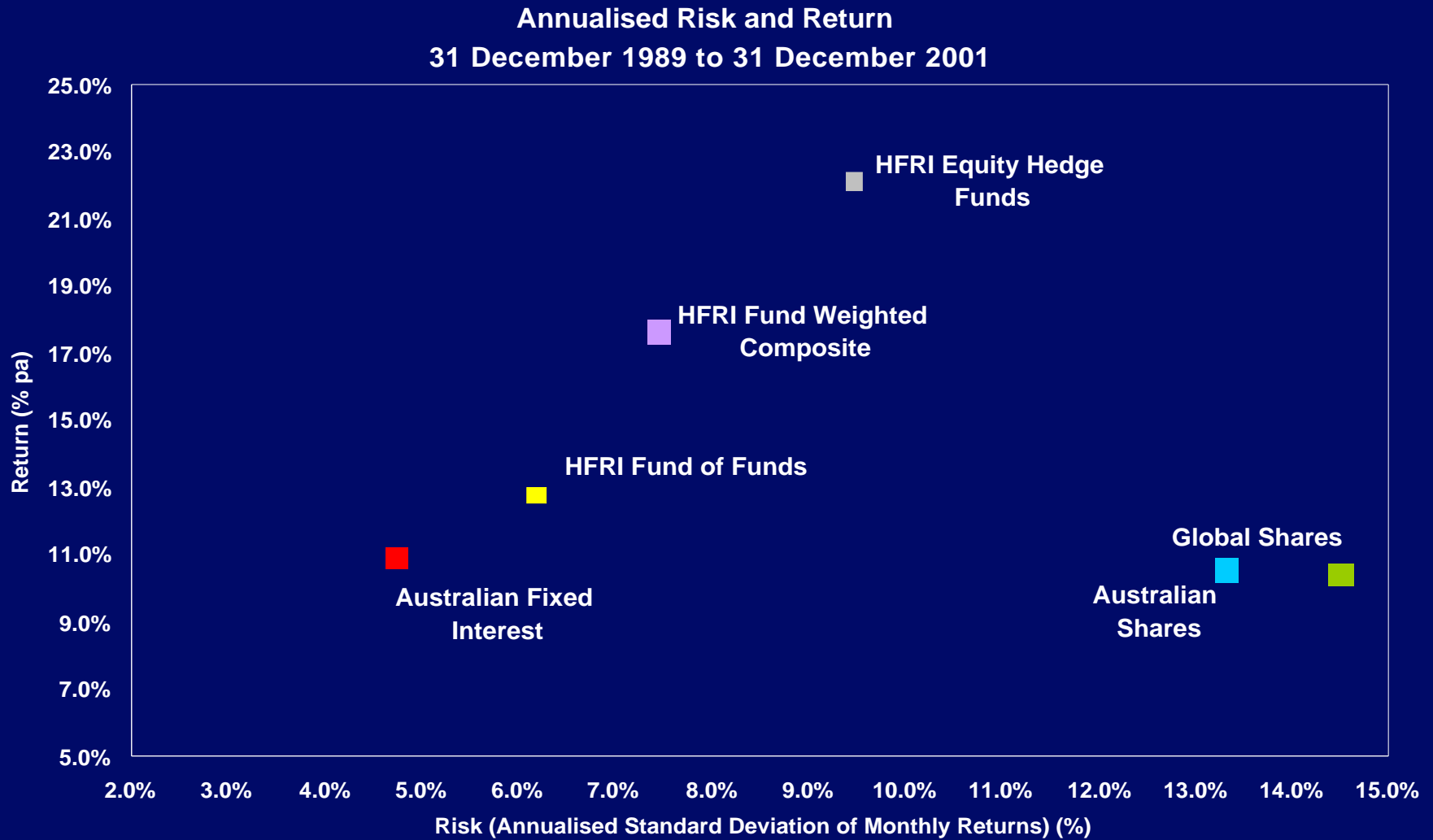
Long Term Capital Management

- Started in 1994 from Salomon Brothers Government Bond Team
- Dealt in Fixed Income Arbitrage
- Used 15-25 times leverage which blew out to 125 times
- Became too speculative and became a victim of the Russian default in August 1998
- Had unrealised losses of \$4.4 billion of which \$1.9 billion was the partner's own money
- Warren Buffett was negotiating to purchase the assets
- Fed directed syndicate of US based Banks advanced \$3.6 billion to cover margin

Why are Hedge Funds included in portfolio construction?

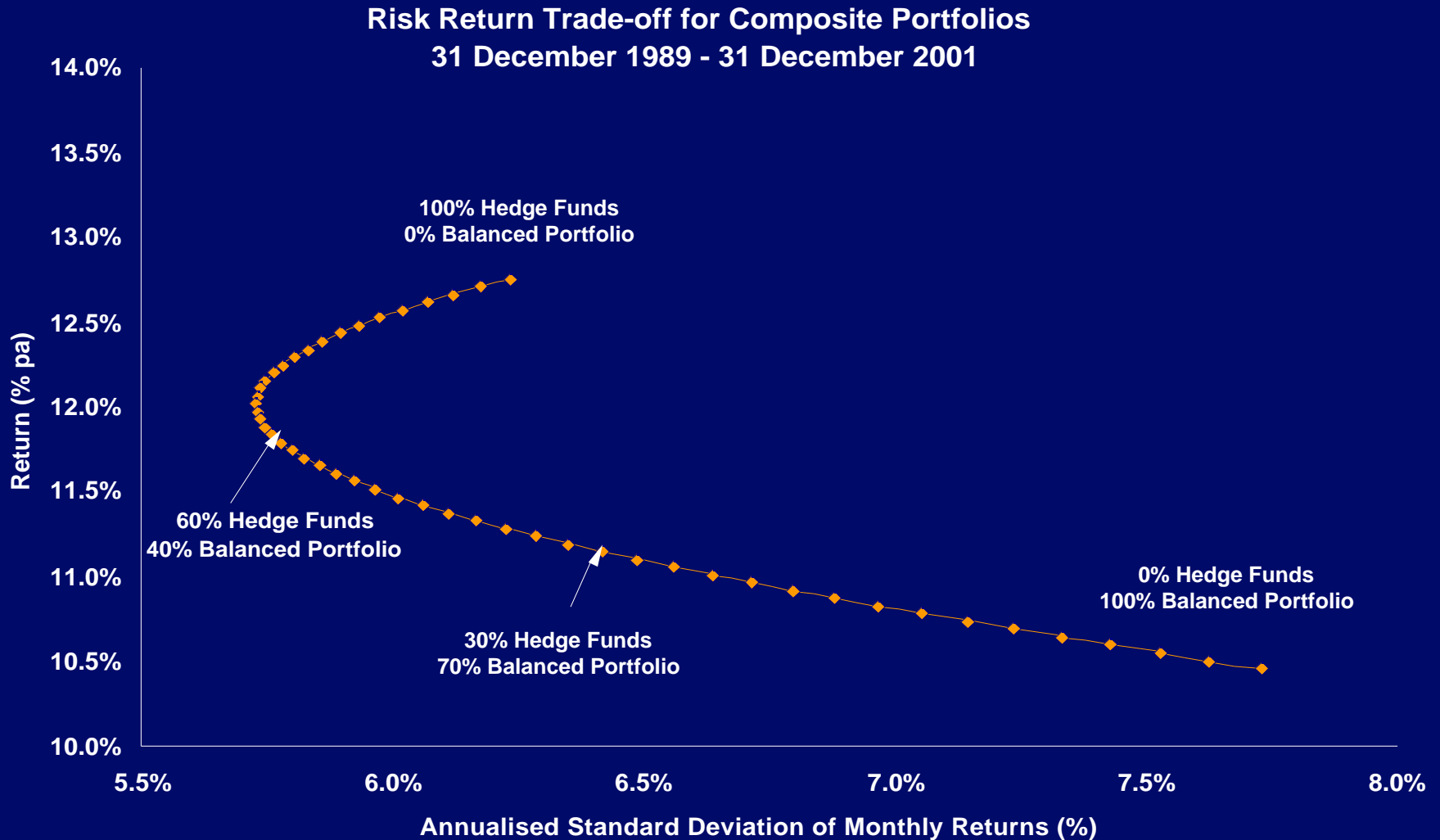
- Low correlation to traditional assets
- Fundamentally different drivers of return, ie natural diversification
- Aim to deliver positive returns in both rising and falling markets
- Potential to provide enhanced risk-adjusted returns
- Scope to add significant value across a wider range of scenarios

Better Risk and Return Characteristics



Source: W M Mercer, Hedge Fund Research Inc., Bloomberg.

Improved risk-adjusted portfolio return



Source: W M Mercer, Hedge Fund Research Inc.

Our approach to Hedge Fund investing

How do we select managers?

Quantitative considerations

- Track record
- Volatility
- Risk and return
- Liquidity

Qualitative considerations

- Organisation & staff
- Investment & risk management
- Controls on leverage
- Service providers

Our approach to Hedge Fund investing

- Long Short Shares
 - Regional managers
(eg US, Europe, Japan)
 - Sector managers
(eg US mid-cap)

Relative Value Shares

Market neutral
Arbitrage strategies
(eg merger, convertible
bond, index)

- Fixed Interest
 - Fixed interest arbitrage
 - Credit, asset backed
strategies
 - Distressed debt
 - Emerging markets debt

Tactical Strategies

Macro
Currency traders
Managed futures

CFS Hedge Funds onshore team

- Damien Hatfield
 - Head of Hedge Funds
 - 14 years experience in alternative investments
 - Chairman of AIMA Australian Chapter
- David Bell
 - Director, Investments, Hedge Funds
 - 4 years with Colonial First State, formerly assistant to GM Investments.
 - Fixed Interest and risk management experience
 - Master of Applied Finance

CFS Hedge Funds – onshore team

- Mike Berry
 - Investment Analyst
 - Formerly Head of Colonial State Bank Derivatives Desk
- Jonathon Lawless
 - Investment Analyst
 - Formerly Research Analyst, Equity Trader

Harcourt – offshore team

- Harcourt
 - Zurich based hedge fund and managed futures consultant
 - 15 Staff including:
 - Dr Kurt Lambert, CEO co-founder and previously with Bank Leu responsible for hedge fund investments
 - Dr Philipp Cottier, Chairman of the Board and CIO co-founder and previously with Swiss Banking Corp
- They Provide
 - Customized and exclusive advice on construction of our portfolios
 - Manager recommendations
 - Research
 - A global connection

Retail Offering

- Global Diversified Strategies Fund:
 - 25 managers across 4 sectors
 - 12% - 14% pa return objective
 - 5% - 7% standard deviation
 - \$1,000 minimum investment
 - 1.4% pa management fee
 - 4% entry fee

Wholesale Offering

- Wholesale Hedge Funds:
 - Sector choices
 - Global Diversified Strategies Fund
 - Long Short Share Strategies Fund
 - Relative Value Share Strategies Fund
 - Fixed Interest Strategies Fund
 - Tactical Strategies Fund
 - \$100,000 minimum investment
 - 0.8% pa management fee
 - No entry fee

Colonial First State Hedge Funds

- Different features to traditional asset classes
 - 10% performance fee on new profits
 - Monthly applications
 - Monthly unit prices
 - Quarterly redemptions
- Treated as taxable income

Growth in FUM

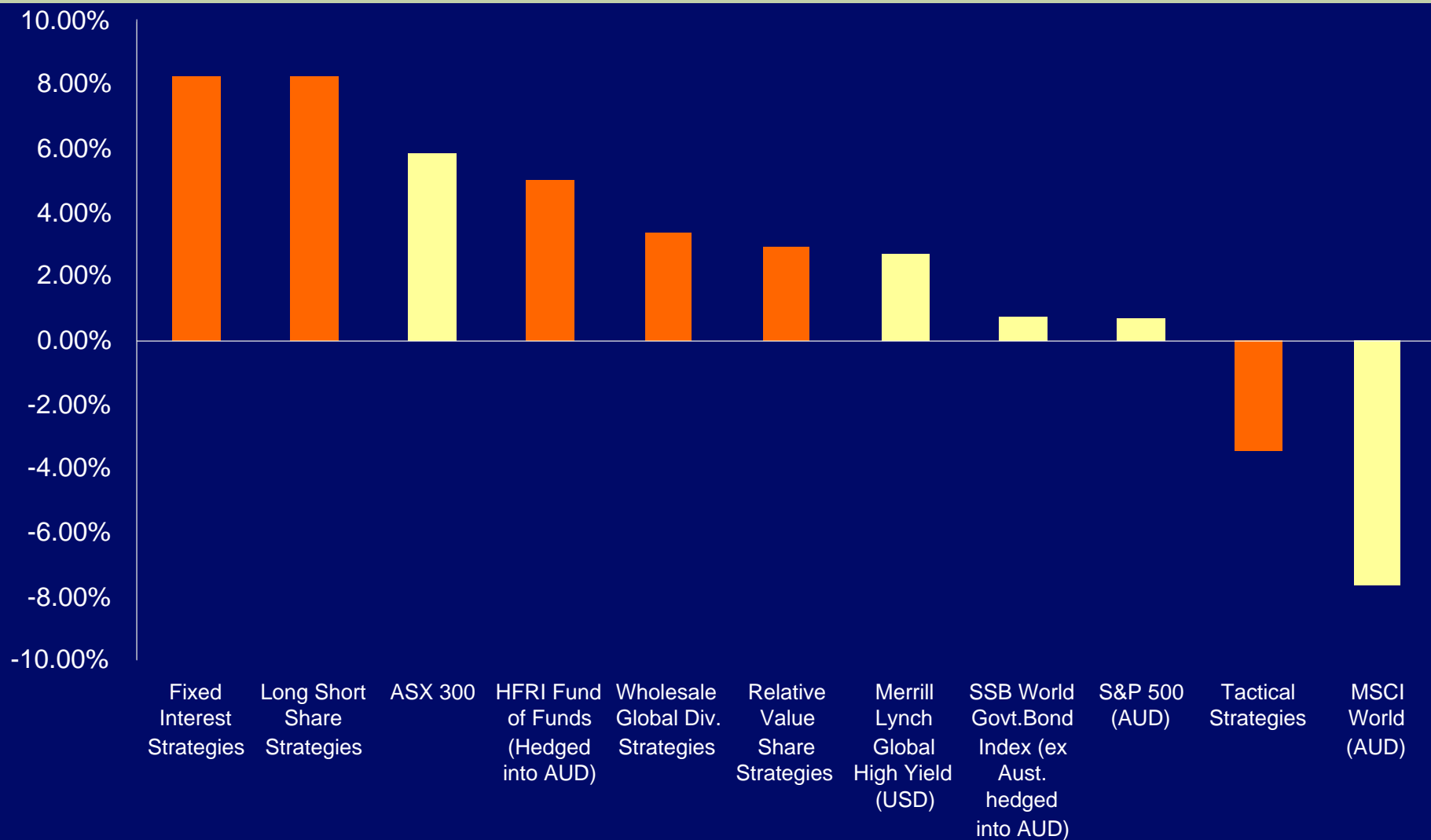
- 6 Funds launched on 31 October 2001 with \$40 million:
 - Global Diversified Strategies Fund
 - Wholesale Global Diversified Strategies Fund
 - Wholesale Long Short Share Strategies Fund
 - Wholesale Relative Value Share Strategies Fund
 - Wholesale Fixed Interest Strategies Fund
 - Wholesale Tactical Strategies Fund
- \$40 million inflow to date
- New flows have been
 - 60% Retail
 - 40% Wholesale

Performance to date

Portfolio	1 month return (%) May	3 month return (%) May	Since Incep. - May return (%) Nov. 2001	End of month weight (%)	Target weight (%)
Long Short Share Strategies	2.16	4.99	8.22	32.4	32.5
Relative Value Share Strategies	0.56	1.75	2.95	31.6	32.5
Fixed Interest Strategies	1.17	2.71	8.26	17.5	17.5
Tactical Strategies	-0.86	3.49	-3.46	16.9	17.5
Cash				1.6	0.0
Wholesale Global Div. Strategies	0.95	2.10	3.37	100.0	100.0

Past performance is no guarantee of future performance

Performance to date



Our strengths

- Experienced on-shore team
- Global reach through our consulting agreement with Harcourt
- Documented and rigorous investment processes
- Strictly enforced Investment Disciplines
- Strategic approach to portfolio construction
- Transparency of process
- Back office and reporting