Annual Report 2009/2010

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SUPERVISED HIGH YIELD FUND

A Year of Excellent Growth +14.6%

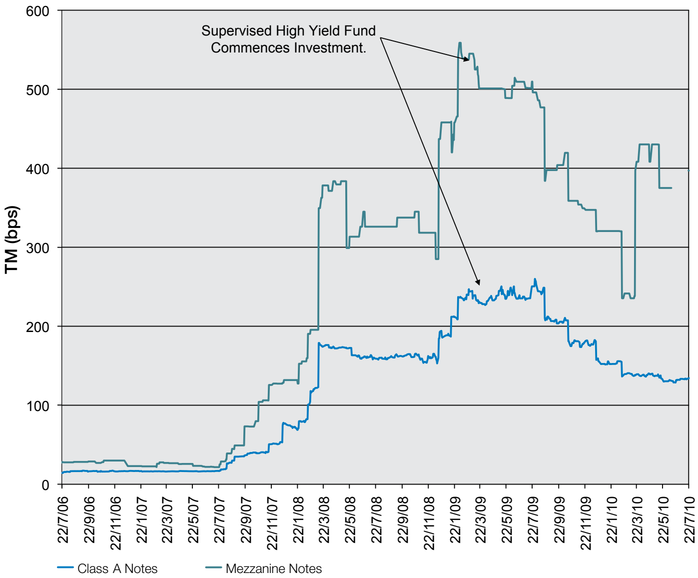
Message from the Investment Manager

30 June 2010 marks the end of the Supervised High Yield Fund's (SHYF) first full financial year of operation and fifteen months since the SHYF made its first investment in April 2009.

During this period we have experienced a partial recovery of the damage caused to the international debt and capital markets by the Global Financial Crisis. Now, with the benefit of hindsight, it is clear that over the past 50 years and possibly during the entire period since the Great Depression there has not been a better environment to commence investments in debt securities than that which prevailed in March and April of 2009.

The following chart provided by Macquarie Bank Research Division illustrates this point by showing how credit spreads on Class A and Mezzanine RMBS Notes have varied over the past 5 years. This chart illustrates that the SHYF managed to pick the perfect time to commence our investments.

Class A and Mezzanine A$ RMBS Credit Margin Index



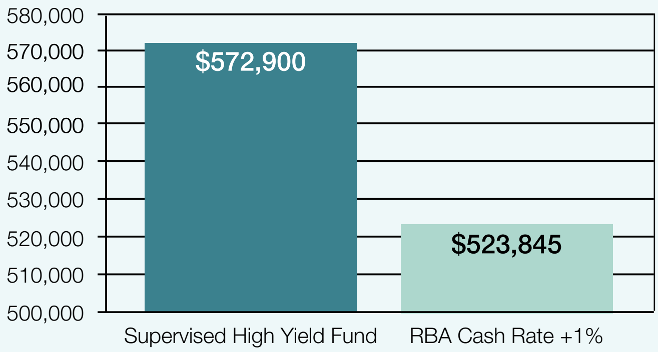
Since then the value of our Australian RMBS investments has risen steadily in parallel with the increasing confidence in financial markets. Even during the recent Euro sovereign debt crisis the SHYF's investments have performed very well, particularly in June when the SHYF experienced it's best monthly performance since inception.

As I look forward, I believe the final leg of the debt market recovery is still ahead. So we can expect our existing portfolio to contribute some further improvement in the value of the SHYF's units over the next half year. Beyond that time frame it is clear that opportunities will be available for the SHYF to identify and acquire new investments with tangible asset backing and at attractive yields. For instance, I have just been offered a $5 million parcel of prime investment grade AA rated RMBS securities domiciled in New Zealand at yields in excess of 12.00%.

I am happy to confirm that my expectations for the SHYF's unit price returns over the year ahead remain unchanged at 12.00% being a margin of 750 basis points over the current Reserve Bank of Australia's Cash Rate of 4.5%. If, as expected, interest rates continue to rise in Australia then SHYF investors can expect to see those increases flow through in the form of higher returns.

Philip Carden
Investment Manager
Supervised High Yield Fund

Figure 1: Value of $500,000 invested in SHYF 2009/2010



Fund Performance

During the twelve months of 2009/2010 the SHYF delivered an absolute return of +14.6%. This compares to the Reserve Bank of Australia Cash Rate +1% return of +4.8%.

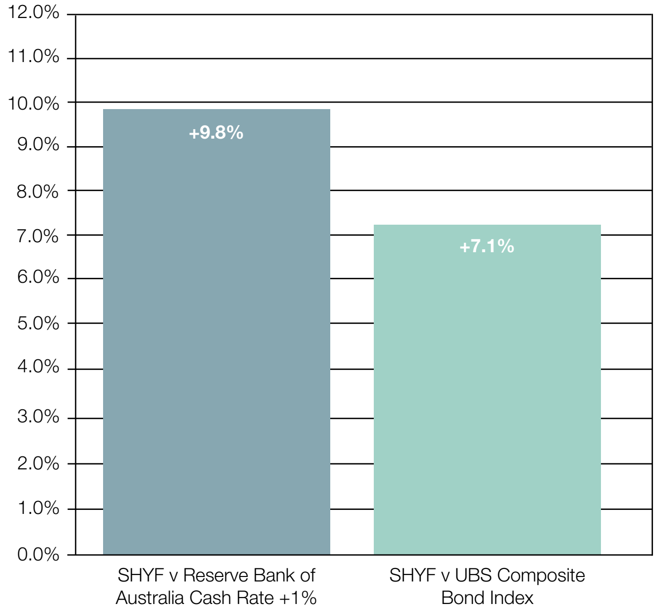
Figure 2: SHYF Unit price 30th June 2010

	June 2010	June 2009	Inception
Unit price	$11.76	$10.26	$10.00

Performance – since inception			
SHYF	+17.6%	RBA +1%	+5.8%
UBS Composite Bond Index			+6.2%

Performance – 2009/2010			
SHYF	+14.6%	RBA +1%	+4.8%
UBS Composite Bond Index			+7.5%

Figure 3: SHYF Relative Performance 2009/2010



The table below illustrates the SHYF portfolio and recent sales.

Figure 4: Value of SHYF securities and their change since acquisition

Security Description	Purchase Price/$100 par value	Current Market Value/$100 par value	Percentage Change
PUMA P12 BA (sold)	$92.75	97.3	4.91%
Liberty 2006 B (sold)	$85.73	90	4.98%
Firstmac 2005 2 A1 (sold)	$93.90	96.67	2.95%
Firstmac 2007 1E A2	$90.50	97.751	8.01%
ME Bank GF2007 1 A3	$92.39	97.265	5.28%
Q 10 C	$90.6	97.757	7.90%
Sapphire 2006 – 1 MZ	$81.50	86.521	6.16%
Sapphire 2005 – 2 MZ	$81.50	83.72	2.72%
Sapphire 2004 – 2 BA	$83.00	84.081	1.30%
Sapphire 2005 – 1E MZ2	$80.00	83.982	4.98%

As can be seen from examining this table the Liberty 2006 B was sold in April. The sale price for the Liberty was $90.00 per $100.00 of par value a price well above the March 2010 book value of $87.39. These transactions are worth noting because they validate the STAR process and the SHYF valuations of its portfolio.

The SHYF then purchased a face value of $9.6 million in new RMBS securities. The new investments have been predominately made in the Sapphire notes issued by Bluestone an Australian non-bank mortgage provider. The new securities were purchased at prices in the low $80's offering us the protection of conservatively geared residential mortgage collateral and exceptionally good running yields at 1000 basis points over the Bank Bill rate. STAR has stress tested these Sapphire notes and identified that they are just as secure as the Liberty notes we sold at $90.

The portfolio also contains $1 million in cash so we are ready to take up new investment opportunities as they arise. Given the recent trading activity and the investment of new funds received in May and June the portfolio is now well positioned to benefit from the increasing confidence flowing through the debt market.

Outlook for the year ahead

As the year unfolds I expect the price of debt securities will continue rising in line with my expectations for a greater confidence in the markets. Although growth in the US and Euro zone appears to be stalling I don't expect slower growth will effect the non-sovereign debt market in a material way.

Opportunities for investment within the non-sovereign sector are expected to continue to be available in the RMBS market. We are also spending a deal of time researching the corporate debt of specific companies domiciled in the Asian growth economies and also the debt securities issued by US multinationals that are exposed to the Asian growth sectors, companies such as Coca-Cola.

In the sovereign debt markets we continue to research the merit of capitalising upon the yield differential that exists between various sovereign issuers. For instance, the ten year Treasury rate in the United States is 2.87% compared to the Australian ten year Treasury rate of 5.11%. The differential of 2.24% appears to be too wide and offers investors the opportunity to earn a positive cash flow of 2.24% and the possibility of capital profits if the differential tightens. This is highlighted when one considers that the Canadian to United States ten year Treasury differential is only 0.29%.

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