

Analysts: Simone Arblaster; Leanne Fook

Products Facts

Manager	Value Partners Limited	Fund type	Wholesale	Boutique	Yes
APIR code	MAQ0441AU	Specialisation	—	Multimanager	No
Fund status	Open	Peer group	International Equities - Emerging Markets China	Inception date	Oct. 31, 2005
Min. investment (A\$)	3500000			ICR (% pa)	1.99

Standard & Poor's View

S&P rates this fund three stars, reflecting our conviction that the manager will consistently generate risk-adjusted returns in-line with both its relevant investment objectives and its peers.

The Premium China fund is designed to provide investors with an exposure to the greater China region. The manager is benchmark-unaware and prepared to take reasonably divergent positions relative to the benchmark. The downgrade from four stars to three stars reflects the increase in attractive competitors offering more economical options in accessing China markets.

S&P considers portfolio manager Yee-man Chau experienced in managing greater China portfolios. The core decision makers within the team have been stable, but turnover at the analyst level is higher than that of peers. Company visits are a key strength of the manager, assisted by their location in Asia and team size. Rigorous original fundamental research drives stock decisions and risk management is focused at the stock level rather than on the overall portfolio.

A dynamic currency hedging strategy has been introduced to reduce the effect of currency movements on the fund's overall performance. This is implemented externally and attracts an additional management fee of 0.12% per year.

Performance has been strong relative to the benchmark over the year to Dec. 31, 2008; however, it has been driven by higher levels of cash rather than stock selection. Over longer periods, the fund is underperforming the benchmark. Fees are high relative to the small peer group; in 2008 the ICR was 2.30%. A performance fee of 15% is also applied to outperformance of the benchmark after fees, which is unusual relative to peers.

Product Features

The Premium China fund is managed by Value Partners Ltd. (VPL) and the investment manager is Sensible Asset Management Ltd. (SAM). The fund aims to provide investors with long-term capital growth by investing in the greater China region. This includes companies listed in Hong Kong, mainland China, and Taiwan. The fund can also invest in a wide range of other equity-like securities that are closely related to the greater China region. For example, it can invest in convertible bonds to be used to reduce risk in portfolios and companies listed on other exchanges which derive a significant portion of revenues from China. Therefore, the manager has the ability to invest in a broader range of securities than is available in its benchmark, the MSCI China Free index.

The ICR was 2.3% in 2008, which is expensive relative to the small peer group of China funds in S&P's ratings universe. The management fee has been increased from 1.88% to 2.00% to take into account the new currency management strategy (see "Currency Management"). The increase is the total cost of hedging charged by Macquarie Investment Management Ltd. (MIML) Treasury. The fund also has a performance

fee of 15% applied to any outperformance of the index, which is subject to a high water mark.

The fund's objective is to outperform the benchmark over a three- to five-year period (before changes in exchange rates), and there is no target outperformance stated. S&P would prefer to see an outperformance target over the benchmark specified even though the strategy is benchmark-unaware. The manager doesn't provide a tracking error forecast. Investors should be aware that positions, and hence performance may differ significantly from that of the benchmark.

Fund Objectives

Benchmark	Index Not Applicable
Target return (% p.a.)	Outperform MSCI China Index over a 3-5 year period

Investment Style

The fund seeks to identify undervalued securities using a value-oriented, fundamental, bottom-up approach to investment management. Any geographic or industry weighting will be driven mainly by the bottom-up stock selection process. Macro-economic input may overlay the bottom-up process, as determined by the chief investment officer (CIO). The manager states that it is a long-term value investor seeking undervalued stocks which are sold when fair value is reached. However, over the past couple of years turnover has been very high relative to peers and the manager's expected range of 100%-120%. In 2006 and 2007, the greater China stock market was strong and volatile; therefore the manager notes that the cycle for a stock to reach fair value was shortened, increasing the portfolio turnover. It was 117.8% in 2006 and 142.0% in 2007. The dramatic downturn in the market in 2008 also led to higher than average portfolio turnover that reached 158%. S&P accepts that unusual market conditions may lead to heightened levels of turnover. However, the manager has consistently generated turnover in excess of 100% which calls into question the manager's assertion that investment decisions are based on long-term fundamental analysis.

The fund is benchmark unaware therefore the manager does not focus on the benchmark when managing money. However, VPL places a strong emphasis on absolute returns. Investors should be aware that the fund does not employ the full range of tools to run as an absolute return fund, and it is being marketed in Australia with an index performance hurdle.

VPL's bottom-up approach to researching companies helps to mitigate concerns about investing in less developed and less transparent markets, such as mainland China. The fund has exposure to companies across a range of market capitalisations; however, compared with the benchmark, the fund has a strong bias to small-cap stocks.

Passive						Active
Value						Growth
Small Cap						Large Cap

Investment Team

The investment team of 16 analysts and portfolio managers is led by CIO Cheah Cheng Hye, who has been in the investment industry for 20 years. Before co-founding VPL in 1993, he headed Morgan Grenfell's Hong Kong equity research department. All members of the team are first and foremost analysts. The investment team is the largest dedicated player in the small peer group, which supports the firm's bottom-up research focus. In addition, there are three dealers. Experience within the senior group, whose members are also the decision makers, is a key strength of the fund. The average industry experience of the broader team is best described as moderate, which is reflective of the firm's tendency to hire analysts as graduates and train them up.

The CIO and the four senior fund managers each head up a "cluster", which is defined as a stock-picking unit with two to three analysts or fund managers. The process of research and investment is implemented at the cluster level and each group operates with a degree of autonomy. In practice, team members communicate on a day-to-day basis in an open environment. Each cluster leader is also responsible for co-ordinating sector research. The remainder of the team members are generalists and don't cover a specific sector. The CIO and senior fund managers meet on a weekly basis to share their views in terms of stock ideas, sector trends, macro-economic views, and to discuss implications on portfolio strategy. The cluster leader has the decision over individual stocks, and the CIO has the ability to override any decision.

Turnover at the analyst level is very high, the manager asserts that this is a consequence of a demanding performance culture at the firm. About four new analysts are hired each year; typically, only one or two would be held beyond a three- to four-year trial period. In September 2008, the manager took the opportunity to let go underperforming analysts and there were eight departures including an assistant fund manager. The core team of decision makers has been relatively stable, although there was one departure in November 2008; this was the first senior loss experienced since the firm's inception. S&P considers there to be key person risk within the senior staff, particularly with the CIO, which is somewhat mitigated through the ownership structure and cluster structure.

Portfolio manager Yee-man Chau joined VPL in 2005 and has 12 years' industry experience. Ms. Chau previously worked with Credit Agricole Asset Management and was responsible for its Hong Kong and greater China portfolios.

In November 2007, VPL was listed on the Hong Kong Stock Exchange. Following the listing, senior investment staff, including Ms. Chau, retained a 15.3% holding in VPL. Despite there being no equity plan in place for the less senior members of the team, most employees took the opportunity to purchase shares at the time of listing. Although the equity ownership of senior fund managers and analysts is not high, it does show some alignment of interests with the fortunes of the firm.

Remuneration is made up of a base salary and variable component. The variable is linked to the firm's profitability, which in turn is driven by the performance of the funds and collective contribution by the investment team. There is therefore a reasonable alignment with the investor.

New					Experienced
Small					Large
Unstable					Stable

Investment Process

The manager has been investing in China for 15 years, and has been invested in some stocks for 10 years, so there is a lot of history in its research. Investment ideas are principally sourced from the broad bottom-up coverage provided by the firm's investment team. Another

source of ideas is initial public offerings (IPOs). The manager notes that it didn't participate in any IPOs in 2008; although, it did spend time assessing most of the opportunities. VPL believes that one of its competitive advantages is its good access to new listings. Trading IPOs is not normally associated with fundamentally oriented bottom-up stock pickers. That said, all investment decisions are based on a bottom-up value investment approach supported by fundamental research.

VPL has established relationships with a network of government officials, including some bureau heads, who also provide some insight into the direction of government policy and the economy.

The large team enables detailed original bottom-up fundamental research to be conducted to generate ideas that are under-researched or unloved by the market. Basic valuation-focused ratio screens, such as price-to-earnings, price-to-book, dividend yield, and return-on-equity ratios are used to narrow the investment universe down to approximately 800 stocks. Company visits are conducted on each of these stocks, and each analyst on average has responsibility for about 50 stocks. An impressive 2,000 company meetings took place in 2008.

In practice, research is broadly conducted by teams that are aligned on a sector basis. A sector overlay was introduced a year ago, and analysts have been roughly split into industry groups. Each cluster is focused on a couple of industries; although, all analysts remain generalists. The manager is attempting to find the most efficient way for its junior staff to develop bottom-up research skills; it is likely that analysts will be rotated around sectors in another year or two. The macro view is the responsibility and decision of the CIO.

The bottom-up research requires full financial analysis of the stock; however, there is no standardised output. Attention is paid to debt levels and interest coverage, cash flow generating ability, margin trends, efficient allocation of capital, changes in directors' holdings, short- and long-term trading patterns, and comparisons with other companies in similar industries. VPL's approach to assessing companies includes on-site inspection of factories or offices and discussions with customers and competitors to verify financial reporting. The qualitative assessment of the depth and strength of the management team is also central to analyst conviction. Analysts use a variety of valuation techniques, depending on the stock. Typically, forecasts are only for one to two years because of the lack of transparency in the Chinese market.

The analyst will determine an enterprise value and the portfolio managers, working with analysts, assign "buy" or "sell" signals to stocks. In total, about 200 stocks are picked for investment across the firm. Although Mr. Cheah is ultimately responsible for the fund, all buy/sell decisions rest with Ms. Chau. The analyst will also recommend a weighting for the stock; however, the portfolio manager may disagree and make a judgement call to change it. New positions often start out small, and are then built up; the level of holding representing the analyst's conviction in the investment thesis. The cash allocation is a strategic decision by the CIO and enforced across all portfolios that VPL manages.

The final portfolio for this fund typically contains about 100 stocks; at Dec. 31, 2008, the fund held 83 stocks. VPL usually has high exposure to small-cap stocks, and at Dec. 31, 2008, the smallest stock held in the portfolio had a market capitalisation of US\$69 million. At the same date, roughly 40% of the fund was invested in stocks with a market value of less than US\$2 billion.

Currency Management

On Jan. 27, 2009, the manager introduced a currency hedging service, managed by the responsible entity, Macquarie Investment Management Ltd. (MIML). The service will hedge a varying portion of the fund's exposure to international assets back to Australian dollars. The strategy used is primarily Dynamic Currency Hedging (DCH) which aims to replicate the currency hedge that would be provided if the manager purchased an option over the fund's foreign currency exposure. To do

this, the fund primarily uses currency forward contracts and may also use static hedging strategies to minimise the cost of the DCH.

The aim of the overlay is not to add value, but to reduce volatility. In implementing the DCH process, MIML adjusts the hedge level of the fund as the value of the Australian dollar changes. As the Australian dollar strengthens, correspondingly the level of the hedge increases with the aim of reducing the magnitude of potential currency losses. Conversely, as the Australian dollar weakens the hedge level is progressively decreased, with the aim of preserving currency gains. At the date it was introduced, the fund was hedged at 50%, and it is reset to 50% at the start of each calendar year. The hedge level can range between fully unhedged to fully hedged. The Hong Kong dollar is hard pegged to the U.S. dollar to provide more liquidity. At any point in time, the fund may have a combination of static hedge and DCH in an attempt to reduce exposure to currency movements in the most cost effective manner. S&P considers the team to be well resourced and its track record has been consistent through the market cycle. S&P considers it appropriate that MIML will work in conjunction with VPL to achieve the best hedge on currency movements.

S&P notes that this hedge - between the Australian dollar and the U.S. dollar - will not necessarily protect the fund from a revaluation or float of the renminbi.

Performance

The fund has over three years' track record and VPL has been operating other mandates that are similar, but not identical, to this fund for many more years. Performance over the 12 months to Dec. 31, 2008, was strong relative to the benchmark and the fund outperformed the MSCI China Free Index by 4.0% (after fees). According to attribution provided by the manager, performance can be mostly attributed to higher cash levels.

During 2008, the cash level got up to as much as 20% in September 2008. We would prefer to see stock selection being the predominant driver of returns; in 2008 it detracted from performance. That said, 2008 was a difficult year in which to add value through bottom-up stock selection as the market experienced an indiscriminate sell-off of assets. Stock selection within financials and an overweight relative to the benchmark in materials were the most significant detractors. Derivatives exposure also detracted from returns. S&P notes that stock selection has not added value since the fund's inception in October 2005; however, value investing is a long-term strategy and a five-year time horizon is more appropriate.

Much of the long-term strong performance in other mandates has been attained with relatively low funds under management (FUM). This is a particularly critical issue given that small-cap stocks have provided much of the manager's excess return.

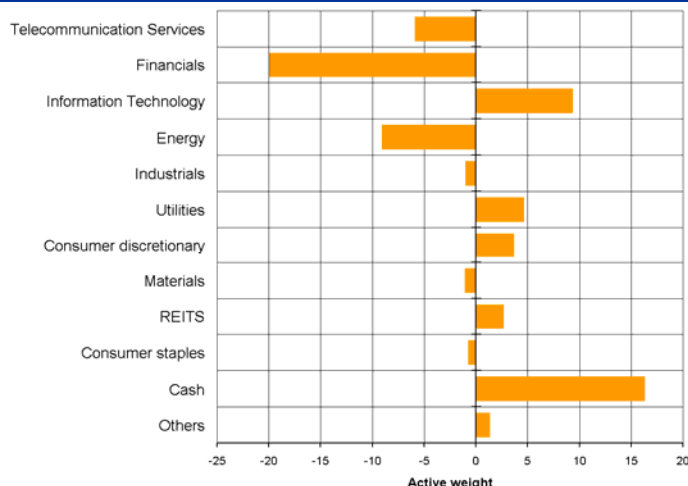
The manager is in the process of cutting out smaller positions, preferring to keep weighting at a reasonable level and the portfolio concentrated. At the time of review, the cash level was around 10%. The manager notes that fundamentals are coming back into play and therefore believes its bottom-up, value-investment stock-picking capabilities will be rewarded in the upcoming cycle.

Performance Measures

Average portfolio turnover (%)	136.8
Typical number of stocks in portfolio	104

Source: Value Partners Limited.

Sector Exposure Versus Fund Benchmark (at Dec. 31, 2008)



Source: Value Partners Limited.

Risk Management

Although the fund is benchmarked against an index, it is largely unconstrained at the stock or sector level. As the portfolio typically holds about 100 stocks, it is well diversified and the likelihood of any stock having a significant negative impact is low. Besides the cash position, the largest portfolio position was 5.8% at Dec. 31, 2008.

VPL has a benchmark-unaware approach and does not use tracking error targets as a form of risk control. Rather, the manager focuses on understanding risk at a stock level by aiming to have a strong fundamental knowledge of each company it invests in. The fund is not permitted to short individual stocks, but may short (or go long) exchange-traded derivatives, such as Hang Seng futures, up to a maximum of 25% of the total asset value of the fund in times of expected market volatility. Other downside protection includes a high allowable allocation to cash (up to 20% of the fund).

The manager uses value-at-risk (VaR) analysis and the Risk Metric tool at the total portfolio level for scenario analysis and stress testing. S&P does not believe that this methodology is appropriate given the benchmark-relative approach; VaR is a more appropriate risk tool for an absolute return fund. Risk levels of the fund, as measured by standard deviation, have historically been less than the benchmark and it would be expected that this continue going forward. In 2008, the fund had a standard deviation of 20.4%, while the benchmark's volatility was 32.3%.

Management Group Profile

SAM is the investment manager and VPL manages the fund on a subadvisory basis. Both SAM and VPL are wholly owned subsidiaries of Value Partners Group Ltd. which is an independent, value-oriented asset management group with a focus on greater China and the Asia Pacific region.

VPL was established in 1993 as a Hong Kong-based dedicated equities manager. The firm was listed on the Hong Kong Stock Exchange in November 2007 following the expiry of a contract with two private equity funds. VPL continues to be majority-owned by co-founder and CIO Mr. Cheah, who owns 35.7%. The chief executive and other senior fund managers own 15.3%, with the remainder of the firm (49.06%) owned by external investors. External owners include Ping Insurance Co. and two U.S. hedge funds.

In 2004, SAM was formed to market the firm's capabilities on a benchmark-relative basis. The driving force behind the creation of SAM

was to segregate the brand from the absolute return focus of VPL. Despite the benchmark-relative marketing of SAM, its underlying VPL investments are very much benchmark-unaware.

Simon Wu and associated companies hold the majority interest in Premium China Funds Management Pty. Ltd. (PCFM). The remainder is held by a law firm Premium Wealth Management as a dealer group, and some firms within Premium Wealth hold minority interests. Premium Wealth Management is a dealer group of 23 member firms spanning the eastern seaboard of China. Among these firms, there are 60 financial advisers. Premium Wealth Management was the initial supporter of the fund, but to date, there are 75 dealer groups actively including this fund in their clients' portfolios. The responsible entity for the fund is Macquarie Investment Management Ltd.

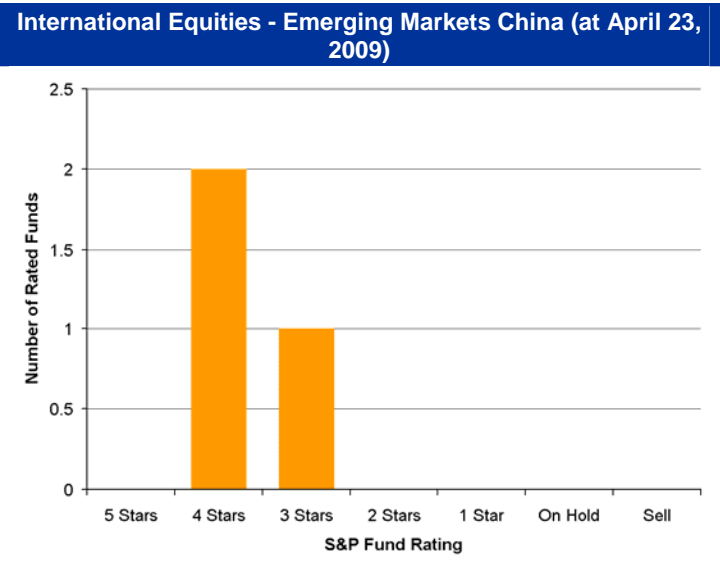
Market Share

At Dec. 31, 2008, the Value Partners business managed and/or advised on US\$3.2 billion of funds from institutional and retail investors from Europe (12%), the U.S. (19%), Hong Kong (56%), Japan (1%), Australia (7%), and other countries (5%). The majority of this is from institutional clients and pension funds. FUM reached a maximum of US\$7.3 billion in 2007. The subsequent drop in FUM has predominantly been from market movements; there was net outflow of US\$400 million in 2008. Altogether, there was A\$264 million in this fund at Dec. 31, 2008, an increase of A\$84 million over 18 months. VPL expects to be able to comfortably manage US\$10 billion, given its own resources and the size and liquidity of the overall market.

Analyst(s): Simone Arblaster; Leanne Fook.

Release authorised by: Mark Hoven.

S&P Fund Rating Reference Information



Reference Material
Sector Reports www.standardandpoors.com.au/funds
Reader's Roadmap www.standardandpoors.com.au/funds
Glossary www.standardandpoors.com.au/funds
Guide to S&P Qualitative Fund Ratings www.standardandpoors.com.au/funds
Fund Rating Team Biographies www.standardandpoors.com.au/funds

Fund Rating Peer Groups by Sector

Australian Equities	International Equities	International Fixed Interest	Alternative Assets
Large Cap Diversified	Diversified Equities	Diversified Fixed Interest	Commodities
Large Cap Income	Emerging Markets	Diversified Fixed Interest Income	Multi-Sector
Large Cap Indexed	Emerging Markets Asia ex Japan	Fixed Interest	Private Equity Listed
Large Cap Industrials	Emerging Markets China	Fixed Interest High Yield	Private Equity Unlisted
Long Short	Emerging Markets India	Fixed Interest Income	Infrastructure Listed
Small Cap	Large Cap Diversified	Mortgages	Infrastructure Unlisted
Specialist	Large Cap Income	Mortgages High Yield	Alternative Strategies
Australian Fixed Interest	Large Cap Indexed	Mortgages High Yield Hybrid	Single Strategy Funds Multimanager
Cash	Large Cap Industrials	Mortgages Conventional	Single Strategy Funds Single Manager
Cash Enhanced	Long Short	Mortgages Hybrid	Multi-Strategy Funds Multimanager
Fixed Interest	Long Short Specialist	International Property	Multi-Strategy Funds Single Manager
Fixed Interest Income	Long Short Regional	Direct Commercial	Multi-sector
Mortgages	Regional Japan	Direct Development	Capital Guaranteed
Mortgages High Yield	Regional UK/Europe	Direct Diversified Direct	20
Mortgages Conventional	Regional US	Direct Industrial	40
Mortgages High Yield Hybrid	Regional Asia	Direct Residential	60
Mortgages Hybrid	Small Cap	Direct Retail	80
Australian Property	Specialist Healthcare	Direct Rural	100
Direct Commercial	Specialist Information Technology	Direct Specialised	Equity
Direct Development	Specialist Resources	Diversified Property	Other
Direct Diversified Direct		Listed	
Direct Industrial			
Direct Residential			
Direct Retail			
Direct Rural			
Direct Specialised			
Diversified Fixed Interest Listed			








Fund Rating Philosophy

A star rating is a forward-looking qualitative assessment of a manager's ability to consistently generate risk-adjusted fund returns (net of fees) in excess of both its relevant investment objectives and its peers.


Fund Rating Process

In assigning a star rating to a fund, Standard & Poor's evaluates: the size, skill, and stability of the manager's investment team; the clarity, implementation, and risk management of the investment process; the fund's objectives, fee structure, and portfolio characteristics; and the manager's business management.

Fund Rating Definitions

	Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
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	Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
	Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
	Issues that may affect the fund's management have emerged; and the fund rating is temporarily suspended, pending clarification.
	Significant issues exist that potentially will adversely affect the fund's performance. Investors should consider obtaining advice on switching or redeeming funds.

Fund Rating Subscript

 The investment process, fund manager, or the fund has a relatively short history, or the analytical team has changed significantly, but a relevant and demonstrable track record is shown on similar funds.

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