

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.

Market	3 mths	6 mths	12 mths
Australian Shares	-14.6	-16.9	-7.2
Australian Listed Property	-19.1	-29.7	-24.2
Australian Fixed Interest	2.2	2.5	4.3
Cash	1.8	3.6	7.0
International Shares (\$A)**	-12.6	-14.5	-15.1
- US*	-8.9	-11.7	-4.6
- Europe*	-13.9	-15.2	-11.7
- Japan*	-17.9	-25.1	-28.1
- Asia*	-14.9	-15.1	7.9
\$A vs \$US	4.1	4.0	13.8

* Returns are in local currencies

** MSCI World ex Aust Index \$A

The impact of the continued deterioration of global credit markets on developed economies remained throughout the March quarter. Volatility was again a key feature of equity markets throughout the quarter, with sentiment waning. Major equity markets slumped, Australia included. Locally, ASX listed companies Allco, MFS and A.B.C. Learning Centres all succumbed to issues relating to debt obligations as the credit market woes continued to have a real impact on the local bourse. Australian bond yields were not immune from the volatility through the quarter; the 10 year bond yield ranged from 5.87% to 6.48% before ending at 6.05%, a fall of 28bps on end December yields. In what continues to be a difficult market, cash has been the best performing asset class over the last six months.

Global Economy

The world's largest economy, the **United States**, continues its move toward recession, with falling house prices, rising fuel costs and the increasing cost of credit slowing US consumption. The US Federal Reserve cut interest rates by 200 basis points (bp) in the first quarter of 2008 to 2.25%; this was coupled with the Government's \$146bn fiscal stimulus package, both designed to lessen the impact of the economic slowdown.

While the slowdown of the US economy continues, the developing economies of Asia currently continue their growth story. The extent to which some of these developing economies continue to perform will be



What direction from here?

determined largely by the severity of a slowdown in the US and the expected decline in US imports.

Commodity prices maintained their bull run, with both Gold and Oil hitting record highs during the quarter. Gold pushed through US\$1,000/ounce and Oil US\$100/barrel for the first time. Platinum, Copper and Tin prices also rose by over 25% each over the quarter.

In continental **Europe**, the European Central Bank (ECB) expects growth to slow and in the **UK** the Bank of England (BOE) has moved to an easing bias, cutting rates on concerns of falling consumer sentiment. Recent market movements in foreign exchange markets have conspired to hurt the economy of **Japan**, driven by the increased value of the Yen and falling demand in the US. **China** and **India** are both expected to lead the developing Asian economies with robust growth forecasts, despite these forecasts being lower than recently observed levels in the region.

Domestic Economy

The Australian economy continues to exhibit strong growth (with GDP at 3.9%), supported by strong economic figures (low unemployment, federal budget surplus, strong AUD, record private sector spending and public spending on plant, equipment and infrastructure), and continued demand flow from the neighboring growth economies of Asia. However, risks still remain: rising inflation and the threat of a slowdown in developed economies forcing commodity prices lower.

With the RBA raising rates twice through the March quarter, controlling inflation is clearly to the forefront in the Bank's actions. The domestic banks all passed on more than the RBA's increase to consumers, reflecting the increased costs of financing debt in the current climate.

The equity market suffered its worst quarterly return for 20 years as the credit crunch continued to be played out, with many speculating that we have yet to see the end of the fallout. Volatility is expected to remain a characteristic of equity markets over the coming months as investors take their guide from the next round of companies reporting, which is expected to give further insight into the depth of the credit market's impact.

Outlook

The local equity market outlook is consistent with end 2007 and is not expected to generate returns in the same order as over the past few years. The strong local currency, the rising cost of debt and the deteriorating global economic outlook are likely to have a negative impact on Australian company profit margins.

Australian bonds seem reasonable value relative to Australian equities, while the official cash rate hit a 12-year high of 7.25% in March.

This quarter Lonsec is moving to slightly increase the Property weighting, with a view to moving back to a neutral allocation over the course of the year. The listed property market has fallen around 30% since early November 2007 and is now starting to offer better value. Lonsec has reduced the Australian Equity allocation to fund the increase in property weighting. The overall effect is that asset allocation remains largely defensive. With the aforementioned changes and a bias away from rate cuts in Australia in the near future, Lonsec remains 'very overweight' Cash.

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

Recommended Asset Allocation Weightings

Lonsec Tactical Asset Class Positions - April 2008

Aust Equity	Slight Underweight
Global Equity	Neutral
Property	Slight Underweight
Aust Bonds	Neutral
Global Bonds	Slight 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	25.0	-5.0
Cash	40	30-50	45.0	5.0
Alternatives				
Total	100		100	0

Balanced

	Benchmark	Ranges	TAA position	+/-
Aust Equity	23	15-31	20.5	-2.5
Global Equity	20	13-27	20.0	0.0
Property	12	8-16	10.5	-1.5
Aust Bonds	15	10-20	15.0	0.0
Global Bonds	15	10-20	13.5	-1.5
Cash	5	0-10	10.5	5.5
Alternatives	10	5-15	10.0	0.0
Total	100		100	0

Defensive

	Benchmark	Ranges	TAA position	+/-
Aust Equity	8	5-11	6.5	-1.5
Global Equity	6	4-8	6.0	0.0
Property	6	4-8	5.0	-1.0
Aust Bonds	25	17-33	25.0	0.0
Global Bonds	25	17-33	21.5	-3.5
Cash	20	10-30	26.0	6.0
Alternatives	10	5-15	10.0	0.0
Total	100		100	0

Growth

	Benchmark	Ranges	TAA position	+/-
Aust Equity	33	22-44	29.5	-3.5
Global Equity	30	20-40	30.0	0.0
Property	12	8-16	10.5	-1.5
Aust Bonds	5	3-7	5.0	0.0
Global Bonds	5	3-7	4.5	-0.5
Cash	5	0-10	10.5	5.5
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	13.0	0.0
Property	12	8-16	10.0	-2.0
Aust Bonds	20	13-27	20.0	0.0
Global Bonds	20	13-27	17.0	-3.0
Cash	10	0-20	17.0	7.0
Alternatives	10	5-15	10.0	0.0
Total	100		100	0

High Growth

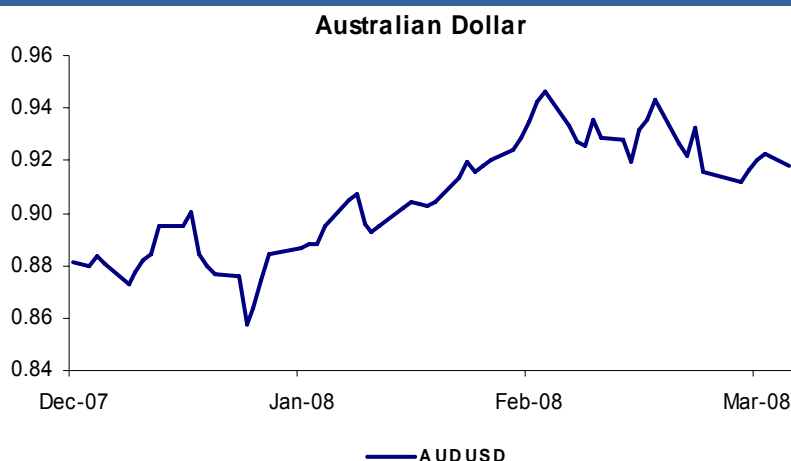
	Benchmark	Ranges	TAA position	+/-
Aust Equity	41	27-55	38.5	-2.5
Global Equity	39	26-52	39.0	0.0
Property	10	7-13	9.5	-0.5
Aust Bonds				
Global Bonds				
Cash				
Alternatives	10	0-20	13.0	3*
Total	100		100	0

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

Sector Overview

Asset Sector	Sector Summary
Cash	Lonsec remains 'very overweight' Cash. On the back of official cash rates hitting 7.25%. With underlying inflation trending up from 3.5% the resultant consensus views are that official cash rates are likely remain at this level throughout 2008.
Australian Fixed Interest	Lonsec remains 'neutral' to domestic fixed interest. With economic growth slowing and the RBA targeting a reduction in inflation, Australian bonds represent reasonable values versus equities.
International Fixed Interest	Lonsec sees better relative value in local bonds and thus remains 'underweight' International Fixed Interest. The recent credit crisis induced 'flight to quality' that pushed down benchmark 10 year bond yields across the major markets of US, UK, Germany and Japan continues unabated.
Australian Shares	Lonsec has decreased to a 'slightly underweight' allocation to Australian equities. Domestic economic fundamentals remain relatively strong, however, the local equity appears fairly valued. Lonsec expects the market to trade in a range between 5,000 – 5,800 throughout 2008.
International Shares	Lonsec continues to recommend a 'neutral' weighting to international equities, reflecting the ongoing uncertainty surrounding developed global economies, offset by the strength of the emerging economies of Asia.
Property Trusts	Lonsec believes that the sector is now worth re-visiting, on a select basis, with a focus on the 'plain vanilla' property trusts that have: a bias to Australian property; high occupancy; mostly rental income; reasonable levels of gearing; and manageable lease maturity and debt maturity profiles. Increased position to 'slightly underweight'.

Australian Dollar



Source: Lonsec Managed Funds Research, Data source: RBA

Review of Quarter

The Australian dollar (AUD) rose by 4.1% against the US dollar (USD) in the March quarter, closing at US\$0.9180 (US\$0.8816 at the end of December *Source: RBA*). This follows a fall of 0.1% in the December quarter. Against the Trade Weighted Index, the AUD appreciated by 0.4%.

The AUD had mixed performance against major currencies in January. Thin trading conditions and risk aversion weighed on the currency early in the month. Strong domestic data (November building approvals and retail sales) and increased expectations for US Federal Reserve (Fed) rate cuts saw the AUD reach an intra-month high of US\$0.9002 on 15 January. Equity market volatility due to losses from global financial institutions and continued nervousness that the US economy could be entering a recession sent the AUD lower soon

thereafter, with a January low of US\$0.8577 on the 22nd, corresponding with global stock markets posted their largest daily declines since September 11, 2001. A total of 1.25% in rate cuts by the Fed (0.75% on January 22 and 0.50% on January 30), coupled with the prospect of higher domestic interest rates and expectations for the Australian economy to remain resilient to the global credit crunch, boosted the AUD late in the month, closing at US\$0.8884.

The AUD strengthened against all major currencies across the board in February. Despite the RBA raising interest rates by 0.25% (to 7.00%) on February 5, the AUD began the month lower with the release of disappointing domestic economic data (December retail sales and building approvals) and declines in equity markets. Stronger-than-expected December housing finance data and a hawkish RBA quarterly statement of

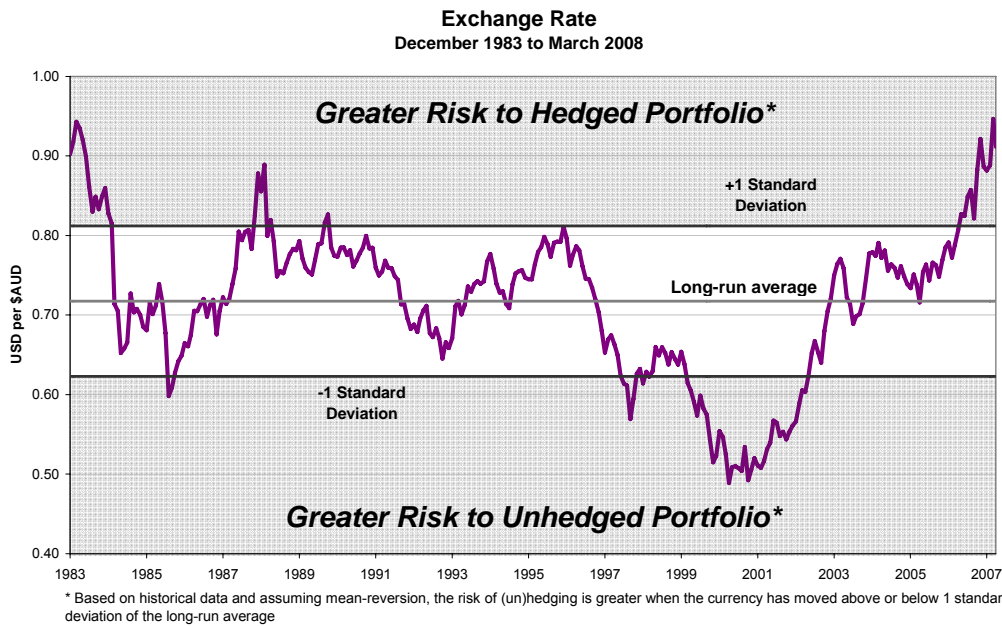
monetary policy on February 11 gave support to the AUD, with markets pricing in two more RBA rate hikes for H108. Softer-than-expected US economic data, bearish comments from the US Fed Reserve Chairman and strong gains in commodities prices (both agricultural and base metals) pushed the AUD higher in late February, closing at US\$0.9466.

The AUD fell heavily against almost all major currencies during March, with risk aversion remaining a driving factor for the AUD. Despite the RBA raising interest rates by 0.25% (to 7.25%), the AUD was weighed down early in the month by soft domestic economic data, a higher-than-expected Q4 current account deficit and a larger-than-expected trade deficit. A strong January housing finance report, February labour market data (33-year low unemployment rate of 4.0%), and the Fed's decision to slash the discount rate gave the currency support mid-month. The release of the RBA's minutes of their March 4 meeting and the Fed's decision to cut interest rates by 0.75% (to 2.25%) on March 18 further underpinned strength in the AUD. These gains were short-lived, with

risk aversion once again engulfing markets; the AUD fell to its intra-month low of US\$0.8955 on March 20. Late in the month the AUD recovered some of these losses on the back of USD weakness, reassurance from the RBA governor that the Australian financial system remained sound, as well as some improvement in risk appetites, finishing the quarter at US\$0.9180.

The chart on the previous page shows the performance of the AUD during the March quarter. As can be seen, the AUD experienced a volatile quarter, trading in a range of US\$0.8577 to US\$0.9466 during the quarter.

The chart below 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 is chosen as the MSCI World index has over 50% exposure in USD. Despite a volatile quarter, the AUD finished the December quarter at US\$0.9180, representing approximately 2 standard deviations above the long-run average since December 1983.



Outlook

The Australian economy is expected to slow over 2008 but remain relatively robust, with the major risks being inflation and any major slowdown in Asia. The December quarter national accounts grew at a solid pace of 0.6% (3.9% over 2007). Demand was strong across the board with Consumption, Government spending and Business Investment all contributing to growth. Households are enjoying strong income growth and rising wealth while company profits remain robust and balance sheets seem in good shape. At the same time the Federal Government is in a strong position, with a Budget Surplus of \$17.3bn (1.7% of GDP).

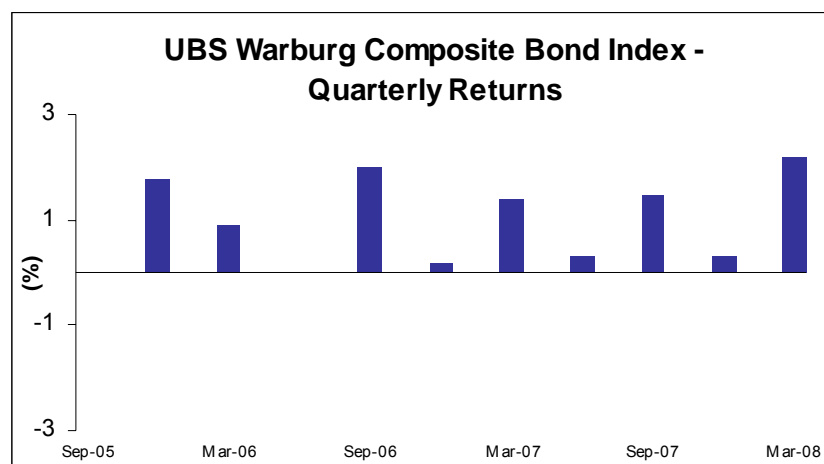
Recent large increases in the price of iron ore, coal and gas have further improved Australia's terms of trade. With a solid economic growth outlook, a strong fiscal position, increasing terms of trade, and high interest rates relative to the G7 economies, Lonsec has an overall firm outlook for the AUD over the near term. That said, downside risks to the AUD versus the USD include Australia's high Current Account Deficit (~7% of GDP), any correction in commodity prices and the RBA cutting interest rates in the future.

Australian Cash

The Australian cash market continued to deliver a consistent return of 1.82% for the March 2008 quarter. Over the 12 months to March 2008, the cash market returned 6.99%. The official cash rate stands at 7.25% and 90 day bank bill yields rose 62 basis points, closing the quarter at 7.86%.

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

Review of Quarter

During the March quarter concerns with the global credit markets persisted. Northern Rock, the stricken UK bank which suffered a 'bank run' during the December 2007 quarter, was nationalised by the UK Government following the failure to identify a suitable buyer. Meanwhile in continental Europe, UBS wrote down a further US\$19 billion in assets. Most noticeably, however, US investment bank, Bear Stearns, agreed to be acquired by JP Morgan Chase (pending shareholder approval) after it also experienced a 'bank run' of sorts. Against this global backdrop, Australian fixed interest delivered a modest return of 220 basis points (bps) beating cash by 40bps.

Monetary Policy

The Reserve Bank of Australia (RBA) has continued with its monetary policy tightening which began in the final months of 2007. The cash target was raised twice in the March quarter: during February and March by 25bps on each occasion, bringing the rate up to 7.25%. The increases were in response to rising inflationary pressures in the Australian economy. The impact of RBA's action has also been compounded to by Australian

lenders increasing their lending rates by over and above the RBA increases as a means to recoup the increased costs of operating in the wholesale markets.

In the US, the Fed took opposite action to prevent the US economy from failing. The Fed cut the benchmark federal funds rate on three separate occasions during the quarter: twice in January and once in March. Importantly, the first rate cut on 21 January followed an unscheduled meeting of the Federal Open Market Committee. All the cuts were highly aggressive, totalling 200bps and reduced the benchmark rate to 2.25% — a level not seen since late 2004. The Bank of England (BoE) cut official rates in February by 25bps reducing the benchmark level to 5.25%.

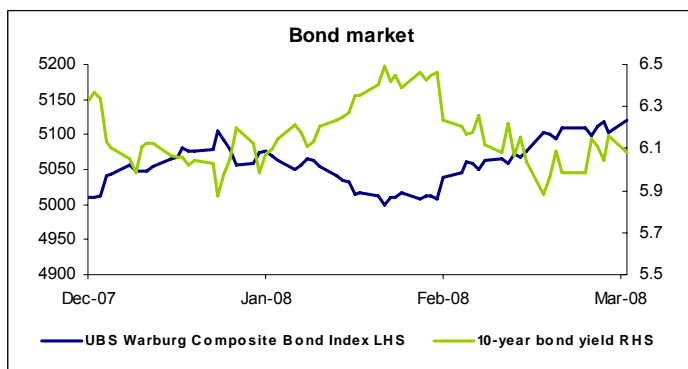
The European Central Bank (ECB) once more left rates on hold this quarter at 4.00%. The Bank of Japan (BoJ) has also kept rates on hold at 0.50%.

Credit markets

Liquidity remains the word on the lips of market participants, or rather the lack of it. The Fed has sought to free up the US capital markets by aggressively cutting rates and the use of other liquidity support measures. It has further broadened the assets it will accept as

collateral from banks for short-term loans, increased liquidity programs and allowed investment banks to access the 'discount window' which is generally reserved for commercial banks with stricter regulatory requirements. The Fed was also reportedly heavily involved in the negotiations to prevent the collapse of Bear Stearns, an investment bank which is a significant counterparty in derivatives markets. The Fed took unprecedented action to intervene and prevent Bear Stearns from collapse: facilitating the negotiations and assuming US\$30 billion of the bank's least liquid assets to facilitate the sale.

US corporate credit spreads remain stretched and are at levels last seen in 2002 post the notable collapses of Enron and WorldCom. The situation is mirrored in the UK and Europe. In Australia, credit spreads have also continued to widen. As an indication, year-on-year to February 2008 spreads over swap rates for corporate bonds with maturities ranging from 1 to 5 years have increased from 52bps for AAA assets to 97bps for A rated names. This is also reflected in yields, which also rose 194bps and 235bps (read: principal values fell) for AAA and A rated names over the same period.



Source: Lonsec

Australian bond yields (as referenced by the benchmark Australian Government 10 year bond yield) compressed during January 2008 as market participants worried about the state of the US economy, increasing demand for safer assets. During most of February bonds were sold off as the RBA increased rates and domestic inflation concerns were prevalent. However, the mood shifted in the latter stages of the month as credit concerns and persistent fears of a US recession again came to the fore, awakening the appetite for 'safe haven' assets. This continued into March, with the Australian market taking the lead from falling yields in the US Government 10 year bond. The broad inverse effect of the yield moves is seen in the meandering of the Australian bond index.

Fixed Interest Outlook

Lonsec believes that the RBA is likely to keep interest rates on hold for the short to mid-term. This should provide some respite to bond investors. Further, Lonsec suspects that the RBA is at the peak of its tightening cycle, with the next potential move being a cut — but not until 2009. Europe and the UK show signs of slowing. While the ECB has remained steadfast and not cut rates for fear of stoking inflationary pressures, there is an expectation that this stance will moderate during the year as its constituent economies are expected to slow. The UK has cut rates (as discussed earlier), and growth is expected to slow and inflation rise.

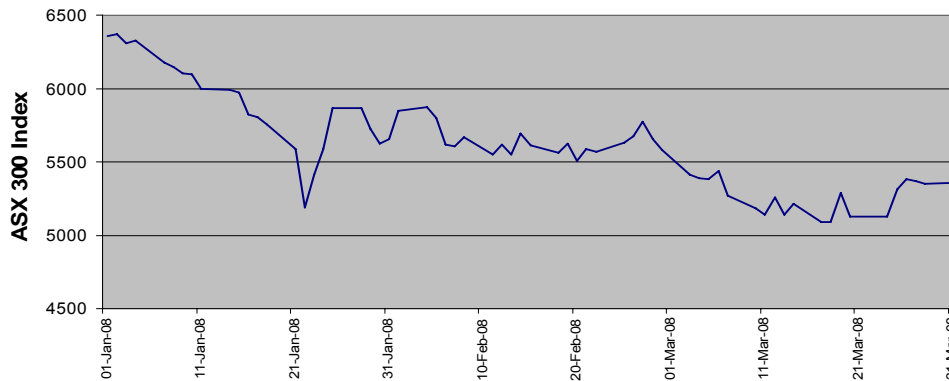
The US economy is showing signs of slowing, with markets expecting further weakness and the increasing possibility of a recession. Fixed income operates in the reverse of equities, and in this instance a recession and weakening macroeconomic conditions should be beneficial for sovereign bond investors. Although the caveat is that the official rate in the US now sits at 2.25% and there is not much more room to move, especially when considering inflation (core inflation, as preferred by the Fed, was 2.7% annualised for the December 2007 quarter), i.e. prospect for negative real rates. This situation is different for corporate debt, given that companies require positive operating conditions to meet their debts. Credit spreads are wide and the relative value question is whether they will contract (increase values) or widen further (decrease values).

Portfolio Action

Lonsec has an unchanged view for Australian fixed interest of a 'neutral' weighting. We retain the view that this asset class shows some value vis-à-vis cash. Lonsec views international fixed interest moderately negatively and we continue to prefer an 'underweight' position. Notwithstanding this, the demand for 'safe haven' assets has given bond prices cause to rally. These higher prices are subject to readjustment should the Fed shift its focus to inflation management.

Australian Shares

March Quarter 2008



Source: Lonsec Managed Funds Research, Data Source: IRESS

Review of Quarter

The Australian share market posted a negative return for the March 2008 quarter, with the S&P/ASX 300 Accumulation Index falling 14.6% for the period, its worst quarterly decline since 1987. As a consequence of the sharp decline in the share market over the quarter, the S&P/ASX 300 Accumulation Index posted a negative 7.2% return over the 12-month period ending 31 March 2008.

The Australian share market experienced its second consecutive quarter of negative returns as the share market suffered further fallout from the global credit crisis and slowing US economy. While these concerns are not new, investors remain uncertain as to the full extent of the fallout and this negative sentiment weighed heavily on the performance of Australian and global share markets. In particular, a series of mortgage-related write-downs and profit downgrades by large financial institutions (including UBS, Merrill Lynch and Bearn Stearns) were the catalysts for panic selling and contributed to what was another volatile period of trading. While many of these casualties were based in the US, Australian companies were not immune to the fallout, with local casualties being Allco Finance Group, MFS, and A.B.C. Learning Centres. Companies with high levels of debt were primarily in the spotlight and aggressively sold down, as investors shunned the broader financials sector, including the traditionally defensive bank stocks, in favour of taking a more cautious approach. In contrast to a slowing US economy and the Federal Reserve's rate cuts, the RBA continued to raise interest rates during the quarter in an attempt to contain inflation and slow down the domestic economy. While the effectiveness of these rate cuts will play out over coming months, the relatively subdued profit reporting season provided a signal as to the tougher operating conditions now being experienced by Australian companies — a prime example being the major banks that have increased their interest rates independently of the RBA in an attempt to recoup some of the losses from higher funding costs.

The Australian share market outperformed two of the four major international regions (in local currency terms) during the March quarter, with the regional markets of Japan and Asia posting returns of -17.9% and -14.9% respectively. The Australian share market underperformed the regional markets of the US and Europe, which delivered returns of -8.9% and -13.9% respectively over the March quarter. Over the 12-month period to March 2008, the Australian market (-7.2%) underperformed Asia (+7.9%) and the US (-4.6%), but outperformed the regional markets of Europe (-11.7%) and Japan (-28.1%).

As shown in the chart above, the month of January saw the Australian share market retreat sharply. From the market peak in November 2007, the Australian share market fell by approximately 20%, as negative economic and corporate news in the US, and ongoing global credit concerns continued to dampen investor confidence. The Australian share market fell on twelve consecutive trading days in January, including a 7% decline on 22 January, the worst one-day fall on the ASX since 1989. The high level of volatility was driven by events in the US, while in Australia, inflationary pressures and interest rate rises weighed on the market.

In an attempt to restore confidence and provide some stability to the US economy the Federal Reserve aggressively cut interest rates, firstly by 0.75%, and then by 0.50%. This provided some short-term momentum to equity markets, including the Australian share market, which rebounded strongly. At its March close, however, the share market had recorded its worst quarterly performance in 20 years. Resource stocks again dominated the best performers' table and most of the takeover announcements during the quarter were centred on resource stocks, including Oxiana's bid for Zinifex, and the BHP Billiton bid for Rio Tinto becoming formal.

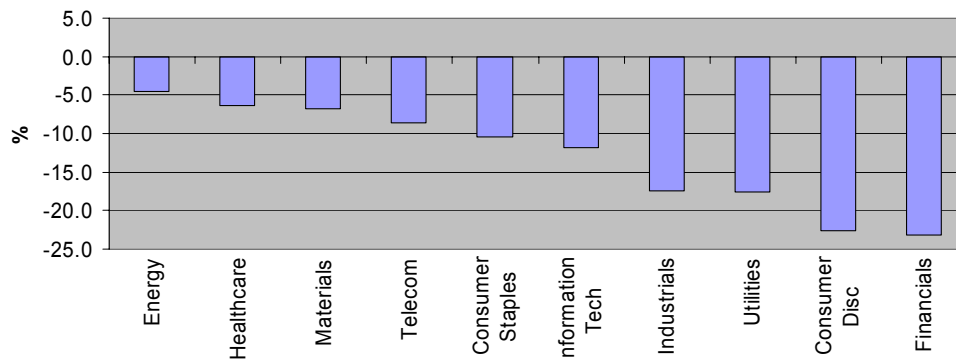
Stock Performance

Over the March 2008 quarter the five best performing ASX 200 stocks (in terms of share price movement) were Felix Resources (+53.9%), Centennial Coal (+36.2%), Macarthur Coal (+33.2%), Lynas Corporation (+31.6%), and Aquaris Platinum (+31.0%). The top three performing stocks operate in the coal industry, and have benefited from the rise in spot coal prices, which reached record levels during the quarter. The transport of coal has been affected by infrastructure bottlenecks (rail and port) contributing to supply constraints. Felix Resources has also risen, due to the stock's inclusion in the S&P/ ASX 200 Index, which has added to share price and liquidity momentum.

Conversely, the five worst performing ASX 200 stocks over the March 2008 quarter (in terms of share price movement) were Allco Finance Group (-92.3%), MFS (-77.5%), ABC Learning Centres (-73.0%), Centro Properties Group (-70.3%), and Centro Retail Group (-64.2%). Allco Finance, MFS, and ABC Learning Centres all saw their share prices plunge due to difficulties refinancing their debt, the forced selling of shares held in margin lending arrangements, and the general negative sentiment surrounding companies with complex structures and high levels of gearing.

Sector Performance

Sector Performance March Qtr 2008



Source: IRESS

As can be seen from the chart above, all sectors in the Australian share market posted negative returns for the March quarter. Energy was the best performing sector for the quarter, returning -4.6%, ahead of the healthcare sector's -6.4%. Within the energy sector, Woodside Petroleum (WPL) returned +6.2% and benefited from the rising oil price, which exceeded \$US100 a barrel during the quarter. WPL's positive performance was in contrast to the sector's broader negative returns and was a key contributor to the sector's outperformance relative to the rest of the market. Queensland Gas Company (QGC) also performed strongly during the quarter, rising 12.2%.

The healthcare sector was the next best performing sector of the market during the quarter, largely due to the performance of CSL Limited. Shares in CSL rose 1.5% during the quarter, after the announcement of an interim profit rise of 36% for the six-month period ending December 2007. The consumer discretionary and financials sectors lagged the rest of the market over the course of the March quarter, returning -22.6% and -23.2% respectively. Negative sentiment towards companies with leverage adversely impacted on the performance of the financials sector, including that of Australia's major banks.

CBA was the worst performed of the major banks during the quarter, with the share price falling 29%, followed by NAB (-20%), ANZ (-18%), and WBC (-15%).

Outlook

Lonsec remains cautious on the outlook for the local share market and believes that short-term sentiment is likely to remain negative. Rising interest rates and a slowdown in the US economy are both expected to provide the domestic share market with headwinds over the remainder of 2008. Despite the short-term risks mentioned, the Australian economy is still expected to grow at a relatively robust pace of around 3.5% in 2008 (down from 3.9% in 2007), due to Australia's exposure to the growing Asian economies. This growth, however, will be largely dependant on the size and extent of the global slowdown in the coming quarters. Considering that 63% of Australia's exports are to the Asian region, a key issue for the Australian economy and share market going forward will be whether the developing markets of Asia can withstand a US slowdown.

The RBA raised interest rates to 7.25% during the quarter in an attempt to curb inflationary pressures brought on by low unemployment levels, rising wealth and income growth in Australia. Lonsec expects that the RBA is near the peak of its tightening cycle and that interest rates will remain on hold in the short term. Already there have been signs that the conditions are slowing, with consumer and business confidence, retail sales, and building approvals all down over the March quarter. Lonsec expects share market volatility to continue, both domestically and abroad, until inflationary risks have abated and a clearer picture can be painted for a recovery in the US economy. The market is not expected to match the impressive double-digit returns of the past five years, and instead Lonsec expects the market to trade within a range of 5,000 to 5,800 points in 2008.

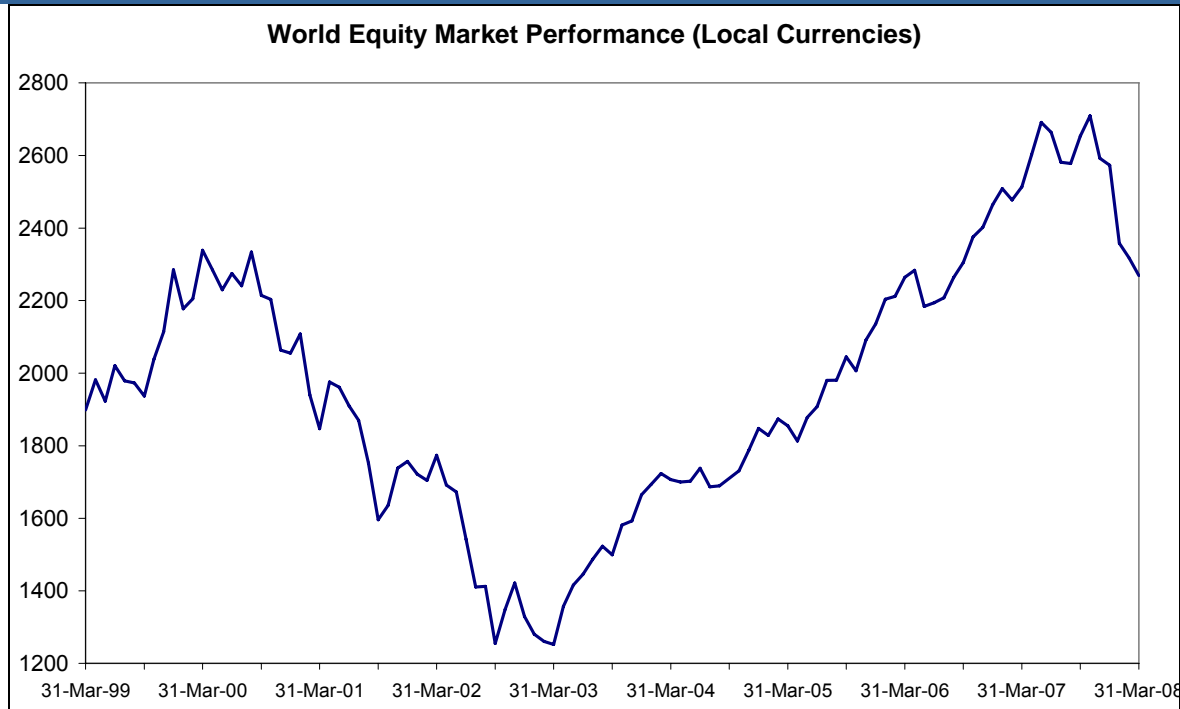
Overall, Lonsec believes that the share market has reasonable earnings prospects for 2008, with broker consensus EPS growth in the range of 6% to 8%. Lonsec however believes that the market has already priced in this growth. Rising costs and a stronger AUD are expected to take some shine off the resources sector, and EPS growth is expected to be in the range of 10% to 15%. In the Financials sector, Australian banks seem to be in better financial shape relative to their overseas peers and corporate borrowers will have to return to the banks for debt financing (due to current credit conditions), allowing them to increase market share. The Industrials sector is expected to deliver 6% to 8% earnings growth.

Portfolio Action

Lonsec expects global growth to weaken over 2008, particularly in the developed economies of the US and Japan to 3.2%, from a previous forecast of 4.1%. Offsetting this weakness, however, is the relatively robust growth expected to stem from the developing economies of Russia, India, and China, which are well placed to withstand a US slowdown. Lonsec has therefore decided to maintain a 'neutral' asset allocation to international equities, which are expected to provide a more diversified exposure to growth assets relative to Australian equities. Accordingly, in Australian equities, Lonsec has moved to a 'slight underweight' position (from 'neutral'), reflecting the higher level of downside risk expected from domestic equities relative to global equities in the short term. In addition to inflationary pressures, Lonsec has some short-term concerns over the possible retraction of commodity prices and its impact on the local market, which is highly concentrated in commodities and financials (in total approximately 61% of the 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 and Regional Equities



Source: Lonsec

Review of Quarter

Global share markets failed to shake off the rising pessimism dominating the business environment during the second half of 2007, resulting in a turbulent first quarter for 2008. The period in general was characterised by bouts of sustained selling across global markets, with January particularly severe. International shares fell by 12.6% in the quarter as all regional markets (US, Europe, Japan and Asia) experienced heavy losses (in local currency terms). On a longer-term view it proved a painful period for investors, with global equities falling by 15.1% over the last 12 months.

Markets continued to take their lead from the US, where market sentiment was dragged down by the worst housing slump in 25 years combined with continued balance sheet evaporation in the financial sector. Tumbling equity values across global markets meant most regional markets performed poorly for the 12 months to the end of March 2008. On the negative side, the US fell by 4.6%, Europe by 11.7%, while Japan experienced the most severe contraction, falling by 28.1%. Asia proved the only market providing some respite, rising by 7.9% for the year. There continued to be a wide range in local currency terms (36%), between the best performing region (Asia) and worst (Japan) for the 12 months to end of March 2008.

The Australian dollar had a mixed quarter against the major currencies, but in general the rising currency movements continued to have a bearing on the disproportionate returns for hedged versus unhedged investors. The US Federal Reserve's (the Fed's) actions

to lower interest rates in the States contrasted with the RBA's tightening policy and provided a positive backdrop for the AUD against the USD.

United States

US shares fell by 8.9% for the three months to the end of March 2008. The Dow Jones Industrials Average closed 2007 at 13,264 points; the downward trend persisted throughout the first quarter of 2008 as the Index fell by more than 1,000 points to close out March at 12,176 points. The period ended with a slight improving rally off the quarter lows reached on 10 March (11,731 points). The dominant theme weighing on Wall Street remained the depth and likely length of the US economic slowdown, evident in continued weak economic data and deepening credit market concerns flowing on from the sub-prime crisis.

The Fed endured another busy and challenging quarter as it moved to shore up market confidence and safeguard the ongoing functionality of the US financial system. The Fed's extraordinary actions included slashing interest rates, providing financial underpinning to JP Morgan's takeover of crippled investment house Bear Stearns, and offering discounted lending facilities to US financial institutions. Expectations for US company earnings also weakened during the quarter.

Europe

European share markets as a whole fared worse than their US counterparts, falling by 13.9% for the quarter — the worst quarterly performance since September 2002. The weakening economic outlook and damaging effects

of the credit squeeze preoccupied market participants. Germany's DAX was down by 17 percent, the UK's FTSE by 13% and France's CAC by 16% for the quarter.

The trauma afflicting the banking sector continued across Europe with the nationalisation of Northern Rock, Société Générale's €7 billion-plus loss, and continued write-downs and losses across a suite of European banks all adding to investor concern during early 2008.

Japan

Japanese shares declined 17.9% for the quarter, with the Nikkei 225 experiencing its worst quarterly performance since mid 2001. Business and investor confidence suffered as markets grappled with the possible impact of a stronger yen on exporters and general fears that events in the US would be magnified in the local economy.

Asia

Asian shares have held up comparatively well over the past year and proved to be somewhat of a safe harbour for investors in a stormy global sea. Nevertheless, Asian markets were not immune to the market turmoil in early 2008 and experienced a 14.9% fall over the quarter. China corrected sharply, reeling under the effects of rising inflation and the severe economic disruption wrought by the worst snowstorms in fifty years. While the Shanghai Composite Index experienced a tremendous rise throughout much of 2007, it has fallen by approximately 50% since its October peak.

Outlook

The prolonged turbulence in global markets, largely attributable to the dysfunctional credit markets, continues to exert downwards pressure on global economic growth forecasts. The International Monetary Fund's latest 2008 global growth forecast has been revised down to 4.1%. There appears a strong likelihood that the extraordinary paralysis disrupting financial markets will continue to depress investment performance for some time yet.

Interestingly, while stock exchanges across many emerging markets also performed poorly over the quarter, the GDP forecasts for larger economies like China and India, while moderating, are still expected to remain relatively robust and come in at close to recent trend levels. This is suggestive of a two-paced global economy, with an expectation that the developing economies of Asia and Latin America will act as a greater engine room for global growth than the old-world developed powerhouses of the G7.

United States Outlook

A steady stream of weak economic data in the US in the first quarter confirmed that the world's largest economy is grinding to a halt. Many market participants, including senior officials at the US Federal Reserve, are bracing for further contraction in the economy throughout the first half

of the year. It is rare to find all but the most optimistic of commentators expecting a speedy recovery from the slowdown. Speculation is rife regarding the likelihood of a US recession and, despite this economic scenario being as yet unconfirmed in the official numbers, many believe it is already a fait accompli.

The Fed is poised to continue its front-line interventionist role in seeking to stabilise the market and provide some fiscal stimulus. Recent monetary tightening has reduced the Fed Funds rate to 2.25%, a fall of 3% since September 2007. While this action, combined with other policy initiatives available to the regulator, has provided some interim and short-term bouts of confidence in equity markets, it is yet to deliver a knockout blow to the market's woes. The weak employment data released in the last week of March suggests that further tightening and policy intervention may be necessary. The US economy lost 232,000 jobs in the first three months of the year.

The Fed is in relatively uncharted territory and has attracted some criticism regarding 'the moral hazard' and the precedent which has been set by their response (direct intervention) to the crisis. It remains to be seen whether the Fed's actions in sponsoring JP Morgan's bailout of Bear Stearns proves a shrewd decisive action in preventing wide-scale corporate financial contagion, or whether it is merely the first major A-List casualty in a string of failures resulting from corporate greed and impaired financial practice. If it proves to be the latter, the prospects may be ominous for the American taxpayer and the broader global economy.

Europe Outlook

The general outlook in European markets remains subdued, given the prospect of slower Eurozone economic growth driven by the effects of a stronger Euro, rising inflation, continued tightness in credit markets, and the prospect of recession in the US. The European Central Bank (ECB) expects European growth to moderate in 2008 to approximately 1.7%. Inflation remains a key focus for the regulator as it moved above 3.0% in February, driven by rising oil and food prices. Meanwhile the Euro hit a record high against the US dollar in mid March, damaging the outlook for European exporters. In contrast to its US counterpart, the ECB continued to leave the borrowing rate unchanged at 4.0% throughout the quarter. There remains a sense that the ECB may eventually be prompted to cut the borrowing rate later in the year to offset the deteriorating economic outlook.

While conceding that economic growth might moderate slightly on previous forecasts, regulators in Germany remain cautiously upbeat about the ability of Europe's largest economy to weather the US slowdown. This judgement reflects Germany's perceived robust industry conditions and improved labour market framework versus many of its European peers.

Growth in the UK continued to weaken in the second half of 2007 with GDP coming in at 3.0% for the year. The trend is expected to intensify in 2008, with Treasury forecasting 2008 growth to be in the range of 1.75-2.25%, as outlined in the UK Budget in mid March. Since December the Bank of England (BOE) has responded to the credit squeeze by reducing rates by 50 basis points to 5.25%. To the disappointment of some, the BOE left rates unchanged following its March meeting, citing fears about rising inflation taking precedence over concerns about the deteriorating economic outlook. However, if the BOE can maintain a degree of inflation control, there is expectation of future downside movement on rates to promote growth.

It proved an eventful quarter in France, given the trading scandal at Société Générale and the growing public doubts concerning the policies and broader character of the French leader. This culminated in the ruling Sarkozy-led party losing local public elections to opposition Socialists in March. Despite the faltering public support, the French administration reiterated no slowdown in its economic reform agenda tackling four key areas – improving competitiveness, stimulating growth, improving state finances and increasing efficiency of pension, health and welfare programs. These reforms have been broadly welcomed by the business community and many of France's EU neighbours. The sluggish economic outlook prompted the French government to pare back its 2008 growth forecast from 2.25% to 1.7-2.0%.

Japan Outlook

The US slowdown weighed heavily on investor confidence in Japan as signs of a possible domestic recession grew. Despite inflation reaching a decade long high of 1.0% in February (by no means high in an absolute sense but welcomed by locals as signalling a possible end to prolonged deflation) broader economic concerns meant regulators continued to leave rates unchanged at 0.5%. Indeed, the BOJ remained more disposed to cutting rates than any moves on the upside. Japan's economy grew by 0.9% in the final quarter for 2007 driven by solid export performance. However, this export resilience is not viewed as sustainable, at least in the first half of 2008, particularly as exporters confront the effects of a rising yen. Household spending retreated in February and when combined with rising unemployment it would tend to suggest there is no rapid turnaround in sight for the poor comparative and absolute performance of Japanese equities.

Asia Outlook

Prospects remain more upbeat in the higher growth emerging economies of Asia, though admittedly the outlook has been tempered by the severity of the US contraction. Growth in China, India and broader East Asia is expected to soften in 2008, yet still remain robust and at impressive levels compared to developed economies. GDP in China grew at 11.5% in 2007 and has triggered some fairly serious inflationary pressures resulting in policy responses in increased price controls and interest rate hikes. The Asian Development Bank (ADB) expects China's economy to grow by 10% in 2008. The Indian economy expanded by 8.7% in 2007 and according to the ADB is expected to deliver GDP growth of 8%. However, the outlook is not as rosy for economies such as Singapore which are more heavily reliant on US trade and therefore more vulnerable to the effect of US recession.

Portfolio Action

Lonsec continues to recommend a 'neutral' weighting to international equities, reflecting the ongoing uncertainty surrounding global economic prospects.

The economic unravelling in the US is likely to dampen global investor confidence and restrict appetite for higher risk assets for the near term. Lonsec expects the outlook for global equities returns will remain volatile for the first half of 2008. While the sharp decline in equity valuations has prompted some recent market talk about greater buying opportunities, Lonsec is unable to 'call the bottom'. Rather, Lonsec continues to recommend investors ensure appropriate balance of 'value'/'growth' style investments within portfolios to ensure investors have appropriate opportunity to participate across the market cycle.

Traditionally, emerging market equities have performed poorly in times of global uncertainty, and there has certainly been a return to more traditional volatility levels in this asset class of late. Asian markets have corrected in recent months and it remains to be seen whether regional equities will continue to weaken in line with their developed peers or instead provide some moderate outperformance. As always, a longer-term perspective is required when formulating global equities performance expectations. Investors may wish to review their international equities allocation to ensure appropriate emerging and Asian equities exposure so as to benefit from the shifting balance of the global economy and projected resilience of the BRIC economies.

Listed Property

Australian Real Estate Investment Trusts (A-REITs)

The March 08 quarter saw the renaming of Listed Property Trusts (LPTs) to Australian Real Estate Investment Trusts (A-REITs). The re-branding was undertaken by the ASX in conjunction with the Property Council of Australia (PCA) to better align the name of Australian listed property trusts with those used in other jurisdictions.

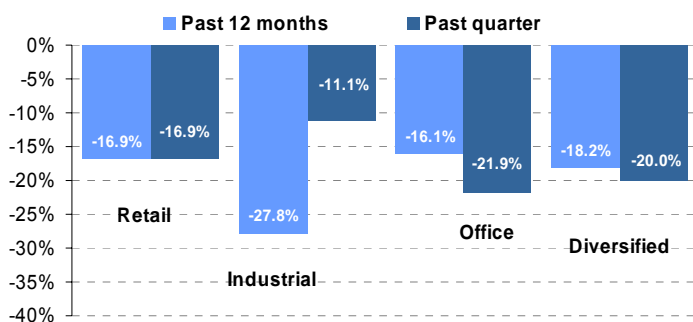
Over the three months to March 2008 the A-REITs sector was severely affected by the credit crisis, which has seen the availability of debt finance reduce and interest costs increase. Overall the S&P/ASX 300 A-REIT Accumulation Index posted a total return for the March quarter of -19.1%, which represents a significant underperformance of the broader equity market of 4.5%. This brings the Australian REIT sector's 12 month total return to -24.2% p.a.

The collapse of the **Centro Properties Group** share price after the Group announced that it had not yet been able to refinance its short-term debt sparked the sell-down of a number of other highly geared trusts.

The Centro debacle has also raised concerns over the sustainability of earnings of other A-REITs with funds management arms. This also resulted in the sell-down of mid-cap stapled A-REITs such as the **Charter Hall Group** (total return over the March quarter of -43.8%).

The worst performing sub-sector over the last quarter was Office (-21.9%), which was affected significantly by the price fall of **Macquarie Office Trust (MOF)**. All sub-sectors recorded negative total returns over the March quarter, with Retail returning -16.9%, Industrial -11.1% and Diversifieds -20.0%.

March Quarter Sub-Sector Total Returns

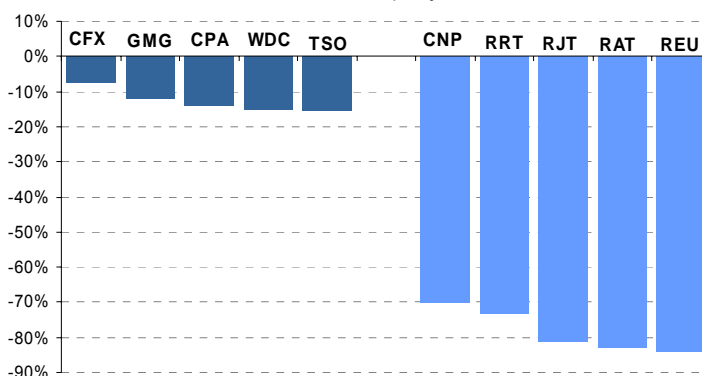


The best performers in the sector were the stocks considered to have strong balance sheets and relatively lower gearing, given the flight to quality. Therefore, **CFS Retail Property (CFX)**, **Goodman Group (GMG)**, and **Westfield Group (WDC)** were the top three performers of

the sector. Highly geared A-REITs have been the hardest hit over the last quarter, particularly as concerns of falling asset values and potential breaches of debt covenants come to light. All three Rubicon Trusts have experienced significant price falls, with the **Rubicon Europe Trust Group** posting the worst return for the quarter (-84.2%).

The following chart highlights the top and bottom five performing LPTs over the three months to March 2008.

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



The yield of the A-REIT sector has increased to 7.5%, a result of the price falls seen over the last quarter. As a result, there is now a premium of 1.5% between the 10 year bond rate (6.05%) and the LPT sector yield. Nonetheless, the A-REIT sector's forecast yield is still below the 90-day bank bill rate of 7.9%.

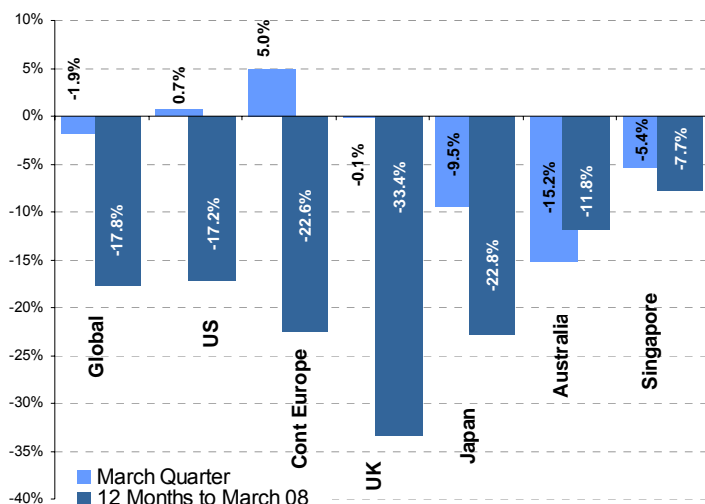
Global Real Estate Investment Trusts

Globally, listed real estate returned -17.8% over the 12 months to March 2008, with all regions delivering a negative return.

Over the three months to March 2008, global real estate delivered 1.7%. The worst performing region was Australia, delivering -15.2%. The best performing region over the March quarter was Continental Europe, with a total return of 5.0% p.a.

Global Listed Property Performance – March Quarter

UBS Global Real Estate Investors Index



The global property sector's returns have continued to be impacted by market concerns over the credit crisis, which has seen the availability of finance decrease and the risk premium demanded by investors increase. There are also concerns that at the direct property market level there will be reductions in valuations, particularly for lower quality assets in the US and Europe. In particular, investors are concerned that some of the more highly leveraged property companies/REITs may breach loan to value debt covenants if underlying asset values fall materially.

Despite fundamental reasons justifying some reduction in listed property company/REIT valuations throughout the world, the market has also been plagued by significant negative market sentiment, which has seen price falls materially exceed fair market valuations.

Outlook

It is impossible to predict whether the global property securities sector has finally reached the bottom of its price fall. Whilst there now appears to be plenty of valuation upside in the sector, further bad news regarding the US economy could see REITs and property companies with exposure to US assets continue to experience pricing pressure.

Furthermore, if values in the direct property market fall, a reduction in net asset values (NAVs) could see the sector experience further pricing pressure and negative sentiment. Whilst talk of increasing yields (via falling property values) has been occurring for half a year now, there is still insufficient transactional evidence at this stage to confirm the extent to which this may have occurred.

Looking ahead, the global property sector could potentially achieve long-term total returns of approximately 10% per annum, comprising a distribution income yield of approximately 3.5% - 4% and the rest capital growth. This is based on the assumption that interest rates will not change materially from current levels and that there will be a soft landing for the US economy. However, given the volatility in the sector, it is quite possible that global property will not see this type of return over 2008.

The domestic property market is likely to continue to correct as a result of the fall in asset values and deteriorating credit markets. Valuation decreases will likely be skewed towards lower quality stock. 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.

Portfolio Action

The Lonsec Investment Committee has increased its allocation to property from 'underweight' to 'slightly underweight', reflecting the increasing valuation upside of the sector.

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