IMA Update Report - December 2008

PERFORMANCE

The average net performance of our portfolios for the December quarter was negative 25.13%, underperforming the MSCI World Index by 4.49% which declined by 20.64%. It was a very disappointing quarter.

As usual, for individually managed account portfolios, returns will vary slightly from the average based on when your portfolio commenced, when other client portfolios commenced, and any net capital contributions.

Our portfolio has changed a little in the quarter, having sold the remaining small position in Moody's, selling out of Northbridge after a takeover bid came from Fairfax Financial and adding to Asta Funding and Berkshire Hathaway as their share prices fell. Cash finished at around 20%.

Dec 2008	net return	MSCI index	out performance
Rolling			
3 months	-25.13%	-20.64%	-4.49%
1 year	-35.89%	-38.69%	2.80%
3 years	-7.87%	-9.48%	1.61%
5 years	0.28%	-0.90%	1.18%
Since inception January 2000	10.81%	-3.87%	14.68%

PORTFOLIO CHANGES

Portfolio at a glance	
American Express	Michael Hill International
ASTA Funding	Mohawk Industries Inc.
Berkshire Hathaway	USG Corporation
Fairfax Financial	
Iron Mountain	
Johnson & Johnson	

Moody's Corporation

We exited Moody's completely during the quarter because our valuation fell significantly as their structured financial product division declined rapidly in line with the credit crunch. We were wrong in assessing the strength of this operation, one of their main income areas of recent times. This cost us approximately 2.1% of our portfolio.

Northbridge Financial

Our position in Northbridge was subject to a $39 per share takeover bid from Fairfax (another of our holdings) during the quarter. Although this bid price was somewhat less then our valuation, it was approximately 30% above the share price on the day. We opted to exit the position ahead of the closing date after the price had narrowed to $38.30.

COMMENTARY

Well, the December quarter saw most asset prices around the world fall significantly as financial debt markets froze amidst people trying to reduce their leverage. The collapse of Lehman Brothers on September 15th, the biggest bankruptcy in history, appears to have been the trigger point. It has all been front page news!

Since 2003, we have written about the need for caution from the imprudent lending practices that have become entrenched in financial institutions around the world this past decade. Yet our cautionary view did not help our portfolio in this quarter.

Market confidence turned on a dime and many businesses and investments, especially those with meaningful debt, have suffered liquidity squeezes and accompanying losses, some catastrophic! While we did not own the headline disasters such as AIG, Allco, Babcock & Brown, various banks including the investment banks, mortgage and bond insurers, home builders and real estate trusts, our portfolio has been impacted as these types of companies have deleveraged or imploded.

This liquidity squeeze led to a reinforcing downward spiral of forced margin selling, share price declines and tax loss selling, all feeding on each other and resulting in instances of share prices significantly below any realistic assessment of intrinsic value. Basically, since October we have seen many share prices determined by need to sell and or emotion rather than long term earning capacity.

This all presents a significant dilemma. In the current environment, there are, in our view, significant value opportunities in the share market given that most world markets have fallen by about half in the last year and given our time horizon is five years plus. On the other hand however, confidence is such, that further significant falls are possible. So, what to do?

During this period, we have been especially diligent on revisiting and reviewing our holdings, the fundamental investment case for each and their ability to weather continued macro economic storms. You will note our portfolio has changed very little, though we have added to some positions very significantly as their share prices have come down and lightened others as theirs have gone up.

We believe this worldwide recession can potentially be deep and long, though given the share market is forward looking, share prices can bounce back relatively quickly, without much fanfare and certainly in advance of the recession ending. So given it is impossible to reliably predict the market bottom, our focus is squarely on the opportunities available to us on a company-by-company basis. Simply, if we purchase a share at $20 believing it has a fundamental value of $40, we are unconcerned if it falls another 10 or 20% in the short term. What we "don't" want to face is a situation where the same share rallies very quickly to $30, having missed the boat, when the market consensus is again rosy! To quote Jeremy Grantham, chairman of Grantham Mayo Van Otterloo "if you are presented with cheap shares and you don't buy them and their price runs up on you, not only do you look like an idiot, you are an idiot."

Our enthusiasm for the prospects of our current holdings is reflected in our invested position which sits just under 80% of the portfolio. We also note that we are in good company, with legendary investor Warren Buffett highlighting in a NY Times article in October that he believes US equities are undervalued. He rightly highlights that while the economy is poised to deteriorate in the periods ahead, this is already discounted into share prices; that as a result, the share market can advance dramatically even in the face of deteriorating economic fundamentals; and that while prices may fall further, for those taking a long-term (10-year plus) view, the rates of return one can expect to earn from today's prices more than compensate for the risk of further near-term price declines. Following is the link to Mr. Buffett's article and we encourage you to read and consider his points.

http://www.nytimes.com/2008/10/17/opinion/17buffett.html?_r=2&pagewanted=print&oref=slogin

Finally, an interesting but under-appreciated fact about investing in the share market is that, while the share market has delivered strong long-term results for investors, with returns tending to be in the 7 to 10% pa range over time, the average investor does NOT achieve anywhere near this result. This is because the average investor gets excited when the market goes up, adding to their investment at just the wrong time, while the same investor becomes fearful when markets drop and get 'scared' out of ownership of quality companies at unusually attractive prices available at the depths of bear markets. Conversely, intelligent investors who understand the benefits of investing for the long-term in high quality companies are able to achieve abnormally high returns through trimming or exiting investments as they become fully or overvalued, and adding to their holdings when prices are unusually attractive.

We would suggest you contact us or your financial adviser should you wish to add to your current position.

If you have any questions please contact us on (02) 9332 2133 or via email at invest@petersmacgregor.com.

Notes:

IMA Portfolio Returns

- Intra year performance figures are unaudited
- Performance figures in excess of 12 months are audited. Performance figures in the table are historical and not necessarily an indication of future performance.
- The performance figures represent the average returns over all the individually managed accounts ("IMA") during the relevant periods. Each IMA will generate discrete returns depending on its portfolio structure from time to time.
- Gross returns include dividends and foreign exchange costs and are presented before taxes and fees.
- The net returns are net of management fees and before taxes.
- The MSCI figures are the MSCI World Total Return Index (net local).