JUNE QUARTER 2012

LONSEC QUARTERLY OUTLOOK

Quarterly Outlook draws on the views and opinions of Australia's leading funds management organisations, as well as the views of the Lonsec Investment Committee. Quarterly Outlook presents shorter-term asset allocation recommendations (overweight, underweight and neutral) towards shares, property, fixed interest and cash, based on these combined inputs.

Lonsec expects the global outlook to continue to improve during 2012.

Economic Overview

Index Returns as at 31 March 2012 (%) p.a.	3 mths	6 mths	1 yr	3 yrs	5 yrs
Australian Shares	8.6	10.8	-6.3	11.4	-2.1
International Shares	10.7	13.0	1.3	5.7	-5.1
Domestic Listed Property	7.1	11.2	1.7	14.8	-13.6
Global Listed Property	12.5	22.8	9.4	37.0	-2.9
Australian Fixed Interest	0.8	2.7	10.0	6.5	7.3
International Fixed Interest	2.2	4.3	11.9	9.8	8.9
Cash	1.1	2.4	5.0	4.4	5.4
$A vs $US	2.4	6.3	0.7	14.8	5.2

Market Indices
S&P/ASX 300 Accumulation Index
MSCI World Ex Aust Acc Ind Gross Div A$
S&P/ASX 300 Property Trusts Accum Index
UBS Global Investors ex Aust TR Hedged AUD
U B S Warburg Composite 0 + Years
BarCap Global Aggregate Index Hedged $A
U B S Warburg Bank 0 + Years

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Australian

The Australian economy grew by a weak 0.4% in the fourth quarter of 2011, with annual growth coming in at 2.3%. At the same time, monthly employment figures have turned negative suggesting that the broader economy has pockets of weakness, with retail, manufacturing, tourism and property construction all experiencing tough conditions.

However, the Australian economy has strong fundamentals, relative to most other developed economies, in terms of a resource-rich economy geographically close to Asia, low public debt, strong corporate balance sheets and a relatively strong banking sector.

Lonsec expects the global economy to rebound during 2012 and the RBA to cut the cash rate to 3.75%, this should see the economy gather momentum in the second half of the year. Australian economic growth should increase to 3.0% in 2012.

Global

The International Monetary Fund (IMF) expects global growth to slow to 3.3% in 2012, down from 3.8% in 2011, with a clear delineation between developed and emerging economies. Developed economic growth is expected to slow to 1.8%, with the Euro area expected to go into mild recession. Emerging economies are expected to slow, but maintain robust growth of 5.8%.

Lonsec expects the global outlook to continue to improve during 2012. Europe is expected to experience a mild recession as a zone, which is a better outcome than expected late last year. There are clearly some major problems in southern Europe, but the EU and ECB seems to be gradually getting on top of the issues. Lonsec expects a 'muddle-through' as the most likely scenario for Europe from here.

Asset Class Overview & Tactical View

Australian Shares (Slight Overweight)

Australian shares returned 8.6% for the quarter.

Lonsec has moved from a Neutral position to a Slight Overweight position. The move reflects Lonsec's view that price to earnings ratios have already priced in an Asian slowdown, the high AUD, relatively high interest rates, a patchy domestic economy, productivity issues (e.g. industrial relations) and flood related issues. Lonsec believes that given the strong fundamentals of the Australian economy and the strong balance sheets of most companies, Lonsec does not expect PE ratios to compress any further. Additionally, we expect the global growth outlook to surprise on the upside this year, the Australian yield curve to come down and the AUD to weaken.

International Shares (Slight Overweight)

International shares returned 10.7% for the quarter. Lonsec has moved from a Neutral to Slight Overweight position in International Shares.

Lonsec expects the US and Asia to gain momentum during 2012. Provided that Europe can 'muddle through' and avoid any further major shocks, then equity market sentiment should continue to improve. Despite the strong US rally, Lonsec is increasing its international equity weighting in recognition that Asian and European markets continue to look relatively cheap and on the expectation that the AUD/USD should weaken further. A bias towards emerging markets is preferred.

Global Listed Property (Neutral) & Australian Listed Property (Slight Overweight)

Domestic and global listed property returned 7.1% and 12.5% respectively for the quarter. No changes were made to the existing positioning to these sectors.

The fall in the Australian yield curve has made the yield on A-REITs attractive with the 10-year bond yield currently at 4.05% versus the A-REIT sector yield of 6.5%. If the US and Australian economies rebound over the medium term then distribution growth should also improve.

Australian Fixed Interest (Slight Underweight)

Australian fixed interest returned 0.8% during the quarter.

Lonsec has reduced the allocation to Australian Fixed Interest from Neutral to Slight Underweight. While the Australian yield curve offers better value than most major debt markets, the curve is still inverted with the cash rate at 4.25% and the 10-year bond yield at 4.05%. Lonsec expects the yield curve to steepen over the short to medium term, that is, we expect the cash rate to fall and bond yields to gradually rise, as the growth outlook improves.

International Fixed Interest (Underweight)

International fixed interest returned 2.2% for the quarter. Lonsec has maintained the Underweight allocation to International Fixed Interest.

Lonsec continues to find the investment case for global bonds to be unattractive on a relative basis, as yields range from 1.0% to 3.2% on most major global 10-year bond issues. The return seems inadequate given the size of the budget deficits and public debt levels of the major issuers.

Cash (Neutral)

Cash returned 1.1% for the quarter. The allocation to Cash has moved from a Slight Overweight position to a Neutral position. The change reflects Lonsec's increased conviction in growth assets.

Inflation is expected to fall well within the RBA's target 2-3% range in the first quarter of 2012 and the RBA has given a strong indication that it will cut the cash rate further in May, once this is confirmed. With the household sector deleveraging and concerned about job security (in the eastern States), Lonsec believes the cash rate will need to fall to 3.75% to encourage a major rebound in consumption

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LONSEC QUARTERLY OUTLOOK

JUNE QUARTER 2012

Recommended Asset Allocation Weightings

Lonsec Tactical Asset Class Positions - March 2012		
	Last Quarter	Current View
Aust Shares	Neutral	Slight Overweight
International Shares	Neutral	Slight Overweight
Australian Property	Slight Overweight	Slight Overweight
Global Property	Neutral	Neutral
Aust Bonds	Neutral	Slight Underweight
Global Bonds	Underweight	Underweight
Cash	Slight Overweight	Neutral
Alternatives	Neutral	Neutral

Secure

	Benchmark	Ranges	TAA position	+/-
Australian Shares				
International Shares				
Aust Property				
Global Property				
Aust Bonds				
Global Bonds				
Cash*	100	100.0	100.0	0.0
Alternatives				
Total	**100**		**100**	**0**

Balanced

	Benchmark	Ranges	TAA position	+/-
Australian Shares	24	16-32	27.0	3.0
International Shares	21	14-28	23.5	2.5
Aust Property	6	4-8	7.0	1.0
Global Property	4	3-5	4.0	0.0
Aust Bonds	17	11-23	15.0	-2.0
Global Bonds	18	12-24	14.0	-4.0
Cash*	5	0-12	4.5	-0.5
Alternatives	5	0-10	5.0	0.0
Total	**100**		**100**	**0**

Defensive

	Benchmark	Ranges	TAA position	+/-
Australian Shares	8	5-11	9.5	1.5
International Shares	6	4-8	7.0	1.0
Aust Property	6	4-8	7.0	1.0
Global Property				
Aust Bonds	27	18-36	26.0	-1.0
Global Bonds	28	19-37	23.5	-4.5
Cash*	25	15-35	27.0	2.0
Alternatives				
Total	**100**		**100**	**0**

Growth

	Benchmark	Ranges	TAA position	+/-
Australian Shares	31	21-41	33.0	2.0
International Shares	29	19-39	31.0	2.0
Aust Property	6	4-8	6.5	0.5
Global Property	4	3-5	4.0	0.0
Aust Bonds	8	5-11	6.5	-1.5
Global Bonds	9	6-12	7.0	-2.0
Cash*	3	0-10	2.0	-1.0
Alternatives	10	5-15	10.0	0.0
Total	**100**		**100**	**0**

Conservative

	Benchmark	Ranges	TAA position	+/-
Australian Shares	17	11-23	20.0	3.0
International Shares	13	9-17	15.0	2.0
Aust Property	6	4-8	7.0	1.0
Global Property	4	3-5	4.0	0.0
Aust Bonds	24	16-32	22.5	-1.5
Global Bonds	26	17-35	21.0	-5.0
Cash*	10	0-20	10.5	0.5
Alternatives				
Total	**100**		**100**	**0**

* Although the TAA position is neutral, cash is used as a balancing item where required

Note: 'Diversified Income' is reallocated in equal proportions to Australian Bonds and Global Bonds

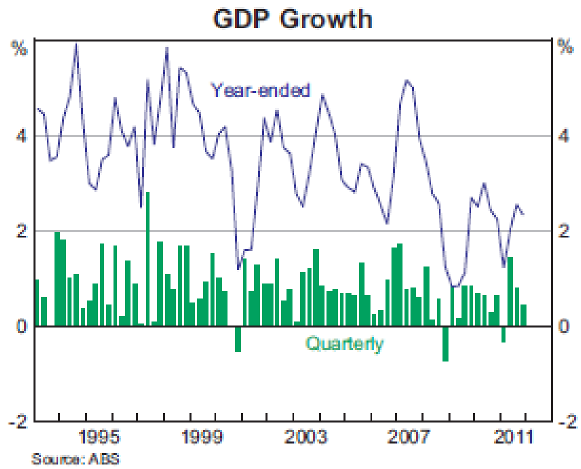
High Growth

	Benchmark	Ranges	TAA position	+/-
Australian Shares	39	26-52	40.0	1.0
International Shares	36	24-48	37.0	1.0
Aust Property	4	3-5	4.0	0.0
Global Property	6	4-8	6.0	0.0
Aust Bonds				
Global Bonds				
Cash*				
Alternatives^	15	5-25	13.0	-2.0
Total	**100**		**100**	**0**

^ Given the absence of cash in the High Growth portfolio, Alternatives are used as the balancing item

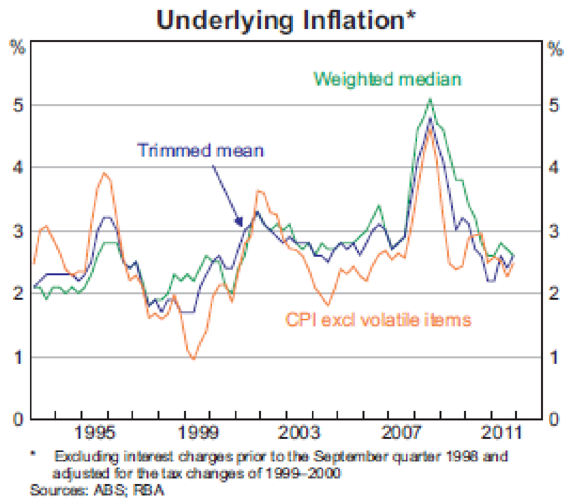
Australian Economy

The Australian economy grew by a weak 0.4% in the fourth quarter of 2011, with annual growth coming in at 2.3%. At the same time, monthly employment figures have turned negative suggesting that the broader economy has pockets of weakness, with retail, manufacturing, tourism and property construction all experiencing tough conditions.



Asset prices have also been weakening, with house prices down by approximately 5% in 2011 and the share market down 15% in 2011 - heavily underperforming the US market. A slowdown in Asia, relatively high interest rates, tightening fiscal policy, a high AUD, new taxes and productivity problems (e.g. industrial relations) seem to explain the underperformance of the Australian economy and share market.

The good news is that inflation has retreated to within the RBA's target range of 2-3%, which has opened the door for interest rate cuts. The RBA reduced interest rates by 50bp in late 2011 and is widely expected to cut interest rates again in May 2012. In addition, the US and Asian economies are expected to pick up during 2012, while Europe should only experience a mild-recession rather than the deep recession feared earlier in the year.



Meanwhile, LNP governments have been transitioning back into each State and the minority Labor government's popularity seems to be waning by the month. It is widely expected that the Federal government will also transition to an LNP government late next year, which should improve business and share market sentiment.

The government ran a budget deficit of $42bn in FY11 and expects to return to surplus by FY13. If achieved, this will mean fiscal policy is actually tightening which further adds to the case that monetary policy should be relaxed. The net debt of the government is around $85bn or 6% of GDP, which is far lower than the average for the G7 countries of around 80%.

The AUD reached a peak of US$1.11 in mid-2011 but has since weakened as the outlook for global growth and commodity prices has weakened and the RBA softened its stance on interest rates. Events in Europe have led to weakness in the Euro and strength in the USD, which has exacerbated the fall in the AUD/USD cross rate. Lonsec expects the AUD to remain softer in the short term as global growth weakens and Australian interest rates are cut. However, it may find renewed strength over the medium term, on Asian demand for commodities and the strong fundamentals of the Australian economy relative to most other developed economies.

Key Positives	Key Negatives
Banking system stable	Economy tied to Asia which is slowing in the short term
Low public net debt	Banking sector sources about 20% of its funding from offshore
RBA has room to cut interest rates further, if required	Asset prices are falling
Government has room to offer stimulus, if required	Inflation may prevent the RBA from cutting interest rates further
Resource-rich economy linked to Asia more so than Europe	Minority government has led to disruptive policy
Strong investment pipeline $1.3 trillion superannuation pool	Productivity gains have been poor over past ten years which leads to weaker living standards and inflation
Corporates strongly capitalised	Household debt levels are relatively high at 110% of GDP
Drought ended	
Population growth 1.5% p.a.	

The Australian economy has strong fundamentals, relative to most other developed economies, in terms of a resource-rich economy geographically close to Asia, low public debt, strong corporate balance sheets and a relatively strong banking sector. In addition, Australia still has relatively high interest rates and has plenty of room to cut rates, if required, to boost growth.

Lonsec expects the global economy to rebound during 2012 and the RBA to cut the cash rate to 3.75%, this should see the economy gather momentum in the second half of the year. Australian economic growth should increase to 3.0% in 2012.

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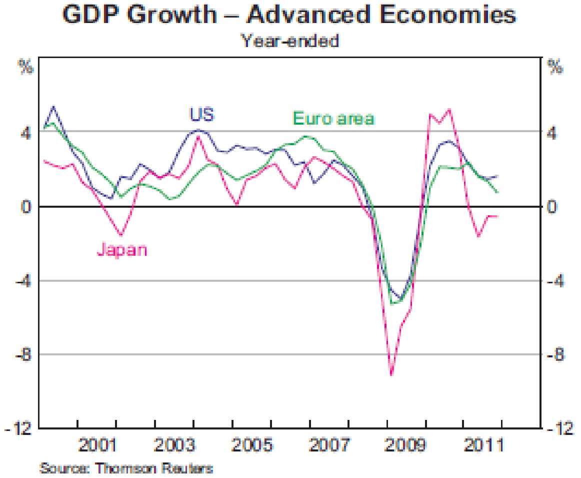
Global Economy

The International Monetary Fund (IMF) expects global growth to slow to 3.3% in 2012, down from 3.8% in 2011. Developed economic growth is expected to slow to 1.8%, with the Euro area expected to go into mild recession. Emerging economies are expected to slow but maintain robust growth of 5.8%.



The US economy continues to pick up steam, with new payrolls rising to over 200,000/month, while the unemployment rate has fallen to 8.3%. The recovery now seems more broad-based, with retail sales, investment, manufacturing and even the housing market all showing signs of life. In addition, some major positive themes are emerging for the US including: a new boom in the technology sector, a nascent recovery in the housing sector and a new found supply of oil & gas within North America.

The low US yield curve is probably the major reason for the turnaround, with the cash rate near zero, the 10-year bond yield at 2.23% and the 30-year bond yield at 3.34%. With core inflation currently at 2.0%, real interest rates in the US are effectively zero, while US mortgage rates are under 4.0%. The extremely low yield curve is surprising given Standard & Poor's has downgraded the US sovereign credit rating from AAA to AA+ and Congress continues to remain polarised regarding how the US public debt (around US$15 trillion and equal to US GDP) will be addressed. It seems the low yield curve can be attributed to US Federal Reserve policy and investors switching funds out of Europe and into the US. While the public debt remains concerning it will most likely be addressed after the US election in November 2012, if a clear majority is established in both houses of Congress. In the short term, the US government has been given time, as low bond yields make the debt easier to service. Lonsec expects US economic growth to surprise on the upside in 2012.

Asia slowed considerably in 2011 as most countries tightened monetary policy to fight inflation and a slowdown in global trade hit in the last quarter. However, inflation concerns have subsided in the first quarter of 2012 (particularly in China), which has opened the door to more accommodative policy. In addition, the recovery of the US economy is beginning to lift sentiment across Asian markets.

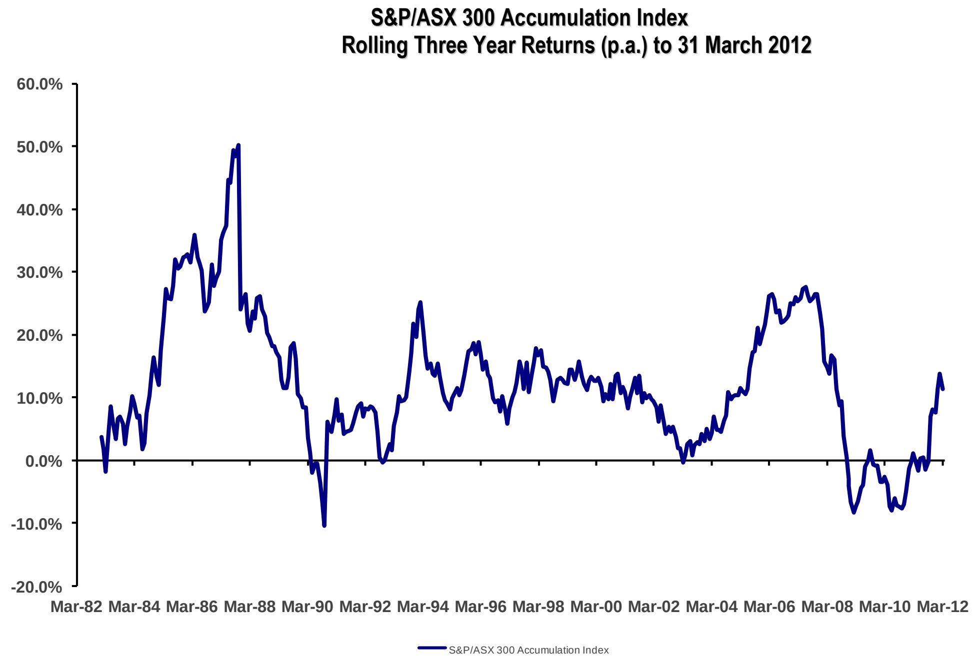
The Chinese government announced a lower target growth rate of 7.5% in its latest five-year plan. This caused a few ripples in financial markets, but the target growth rate should be viewed as a minimum growth rate, or hurdle rate, as growth usually comes in above the target rate. In any case, a lower growth rate for China has to be expected given the increased size (US$6 trillion) and scale of the economy.

Japan should recover in 2012 from a very tough 2011 that included the Japanese earthquake & tsunami and the Thai floods which hurt Asian supply chains and led to the first trade deficit since 1963. The BOJ is becoming more aggressive about re-igniting inflation (currently zero) by implementing 'powerful monetary easing'. This has led to some weakness in the Yen, which will help boost the export led economy. Still, Japan still has a lot of work to do to get back onto a growth trajectory and sustainable fiscal path. Lonsec expects Japan to experience low growth in 2012.

Europe contracted in the last quarter of 2011 and data suggests the economy will probably contract in the first quarter of 2012 which would imply the Euro-zone will enter recession (two quarters of negative growth). The sovereign debt and banking crisis has led to political change, fiscal austerity measures, tight credit conditions and falling confidence, which has taken a toll on the real economy, particularly in the southern countries of Europe.

However, there are signs that Europe is stabilising after the ECB cut interest rates and provided €489bn in three-year loans (at an interest rate of 1.0%) to European banks in late 2011. This has resolved the banks' liquidity problem and is showing signs of unlocking debt markets with European sovereign debt yields gradually falling in 2012. The ECB's actions have also lowered the Euro, which will help stimulate the economy in 2012. Lonsec expects that the EU bailout facilities and the liquidity offered by the ECB should be enough to stabilise the situation in 2012, but acknowledges Europe remains the major downside risk for the global economy in 2012. Lonsec expects Europe to experience a mild recession in 2012.

Australian Shares



Source: Lonsec, Data Source: Lonsec/Morningstar

Review

The Australian equity market returned 8.6% over the quarter. Despite the solid return the Australian share market still lingers some 12% below its April 2011 high and 35% below its November 2007 high.

The market reacted well to better economic news on the global front. However, the domestic market lagged global markets, with the US, Europe and Asia ex-Japan all positing double digit returns for the quarter in local currency terms.

Performance was solid despite mixed company earnings news. Analyst downgrades outnumbered upgrades in the first quarter. The quarter witnessed some corporate activity, with private equity buyers approaching several companies, including Billabong and Pacific Brands.

Strongest stock performers within the S&P/ASX 50 Index for the quarter included, Toll Holdings (41%), Fortescue Metals (37%) and Qantas (22%), while weakest performer included Stockland (-8%) and Transurban (-0.4%).

Performance of Major Stocks

Company	3 month	6 month	1 year
BHP	2.0%	0.2%	-23.6%
CBA	4.7%	13.1%	2.3%
WBC	9.5%	11.7%	-3.6%
ANZ	13.3%	23.5%	4.1%
NAB	5.3%	13.9%	1.8%
TLS	3.0%	10.7%	27.5%
WOW	5.9%	7.0%	1.5%
WES	4.2%	-2.7%	-0.4%
RIO	9.8%	7.2%	-21.3%
WPL	15.2%	8.6%	-23.5%
NCM	0.7%	-12.1%	-24.3%
WDC	16.3%	17.2%	0.4%
CSL	13.4%	22.2%	3.3%
FMG	37.1%	32.4%	-8.1%
QBE	11.7%	12.3%	-14.3%
NWS	6.6%	17.4%	7.7%
ORG	1.9%	1.5%	-14.7%
STO	17.6%	26.6%	-6.3%
AMP	9.8%	13.1%	-14.8%
SUN	2.7%	7.9%	4.2%
BXB	1.0%	11.8%	4.3%
MQG	22.2%	30.7%	-15.9%
ORI	15.4%	21.6%	9.9%
CCL	11.1%	7.2%	11.1%
OSH	11.8%	23.5%	-1.5%
QRN	10.1%	19.2%	13.7%

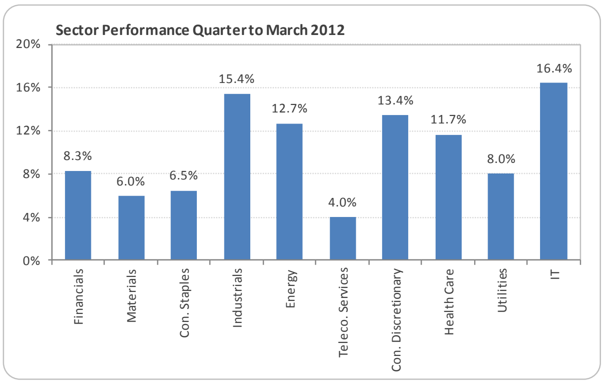
Data Source: IRESS

Some of the key stock-specific news during the quarter included:

- **CSL:** 1H12 results came in ahead of expectations with an NPAT of $483.3m. Company management raised NPAT guidance for FY12 from 10% growth in constant currency terms to 13% based on the current momentum within the business.
- **Amcor Limited**: has reached an agreement to acquire Aperio Group for $238m. The ACCC announced that it would not intervene in the proposed acquisition. Aperio is currently owned by a private equity firm and is a leading producer of flexible packaging products in the Asia Pacific region.
- **David Jones:** requested a trading halt prior to the release of its 1H12 results. Whilst the result was largely in line with guidance. The company releases their Future Strategic Direction document. DJS highlighted the weak trading environment and acknowledged being behind the curve on structural changes such as the digitization of retail.
- **QR National:** revised underlying FY12 EBIT guidance to $540-580m (from $578m previously). The revision was driven largely by one-off factors that contributed to the deterioration in volumes over the past month industrial action, track closures due to wet weather conditions and weak customer demand.
- **NWS:** James Murdoch resigned from his position as Executive Chairman of News International, following the fallout from the recent phone hacking scandal in the UK.

Sector Performance

As can be seen from the chart below, all sectors generated positive returns for the quarter, with IT positng the strongest return at 16.4%. Defensives, such as Telcos and Food Retailers were the weakest performers durng the quarter.



Data Source: IRESS

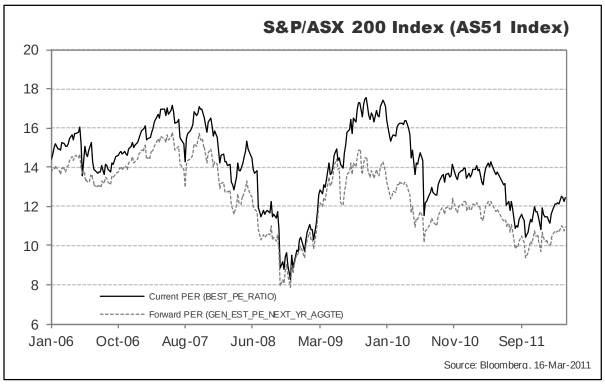
Outlook

Lonsec has moved the allocation to Australian equities from a **'Neutral'** to **'Slight Overweight'** allocation

The move reflects Lonsec's view that price to earnings ratios have already priced in an Asian slowdown, the high AUD, relatively high interest rates, a patchy domestic economy, productivity issues (e.g. industrial relations) and flood related issues.

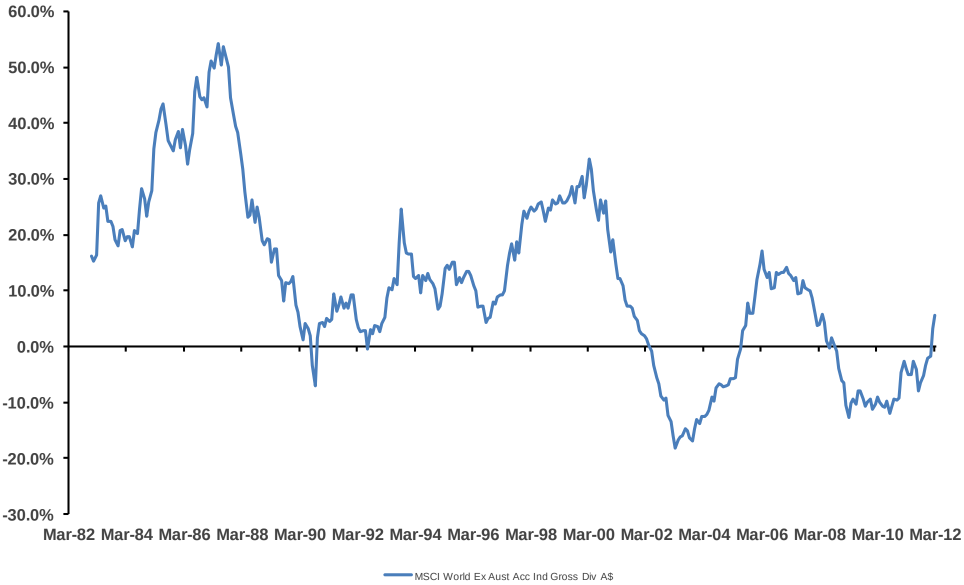
Lonsec believes that given the strong fundamentals of the Australian economy and the strong balance sheets of most companies, Lonsec does not expect PE ratios to compress any further. Further, we expect the global growth outlook to surprise on the upside this year, the Australian yield curve to come down and the AUD to weaken.

The following chart shows the forward and trailing price to earnings ratio for the Australian equities market.



Global Shares

MSCI World ex Australia Accumulation Index - Gross Div A$
Rolling Three Year Return (p.a.) to 31 March 2012



Source: Lonsec, Data Source: Lonsec/Morningstar

Review

The following table provides a comparison of the quarter-on-quarter performance and highlights other periods to the end of March 2012:

MSCI Indices*	Mar Quarter 2012	6 months	12 months
World ex Aust.	10.7	13.0	1.3
USA	11.9	23.9	6.0
Japan	7.6	15.6	-4.5
Europe	19.0	14.2	-0.5
Asia ex Japan	10.9	14.2	-5.6

*All indices, except the World ex Australia, are expressed in local currency terms. The World ex Australia index is expressed in A$ terms.

Global markets entered 2012 on broadly positive footing given some overdue impetus by European regulators making some progress in salvaging Greece from the widely anticipated threat of sovereign default. Growing recognition of improving economic stability in the US breathed life into equity markets translating to US Treasuries sustaining their worse quarter since late 2010.

The European debt crisis ticked past the two year stage and despite the sense of relief at the partial progress on Greece, doubts remain that Greece may prove an appetiser to more significant government debt issues in Spain, Italy and even France. Still, investors welcomed more positive news on the economic front considering much of the pessimism that characterised markets in 2011.

Meanwhile emerging markets performed in line with historic trends, benefiting from increased risk appetite and partially casting off the disappointment of poor performance in 2011.

United States

It was a familiar story for US equity investors in the first quarter with US markets continuing the strong upward trend that surprised many through much of the second half of 2011. The strong relative performance of the S&P 500 Index compared to the ASX and Asian regional bourses, proved a conundrum considering the apparent relative economic strength of the region versus the world's largest economy. Nevertheless, the US recorded an impressive set of GDP data, growing at 3 percent annually in the last three months of 2011. This combined with better than expected employment and manufacturing data, which resulted in the S&P 500 Index registering a 12% gain by end of Q1, its strongest performance since 1998.

On the corporate front, earnings surprises proved a recurrent theme with company balance sheets benefiting from cost cutting and capital management discipline. Apple continued its stellar rise moving above $US 600 per share driven by continued product evolution, stunning sales and a positive market reception for the new management team. Apple stock is also benefiting from $ US 2.65 divided and multi-billion share buyback scheme. Apple's success as a beacon of technology innovation contrasted with the declining fortunes of Kodak, which, after failing to adjust to the digital era, filed for bankruptcy protection in January.

Europe

European equities performed strongly over the quarter benefiting from mildly improving sentiment. Nevertheless, the Eurozone remains hampered by fiscal imbalances and prolonged austerity programs. European growth is expected to flat line in 2012, with much of Southern Europe in recession. The ECB topped up its bailout fund in March with a fresh capital injection. Over €1 trillion has been tipped into the banking system since the crisis commenced. Spain preoccupied investor fears late in the quarter with yields on Spanish government bonds soaring amidst debt refinancing difficulty. Spanish unemployment reached 23% in the quarter, the highest in Europe and twice the European average.

Meanwhile France experienced a minor improvement in economic data giving hope that Europe's second largest economy can avoid a recession. Even so growth is expected to be anaemic at best with the Government forecasting growth of 0.7% in 2012. The French visit the polling booths in May, with President Sarkozy expected to face a stern challenge from Socialist candidate Francois Hollande. Hollande appears to be running a populist agenda with a call for a 75 percent super tax on all individual income over €1 million Euros among the more topical of his campaign policies.

Japan

Japanese stocks enjoyed a rare strong quarter, outperforming much of the OECD in Australian dollar terms, driven by a moderately weaker currency, improved export demand expectations, and mildly improved business confidence.

Toyota, Asia's largest vehicle manufacturer, typified the appetite for Japanese stocks rising steadily throughout the quarter with the stock up by 30% over the three-month period. The manufacturer appears to have restored investor confidence following a disappointing couple of years characterised by product quality and vehicle disruption issues triggered by natural disasters. The US market proved particularly supportive with Toyota registering record sales of the Prius Hybrid during March.

Asia

Asia was an underperforming region for equity investors through 2011. However, the region also participated in the more buoyant mood in the first quarter recording the best quarterly performance since September quarter 2010.

Chinese equities continued to be relatively unloved underperforming broader Asian equities, though the Shanghai Composite still managed to register a modest gain of 2.9% for the quarter. Investors remain wary of Chinese authorities ability to maintain sufficient economic growth while transitioning the traditionally export driven economy to one fuelled by domestic consumption. There is keen interest in the leadership handover later this year with seasoned Sino observers expecting a smooth transition and maintenance of established economic policy.

Meanwhile, the uplifting political development of the region came in Myanmar where Aung San Suu Kyi and other members of the National League for Democracy Party won seats in the Parliamentary Elections. Cautiously welcoming the ruling military's fledgling democratic steps, western leaders may move to ease economic sanctions which have crippled the development of one of the poorest nations in South East Asia. Despite this, Myanmar has an abundance of natural resources and increased political stability, openness and trade liberalisation of this frontier market does suggest future investment opportunity for early movers. Nevertheless, the years of neglect have left a legacy of decrepit infrastructure, virtually no functional stock exchange and an outdated legal framework unsupportive of commercial enterprise.

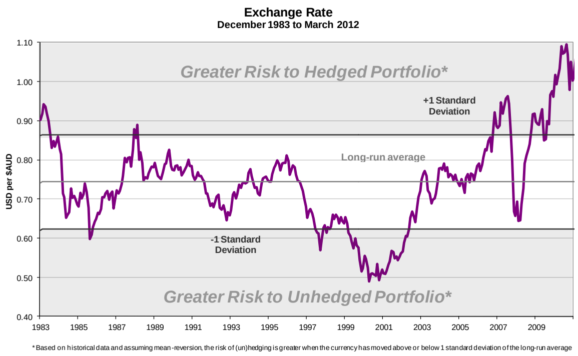
Currency

The Australian dollar experienced another volatile March quarter, moving from $1.02 at end of 2011 to a high of US$1.08 in mid Feb before ending the quarter at $1.03 versus the US dollar. A raft of weaker economic data on the local front cooled market expectations of the RBA tightening monetary policy. This realisation, combined with ongoing concerns about Chinese demand for Australian resources, saw the AUD drift closer towards parity.

This trend was also reflected in other majors with the AUD losing ground against the Euro. It started the year at 0.7895 Euro only to retrace to 0.7781 by end of the first quarter. This modest retreat is not overly surprising since the AUD had appreciated considerably in late 2011 against a sharply weakening Euro.

The AUD also appreciated sharply against a depreciating Yen over the period. One AUD returned 78.92 Yen at end of 2011. By the end of the quarter the same currency pair was trading at 85.74.

On a topical note, the RBA also signed a currency swap agreement with the People's Bank of China in March. The Agreement allows for the exchange of local currencies between the two central monetary authorities of up to $A30 billion or CNY 200 billion. As well as fostering bilateral ties between both nations, the move is viewed as further evidence of the increasing internationalisation of the Renminbi as a trading currency.

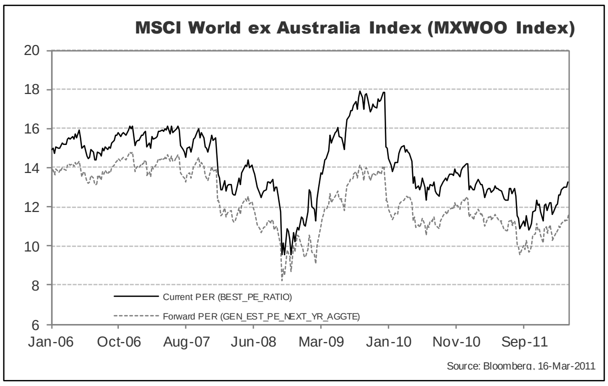


Outlook

Lonsec moved from a **'Neutral'** to **'Slight Overweight'** allocation to global equities.

Lonsec expects the US and Asia to gain momentum during 2012. Provided that Europe can 'muddle through' and avoid any further major shocks, then equity market sentiment should continue to improve. Despite the strong US rally, Lonsec is increasing its international equity weighting in recognition that Asian and European markets continue to look relatively cheap and on the expectation that the AUD/USD should weaken further. A bias towards emerging markets is preferred.

The following chart shows the forward and trailing price to earnings ratio for the global equities market.



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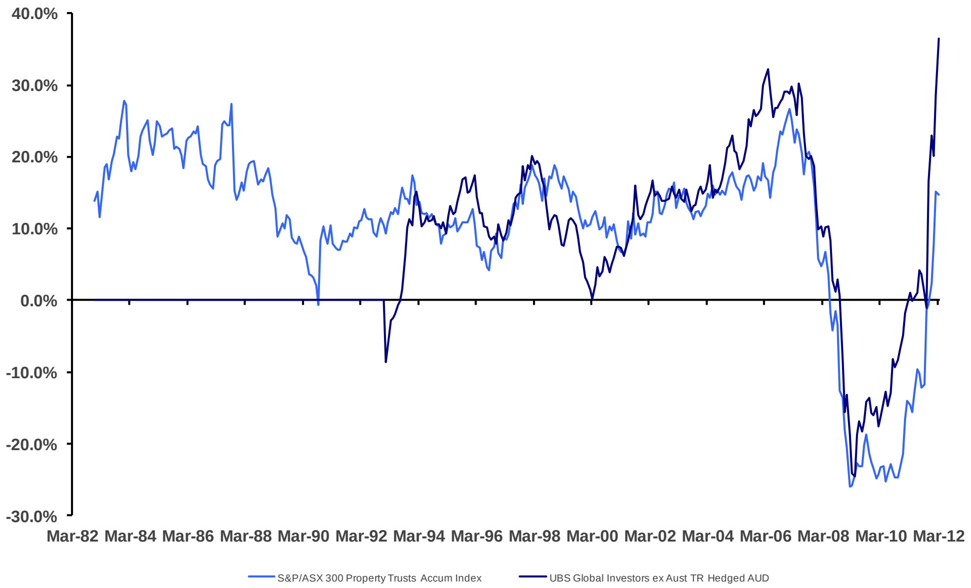
Property

S&P/ASX 300 Property Trust Accumulation Index & UBS Global Real Estate Investors Index ($A) Rolling Three Year Returns (p.a.) to 31 March 2012



Source: Lonsec, Data Source: Lonsec/Morningstar

Review: Direct Property Markets

Transactions continue to provide clarity on cap rates and volumes reflect a functioning, healthy underlying property market. Transaction volumes among listed property companies globally have now exceeded US$18 billion per quarter over the past nine quarters.

Direct asset valuations for commercial real estate in Australia still appear reasonable versus the cost of debt and given the expected level of inflation. Australian asset values continue to be tested, with transactional evidence demonstrating the strength of the market and sales are often occurring at premiums to independent valuations. However, retail landlords are presently facing some concerns, with current retail conditions in Australia considered to be the worst seen for over two decades.

Markets appear to be relatively more expensive overseas, with asset values have been driven higher by loose monetary policy and primary yields remaining very low in major cities in the US, parts of Asia and the UK.

Review: Property Securities Markets

Over the quarter the S&P/ASX 300 A-REIT Accumulation Index advanced by 7.1% and the UBS Global Real Estate Investors (Ex-Australia) Index – $A Hedged rose by 12.5%. In comparison, Australian equities delivered a return of 8.6% and global equities (local currencies) returned 10.7%.

Property securities markets generated positive performance over the quarter, with aggressive monetary and fiscal policy boosting investor confidence. Sentiment has lifted globally, as it becomes clear that many of the world's policy makers remain focused on maintaining well-functioning capital markets and targeting growth.

The following chart shows the absolute returns of major stocks in the A-REIT sector over the quarter. As can be seen, retail property landlords Westfield Group and Westfield Retail Trust rebounded strongly over this period after having been oversold to very low levels.

Major A-REIT Returns over March 2012 Quarter

Stock Name	Q1 2012 Return
Goodman Group	21.1%
Westfield Group	16.2%
Westfield Retail Trust	7.0%
CFS Retail Property	6.2%
S&P/ASX200 A-REIT Acc. Index	**5.5%**
Dexus Property Group	4.8%
GPT Group	3.2%
Commonwealth Office Prop Trust	3.1%
Mirvac Group	0.8%
Stockland	-7.8%

The A-REIT reporting season delivered mixed results, with Stockland being seen by the market as the major loser. By comparison, U.S., U.K. and European property companies mostly reported solid earnings numbers.

Outlook: Australian and Global REITs

The Australian listed property market presently looks to be a better value path to gain exposure to Australian commercial property assets than direct property. Aside from a small number of stocks (such as Westfield Group and Goodman Group) most of the A-REIT sector is still trading at levels well below net tangible asset (NTA) value. Strong balance sheets remain a noticeable feature of the A-REIT sector, with low weighted average gearing of around 30-35%.

By comparison, most global property securities markets currently appear less attractive from a valuation point of view, with US markets, in particular, looking relatively expensive.

While Asian securities markets still appear cheap compared to underlying real estate values, it is worth noting that Asian property stocks generally tend to trade at a discount to net asset value due to poor alignment of interest between management and stock holders. Asian stocks also typically have very low leverage, which is a legacy of the Asian financial crisis.

Despite a strong recent rally the Japanese market is still trading at a significant discount. Lonsec notes that this is not uncommon, as Japanese property stocks always tend to trade at a material discount due to poor corporate governance and conflicted management structures.

In Europe, markets now appear fairly valued, with concerns having eased about sovereign debt and currency breakup.

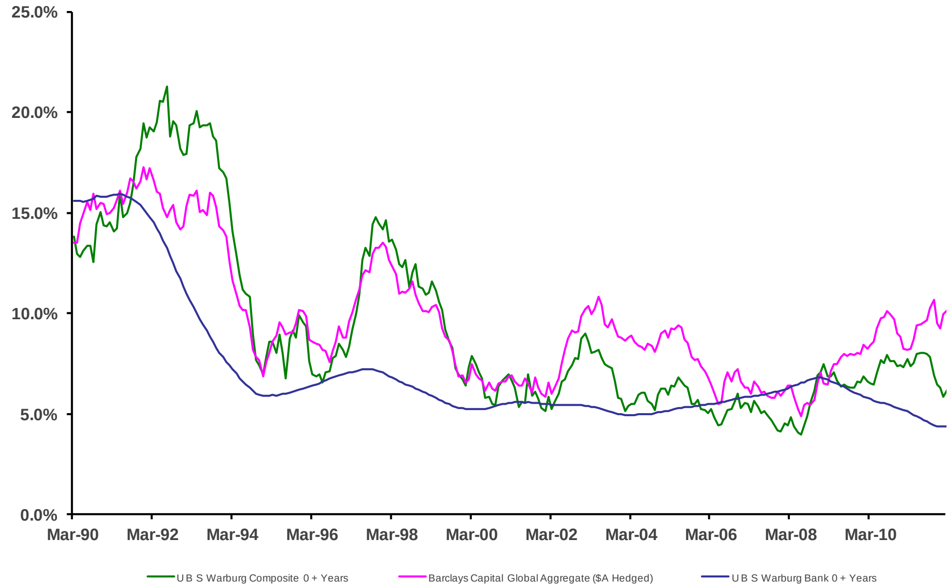
UK stocks are still looking reasonably attractive at current valuations despite low growth outlook for the UK economy.

Overall, weighing up the reasonable valuations and the uncertainty of the macroeconomic environment, Lonsec has retained a **'Slight Overweight'** allocation to domestic listed property and a **'Neutral'** allocation to global listed property. At current price levels A-REITs are expected to deliver a sector yield of around 6.0% p.a. This is a significant premium above the income return being generated from global property securities, which are expected to return a weighted average yield of around 4.0% p.a.

The A-REIT market is still expected to deliver less volatile returns than Australian shares and global property securities (hedged) over the short-to-medium term due to the strong balance sheet position of Australian property vehicles. This factor, in combination with the current valuation discount and high yields, means that Lonsec still has a preference towards A-REITs over global property securities at this point in time. This is despite the additional concentration risk associated with the sector.

Fixed Interest & Cash

Fixed Interest and Cash
Rolling Three Year Returns (p.a.) to 31 March 2012



Source: Lonsec, Data Source: Lonsec/Morningstar

Review: Cash

The official cash rate remained on hold during the quarter. While the RBA rhetoric leaned towards a rate cut rather than hike, and the financial markets priced in a number of rate cuts, the Board was reluctant to pull the trigger

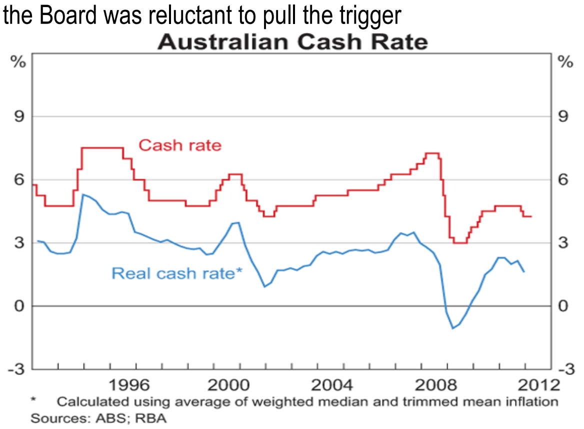


Chart Source: RBA Chart Pack April 2012

The ANZ continued to act independently of the central bank passing on two rate hikes of 6bps to its customers in February and April. Retail investors continue to enjoy attractive rates, relative to the wholesale market

A number of other central banks also trimmed rates during Q1-2012 in the face of continued soft economic conditions. The Reserve Bank of New Zealand also left rates on hold at 2.50% during the quarter.

Review: Australian and International Fixed Interest

US Treasury yields finished the quarter little changed, though not without some wild swings as the market continued to oscillate between risk on and risk off mindsets.

Early in the quarter, the effects of the European Central Bank's (ECB) Long Term Refinancing Operation answered the financing question for the European banks – at least for now. For a time, financial markets breathed a sigh of relief about Europe and the focus shifted to the steady stream of more positive economic data emanating from the US, particularly with respect to industrial production and jobs. With an unemployment rate still above 8%, there is still a way to go to restore the economy to full employment – an objective of the Federal Reserve, but at least there may now be some hope for the swollen ranks of unemployed. European sovereign downgrades during January helped fuel a flight to quality which benefitted US and Australian bonds – risk off.

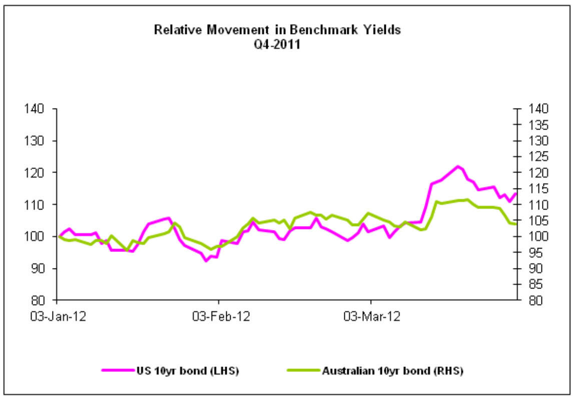
During February, Europe remained in the headlines as Greece inched its way towards a bailout package. By month end the Greek government agreed to fiscal austerity and economic reforms and received a second package of loans.

March in particular was a month of two halves. Early on, stronger US payroll data, retail sales dominated softer domestic economic data. Yields rallied back when Federal Reserve Chairman Ben Bernanke reminded markets that it was “too early to declare victory” which the markets interpreted as more stimulus to come.

10 Year Bond Yields	Australia (% p.a.)	United States (% p.a.)	Differential (% p.a.)
31 March 2012	3.98	2.21	1.77
31 December 2011	3.67	1.87	1.80
30 September 2011	4.22	1.92	2.30
30 June 2011	5.20	3.16	2.04
31 March 2011	5.48	3.47	2.01

The Australian fixed interest market returned 0.8% over the quarter over the year ending 31 March 2012. Australian Government bonds detracted from overall performance during the quarter but the strong returns delivered from State government and corporate bonds more than compensated.

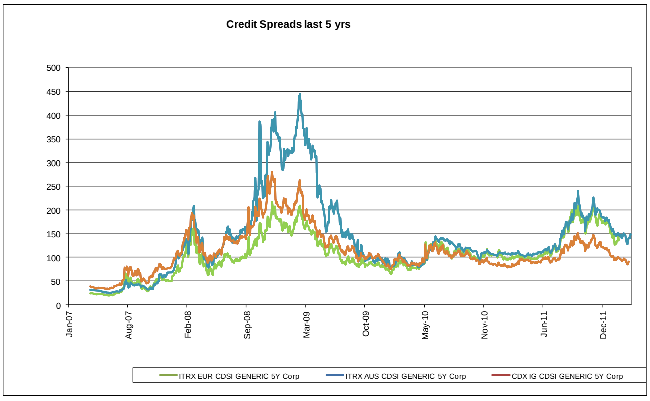
Global Fixed Interest as measured by the Barclays Capital Global Aggregate Bond Index (AUD Hedged) outstripped Australian fixed interest, returning 2.2% (hedged) over the quarter ending March 2012 and 11.9% over the year.



Source: Bloomberg

Credit Markets

Similar to the last quarter of 2011, credit spreads finished the quarter wider. Investment grade spreads finished a touch wider in both the US and Europe. However bank hybrid spreads tightened in on improved outlook for European financials. High yielding asset classes came under pressure as investors shifted their focus to equities.



Source: Bloomberg

Fixed Interest Outlook

Lonsec has reduced its overall position in defensive assets. The cash weighting was reduced from slight overweight to neutral and the position in Australian Fixed Interest was reduced from neutral to slight underweight. International Fixed Interest remained underweight. Term Deposit rates continue to offer retail investors an attractive proposition in a risk return sense however Lonsec cautions against extensive use of long fixed deposits (3-5 years) as cash proxies given the liquidity and interest rate risks.

In terms of product considerations, Lonsec favours active management, particularly in Global Fixed Interest. Bond yields remain low in a historical context and active managers are able to tilt risk away from less favoured countries or fixed rate bonds in favour of those countries with improving demographics and reduced interest rate risk. Further, active managers are able to allocate to corporate bonds and take advantage of attractive credit spreads where appropriate. Advisers should be aware that a sharp spike in bond yields (essentially market interest rate expectations) may give rise to a fall in bond capital prices. A negative mark to market impact may occur regardless of any shift in credit quality of the bonds (i.e. likelihood of receiving coupons over the life of the bond and full repayment of principal at maturity).

Quarterly Outlook – Product/Sector Considerations

The Quarterly Outlook aims to provide advisers with shorter-term asset allocation recommendations (overweight, underweight and neutral) towards shares, property, fixed interest and cash.

Lonsec also considers the impact that the market and asset class themes identified in the earlier section of this document may also have on specific products and sectors. The summary of these considerations is not intended to provide 'tactical' recommendations on product allocations, but is intended to highlight factors that may impact the performance of funds (both positively and negatively) within certain sectors.

Sector / Product	Consideration	Portfolio Implications
Australian Shares	Ongoing market volatility	▪ Market environment should suit active stock pickers, or managers that have the ability to vary their market exposure. Investors should be aware that concentrated products and high tracking error products may perform towards the upper end of their risk bands in such an environment. ▪ In the shorter term, volatility may continue with uncertainty regarding the impact of government policy on carbon tax and continued global geo-political risks contributing to market volatility.
International Shares	Ongoing market volatility. The AUD is at high levels relative to long term averages.	▪ Market environment suits active stock pickers. Wide investment opportunity set allows active managers to target growth areas, such as emerging markets. ▪ Currency movements have an impact on returns for international share investors. Extreme falls in the AUD can adversely impact the cashflow of a fund manager that engages in currency hedging and therefore impact the performance of a fund. Any fall in the Australian dollar requires a manager to settle the loss on the currency forward contract in cash. A significant fall in the AUD may require a manager who has hedges in place to sell down assets to settle the loss, which can have an adverse impact on fund performance.
Property	Domestic - market remains concentrated. Global - the AUD is at high levels relative to long term averages.	▪ Domestic - Sector concentration means that benchmark-oriented products will be materially influenced by a number of key stocks. Conversely, advisers should be prepared for material deviations from the market return if using benchmark unaware products. ▪ Expect return profile of the sector to be driven predominantly by yield, with some capital growth over the long term. ▪ Global - Most global REIT funds are hedged back into Australian dollars. As noted in the international shares 'Portfolio Implications' section of this table, extreme currency movements can have an impact on fund cashflows, when a manager engages in currency hedging.
Australian Fixed interest	More narrow universe of government and corporate debt on issue than global universe	▪ Advisers should be aware that domestic fixed interest and credit products will typically be less diversified than global alternatives. If using active products, advisers should be aware that funds may hold a greater (at times significant) proportion of bonds issued by Australian states, banks and supranational entities than indicated by the UBS Composite Bond Index. These securities tend to be more sensitive to movements in credit spreads. Active products may also adjust duration sensitivity. For instance, if the Fund has a shorter duration than the benchmark, the impact of rising yields (and capital losses) will be less than a passive fund with benchmark duration. Lonsec believes that the case for active management within Australian fixed interest has improved in the current market environment.

International Fixed Interest	Increased sovereign risk. The AUD is at high levels relative to long term averages.	▪ Consider using active managers who have the ability to decrease (or increase) the exposure to sovereign debt and the ability to add value through active sector rotation. Bond yields remain low in a historical context and active managers are able to tilt risk away from less favoured countries or fixed rate bonds in favour of those countries with improving demographics and reduced interest rate risk. Advisers should be aware that a sharp spike in bond yields (essentially market interest rate expectations) may give rise to a fall in bond capital prices. A negative mark to market impact may occur regardless of any shift in credit quality of the bonds (i.e. likelihood of receiving coupons over the life of the bond and full repayment of principal at maturity). ▪ Advisers using passive products should be aware that they may have a fixed, relatively high exposure to sovereign debt, including those regions facing problems. ▪ Most global fixed interest funds are managed on a fully hedged basis. As noted in the international shares 'Portfolio Implications' section of this table, extreme currency movements can have an impact on fund cashflows, when a manager engages in currency hedging.
Cash	Term deposit rates remain an attractive proposition at current rates; however the attractiveness of term deposits will decrease if rates continue to fall.	▪ Term Deposit rates continue to offer retail investors a particularly attractive proposition in a risk return sense. The Australian bond yield curve is inverted, with 10 year government bonds yielding just 3.8% at time of writing (versus a cash rate of 4.25%). Due to the liquidity constraints i.e. investors are locked into a fixed term, and the interest rate risk (particularly for longer dated term deposits) Lonsec does not consider term deposits to be a direct replacement for cash, which Lonsec defines as at call short duration bank bill type investments.
Other	N/A	N/A

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