CANNAE
Capital Partners

Monthly – Australian Share Fund

October 2008

Performance Summary

	1 month	3 months	Inception
Portfolio[1]	-13.8%	-19.0%	-21.8%
Benchmark[2]	-12.9%	-18.4%	-22.2%
Performance	-0.9%	-0.6%	0.4%

Month Summary

The portfolio returned -13.8% for the month of October 2008. This underperformed the benchmark S&P/ASX 300 Accumulation Index, which returned -12.9% for the month.

Equity markets remained under extreme pressure during October as focus shifted from the global financial system to the increasing likelihood of a global recession. The Australian equity market had its worst monthly performance since the October 1987 crash. Volatility (as measured by the VIX Index) hit new record highs as risk aversion increased. As a result, defensive positions were favoured with Healthcare, Telecoms and Utility sectors outperforming. Commodity prices came under significant pressure on the back of increasing concerns over China's economic growth and hence Resource and Energy stocks came under selling pressure. REITs were impacted by a number of large fund raisings, combined with concerns around refinancing and asset sales. REITs, Energy and Industrials sectors lagged the broader market.

Portfolio Activity

The high volatility during the month resulted in some high quality large cap stocks being sold down to the point where they appeared attractively priced. We were able to take advantage of this by establishing several new positions including Downer EDI, Insurance Australia Group, Orica and Suncorp, while topping up holdings in Abacus Property, Commonwealth Bank, Lend Lease, Origin Energy and Ramsay Healthcare. Holdings in BHP Billiton and Metcash were trimmed to partly fund these purchases. Two positions were completely exited. Caltex was sold, ahead of its profit warning, on global growth concerns and Cabcharge was sold as the company’s relative attractiveness declined following outperformance. A small position in Woolworths was initiated under our portfolio construction rules as the stock now comprises 4% of the index.

Stock Performance

We are disappointed both with the absolute and relative returns achieved for the month. Nevertheless, we remain convinced that we have a strong process which should deliver pleasing performance over the medium to long term. In such volatile times we continue to adhere to our process and style and thank our investors for their support and patience.

The most outstanding feature of the month was a panic driven flight to size. While size and liquidity feature in our process, the key focus for us is quality combined with valuation. However, quality and valuation were secondary considerations for investors during the month. The following example is reflective of the trend.

We own a large position in Lend Lease and own no Westfield, creating a weighting in favour of Lend Lease over Westfield of close to 10%, as Westfield accounts for about 3.5% of the index. In October Westfield outperformed Lend Lease by 22%, so our choice of Lend Lease over Westfield (and our conviction as to the value in Lend Lease) cost the portfolio around 2% (200 basis points) of relative performance. While we obviously made our share of mistakes and good choices across the portfolio this is a very significant move during the month.

Lend Lease is no small cap and nor is it some sort of new, untested company. Lend Lease has exposure to retail assets, property development and construction while Westfield is solely focussed on retail assets (in similar geographies). Lend Lease has almost no net debt ($86m on assets of $8.6bn), while Westfield has quite significant debt ($16.5bn on assets of $51bn). Lend Lease retains earnings yet at the beginning of the month sported a gross yield of 9.6% compared to Westfield at 6.4% (on a 103% payout of earnings). The PE of Lend Lease was well below Westfield's at 9.8 vs 16.5 times. We do not question the quality of Westfield's assets but Lend Lease also has some of the highest quality retail assets in the world (Bluewater and King of Prussia). Lend Lease's retail assets alone are worth $6.50 per share, using conservative valuations and can almost justify the current share price alone, even though historically development and construction have accounted for approximately 65% of their earnings.

The top performers for the month were Tatts Group (+5.0%), Regional Express Holdings (+4.5%) and Gunns (+2.6%), which rebounded following underperformance in previous months.

Continued weakness in commodity prices due to plunging sentiment on Chinese demand resulted in resource companies being among the main monthly underperformers. These included Mount Gibson (-75.3%) and Equinox (-57.3%).

Abacus Property (-63.3%) also underperformed as the negative sentiment against mid-small cap property trusts resulted in indiscriminate selling across the sector. While the sell down was warranted for property trusts that either raised capital at low dilutive levels or those that maintain ominous levels of gearing, Abacus falls into neither of these categories. Despite a strong balance sheet and sustainable high yield, the stock has been punished by a fear-driven market with a sell first, ask questions later attitude. We maintain a high level of conviction in Abacus. Its investment case remains strong and as mentioned above we have added to the position.

[1]Source: RBC Dexia Investor Services

[2]Benchmark: S&P/ASX 300 Accumulation Index