

Period: 1st to 31th July 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 June was 26.7% as we have taken the opportunity to sell stocks at favourable prices. The actual returns in July for the Retail and Wholesale funds were +2.36% and +2.50% respectively compared to the +2.60% 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 The Australian Stock Exchange (ASX), BHP Billiton (BHP), BlueScope Steel (BSL), Futuris (FCL), Paperlinx (PPX), Santos (STO), Toll Holdings (TOL) and Woodside Petroleum (WPL)

The stocks that performed well this month and generated unrealized capital gains include BHP Billiton (BHP), Futuris (FCL), Orica (ORI), OneSteel (OST), Publishing & Broadcasting (PBL), Paperlinx (PPX), Toll Holdings (TOL), Westpac Bank (WBC) and Wesfarmers (WES).

During the month, shares that detracted from performance either due to low volatility or because they were displaying unrealized losses include ANZ Bank (ANZ), Coca-Cola Amatil (CCL), Origin Energy (ORG), Santos (STO), Tabcorp (TAH) and Woolworths (WOW).

The NavTraDE system resulted in increased weightings in: Westpac Bank (WBC), ANZ Bank (ANZ), Tabcorp (TAH), Woolworths (WOW), Macquarie Bank (MBL) and Wesfarmers (WES)

The NavTraDE system also resulted in decreased weightings in: Paperlinx (PPX), BlueScope Steel (BSL) and Futuris (FCL).

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

The Australian Share Market

The Australian equity market increased 2.60% in July (S&P/ASX200 Index), reflecting solid economic fundamentals. The Australian economy is now in the longest sustained growth period since Federation and was steady in the month of July.

Retail sales rose 1.3% in June, following the rise in May of 0.9%, reflecting a broad-based strength in the market, particularly in food (+1.2%), department stores (+3.5%), clothing and soft goods (+2.1%) and household goods (+1.3%). Credit growth slowed to 0.7% in June to be up 11.8% on a year ago. Housing credit growth was steady at 0.9%, business credit grew only 0.2%, while personal credit rose 1.5%.

The Australian stock market rose 2.6% in July. All major stock markets also rose in the face of increasing interest rates and high oil prices.

The unemployment statistics for July have not been released but should not materially differ from the record low of 5.0% in June.

The housing market continues to bubble with dwelling approval rising 0.9% in June. Compared to a year ago, approvals were down by 4.8%. Fundamentals remain solid for construction activity with non-residential approvals rising to a record \$1.59 billion, or 23% higher year on year.

The trade deficit narrowed modestly to \$1.4 billion in June (\$1.5 billion in May). Export values fell 0.8% (rural exports was up 2.6% but non-rural was down 1.7%) while import values fell 1.5% (capital goods fell 6.6%). For the June quarter, the trade deficit narrowed to \$5.1 billion from \$6.7 billion, and looks to be price driven. Export volumes rose about 1.4% (1.0% in March quarter) while import volumes rose 2.5% (2.0% in March quarter).

CPI rose 0.6% in the June quarter, or 2.5% higher than a year ago. The

underlying inflation rate rose 0.1% to 2.5%. Consequently, the RBA kept rates steady and dropped its tightening bias to neutral. It expects the underlying inflation to peak at 3% in 2006.

In summary, the Australian real economy continued to grow, with the small rebound in the housing market continuing. Interest rates were steady, and consumer confidence surged due to record unemployment, relatively low inflation and the wealth effect of strong housing and equity markets.

The best performing sectors in June were Software & Services (+8.56%); Automobiles & Components (+8.40%); Consumer Durables & Apparel (+8.25%); and Materials (+6.28%).

The worst performing sectors were Transportation (-2.0%); Hotels Restaurants & Leisure (+0.32%); Utilities (+0.41%); and Telecommunication Services (+0.49%).

All but one of the sectors increased in value, but the market was weighed down by the flat results from Banks (+0.86%) and Utilities.

The performances of the global stock markets were strong: The S&P 500 index rose 3.60%, the Nasdaq rose 6.22%, the FTSE rose 3.31%, the Nikkei 225 rose 2.72% and the HangSeng rose 4.79%.

Business confidence in the US remains firm. Greenspan testified to Congress on 21 July that "our baseline outlook for the US economy is one of sustained economic growth and contained inflation pressures". The Fed rose their baseline inflation forecast from 1.5-1.75% to 1.75-2.0% for 2005 and 2006. GDP growth forecast was lowered to 3.5% in 2005 (from 3.75-4.0%) and 3.25-3.5% in 2006.

GDP rose to 3.4% in the June quarter, after a 3.8% rise in the last quarter. Industrial production surged by 0.9% in June to be up 0.4% over the year, driven by a 5.3% rise in utility output. Capacity utilization rose 0.6% to 80.0%.

Nonfarm employment grew by 207,000 in July, and the unemployment rate was unchanged at 5.0%. Retail sales surged by 1.7% in June or up 8.3% over the year. Auto sales surged to the strongest level since September 2001. CPI was unchanged in June at 2.5% p.a. The core inflation rate rose by 0.1% to 2.0%.

The US housing market is booming. Home sales rose to a record high in June, existing homes rising 2.7% to be 4.4% above a year ago. The median selling price rose a record 14.7% in the year. New home sales also increased to a record level.

The US trade deficit in May was lower than expected at US\$55.3 billion (US\$57.0 billion in April). Exports rose 0.1% to be up 10.9% on a year ago, while imports fell 0.9% mainly due to weaker petroleum prices and volumes (imports increased 11.8% over the past year). Import prices increased 1.0% in June mainly due to a 7.6% rise in petrol prices while non-petrol prices fell 0.4% due to the stronger USD.

The Eurozone economy was relatively flat. UK GDP rose by 0.4% in the June quarter or 1.7% over the past year, the lowest level since early 1993. The UK CPI was unchanged in June, while the annual rate increased from 1.9% to 2.0%. The core inflation rate fell from 1.6% to 1.5%. The Bank of England cut official interest rates as expected by 0.25% to 4.50%. The ECB left official interest rates unchanged at 2.0%.

China's GDP grew by 9.5% p.a. in the June quarter, above market expectations of 9.2%. Retail sales grew by 12.9% in the year to June (12.8% p.a. in May). CPI increased to 1.6% p.a. while industrial production increased by 16.8% p.a. (16.6% p.a. last month). The Peoples Bank of China announced a currency revaluation of the yuan from 8.28 to the USD to 8.11, a 2.1% move. The yuan will now be managed against a basket of currencies and will be allowed to fluctuate by 0.3% day to day.

All but one of the major sectors increased in value in July, though the market was weighed down by the flat banking sector.

The world economy remains strong, largely driven by the US and Chinese economies.

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.

Share Market Outlook

The world economy is clearly slowing after growing by 5.1% in 2004, the fastest rate since 1976. The present growth rate is around 4.5%. The key drivers of world economic growth remain the USA and China. The US economy is growing at around 3.5 to 4.0% while China is maintain its above 9.0% rate.

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.

Consumer demand remains high and the labour market appears healthy. The risk of a freefall in the housing market is low, and consumer sentiment has rebounded.

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

Most stocks should benefit from the stimulatory effect of the 2005/06 budget, particularly the banks and retail sectors. Energy stocks should benefit from high fuel 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.

The single biggest threat to the US economy remains the burgeoning current account deficit, now at 6.3% of GDP and rising. This is largely driven by strong Asian appetite for US financial assets. The fundamentals for the US economy appear solid: the unemployment rate is low, consumer confidence is high, the housing market is hot and the equity market continues to grow. 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 and high oil prices.

The Australian economy remains strong: the unemployment rate is at record lows, inflationary pressures have abated, consumer confidence is high and the housing market is resilient. 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. It is likely that the A\$ will fall slightly as the US continues to raise interest rates and demand for commodity falls in line with a slowing and rebalancing Chinese economy. 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. 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. Despite Chinese government attempts to slow the economy, 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 risks to the world economy in the short to medium term are unforeseen 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.

The banking sector should continue to benefit from high economic activity and productivity gains. Rebounding consumer confidence bodes well for retail stocks, particularly in the consumer discretionary sector. Energy companies should continue to benefit from high crude oil prices, utilities may benefit from investor speculation on interest rates, and transportation companies may benefit from continued high economic activity.

Negatives are expected from wine stocks and companies associated with the rural sector. 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\$.