



Are we there yet?



MARKETS SUMMIT

Tuesday 16 February 2010

Theme 2

Global debt markets



portfolio
construction

MARKETS SUMMIT

Tuesday 16 February 2010

Global debt markets

Kumar Palghat

Managing Director, Kapstream Capital, Australia

Dan Norman

Head of Snr Loans, ING Investment Management, US

Stephen van Eyk

Founder, van Eyk Research

Robert Swift

Head of Multi Strategies, BT Investment
Management



MARKETS SUMMIT

Tuesday 16 February 2010

Global debt markets

Kumar Palghat

Managing Director, Kapstream Capital, Australia



portfolio
construction

MARKETS SUMMIT

Tuesday 16 February 2010

Portfolio Construction Markets Summit

Kumar Palghat
Founder, Managing Director



Important Information

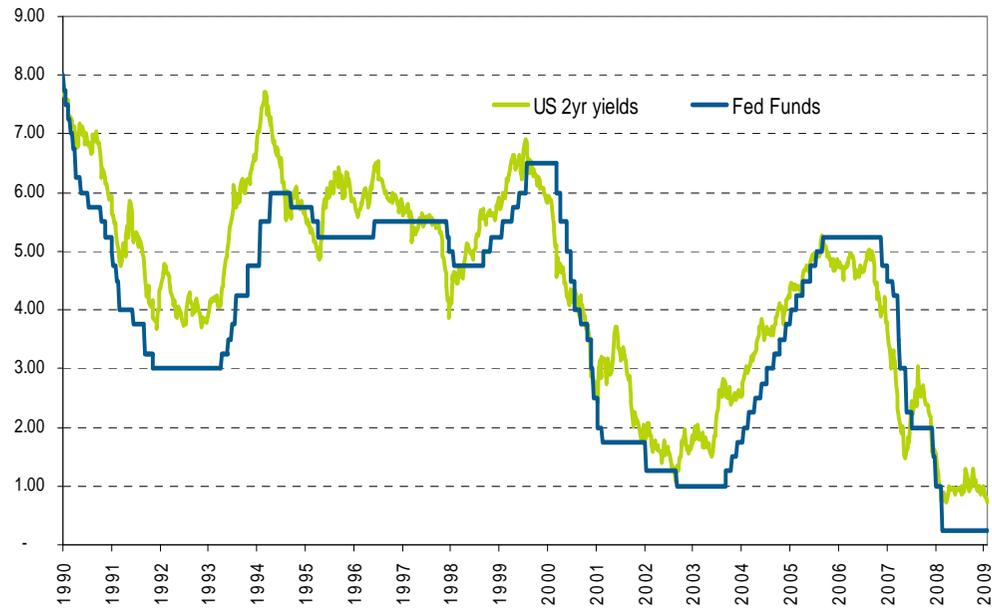
The information contained in this publication is current as at 1 March 2007 unless otherwise specified and is provided by Kapstream Capital Pty Limited ABN 19 122 076 117, AFSL 308870 ('Kapstream') and is intended solely for holders of an Australian financial services licence or other wholesale clients (as defined in the *Corporations Act 2001 (Cth)*). It must not be passed on to a retail client. It should be regarded as general information only rather than advice. It has been prepared without taking account of any person's objectives, financial situation or needs. Because of that, each person should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs.

Kapstream is the investment manager of the Kapstream Absolute Return Income Fund ARSN 124 152 790. The issuer of the Fund is Challenger Managed Investments Limited (ABN 94 002 835 592, AFSL 234668). Initially the Fund will only be available to wholesale clients. If the Fund is ever offered to retail clients it would be so offered in a product disclosure statement which would be available when so offered. The information contained in this publication must not be copied or disclosed in whole or in part without the prior written consent of Kapstream, and Kapstream and its related entities accept no liability whatsoever for the actions of third parties in this respect. It is presented for informational purposes only and is not to be construed as a recommendation, solicitation, advice or an offer to buy or sell any securities.

Past performance is not a guide to future performance. Kapstream Capital does not guarantee the repayment of capital or any particular rate of return.

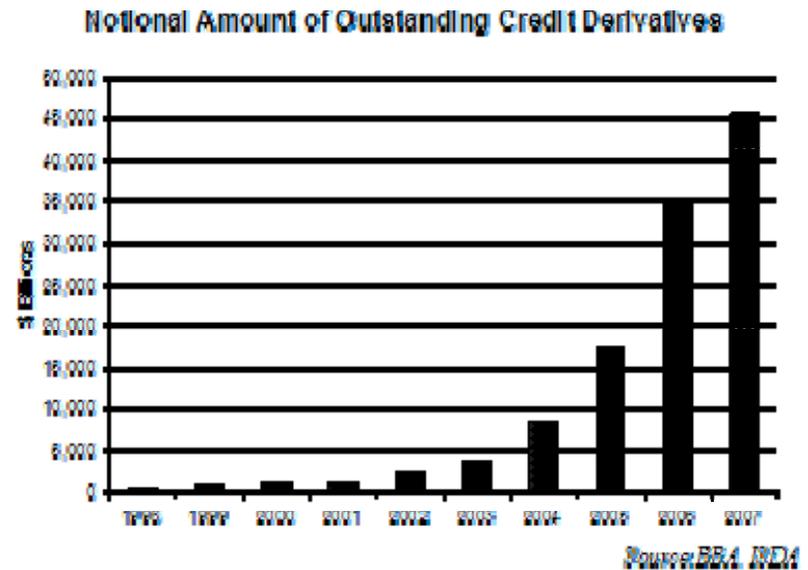
What Happened in 2008/2009

- Low Interest Rates
- Leverage
- Housing Boom
 - Sub prime
 - Poor lending and underwriting standards
- Financial Engineering (CDO's/CLOs)
- **Caused** Financial systems to collapse
- Brought economies to their knees ~ Government's stepped in to bail out



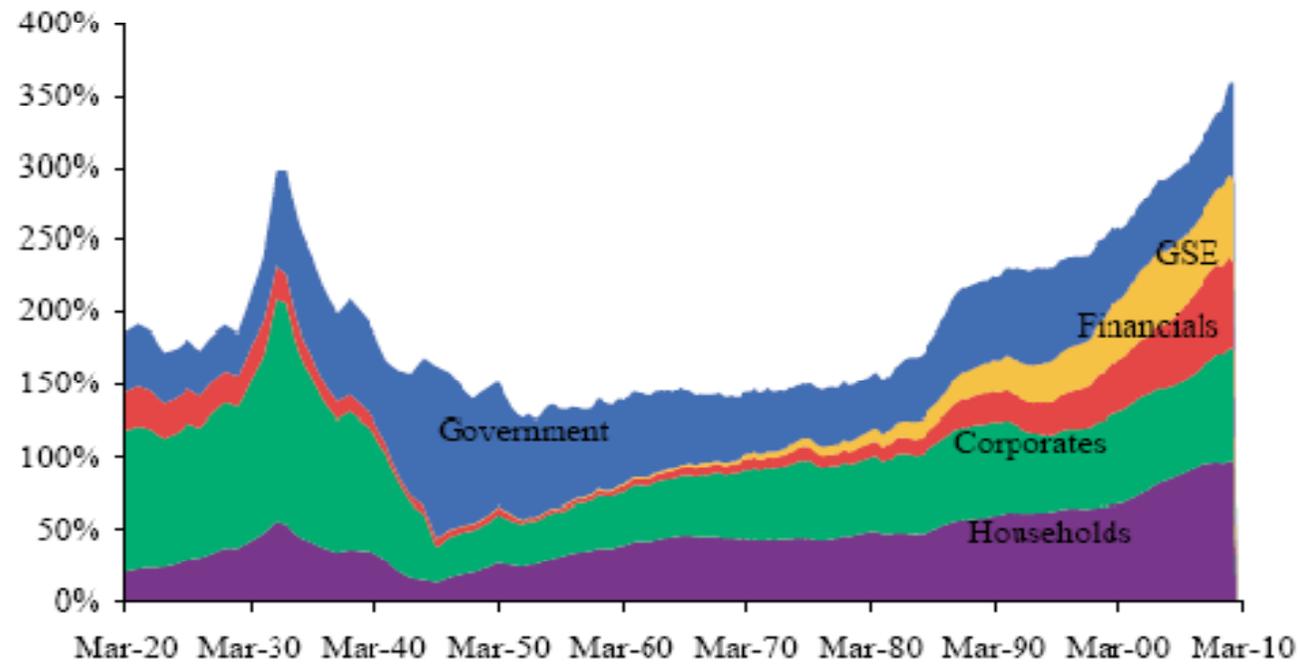
What Happened in 2008/2009?

- \$1.8 trillion in losses and counting!
- Too big to fail (Fannie/Freddie, AIG)
- Marriage of convenience (Merrill/BOA, JPM/Bear Stearns)
- Sacrificial lamb (Lehman)
- US Government owns
 - Freddie Mac, Fannie Mae
 - AIG
 - Chrysler, GM

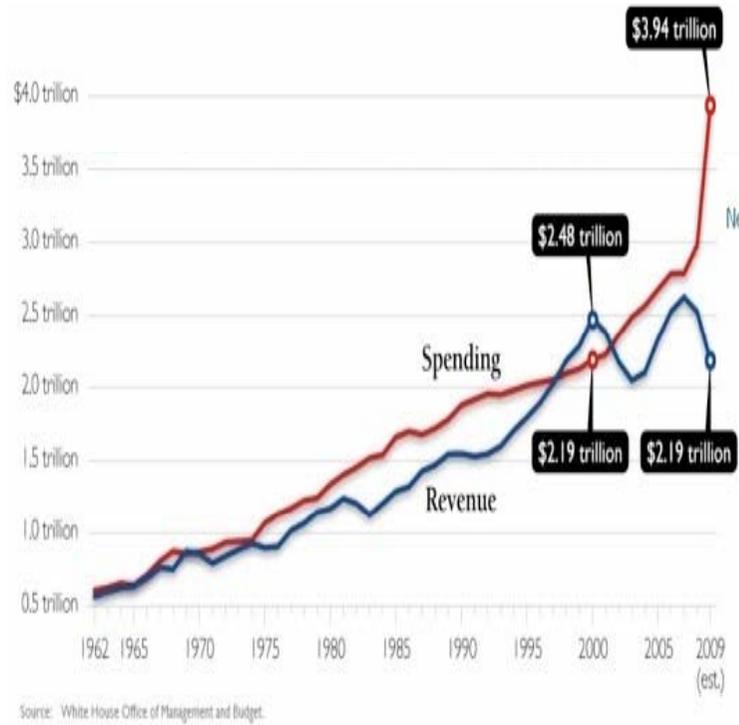


Current State ~ US Government Debt

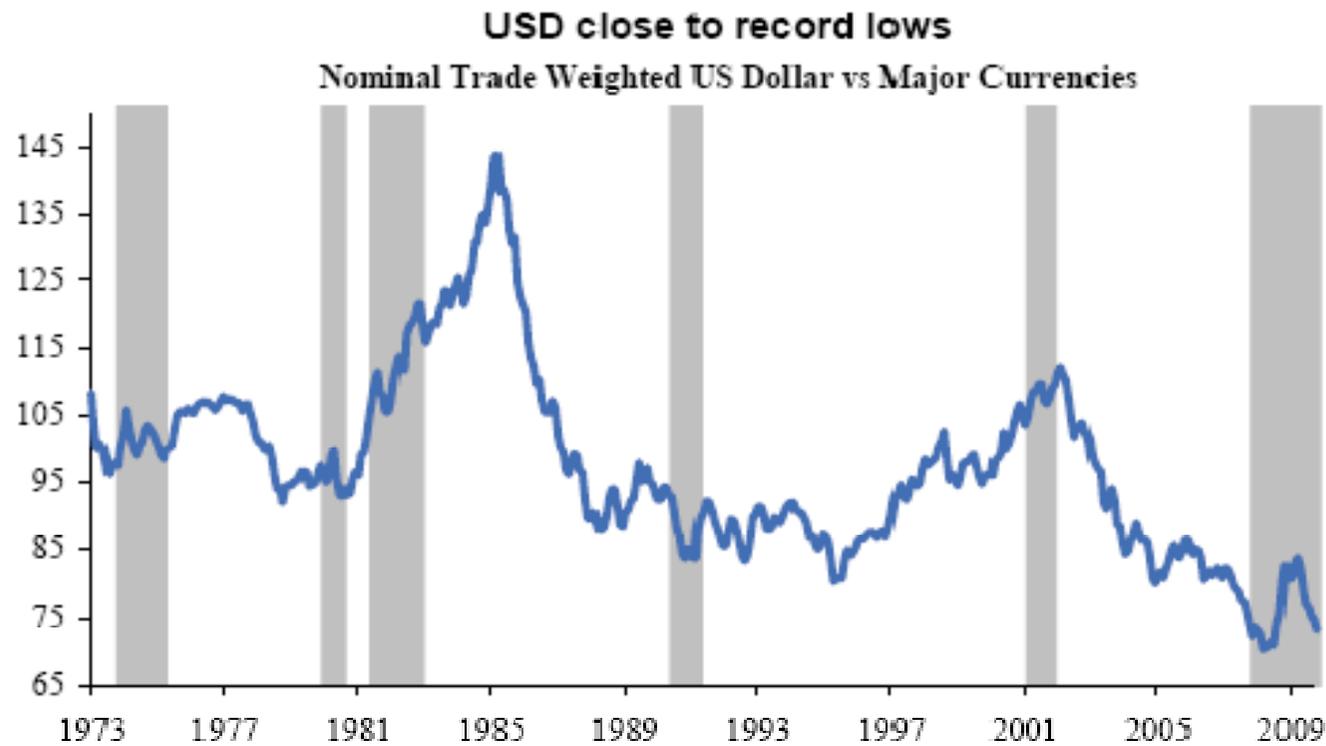
The Debt Supercycle - US Debt to GDP



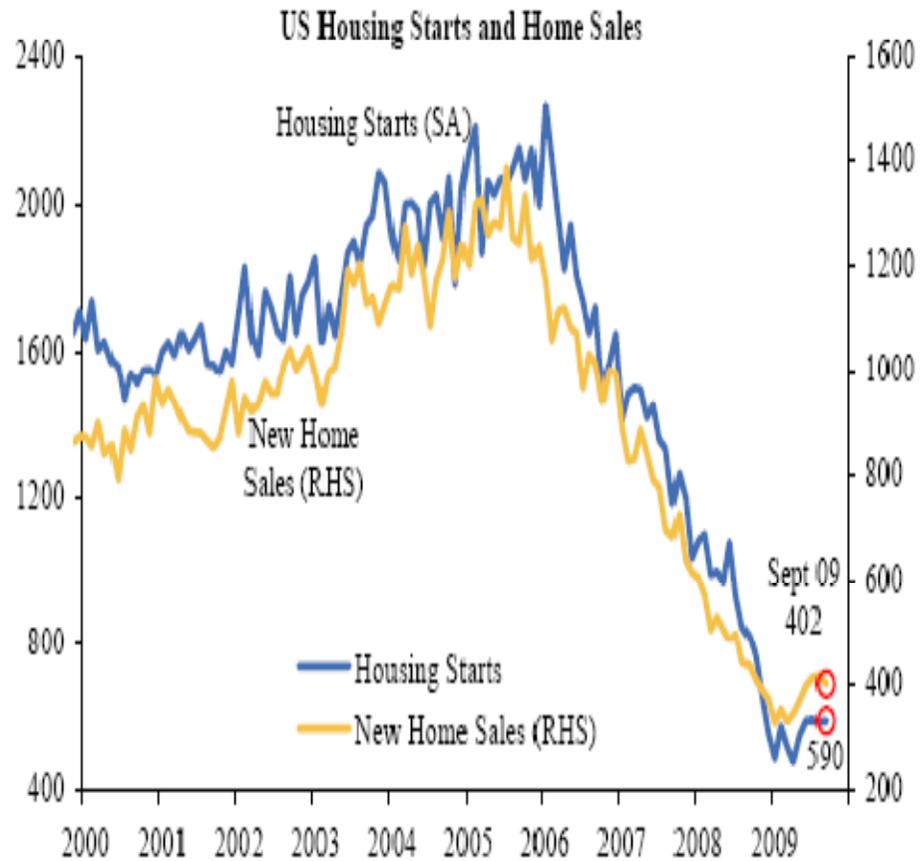
Current State ~ US Fiscal position



The Aftermath ~ US \$ weaker



The Aftermath ~ Housing



- Housing market yet to show any signs of life
- Over supply in areas like California continue to weigh on the economy

The Aftermath ~ US Job losses

US Unemployment

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
2000	4	4.1	4	3.8	4	4	4	4.1	3.9	3.9	3.9	3.9	4.0
2001	4.2	4.2	4.3	4.4	4.3	4.5	4.6	4.9	5	5.3	5.5	5.7	4.7
2002	5.7	5.7	5.7	5.9	5.8	5.8	5.8	5.7	5.7	5.7	5.9	6	5.8
2003	5.8	5.9	5.9	6	6.1	6.3	6.2	6.1	6.1	6	5.8	5.7	6.0
2004	5.7	5.6	5.8	5.6	5.6	5.6	5.5	5.4	5.4	5.5	5.4	5.4	5.5
2005	5.3	5.4	5.2	5.2	5.1	5	5	4.9	5	5	5	4.9	5.1
2006	4.7	4.8	4.7	4.7	4.6	4.6	4.7	4.7	4.5	4.4	4.5	4.4	4.6
2007	4.6	4.5	4.4	4.5	4.4	4.6	4.6	4.6	4.7	4.7	4.7	5	4.6
2008	5	4.8	5.1	5	5.4	5.5	5.8	6.1	6.2	6.6	6.9	7.4	5.8
2009	7.7	8.2	8.6	8.9	9.4	9.5	9.4	9.7	9.8	10.1	10	10	9.3

- US Unemployment Rate has risen from 4% to 9.3%
- US Unemployment will likely remain over 10% for a long time

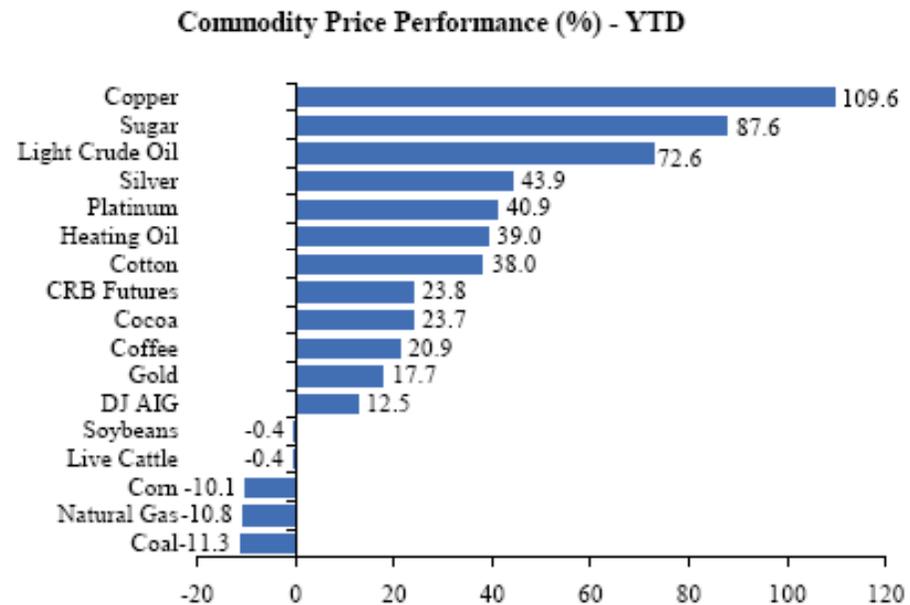
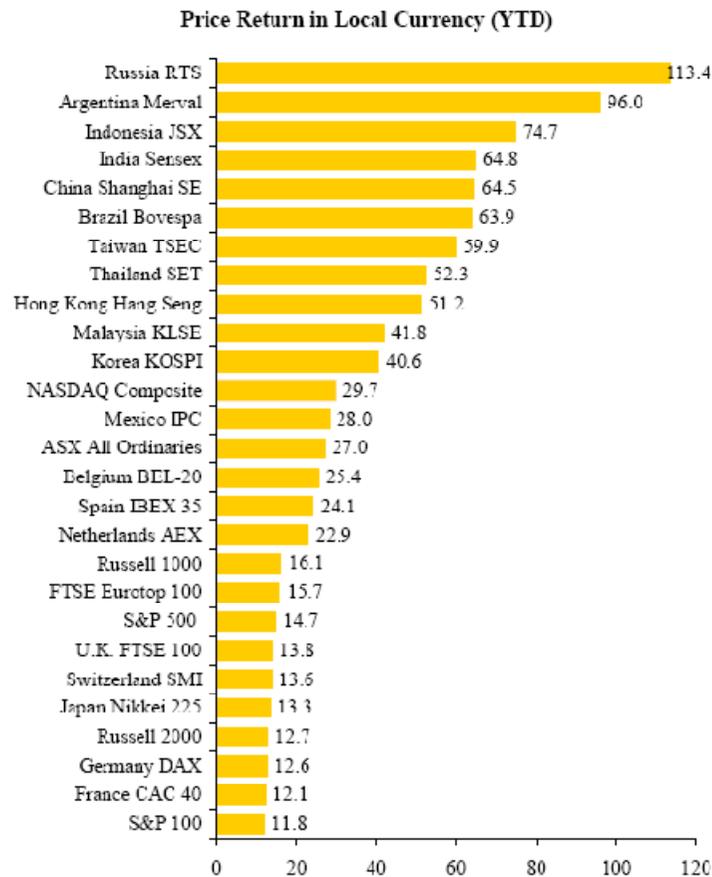
US Non Farm Payroll

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
2000	249	121	472	286	225	-46	163	3	122	-11	231	138	163
2001	-16	61	-30	-281	-44	-128	-125	-160	-244	-325	-292	-178	-147
2002	-132	-147	-24	-85	-7	45	-97	-16	-55	126	8	-156	-45
2003	83	-158	-212	-49	-6	-2	25	-42	103	203	18	124	7
2004	150	43	338	250	310	81	47	121	160	351	64	132	171
2005	182	221	121	312	212	259	322	190	87	98	380	160	212
2006	294	274	282	151	24	70	186	149	147	82	261	219	178
2007	180	36	184	35	156	54	-65	-28	100	165	215	120	96
2008	-72	-144	-122	-160	-137	-161	-128	-175	-321	-380	-597	-681	-257
2009	-741	-681	-652	-519	-303	-463	-304	-154	-139	-127	4	-85	-347

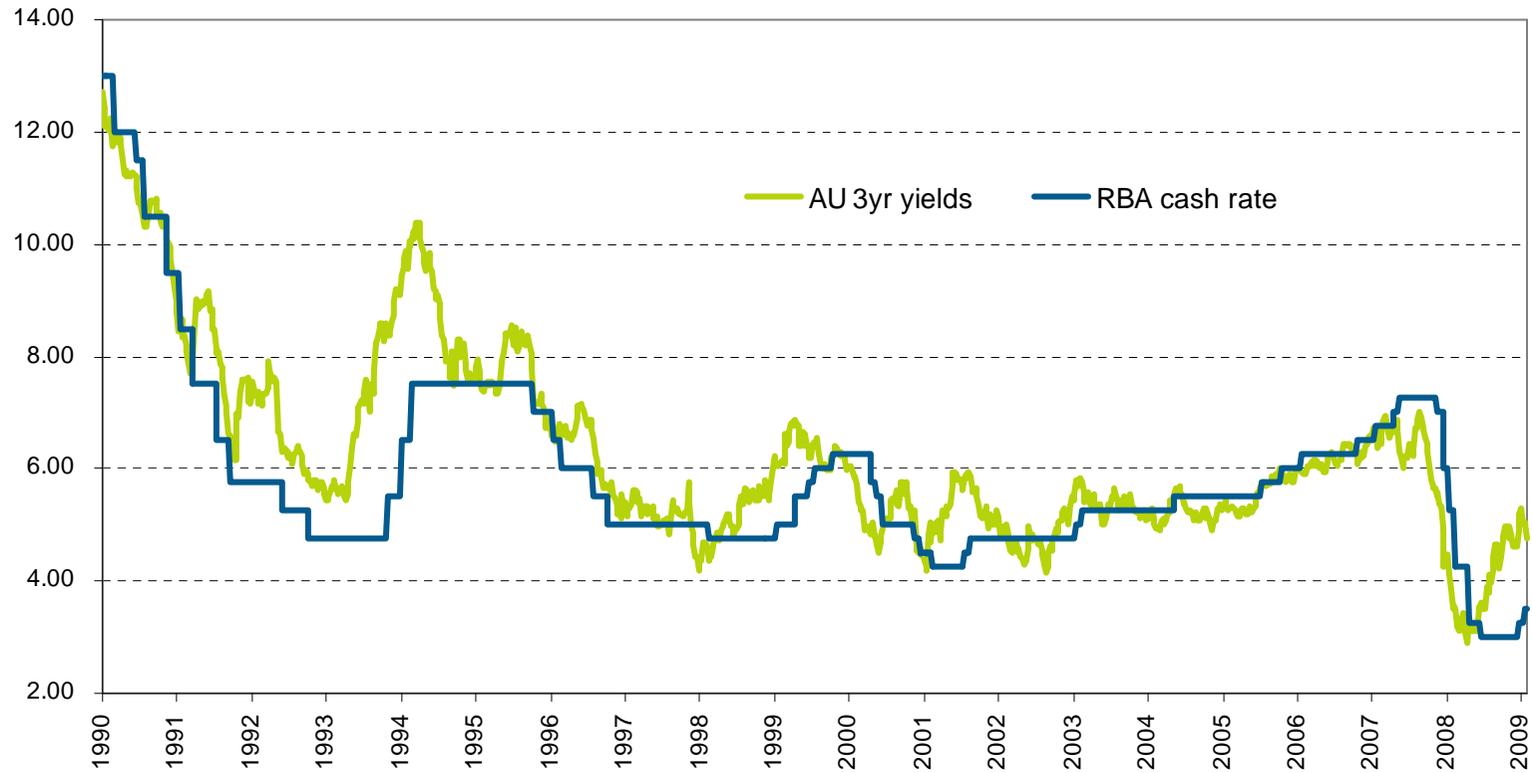
- US needs over 15 million jobs over the next 5 years to get back to pre-recession levels.

Where are we now?

Massive stimulus led to recent risk asset rally



GFC ~ Impact on Australia



GFC ~ Impact on Australia

- **Australia Unemployment Rate held steady.**

Aussie Unemployment

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
2000	6.5	6.4	6.6	6.5	6.4	6.2	6.1	6.1	6.0	6.0	6.3	6.3	6.3
2001	6.2	6.6	6.5	6.8	6.8	6.9	6.9	6.9	6.8	7.1	6.9	6.8	6.8
2002	7.0	6.6	6.4	6.3	6.3	6.5	6.2	6.3	6.3	6.1	6.2	6.2	6.4
2003	6.1	6.0	6.1	6.0	6.1	6.1	6.1	5.8	5.8	5.8	5.7	5.7	5.9
2004	5.5	5.7	5.4	5.5	5.3	5.5	5.5	5.5	5.4	5.1	5.2	5.1	5.4
2005	5.1	5.1	5.2	5.1	5.1	5.0	5.0	4.9	5.0	5.1	5.0	5.1	5.1
2006	5.1	5.1	4.9	4.9	4.8	4.8	4.7	4.7	4.7	4.5	4.6	4.6	4.8
2007	4.5	4.6	4.4	4.3	4.2	4.3	4.3	4.3	4.2	4.4	4.5	4.3	4.4
2008	4.2	3.9	4.0	4.2	4.2	4.2	4.3	4.1	4.3	4.4	4.5	4.6	4.2
2009	4.9	5.3	5.7	5.5	5.7	5.8	5.8	5.8	5.7	5.8	5.6	5.5	5.6

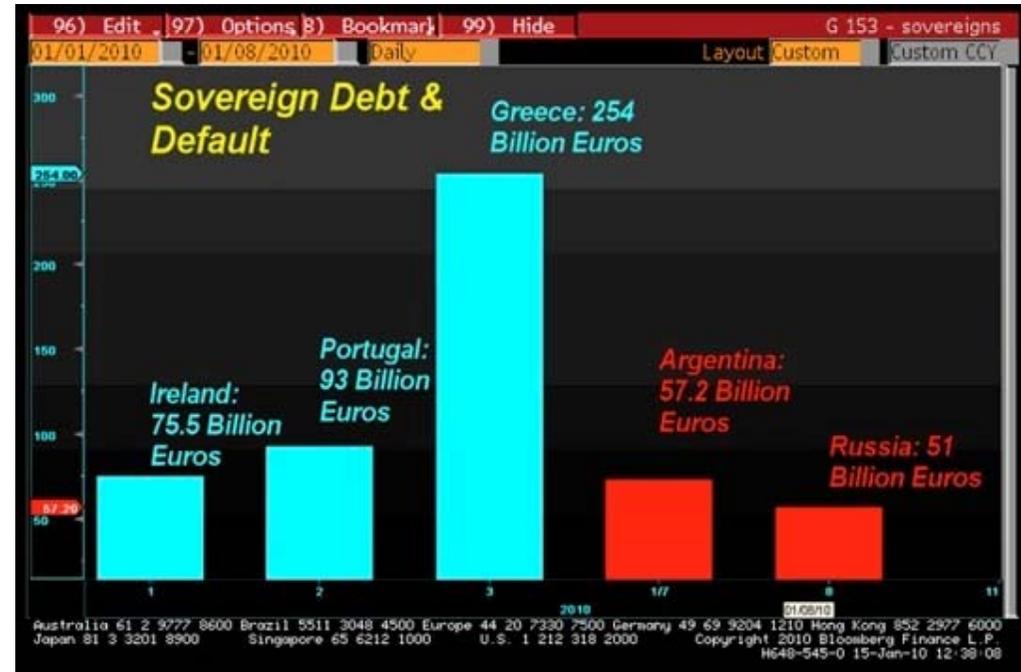
- **Australia has created jobs every year in the last decade!**

Aussie Jobs

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
2000	-18	40	24	36	12	17	82	10	-13	-5	-40	31	15
2001	0	-16	7	55	-9	-3	12	29	-24	21	20	1	8
2002	16	49	11	-3	12	28	4	50	1	9	63	38	23
2003	43	32	-44	8	14	-24	-4	50	11	24	12	20	12
2004	-7	15	38	18	18	-3	14	-12	65	52	25	23	20
2005	51	34	45	46	-12	40	18	39	-10	-0	34	-4	23
2006	6	34	43	11	38	34	49	16	48	-30	25	53	27
2007	11	13	26	28	40	9	12	29	33	-3	41	15	21
2008	40	33	9	38	-33	37	7	13	-6	22	-20	-7	11
2009	7	3	-38	28	-11	-24	34	-23	41	28	31	35	9

Key Risks ~

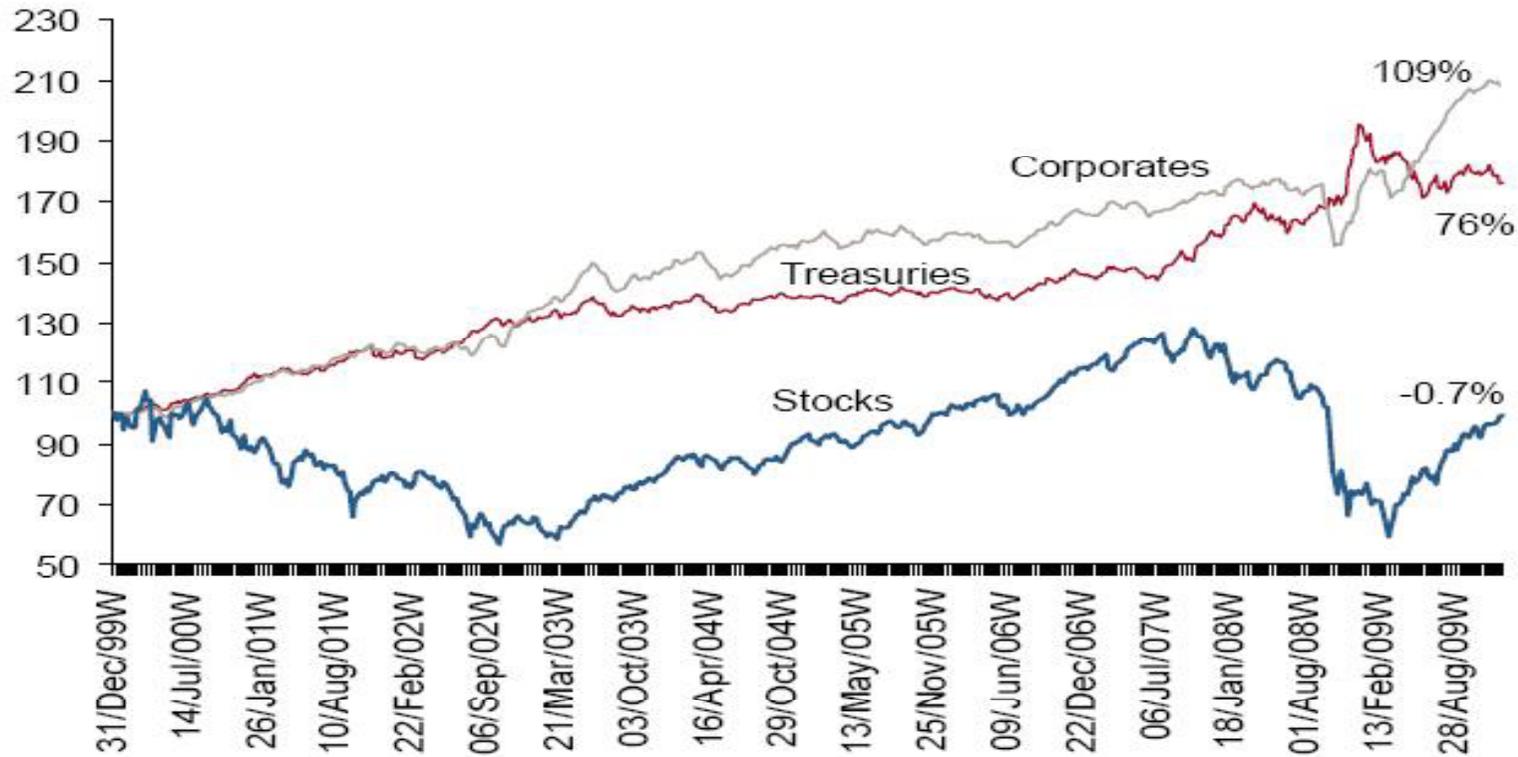
- **The US cannot afford: (Can't fund debt with debt)**
 - A drop in GDP
 - A fall in equity markets
 - Rise in interest rates
- **European Economies in a mess**
 - Greece, Spain, Italy, Portugal and Ireland all in trouble
 - They have to cut spending and increase taxes ~ when economic growth is on shaky ground!
- **RBA – A little too trigger happy**
 - Domestic economy is good shape
 - Global backdrop remains tricky



Outlook ~ US Equities ~ “the lost decade”

Total Returns for the “Aughts”

Including reinvestment of dividends and coupons, 100=December 31, 1999. Treasuries and Investment-Grade Corporates are composite indices, stocks are the Wilshire 5000



Source: Treasuries: Ryan Labs; Corporate Bonds: Dow Jones, Stocks: Wilshire, Haver Analytics, Credit Suisse

Out look ~ Aussie assets ~ “the sweet spot”





Are we there yet?



MARKETS SUMMIT

Tuesday 16 February 2010