



Fund Performance Commentary

Period: 1st to 30th September 2005

Fund Performance

The volatility in the Australian equity market presented us with buying opportunities. The NavTraDE system buys shares as share prices depreciate. Our cash holding at the end of September was 36.8% as we have taken the opportunity to sell stocks at favorable prices. The actual returns in September for the Retail and Wholesale funds were +4.36% and +4.50% respectively compared to the +4.37% return of the S&P/ASX200.

The NavTraDE system takes advantage of irrational investor behaviour to buy quality companies as their share prices are falling and to sell them as they are rising. Consequently, the system can realize capital gains from dealing in shares with volatile price movements, irrespective of the net price movement from the beginning to the end of the period. It takes time for shares to move through price cycles and therefore for the potential of the NavTraDE system to be fully realized.

The stocks that performed well this month and generated realized capital gains through trading include BHP Billiton (BHP), Macquarie Bank (MBL), OneSteel (OST), and Woodside Petroleum (WPL).

The stocks that performed well this month and generated unrealized capital gains include ANZ Bank (ANZ), Futuris (FCL), Macquarie Bank (MBL), Orica (ORI), Santos (STO), and Westpac Bank (WBC).

During the month, the share that detracted from performance either due to low volatility or because they were displaying unrealized losses was Coca-Cola Amatil (CCL).

The NavTraDE system resulted in increased weightings in: The Australian Stock Exchange (ASX).

The NavTraDE system also resulted in decreased weightings in: Australian Gas Light Company (AGL), ANZ Bank (ANZ), BHP Billiton (BHP), Macquarie Bank Ltd (MBL), Origin Energy (ORG), OneSteel (OST), Santos (STO), Tabcorp Holdings (TAH), Woolworths (WOW) and Woodside Petroleum (WPL).

To view our current portfolio, please [click here](#).

The Australian Share Market

The Australian equity market surged 4.37% in September (S&P/ASX200 Index), reflecting sound economic fundamentals. The Australian economy is now in the longest sustained growth period since Federation.

Retail sales grew strongly by 0.6% in August following a small fall in July. Food and clothing sales surged by 1.1% and 1.6%. Household goods sales and department store sales recovered by 0.7% and 0.5% after declines in July. However, discretionary spending was flat, probably reflecting the impact of high petrol prices.

The Australian stock market surged 4.4% in September. Credit growth slowed due to high oil prices and a slowing housing market.

Total credit also surged; rising by 1.3% in August after 0.5% in July. The annual credit growth rate is now 13.5% compared to 14.5% last year. Business credit rose by 2.1% in August; the yearly growth rate was 13.0% compared to 8.8% last year. Personal credit rose by 1.2% or 14.0% p.a. Housing credit growth continued to slow with a rise of 0.9% in the month, or 13.7% p.a. compared to 18.8% p.a. last year. As expected the RBA left the cash rate at 5.50%.

The housing market continues to cool, with approvals falling 8.0% in August following a fall of 8.9% in July. The monthly data showed a 3.5% decline in private housing approvals and a 21.2% drop in other residential categories. However, the commercial, industrial and retail sectors were still strong, with non-residential approvals rising 0.8%.

Total employment rose 32,600 in August; driven mainly by part-time employment, and represents the 12th successive monthly increase. The jobs growth rate of 4.2% is the strongest for 10 years. The unemployment rate was unchanged at 5.0% as the participation rate rose to a record 64.8%.

GDP growth for the June quarter was above expectations at 1.3% (+2.6% over the past year), driven mainly by domestic demand (+1.9%) while net exports and inventories fell. The terms of trade surged 5.8% (+11.5% over the past year). The largest contributor to GDP was construction. Retail sales contracted in the quarter. The trade deficit rose back to \$1.64b from \$1.33b in July, due mainly from a 3% fall in exports compared to a 1% drop in imports. The drop in exports was mainly due to lower coal shipments and other mineral fuels as infrastructure and capacity constraints continue to bite. Australia's trade remains skewed to the strongest growth region of China, Hong Kong and Taiwan, while imports are derived mainly from the EU.

In summary, the Australian real economy continued to grow, mainly due to exports and construction. Retail spending and the housing market are clearly slowing, partly impacted by high petrol prices. On the positive side, employment is still strong, interest rates are relatively low and demand for Australian minerals exports remain strong.

The best performing sectors were the rebounding Technology, Hardware & Equipment and the Pharmaceuticals & Biotechnology sectors.

The best performing sectors in September were Technology, Hardware & Equipment (+16.56%); Pharmaceuticals & Biotechnology (+11.04%); Materials (+10.41%); and Diversified Financials (+9.72%).

The worst performing sectors were Telecommunication Services (-11.29%); Automobiles & Components (-4.73%); Software & Services (-3.08%); and Media (-1.37%).

World markets were mostly strong, led by Japan and Hong Kong.

The performances of the global stock markets were mostly positive: The S&P 500 index rose 0.69%, the Nasdaq fell 0.02%, the FTSE rose 3.41%, the Nikkei 225 surged 9.35% and the HangSeng rose 3.52%.

US economic fundamentals were solid in the June quarter.

The US Federal Reserve increased official Fed Funds rate by 0.25% to 3.75% after rising 0.25% in August, the 11th consecutive interest rate rise. Monetary policy remains slightly tight as the Federal Reserve viewed the US economy as strong while inflationary pressures have been relatively low, although higher energy and other costs are of some concern.

June quarter GDP growth was revised down to 3.3% from 3.4%. March quarter GDP rose by 3.8%. Industrial Production rose 0.1% in August after a similar rise in July. If not for the impact of Hurricane Katrina, Industrial Production would have risen by 0.3%. Capacity utilization rose 0.1% to a historical high of 79.8%.

The trade deficit was lower in July at US\$54.6b compared to US\$56.8b in June. Exports were up 0.4% while imports fell 0.7%. The current account deficit for the June quarter fell slightly to US\$195.7b, giving the annual deficit of US\$749.7b or 6.1% of GDP, up from 5.9% of GDP in the previous quarter.

CPI rose 0.5% in both July and August, lifting the annual rate to 3.6% from 3.2%. The core CPI (excluding food and energy) rose by only 0.1% for the 4th consecutive month, keeping the annual rate steady at 2.1%. Producer prices rose 0.6% in August, after rising 1.0% in July, driven by a 3.7% surge in energy prices.

The unemployment rate dropped 0.1% to 4.9% in August to be the lowest level in four years. Retail sales fell 2.1% in August after rising 1.8% in July, to be up 7.9% over the past year. The fall was mainly due to automotive sales. Taking this out, retail sales rose 0.5%.

China is still the engine of world economic growth. Fundamentals look sound and bode well for continued GDP growth and demand for Western goods and Australian mineral imports.

The housing market softened in August. Housing starts fell 1.3% in August after sliding 0.1% in July. The number of building permits fell 2.2% in the month, still 3.2% higher than a year ago. Existing home sales rose 2.0% to be 7.8% higher than a year ago. The median house price rose 15.8% over the past year. New home sales fell 9.9% in August, following a 5.3% rise in July or up 6.2% over the past year.

The US Conference Board consumer confidence index fell to the lowest level since October 2003, mainly due to Hurricanes Katrina and Rita, and surging energy prices.

The Eurozone economy was unexpectedly strong in August but was flat in the medium term. The EU expects GDP growth to slow from 2.1% in 2004 to 1.2% this year. The UK CPI rose 0.4% in August, or 2.4% over the past year. UK GDP during the June quarter grew by only 1.5% p.a.; the lowest rate for two years. The UK GDP growth is expected to be around 1.7% in 2005 compared to 3.2% in 2004, well short of the 3-3.5% expected by Treasury. UK unemployment rate was unchanged at 4.7% in July, while average earnings rose 3.9% p.a. Eurozone retail sales were weak in July, however, falling 0.5% to be flat in the year. Notwithstanding this, the Eurozone economy is expected to be flat in 2005.

China's GDP grew by 9.5% p.a. in the June quarter, above market expectations of 9.2%. Fixed asset investment rose 27% p.a. and industrial production rose 34% p.a. The OECD expects GDP to slow to 9.0% by year end and rebound to 9.2% by 2006. CPI slowed to 1.6% p.a. in June from 1.8% p.a. in May, while producer prices fell to 5.2% p.a. Real retail sales growth accelerated to 12% in the June half year from 10.25% in 2004. It is unlikely that the recent revaluation of the yuan will significantly affect the Chinese economy.

Share Market Outlook

The impact of Hurricanes Katrina and Rita are already being felt. The US share market has undergone a slight correction in early October due to concerns about economic growth and high energy prices. It is likely that some rebuilding activity in the US should spur economic activity in the short term, although this may be offset by weaker consumer confidence. It is becoming apparent that the US housing market has slowed, further adding to a more subdued outlook. Inflationary pressures are growing, albeit too slow to moderate a tightening monetary policy.

Economic fundamentals remain healthy for Australia. Inflationary pressures have moderated and thus the likelihood of further interest rate rises in the latter half of the year has faded. Economic growth is likely to remain around 3.0% due to healthy domestic fundamentals and the continuing strengths in the US and Chinese economies.

The labour market appears healthy. The risk of a freefall in the housing market is low. Consumer confidence is softening with continued high oil prices.

Nevertheless, the fundamentals for the US economy appear resilient: the unemployment rate is low, interest rates are still relatively low, the share markets are strong, and the housing market still healthy. The business outlook remains positive in the short term. Business confidence is strong with corporate net cash flow at near record levels. The trade deficit appears to be moderating slightly. However, inflationary pressures remain due to the tight labour market, lower productivity, and high oil prices.

The risks to the global economy is slightly abating with long-term bond rates suggesting continued strong growth in a low inflation environment, even in the face of high oil prices. The risk of the crude oil prices spiking appears to have been overstated with the likely impacts on the key US market appearing marginal due to continued Asian appetite for US assets.

Economic fundamentals appear sound for Australia. The unemployment rate is low, inflationary pressures are contained, business profit outlook is solid, and equity markets remain strong. It is likely that the risks to the housing market have moderated. Consumer confidence should soften with continued high oil prices. The risk of an official interest rate rise remains low for the next few months. Chinese demand for Australian minerals, particularly iron ore and coal, remains strong for the foreseeable future.

The drivers of the A\$ remains the US\$, Australian monetary policy and commodity prices. While the Chinese economy continues to defy governmental restrictions, it is likely that global demand for Australian minerals should continue, supporting the A\$. This should aid exporters at the expense of importers. Revenues and profits for materials companies should continue to benefit from the substantial April price increases. The likelihood of a significant downturn in the world economy is low. A minor correction in the US market already occurred in early October. The outlook continues to be positive in the short to medium term. The global economy grew by about 5% in 2004, and is expected to grow by 4.3% this year. China's GDP growth is now expected to be around 9% and a soft landing is becoming more of a reality as the economy shifts from industrial investment to residential and consumer spending.

The key drivers of global growth remain the US and China.

The risks to the world economy in the short to medium term are prolonged spikes in the crude oil prices, the US current account deficit, a widening US trade deficit, and a sharp rise in interest rates should Asian appetite for US assets diminish, and a marked slowdown in the Chinese economy. Higher inflation in the US and China is likely to lead to modestly higher interest rates.

Most stocks should benefit from the stimulatory effect of the 2005/06 budget. Energy stocks should retreat from recent highs. Retail stocks will be negatively affected by continued high oil prices.

The banking sector should continue to benefit from high economic activity and productivity gains. Energy companies should see volatility from fluctuating oil prices as the effects of Hurricanes Katrina and Rita moderate, utilities may benefit from investor speculation on interest rates, and transportation companies may benefit from continued high economic activity.

Negatives are expected from retail stocks, wine stocks and companies associated with the rural sector. The retail sector will see a shift in consumer spending due to high energy prices. Steel companies may face pressure from Chinese exports due to slowing Chinese demand and recent capacity additions. Industrial stocks are not particularly compelling as a sector, however exporters will benefit from a falling A\$.