



Period: 1st to 31st October 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 October was 6.4% as we have taken the opportunity to buy stocks at favourable prices. The actual returns in October for the Retail and Wholesale funds were -4.64% and -4.66% respectively compared to the -3.91% 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 Gaslight Company (AGL), the Australian Stock Exchange (ASX), BHP Billiton (BHP), Macquarie Bank (MBL), Santos (STO), and Wesfarmers (WES).

The stocks that performed well this month and generated unrealized capital gains include the Australian Stock Exchange (ASX).

During the month, the share that detracted from performance either due to low volatility or because they were displaying unrealized losses was BlueScope Steel (BSL), Coca-Cola Amatil (CCL), Futuris (FCL), Lion Nathan (LNN), Origin Energy (ORG), Orica (ORI), Tabcorp (TAH), Toll Holdings (TOL), Woolworths (WOW), and Woodside Petroleum (WPL).

Inclusions to the portfolio this month include Westfield (WDC), and National Australia Bank (NAB).

The NavTraDE system resulted in increased weightings in: Woodside Petroleum (WPL), OneSteel (OST), Lion Nathan (LNN), Macquarie Bank (MBL) and Tabcorp (TAH).

The NavTraDE system also resulted in decreased weightings in: Australian Gas Light Company (AGL).

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

The Australian Share Market

The Australian equity market fell 3.91% in October (S&P/ASX200 Index), as the world markets fell on concerns of the economic impact of high oil prices.

Retail sales value dipped 0.3% in September compared to growth of 0.5% in August (discretionary spending dropped 0.4%). Retail volumes rose 0.5% in the September quarter, bringing the annual rate to a five-year low of 1.2%. Retail prices (excluding fuel) rose 0.7% in the quarter, down from an increase of 0.4% in the previous quarter. As expected, consumer sentiment was adversely affected by continued high fuel prices reducing discretionary expenses and raising prices, compounded by the end of the housing boom.

The Australian stock market fell 3.9% in October. Retail sales slowed due to high oil prices and a slowing housing market. The jobless rate rose for the first time in 13 months.

Credit growth is slowing. Business credit is still high but personal and housing credit growth is slowing with a weakening housing market and lower consumer confidence.

The housing market remains weak, with residential approvals rising 1.8% in September after falling 8.0% in August and 8.9% in July. The value of non-residential approvals fell 1% in September to be down 3.5% on a year ago and down 14% from the May peak of \$3.2b. John Symonds, MD of Aussie Home Loans, has predicted a fall in the residential home prices of around 10% in the coming 12 months.

Employment fell for the first time after 12 consecutive monthly rises. The annual rate of jobs growth slipped to 2.9% from 4.2%. The number of full-time jobs fell 25,900 while part-time jobs dropped 16,500. Consequently the jobless rate rose 0.1% to 5.1% and the participation rate fell from its record high of 64.8% to 64.5%.

The trade deficit widened from \$1.46b in August to \$1.62b in September, reflecting a 0.3% rise in imports and a 1.0% fall in export values. The fall in

exports was mostly due to a transportation disruption in the resources sector and an easing in cereal grain exports. Capital good imports rose 2.7% while consumption goods imports fell 1.2%. The CPI rose 0.9% in the quarter and the annual inflation rate is now 3.0%. The underlying inflation rate is at 2.5%. The inflation rate is now at the top of the RBA's target range for the first time since early 2003.

In summary, the Australian real economy continued to grow, mainly due to exports and construction. Retail spending and the housing market are clearly slowing. 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 Telecommunication Services; Technology, Hardware & Equipment; and the Software & Services sectors.

Most sectors performed poorly in the month. The best performing sectors in October were Telecommunication Services (+2.82%); Technology Hardware & Equipment (+1.46%); and Software & Services (+1.01%).

The worst performing sectors were Energy (-11.34%); Diversified Financials (-8.08%); Transportation (-7.91%); Capital Goods (-6.81%) and Materials (-6.81%). Despite strong demand Material stocks fell due to transportation difficulties.

World markets fell due to the correction in the US stock markets on fears of high oil prices and future earnings growth.

The performances of the global stock markets were mostly negative in October, following the correction in the US: the S&P 500 index fell 1.77%, the Nasdaq fell 1.46%, the FTSE fell 2.93%, the Nikkei 225 was steady and edged up 0.24% and the HangSeng fell 6.75%.

Inflationary pressure is gathering pace in the US and is likely to lead to further interest rate rises.

US economic growth surged in the September quarter to 3.8% p.a. from 3.2% the previous quarter, despite the hurricane disruption. The September quarter GDP rose 3.8%, up from 3.3% in the June quarter. The trade deficit increase \$US1b in August to UD\$59b. Imports rose 1.8% due to higher oil prices while exports rose 1.7% due to a surge in capital goods exports. Industrial production decline 1.3% in September, with manufacturing down 0.5%. Capacity utilization fell 1.2% to 78.6%. These data are probably distorted by the disruption of the hurricanes strikes on economic production.

The headline CPI increase 1.2% in September, the largest monthly gain in 25 years. The annual rate increase from 3.6% to 4.7% in the month to be at the highest level since 1991. The huge increase was due to energy. The core CPI rose only 0.1%, causing the annual rate to fall 0.1% to only 2.0%. The US Federal Reserve increased interest rates by 0.25% to 4.0% for the 12th consecutive increase. There seems no immediate end to the tight monetary policy.

Retail sales rose only 0.2% in September. However, excluding gasoline and auto sales, retail sales rose a consistent 0.6% after a similar rise in August. Falling consumer sentiments are yet to translate to reduced retail sales. The University of Michigan's consumer sentiment index for October slid 1.2 points to 74.2.

Housing starts for September was up 3.4% with the hurricane impact yet to be seen in the data. Building approvals surged to 32 year highs and should continue to increase with post-hurricane reconstruction when housing construction is expected to be strongest since 1972.

The unemployment rate was essentially unchanged at 5.0% in October. After a similar increase in September, the number of persons unemployed due to job loss fell by 201,000 in October to 3.5 million. Since December, the number of unemployed job losers has decreased by 585,000. While the unemployment rate was essentially unchanged, the decrease in part-time workers of 330,000 to 4.3 million suggests a shift towards full-time employment.

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 European economies are slowing. The EU expects GDP growth to slow from 2.1% in 2004 to 1.2% this year. Soaring oil prices has caused UK inflation to rise to 2.5% in September, the highest rate since 1997. The CPI rose 0.1% to 2.5%, the third month in a row that inflation has been above the Bank of England's target of 2.0%. The UK employment market was essential flat: the unemployment rate was 4.7%, the second lowest figure for 30 years. Average earnings increased by 4.2% in the year to August, unchanged on the previous month. The Eurozone unemployment rate fell 0.1% to 8.4% in September, the lowest level in three years.

The Chinese growth story continues. GDP rose to 9.4% p.a. in the September quarter. The quarterly growth rate rose from 1.0% to 1.9% and showing no signs of slowing. Industrial Production rose 16.3% in the first nine months of 2005. Inflation rose only 0.9% in September due to a fall in food prices. The CPI rose 2.0% p.a. in the first three quarters of 2005. Prices maintained a moderately upward trend with 1.7% rise in cities and 2.5% rise in rural areas. Retail sales of consumer goods rose 13.0% year-on-year. Producer prices of manufactured goods jumped 5.4% and prices of raw material, fuel and power surged 9.2%. Total fixed assets investment rose 26.1% year-on-year while housing development rose 22.2%. All in all, China's economic boom shows no signs of abatement.

Share Market Outlook

The impact of Hurricanes Katrina, Rita and Wilma are already being felt. The US share market has undergone a slight correction in October due to concerns about economic growth and high energy prices. It is likely that the rebuilding activity in the US should spur economic activity in the short term, although this may be offset by weaker consumer confidence. Inflationary pressures are growing, giving impetus to a tightening monetary policy.

Australian economic fundamentals remain healthy. Inflationary pressures have moderated and the possibility of further interest rate rises 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.

Nevertheless, the fundamentals for the US economy appear resilient: the unemployment rate is low, interest rates are increasing but still relatively low, the share markets are strong, and the housing market awaits the hurricane reconstruction boost. The business outlook remains positive in the short term. However, inflationary pressures remain due to the tight labour market, lower productivity, and high oil prices.

The hurricane rebuilding and relief expenditure should provide a medium-term boost to the US economy of upwards of US\$200b. This should offset the effects of high fuel prices, at the expense of retail spending, the current account and the budget deficits. Housing starts should spurt and construction related industries should benefit.

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 labour market appears healthy but may have passed its peak. Consumer confidence is softening with continued high oil prices and is affecting retail stocks hit by both lower consumer demand and higher transportation costs.

Australian economic fundamentals appear sound in the short term. The unemployment rate is low, inflationary pressures are contained, business profit outlook is good, and equity markets remain strong. It is likely that the risks to the housing market have moderated and the housing dip is expected to be shallow. Consumer confidence should continue to soften with ongoing 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 Chinese demand for Australian commodities should support the A\$, this is more than offset by the strongly rebuilding US economy and higher US interest rates. Thus, the A\$ is weakening and 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. China's GDP growth is now expected to be around 9%.

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, 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 and consequently pressure on the A\$.

Energy stocks should retreat from recent highs. Resources companies may benefit from a falling A\$. Retail and transportation 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. Resources companies may benefit from a falling A\$.

Negatives are expected from retail stocks, wine stocks and companies associated with the rural sector. Transportation companies will begin to feel the effects of higher fuel prices. The retail sector will see a shift in consumer spending due to high energy prices. The customs clearance debacle is not helping these sectors, particularly as the peak Christmas sales period approaches. 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\$.