

## Portfolio Review

Portfolio performance for the June Quarter 2010 was -2.50% versus the benchmark return of -1.71%.

The Fund produced a negative return for the June quarter. Markets were volatile over the period with concerns about sovereign risk and slowing economic growth weighing on risk assets. Australian equities delivered a negative market return of 11.2% and the impact on the Fund was adverse. International equities also delivered negative returns but the return to the Fund was moderated by the weaker AUD, where the Fund was not hedged. The property asset class delivered positive returns of over 3% over the quarter with nearly half of the returns due to the strong rental income flow. Improved capital revaluation delivered the remainder of the positive return. Bonds performed strongly for the quarter (up 3.6%) as the market invested in the safety of fixed interest and cash returns.

## Market Outlook

The recent strains in equity and credit markets create constraints for the global recovery. Nevertheless, these pressures do not derail the view of a "sustained but uneven" global recovery. A crucial element in this view is that global growth is being driven far more by Asia, with the US delivering 3% to 3½% growth over the course of 2010. China's economy will continue to grow rapidly this year and next but at a slower pace relative to recent history. Moreover, the major central banks will not tighten monetary policy aggressively. The ongoing monetary stimulus will continue to provide support against the problems of poor credit availability and budget uncertainty in many industrial countries.

Within the euro area, divergences are likely to continue to grow. The forecast German growth (improving to 2.0% for 2010 for example) reflects the lower Euro, plus Germany's big trade exposure to high-growth emerging markets. In contrast, peripheral countries face painful prospects, with heavy fiscal tightening, weakened banking systems and poor competitiveness.

There is a sizeable risk of public debt restructuring in Greece, Portugal and Spain in coming years. Fiscal and structural reforms proposed in those countries so far may not achieve the near impossible task of achieving a return to fiscal sustainability and economic growth in coming years. Nevertheless, the rescue measures should be enough to sustain these countries without debt restructuring for the next 12-24 months at least and ensure that any eventual restructuring is not overly disruptive for banks and investors.

For the UK, the key message is that recovery is more sustainable in terms of combining growth with a decline in the fiscal deficit, relative to other problem European economies.

For the US the growth forecasts are lower for 2010 and 2011, reflecting the erosion of financial conditions and the recent setback in housing-related indicators. Unfortunately, there is now little offsetting currency boost, with the trade-weighted USD up due to the flight to safety by markets.

Among China and other Asian economies, the data flow has generally been stronger than expected, creating some cushion to absorb the potential slow-down in exports to the US and Europe. The change in China's currency policy is not expected to lead to rapid near-term currency appreciation. China's imports from ASEAN countries rose 70% year on year over the January-May period, helping to propel the broadly spread upturn. China and the non-Japan Asian economies will likely generate about 40% of real global GDP growth (at current exchange rates, a higher share at Purchasing Pricing Parity exchange rates), roughly twice the contribution of the US and more than four times the European contribution.

For Japan, the growth forecasts continue to surge, lifted by the boom in exports to China and other Asian economies. This has a spill over to business investment and jobs. (Exports to China equal 2.5%-3% of Japan's GDP, while exports to China are about 0.5% of US GDP). Japan's GDP is expected to grow by 3.5% for this year and it's growth will likely far outpace that of the Euro area and for the first time since 1991 and also outpace that of the US.

As before, major central banks are in no rush to tighten monetary policy, given uncertainties over growth prospects and general lack of near-term inflation pressures. The base case is that the US Federal Reserve (Fed) and the Bank of England (BoE) will keep rates stable for an extended period, with the European Central Bank (ECB) likely to be on hold until well into 2011 and the Bank of Japan (BoJ) on hold even longer. Tightening, when it eventually comes, will be gradual, gauged against fiscal difficulties and the health of the banking system.

## Portfolio Characteristics

Performance as at the 30th June 2010

Period	Portfolio Return%		Benchmark %	Out/Under Performance %	
	Gross	Net		Gross	Net
One Month	-2.50	-2.58	-1.71	-0.80	-0.87
Three Month	-6.85	-7.06	-4.77	-2.08	-2.29
One Year	10.34	9.36	8.92	1.42	0.44
Three Yrs p.a.	-2.01	-2.89	-3.90	1.89	1.01
Five Years p.a.	5.32	4.38	3.87	1.45	0.51
Seven Years p.a.	8.75	7.77	6.71	2.04	1.06
Nine Years p.a.	6.13	5.16	4.53	1.60	0.63
Since Inception Date: July 1997	7.84	6.86	5.98	1.86	0.87

Asset Allocation as at the 30th June 2010

	Target%	Actual%	Range Tolerance
Australian Equity	40.0	48.03	35-55
International Equity	25.0	20.82	20-30
Direct Property	10.0	10.32	5-15
Australian Fixed Interest	20.0	16.23	15-40
Cash	5.0	4.60	0-20
Total	100.0	100.0	