

Back to fundamentals - real investing and not momentum - Part 2

28 November 2008

GVI's Hedging Strategy

Falling yields and commodity prices, amid fears of a global recession, placed a lot of pressure on the \$AUD from offshore sellers in September and October as funds were heavily repatriated. Movements in the AUD over this period reached historical levels of volatility. It has been reported that some fund managers running hedged funds have been forced to sell stocks in order to provide the cash to offset their obligations under their hedging contracts and/or have been forced to remain unhedged during parts of this period. At GVI, we had managed the FX contracts and cash positions very carefully and were therefore able to come through this volatile period in a good position.

The GVI Global Industrial Share Fund is managed with the assets of the fund predominantly hedged back into AUD. This strategy seeks to minimise the currency-related volatility in returns of the fund and deliver the returns of the underlying stocks in which we invest. Any changes in the AUD value of the stocks in the portfolio as a result of currency movement are offset by similar and opposite changes in the value of the portfolio's hedged position.

This hedged strategy of the GVI Global Industrial Share Fund should be kept in mind when comparing performance over recent periods to returns from unhedged funds, some of which may have significant currency volatility impacting their recent returns, especially against assets denominated in USD and Yen.

In summary, the returns of the GVI portfolio over this period have reflected the movements of the stocks selected for the Fund and more generally, the returns of the local markets in which those picks were made. With the A\$ at current levels we will continue to hedge the assets of the portfolios to ensure that the returns of the portfolios are not diluted by any recovery in the value of the A\$ or otherwise distorted by currency movements.

Cash position

You may have noticed that the reported cash position of the GVI Global Industrial Share Fund has decreased to 4% at the end of October 2008 from levels above 10% in previous months. At the time of writing it is 8%.

The reported cash position is the effective exposure of the Fund to:

- physical cash in the bank
- cash due to be paid for stocks purchased
- cash due to be received from stocks sold
- amounts that may be payable/receivable when FX contracts are due and
- any other miscellaneous receivables or payables....

Therefore, the cash amount disclosed is a snapshot that changes daily. The change over October was not necessarily brought about solely by the net result of buying and selling stocks but also through accounting for our potential FX obligations.

Delivering sustainable growth and income

Market Outlook

We believe that economic conditions will become worse before they become better. In many cases, economies have only just entered the initial phase of a recession and so we are expecting a difficult 2009. This is the major message coming out of the recent reporting season as earnings downgrades are commonplace. We don't expect that stocks will really bottom out until the extent and duration of the profit downgrade cycles are better understood and discounted into stock prices. To what extent the market has already priced in this scenario is difficult to determine, but we are seeing compelling value in certain areas.

It is only a matter of time before we see investors move from fear to fundamentals and the market start to value companies correctly. After years of easy credit conditions fuelling rampant returns, the tables have turned and we believe investors (not speculators) will once again focus on fundamentals, making patient long-term decisions. In our view, after a severe correction (particularly a credit-induced decline), markets tend to reward, at the initial stages of recovery, those companies that have competitive strengths within sectors/industry groups, strong balance sheets and cashflows, that are attractively valued and dividend paying. We believe the GVI Global Industrial Share Fund portfolio is well-placed in this regard.

Currently, investors do not know how deep the upcoming global recession will be or how long this recession will last. Clearly, recent emergency monetary and fiscal measures (with further rate cuts likely to follow), diminishing inflationary fears and attractive valuations will assist greatly in establishing a bottom in readiness for a turnaround. Despite current uncertainty and extreme volatility, investment markets are trading on historically low PE's and high yields which represent an ideal environment for long-term wealth creation. The GVI investment team is extremely focused on evaluating the opportunities presented to us by this market downturn. Our regular meetings and research efforts aim to identify only what we believe to be the best high-conviction ideas to be represented in the flagship fund and in this way, we look to continually upgrade the overall quality of the portfolio for superior risk-adjusted returns over the long-term.

Kind regards,
The GVI Investment Team

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