

QUARTERLY
REPORT
31 DECEMBER 2008



ORBIS MIS
ORBIS/SM AUSTRALIA
EQUITY

ORBIS/SM AUSTRALIA EQUITY FUND

INVESTMENT OBJECTIVE

The Investment Manager seeks long-term returns for investors that are higher than those of the S&P/ASX 300 Accumulation Index, a broad-based index compiled by Standard & Poor's representing the total returns available in the Australian stockmarket. The Investment Manager aims to achieve this without assuming any greater risk of loss than that of an investment in the securities represented on the S&P/ASX 300 Accumulation Index.

INVESTMENT APPROACH

The Fund is managed using the techniques developed at Allan Gray Limited and the Orbis Group over more than 30 years, applied to the Australian stockmarket. The basic philosophy underlying the approach is the belief that while stockmarket prices are the best indicator of value for companies over very long periods of time, substantial deviations of those prices from their true value do occur over the short-to-medium term. Most businesses (and thus their underlying value) do not change much from one week to the next. Yet their stock prices are often subject to huge moves, often for no particularly good reason. The Investment Manager focuses its efforts on calculating the real underlying value of various companies using the extensive technology developed by the Orbis Group over the past 15 years, and the insights of Orbis' global team of analysts as well as a local team of analysts. The Fund's portfolio is constructed by taking all the Investment Manager's best ideas (i.e. where the gap between assessed value and the stockmarket price is the largest) and combining them in a way that seeks to limit the exposure to any single underlying variable.

NOTICES

Buy/Sell Spread. *The Net Asset Value per Unit of a Class differs from the application or withdrawal price of the Class by the allowance for transaction costs (i.e. the Buy/Sell Spread). The Buy/Sell Spread is the Responsible Entity's estimate of the cost of acquiring, or disposing of, interests in the Fund, and is currently set at 0.35% of the application monies received on an application, and 0.35% of the withdrawal proceeds on the amount of a withdrawal request received.*

Source. *The source for the S&P/ASX 300 Accumulation Index is Standard & Poor's. ASX 300 is the trademark of ASX Operations Pty Limited ("ASXO"); "S&P/ASX300TM" exists pursuant to an arrangement between ASXO and Standard & Poor's (S&PTM is a trademark of Standard & Poor's, a division of The McGraw-Hill Companies, Inc.).*

Returns. *Fund and Benchmark returns are quoted excluding any Buy/Sell Spreads that are payable on some transactions, i.e. on a "mid-to-mid" basis.*

Other. *Equity Trustees Limited AFSL No. 240975 is the issuer of units in the Orbis/SM Australia Equity Fund (the "Fund") and Orbis Investment Management (Australia) Pty Limited AFSL No. 298487 is the Fund's Investment Manager. A Product Disclosure Statement for the Fund ("PDS") is available from www.orbisfunds.com.au or by contacting Orbis' Client Services Team on +61 (0)2 82248600. You should consider the PDS in deciding whether to acquire, or to continue to hold, units in the Fund. This report should not constitute an offer to sell, or a solicitation to buy, units in the Fund.*

This report provides general information only and should not be construed as financial product advice. This report is current as at its date of publication, is given in good faith and has been derived from sources believed to be reliable and accurate. It does not take into account your individual objectives, financial situation or needs. Subject to applicable law, we do not provide any warranty of accuracy or reliability in relation to information in this report or accept any liability to any person who relies on it.

Risk Warnings. *Past performance is not indicative of future performance. The Fund's unit price will fluctuate and is not guaranteed. When making an investment in the Fund, an investor's capital is at risk.*

ORBIS/SM AUSTRALIA EQUITY FUND AT 31 DECEMBER 2008

Total Rate of Return in Australian dollars	From Public Launch	Latest		From	Latest
	on 4 May 2006	2 Years	1 Year	30 Jun 2008	Quarter
	% Annualised			% Not Annualised	
Orbis/SM Australia*	(10.4)	(19.1)	(45.9)	(31.3)	(26.9)
S&P/ASX 300 Accumulation Index	(8.1)	(15.7)	(38.9)	(27.2)	(18.5)
Relative Performance	(2.5)	(4.0)	(11.5)	(5.6)	(10.3)

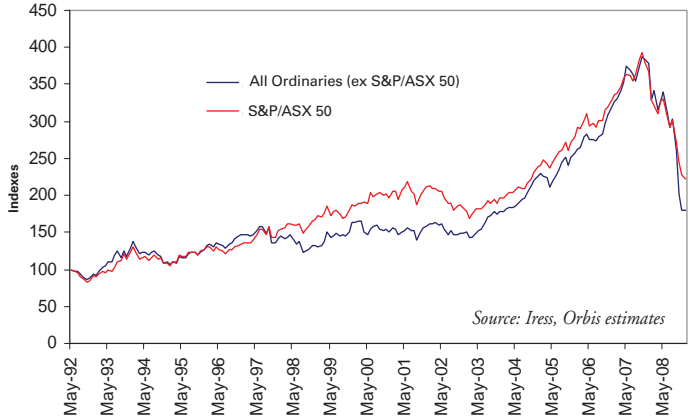
* Fund returns are gross of all income, net of all expenses and fees and assume reinvestment of distributions.

The last year has been very disappointing for the Fund and its investors. Not only did the stockmarket, as represented by the benchmark S&P/ASX 300 Accumulation Index, fall 38.9%, but the Fund underperformed this very weak market. Usually we would expect to do relatively well when markets are weak, so we thought it appropriate to analyse the Fund’s performance further.

During the current market crisis we have seen an extraordinary flight to perceived safety. The yield on US 30-year Treasury Bonds declined to an all-time low of 2.5% per annum. At the same time the extra yield demanded by the market for corporate debt reached record highs, exceeding even the peak set in the Great Depression in 1931 (Source: Deutsche Bank).

The same has happened in the Australian stockmarket. Most equity investors are trying to protect themselves by moving their exposure into a few large companies which have consequently held up well and avoiding, at all costs, investments in smaller companies. The graph alongside illustrates this.

**S&P/ASX All Ordinaries (excl. S&P/ASX 50) and S&P/ASX 50
Common Base, 1992 - 2008**



Source: Iress, Orbis estimates

Since the beginning of 2008, the S&P/ASX All Ordinaries excluding the top 50 companies has fallen 25% more than the S&P/ASX 50 (ASX 50) itself.

Not surprisingly, the S&P/ASX Small Ordinaries (Small Ords) Index is now at its lowest point relative to the ASX 50 since it was first calculated in 1990. The recent correction has taken the ASX 50 back to 2004 levels, but the Small Ords Index is now no higher than it was in 1993.

A very large percentage of the Fund consists of companies outside the top 50 – at the end of the quarter shares outside the ASX 50 accounted for 90% of the Fund, but less than 20% of our benchmark. This multiplied by the 25% underperformance of these stocks can account for all of the Fund’s underperformance this year.

While the past year has been one we all hope to quickly forget, there is a distinct silver lining. Over very long periods of time, smaller shares tend to do a little better than the overall stockmarket¹. Given that these shares are at all-time low levels relative to a stockmarket that itself is almost 50% off its high should mean that great value is available.

¹Dimson, Marsh and Staunton, *Triumph of the Optimists*, Princeton University Press, 2002, page 124 ff.

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The table below shows our estimate of the earnings yield and dividend yield of our aggregate share portfolio projected forward one and two years (to 31 December 2009 and 2010 respectively). While it is always difficult to forecast, we believe these numbers to be conservative and assume economic conditions that are well below average.

Estimated Fund Yields		
	Earnings yield	Dividend yield
2009	18%	8%
2010	21%	11%

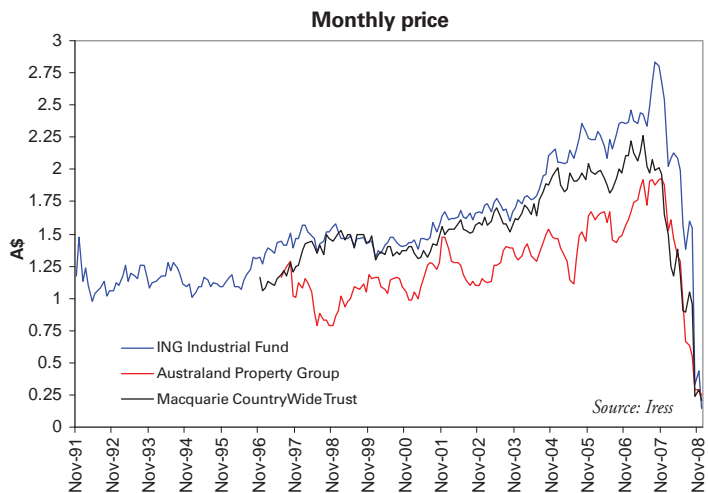
Source: Orbis

For 2010 we estimate the average earnings yield of the Fund’s portfolio at 21% (i.e. an average Price-to-Earnings ratio of 4.75) and its dividend yield at 11%. About 12% of the portfolio is invested in companies in development (such as bio-tech shares) that we expect to contribute no earnings in 2009 or 2010. From 2010, earnings should grow substantially as the economy returns to more normal conditions and developing companies mature. The average price of a share in our aggregate portfolio is less than 50% of its tangible net asset value.

Value can be well illustrated by looking at one specific area that we believe offers some of the best value we have ever seen in a stockmarket. Real Estate Investment Trusts (REITs, previously known as Listed Property Trusts) used to be the favourite investment of risk-averse investors who were looking for stable, growing income yield. However, over the past 12 months a number of scandals have plagued the industry with a number of prominent ‘stable’ income fund managers such as Babcock & Brown and Allco nearing bankruptcy. At the same time the credit crisis has made any company with significant debt (as many REITs have) investment lepers.

This has caused the market to lose confidence in high-income funds and shares leading to massive redemptions or sales. REITs (except for a few of the largest ones) have seen massive selling pressure pushing prices down as much as 95%, which is extraordinary considering that REITs were seen as stable for many years.

The price graph of ING Industrial Fund, Macquarie CountryWide Trust and Australand Property Group, is shown alongside. All of these are large Australian REITs in which the Fund has now invested – what has happened this year is without precedent.



In many instances these REITs have become so small that they are too small for the Fund to buy; therefore, to obtain sufficient exposure and diversify risk, we have bought a collection of the best ones. We list 10 of these in the table on the following page together with their economic fundamentals. Most of the REITs listed in the table have position sizes that are individually less than 1% of the Fund.

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Fund Name	Price-to-Net Tangible Asset Value per share (NTA)	Earnings Yield	Gearing (Debt/Assets)	Interest cover (Property Income / Interest Paid)
APN European Retail Property	6%	80%	53%	1.8
Centro Retail Trust	5%	181%	65%	1.7
Galileo Japan Trust	6%	126%	58%	3.3
ING Industrial Fund	7%	114%	56%	2.1
ING Real Estate Community Living	5%	185%	63%	1.9
Macquarie CountryWide Trust	12%	58%	52%	2.0
Macquarie DDR Trust	3%	207%	59%	1.8
Mirvac Industrial Trust	12%	45%	53%	1.8
Reckson New York Property Trust	11%	54%	56%	1.8
Valad Property Group	5%	111%	56%	1.8
Average	7%	116%	57%	2.0

Source: Orbis

These REITs offer extraordinary value. You can basically buy these REITs for less than 10% of their latest independent valuations (net of associated debt), and well below the cost of building. Net income (excluding any items of an unusual nature) is more than 100% of the purchase price. While debt levels are higher than one would like, rentals, on average, cover interest twice. Many REITs have decided to slash distributions (effectively dividends paid to investors) and retain the cash to reduce debt, a sensible strategy in our opinion and one which will reduce future risk. Nevertheless, with only 20% of profits paid out, we estimate the average distribution yield will be over 20%.

The two major risks for investors are that banks refuse to renew the REITs' loans when they mature and tenant bankruptcy. Since they are still covering their interest easily and are reducing rather than increasing debt, we think it very likely that the banks will roll the debt forward. In fact, in December, a large consortium of banks extended Centro Retail Trust's debt for two years despite it being one of the most leveraged players. Directors have also been significant buyers of a number of these shares in the last quarter. The risk of tenant bankruptcy is higher than usual given the weak economic conditions, however this risk is very diversified.

Perhaps it is easier to see the value by reducing the parameters above into a single building. Take a building that costs \$1 million to build and generates \$70,000 in annual rental income with leases fixed for six years (the average length of leases in the table above). The building has a \$570,000 mortgage which you have to take over with interest costs of \$35,000 per annum. The equity should be worth \$430,000 with annual pre-tax income of \$35,000. The market currently offers this opportunity to us for somewhere between \$30,000 and \$40,000, down from more than \$500,000 last year.

So while we are deeply disappointed by the losses suffered in 2008, we think that, in some cases, markets have hugely overreacted presenting investment opportunities which have not been available for decades. It is impossible to tell when markets will recover, but even if a recovery in prices is not forthcoming, income yields are very likely to exceed cash returns by a wide margin. When the recovery happens, the upside, as some of these values move to more normal levels, is very high.

Yours sincerely,



Simon C Marais

Sydney, Australia
8 January 2009

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STATEMENT OF NET ASSETS (UNAUDITED)

Security	Market Value A\$ 000's	% of Fund
Caltex Australia	16,432	5
Centennial Coal	14,128	4
Australia and New Zealand Banking Group	14,124	4
PMP	13,346	4
PaperlinX	12,831	4
National Australia Bank	11,547	3
Fisher & Paykel Appliances	11,386	3
CSR	10,621	3
Air New Zealand	9,329	3
ALE Property Group	9,265	3
Roc Oil	8,568	3
Australand Property Group	8,328	2
Pharmaxis	7,740	2
Platinum Asset Management	7,571	2
Thakral	7,434	2
Challenger Financial Services Group	7,337	2
Guinness Peat Group - CDI	7,235	2
Salmat	7,123	2
Ridley	7,037	2
Iluka Resources	6,540	2
Mirvac Group	5,785	2
Alumina	5,522	2
Tower	5,316	2
Nuplex Industries	5,140	2
Centro Retail Trust	4,836	1
Austal	4,830	1
nib Holdings	3,852	1
Mortgage Choice	3,811	1
ING Real Estate Entertainment Fund	3,607	1
Macquarie CountryWide Trust	3,498	1
Positions less than 1%	56,247	17
Total Equity Exposure	300,366	88
Stock Index Futures Bought*:		
SPI 200 03/2009	35,509	10
Net Current Assets	5,471	2
Net Assets	341,346	100
Net Asset Value per Unit	A\$ 0.7267	
Total Assets Under Management for the Australian equity strategy (000's)**	A\$ 765,637	

* All stock index futures are fully backed by cash holdings. The Fund buys stock index futures to maintain share exposure while investing new subscriptions. As selected shares are bought for the Fund, the stock index futures are sold.

** Orbis Investment Management (Australia) Pty Limited also manages several segregated accounts that have the same investment goals and restrictions as the Fund.

CHARACTERISTICS OF ORBIS/SM AUSTRALIA EQUITY FUND

Investment objective	The Fund seeks higher returns than the Australian stockmarket without greater risk of loss.
Investments	The Fund is designed to remain continuously invested in selected Australian equities. These equities are selected using extensive proprietary investment research undertaken by the Investment Manager.
Structure	Registered Managed Investment Scheme aimed at Australian investors.
Who should invest?	The Fund is designed for investors who seek income and long-term capital appreciation by investing in an actively-managed portfolio of Australian equities. This portfolio may deviate meaningfully from the performance of its benchmark in pursuit of superior returns.
Minimum initial investment	A\$50,000. Subsequent investments minimum A\$10,000.
Minimum withdrawal	A\$10,000. Minimum investment balance is A\$50,000.
Applications/withdrawals	Weekly, normally each Thursday at the Net Asset Value per Unit, after allowance for transaction costs, calculated at 4:15 p.m. Australian Eastern Standard Time on that day.
Dealing deadlines	<p>Written applications for Units received by the Administrator by 2:00 p.m. Australian Eastern Standard Time (the "Deadline") on or before the particular Dealing Day will be processed, and Units will be issued as at that Dealing Day, provided that sufficient cleared funds have also been received by the Administrator in Sydney by the Deadline. All applications are irrevocable after the Deadline.</p> <p>Withdrawal requests should be received by 2:00 p.m. Australian Eastern Standard Time on a Dealing Day for processing on that Dealing Day. A Unitholder who submits a request for a Significant Withdrawal must make that request by 2:00 p.m. on the day that is 10 Business Days before the Dealing Day. All withdrawal requests are irrevocable after the Deadline for their submission described above.</p>
Fees and expenses	The Management Fees payable from the Fund have a fixed component (the " Base Fee ") and a performance component (the " Performance Fee "). The Base Fee is 0.75% per annum of the Net Asset Value of the Fund. The Performance Fee is 20% of the extent to which the Fund outperforms its Benchmark once the Fund has reached a new High Water Mark. Other expenses such as stamp duty and GST will be deducted from the Fund as appropriate.



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