

Navra Asia Pacific Growth Fund

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OVERALL RATING

SOUND

COMPONENT ASSESSMENT

UNDERLYING
NOT ASSESSED

STRUCTURE
DELIVERS

Product Facts

Name:	Navra Asia Pacific Growth Fund	Open date:	19 Apr, 2010	Coupon date:	Each 18 Jun
Responsible entity:	NavralInvest Limited	Close date:	15 Jun, 2010	Liquidity:	Monthly
Protection Provider:	RBS	Maturity date:	29 May, 2020	Min. investment:	\$25,000
Portfolio manager:	RBS	Investment date:	29 Jun, 2010	Min. notional loan:	\$25,000

Standard & Poor's View

Standard & Poor's Fund Services has issued the Navra Asia Pacific Growth Fund (the 'fund') a 'SOUND' rating. The rating reflects a well-designed and flexible structure, but also the risks and uncertainties associated with an untested underlying algorithmic trading strategy.

The fund has a near ten year maturity. However, at the end of each annual period the investor has the option to exit the investment free of any charges. Investment in the fund is being presented by the issuer through a 100% investment loan (the "loan") which requires the investor to prepay annually in advance an expense of 8% of the loan amount. Investors can not incur a loss on the loan amount, similar to a capital protected loan.

The fund provides exposure to the Dynamic Asian ACES (A\$) investment strategy (the investment strategy) which, in turn, provides volatility adjusted exposure to the Enhanced Asian ACES Dynamic Strategy (ACES). ACES is a rules-based absolute returns long/short strategy that employs a "buy low – sell high" trading strategy over a pool of 150 of the largest and most liquid stocks in the Asia-Pacific region. The strategy is based on a mean reversion concept, specifically that a stock's movement will revert to the market or sector mean over time. The strategy does not yet have an actual track record.

Returns to investors comprise a contingent annual coupon and capital on redemption. The annual coupon is contingent on the performance of the investment strategy and will be up to 10% of the loan amount. Where the performance of the investment strategy since the issue date (minus any previously paid coupons) exceeds, for example, 110% then the coupon amount will equal the capped amount of 10% in the particular annual period.

The capital return on redemption will be the greater of zero and the "participated growth". The participated growth is equal to the amount by which the value of the investment strategy exceeds the loan amount, multiplied by the participation rate. The participation rate increases from 50% in year one to 200% in year 10.

Investors who remain invested for the whole term will receive a minimum return of 50% of the issue price. This amount is inclusive of contingent coupons paid to investors throughout the term. This means that if a total of \$0.50 per unit has been paid in contingent coupons over the term and in the final redemption amount, then the minimum investment return will have been achieved (i.e. there will be no extra payment in addition to the contingent coupons and the final redemption).

The fund structure is designed to provide investors with the benefits of a 100% capital-protected investment loan investment, yet without the typical liquidity constraints and the need to make a long-term investment commitment. Essentially the fund can be viewed from the investor's perspective as a series of one year options. This is in the sense that the investor can exit or remain invested depending on their personal circumstances and/or market outlook.

The cash-flow and exit-timing flexibility of the structure is a strong feature in the context of the Australian structured products market. Additionally, the potential for coupon payments as an offset to the

annual costs reduces the maximum after-tax loss profile, as well as improving exit flexibility for the investor. While the participation rate of capital growth in the initial years is less than 100% (for inherent pricing reasons) RBS has ensured a 100% participation rate with respect to the contingent income. This is to increase the likelihood that the income amount will largely or wholly offset the annual costs.

We essentially view the fund as a product of two halves. On the whole, the structure is strong and well-designed for the target market. However, the investment strategy is untested and, by this very fact, introduces a high degree of uncertainty and risk into the fund. While back-tested results are impressive, the validity of back-tested results for an algorithmic trading strategy is problematic. This is because the profitability of a successful algorithmic model can be fast eroded through replication in this highly competitive and dynamic investment strategy market segment.

Having said this, we recognise that the ability to walk away from the investment annually and the likely income (even if the investment strategy is only moderately successful) serve to mitigate the degree of the loss risk. In other words, for those investors comfortable with the uncertainty associated with the underlying strategy, it could be viewed as an acceptable risk-return equation.

As a long/short absolute returns strategy, the underlying investment strategy may be suitable to those investors concerned about a continuation of heightened volatility and/or uncertainties about market direction. Furthermore, the capital protection structure works well in a volatile market environment in the sense that expected performance is not adversely affected by volatility, unlike the commonly used constant proportion portfolio insurance (CPPI) structure.

Investors should note that while they can not incur a loss on the loan amount, they may incur a loss equal to cumulative annual costs, income-related tax costs plus any sell spreads on redemption. The risk of loss may be material in certain market environments.

SWOT Analysis

Strengths

- Investors are given the choice to periodically exit the investment without incurring early exit fees, in contrast to capital protected loan products in general which also subject the investor to the risk of a loss of capital prior to the maturity date.
- Contingent coupon payments may partly or wholly meet annual costs reducing annual costs and the maximum loss profile.
- The fund combines the liquidity of a short-dated investment with the attractive features that can be built into longer-dated products.
- Even in the case where the investment strategy generates moderate returns at most, the expected level and likelihood of the contingent income will materially offset the total annual costs, according to a Monte Carlo analysis undertaken by S&P.

Weaknesses

- A significant weakness is ACES does not have a live actual track record. While the strategy has been back-tested, and performance is strong, back-tested performance of an algorithmic trading model is an unreliable guide to potential future performance.
- The tax opinion regards the product as a capital-protected borrowing. Consequently, annual costs may only be partly tax-deductible.
- In the competitive algorithmic trading market it is often necessary to continually evaluate the effectiveness of existing algorithms and, if necessary, evolve (or decommission) the strategy. Once launched, ACES will be static. We note that ACES represents an evolution of the Asian Alpha Centurion Equity Strategy (Asian ACES) which has recorded average performance.

Opportunities

- The fund provides a very high degree of investment term flexibility and cash flow convenience.
- ACES has low correlation to other common asset classes, based on back-tested performance data, and may be an effective source of portfolio diversification.

Threats

- The algorithmic trading model market is highly competitive. Should the model prove successful the strategy may be replicated and performance potentially undermined.
- The annual costs may not be tax deductible in the year paid but, rather, may represent a reduction to the cost base for capital gains purposes.

Product Structure

Structure

The fund is an Australian unit trust registered as a managed investment scheme. Investors buy units in the fund. RBS, as the hedge provider, is contracted to provide exposure to the underlying investment strategy, the minimum investment return and any contingent coupons.

Counterparty risk lies with RBS and, in the unlikely event of insolvency, there is a risk that investors will not receive the value of their investment.

Investment in the fund is being presented by the issuer through a 100% investment loan. During the term on each annual cost payment date investors have the option whether to continue with the loan and investment (in which case the investor will need to prepay costs for the next year) or to terminate the loan and exit the investment free of charge

As the hedge provider and under the terms of the contract RBS will undertake to deliver a basket of ASX-listed shares to the fund at maturity equal in value to the net redemption amount of the fund on the maturity date. The shares are expected to be: BHP Billiton Ltd; Telstra Corporation Ltd; National Australia Bank Ltd; Woolworths Ltd; and Wesfarmers Ltd.

Payoff Profile

Returns to investors comprise a contingent annual income and capital upon redemption.

During the term investors may receive an annual contingent coupon based on the performance of the investment strategy since inception capped at 10% of the loan amount. The determination of the amount is based on 100% exposure to the performance of the investment strategy. If a payment is made the value of the investment strategy will decrease by the coupon amount.

On redemption the capital return is equal to the greater of zero, the participated growth and the minimum investment return. The

participated growth is equal to the amount by which the value of the investment strategy exceeds the loan amount, multiplied by the participation rate. The participation rate increases in a step fashion over the term, increasing from 50% in year one to 200% in year 10 (see table 1).

The minimum investment return applies at maturity only and is equal to 50% of the issue price (\$0.50 per unit) less cumulative contingent coupon payments and the final redemption amount. As such, where the cumulative contingent coupon payments are greater than \$0.50 then the minimum investment return will have been achieved and there will be no additional payment at maturity.

Table 1: Redemption Value Participation Rate Schedule

Year	Payment Date	Redemption Value Calculation Date	Participation Rate (%)
0	June 29, 2010	N/A	N/A
1	June 18, 2011	June 29, 2011	50%
2	June 18, 2012	June 29, 2012	60%
3	June 18, 2013	June 29, 2013	70%
4	June 18, 2014	June 29, 2014	80%
5	June 18, 2015	June 29, 2015	100%
6	June 18, 2016	June 29, 2016	120%
7	June 18, 2017	June 29, 2017	140%
8	June 18, 2018	June 29, 2018	160%
9	June 18, 2019	June 29, 2019	180%
10	N/A	May 29, 2020	200%

Lastly, the manager applies a volatility stabilisation overlay to the exposure to the performance of ACES. Exposure is increased during periods of low volatility and decreased during periods of high strategy volatility. The overlay is partly designed to ensure the investment strategy remains in a volatility band broadly consistent with the stable, low drawdown profile of the fund.

The exposure is based on a 20-day realised volatility measure, with the exposure determined by reference to table 2.

Table 2: Volatility Adjusted Exposure Bands

20-day realised volatility (%)	Exposure (%)
0.0–7.52	133.0
7.52–10.00	100.00
10.00–12.50	80.00
12.50–17.50	57.14
17.50–22.50	44.44
22.50–27.50	36.36
27.50–32.50	30.77
32.50–37.50	26.67
37.50–42.50	23.53
> 42.50	0

S&P notes that based on the back-tested performance of ACES, the volatility has generally remained in a narrow band from 7% to 9%, equating to an exposure of 100%. Volatility never exceeded 10%.

Loan

According to the issuer, the fund has been structured based on a loan. Investors can not incur a loss on the principal amount. In effect, it essentially works similar to 100% capital protected limited recourse borrowings. Costs on the loan are prepaid annually in advance. For the first year the investor must prepay the annual costs for the units to be purchased. In the following years, the investor will have the choice

whether to prepay costs for the following year or simply walk away and exit the investment.

In the event of the payment of a contingent annual coupon then the annual amount will be reduced. In the possible event that the contingent income amount exceeds the annual cost then investors will receive a distribution equal to the difference. At the date of this report, the indicative rate was 8% per annum.

Taxation

The contingent annual coupon amount is expected to be taxed on income account the year earned. The capital return upon redemption is likely to be taxed on capital account and may be eligible for the 50% capital gains tax (CGT) discount if the investment has been held in excess of 12 months.

The loan may be viewed as a capital-protected borrowing by the ATO, and indeed this is consistent with the tax opinion contained in the PDS, then the annual costs may be deductible up to a level equal to the relevant Reserve Bank of Australia (RBA) benchmark indicator rate plus

The above is consistent with the announcement by the Federal Treasurer on 11 May 2010 in the 2010/2011 Federal Budget a proposed change to the capital-protected borrowing rules in Division 247 of Part 3-10 of the 1997 Act. The Treasurer has proposed to amend the benchmark interest rate to the Reserve Bank of Australia's Indicator Rate for Standard Variable Housing Loans plus 1.00%.

Relevantly, it is proposed that this Budget announcement will apply to arrangements entered into after 7.30 pm (AEST) on 13 May 2008 (being the date changes to the capital protected borrowing rules were originally announced). This proposed amendment has been drafted into exposure draft legislation entitled Tax Laws Amendment (2010 Measures No. 4) Bill 2010: Capital protected borrowings as released on 11 May 2010.

The excess annual cost amount may be included in the cost base of an investment in the fund.

As at the date of this report, the RBA Indicator Variable Rate for Standard Housing Loans is 6.9%, equating to 7.9% with the 1% incremental amount. Consequently, of the 8% interest rate on the investment loan it is expected is only deductible up to a level of 7.9%.

S&P notes that Part IVA of the Tax Act introduces a degree of risk to the above tax treatment, with the possible consequence that the annual costs of the loan amount representing a reduction of the cost base rather than a tax deduction during the term.

The loan administration fee is deductible on a pro rata basis over the first five years of the loan. If the loan is repaid in less than five years, the remaining balance of the fee will be deductible in the year the loan is repaid.

At maturity investors may choose to receive the delivery asset or crystallise the value of the investment by requesting the sale of units and payment in cash. Irrespective, a CGT event will occur at the maturity of the product.

We note that RBS is in the process of applying for a product ruling from the Australian taxation office (ATO) regarding the tax consequences for investors.

S&P advises that tax consequences depend on individual circumstances and investors should seek their own taxation advice. The above comments regarding taxation treatment are based on S&P's understanding, but cannot be considered tax advice.

Fees

Total fees are shown in the table below. The investment strategy management fee, the performance fee, the transactional and operational costs and the 1.56% fund management fee are deducted from the value of the investment strategy. RBS pays the responsible entity fee to NavraInvest out of its own funds. These fees do not represent an additional payment for the investor.

Consequently, that directly paid by investors is the one-time, upfront 2.0% loan administration fee.

The performance fee is equal to 5% multiplied by the growth in the investment strategy minus the maximum contingent coupon amount of 10%. This essentially equates to a 10% performance fee hurdle. S&P regards this as an appropriate level broadly consistent with the risk-return profile of the fund. However, S&P notes the absence of a high watermark, which is not best practice.

Transactional and operational costs are the cost of buying and selling shares in the underlying strategy. The costs are deducted from the performance of ACES, rather than paid directly by investors. These costs are estimated to range from 1.56% to 4.68% per year. However, the manager expects the actual amount will be around the 3% level, which is supported by the actual costs of the Asian ACES costs. It should be noted that the back-testing was also based on the assumption of 3% transactional costs.

Adviser commissions are subject to the commercial terms between the investor and adviser. As such, commissions are exogenous to the fund and, hence, the rating itself.

Fees And Costs (% incl. GST)

Type	Amount
Upfront Commissions	N/A *
Trailing Commissions	N/A *
Loan Administration Fee	2.0
Management Fee	1.56**
Performance fee	5.0**
Responsibility Entity fee	1.65
Transactional & Operational costs	1.56 to 4.68

* Subject to the commercial terms between advisors and investors.
** This amount is deducted from the value of the underlying index. It is not directly paid by investors

	Low	Medium	High
Income return			
Capital return			
Income risk			
Capital return risk			
Income payment risk			
Risk to capital			
Leverage			
Cost			
Liquidity			
Transparency			
Tax efficient			
Manager experience			

The Underlying Investment Strategy

ACES is a rule-based investment strategy that seeks to deliver absolute returns to investors with low draw-downs. The strategy is based on the common theory of mean reversion, specifically that a stock's movement can not deviate from the mean of market or sector forever.

The strategy is based on a high-frequency rebalancing, long/short strategy developed by RBS. A pool of 150 highly liquid stocks is selected through criteria that emphasize the liquidity, market capitalization and the ability to "short" (sell) stocks.

Every trading day, the performances of all the members of the universe are observed. A selection criteria value is calculated for each security which is based on how the security has performed relative to

its sector. A low selection criteria value corresponds to securities which have underperformed their respective sectors and conversely a high selection criteria value corresponds to securities which have outperformed their respective sectors.

On the first trading day, 50 securities with a low selection criteria value are selected to compose the equally weighted "long basket" and 50 securities with a high selection criteria value are selected to compose the equally weighted "short basket". The remaining 50 stocks are not invested in. Thereafter, the daily rebalancing will take positions on the strongest mean-reversion candidates.

To reduce concentration risk from individual countries, the securities universe is divided into geographic regions. The notional invested in each of the short positions will be the same as the notional invested in long positions. Each geographic basket comprises a number of securities in the same proportionate representation of that region in the total universe. For example, if North Asia securities form 70% of the universe of securities, the long and short baskets will comprise 35 North Asian securities in each basket.

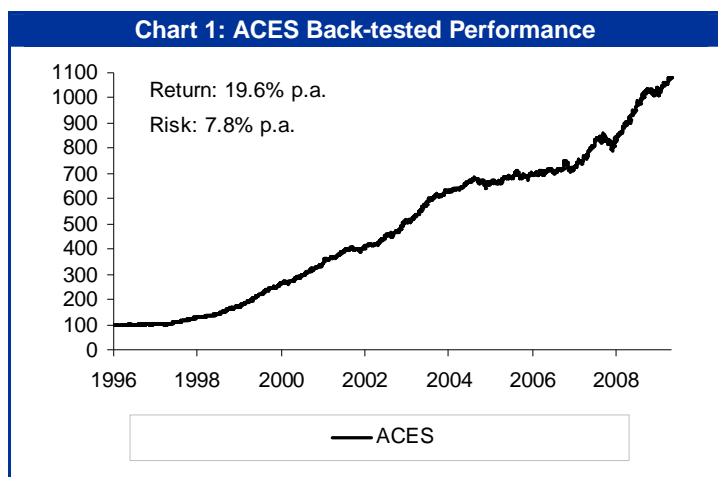
The significant degree of rebalancing and trading creates a risk of high direct and indirect trading costs. RBS has addressed this by guaranteeing that the performance of ACES will be based on the closing price of all securities and a 3 to 8 basis point bid/ask spread, and that any cost of slippage will be deducted from RBS' MER. Over the course of the year, the total level of costs is expected to be 3%.

Back-tested Performance

ACES and the investment strategy do not have an actual track-record. ACES is derivative of an existing strategy, the Asian Alpha Centurion Equity Strategy (Asian ACES), but there are significant enhancements to ACES to render Asian ACES actual track-record largely irrelevant.

In the absence of a track-record, RBS has conducted a back-tested analysis from the period November 1996 to March 2010. The risk-return performance since inception is detailed in Chart 1. Back-tested volatility generally remained within a narrow band from 7% to 9%.

S&P recommends investors exercise extreme caution in viewing the back-tested performance as being in any way indicative of potential performance. Back-testing an algorithmic trading model is fraught with significant risks. The market place for algorithmic trading is highly competitive and dynamic that constant change is almost a given. An algorithm that gains a first mover advantage and is highly profitable, as the back-testing suggests ACES is, may subsequently be replicated and performance potentially undermined. As such, back-tested performance may be a significantly less reliable guide to potential expected performance than may ordinarily be the case.



Simulated Risk-Return Analysis

S&P has conducted a Monte Carlo analysis to assess the simulated expected risk-return performance of the fund

The analysis is based on particular risk and return scenarios defined as "weak", "average" and "strong" (see table below). The reference point for the risk-return parameters of the scenarios is one of S&P simply being conservative.

Scenario	Return (%)	Risk (%)
Weak	8	7
Average	10	7
Strong	12	7

Table 4 details the expected total returns under the three scenarios by year of redemption.

Scenario	Weak	Average	Strong
Year 2	7.4%	8.9%	10.2%
Year 3	7.6%	9.4%	11.0%
Year 4	8.0%	9.9%	11.7%
Year 5	8.4%	10.4%	12.6%
Year 6	9.1%	11.4%	14.0%
Year 7	9.8%	12.3%	15.3%
Year 8	10.5%	13.3%	16.4%
Year 9	11.2%	14.1%	17.3%
Year 10	13.3%	16.7%	20.3%
# Coupons Paid	7.0	7.6	8.3
Average Coupon	5.3%	6.1%	7.0%

Chart 2 illustrates the probability distribution of capital and income returns under an "average" scenario for a redemption at year 10.

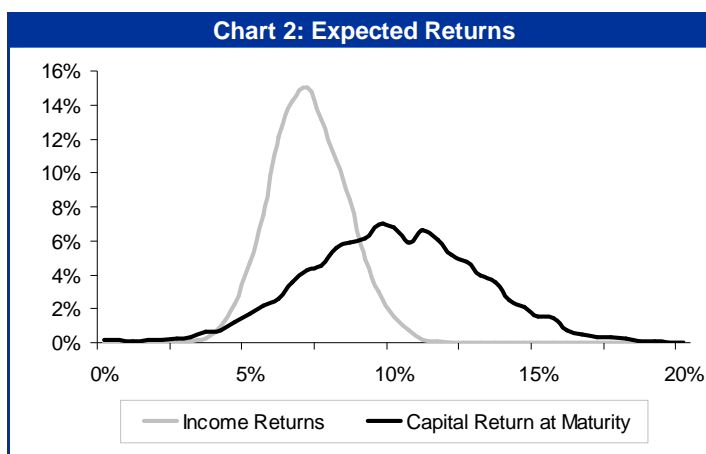


Chart 3 below shows the expected number of coupon payments over the 10-year term under an "average" scenario, with the actual number being 7.6 out of the possible 10.

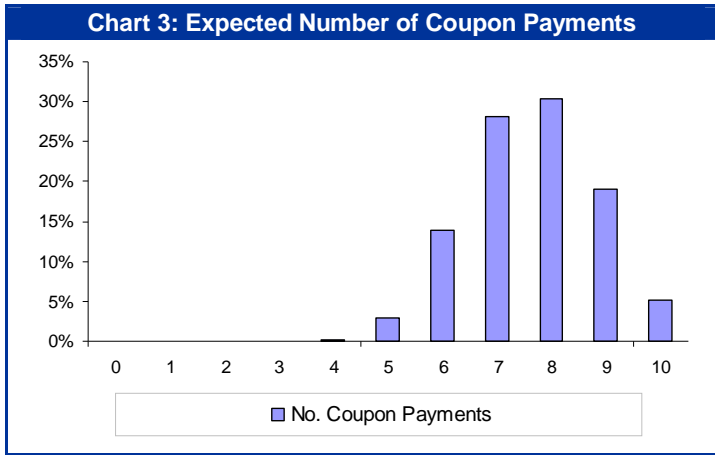
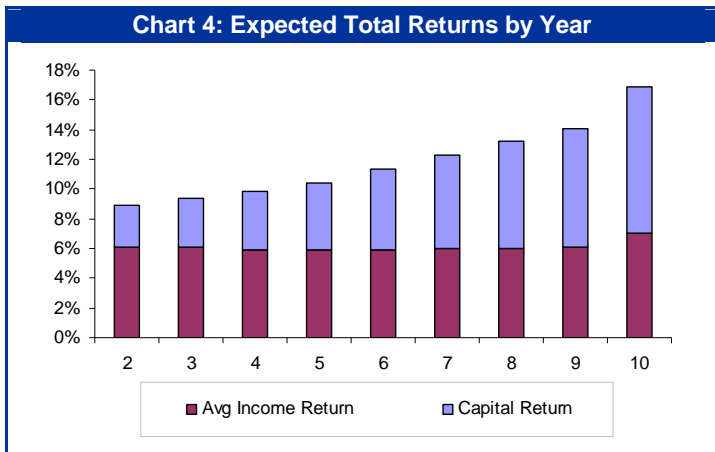


Chart 4 shows the expected total returns by year of redemption, with the expected capital return component progressively increasing on account of the increasing participation rate.



The key conclusions drawn from the analysis are:

- As is evident in chart 2, the distribution of income returns is narrow meaning the risk profile of the expected contingent coupon amount is low. Furthermore, as evident in chart 3, the narrow distribution of the number of coupon payments also means there is high likelihood of receiving most coupon payments. These results suggest that the net annual cost and the maximum potential loss may be relatively low.
- As chart 4 highlights, the escalating participation rate rewards longer-term investors, yet the 100% participation rate on income serves to not overly punish investors who redeem early from a total returns perspective. The fund's investment flexibility is a strong point.
- As a statement of fact, in any given year investors should not expect to receive a coupon payment, with the expected number of total coupon payments ranging from 7.0 to 8.3 in a weak and strong environment, respectively. Furthermore, where a coupon is paid it may not cover the full interest cost, with the average coupon amount ranging from 5.3% to 7.0%.

Analyst(s): Rodney Lay, Michael Armitage.
Release authorised by: Leanne Milton.

Rating Philosophy

A structured product rating combines a qualitative assessment of the structures ability to provide exposure to the underlying asset class(es) and a view on the management of the underlying exposure the product is replicating/delivering.

OVERALL RATING VERY STRONG	S&P has assigned a very strong rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has scored exceptionally in a number of categories but may not be suitable for all investors.
OVERALL RATING STRONG	S&P has assigned a strong rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has scored strongly in a number of categories but may not be suitable for all investors.
OVERALL RATING SOUND	S&P has assigned a sound rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has scored satisfactorily in a number of categories but may not be suitable for all investors.
OVERALL RATING PASS	S&P has assigned a pass rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has passed a number of categories but may not be suitable for all investors.
OVERALL RATING WEAK	S&P has assigned a weak rating to the product based on its conviction that it can not meet its objectives over the stated time period. The product has scored weakly in a number of categories and may not be suitable for most investors.
OVERALL RATING ON HOLD	An On Hold designation is a suspension of a rating pending further analysis of a material change in the characteristics of a product.

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