

Portfolio Review

Portfolio performance for the March Quarter 2009 was -3.65% versus the benchmark return of -3.77%.

The Fund outperformed its benchmark over the March quarter. The Fund retained an underweight exposure to domestic and international equities, outperforming their benchmarks in a negative market. International equities (unhedged) reported a larger loss than domestic equities for the quarter, due significantly to the appreciating Australian dollar. The 50% currency hedge on the international equities holdings added to performance over the quarter. Both domestic and international equity markets improved over the quarter, with a notable uplift in March. Again, the stronger Australian dollar meant that the domestic equity market provided superior performance. The Australian bond exposure was modestly reduced with interest rates neutral but credit remaining weak. The direct property holdings performed poorly in the quarter as asset valuations were adjusted to reflect weakening market conditions.

Market Outlook

Tentative signs of stabilisation in the international data and aggressive policy action have helped move markets higher. Given constraints on the financial front for banks and the difficulty of translating policy actions into sustainably easier financial conditions, the big decision is whether the cyclical picture is improving enough to keep markets moving higher from these levels.

At the margin, circumstances have clearly changed for the better. Financial conditions have eased after the US Federal Reserve and Treasury actions. The economic news flow continues to be, on average, a little 'less bad'. The US consumer and housing picture looks more stable, fiscal stimulus is due and we are now seeing evidence, in the US and UK at least, that inventories may be running down more rapidly. The combination of better final demand and destocking makes it more plausible that we may be set for a genuine stabilisation in production. The momentum on the global industrial side is slowly improving and we are heading closer to a turn on the inventory side, though it represents only a partial perspective.

Growth will be weak in the US for a sustained period with the unemployment rate heading sharply higher. This is, at best, a shift from negative to modest positive growth, not a robust recovery. Beyond this near-term stabilisation, the outlook (for the US in particular) is still a sluggish, disinflationary environment with all the risks to profitability and credit quality that this poses. The transition even to that kind of environment after a period of strongly contracting activity is still a meaningful one.

Beyond the data, the Achilles heel for the current rally remains the financial sectors. The combination of the US bailout measures and the stress tests mean that the policies needed to address the banking sector issues more comprehensively are only slowly falling into place. None of this mitigates the need for more capital in the financial sector or provides a road to viability for the weakest banks. With additional money likely to be needed to back these plans, the risk of another messy policy debate remains high.

The big policy question is the role of the European Central Bank (the ECB). The 25bp cut was more modest than expected. The ECB has been slower to move towards the active easing that the Bank of England (BoE) and the US Federal Reserve have committed to. With the US dollar weakness and the agreements reached at the G20 meeting we may see additional news on the international financial structures.

As the March quarter closes, it has felt at times as though 2009 would be 'more of the same'. But despite the pervasive negativity, the trading environment has proved more nuanced. Emerging market equities are up, commodity prices are significantly higher, credit tighter and US bond yields are higher. This is very clearly not the simple growth downgrade that dominated the second half of 2008.

Portfolio Characteristics

Performance* as at the 31st March 2009

	Portfolio%	Index%	Value Add%
3 Month	-3.65	-3.77	0.12
1 Year	-14.81	-16.54	1.73
3 Years	-2.75	-3.43	0.68
5 Years	6.55	4.74	1.81
7 Years	5.56	3.94	1.62

* Before Fees and Taxes

Asset Allocation as at the 31st March 2009

	Target%	Actual%	Range Tolerance
Australian Equity	40.0	40.0	35-55
International Equity	25.0	21.50	20-30
Direct Property	10.0	14.70	5-15
Australian Fixed Interest	20.0	21.70	15-40
Cash	5.0	2.10	0-20
Total	100.0	100.0	