Managed Funds Report 2009–10

The Risks and Rewards of Emerging Markets Investing

by Zac Wallis, Research Analyst

Investing in the emerging markets offers substantial potential rewards over the longer term – but big short-term risks as well.

Emerging markets investment strategies are receiving increasing attention as investors seek to tap into the fast-growing economies of the developing world. The performance of many of these offerings undoubtedly also has a lot to do with it. The standard benchmark of emerging market investing, the MSCI Emerging Markets Index, was up about 20.0 percent in A$ terms over the year to 31 May 2009 compared to the Australian sharemarket's more modest five percent.

These gains were due in part to investors rediscovering their appetites for risk, and in part to these strategies' sharp falls in the late 2007 to early 2009 global meltdown, which gave them plenty of room to bounce back. Outperformance in 2009 was also due to investor excitement about improving macroeconomic conditions in the developing world. And most of the developing world's economic advantages over the developed world, such as higher GDP growth rates and healthier demographic conditions, are expected to persist for years to come. This is all encouraging, and a moderate level of emerging markets exposure makes sense for many long-term portfolios, but you should approach this asset class with your eyes wide open.

Enough Exposure Already?

The first thing you should do is determine how much emerging markets exposure you already have. The average emerging markets exposure of the international share funds we cover is approximately four percent of assets. But there are funds with substantially greater exposures. **Advance International Sharemarket**, **DWS Global Equity Thematic**, **Perennial Global Shares High Alpha**, and **Platinum International** are funds which have consistently had substantial minority allocations to the developing world. As fund managers are buying more or adding to their existing emerging markets holdings, you may already have some exposure to the developing world, even if you don't own a separate emerging markets fund.

Big Risks As Well As Big Rewards

If you want more emerging markets exposure, make sure that you fully-understand the explosive nature and volatility of the developing world. This isn't the first time that emerging market offerings have outperformed – they soared in the early 2003 to late 2007 rally, for instance. Because of the dependence of many developing economies on commodity prices, and the sector concentration of most emerging markets, these strategies are extremely volatile and prone to sharp declines in unfavourable environments. They suffered much more than developed international share funds during the late 2007 to early 2009 global downturn, losing almost half of their value as demand for emerging markets materials and products sank and local conditions weakened. This was not an isolated incident, as many emerging markets strategies have suffered significant losses over numerous other periods during the past decade. Emerging markets funds have been able to generate greater returns over the long term than Australian share funds. But at the same time, the emerging market funds' returns have fluctuated to a much greater extent – in other words, their returns have been substantially more volatile.

Choose Wisely

Your first impulse may be to focus on the trendiest developing countries or offerings that leave their competition in their dust during rallies. A cautionary note: single-country emerging markets unlisted and exchange-traded funds are problematic. Single-country emerging market funds can't escape trouble in their chosen market and tend to be concentrated at the sector level, making them more susceptible to significant losses when conditions turn against them. Some regional strategies, such as those that focus on Eastern Europe, have weaknesses similar to those of single-country emerging market funds. (Those in

Continued on Page 2

the Asia ex-Japan category are an exception to this rule because of the number, size, and diversity of markets in their region.) And wider-ranging emerging market strategies that employ very aggressive strategies tend to blow up in tough times, as their styles exacerbate the already significant risks of investing in the developing world.

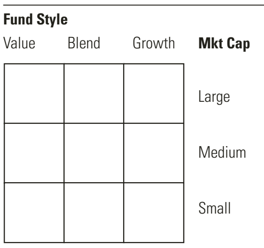
Finally, the extra upside of investing in the emerging markets doesn't always adequately compensate for the extra downside. And even when it does, the exceptional volatility of such strategies may end up being more than you can handle. The best course for most investors is to use a broad emerging markets fund – one which invests across the regions of the developing world – as a supplement to a fund investing primarily in the developed world regions of the United States, Europe, and Japan.

Morningstar's fund research team will soon begin to publish detailed research reports for the funds which invest in the emerging markets and Asia, shown in the accompanying table. Like the other fund research available through our website www.morningstar.com.au, these reports will contain our overall Morningstar Recommendation; the inside story on the fund's investment philosophy, process, and the people running the fund; and how much you'll pay. You'll come away with an in-depth understanding of these funds, and whether and how you should use them in your investment portfolio.

Fund Name	Ticker	Equity Style Box	Launch Date	Net Assets $m	Fee %pa	Return 1 yr %	Return 3 yr %pa	Return 5 yr %pa
Aberdeen Asian Opportunities	10438		20-Oct-03	293.76	1.18	-8.36	2.85	10.35
Aberdeen Emerging Opportunities	11594		01-Jul-04	112.47	1.50	-9.85	5.55	—
Advance Wholesale Asian Equity	11179		18-May-04	12.06	1.25	-14.00	-0.57	—
AMP Capital Asian Equity Growth	17155	—	10-Dec-08	—	1.10	—	—	—
Arrowstreet Emerging Markets	15444		09-Jul-07	169.62	1.48	-23.59	—	—
BT Wholesale - Asian Share	4246		27-Aug-96	188.91	1.00	-15.73	-0.11	8.53
Dimensional Emerging Markets	6468		31-Aug-00	168.55	0.74	-18.10	2.28	12.10
Fidelity Asia	13316		30-Sep-05	14.36	1.15	-22.02	-0.05	—
GMO Emerging Markets	8877		12-Feb-02	490.95	1.25	-27.45	-2.61	11.22
Platinum Asia	9894		03-Mar-03	2710.00	1.54	-1.78	8.42	19.74
Schroder Global Emerging Markets	14838	—	25-Oct-06	58.05	1.35	-19.64	—	—
TAAM New Asia	13432		04-Nov-05	49.60	1.17	-12.85	2.45	—
Vanguard Emerging Markets Shares Index	4743		22-Dec-97	277.97	0.56	-20.33	1.45	12.56

Source: Morningstar.com.au. Performance data to 31-May-09

Key Terms



Morningstar Recommendation
Morningstar Recommendations are decided by considerable debate within Morningstar's fund analyst team. Recommendations are based on the key issues of people, process, and the parent. A number of other issues are also taken into account, including a relative ranking of similar investment styles and approaches.

Morningstar Recommendations for funds with global securities are discussed, when appropriate, with Morningstar's global fund analyst teams. The Head of Adviser & Research has final say in all recommendations and signs off all reports.

Morningstar Rating
The Morningstar Rating for funds is a measure of a fund's risk-adjusted return relative to similar funds. Funds are rated from one to five stars, with the best performers receiving five stars, and the worst receiving a single star.

Morningstar Style Box
Style Box assignments begin at the individual stock level. Morningstar determines the investment style of each individual stock in its database. The style attributes of individual stocks are then used to determine the style classification of stock managed funds.

Role in Portfolio
Role in Portfolio tells you whether a fund is Core, a Supporting Player, or Satellite holding within the sector under review, and whether you need to blend the strategy with other investment styles and strategies. This is a guide only, and is not a recommendation to invest.

Morningstar Take
The Morningstar Recommendation is outlined in the qualitative report's Morningstar Take summary paragraph, which clearly communicates Morningstar's overall opinion of the fund manager's strategy and capabilities in the asset class.

The Ins and Outs of Performance Fees

by Chris Gillings, Associate Analyst

An increasing number of Australian managed funds come with both ongoing management fees and performance-based fees as well. How do these performance fees work, and what are the associated best practices?

We write about fund costs a lot here at Morningstar, usually in terms of a fund's management fee and any performance fee. You'll also find frequent mention of the Indirect Cost Ratio (ICR), a standard way of evaluating ongoing fund costs.

Costs are also a significant element of our Morningstar Recommendation for funds. We pay close attention to expenses for a few simple reasons. First, fees are among the more important factors in determining relative fund performance – they chip away at performance year after year, and their impact compounds through time. Fees (unlike returns) are also largely controllable, and at the fund manager's discretion. In many cases, they can indicate the manager's philosophy about putting the investor first.

The ICR is a representation of the total costs of a portfolio, expressed as a percentage. This includes the ongoing management fee, along with the total indirect fees and costs incurred by investors. ICRs can also include performance fees, which can make the ICR substantially higher. That isn't necessarily bad, but it's worth having a closer look at the pros and cons of these additional charges.

What are Performance Fees?

Performance fees are contingent charges a fund manager levies if a fund outperforms a specified benchmark or 'hurdle rate'. These fees are almost always charged in addition to a fund's annual management fee. (The table on page 5 shows the large-cap Australian share funds which have performance fees, and their hurdle rates.)

To illustrate, let's look at the 'two and 20' fee structure common in the hedge fund world. Under this system, these funds charge a two percent annual management fee and an additional 20.0 percent on any returns that exceed a specified hurdle rate. Although hedge funds have long charged performance fees, they're a relatively recent but growing phenomenon in the universe of retail funds.

We have mixed feelings about performance fees. If structured poorly, performance fees can reward a manager for failing to meet the minimum qualifications for doing their job. After all, active fund managers charge more than their index counterparts because they contend that they can beat the benchmark. Therefore, in some sense, the fund's management fee already includes a charge for assumed outperformance. (Never mind that the average manager has a tough time beating index funds consistently, but that's a subject for another day.)

Still, charging an additional fee for outperformance doesn't have to be a negative. An appropriately-structured performance fee can align a manager's desire to maximise income with its investors' goal of positive long-term growth – without allowing total fees to become unreasonable. Magellan Global, for instance, has a competitive management fee of 1.36 percent (lower than the retail average of just over two percent), and a 10.10 percent performance fee contingent on a double hurdle of outperforming both the MSCI World Total Return Net of Dividends ($A) Index, and the Australian government 10-year bond yield.

Appropriate Benchmarks are Key

Performance fees should reference a benchmark that best represents the fund manager's investible universe, in order to reward a strategy for outperformance of its own asset class. Failure to select an appropriate hurdle rate may reward the fund manager for the performance of its own asset class, or beta – rather than the excess returns generated by the manager.

One example of the latter is Five Oceans World Fund, which has an additional performance fee of 20.0 percent for beating an absolute return benchmark of five percent per annum. (In other words, Five Oceans takes 20.0 percent of any performance the manager achieves above five percent.) If this hurdle is met, the fund manager may receive the performance fee even if falling short of a relevant sharemarket benchmark such as the MSCI World Index by a substantial margin. We view performance fees that reward managers even when they subtract value as poor propositions. A performance fee should reference a benchmark that rewards a fund when its manager adds value, not when inherent strategy biases are in favour.

High Watermarks

Performance fees should also incorporate a high watermark or similar mechanism. The term 'high watermark' refers to a requirement that a performance fee won't kick in until the fund's performance has returned to its previous peak. This prevents investors from paying performance fees on returns that represent the recovery of past periods of underperformance.

For example, if a fund underperformed in 2008, investors shouldn't be expected to pay a performance fee until the fund has regained the ground it lost. If a fund manager implements a performance fee without this requirement, we see this as a big negative.

A fund manager may sometimes stipulate that the high watermark is to be reset after a certain period, for example two years. We believe this is inappropriate: the fund and its investors may still be suffering overall losses after two years. The best solution is for the fund manager not to charge any performance fee until previous underperformance has been recouped, irrespective of how long that takes.

The Case for Fulcrum Fees

Ideally, we'd like performance fees to be structured as fulcrum fees. That is, fees should go up if a fund outperforms, but should also go down by an equal proportion when the fund underperforms. A few countries, like the United States and Norway, require fund managers to employ this symmetrical structure for performance fees. Unfortunately, these countries are the exception rather than the rule. The majority of performance fees only go one way – in the fund manager's favour. They're rewarded for outperformance, but there's no penalty for underperformance. Does that strike you as unfair? It does to us. Nevertheless, sadly it's the current norm in Australia and New Zealand.

Below Average Base Fee

If a performance fee isn't applied symmetrically – and this is not the norm in Australia and New Zealand – then at the very least the fund's ongoing management fee should be below average. Otherwise, there's no risk at all to the fund manager, which can earn the full fee any active fund would even if they underperform. Moreover, under this scenario a fund's ICR can become exceedingly burdensome. Consider the Acadian Wholesale Global Equity Long-Short Fund, a quantitatively-based approach to investing in international shares. This has a costly wholesale management fee of 1.45 percent, and an additional performance fee of 15.0 percent on returns exceeding its MSCI World ex-Australia benchmark (there is no fulcrum). As a result, after a short burst of strong outperformance the fund's ICR at 31 August 2008 reached a substantial 2.40 percent. Weak performance in 2008 has resulted in a high watermark well beyond the strategy's near-term reach, so investors are unlikely to pay a performance fee any time soon. However, they're still slugged with a hefty management fee.

Clear Disclosure

Lastly, performance fees should be disclosed clearly and explained in fund literature. Investors should be able to locate and understand the section about performance fees easily. Several scenarios should be provided in the product disclosure statement to help investors understand how the performance fee might apply under a variety of market conditions.

To sum up, there are a number of best practices fund managers should follow when charging performance fees. To earn the fee, the hurdle rate should be against an appropriate benchmark representative of the asset class in which the fund invests. There should also be a high watermark – the fund manager should have to recover previous losses before charging future performance fees. If there's a performance fee, the fund manager should also charge a base management fee lower than the average – otherwise their total fee take represents an attempt at having both their cake and the cherry on top, too. The way the performance fee works should be disclosed prominently and explained clearly in offer documents. And finally, we'd also like to see the introduction in Australia and New Zealand of 'fulcrum fees' – the arrangement whereby the fee goes up if the fund manager outperforms, but also down by an equal amount when there's underperformance. This would provide a more satisfactory alignment between the interests of the fund manager and those of investors in their funds. M

Large-Cap Australian Share Funds With Performance Fees

Fund Name	Ticker	Ongoing Fee %pa #	Performance Fee
Advance Concentrated Australian Shares	13025	1.99	20% of perf > 200 Accum
Advance Wholesale Concentrated Australian Shares	13026	0.80	20% of perf > 200 Accum
All Star Independent Asset Management Australian Equities	15583	2.58	20.5% of perf > S&P/ASX200 Accum
Armytage Enhanced Leaders	16230	0.97	10.25% of perf >10.0%pa
Armytage Strategic Opportunities Retail	13154	2.31	10.25% of perf >10.0%pa
Armytage Strategic Opportunities Wholesale	16235	1.31	10.25% of perf >10.0%pa
Australian Unity/Platypus Aust Equities – Retail	14368	2.30	15.0% of perf > 300 Accum +1.0%pa
Australian Unity/Platypus Aust Equities – Wsale	14369	1.88	15.0% of perf > 300 Accum +1.0%pa
Aviva Pers High Growth Shares	5852	2.90	20.0% of perf > 200 Accum + 5.0%pa
Aviva Prof High Growth Shares	5851	2.15	20.0% of perf > 200 Accum + 5.0%pa
Bennelong Concentrated Australian Equities	16999	0.85	15.0% of perf > 300 Accum +2.0%pa
BT Wholesale Focus Australian Share	12910	0.73	15.0% of perf > 300 Accum +0.75%
Cannae High Conviction	16995	1.03	10.25% of perf > 300 Accum + 1.025%
Challenger Wholesale Enhanced Opportunity Share	15888	1.50	20.0% of perf > 200 Accum +1.50%pa
Challenger Wholesale Select Australian Share	12177	0.90	15.0% of perf > 200 Accum
Clime High Yield Underdogs	16228	0.57	10.25% of positive performance
Colonial First State Acadian Australian Equity Long/Short	13549	3.30	15.0% of perf > 300 Accum
Colonial First State Wsale Acadian Long/Short Aust Share	13525	2.61	15.0% of perf > 300 Accum
Colonial First State Wsale PM Capital Aust Share	11103	1.02	25.0% of perf > 200 Accum
Fortis Concentrated Australian Equity	14114	0.96	15.0% of perf > 200 Accum + 3%pa
Ganes Focused Value	13449	1.69	18.64% of perf > 300 Accum
Ganes Value Growth	13151	0.42	20% of performance
Greencape Wholesale Broadcap	14654	1.40	15.0% of perf > 300 Accum +0.95%pa
Greencape Wholesale High Conviction	14653	0.72	15.0% of perf > 200 Accum +0.90%pa
Guild Capital Australian Equities Fund Retail	14272	1.50	20.0% of perf > S&P/ASX300 Accum
Guild Capital Australian Equities Fund Wsale	14273	1.02	20.0% of perf > S&P/ASX300 Accum
H3 Australian Equities	14793	1.00	10.0% of perf > S&P/ASX300 Index
Hayberry Australian Share	13180	1.28	20.5% of perf > S&P/ASX300 Accum
Macquarie Alpha Opportunities	13182	0.70	15.0% of perf > 200 Accum +0.70%
Macquarie Australian Market Neutral	13183	1.02	20.0 of perf > UBS bank bill +1.0%
Macquarie High Conviction	14326	2.00	10.0% of perf > 200 Accum + 1.0%
Macquarie High Conviction Incentives	15137	1.11	35.0% of perf > 200 Accum
Maple-Brown Abbott – Australian Equity	2867	0.38	20.0% of perf > 300 Accum + 3.0%
MMC Concentrated	13150	0.46	20% of performance
Naos Absolute Return	13176	1.54	20% of perf > UBS Bank Bill
NavraInvest Blue Chip Aust Share Retail	9850	1.72	0.395 x return > 200 Price
NavraInvest Blue Chip Aust Share Wsale	9851	1.37	0.358 x return > 200 Price
Northward Capital Australian Equity	16246	0.96	15.0% of perf > S&P/ASX300 ex-LPTs
OC200	16569	1.32	10.25% of positive perf > 200 Accum
Officium Australian Shares Fund	11511	0.73	5.125% of positive returns
Orion Wholesale Australian Share	10717	1.00	15.375% of perf > 300 Accum + 0.50%
Patriot Australian Share	14110	0.92	20.5% of perf > 5-Yr Commonwealth Bond
Plato 130/30	17254	0.50	15.0% of perf > S&P/ASX200 Accum
Plato Market Neutral	17255	1.00	20.0% of perf > UBSA Bank Bill
PM Capital – Australian Opportunities	6829	2.74	20.0% of positive performance
Prime Value Growth	11232	1.44	20.5% of perf > 300 Accum
Prime Value Growth – Class B	13206	1.23	20.5% of perf > 300 Accum
Prime Value Imputation	11233	1.44	20.5% of perf > 300 Accum
Prime Value Imputation – Class B	13205	1.23	20.5% of perf > 300 Accum
Saratoga Investment	16863	—	50.0% of perf > 200 Accum
SGH IC2E	14466	1.18	10.25% of perf > 7.50%pa
Solaris High Alpha (Institutional)	17048	0.90	20.0% of 200 Accum +2.0%
Solaris High Alpha (Retail)	16752	0.90	20.0% of 200 Accum +2.0%
Souls – Australian Wsale Equity	4708	0.65	20.0% of perf > All Ords Accum
Souls – Select Australian Share	15885	0.70	20.0% of perf > 200 Accum + 2.0%pa
Tribeca Australian Equity Long/Short	15451	0.87	20.50% of perf > 200 Accum

latest-available Indirect Cost Ratio or management fee stipulated in offer documentation

Source: Morningstar.com.au

Fidelity Australian Equities | FID0008AU

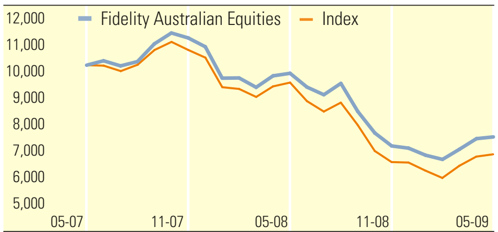
Australian Equity | Australian Large Blend

Recommendation **Highly Recommended**

Morningstar Rating	★★★★★
Morningstar Style Box	
Role in Portfolio	Core
No. Stocks	30 – 50
Max/Min Weights	+/-5.0%
Expd Turnover %pa	50.0
Ongoing Fee %pa	0.85
Lead Manager	Paul Taylor
Appointed	2003

	1 yr %	3 yr %pa	5 yr %pa
Fund	-24.77	-1.17	11.51
Index	-28.94	-4.41	6.59
Peer Group Average	-27.08	-4.16	6.71

Performance data to 31 May 2009



Morningstar Take

A high-calibre portfolio manager backed by an impressive research platform that's delivered a great track record – it's not hard to see why Fidelity remains one of the premier Australian equities strategies. Portfolio manager Paul Taylor has piloted this strategy from its inception in June 2003, demonstrating astute stockpicking ability. Research is Fidelity's hallmark, and Taylor draws ideas from an 11-member investment team with analysts in Sydney and Hong Kong. This unusual structure sees domestically-oriented sectors such as financials and consumer discretionary stocks covered locally, while global sectors like resources and telecoms are analysed from Hong Kong. We believe the analyst team to be one of the best in the asset class, giving Taylor a valuable leg-up on his peers. The portfolio has a soft-growth tilt, with a preference for companies benefitting from favourable industry dynamics that enjoy a measure of pricing power. Although driven primarily by stock level dynamics, Fidelity also takes advantage of potentially favourable investment themes presenting themselves. The outcome is a diversified portfolio of 30 – 50 names, Taylor happy to take meaty active bets and back his convictions. Paul Taylor's central role in the strategy means that we believe he represents a key person risk to Fidelity, although it's a risk worth taking, and we acknowledge that the firm has put in place a designated back-up manager in Kate Howitt. Strengths in portfolio management, research, and track record mean that Fidelity really has all the bases covered, and is fully-deserving of a place among the top tier of Australian equities managers.

The full report is available at www.morningstar.com.au

GMO Global Equity | GMO0103AU

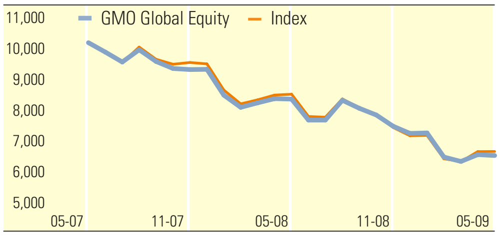
International Equity | World Large Value

Recommendation **Highly Recommended**

Morningstar Rating	★★★
Morningstar Style Box	
Role in Portfolio	Core
No. Stocks	300 – 400
Max/Min Weights	+/-5.0%
Expd Turnover %pa	50.0 – 70.0
Ongoing Fee %pa	0.67
Lead Managers	Tom Hancock, Anthony Hene
Appointed	1995, 1995

	1 yr %	3 yr %pa	5 yr %pa
Fund	-22.27	-10.58	-1.65
Index	-22.21	-9.85	-1.95
Peer Group Average	-22.06	-9.18	-1.02

Performance data to 31 May 2009



Morningstar Take

We continue to be strong advocates of GMO as a global equities manager. The firm has a long and successful history of investing, and has proven time and again that it can deliver when it counts. What elevates GMO above the rest is the strength of the shop's investment process and its high-calibre staff line-up. GMO uses three sophisticated quantitative models. Two have distinct value biases, based on the firm's conviction in mean reversion. The third, a momentum model, acts as a counterbalance, providing a cushion when value lags the market. Led by co-portfolio managers Tom Hancock and Anthony Hene, the team possesses extensive industry knowledge, a diverse range of experiences, and longevity in tenure. We're impressed by members' willingness to back themselves and their demonstrated aptitude at thinking outside the box. GMO dedicates significant resources to ensuring that its models work efficiently even when markets do not. The firm refocused the US portion of the Intrinsic Value model exclusively on high-quality names in 2008. This gutsy call ultimately proved a touch of class when markets collapsed late in the year. The portfolio's dominant value orientation means that performance may lag the index and more growth-focused fund managers when markets are running hot. The momentum driver removes some of this bias, but the portfolio will still show a value tilt. GMO's steady approach is unlikely to top the charts in this peer group, but long-term results are evidence of the firm's ability to reward investors across the full market cycle. This is a top-notch, high-quality global equities offering.

The full report is available at www.morningstar.com.au

Investors Mutual Future Leaders | IML0003AU

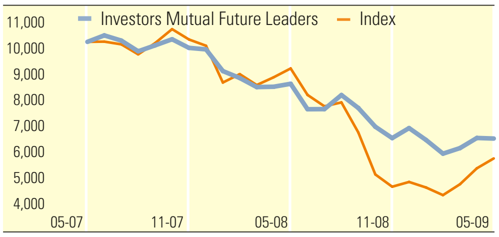
Australian Small Companies | Australian Mid/Small Value

Recommendation **Highly Recommended**

Morningstar Rating	★★★★
Morningstar Style Box	
Role in Portfolio	Core
No. Stocks	40 – 70
Max/Min Weights	+5.0%
Expd Turnover %pa	15.0 – 35.0
Ongoing Fee %pa	0.97 + 15.0% performance fee
Lead Manager	Simon Conn
Appointed	2006

	1 yr %	3 yr %pa	5 yr %pa
Fund	-25.11	-4.95	4.61
Index	-38.53	-6.97	5.32
Peer Group Average	-25.88	-3.47	6.13

Performance data to 31 May 2009



Morningstar Take

Investors Mutual's conservative, steady-as-she-goes approach to small-/mid-cap investing continues to make a lot of sense to us. While there has been some upheaval in the firm's broader Australian equities team, the bedrock of this approach remains in place, Senior Portfolio Manager Simon Conn having been in charge here since 2006 following the departure of Andrew King, and also having run the shop's dedicated small-cap strategy since its inception in 1998. There's no doubt these personnel changes have been a distraction, but with Conn in charge and IML's low-turnover, longer-term investment horizon, this has not been a material blow. At a time when small-cap staff turnover has reached endemic proportions, Conn's decade-long tenure and successful track record during that period are very reassuring. More importantly, we remain confident about the process. Our overall view still depends on Conn remaining at the helm, IML founder Anton Tagliaferro continuing to have a significant influence. The focus on identifying stocks with predictable and recurring earnings streams and avoidance of more cyclical companies like resources meant this strategy lagged through the commodities bull market of the middle of this decade. But this strategy does tend to come into its own during tougher market environments when preservation of capital is important. Low portfolio turnover also makes this one of the most tax-effective small-/mid-cap portfolios in the market. When up against the competition, we continue to think Investors Mutual Future Leaders is one of the best offerings available.

The full report is available at www.morningstar.com.au

EQT PIMCO Diversified Fixed Interest | ETL0016AU

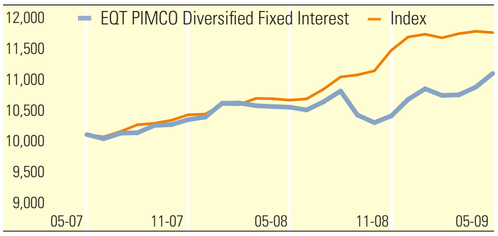
Fixed Interest | Global/Australian Bonds

Recommendation **Highly Recommended**

Morningstar Rating	★★★
Morningstar Style Box	
Role in Portfolio	Core
No. Stocks	N.Ap.
Max/Min Weights	N.Ap.
Expd Turnover %pa	N.Ap.
Ongoing Fee %pa	0.60
Lead Manager	Robert Mead
Appointed	2003

	1 yr %	3 yr %pa	5 yr %pa
Fund	5.22	4.47	5.12
Index	10.31	6.56	6.52
Peer Group Average	5.80	4.61	5.15

Performance data to 31 May 2009



Morningstar Take

The old adage that "form is temporary, but class is permanent" springs to mind when thinking about behemoth PIMCO. This Newport Beach, California-based firm hasn't got every call right, but we remain convinced that the quality and expertise will win out over the long term. PIMCO has built its reputation on the back of its sector calls, the result of annual forums that bring together the firm's investment teams from all over the globe. The result is a diverse portfolio made up of a number of small active positions designed to minimise risk. The shop expects these calls to be the major drivers of potential alpha. The strategy generated positive returns in 2007–08, but disappointingly failed to capitalise fully on its correct call on the housing bubble which led to the credit crisis. We're not overly concerned by this, though, as no firm can get it right all the time. What is important is the underlying level of research and insight, and we believe that this remains one of PIMCO's core strengths. The firm was one of the first to spot the potential problems from the US sub-prime mortgage sector which led to the credit crunch in mid-2007, but failed to foresee the global dramas ahead. Rob Mead leads the local investment team of five, having taken up the reins in mid-2007. The team's able to leverage effortlessly off the many specialist investment teams, such as emerging markets, asset-backed, and duration which PIMCO has situated around the world. Although recent numbers have not been healthy relative to peers, we firmly believe that PIMCO remains a top-notch option for investors looking for a diversified fixed interest vehicle.

The full report is available at www.morningstar.com.au

Vanguard Balanced Index | VAN0108AU

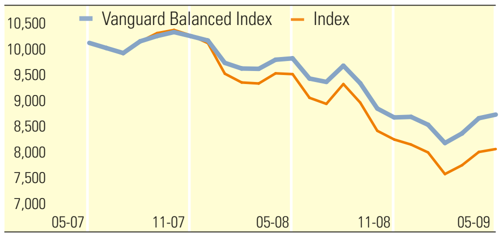
Multi-Sector | Multi-Sector Balanced

Recommendation **Highly Recommended**

Morningstar Rating	★★★★
Morningstar Style Box	
Role in Portfolio	Core
No. Stocks	N.Ap.
Max/Min Weights	N.Ap.
Expd Turnover %pa	N.Ap.
Ongoing Fee %pa	0.90
Lead Manager	Joseph Brennan
Appointed	2009

	1 yr %	3 yr %pa	5 yr %pa
Fund	-11.24	-0.21	4.73
Index	-15.48	-2.25	4.03
Peer Group Average	-15.72	-2.76	3.34

Performance data to 31 May 2009



Morningstar Take

Vanguard's inexpensive multi-sector funds have consistently shown themselves to be among the best in the sector, a result of straightforward indexing and sensible portfolio construction. We have full confidence that this will persist. Chief Investment Officer Joseph Brennan leads a team palpably committed to squeezing costs. Execution, rebalancing, and avoiding illiquid asset classes such as private equity are all undertaken with the investor's hip pocket firmly in mind. Most importantly, the shop's fees are less than half of most of its peers, giving it a substantial headstart over rivals. Brennan oversees the benchmark selection process, essentially picking the most consistently-performing portfolio over a sample period, then tweaking asset weightings to meet preset income/growth mixes. Investors end up broadly-exposed to Vanguard's suite of single-sector index funds. We consider this approach to be simple and intuitive. The strategic asset allocation (SAA) has been stable – the most recent change occurred in 2007, when a hedged international small companies component was added to match index changes. We like the underlying equities and fixed interest sleeves: we're fans of the processes and people behind these portfolios, particularly the efficient optimisation approach. Encouragingly, operations have been largely unaffected by personnel change, as the firm's quantitative base reduces key person risks. Overall, we're confident Vanguard's superior peer-relative performance will continue, and believe that this multi-sector fund is ideal for investors seeking a low-cost, diversified solution.

The full report is available at www.morningstar.com.au

ING Global Property | HML0015AU

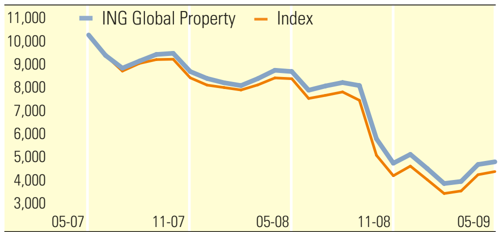
Global Property | Global Real Estate

Recommendation **Highly Recommended**

Morningstar Rating	★★★★
Morningstar Style Box	
Role in Portfolio	Core
No. Stocks	60 – 80
Max/Min Weights	+5.0%
Expd Turnover %pa	40.0 – 80.0
Ongoing Fee %pa	0.90
Lead Manager	Ritson Ferguson
Appointed	2001

	1 yr %	3 yr %pa	5 yr %pa
Fund	-46.08	-14.59	N.Ap.
Index	-49.17	-17.78	N.Ap.
Peer Group Average	-46.95	-17.06	N.Ap.

Performance data to 31 May 2009



Morningstar Take

A long-tenured and highly-capable management team coupled with a robust investment process make ING Clarion one of the standout global property fund managers. Ritson Ferguson, Managing Director and CIO, has been with the firm since it was founded in 1991, and leads a well-resourced group. The firm has run a global property vehicle since 2001, and the talent and experience are demonstrable. ING boosted its analyst ranks significantly from 2006 – 08, adding a further nine members. The Asian team was the greatest beneficiary of the increased headcount. Such rapid growth can be difficult to manage, although ING appears to be on top of it. The shop has two portfolio managers for each region – one based in Philadelphia, and one leading the regional team. It's an arrangement that appears to work well, and the team looks very well-balanced. We also like that ING can draw on the local experience of the wider group's private market real estate teams around the world, rather than relying on external consultants. The team was able to add significant value across regions from stockpicks during 2008, a dreadful year for property investors. ING suffered absolute losses like all the players in this sector, but to its credit was able to buffer investors from the full extent of the selloff. Not everything here's perfect. ING's one of the bigger REIT managers globally, and while size is not an issue at the moment, it's something to watch. This is not an insurmountable hurdle, though, and we have a high degree of conviction that ING will be among the best long-term performers in this sector.

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