

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 tactical positions (overweight, underweight and neutral) towards shares, property, fixed interest and cash, reflecting the latest asset allocation weightings adopted by these organisations.

Performance to 30 September 2008

Market	3 mths	6 mths	12 mths
Australian Shares	-10.7	-12.3	-27.1
Australian Listed Property	-1.7	-17.2	-41.8
Australian Fixed Interest	5.3	5.8	8.4
Cash	1.9	3.9	7.7
International Shares (\$A)**	2.5	-4.1	-18.0
- US*	-10.0	-11.0	-21.5
- Europe*	-11.3	-14.5	-27.5
- Japan*	-17.5	-10.0	-32.6
- Asia*	-16.5	-20.4	-32.4
\$A vs \$US	-16.9	-12.9	-9.4

* Returns are in local currencies

** MSCI World ex Aust Index \$A

The near-breakdown of financial markets was evident this quarter as the cost of credit soared, halting the ability of some intermediaries and market makers to re-finance. Capital raising was reduced to a virtual "fire sale" of assets to meet obligations. With banks unwilling to lend to each other, the cost of overnight cash spiralled, pushing institutions once considered resilient to the brink and, in some cases, beyond.

Major equity markets suffered over the quarter, with most posting double-digit share price falls. With the credit crisis in full swing, regulators took the unprecedented step of temporarily banning short selling on financial stocks in the US and UK. In Australia, ASIC and the Government went one step further, banning all short sales across the market for 30 days. Guidance is expected from the regulators during Q408 as to how shorting of stocks will operate going forward; many expect tighter regulation to increase transparency of market participants. With "thanks" to the increased costs of debt and a "flight to quality", Australian Fixed Interest securities were the best performing asset class over the last 3, 6 and 12 months.

Global Economy

As the impact of the credit crunch in the **United States** continues, the third quarter saw some high-profile casualties in the shape of Lehman Brothers, AIG, Merrill Lynch, Fannie Mae and Freddie Mac as they either disappeared, were rescued by public capital injections or were swallowed up by major competitors.



How well prepared is Australia to ride out the storm?

In early October, the US government was compelled to intervene in the markets, in an attempt to restore liquidity to the financial system by making available a \$700bn fund to purchase 'troubled assets'. This action puts US government debt at over 70% of GDP, with falling house starts and prices, coupled with increased unemployment indicators, pointing towards an almost unavoidable recession. Any fall in GDP will increase the level of Government debt (as a % of GDP) towards levels not seen since the end of WWII.

Following a co-ordinated 0.5% rate cuts by key global central banks on 8 October, led by the US Federal Reserve, the US Federal Funds Rate is now 1.50%.

The concerns over levels of inflation in **Europe** were alleviated when Q208 figures showed negative growth in the region. During the third quarter the first European country, Ireland, officially fell into a recession. Despite this fall in growth, the European Central Bank (ECB) held the overnight funds rate at 4.25% in the second half of the quarter before cutting rates by 0.5% as part of the co-ordinated central bank action.

Concerns over inflation in the **UK** are shifting towards future economic growth as the impact of the global financial crisis plays out. House prices fell by 10.5% in the quarter, the largest fall since 1990. Home loan approvals fell in kind. Economic growth in the June quarter was 0%. On 8 October the Bank of England (BOE) cut the official Bank Rate paid on commercial bank reserves to 4.5%. In conjunction with the rate cut, the British Government announced a 50 Billion pound package to partially nationalise eight of its major banks in an effort to stabilise the UK banking system.

The continued rise in the value of the Yen vs USD is contributing to the softening of the domestic economy in **Japan**, where GDP fell by 2.4% in the June quarter, edging the nation closer to a recession. **China** and **India** are both expected to continue the growth in developing Asian economies, with robust growth forecasts of 8% and 6% respectively, albeit a fall from previous estimates of 10% and 8%, on the back of a perceived lack of dependence on other economies due to strong levels of domestic consumer demand and spending. While the slowdown of G7 economic countries continues, the developing economies of Asia are expected to provide a counter balance and continue to grow. The International Monetary Fund predicts that the extent to which these developing economies will continue to grow will reduce by 1.5% - 2.0%.

Commodity prices reversed their recent growth trend, with key commodities all falling over the September quarter. Oil prices were off over 30%, to end the quarter at \$100.70/ barrel. Most metals and food commodities fell over 20% during the three month period. Gold fell just 5% as investors sought security in the precious metal. Many argue the fundamentals of supply and demand will maintain commodity prices; the counter view is that an imminent global economic downturn means prices cannot be sustained. The impact of the downturn on China's growth, and therefore demand, will be vital to commodity prices.

Domestic Economy

Following 15 years of robust economic growth, strong headwinds to domestic growth are apparent in the form of tightening global credit market conditions, domestic capacity constraints, food and energy price increases and the threat of the slowdown in developed economies. Signs of a domestic slowdown are evident as the last 6 months have produced falling building approvals, retail sales and house prices.

Inflation remains above the RBA target of 2-3%, with the latest figures showing underlying inflation at 4.2%. The RBA is now faced with a juggling act of maintaining interest rates for long enough to stem inflation without maintaining the position for too long, which could see the domestic economy enter into a sharp slowdown. The RBA Cash Rate was cut by 25bps to 7.00% in September, the first rate cut in 7 years, offering suffering home owners in mortgage belts some light relief. At the October RBA Monetary Policy Committee meeting, the RBA Cash Rate was cut by 100bps to 6.00%, a cut double the size of consensus expectations. Recent market commentary is speculating on the ability, or lack thereof, of the nation's banks to completely pass on the cut in official rates by the RBA. Increased costs of financing on the global stage could render the passing on of the full cut problematic for local lenders.

The domestic equity market finished the quarter down 10.7%, the fourth successive negative quarter, leaving the S&P/ASX300 down 27.1% for the year to September. Any positive sentiment from within the Australian market was predominately overshadowed by the playing out of the financial market crisis in the US. Notably, as the quarter drew to an end, the US congress rejected the first incarnation of the bail out proposal, sending the Australian market down 4% on the final day of trade for the quarter, no doubt impacting numerous equity managers' quarterly results. The latest round of company reporting failed to provide clear profit guidance for 2009, such is the uncertainty looming over global markets and the impact this will have on earnings going forward.

Outlook

Themes present in the previous three quarters continue to prevail as issues surrounding company earnings and the credit crunch continue to be drawn out. The rising cost of debt and high input prices, combined with the deteriorating global economic outlook, are likely to have a negative impact on Australian company profit margins.

Australian bonds seem reasonable value relative to equities and their international brethren. Bond yields range from 4.9% for three year bonds to 5.3% for ten year bonds; however, both yields continue to lag the official cash rate of 6.00%.

This quarter Lonsec has moved to a "neutral" position in Australian Listed Property. This is consistent with the long-term view to move back to a neutral allocation through the course of 2008. The listed property market has now fallen around 40% for the year ended September 2008, and Lonsec considers the sector is now showing signs of becoming fair value. Lonsec prefers entering this space selectively through quality 'plain vanilla' property listings.

Lonsec maintains the "slight underweight" bias to Australian Equities, believing that the market appears to be fairly valued despite the fundamentals appearing quite healthy versus other OECD countries. Lonsec has moved the International Equity weighting to "slightly underweight" as the uncertainty over earnings globally and Lonsec's bearish expectations for global growth have tempered expectations for this sector. The overall effect is that the asset allocation remains largely defensive. With Lonsec's expectation that growth assets have more downside to play out before a recovery will take hold, Lonsec remains "very overweight" Cash as an important means of capital protection.

The outlook for equity, fixed interest and property markets are discussed further in the relevant sections of the Quarterly Outlook.

Recommended Asset Allocation Weightings

Lonsec Tactical Asset Class Positions - October 2008

Aust Equity	Slight Underweight
Global Equity	Slight Underweight
Property	Neutral
Aust Bonds	Neutral
Global Bonds	Underweight
Cash	Very Overweight
Alternatives	Neutral

Secure

	Benchmark	Ranges	TAA position	+/-
Aust Equity				
Global Equity				
Property				
Aust Bonds	30	20-40	30.0	0.0
Global Bonds	30	20-40	22.5	-7.5
Cash	40	30-50	47.5	7.5
Alternatives				
Total	100		100	0

Balanced

	Benchmark	Ranges	TAA position	+/-
Aust Equity	23	15-31	21.5	-1.5
Global Equity	20	13-27	18.5	-1.5
Property	12	8-16	12.0	0.0
Aust Bonds	15	10-20	15.0	0.0
Global Bonds	15	10-20	13.0	-2.0
Cash	5	0-10	10.0	5.0
Alternatives	10	5-15	10.0	0.0
Total	100		100	0

Defensive

	Benchmark	Ranges	TAA position	+/-
Aust Equity	8	5-11	7.0	-1.0
Global Equity	6	4-8	5.0	-1.0
Property	6	4-8	6.0	0.0
Aust Bonds	25	17-33	25.0	0.0
Global Bonds	25	17-33	19.0	-6.0
Cash	20	10-30	28.0	8.0
Alternatives	10	5-15	10.0	0.0
Total	100		100	0

Growth

	Benchmark	Ranges	TAA position	+/-
Aust Equity	33	22-44	31.0	-2.0
Global Equity	30	20-40	28.0	-2.0
Property	12	8-16	12.0	0.0
Aust Bonds	5	3-7	5.0	0.0
Global Bonds	5	3-7	4.0	-1.0
Cash	5	0-10	10.0	5.0
Alternatives	10	5-15	10.0	0.0
Total	100		100	0

Conservative

	Benchmark	Ranges	TAA position	+/-
Aust Equity	15	10-20	13.0	-2.0
Global Equity	13	9-17	11.5	-1.5
Property	12	8-16	12.0	0.0
Aust Bonds	20	13-27	20.0	0.0
Global Bonds	20	13-27	15.0	-5.0
Cash	10	0-20	18.5	8.5
Alternatives	10	5-15	10.0	0.0
Total	100		100	0

High Growth

	Benchmark	Ranges	TAA position	+/-
Aust Equity	41	27-55	40.0	-1.0
Global Equity	39	26-52	38.0	-1.0
Property	10	7-13	10.0	0.0
Aust Bonds				
Global Bonds				
Cash				
Alternatives	10	0-20	12.0	2*
Total	100		100	0

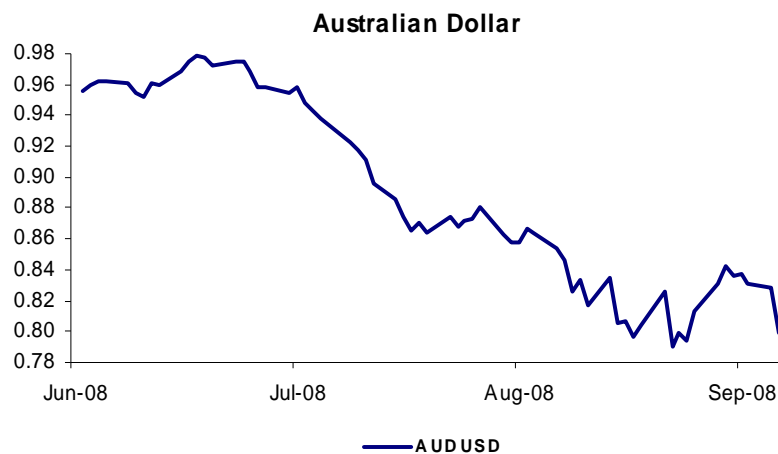
* Given the absence of cash in the High Growth portfolio, the overweight has been allocated to Alternatives

Sector Overview

Asset Sector	Sector Summary
Cash	With a defensive stance remaining this quarter, Lonsec maintains its “very overweight” cash position.
Australian Fixed Interest	Lonsec has an unchanged “neutral” view on Australian fixed interest. Lonsec believes that, with lower corporate bond default rates, Australian fixed interest continues to offer reasonable value versus global bonds and equities.
International Fixed Interest	Lonsec remains more “bearish” with respect to international fixed interest and recommends an “underweight” position. Lonsec notes that the ‘flight to quality’ has driven bonds yields down. While the spectre of inflation remains ever-present it is forcing real yields to fall below zero.
Australian Shares	Lonsec has decided to maintain its “slight underweight” position as the Australian equity market appears fairly valued. Opportunities may present should an over reaction to events on Wall Street be felt domestically.
International Shares	Lonsec moved to a “slight underweight” asset allocation to international equities, the major economies of the world are slowing, with the US in danger of entering recession, and the stability of corporate earnings going forward unclear. The benefits of a falling Australian dollar to unhedged international investors are unlikely to continue.
Property Trusts	Consistent with Lonsec’s long-held view, Lonsec is recommending a move back to a “neutral” allocation to property. Lonsec believes the sector is now worth re-visiting on a selective basis.

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Australian Dollar



Source: Lonsec, Data source: RBA

Review of Quarter

The Australian dollar (AUD) fell by 16.9% against the US dollar (USD) in the September quarter, closing at US\$0.7996 (US\$0.9626 at the end of June, *Source: RBA*). This follows a rise of 4.9% in the June quarter. Against the Trade Weighted Index, the AUD depreciated by 13.6%. At the time of writing (9 October), the AUD is now trading at US\$0.6696, this significant depreciation is reflective of the recent RBA rate cut and falling commodity prices.

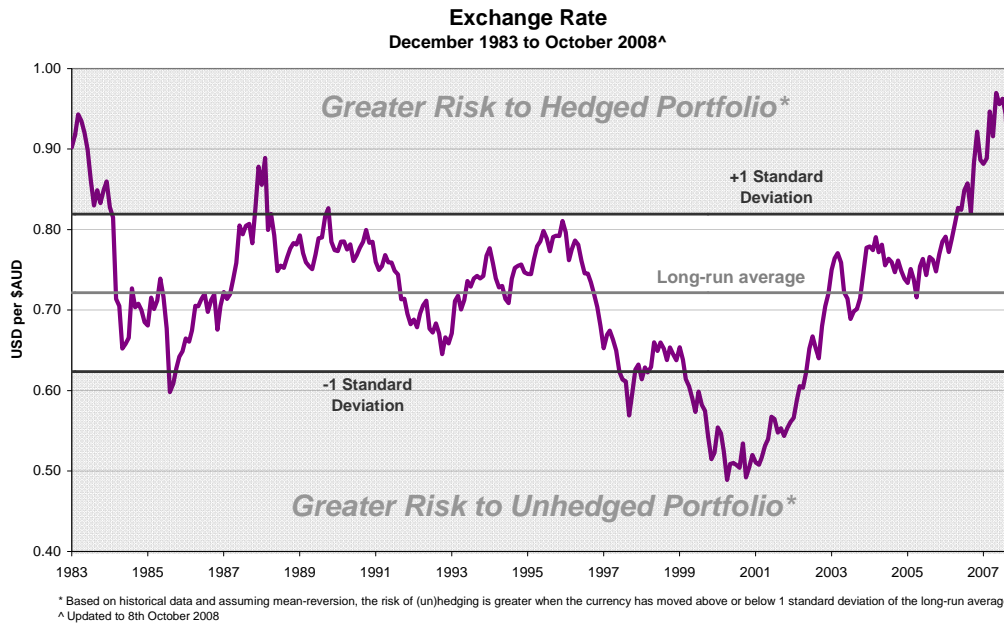
The AUD depreciated against most major currencies in July. Early in the month, stronger-than-expected domestic economic data (May retail sales, an upward revision to the April trade balance and June employment report), coupled with USD weakness, underpinned strength in the AUD. The AUD rose to a 25-year high of US\$0.9849 in overnight trading after the RBA released its minutes (July 15) showing that it was satisfied with the slowing in economic activity. Late in the month however, further disappointing results from US financials, announcements of provisions for write-downs for two of Australia's big four banks, poor domestic market data (June building approvals, retail sales and private sector credit data) and general market nervousness weighed on investor sentiment, with the AUD finishing July at US\$0.9434.

The AUD suffered a broad-based depreciation in August. Weighing on the AUD early in the month was speculation that the RBA may soon move to an easing bias, with the market aggressively pricing in potential rate cuts. The RBA soon confirmed this, stating that the next move in interest rates was likely to be a rate cut, rather than a rate hike. Also driving the AUD lower was the release of disappointing June housing finance data (despite a stronger-than-expected July labour force report) and a surge in the USD. The AUD reached a monthly low of US\$0.8580 on Aug 26 on the back of poor European economic data and investor sentiment toward global growth. Late in the month, the USD recovery faced

headwinds from stronger oil prices and a neutral tone in FOMC minutes, which alleviated some of the downward pressure on the AUD. The AUD finished August at US\$0.8639, falling 8.4% against the USD during the course of the month.

The AUD lost more ground in September, with risk aversion sweeping markets on the back of trouble amongst US financial institutions. For the first time since 2001, the RBA cut interest rates on Sept 2 (by 0.25% to 7.00%) and indicated that there was scope for further easing. Markets sent the AUD lower, which continued with the release of a disappointing domestic Q2 GDP report (Sept 3) and concerns for the future of Freddie Mac and Fannie Mae in the US. Troubled US investment banks, particularly Lehman Brothers, which eventually had to file for bankruptcy, sent global equity markets into a downward spiral mid-month, with the AUD closing below US\$0.8000 on Sept 16. The US announcement on Sept 19 that a plan (Troubled Asset Relief Program – TARP) was being devised to save failing US financial institutions led to a recovery in risk appetite, bolstering the AUD. This was short lived as the markets became concerned as to whether the bill would be passed, its effectiveness and the cost to the US government. The plan was subsequently rejected in the US House of Representatives on Sept 29, sending the AUD south, finishing the quarter at US\$0.7996.

The chart overleaf shows the movement of the AUD versus the USD since the float of the AUD in December 1983. Assuming mean-reversion, the risk of (un)hedging is greater when the currency has moved above or below 1 standard deviation of the long-run average. The exchange rate between AUD and USD was chosen as the MSCI World index has over 50% exposure in USD. The AUD finished the September quarter at US\$0.7996 representing approximately 1 standard deviation above the long-run average since December 1983.



Outlook

The Australian economy is expected to slow sharply, with the major risks being the global financial crisis and any slowdown in Asia. With the June quarter national accounts showing the Australian economy slowed to a modest growth rate of 0.3% (2.7% on the rolling year), the economy is facing a number of strong headwinds including: a global financial crisis, domestic infrastructure constraints, relatively high inflation and a slowdown in the global economy. The global financial crisis and increasing probability of a US-led global recession has seen the RBA become more concerned about growth prospects than inflation. The RBA expects inflation to fall from 4.5% to 3.0% over the next two years.

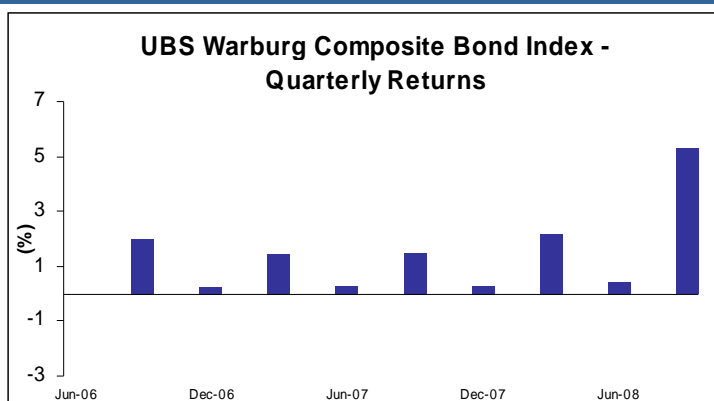
During the course of the September quarter, we have seen downward pressure exerted on the AUD from the beginning of a domestic interest rate easing bias, falls in commodity prices and the relative strength of the USD. The direction of the AUD will largely be dependent on each of these key variables. Lonsec notes that at the end of the September quarter, the AUD has retraced to within 1 standard deviation of its long-run average (refer to previous chart) and by 9 October is trading below its long-run average.

Australian Cash

The Australian cash market continued to deliver a consistent return of 1.93% for the September 2008 quarter. Over the 12 months to September 2008, the cash market returned 7.65%. The official cash rate ended the quarter at 7.00%, whilst 90 day bank bill yields fell 52 basis points, to finish at 7.32%.

Lonsec approaches its cash exposure as a residual of its views on the outlook of the major asset classes – fixed interest, Australian shares, listed property and international shares.

Fixed Interest



Source: Lonsec Data Source: IRESS

Review of Quarter

Australian fixed interest, as measured by the UBS Composite bond Index, returned an exceptional 5.3% for the September 2008 quarter, well ahead of the cash return of 1.9%. There were relatively few monetary policy changes in the major developed economies (see below), although most central banks were active in the markets during the quarter, putting out brushfires by injecting liquidity where necessary to maintain ailing financial and banking systems. Distress in credit markets intensified over the quarter with few new issues coming to primary market and secondary market trading still remaining difficult.

Monetary Policy

The Reserve Bank of Australia reduced the benchmark official cash rate by 0.25% to 7.00% in September. Economic data over the quarter continued to point to weakness in fundamentals, despite headline inflation remaining at the higher end of the band, although it took the financial system crisis in September to be the catalyst for the RBA to cut rates. Markets have priced in further (and larger) rate cuts for the RBA over the next quarter.

The Federal Reserve in the US maintained the federal funds rate at 2.00% over the quarter as attention in the US turned from weak economic growth to the immediate concerns over the viability of the US financial system. The list of casualties in September included:

- Freddie Mac and Fannie Mae (entered US government conservatorship)
- investment banks Lehman Brothers (filed for bankruptcy) and Merrill Lynch (acquired by Bank of America)
- insurance giant AIG (nationalised)
- retail banks Washington Mutual (banking operations acquired by JP Morgan) and Wachovia (acquisition currently contested by Citigroup and Wells Fargo). These troubled banks followed the failure of IndyMac Bancorp in August

The Fed moved to shore up liquidity in the US financial system, increasing its Term Securities Lending facility to US\$200bn (from US\$175bn) and broadened the list of acceptable collateral in its Primary Dealer Credit Facility. These facilities provide immediate liquidity to the US banking system. Financial institutions were not the only ailing sector, with the Fed forced to establish the Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility and provide assistance to the money market funds. The rapid loss of confidence in the US financial system and losses which saw many funds "break the buck" (NAV under \$1.00) gave way to immediate concerns of a run on money market funds. As the spot fires encircling the US financial system turned into a major conflagration, US authorities went to congress with the US\$700bn Troubled Asset Relief Program (TARP), a plan to support US financials damaged by investments in asset backed credit instruments. After initially being rebuffed, TARP was eventually passed by the US Congress on October 3.

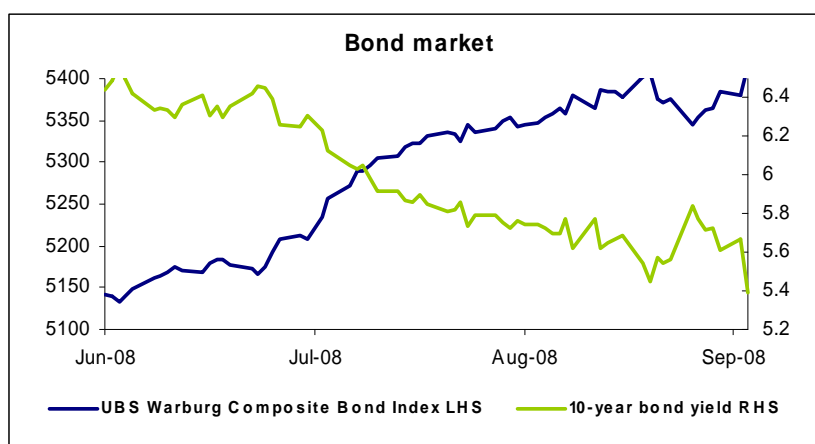
Whilst attention was duly focused on the US during the quarter, European central banks were also kept busy. The ECB raised its benchmark rate by 0.25% to 4.25% in early July and the Bank of England maintained its rates over the quarter prior to both institutions initiating the co-ordinated 0.5% rate cuts on 8 October. Authorities in Europe and the UK were also forced to address their own casualties in the September financial crisis, with the governments of Luxembourg, the Netherlands, and Belgium bailing out the Fortis Group (BNP Paribas and the government of Belgium have since acquired control of the Fortis Group), whilst the UK saw HBOS acquired by Lloyds TSB and Bradford & Bingley nationalised with its savings and branch network sold to Spanish firm Santander.

On the economic front, European economic growth turned negative (down 0.2%) with flat consumption and a weak industrial sector. European inflation recently slipped from 3.8% to 3.6%, suggesting the ECB had room to cut rates if necessary. However, inflation in the UK remained high at 4.4%.

The major central banks have turned their focus momentarily away from the inflation agenda to address the more immediate concerns over the health of the global financial system and its impact on future economic growth, with liquidity injections where necessary into markets. The US Fed moved to establish swap facilities with the Bank of Japan, Bank of England, and the Bank of China, while expanding existing swaplines with the ECB and Swiss National Bank, with total facilities amounting to US\$620bn.

Credit markets

Not surprisingly, distress in the Credit markets intensified over the quarter. The quarter started off relatively well, with some optimism in July that US government support of Fannie Mae and Freddie Mac may stem the widening in credit spreads. However, this quickly abated, developing into pessimism over the survival of some large financial institutions and finally ending in the calamity that was September. The primary capital markets remain difficult to access (few new issues) and rolling over maturing debt has become increasingly difficult and more expensive. Credit spreads continue to remain wide in Australia and across the world.



Source: Lonsec Data Source: IRESS

Australian bond yields fell sharply during the quarter as concerns over the health of the global financial system saw a flight to quality to government bonds. Bond yields traded over a wide band during the quarter, with a high of 6.57% on 2 July and a low of 5.39% on 30 September bookending the quarter. The UBS Composite Bond index traded in a range of over 283 points during the quarter, closing up 5.3%.

Fixed Interest Outlook

As a result of global conditions deteriorating and local leading economic indicators weakening, the RBA moved to cut the cash rate by 25bp in early September 2008 and 100bp in October to 6.0%. The rate cutting cycle should help soften the landing for the Australian economy and ease pressures in the banking system, but at 6.0% the RBA retains capacity for further rate cuts if necessary.

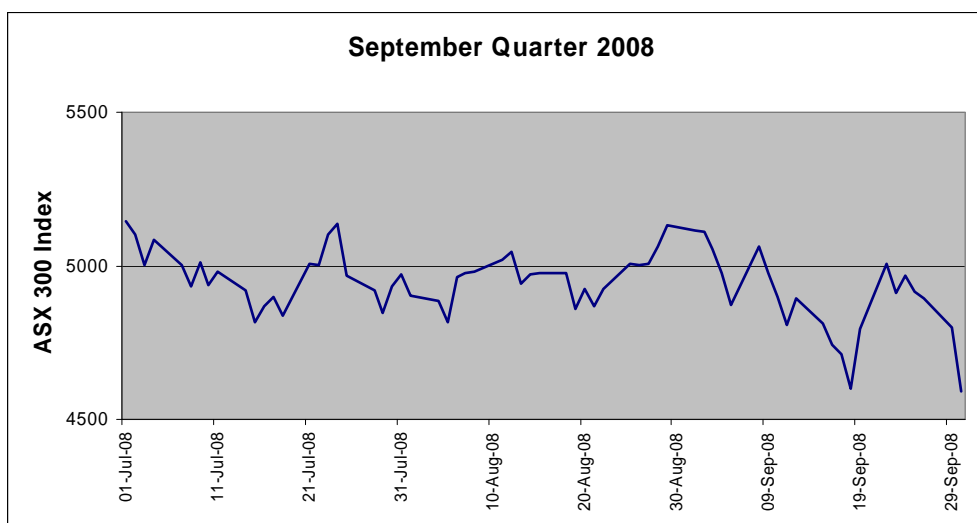
Globally, the US faces significant challenges. The significant reduction in debt finance as the financial sector de-leverages and shrinks is likely to severely dampen US growth in coming years. An indebted Government unable to increase spending materially, without negatively affecting its 'AAA' credit rating and the value of its currency, makes the recovery process

even more challenging. With the Fed funds rate already at a low 1.5%, authorities are relatively constrained in their ability to cut rates further. With European inflation showing some evidence of decline, the ECB does retain some leeway to cut rates. Credit markets remain harried and spreads continue to be very wide.

Portfolio Action

Lonsec has an unchanged view for Australian fixed interest: 'neutral' weighting. Lonsec believes that Australian fixed interest continues to offer reasonable value versus global bonds and equities. In contrast, Lonsec remains 'bearish' with respect to international fixed interest and recommends an 'underweight' weighting. In contrast to Australian bonds, International bonds are showing less value as the 'flight to quality' during the global credit crisis has driven down ten year bond yields in the major bond markets. Real rates remain negative and the increase in supply of US bonds will be very significant in coming quarters as the US Treasury finances the expanding Budget deficit. With US Government Debt approaching \$10,000bn and US GDP expected to decline in coming quarters, Lonsec views US bonds, in particular, as currently offering a poor risk/return outcome.

Australian Shares



Source: Lonsec, Data Source: IRESS

Review of Quarter

The Australian share market (as measured by the S&P/ASX 300 Accumulation Index) returned -10.7% for the September quarter, the fourth consecutive quarterly decline in returns. For the 12 month period ending 30 September 2008, the benchmark returned -27.1%.

Although there were some positives for the local share market in the form of an interest rate cut, a declining oil price and assurances as to the relatively well capitalised nature of our major banks, these factors were overshadowed by the stream of negative news coming out of Wall Street. In an attempt to restore confidence in the US banking system following a series of major corporate collapses, the US Federal Reserve announced a US\$700 billion bail out plan to buy 'sub prime' mortgage related assets highlighting the extent of the financial crisis. The plan, however, proved to be only a short-term positive catalyst for global and domestic markets. Investors, faced with the increased probability of a US recession and a deteriorating global economic outlook continued to sell down equities in Australia and around the globe contributing to the quarter end market declines.

The quarter also saw the 2008 financial year profit reporting season take place. In general there were no major earnings surprises, with just under 50% of companies reporting in line with expectations. Despite the difficult macro economic environment there were also a number of results that came in better than expected. These centred on large cap mining, telecommunications and healthcare companies. That said, the lack of clear profit guidance for 2009 highlights the level of uncertainty facing corporate Australia and investors in general going forward.

Compared to other global markets the Australian share market outperformed three of the four major international regions (in local currency terms) during the September quarter, with the regional markets of Japan, Asia and Europe posting returns of -17.5%, -16.5% and -11.3% respectively. However, the Australian share market underperformed versus the US over the quarter (-10.7% versus -10.0%). Over the 12 month period to September the Australian share market returned -27.1% underperforming relative to the US which returned -21.5% over the period. However, the domestic market outperformed both Japan (-32.6%), Asia (-32.4%) and Europe (-27.5%) for the 12 months to 30 September 2008.

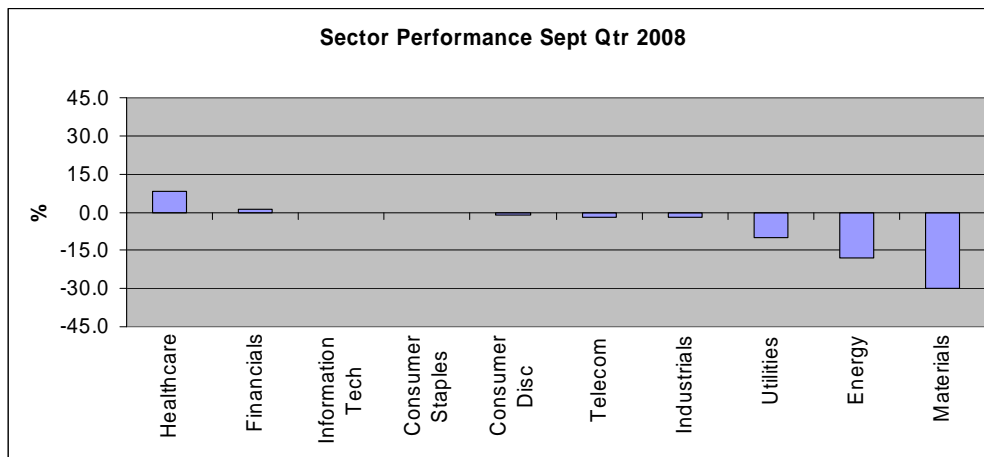
As shown in the chart above, the share market was sold down heavily throughout September and at one point reached its lowest levels since December 2005. Uncertainty continued to plague the local market and contributed to the sharp swings in performance which included a 4.2% and 4.4% rise on the 19th and 22nd of September respectively, and a 4.3% decline on the 30th of September. During the month the market declined on all but five trading days reflecting the overall 'bearish' sentiment of investors towards equities.

Stock Performance

Over the September 2008 quarter the five best performing stocks within the ASX top 200 (in terms of share price movement) were David Jones (+53.0%), ResMed (+48.7%), Ansell (+37.1%), Cochlear (+35.8%), and PMP Limited (+33.7%). Despite a challenging retail environment 'high-end' retailer David Jones performed strongly on the back of a record financial year profit result but also after reaffirming its profit guidance for 2009. Small cap healthcare company ResMed also reported a record financial year profit result causing its share price to rise as investors switched to the traditionally defensive healthcare sector.

Conversely, the five worst performing stocks within the ASX top 200 (in terms of share price movement) over the September quarter were Babcock & Brown Power (-79.6%), Babcock & Brown (-74.0%), Aquarius Platinum (-64.8%), Straits Resources (-64.4%), and Panoramic Resources (-63.6%). Babcock & Brown and B&B Power were both heavily sold down by investors on concerns over the companies' high debt levels and impending debt maturity. Metals group Aquarius Platinum was adversely impacted by the steep fall in the price of platinum which fell by 48% during the quarter.

Sector Performance



Source: Lonsec Data Source: AFR/Bloomberg

As can be seen from the chart above, only the Healthcare and Financials sectors posted positive returns during the quarter. The Healthcare sector returned +8.0% for the quarter ahead of the Financials sector +1.0%, whilst the Information Technology and Consumer Staples sectors finished the quarter flat. Investors favoured the defensive characteristics of the Healthcare sector amidst market uncertainty. Within the sector, Cochlear (+35.8%) was the beneficiary of a strong 2008 earnings result with the company announcing a 15% increase in yearly profit which was in line with guidance. The Financials sector was the next best performing sector of the market during the quarter with the major banks offsetting some of the poor performance stemming from the diversified financials. Of the big four banks, WBC and CBA contributed to a large part of the sector's performance returning 7.4% and 6.1% respectively. In contrast, diversified financials such as Babcock & Brown and Macquarie fell 74.1% and 23.9% respectively. At the other end of the scale the Energy (-18.0%) and Materials (-30.0%) sectors reversed the trend of recent times and were the two worst performing sectors during the quarter. Falling commodity prices and doubts over China's ability

to withstand the US economic slowdown caused sentiment to reverse in these sectors. Whilst mine closures and falling metal prices impacted on the performance of some small to mid sized 'pure play' metal miners, the diversified large cap resource companies were also not immune to the sell down in this sector. BHP and RIO were both down 29% and 38% respectively for the quarter.

Outlook

Lonsec remains cautious on the outlook for the local share market (and growth assets in general). The key issues of concern which are likely to persist throughout the remainder of FY09 include underlying inflation, worsening credit conditions and a slowing global economy. The Australian economy has already shown signs of slowing with building approvals and retail sales declining whilst consumer and business confidence is also down. In light of these headwinds, the Australian economy slowed to a modest growth rate of 0.3% for the June quarter (2.7% on the rolling year). Despite these risks to Australian economic growth there are a number of

fundamental positives that distinguish the Australian market place compared to many other OECD countries. The financial system remains robust with the capital position of the major banks in good shape relative to their global peers. In addition, the Australian government is also in budget surplus and interest rates are high relative to most OECD countries which provides an opportunity for both fiscal and monetary policy stimulus should economic conditions slow dramatically. Australia's resource and energy sector is also expected to continue to benefit from growth from Asia (albeit at a slowing pace).

Overall, Lonsec believes that the Australian equity market appears to be fairly valued and generally does not offer any real compelling value as yet. Whilst volatility is expected to continue in the short-term, any over reaction to weakness on Wall Street should provide some selective buying opportunities taking a medium to long-term view.

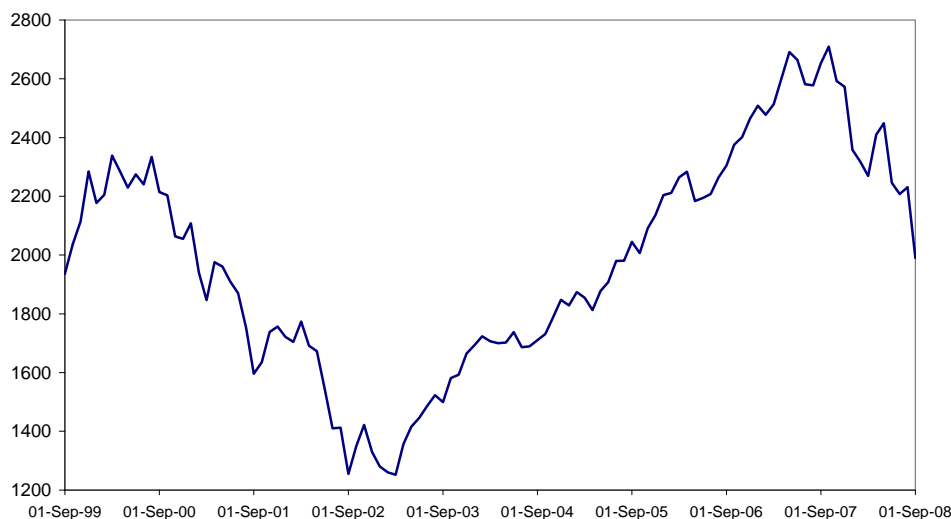
Portfolio Action

Lonsec has decided to maintain its “**slight underweight**” position in Australian equities. This decision reflects Lonsec's overall cautious view on growth assets in general, but more specifically the earnings uncertainty surrounding the financials and resources sectors which make up a large part of the local market.

In relation to managed funds, investors should ensure that they give due consideration to the balance of 'value' and 'growth' style investments in their portfolio, and be cautious of adopting any major bias to either style on the basis of short term outperformance of one versus the other.

Global Equities

World Equity Market Performance (Local Currencies)



Source: Lonsec Data Source: IRESS

Review of Quarter

Due primarily to the cushioning effects of a falling Australian dollar, international shares rose by 2.5% over the September quarter (as measured by the MSCI World ex Australia Index in \$A). However, in local currency terms, all major regional sharemarket indices fell over the quarter with markets in US, Europe, and Asia experiencing hefty losses (in local currency terms). For the year ending September 2008, the poor 'annual' performance from global equities continued, returning -18.0%, reflecting the turbulent investment climate throughout much of this year. However, global investors fared slightly better in a relative sense than local investors, with the Australian market (S&P/ASX 300 Accumulation Index) returning -27.1% over the same period.

Performance across regional markets for the 12 months to the end of September 2008 was uniformly weak for the second quarter in a row. Japan continues to be the worst performing region, falling by 32.6% for the year; however, the decline in Asian markets resulted in similar underperformance. Returns from Asian equities depreciated rapidly in the last quarter with a 32.4% fall over the 12 month period. Europe fell by 27.5% while the US, ironically the impetus for the market selloff, experienced the least severe falls with a 21.5% retreat. The difference between the best performing region (US) and worst (Japan) in local currency terms for the 12 months ending September 2008 was 11.1%. In last quarter's report the difference between these countries was 16.8%.

A major difference between this quarter and the previous was the contrasting fortunes of the local currency. The Australian dollar has experienced a recent sharp fall against the major currencies, and the declining currency

movements have dampened investor returns for hedged investors. Over the quarter the Australian dollar reversed its previous upward trend by weakening against the USD -16.9%, GBP -8.2%, JPY -18.2% and the EUR -4.9%. The steep decline in the Australian dollar over the quarter reflects the deteriorating economic outlook and investor preference for perceived traditionally safer assets like the US dollar and Yen. The extent of the currency weakness over this period has actually meant the Australian dollar has lost ground against the majors over the past 12 months to 30 September.

United States

US shares fell by 10.0% for the three months to the end of September 2008. The quarter was characterised by generally weaker economic data, all pointing to the early stages of a fairly severe recession in the US. September payroll numbers fell by 159,000, the biggest monthly reduction in five years. The housing market continued to reach new lows with US Commerce Department figures confirming the number of housing starts in August declined 6.2%, the lowest level of new activity since 1991. The outlook was no brighter with Building Permits, a sign of future construction activity, also weakening in the quarter by 8.9% on the month.

Meanwhile the credit crunch juggernaut rolled on, impacting a number of major financial players and radically reshaping the Wall Street corporate landscape. The market continued to grapple with the scale of the liquidity issue and as the quarter wore on it became clear that major US government fiscal intervention would be required to kick-start credit markets and help release the necessary money flows underpinning the economy.

The breakdown in the functionality of markets and its impact on the economic outlook increased markedly in September as investors and corporates continued the

rapid deleveraging. The bursting of the housing bubble, leaving many financial firms with balance sheets holding virtuously worthless assets and too much debt, continues to reduce available credit and depress asset values as these firms seek to improve capital by selling assets at whatever price they can.

Europe

European sharemarkets collectively fared slightly worse than their US counterparts, falling by 11.3% for the quarter. Returns on all major European bourses (FTSE, DAX and CAC 40) have all been negative over the last 12 months. August releases showed European GDP fell by 0.2% in the June quarter with the German economy contracting by 0.5% in the period. The economic situation weakened considerably in the UK with zero economic growth in the June quarter and the Nationwide Housing Price Index, a key barometer of residential property, falling by 10.5% on the year in August. This was the biggest recorded drop since 1990. The news was no better in other parts of Europe, with official Irish data confirming the good times were over for the one-time European tiger economy. Ireland entered a recession in September, brought on by a severe housing slump and consumer weakness.

Japan

Japanese shares suffered a major buffeting in the September quarter, falling by 17.5% as the economy faltered. Recent GDP figures reveal growth contracted by 2.4% on a year earlier in the June quarter, reversing a 3.2% rise in the March quarter. Meanwhile exports slumped by the most since the recession of 2001-02, accompanied by weaker housing investment and earnings data. Toyota delivered its poorest earnings growth in five years in August reflecting poor demand from US customers.

Meanwhile the political climate remained clouded as Prime Minister Yasuo Fukuda became the second Japanese Prime Minister to resign within a year in September. Taro Aso becoming Japan's 92nd Prime Minister later that month. Many commentators continue to suggest major economic reform and political vision are needed to improve Japan's economic prospects.

Asia

The news was no better beyond Japan, with Asian shares declining by 16.5% (in local currency terms) for the September quarter. It appears investor concerns about a US recession outweigh confidence in the Asian growth story, with few bright spots across the region. Over the quarter Industrial output fell in Singapore by 12.1% in August on a year earlier and house pricing indicators weakened for the first time in four years. Meanwhile, in September the Taiwanese central bank cut rates for the first time since 2003, citing the reduced inflationary pressures and a weakening global economic outlook.

According to IMF forecasts, China's growth rate is expected to slow from 11.5% to 10% due to recent tightening measures taken to curb rising inflation. Growth in India is also forecast to slow from 9% to 8.4%, with the rest of East Asia declining from 5.2% to 4.9%. In an attempt to curb rising inflation, India and Taiwan have both recently increased key lending rates and banks' reserve requirements.

Outlook

With no visible signs of improving global growth and concerns about future economic weakness intensifying over the quarter, pessimism continues to dominate economic sentiment. While inflationary concerns have broadly weakened as oil and commodity prices have eased, any hopes of a relatively short correction have evaporated as the subprime mess continues to weaken the economic outlook.

The International Monetary Fund continues to moderate its economic expectations, with global growth expected to slow to 4.1% over 2008 and 3.9% over 2009.

United States Outlook

US and global investors anxiously await the impact of Congress' approval of the US financials rescue package. Volatility on sharemarkets appears set to continue as it will take some months for the workout to take effect. The initial muted reaction to the package suggest the market has decided that, despite it possibly saving some financial firms, it will be unable to offset a painful global recession. Meanwhile, recent earnings data from major global firms including GE and Ford confirm the rapidly deteriorating profit outlook as US consumers remain under pressure. The share price weakness, so prevalent to date in the financial and housing stocks, has spread to other sectors of the economy including commodities and consumer discretionary. The gravity of the situation has prompted increased calls for more drastic and coordinated rate cutting action from the major central banks, an instalment of which appears to have been delivered though October's rate cuts.

Europe Outlook

The outlook in European markets continues to take its cue from the US and has continued to slide south. In September The European Commission cut its 2008 GDP forecasts for those countries tied to the Euro from 1.7% to 1.3%. A number of European economies teeter on the brink of recession including Italy, France, Germany, UK and Spain, where the construction market has severely contracted, triggering a spike in unemployment.

European leaders recently met at a summit in response to the global financial crisis and have called for increased banking regulation, stricter controls on credit rating agencies and greater transparency and limits on executive pay. These sentiments have also been echoed in Washington, suggesting greater regulatory oversight of financial operations is one major consequence of the current carnage.

Japan Outlook

Economic indicators have continued to weaken in Japan suggesting the world's second largest economy is moving closer to recession. The mood of Japanese manufacturers is the most pessimistic in five years with fears that the slowdown will weaken demand and a rising yen will lessen their competitive edge. The yen has continued a strong recent period of appreciation against the dollar.

Asia Outlook

The unshakeable resolve of those believing that Asian developing economies would provide a buffer against the downturn in the G7 economies suffered a serious credibility test as the movement of assets out of Asian equities gathered momentum. Most Asian sharemarkets have realised steep losses in 2008 — the Shanghai Composite, for example, was down 56% year to date to end of September. Growth in these economies is expected to soften as a result of a dip in global demand and, accordingly, the IMF has continued to moderate its growth expectations for Asian economies. Even so it expects China, India and much of developing Asia to continue to deliver robust economic growth in 2009. Factors deemed to work in the favour of companies in these economies compared to their developed counterparts are strong, deleveraged balance sheets with large cash levels able to withstand the tight credit environment, low levels of public debt and strong domestically driven demand and investment within their economy.

Asian central banks have followed the lead of their developed counterparts with recent rate cuts to stimulate growth. The China and Taiwan central banks cut the cost of borrowing in September. Other economies like Indonesia and Malaysia have recently kept rates on hold despite recording high inflationary pressures.

Portfolio Action

Lonsec has moved from its previous 'neutral' weighting to an "**underweight**" position (on an unhedged basis) to international equities this quarter, reflecting in large part the deteriorating outlook for US, European and Asian equities. The Australian dollar has continued to weaken against the majors as investors weigh up weaker global growth forecasts and the likelihood of further cuts in interest rates by the Australian central bank. This will likely impact on returns for hedged investors.

The likelihood of positive economic news in the near term seems remote, suggesting ongoing pain for the consumer sector and restricted capital options for international companies. This may translate to a forthcoming period of corporate weakness and, indeed, it is possible we are at the early onset of a sustained period of earnings downgrades as companies pare back their revenue projections and demand forecasts while the investment sell side which traditionally overestimates earnings to a degree, comes to grips with the extent of the economic contraction. This will likely weaken demand for equities as investors require capital for other economic priorities. In short there is little to suggest an end to the troubled outlook for global equities.

The extreme nature of these conditions has not previously been seen by many seasoned market participants and is proving a challenge for the best in the industry. However, there are opportunities in every market and these moments of extreme volatility confirm the need for an appropriate mix of 'value'/'growth' style investments within portfolios to ensure that investors have appropriate opportunity to participate across the market cycle. Lonsec reiterates the need for investor comfort with longer-term horizons when formulating global equities performance expectations.

Listed Property

Australian Real Estate Investment Trusts (A-REITs)

The S&P/ASX 300 A-REIT Accumulation Index posted a total return for the September quarter of -1.7%, which represented a significant outperformance of the broader equity market by 9.0%.

Volatility over the quarter remained high, fuelled by the US Treasury and the looming bailout plan. A continued 'flight to quality' has seen well capitalised A-REITs such as CFS Retail Property, Commonwealth Property Office Fund and Westfield Group continue to outperform the broader market over the recent quarter.

Post-reporting season, several A-REITs revised their distributions downwards, to align them with core earnings. This included some of the A-REITs with the more volatile revenue streams, which reduced their payout ratios to more sustainable levels.

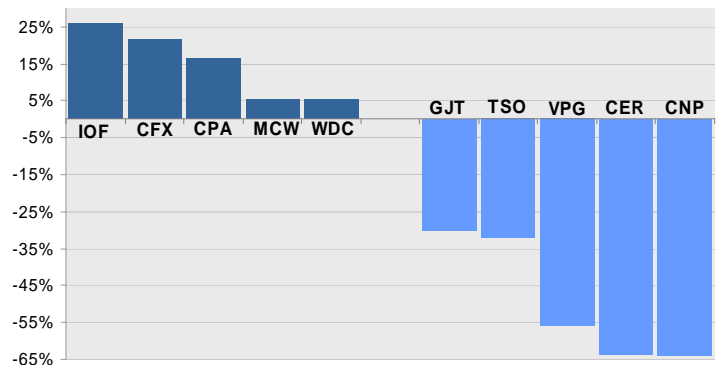
This was well received by the market, as it increased investor confidence in the long-term sustainability of distributions going forward. The recent rate cut from the Reserve Bank Australia (RBA), as well as the potential for future cuts, has also been a contributor to the A-REIT sector's outperformance of the broader equity market.

Nonetheless, this brings the Australian REIT sector's 12 month total return to -41.8% p.a., well below the broader market.

A-REITs with exposure to US office markets (such as Tishman Speyer Office Fund) were sold down with concerns over a potential increase in supply in that sector.

The following chart highlights the five top and bottom performing A-REITs over the three months to September 2008.

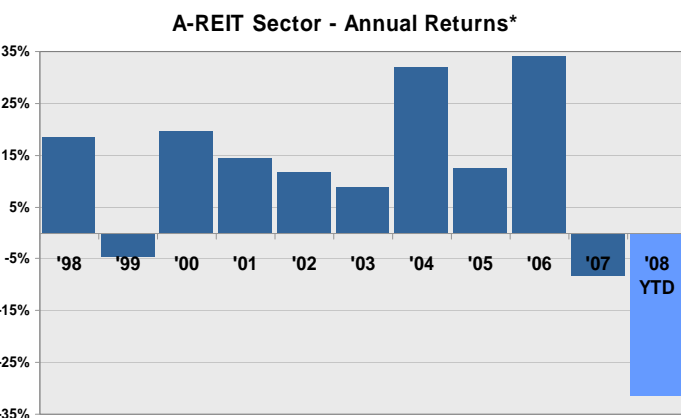
Top/Bottom September Quarter Total Return
S&P/ASX 300 Property Index



Source: IRESS

Office (+11.1%) and Retail (+5.0%) were top performers for the quarter, with all other sectors posting negative returns. Strong performance from defensive office A-REITs such as the ING Office Fund and Commonwealth Property Office Fund were significant contributors.

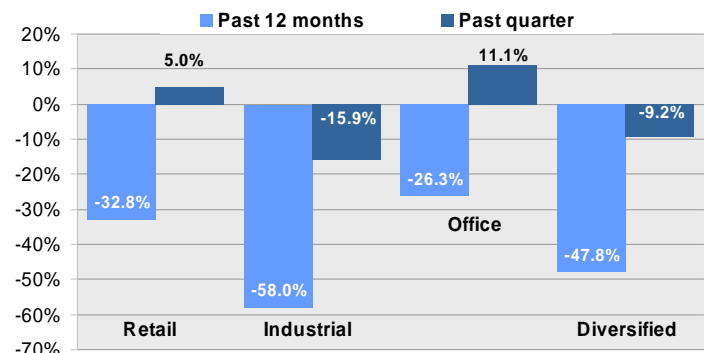
The worst performing sub-sector over the last quarter was Industrial (-58.0%), which was affected significantly by price falls in the Goodman Group.



*S&P/ASX 200 A-REIT Accumulation Index
Source: IRESS

The best performing A-REITs over the quarter were the 'safe havens' considered to have modest leverage, good credit quality and quality assets mainly domiciled in Australia. This included ING Office Fund (+25.8%), CFS Retail Property (+21.6%) and Commonwealth Property Office Fund (+16.6%). On the flip side, A-REITs that are highly geared and/or have exposure to failing US banks underperformed. Centro Property Trust (-64.1%) and Centro Retail Group (-63.5%) led this charge with Valad Property Group (-56.0%) not too far behind.

September Quarter Sub-Sector Total Returns



Source: IRESS

The following table provides a summary of the sector's estimated valuation as at 30 September 2008:

A-REIT Sector Metrics	
Forward Sector Yield	7.7%
Average Property Yield	6.9%
Gearing	33.8%
Premium/(Discount)	
NAV	-8.34%
NTA	0.62%
DCF	-11.85%

Source: Merrill Lynch

Lonsec believes that potential catalysts which may mark the beginning of the end of these tumultuous times will include mergers and acquisitions, transactional data and evidence of generally prudent capital management.

The Australian direct property market has not come under significant pricing pressure compared with what has occurred within the A-REIT sector. Hence, investing in A-REITs now appears to be attractive on valuations relative to direct property.

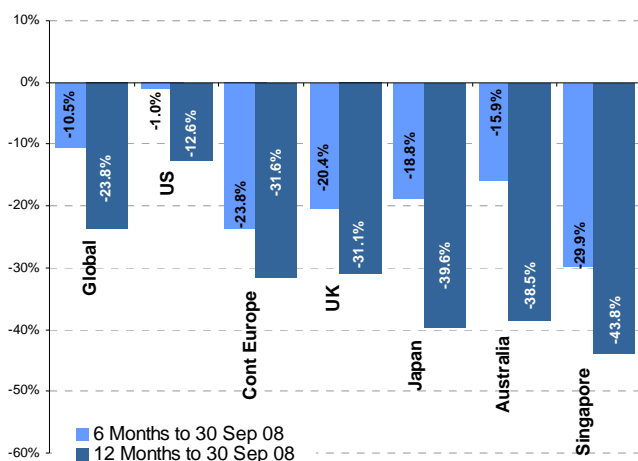
Global Real Estate Investment Trusts

According to the UBS Global Real Estate Index, global listed real estate returned -23.8% in Australian dollar terms over the 12 months to September 2008. During this period, all regions delivered a negative return.

Singapore was the worst performing region, delivering a total return (in local currency terms) of -43.8% over the year to 30 September 08. The best performing region over this timeframe was US/Canada, which delivered a nonetheless disappointing return of -12.6% in local currency terms.

Global Listed Property Performance – Sep Quarter

UBS Global Real Estate Investors Index – Local Currency



The global property sector's returns have continued to be impacted by the credit crisis, which has seen the availability of finance decrease and debt become more expensive. Just about all global property securities managers reviewed by Lonsec are now running portfolios which focus on the quality companies with stable balance sheets. Most managers have become risk averse, running smaller active positions and generally avoiding companies with exposure to riskier activities such as development and construction.

The events of last month have highlighted that the credit crisis is far from over. The collapse/bailout of prominent financial institutions throughout the US and Europe has been well publicised. Debt continues to be very difficult and expensive to source, while stockmarket volatility and negative sentiment are well entrenched in the listed property sector world-wide.

Rising funding costs, decreasing development margins and to some extent decreasing rental growth /falling rental income have seen some property stocks recently announce earnings and distribution downgrades.

It can be argued that generally, listed property stocks globally appear to be trading at attractive values. However, we have not yet seen the full impact of the credit crisis on the direct property markets world-wide. Many fund managers are now concerned about potentially much lower direct property valuations, as valuation capitalisation rates continue to loosen.

It is estimated that in the UK/Europe alone, there could be a total of €340b of properties for sale over the next 15 months. This is a significant amount in the current environment, where only €66.5b of transactions occurred over the six months to June 2008. A material proportion of these assets may be disposed of at 'forced sale' prices, given that banks are becoming increasingly focused on loan covenant breaches.

Whilst under normal market conditions, private equity funds could be expected to take advantage of attractively priced assets, the credit crisis and investor risk aversion means that this 'floor' might still be some time away. Importantly, while we have seen the ramifications of the financial crisis play out, we have not yet seen the economic impact on some of the world's large economies potentially falling into recession.

Outlook

Australian REITs

Whilst there is the prospect of further distribution cuts for some A-REITs, the sector in general now appears to be trading at attractive prices relative to valuation. However, additional financial and economic 'shocks' could see further price falls. The rising cost of debt will put pressure on the sector's earnings as debt is refinanced at higher

rates. On the other hand, the falling Australian dollar will benefit trusts with offshore exposure, as foreign exchange hedges on foreign income are rolled forward at more attractive exchange rates.

Lonsec continues to hold the view that A-REITs with conservative gearing, a focus on quality domestic assets and no exposure to funds management and development activities are likely to be the better performers over the short term. Over the long term, Lonsec expects that the domestic A-REIT sector should deliver average long-term total returns of 8-10% p.a. Whilst the sector may deliver materially lower returns over the short term, it may also deliver materially higher returns when it commences its recovery.

Global REITs

Global REITs are also beginning to look attractive on most valuation measures, given the deep discounts to valuation that they are generally trading at. However, there currently exists no clear catalyst to drive a re-rating of the global property securities sector. Lonsec believes that the volatility in the sector is therefore likely to persist at least over the next few quarters. This will extend further if the US and UK/European economies deteriorate materially.

Investors considering investing in the sector now should target a portfolio of property companies/REITs comprising the larger, quality stocks with low gearing. These are the stocks that are best positioned to ride out further bad news and to take advantage of the opportunities that such downturns eventually present.

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