Colonial First State

Colonial First State Global Asset Management

Comparing the Wholesale Global Credit Income Fund to the Lehman Global Corporate Index

Date: 30 June 2008

The following analysis on the excess returns of the Global Credit Income Fund (the Fund) against the Lehman Global Corporate Index (LGCI) demonstrates that the Fund provides a significantly superior risk adjusted return over all periods. The absolute return of the Fund has significantly outperformed the LGCI during difficult credit periods and while, during a positive credit environments the Fund performs approximately on par with the LGCI, it does so with significantly less volatility.

The Wholesale Global Credit Income Fund is managed without reference to any benchmarks. Colonial First State Global Asset Management believes that credit benchmarks, due to their construction and inclusion rules, do not represent a 'risk neutral position', they are a representative of 'market risk'.

Many market participants, however, wish to see the performance of the Fund against an index. As the Fund is global, the index that is deemed most appropriate is the Lehman Global Corporate Index. It is believed that this approach adds simplicity to the task of comparing the size and the quality of the return of the Fund, and other competitive portfolios, by assuming (incorrectly) that portfolios are of 'similar risk' to the index and thus their returns can be compared directly.

Benchmarks are often considerably more risky than many investors understand them to be. Further, management to a benchmark often results in 'index tracking' type behaviour rather than rational economic decision making. It is easily possible to outperform an index by holding a higher level of default risk than a benchmark, it is less easy to meet benchmark performance with a lower level of default risk. However, this is not captured in normal tracking error or information ratio measures of risk and performance.

The following table outlines the broad characteristics of the Fund and the LGCI.

	Wholesale Global Credit Income Fund	Lehman Global Corporate Index (LGCI)
Rating rage	AAA – CCC	AAA-C
Number of securities	508	7,685
Investment grade	80.92%	86.98%
High yield	19.08%	13.02%
Number of countries	38	17
Number of industries*	60	56
Number of currencies	9	6

* Note that industry definitions and classifications may differ.

There are two key differences between the Fund and the LGCI. These are:

- The LGCI is a fixed rate index, whereas the Fund is a floating rate fund, and
- The LGCI is USD based, whereas the Fund is fully hedged into AUD.

Notwithstanding these differences, it is possible to compare the performance of the Fund, with reasonable accuracy, to the corporate component of the Lehman Global Credit Index. The approach taken to compare the performance of the two is as follows:

1. Rather than work in total return space we deal with excess returns with the excess returns of the Fund being the returns above the bank bill index.
2. Lehman provides an 'excess return' series which represents the return of the Index over duration adjusted US Treasury Notes. This effectively strips the interest rate component out and provides a measure of the credit return of the LGCI.
3. The Lehman 'excess return' series is a return measured as an excess to US Treasury Notes, whereas the 'excess return' of the Fund is effectively an excess to swap. To compensate for this it is relatively easy to deduct the carry and any spread gain/loss in the swap/treasury spread from the 'excess return'.
4. Adjust for the value of the currency hedge. The basis swap between the AUD and USD LIBOR curves generally provides a pickup when swapping from floating USD to floating AUD. While this amount varies, it usually does so within a fairly tight range. Using Bloomberg data, the five year mid point has varied between -1.50 and 12.5 over the five-years to June 2008. The average has been 8.35. To simplify the calculation it is assumed that the Index would earn a constant pickup each month. As the Fund deals across the bid offer spread, it has been assumed that the Index would pick up 8 basis points per year were it hedged into AUD.

Thus, the monthly return of the LGCI over swap can be given by:

$$\mathbf{ERS = ER - SS/12 + [\Delta SS \times MD_i] + BS/12}$$

ERS = Excess return to swap
ER = Excess return (from LGCI)
SS = Swap spread
ΔSS = Swap spread at end of month – Swap spread at start of month
MD_i = Modified duration of LGCI
BS = Average five year basis swap from USD LIBOR to AUD BBSW (assumed to be 8 basis points)

Modified Duration of the LGCI has varied little over the last five years to June 2008 (between 5.176 and 5.50) the five year swap spread provides a simple, yet realistic, measure of the swap spread of the Index. This produces a reasonable and relatively accurate estimate of the total returns of the LGCI over the floating rate swap based index. This can then be compared directly to the excess returns of the Fund.

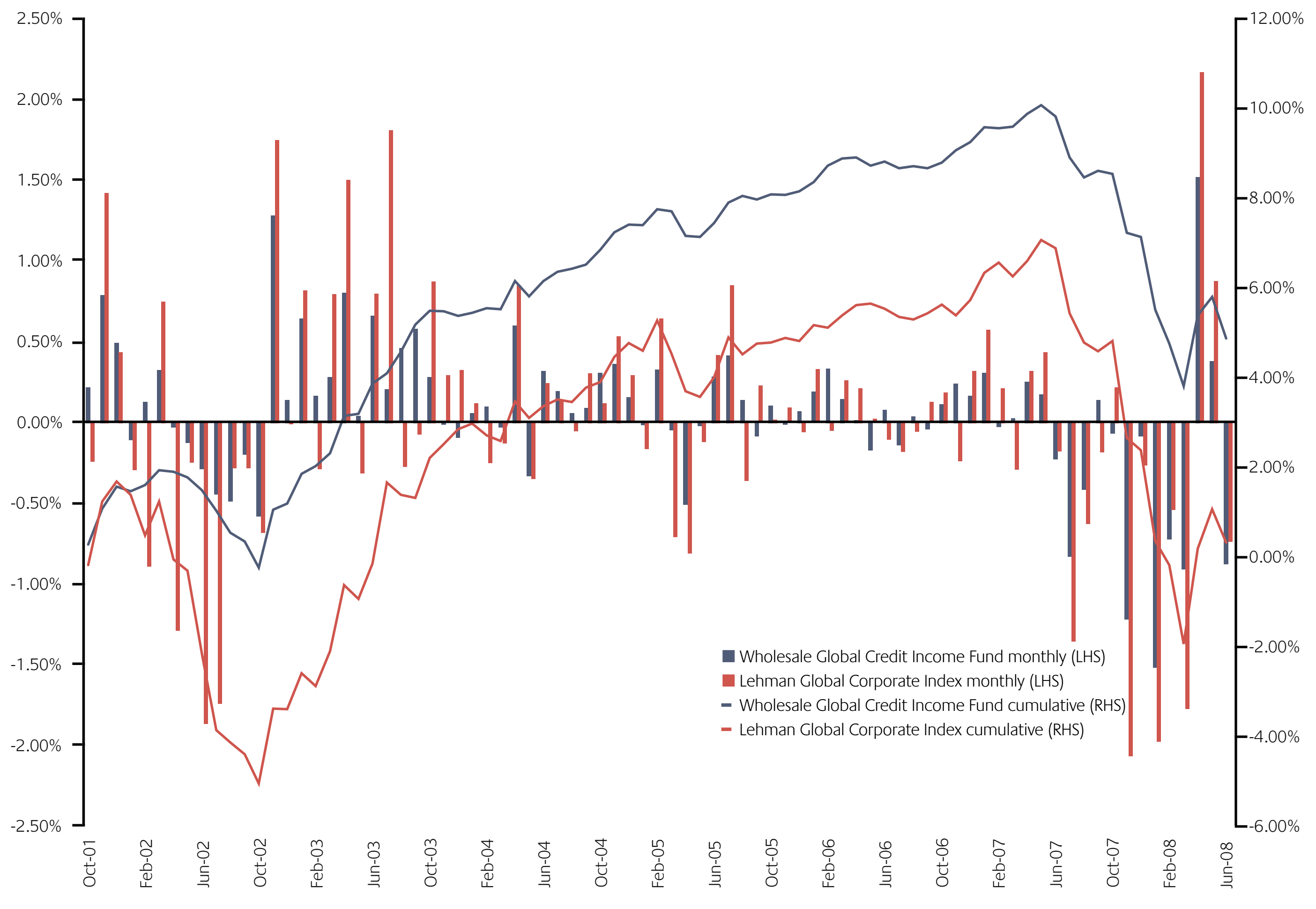
While volatility is a commonly used of measure for the 'risk' of credit portfolios it suffers from significant weakness as it ignores the asymmetrical nature of credit risk and the resultant 'tail risks'. For a full explanation please see the research paper by Tony Adams and Leah Kelly PhD titled 'Measuring Credit Portfolio Risk' available on www.cfsgam.com.au.

The following table and graph represent this result.

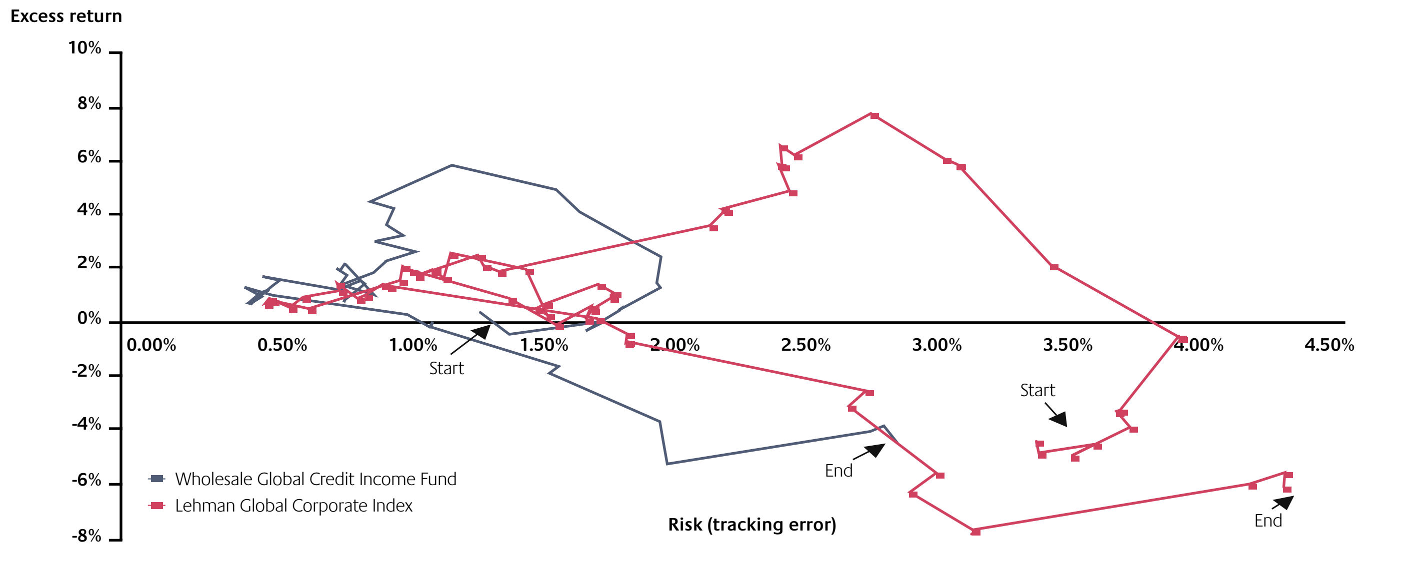
As at 31 January 2008	1 year	3 years	October 2001*
Fund excess	-4.51%	-0.81%	0.70%
LGCI exess	-6.14%	-1.19%	0.04%
Net	1.63%	0.39%	0.66%
Fund tracking error	2.74%	1.81%	1.59%
LGCI tracking error	4.09%	2.70%	2.72%
Fund info ratio	-1.65	-0.44	0.44
LGCI info ratio	-1.50	-0.44	0.01

* The excess returns for the Lehman Global Corporate Index Hedged in USD are only available from October 2001.

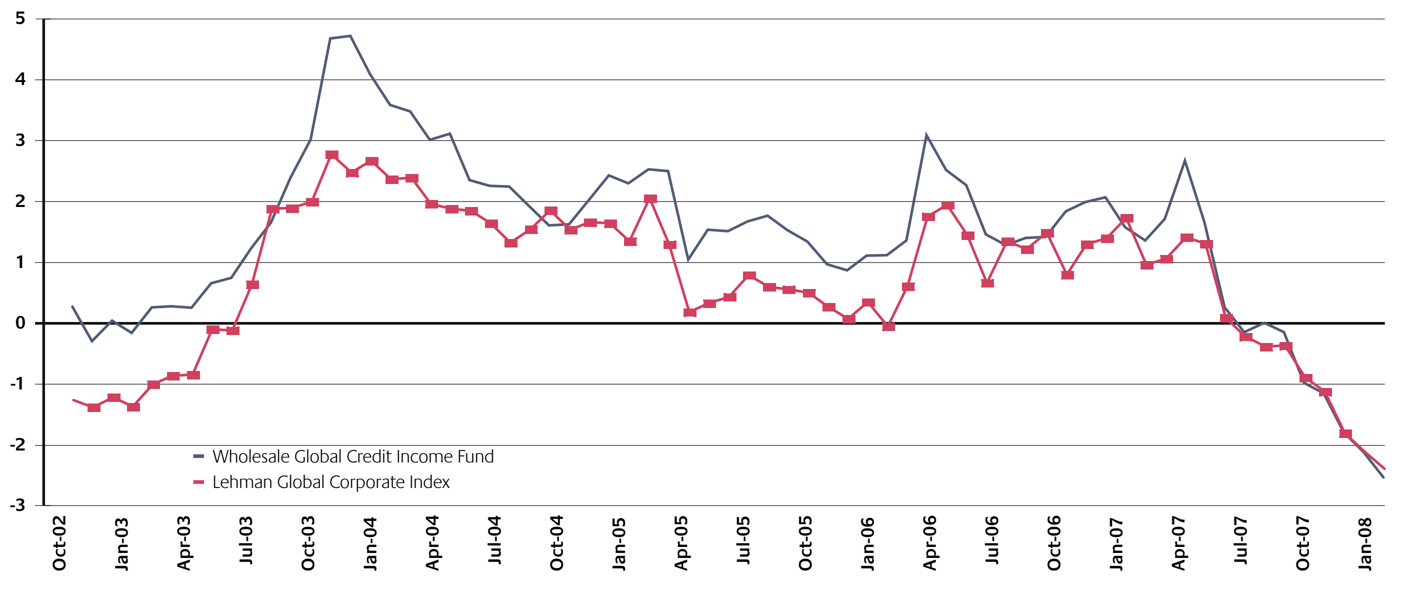
Fund and LGCI Indices – monthly and cumulative returns



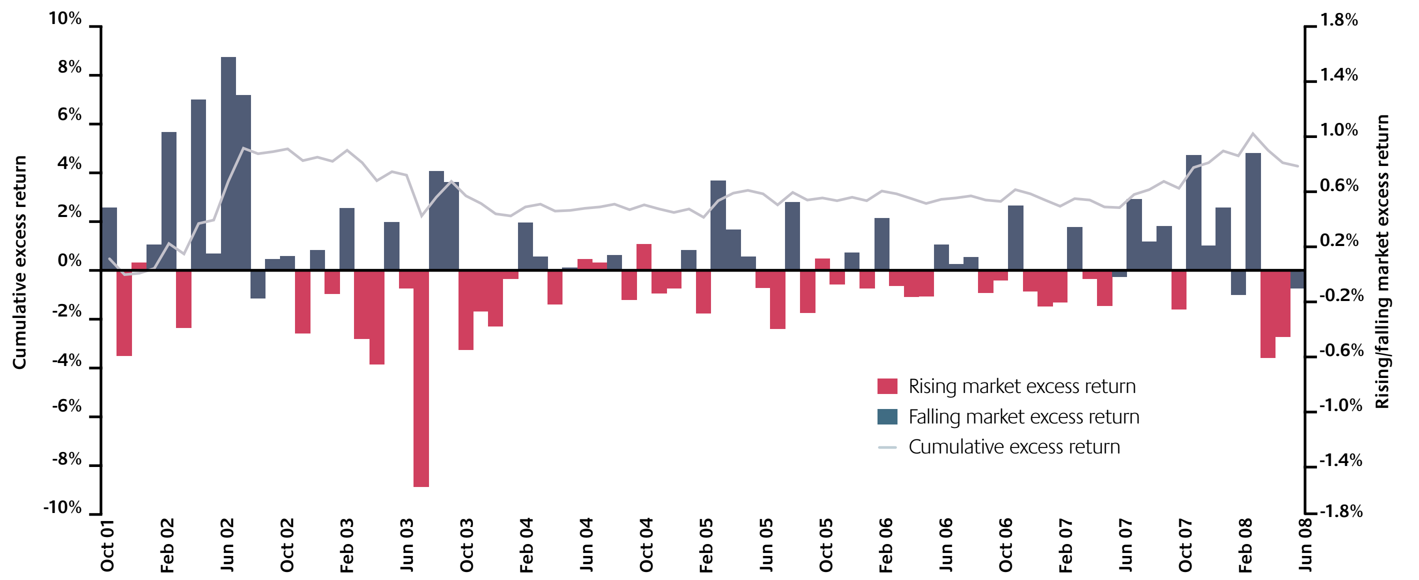
Rolling return paths – rolling 12 months from October 02



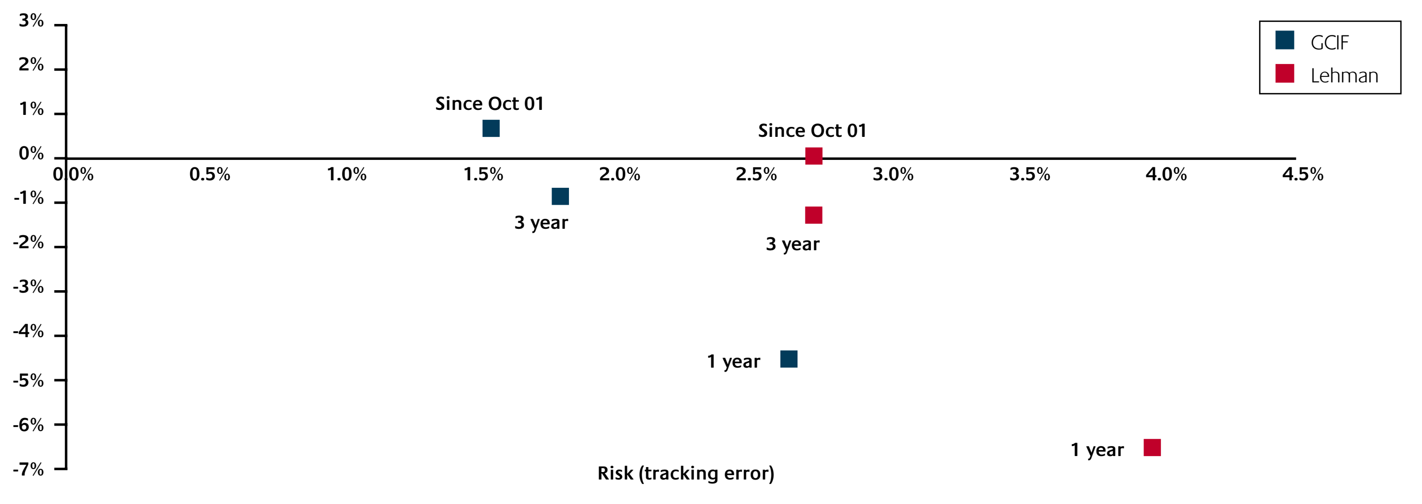
12 month rolling information ratios



Cumulative excess return relative to benchmark index



Historical risk return plot



Note on the Lehman Global Corporate Index

Lehman's broadly run three separate index hierarchies:

- Aggregate – all investment-grade securities in a currency or across currencies
- Universal – all investment-grade and high-yield securities within a single currency, and
- Multiverse – all investment-grade and high-yield securities in all currencies.

The Lehman Global Aggregate Index (and its credit sub components) is only a high grade index and thus inappropriate as a comparison tool for the Fund.

One index under the Multiverse category is the Global Credit Index (also known as the Global IG/HY Credit Index). This Index is comprised of the Global Aggregate Credit Index and the corporate portion of the Global High-Yield Index. It therefore contains both investment-grade and high-yield credit securities from the Multiverse Index, so it is more comparable to the Fund. However, the Global Credit Index also contains Supranationals, Sovereigns (non US Treasury), Foreign Agencies and Local Government Securities which are not held by the Fund. Lehman supply a subset of the Global Credit Index, the Global Corporate Index, that excludes these other issuers. The Global Corporate Index provides an appropriate index through which to compare the relative market risk of the Fund.

The Lehman's data series used is as follows (although excess return data is only available for this series from October 2001):

Group name:	Global Corporate
Currency:	USD
Returns type:	Hedged
Frequency:	Monthly
Start date:	31/10/2001
End date:	30/6/2008

Data used in analysis is as follows:

(1) Lehman Bros Global Credit Index excess return series

(2) CFS Global Credit Income Fund excess return over UBS Bank Bill Index

(3) Bloomberg five year swap spread at close of previous month. Ticker: USSP5 <Index>

(4) Lehman Bros Global Credit Index modified duration for close of previous month

(5) Calculation of adjusted Lehman excess as per formula provided above.

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Date	Lehman Excess Return to Treasury's (1)	WGIF Excess Return (2)	5 Year Swap Spread (3)	Lehman Mod Duration (4)	Lehman ERS with AUD hedge Adjust. (5)
31-Oct-01	0.10%	0.22%	0.70%	5.06	-0.24%
30-Nov-01	1.48%	0.79%	0.70%	5.14	1.42%
31-Dec-01	0.21%	0.49%	0.76%	5.12	0.44%
31-Jan-02	0.20%	-0.10%	0.67%	5.09	-0.29%
28-Feb-02	-0.56%	0.13%	0.62%	5.10	-0.89%
31-Mar-02	0.87%	0.33%	0.60%	5.12	0.75%
30-Apr-02	-0.81%	-0.03%	0.52%	5.09	-1.29%
31-May-02	0.15%	-0.12%	0.45%	5.11	-0.25%
30-Jun-02	-2.19%	-0.29%	0.52%	5.11	-1.86%
31-Jul-02	-2.44%	-0.44%	0.66%	5.09	-1.74%
31-Aug-02	0.48%	-0.49%	0.52%	5.05	-0.28%
30-Sep-02	-1.01%	-0.20%	0.67%	5.10	-0.28%
31-Oct-02	-0.30%	-0.58%	0.61%	5.12	-0.68%
30-Nov-02	2.45%	1.29%	0.48%	5.05	1.75%
31-Dec-02	0.10%	0.14%	0.46%	5.08	-0.01%
31-Jan-03	0.88%	0.65%	0.46%	5.14	0.82%
28-Feb-03	0.05%	0.17%	0.40%	5.13	-0.29%
31-Mar-03	0.62%	0.29%	0.44%	5.19	0.80%
30-Apr-03	1.84%	0.81%	0.38%	5.18	1.50%
31-May-03	-0.01%	0.04%	0.32%	5.21	-0.31%
30-Jun-03	0.78%	0.66%	0.33%	5.30	0.80%
31-Jul-03	0.51%	0.21%	0.58%	5.30	1.81%
31-Aug-03	0.32%	0.46%	0.48%	5.21	-0.27%
30-Sep-03	0.25%	0.58%	0.42%	5.19	-0.07%
31-Oct-03	0.85%	0.29%	0.43%	5.30	0.88%
30-Nov-03	0.43%	-0.01%	0.41%	5.24	0.30%
31-Dec-03	0.33%	-0.09%	0.42%	5.24	0.33%
31-Jan-04	0.22%	0.06%	0.40%	5.25	0.12%
29-Feb-04	-0.22%	0.10%	0.40%	5.25	-0.25%
31-Mar-04	-0.05%	-0.03%	0.39%	5.29	-0.13%
30-Apr-04	0.51%	0.60%	0.46%	5.30	0.85%
31-May-04	-0.39%	-0.33%	0.48%	5.20	-0.34%
30-Jun-04	0.23%	0.32%	0.49%	5.18	0.25%
31-Jul-04	0.19%	0.20%	0.49%	5.19	0.14%
31-Aug-04	0.17%	0.06%	0.45%	5.21	-0.05%
30-Sep-04	0.42%	0.09%	0.44%	5.23	0.31%
31-Oct-04	0.22%	0.31%	0.42%	5.24	0.12%
30-Nov-04	0.64%	0.36%	0.41%	5.23	0.53%
31-Dec-04	0.27%	0.16%	0.42%	5.21	0.30%
31-Jan-05	0.04%	-0.01%	0.39%	5.23	-0.16%
28-Feb-05	0.59%	0.33%	0.40%	5.26	0.65%
31-Mar-05	-0.95%	-0.04%	0.45%	5.25	-0.70%
30-Apr-05	-0.78%	-0.51%	0.45%	5.25	-0.81%
31-May-05	0.11%	-0.02%	0.42%	5.29	-0.12%
30-Jun-05	0.38%	0.29%	0.43%	5.33	0.42%
31-Jul-05	0.80%	0.42%	0.44%	5.37	0.85%
31-Aug-05	-0.24%	0.14%	0.43%	5.33	-0.36%
30-Sep-05	0.06%	-0.08%	0.46%	5.36	0.23%
31-Oct-05	-0.12%	0.11%	0.50%	5.31	0.02%
30-Nov-05	0.05%	-0.01%	0.51%	5.28	0.10%
31-Dec-05	-0.09%	0.07%	0.52%	5.30	-0.06%
31-Jan-06	0.46%	0.19%	0.51%	5.34	0.33%
28-Feb-06	0.18%	0.34%	0.47%	5.35	-0.05%
31-Mar-06	0.16%	0.15%	0.49%	5.35	0.26%
30-Apr-06	0.29%	0.02%	0.49%	5.29	0.22%
31-May-06	-0.11%	-0.17%	0.52%	5.25	0.03%
30-Jun-06	-0.25%	0.08%	0.55%	5.25	-0.10%
31-Jul-06	0.03%	-0.14%	0.52%	5.26	-0.18%
31-Aug-06	0.14%	0.04%	0.49%	5.29	-0.05%

Date	Lehman Excess Return to Treasury's (1)	WGIF Excess Return (2)	5 Year Swap Spread (3)	Lehman Mod Duration (4)	Lehman ERS with AUD hedge Adjust. (5)
29-Sep-06	0.15%	-0.04%	0.49%	5.30	0.13%
31-Oct-06	0.35%	0.12%	0.47%	5.32	0.19%
30-Nov-06	0.13%	0.24%	0.41%	5.34	-0.23%
29-Dec-06	0.38%	0.17%	0.40%	5.38	0.32%
31-Jan-07	0.41%	0.31%	0.44%	5.36	0.58%
28-Feb-07	0.06%	-0.03%	0.47%	5.36	0.21%
30-Mar-07	-0.16%	0.03%	0.46%	5.41	-0.29%
30-Apr-07	0.22%	0.26%	0.48%	5.40	0.32%
31-May-07	0.39%	0.18%	0.50%	5.41	0.44%
29-Jun-07	-0.49%	-0.23%	0.56%	5.39	-0.18%
31-Jul-07	-1.96%	-0.83%	0.68%	5.43	-1.35%
31-Aug-07	-0.78%	-0.41%	0.72%	5.43	-0.62%
28-Sep-07	0.29%	0.14%	0.64%	5.45	-0.18%
31-Oct-07	0.20%	-0.07%	0.65%	5.44	0.22%
30-Nov-07	-2.71%	-1.22%	0.78%	5.45	-2.06%
31-Dec-07	0.06%	-0.08%	0.73%	5.46	-0.26%
31-Jan-08	-1.84%	-1.51%	0.72%	5.48	-1.97%
29-Feb-08	-1.38%	-0.72%	0.88%	5.50	-0.54%
31-Mar-08	-1.57%	-0.90%	0.86%	5.46	-1.77%
30-Apr-08	2.73%	1.52%	0.76%	5.40	2.17%
31-May-08	0.67%	0.38%	0.81%	5.42	0.88%
30-Jun-08	-1.31%	-0.87%	0.93%	5.40	-0.74%

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