

Portfolio Review

The Fund produced a negative return for the June quarter, with continued domestic and international market volatility a feature over the period. Risk avoidance was evident due to a rolling sequence of natural and manmade events. The cumulation was the sovereign debt concerns in Europe manifested by a flight to the perceived safe haven of well rated Treasuries. Over the quarter, the Fund's domestic and international equities performed poorly in a market context, with domestic equities slightly underperforming against benchmark. The fixed interest market outperformed while the underweight holdings and shorter duration detracted from relative performance. Direct property provided a positive return whilst the AREITs market was weaker, with our holdings making a relative positive contribution. The Fund's overweight Australian equity asset allocation (and the equity holdings within the asset class) remains positioned for a broad pick-up in growth with overweight positions in cyclical stocks and sectors which should benefit from a recovery in earnings. The allocation to the Dexia Alpha Dynamic Fund delivered a positive performance, whilst the smaller allocation, within Australian equities, to the Active Extension Fund and the MicroCap Fund delivered positive relative performance within a weak market. The international equity market was impacted by the continued strengthening Australian dollar. We maintained an unhedged position with regard to our overvalued currency.

Market Outlook

We continue to expect strong global growth this year and the next but the divide between winners and losers in terms of the growth outlook has become more pronounced. Recent economic data for advanced economies have generally remained soft, with further downgrades to the GDP growth forecasts for 2011-12 in the US, euro area and the UK. This is in stark contrast to growth forecasts for the major emerging markets, which have remained strong and with no significant revisions. The latest IMF forecast for global growth has been revised down a point to 4.3% for 2011, but unchanged for 2012 at 4.5%. This is still above long term trend growth. The key emerging economies are delivering strong performance, whilst leading economies are weaker.

Part of the recent slowdown is temporary; impacted by unusually heavy snow in the US in the March quarter, erosion of real incomes by high oil prices in February-April and the supply chain disruptions stemming from Japan since March. These supply chain effects appear to be more pronounced in the UK and US than the euro area, consistent with the fact that car output by Japanese owned companies is a higher share of the total in those markets.

However, the drop in the growth forecasts isn't purely a result of March and June quarter weakness. There has been shift in future expectations, with confidence in the recovery sufficiently fragile that even temporary disruptions can have more lasting effects on growth. Weaker confidence may interrupt the path to improving financial conditions and reinforce the lingering mood of caution among businesses.

Uncertainties stemming from the euro area sovereign crisis are unlikely to abate quickly. Greece, Portugal and Ireland will all have to implement sovereign debt restructuring (including write-offs) in coming years, perhaps with several phases of restructuring. There is likely to be only a "soft restructuring" this year, with

some form of rollover of debt by some banks. However, the ability of the governments - in combination with the EU/IMF/ECB - to deal with to eventual hard structuring (i.e. with write-offs to principal) without near-term disruption looks increasingly doubtful. Fiscal tightening on the necessary scale will probably be economically unsustainable as it would crush individual economies and hence fail to cut the deficit as far as needed. Even if aggressive supply-side reforms could be implemented, debt/GDP ratios will have spiralled by the time the benefits start to emerge.

With softer growth in the developed economies, the outlook for policy rates remains moderate for the US, euro area and the UK. The European Central Bank (ECB) remains likely to increase rates again in the July meeting (to 1.5%), given the "strong vigilance" emphasised at the June meeting. The ECB intends to increase rates to about 2.0% by mid-2012 unless the economy weakens sharply. The ECB believes that, with the recession over, keeping ultra-low rates is dangerous because of risks of fuelling a future credit boom or lifting inflation expectations.

The US Federal Reserve however is likely to keep rates low for an extended period; further lengthened due to the recent soft patch and uncertain financial conditions. By contrast, there will be continued tightening across many emerging markets in coming months. This tightening will be calibrated not to derail growth in 2012-13.

Portfolio Characteristics

Performance as at the 30th June

Period	Portfolio Return %	Benchmark %	Out/Under Performance %
One Month	-1.35	-1.31	-0.04
Three Month	-2.70	-2.13	-0.57
One Year	9.58	7.67	1.90
Three Yrs p.a.	2.27	1.42	0.86
Five Years p.a.	2.71	2.13	0.57
Seven Years p.a.	6.69	5.76	0.93
Ten Years p.a.	5.59	4.84	0.75
Since Inception <small>Since July 1997</small>	7.05	6.11	0.95

1. Portfolio returns are net of fees and before taxes

Asset Allocation as at 30th June

	Neutral %	Actual %	Range Tolerance %
Australian Equity	40.0	47.82	35-55
International Equity	25.0	22.71	20-30
Direct Property	5.0	4.89	0-10
Listed Property	5.0	4.82	0-10
Fixed Interest	15.0	12.87	10-35
Alternatives	5.0	4.72	0-10
Australian Cash	5.0	2.46	0-20
Total	100.0	100.0	