Responsible Entity: Equity Trustees Limited
ABN 46 004 031 298 AFSL 240975
Protection Strategy Provider and Manager : Credit Suisse International
ARBN 062 787 106

Principal Protected Yield Fund

Half yearly report

December 2008

Commentary

The year 2008 will be remembered for the wave of deleveraging that followed the bursting of the U.S. housing bubble and produced a financial system crisis that continues to roil markets and economies worldwide. The fourth quarter saw this crisis spread from the finance realm to the real economy and from the U.S. to around the globe.

By year end, G10 countries were experiencing a full-blown economic recession and major emerging economies, though avoiding outright contraction, faced strong headwinds as exports to the developed world slowed and credit markets slammed shut. Widespread destruction of demand and wealth had left a large and growing stock of excess capacity and decimated production and employment.

Awakening during the quarter to the reality of a global recession, central banks around the world shifted into crisis mode and sought additional tools to stimulate the economy. Policy makers' unconventional moves reflected the seriousness of the economic downturn, but also made clear that governments were intent on doing whatever was necessary to promote the resumption of growth.

Fiscal plans in various forms were announced in an effort to substitute public balance sheets for those of the private sector, with the objective of restoring normal intermediation between savers and private borrowers. Still, the effectiveness of these policies remained to be seen, as risk appetites in the private sector continued to weaken over the quarter, and saw only modest recovery in December.

Performance of the Underlying Portfolio

Markets had the upper hand in the fourth quarter, with turmoil in the banking sector leading to a virtual meltdown in credit markets that helped push G10 economies into recession and led to an unprecedented policy response. Notable market dislocations were:

- The USD Libor-OIS spread, an important measure of interbank liquidity, widened to over 350bps during October.
- Three-month US T-Bills traded at a yield of zero at several points during the quarter while ten-year yields ended the year at 2.22%, near a record low and 161 basis points lower than at the beginning of the fourth quarter.
- German and U.K. 10yr yields fell 105 and 140 basis points respectively, but still lagged 2yr yields which collapsed by 170 and 290bps.
- Inflation-linked bonds underperformed significantly, with breakeven inflation rates dropping towards zero in the US and to *negative* 3.5% in Japan
- Swap spread curves gyrated wildly, with long dated swap rates in all the major markets trading at least 50bps below sovereign yields while 2yr spreads flirted with record-highs.
- A preference for liquidity meant cash corporate bonds drastically underperformed credit derivatives, leaving the cash-CDS basis more than 250bps in the red by year end.
- Despite a modest recovery in December, credit spreads widened sharply in the quarter, with investment grade (+110bps in the quarter), EM (+280) and HY (+700-900) all experiencing one of their worst quarters ever.

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Government Policy

While in the third quarter some central bankers were still voicing concerns about the inflation implications of easier monetary policy, weak growth was unambiguously the focus of policy in the fourth quarter. With headline inflation declining across the globe and increasingly gloomy economic conditions, central banks around the world have embarked on a campaign of rapid easing.

- After pausing since April, FOMC resumed its rate-cutting in October and in December proceeded to reduce the Fed
- funds rate to essentially zero for the first time ever.
- The BOE was in catch-up mode, aggressively cutting rates by 300bps to a historical low of 2%.
- Even the ECB, previously the most hawkish of the major banks, reduced rates by 175bps to 2.5%.
- The BOJ, facing an unprecedented drop in production, made two 20bps cuts to take the rate to 0.1%.
- The Reserve Bank of Australia, which was one of the first major central banks to respond to the shifting growth and inflation dynamics this fall, slashed its policy rate by a total of 275bps over the 3 month period.

For some policy makers, the exhaustion of rate reduction has also prompted consideration of other stimulus measures to limit further economic deterioration. The Fed and other banks have declared their commitment to support the financial markets by extending the terms and range of collateral eligibility on lending facilities. Government balance sheets have been brought to bear through direct investment in financial institutions, short term lending in the CP market, debt guarantees, and the purchase or guarantee of "troubled" financial assets. Policy makers' unconventional moves reflected the seriousness of the economic downturn, but also made clear that governments were intent on doing whatever was necessary to promote the resumption of growth.

Outlook

Looking forward, PIMCO expects the pressures of global deleveraging to drive developed economies into one of the most severe recessions since World War II in 2009. Signs that government policy responses to the crisis are gaining traction will likely come first from the revival of risk appetites in financial markets Major emerging economies such as Brazil, Mexico and Russia are not expected to contract but will face strong headwinds as their exports slow and credit markets remain restrictive. PIMCO continue to have a postive outlook for Emerging Markets bonds. Despite the massive volatility experienced by global financial markets during the first half of the year, economic forecasts for Emerging Markets countries remain robust.

How did CSPPYF perform to 31 Dec 2008?

	1 month %	3 month %	6 month %	12 month %	Since Inception %*
Growth	1.37	3.18	-0.03	-2.16	-5.38
Income	0.00	0.00	0.00	2.20	1.46
Net returns	1.37	3.18	-0.03	0.02	-3.98
Gross returns	1.39	3.28	0.15	0.39	-3.65

*Date of Inception – 11 July 2007

Net Returns are calculated using pre-distribution month end mid unit prices and assumes all income is reinvested in additional units. Gross returns are calculated by adding back the Responsible Entity Fee deducted. **Past performance is not necessarily indicative of future performance. Returns are volatile and may vary from year to year.**

Distribution History (CPU)

	June	Dec
2007	n/a	2.0601
2008	-	-