

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	-1.7	-16.1	-13.7
Australian Listed Property	-15.8	-31.9	-37.7
Global Listed Property	-9.1	-11.9	-23.4
Australian Fixed Interest	0.4	2.6	4.4
Cash	2.0	3.8	7.3
International Shares (\$A)**	-6.4	-18.2	-21.5
- US*	-1.2	-10.0	-11.0
- Europe*	-3.6	-17.0	-20.1
- Japan*	9.1	-10.4	-24.5
- Asia*	-4.6	-18.8	-7.7
\$A vs \$US	4.9	9.2	13.4

* Returns are in local currencies

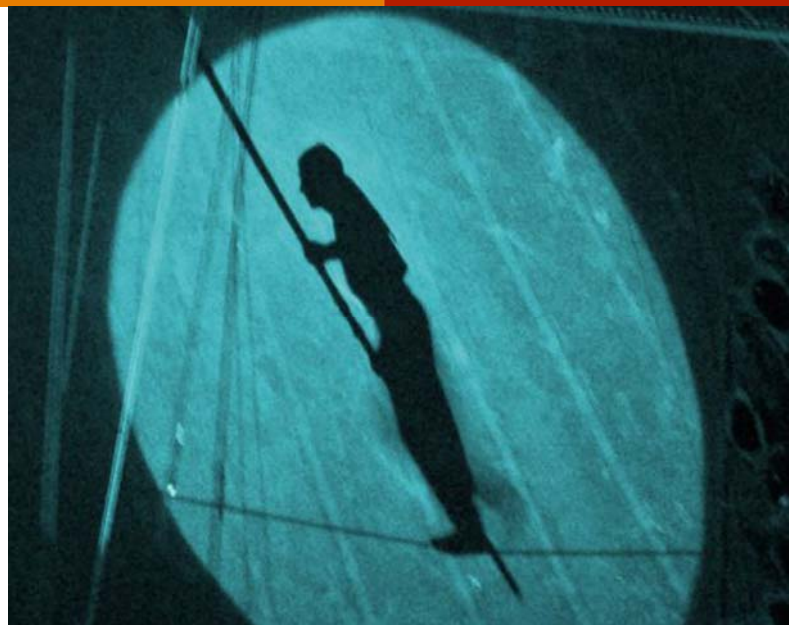
** MSCI World ex Aust Index \$A

Inflation and tight credit markets following the fallout from the credit crunch impacted on global economies throughout the June quarter. Inflation continues to be driven by rising food and energy prices, with oil breaking through the US\$140/ barrel mark and corn up over 100% for the year to June. In credit markets, the repricing of risk continues, with the fallout from the credit crunch still causing difficulties in raising finance and placing stress on local institutions with margin loan exposure. Major equity markets suffered over the year. Of the major regional markets, only Hong Kong's Hang Seng index posted positive returns. Australia was not immune, with the worst financial year results on the stock market since 1982. As was the case last quarter, cash has been the best performing asset class over the last 6 months.

Global Economy

It is a consistent story from the world's largest economy, the **United States**, with indicators continuing to point towards a recession. Falling house prices, rising fuel and food costs and the increasing cost of credit are all slowing US consumption. In April the US Federal Reserve cut interest rates by a further 25 basis points (bp) to 2.00%.

While the slowdown of the US economy continues, the developing economies of Asia are expected to continue their growth story, albeit at a slower rate. The International Monetary Fund predicts that the extent at which these developing economies continue to grow will



A delicate balancing act: stimulate or restrain?

be more than four times greater than the pace of growth in developed economies.

Commodity prices maintained their trend growth, with oil continually hitting record highs during the second quarter as it pushed through \$140/barrel. The price of some base metals was lower over the financial year; however, precious metals and food prices increased over the period. The continuing influence of China on demand for resources will be key to determining whether the increasing price of resources is a trend, leading to a correction, or a shift caused by a permanent move in demand.

The appreciation of the Euro is contributing to concerns over levels of inflation in **Europe**, where the European Central Bank (ECB) expects growth to slow throughout the remainder of 2008. The Bank of England (BOE) continues to cut rates in the **UK**, with similar fundamentals to Europe playing out, as concerns about falling house prices, slowing retail trade and continued decline in consumer sentiment drag on the economy. The continued rise in the value of the Yen vs USD is contributing to the softening of the domestic economy in **Japan**. **China** and **India** are both expected to lead the developing Asian economies, with robust growth forecasts on the back of large foreign reserves; these should help withstand the slowdown in the larger G7 economies.

Domestic Economy

Significant risks to continued domestic growth remain in the form of rising inflation, tightening credit market conditions, food and energy price increases and the threat of the slowdown in developed economies.

Low unemployment and high participation rates have been sustained, supported by strong economic figures as the risks to growth are yet to have a major material impact on the domestic economy. Growth has remained strong, with GDP at 4.2% (above the targeted long-term level for the RBA), on the back of continued demand from Australia's major trading partners. As the RBA tackled the dilemma of attempting to slow the economy to a manageable level without plunging into a sharp slowdown, rates were held at 7.25% through the quarter. Commentary emanating from the RBA suggests the battle with inflation remains a key challenge, and further rate rises are still possible in the near future.

After gains in April and May, the domestic equity market finished the quarter down 1.7% after a difficult June. As the impact of the credit crunch and inflationary pressures from rising input prices continue to be played out, the financial year on the ASX was notable for the disparity between Industrial and Resource sector performance. For the year to June the Resources sector outperformed the Industrial segment by 54%. The next round of company reporting will provide further insight into the impact of the deteriorating global outlook on profit margins in Australia.

Outlook

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

Recommended Asset Allocation Weightings

Lonsec Tactical Asset Class Positions - July 2008	
Aust Equity	Slight Underweight
Global Equity	Neutral
Property	Slight Underweight
Aust Bonds	Neutral
Global Bonds	Slight Underweight
Cash	Very Overweight
Alternatives	Neutral

Australian bonds seem reasonable value relative to Australian equities and international bonds. Bond prices range from 6.5% for 10 year bonds to 6.8% for three year bonds; however, both yields are lagging the official cash rate of 7.25%.

This quarter Lonsec is maintaining a "slight underweight" bias to Property. This is consistent with our view to move back to a neutral allocation over the course of 2008. The listed property market has now fallen around 40% since early November 2007 and is showing signs of becoming fair value. Lonsec prefers entering this space through quality 'plain vanilla' property listings.

Lonsec continues to have a "slight underweight" bias to Australian Equities, maintaining its belief that the AUD has more downside than upside from these levels and that, coupled with the uncertainty over earnings globally, the unhedged International Equity weighting may well outperform the Australian Equity weighting. The overall effect is that the 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 the Quarterly Outlook.

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

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

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

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

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

High Growth

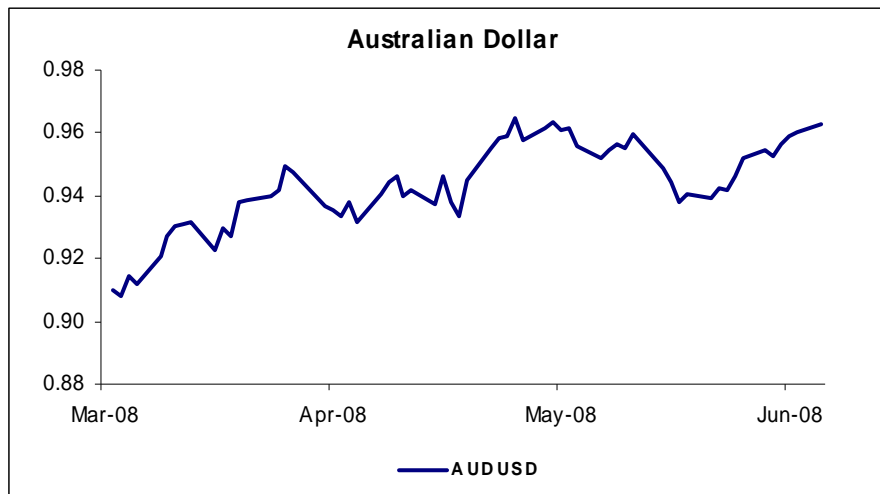
	Benchmark	Ranges	TAA position	+/-
Aust Equity	41	27-55	38.5	-2.5
Global Equity	39	26-52	39.0	0.0
Property	10	7-13	9.5	-0.5
Aust Bonds				
Global Bonds				
Cash				
Alternatives	10	0-20	13.0	3*
Total	100		100	0

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

Sector Overview

Asset Sector	Sector Summary
Cash	With a defensive stance being taken this quarter, Lonsec remains “ very overweight ” cash
Australian Fixed Interest	Lonsec has an unchanged “ neutral ” view on Australian fixed interest. Lonsec believes that 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 a “ slight underweight ” weighting. Lonsec notes that, while bonds yields have increased, the spectre of inflation remains ever-present and is forcing real yields close to zero.
Australian Shares	Lonsec has decided to maintain its “ slight underweight ” position due to the highly concentrated nature of the Australian market, which is heavily reliant on the performance of the Resources sector and Financials sector
International Shares	Lonsec maintains a “ neutral ” asset allocation to international equities, believing that this asset class provides a more diversified exposure to growth assets, relative to Australian equities.
Property Trusts	This quarter Lonsec is maintaining a “ slight underweight ” bias to Property. This is consistent with our view to move back to a neutral allocation over the course of 2008.

Australian Dollar



Source: Lonsec, Data source: RBA

Review of Quarter

The Australian dollar (AUD) rose by 4.9% against the US dollar (USD) in the June quarter, closing at US\$0.9626 (US\$0.9180 at the end of March *Source: RBA*). This follows a rise of 4.1% in the March quarter. Against the Trade Weighted Index, the AUD appreciated by 6.5%.

The AUD strengthened against all major currencies across the board in April, as concerns for a global slowdown subsided and markets speculated that the worst of the credit crunch was over. The AUD began April at its monthly low on the back of the RBA's decision to leave rates on hold at 7.25%, indicating it was in 'wait-and-see' mode. Despite some disappointing domestic economic data (February retail sales, trade deficit and housing finance), USD weakness supported the AUD in early April. Gains in commodity prices and a strong Chinese Q1 GDP report (strengthening arguments for 'decoupling') boosted the AUD mid-month, with a stronger-than-expected Q1 domestic CPI report and a rate cut by the US Federal Reserve pushing the AUD higher toward the end of April, closing at US\$0.9337.

The AUD posted broad-based gains against major currencies during May. Disappointing economic data (March building approvals and Q1 retail sales) saw the AUD fall to its monthly low of US\$0.9318 on May 2. Encouraging US economic data (smaller-than-expected decline in non-farm payrolls), prompted an improvement in risk appetite, benefiting the AUD. Strong domestic economic data (Q1 house prices, April job advertisements and an improvement in the March trade balance) also supported the AUD. A hawkish speech by RBA Governor Stevens on inflation (May 15) and the Board's May meeting minutes (May 20), which indicated that the choice between raising rates and leaving them on hold had been close, coupled with the release of more Australian government bonds and announced withholding

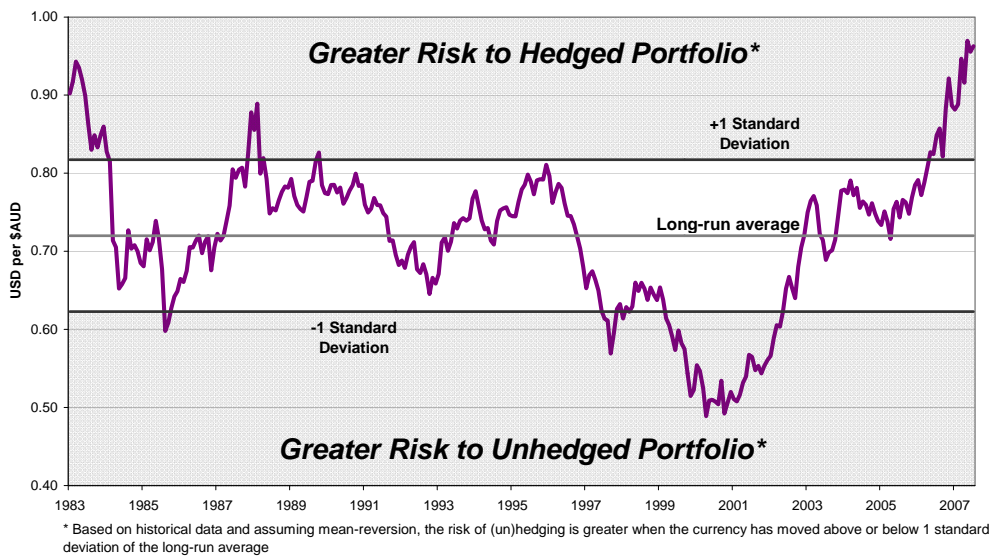
tax changes to state government bonds, fuelled demand for the AUD. On May 21, the AUD reached an intra-day post-float high of US\$0.9654. These gains were consolidated for the remainder of May, with the AUD closing at US\$0.9559.

The AUD had mixed performance against major currencies in June. Domestic economic data released early in the month generally showed the resilience of the Australian economy to the credit crunch, providing support for the AUD. After leaving rates on hold (June 3), RBA Governor Stevens reiterated the need for a tight monetary policy setting to combat inflationary pressures stemming from Australia's strong terms of trade (June 13), providing a boost for the AUD. USD weakness continued throughout June, with a disappointing rise in the unemployment rate (June 6) and markets increasingly pushing back their pricing for US Fed rate hikes, weighing on the USD. After touching a 25 year intra-day high of US\$0.9668 on June 30, the AUD finished the quarter at US\$0.9626.

The above chart shows the performance of the AUD during the June quarter. As can be seen, the AUD traded between a range of US\$0.9079 and US\$0.9644 during the quarter.

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 June quarter at US\$0.9626, representing approximately 2.5 standard deviations above the long-run average since December 1983.

Exchange Rate
December 1983 to June 2008



Outlook

The Australian economy is expected to slow sharply to low growth levels, the major risks being inflation and any major slowdown in Asia. While the March quarter national accounts grew at a solid pace of 0.6% (3.6% on the rolling year), the economy is currently facing a number of strong headwinds including: a global credit crunch that has markedly tightened credit conditions; domestic capacity constraints and sharply rising food and energy prices that are combining to feed inflation; and a slowdown in the global economy.

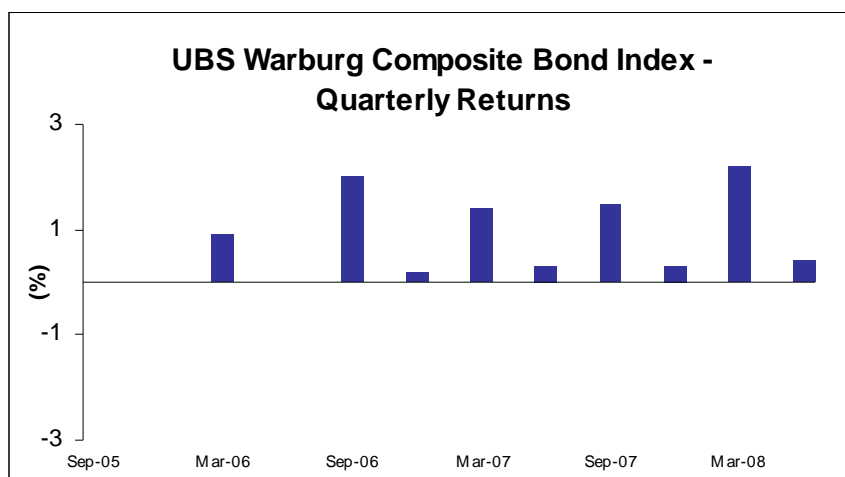
On the positive side, strong demand and rising prices for Australia's key exports (iron ore, coal, gold, crude oil, LNG, base metals, wheat and beef) continue to boost Australia's GDP and terms of trade. The Federal Government's fiscal position has also been boosted; the most recent budget forecast is for a \$20bn surplus (2% of GDP). With 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, 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 1.95% for the June 2008 quarter. Over the 12 months to June 2008, the cash market returned 7.34%. The official cash rate stands at 7.25% and 90 day bank bill yields fell 2 basis points, closing the quarter at 7.84%.

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 returned a miserly 0.4% for the June 2008 quarter lagging the cash return of 2.0%. There were few monetary policy changes in the major developed economies (see below), although there were many statements from officials to temper and lead markets. Credit markets continue in their distressed state, with few new issues coming to primary market and secondary market trading still remaining difficult.

Monetary Policy

The Reserve Bank of Australia (RBA) did not tighten monetary policy further during the June quarter, maintaining the benchmark rate at 7.25%. Data released during the quarter suggested that the previous interest rate increases were having the desired economic cooling effect, although there were some mixed signals.

The Federal Reserve (the Fed) in the US continued to take action during the quarter in an effort to support economic growth by reducing the cost of money (reducing the benchmark federal funds rate by 25bps to 2.00% in April 2008). Notwithstanding, towards the end of the quarter the Fed appeared to have turned its attention to rising US inflation, bringing the prospect of interest rate rises onto the agenda in the future. However, this stands in stark contrast to the dramatic actions taken in the previous quarter (in recapping: rates reduced by 200bps and the facilitation of the Bear Stearns sale to JP Morgan).

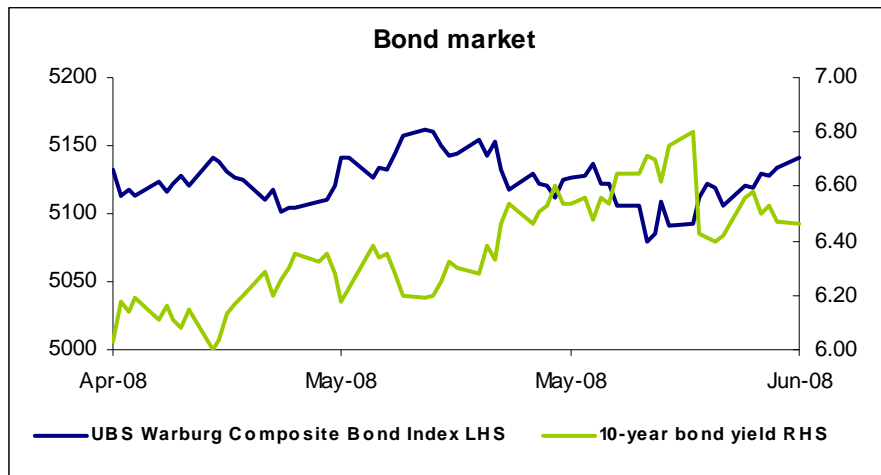
The Bank of England (BoE) also reduced rates by 25bps to 5.00% in April 2008 (and maintained the status quo in the subsequent two meetings in the quarter), having similar aims to the Fed. By contrast, the European Central Bank (ECB) has made it clear to the market that it is more concerned with inflation, albeit without moving the benchmark rate from 4.00% during the quarter.

In Japan, the Bank of Japan has maintained the benchmark rate at 0.50%.

It is becoming increasingly clear that the central banks mentioned here are taking actions based on two very divergent views of their economies, while receiving similar mixed signals on the state of their own and the global economies. Some are taking steps to curb domestic inflation and cool growth (e.g. ECB and RBA) and others are supporting their domestic economies (e.g. the Fed and BoE).

Credit Markets

Credit markets have continued to be strained during the quarter, despite the promise of better times that the Bear Stearns sale brought to the market. Persistent negative views weighed on participants, including ongoing speculation about the potential for demise of another prominent Wall Street firm, in this case Lehman Brothers. The ever-increasing price of oil (irrespective of whether it is driven by fundamentals or speculators) drove down confidence in the US (and global) economy—which, while it may be better for sovereign debt from a security of capital perspective, augers poorly for credit. 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 very wide in Australia and across the globe.



Source: Lonsec Data Source: IRESS

Bond yields traded within a 92.5bps band over the quarter, peaking at 6.8% on 16 June 2008 and finishing at 6.46% for the quarter. The sharp fall following the peak was attributed to changing interest rate expectations in the US and Europe (tightening bias) as well as increased demand for 'safer' assets. Australian fixed interest generally 'treaded water' for the quarter. The index only moved 9.1 points from the opening and closing days of the quarter, or up 0.4%, and traded within a narrower band than in the previous quarter.

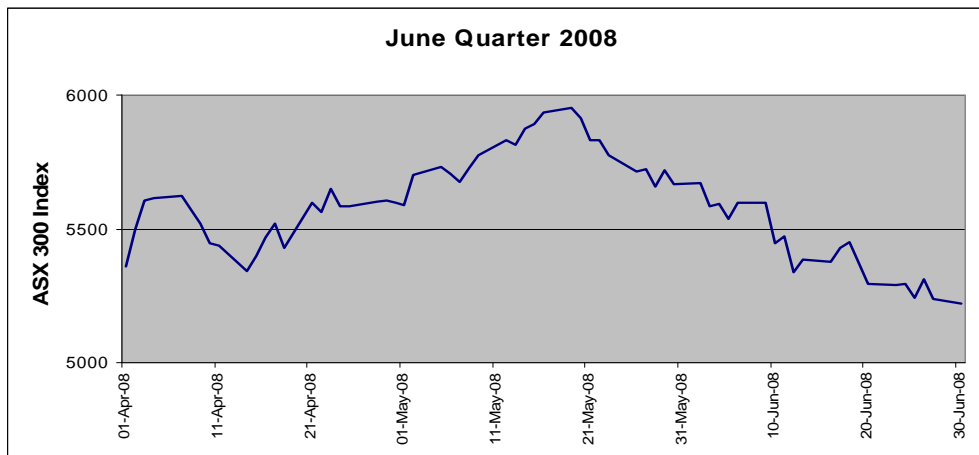
Fixed Interest Outlook

Lonsec believes that the RBA is likely to keep rates on hold, at least in the short term, and that it is near the top of its tightening cycle. Lonsec suspects that a cut may not be forthcoming until late 2009 as inflation fighting remains the key priority. Globally, the Fed appears to be in a bind: the economy is slowing but inflation is ticking up—a situation otherwise known as 'stagflation'. The ECB has followed through with its anti-inflation rhetoric, and increased the benchmark rate by 25bps early in July to 4.25%. Credit markets remain harried and spreads continue to be very wide.

Portfolio Action

Lonsec has an unchanged view for an 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 more 'bearish' with respect to international fixed interest and recommends a '**slight underweight**' weighting. Lonsec notes that, while bonds yields have increased, the spectre of inflation remains ever-present and is forcing real yields close to zero.

Australian Shares



Source: Lonsec, Data Source: IRESS

Review of Quarter

The Australian share market posted positive returns for the months of April and May, but finished the June 2008 quarter in negative territory, with the S&P/ASX 300 Accumulation Index falling 1.7% for the quarter. Over the 12-month period ending 30 June 2008, the S&P/ASX 300 Accumulation Index returned a negative 13.7%, which was the share market's worst performing financial year since 1982.

Many of the factors impacting on the Australian share market in the March quarter were again the key drivers for its declines over the June quarter. The Australian share market continued to suffer headwinds stemming from the ongoing global credit crunch, a slowing US economy and inflationary pressures caused by rising food and energy prices. The overall decline in the share market, however, was partly offset by the strong performance of the resource sector, with many resource companies the better performing stocks over the last 12 months. This was highlighted by the year-end divergence in returns between the resource and industrial sectors, with the S&P/ ASX 200 Materials Index gaining 18.1% for the year versus a decline of 36.5% for the industrials sector (as measured by the S&P/ASX 200 Industrials Index). While BHP Billiton and Rio Tinto again contributed to a large part of the gains in the resource sector, a number of small to mid cap stocks also performed very strongly on the back of record high commodity prices and merger and acquisition activity. In contrast, the industrials sector was severely hampered by cost pressures and earnings downgrades across a broad range of stocks including, for example, Qantas and Asciano Group.

In a sign of a slowdown in consumer spending, retail sales declined in April and, despite inflation remaining above the RBA's stated target range, interest rates remained on hold during the quarter at 7.25%. Going

forward, the RBA will need to carefully juggle the risks associated with rising inflation while at the same time ensuring that the economy is not headed for a major slowdown.

The Australian share market outperformed two of the four major international regions (in local currency terms) during the June quarter, with the regional markets of Asia and Europe posting returns of -4.6% and -3.6% respectively. The Australian share market underperformed the regional markets of the US and Japan, which delivered returns of -1.2% and +9.1% respectively over the June quarter (in local currency terms). Over the 12-month period to June the Australian market (-13.7%) underperformed Asia (-7.7%) and the US (-11.0%), but outperformed the regional markets of Japan (-24.5%) and Europe (-20.1%).

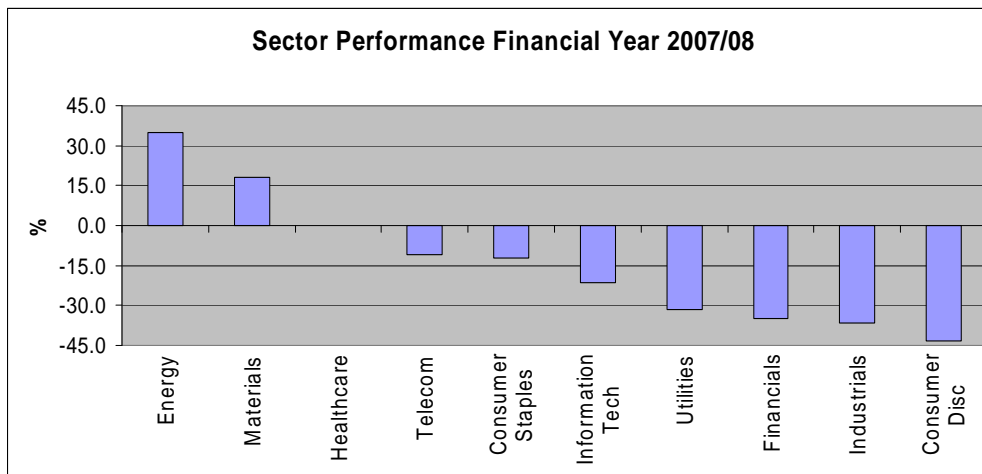
As shown in the chart above, the share market (as measured by the S&P ASX 300 Accumulation Index) began the June quarter positively, rising by approximately 10% to just under 6000 points by the middle of May. The rally was driven by gains in a narrow universe of stocks (predominantly resources) and corporate takeover activity which included QBE's offer for IAG, BG Group's offer for ORG and WBC's offer for SGB. The rally, however, proved to be short-lived as investors became increasingly concerned about slowing economic growth and the threat of rising inflation. In particular, a surging oil price that reached record highs of over \$US140 a barrel increased concerns about inflation and the earnings outlook for the market. From its intra-quarter peak on 19 May 2008, the share market subsequently fell by approximately 12% to end the financial year well into negative territory, and reversing the trend of the previous four years, during which the share market returned positive double-digit returns each year.

Stock Performance

Over the 2008 financial year the five best performing stocks within the ASX top 50 (in terms of share price movement) were Fortescue Metals (+252.0%), Incitec Pivot (+132.1%), Origin Energy (+62.2%), Oil Search (+61.9%), and Sims Group (+57.3%). Fortescue Metals was a standout performer, having announced during the period that it had transported the first train load of iron ore from its Pilbara project in Western Australia to port. Incitec Pivot, which is involved in the manufacture, distribution, and sale of fertiliser and industrial chemicals, benefited from rising fertiliser prices that lifted its profits. The company's share price hit the \$200 mark during the quarter.

Conversely, the five worst performing stocks within the ASX top 50 (in terms of share price movement) over the financial year were Goodman Group (-54.0%), GPT Group (-52.4%), Transurban (-47.2%), Qantas (-45.7%), and Tabcorp (-42.8%). Goodman Group and GPT were both generally impacted by the negative sentiment towards REITS, whilst Qantas was sold down because of profitability concerns due to the escalating oil price. Even Tabcorp, which has traditionally been a relatively defensive stock, recorded significant falls in its share price following the announcement that it will lose its duopoly Victorian gaming license from 2012.

Sector Performance



Source: Lonsec Data Source: AFR/Bloomberg

As can be seen from the chart above, the Energy and Materials sectors were the standout performers in the Australian share market over the course of the financial year. The Energy sector, which returned +35.0% for the financial year, was clearly the best performing sector, ahead of the Materials sector (+18.2%) and a relatively flat Healthcare sector (-0.1%). Origin Energy (ORG) is an example of a stock that contributed to the gains in the Energy sector. The company received a takeover offer from BG Group (subsequently rejected by the board), which helped contribute to ORG's 62% gain for the financial year. Other positive performers within the Energy sector included WPL and OSH, which continued to benefit from the rising oil price and their exposure to liquefied natural gas (LNG). The Materials sector was the next best performing sector of the market during the financial year, reflecting the overall dominant performance of resource-related companies. BHP Billiton and Rio Tinto (the two largest stocks in the sector) contributed a large part of the sector's gains, returning +24.7% and +37.1% respectively. The Consumer Discretionary and Industrials sectors lagged the rest of

the market over the course of the financial year, returning -43.2% and -36.5% respectively. A downturn in consumer spending negatively impacted on retailers in particular. Harvey Norman (HVN) and David Jones (DJS) fell 41.5% and 49.5% respectively. In the Industrials sector, increasing cost pressures and uncertainty over the earnings outlook contributed to poor performance.

Outlook

Lonsec remains cautious on the outlook for the local share market (and growth assets in general), believing that short-term sentiment is likely to remain negative—the key risks being inflation and a slowing global economy throughout the rest of 2008. The Australian economy has already shown signs of slowing, with building approvals and retail sales declining over the first half of 2008. In light of these factors, the Australian economy is expected to slow sharply over FY09, to about 2.5% (from a current rolling March 2008 pace of 3.6%). Despite the expected slowdown, the major positives remain the strong demand and rising commodity prices for Australia's key exports to

developing countries, particularly Asia. Therefore the full extent to which Australia will be affected by slowing global growth will be based on the degree to which the demand from developing countries (Asian regions) outweighs the reduction in demand from developed countries (such as the US).

Lonsec expects share market volatility to continue until inflationary pressures have abated and a clearer picture can be painted for a recovery in the US economy. Lonsec believes that in general the market as yet offers no real compelling value and recommends a cautious strategy of dollar cost averaging on any major weakness with a long-term view. Lonsec expects the market to trade within a range of 5,000 to 5,800 points over FY09.

Overall, Lonsec believes the outlook for growth investments (including Australia shares) is one of generally falling earnings and valuations (especially outside the Resources sector). In the Resources sector, Asian growth and, hence, the demand for exports is likely to slow but remain robust, and the sector is expected to deliver 10-15% EPS growth. The additional risks in this sector are rising production costs and a stronger AUD.

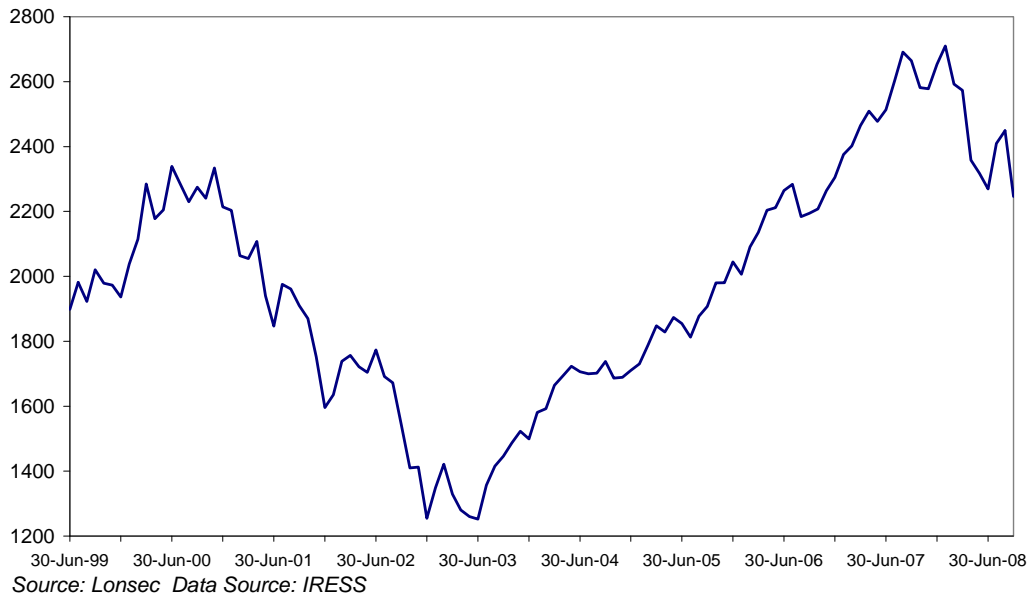
Within the Industrials sector, most companies are expected to struggle to deliver earnings growth over FY09. Lonsec therefore favours the defensive sub-sectors of consumer staples, telecommunications, health and gaming. In the financials sector, Australian banks seem to be in better financial shape relative 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.

Portfolio Action

In Australian equities, Lonsec has decided to maintain its 'slight underweight' position due to the highly concentrated nature of the Australian market, which is heavily reliant on the performance of the Resources sector (31% of the market) and Financials sector (30% of the market). In addition to the current inflationary risks, Lonsec has some concerns over the possible retraction in commodity prices should the US slowdown materially impact on the growth of the developing Asian region.

Global Equities

World Equity Market Performance (Local Currencies)



Review of Quarter

Over the quarter, International shares fell by 6.4%, as the majority of regional markets (US, Europe, and Asia) experienced losses (in local currency terms). Japan was the only region to produce a positive quarterly result—in stark contrast to the other regional markets and Japan's own recent track record. The second quarter of 2008 was the fourth consecutive negative quarter for International shares, with the one year result (ending June 2008) being -21.5%. The Australian market (S&P/ASX 300 Accumulation Index) returned -13.7% over the same period.

Performance across regional markets for the 12 months to the end of June 2008 has generally been negative. In last quarter's report, Asia was the only market with a positive 12 month result, but now even Asia has slipped into negative territory with a return of -7.7% for the past year. As has been the case for some time, Japan continues to experience the most severe contraction, falling by 24.5% for the year, followed by Europe at -20.1% and the US at -11.0%. The difference between the best performing region (Asia) and worst (Japan) in local currency terms for the 12 months ending June 2008 was 16.8%. In last quarter's report the difference between these countries was 36%, so although the difference remains considerable, it is less pronounced than for last quarter.

The Australian dollar had a strong quarter against the major currencies and, as has been the case for some time, the rising currency movements continue to impact investors returns depending on whether they have been hedged or unhedged. Over the quarter the AUD continued to strengthen against the weaker USD (4.9%), GBP (4.8%), JPY (11.3%) and the EUR (4.9%).

The last year has proved positive for the AUD against the USD (rising by 13.4%), reflecting the continued strength in commodity markets, a factor traditionally supportive of the AUD. The AUD also rose strongly against the GBP (+14.0%) while retreating slightly against the JPY (-2.6%) and the EUR (-3.4%) over the 12 month period.

United States

US shares fell by 1.2% for the three months to the end of June 2008. The dominant theme continuing to weigh on Wall Street remains the depth and length of the US economic slowdown, evident in continued weak economic data and deepening credit market concerns flowing on from the sub-prime crisis. US debt levels remain high and the process of de-leveraging and reducing these levels will not be without hardship. Decreased spending and falling asset prices would suggest that a period of low growth or recession is inevitable before a turnaround is achieved.

Although the US Government has released a \$146bn fiscal stimulus package and the US Fed has provided new liquidity measures for the US Banking system in addition to progressively cutting the Fed Funds rate (now at 2.0%), rising concern about inflation has led the market to expect rate increases going forward.

Europe

European share markets as a whole fared worse than their US counterparts, falling by 3.6% for the quarter. Returns for France (CAC 40), Germany (DAX) and the UK (FTSE) have all been negative over the last 12 months.

Japan

Japanese shares increased by 9.1% for the quarter. Several catalysts drove heavy buying by foreign investors, particularly in the large cap arena. Specifically, Japan's strong relative performance, combined with many global investors being underweight in Japan and a building of consensus opinion that Japanese large-cap shares are currently very cheap on a historical basis. This positive sentiment did not flow through to the higher risk small and mid cap markets.

Asia

Asian shares declined 4.6% for the quarter, in line with the performance of the majority of other regional markets. While Asian share markets have held up relatively well over the last year, recent results would indicate they will not be immune to the market turmoil.

Outlook

Rising pessimism continues to dominate the business environment and financial markets. Inflationary worries, increasing energy costs, difficult credit markets and the US housing market recession leave very little on the horizon to be positive about.

The International Monetary Fund has revised global growth figures down further, with the expectation that global growth will slow to 3.7% over 2008 and 3.8% over 2009.

United States Outlook

Given US consumption makes up nearly 70% of US GDP, a slowdown in US consumption would have a major impact on the economy. There is widespread concern that tightening credit conditions, falling house prices and rising petrol prices will do just that, and recent consumer sentiment figures plummeting to recessionary levels would suggest that US consumers are being squeezed. Recent earnings announcements by US corporates have been closely linked to the nature of underlying demand—that is, whether demand has been predominantly domestic or global. Companies that have strong demand for their products and services from emerging markets or revenue sourced from outside the US have fared much better than companies driven primarily by US domestic consumption.

At the Fed's last meeting, rates were kept steady, although worries about inflation may compel the Fed to raise rates later in the year. The impact of a potential increase in rates on the debt-laden and already struggling consumer (via what is paid on mortgages and other forms of credit) will present the Fed with a significant balancing act.

Europe Outlook

The general outlook in European markets remains subdued, given the prospect of slower eurozone economic growth, rising inflation, continued tightness in credit markets, and the prospect of recession in the US. European growth is expected to moderate in 2008 to approximately 1.8%. In early July 2008 the ECB decided to raise the borrowing rate by 0.25% to 4.25%, primarily due to rising inflation. The ECB has stated that their emphasis is on keeping medium- and long-term inflation expectations firmly anchored in line with price stability. However, the market expects that the deteriorating global outlook will see the ECB soften its tough stance later in the year.

UK growth is expected to slow to 1.4% over 2008 while inflation is expected to rise towards 3.0%. The Bank of England (BOE) reduced rates twice in the earlier part of 2008 on concerns about falling house prices, slowing retail trade and falling consumer sentiment. The BOE is not unlike many other central banks, where the tug of war between rising inflation and declining growth is becoming an increasing dilemma. Although the BOE has held rates steady over the last few months, it is expected the BOE may have to re-consider inflation as a priority over growth in coming quarters.

Japan Outlook

The BOJ last met in mid June 2008, where rates were kept steady—rates have now remained unchanged since February 2007. However, the BOJ has cut its economic growth forecasts, and has predicted that inflation is set to increase. Macro-economic data for Japan is showing evidence of a continued slowdown of the economy. Industrial production has been weaker than expected, household spending has been weaker and the jobs-to-applicant ratio has also recently fallen to a three-year low.

Asia Outlook

Although prospects for the Asian economies remain more positive than in the majority of other regions, and are likely to remain at more impressive levels compared to developed economies, growth is expected to slow. However, the outlook is not rosy for all economies—for example, there are countries that are more heavily reliant on US trade and are therefore more vulnerable to the effect of a US recession.

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.

Portfolio Action

Lonsec maintains a **'neutral'** asset allocation to international equities, believing that this asset class provides a more diversified exposure to growth assets relative to Australian equities. In addition, the AUD is trading well above its long-term average versus the USD, thereby presenting the potential for upside risk to unhedged global equities should the AUD fall to levels closer to its long-term average.

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 to remain volatile for the second half of 2008. Certainly the continued decline in equity valuations may prove tempting for investors perhaps sitting on the sidelines and keen to consider a more fulsome allocation in global equities. Once again, Lonsec believes 'calling the bottom' is fraught with danger. Rather, Lonsec continues to recommend investors ensure appropriate balance of 'value'/'growth' style investments within portfolios to ensure that they have appropriate opportunity to participate across the market cycle.

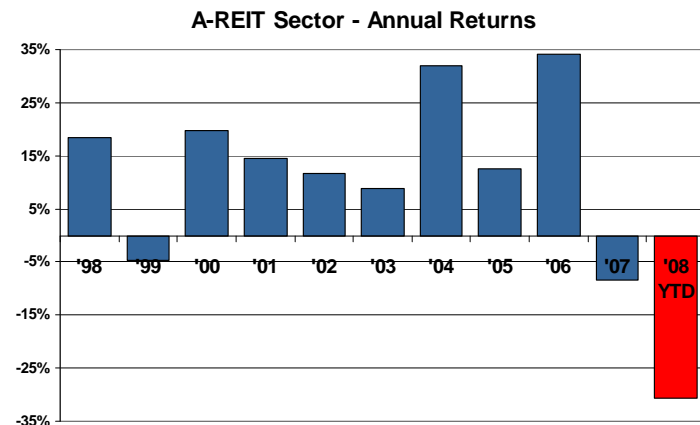
Traditionally, emerging market equities have performed poorly in times of global uncertainty, and there has certainly been a return to more traditional volatility levels in this asset class. In times of economic decline, capital has tended to flow out of this segment of the investment spectrum into perceived safer securities (witness the recent uptick in the gold price). It remains to be seen whether regional equities will continue to weaken in line with their developed peers or, instead, provide some moderate outperformance. To date, despite the improved economic resilience of these economies, there is scant evidence of economic decoupling. 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)

Overall the S&P/ASX 300 A-REIT Accumulation Index posted a total return for the June quarter of -15.8%, which represents a significant underperformance of the broader equity market. This brings the Australian REIT sector's 12 month total return to -37.7% p.a.

The fall seen by the A-REIT sector over the six months to June 2008 is larger than any previous annual reduction seen by the Australian listed property securities sector. The following chart highlights the extent of this fall and compares it with the sector's annual returns over the previous ten years.

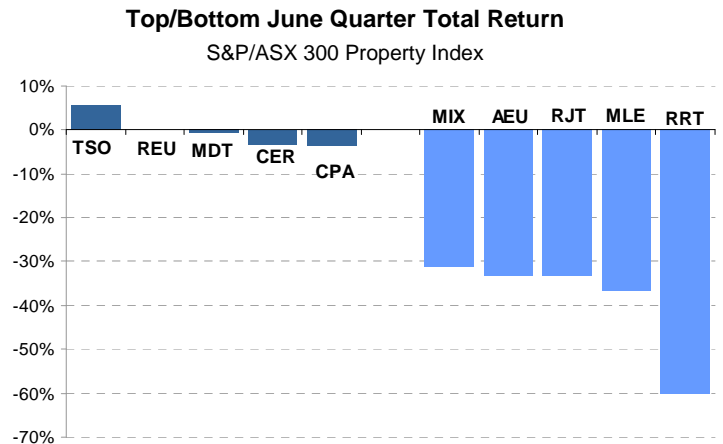


Source: IRESS and Lonsec

There was a clear divergence of returns for the June quarter between high quality, well-capitalised vehicles such as **Commonwealth Property Office Fund** (-3.6%) and the lower quality, highly geared companies like **Record Realty** (-60.0%).

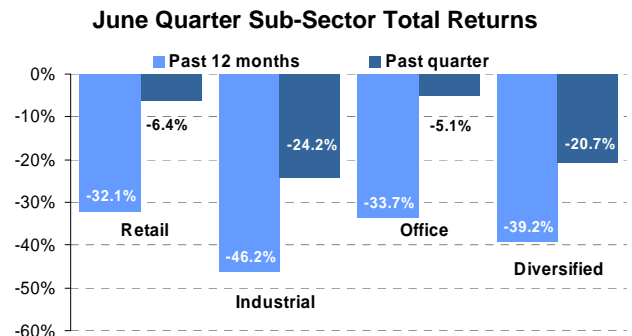
The best performing A-REITs were **Tishman Speyer Office Fund** (+5.8%), **Rubicon Europe Trust** (0.0%) and **Macquarie DDR Trust** (-0.88%). On the flip side, A-REITs with the worst returns for the quarter included **Record Realty** (-60.0%), **Macquarie Leisure** (-36.6%) and **Rubicon Japan** (33.3%).

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



Source: IRESS and Lonsec

All sub-sectors recorded negative total returns over the June quarter, with Retail returning -6.4%, Industrial (-24.2%), Office (-5.1%), and Diversified (-20.7%). The retail sector was the best performer, down -6.4% on the back of the **Westfield Group** holding most of its ground over the quarter. The worst performing sub-sector over the last quarter was Industrial, which was affected significantly by price falls in the **Goodman Group**, **Mirvac Industrial Trust** and **ING Industrial Trust**.



Source: IRESS and Lonsec

The credit crisis is still affecting A-REITs, with the availability of finance low and borrowing costs higher in the current market environment. The effects of the credit crisis have been particularly apparent for the more highly geared A-REITs, or those holding lower-quality assets.

Reducing property valuations are increasingly becoming an issue, with valuation capitalisation rates now on the rise. Of note was **Mirvac Group**, which very recently declared a \$300-\$400m write-down of assets and a downward revision of earnings.

A-REITs with lower quality assets, particularly those with exposure to the US and to some extent Europe/UK, continue to demonstrate pricing pressure. This is because investors are concerned that significant valuation

reductions may have the potential to see some A-REITs with loan to value-based debt covenants breach their lending agreements.

In addition, A-REIT distribution policies have come under fire, with those paying out more than their free cash flow being severely punished. A-REIT managers with prudent capital management have been rewarded for cutting distributions or holding back on distribution reinvestment plans.

A recent shock in the sector was the **GPT Group's** massive downward earnings revision of 27%, coming only six weeks after having released an upbeat operational update. The earnings downgrade was driven by GPT's exposure to development and funds management businesses and highlights the potential pitfalls of these higher risk businesses in this type of environment.

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

A-REIT Sector Metrics		
Forward Sector Yield		8.5%
Average Property Yield		9.81%
Gearing		33.73%
Premium/(Discount) to :		
	NAV	(25.5%)
	NTA	(1.4%)
	DCF	(25.6%)

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 improved capital management.

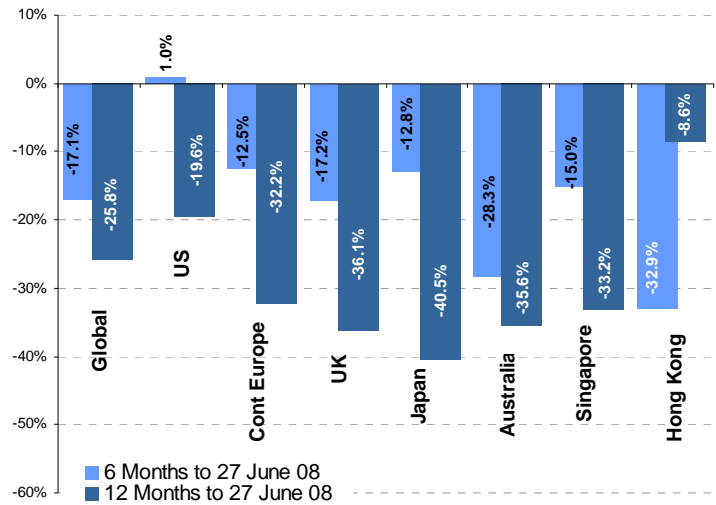
The Australian direct property market has not come under significant pricing pressure when compared with what has occurred within the A-REIT sector. Hence, investing in A-REIT's now appears to be a cheaper way to gain exposure to the property market.

Global Real Estate Investment Trusts

According to the UBS Global Real Estate Index, global listed real estate returned -23.4% in Australian dollar terms over the 12 months to June 2008. During this period, all regions delivered a negative return.

Japan was the worst performing region, delivering a total return (in local currency terms) of -40.5% over the year to 27 June 08. The best performing region over this timeframe was Hong Kong, which delivered a disappointing return of -8.6% in local currency terms.

Global Listed Property Performance – June Quarter
UBS Global Real Estate Investors Index – Local Currency



The global property sector's returns have continued to be impacted by concern over the credit crisis, which has seen the availability of finance decrease and debt become more expensive. Investors are now more than ever focussing on property stocks' balance sheet health rather than fundamental valuations.

Investors continue to be concerned over direct property market valuations, with many market participants now expecting property valuation reductions across the developed world. Whilst talk of increasing yields (via falling property values) has been occurring for almost a year now, there is still insufficient transactional evidence at this stage to confirm the extent to which this may have occurred.

In addition to factoring in lower property values, investors are reducing their expectations of rental and hence distribution growth of many listed property stocks/REITs.

A US/European recession, rising global inflation/interest rates and further corporate collapses would drive further downward pressure and volatility in the global property securities sector over the short term.

Despite fundamental reasons justifying a reduction in listed property company/REIT valuations throughout the world, the market has also been plagued by significant negative sentiment, which has seen price falls materially exceed fair market valuations. While there may be further pain in the short term, the sector is beginning to look attractive on most valuation measures, particularly for REITs invested in a diversified portfolio of quality assets and low gearing.

Outlook

It is difficult 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 would see the global property securities sector come under further pricing pressure.

In particular, if values in the direct property market fall significantly, a material reduction in net asset values (NAVs) could see the global property sector experience further pricing pressure and negative sentiment

Looking ahead, the global property sector can achieve long-term total returns of 10%+ per annum, comprising a distribution income yield of approximately 4% and the rest capital growth. Given the volatility in the sector, it is quite possible that global property will not see this type of return over 2008.

The length of this downturn will be largely a function of the strength of the European and US economies and how the credit crisis plays out. However, post the negative sentiment, over certain periods the global property sector may experience significant price growth as it rebounds to more realistic levels.

The domestic property market is likely to continue to correct as a result of the fall in asset values and

deteriorating credit markets. A-REITs with unsustainable payout ratios are expected to announce earnings downgrades. 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

This quarter Lonsec is maintaining a "slight underweight" bias to Property. This is consistent with our view to move back to a neutral allocation over the course of 2008. The listed property market has now fallen around 40% since early November 2007 and is showing signs of becoming fair value. Lonsec prefers entering this space through quality 'plain vanilla' property listings.

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