



Fund Performance Commentary

Period: 1st to 31st December 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 December was 16.5% as we have taken the opportunity to sell stocks at favourable prices. The actual returns in December for the Retail and Wholesale funds were +1.60% and +1.57% respectively compared to the +2.77% 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 ANZ Bank (ANZ), BHP Billiton (BHP), Orica (ORI), Santos (STO), Toll Holdings (TOL), and Woodside (WPL).

The stocks that performed well this month and generated unrealized capital gains include The ANZ Bank (ANZ), BHP Billiton (BHP), Coca-Cola Amatil (CCL), Lion Nathan (LNN), Origin Energy (ORG), Orica (ORI), Santos (STO), Toll Holdings (TOL), Westpac Bank (WBC), Westfield (WDC), and Wesfarmers (WES).

During the month, the shares that detracted from performance either due to low volatility or because they were displaying unrealized losses were Futuris (FCL), Bluescope Steel (BSL), National Australia Bank (NAB), OneSteel (OST), Publishing & Broadcasting (PBL), and Woolworths (WOW).

There were no inclusions or exclusions to the portfolio.

The NavTraDE system resulted in increased weightings in: Orica (ORI), Woolworths (WOW), and Santos (STO).

The NavTraDE system also resulted in decreased weightings in: BHP Billiton (BHP), Woodside (WPL), Futuris (FCL), Coca-Cola Amatil (CCL), and Lion Nathan (LNN).

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

The Australian Share Market

The Australian equity market rose 2.77% in December (S&P/ASX200 Index), continuing the strong rise in November.

ABS retail trade figures showed a 0.1% drop in consumer spending in November. Sales at clothing stores fell 1.5% and sales at supermarkets dropped 0.7%, while sales at department stores rose 0.3%. Retail figures are likely to be weaker than usual for December due to heavy pre-Christmas discounting.

The Australian stock market rose 2.8% in December. Unemployment ticked down even while trade performance improved. Retail sales continue to weaken.

The housing market is surprisingly resilient. Building approvals were stronger than expected in November, rising 3.4% in the month. Private house approvals rose 2.6% while other approvals rose 7.6%. Housing finance loans increased in October by 1.1%, or 3.0% excluding re-financing. The total value of housing loans increased 2.5% in October. Even the value of loans to the investor segment rose 4.0%. First-homebuyers re-entered the market, boosting loans by 4.9%.

The November employment level grew 28,000, after falling 63,000 in the previous two months, to be up 2.3% over the past year. Full-time jobs grew for the first time in three months, to be up 48,000, while part-time jobs fell by 20,000. Full-time jobs were up 1.9% over the year compared to part-time jobs rising by 3.5%. The unemployment rate slipped from 5.2% to 5.1%.

The October trade deficit narrowed to \$1.33billion in October from

\$1.56billion in September. Exports rose 2.3% while imports rose only 0.6%. Rural exports rose 1.0% but volumes fell. Non-rural exports rose 3.5%. Capital imports rose 6.6% implying corporate confidence in future growth.

The September quarter GDP showed only growth of 0.2% after the rise of 1.3% the previous quarter. House prices weakened in the quarter and private consumption was up only 0.6%. Business investment rose an encouraging 2.5% while public spending fell 1.8%. Exports fell 2.3% in the quarter compared to imports falling 0.5%. Growth in the business sector is likely to come from mining and infrastructure, particularly roads, as infrastructure expenditure rose 5.8%.

In summary, the Australian real economy continues to bubble along. Retail spending is clearly slowing while the housing market is resilient. Employment is strong, interest rates are relatively low and demand for Australian minerals exports remains keen.

The best performing sectors were the Consumer Durables & Apparel, Energy, Materials and Capital Goods.

Most sectors performed well in December. The best performing sectors in the month were Consumer Durables & Apparel (+10.73%); Energy (+6.47%); Materials (+6.00%); Capital Goods (+4.14%); and Pharmaceuticals & Biotechnology (+4.13%).

The worst performing sectors were Software & Services (-2.10%); Retailing (-3.20%); Automobiles & Components (-5.92%); and Technology Hardware & Equipment (-6.09%).

The performances of the global stock markets was largely steady for the month of December: the S&P 500 index fell 0.10%, the Nasdaq fell 1.23%, the FTSE rose 3.61%, the Nikkei 225 leapt 8.33% and the HangSeng fell 0.41%.

The US economy performed as expected. The economy grew at a 4.1% annual rate in the third quarter, the fastest since the first three months of 2004 and the 10th quarter in a row of +3% growth.

World markets were steady in December.

Retail sales rose 0.5% in December following a gain of 0.3% in November. In 2005 total sales rose 7.6%, excluding automobiles and gasoline. The headline CPI fell 0.6% in November due to a 16% decline in gasoline prices. Annual inflation fell to 3.5% from 4.3% in October. The core CPI rose 0.2% in November, or a steady annual rate of 2.1%.

The US economy continues to grow while Europe is showing signs of picking up after several years in the doldrums.

The housing market weakened slightly in November. New home sales fell 11.3% while existing home sales fell 1.7%. Median prices rose 13.2% over the year.

Employment grew by 108,000 in December compared to 305,000 in November, bringing 2005 jobs creation to just over 2 million for the second consecutive year. The unemployment rate fell to 4.9% from 5.0% in November.

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 current account deficit narrowed in the third quarter to US\$195.8b from \$197.8b in the previous quarter, or 6.2% of GDP compared to 6.4%. However, the trade deficit deteriorated by US\$11b in the quarter. In October, the trade deficit widened by US\$2.9b to US\$68.9b. Exports rose 1.7% to be up 9.2% for the year, while imports rose 2.7% to be up 14.5% for the year. Industrial production grew in November by 0.7% after a 1.3% gain in October. Capacity utilization rose 0.4% to 80.2%.

The Federal Reserve raised its main lending rate by 0.25% to 4.25% on Dec. 13, the 13th consecutive increase, and foreshadowed nearing the end of its tightening stance.

Europe's economy is picking up pace. German industrial production increased 4.7% in November from a year earlier, the largest gain in nearly five years. The euro-region's jobless rate stayed at 8.3% in November, the lowest in more than three years. The ECB raised its benchmark rate for the 12 euro countries to 2.25% in December after setting it at a six-decade low for two and a half years. The bank expects euro-region growth to accelerate to about 1.9% next year from 1.4% this year.

China's economic boom continues, with a record monthly trade surplus of about US\$13 billion in December or around \$104 billion in 2005. The National Bureau of Statistics revised 2004 GDP growth from 9.5% to 10.1%.

Retail sales rose 12.4% year-on-year in November compared to 12.8% in October. CPI in November rose 1.3% year-on-year, compared to 1.2% in October, while for the first 11 months of the year it rose a remarkably low 1.8%.

Share Market Outlook

US economic fundamentals appear sound. Unemployment is low, and strong housing and equity markets bode well for consumer confidence. Inflationary pressures are under control, although the risk is on the upside. Accommodative monetary policy is stimulating production and with anticipated fiscal stimulus in 2006 should see the economy continue to expand. High fuel prices and the effects of last year's hurricanes do not appear to have any noticeable dampening effects, although high fuel prices could see moderating consumer confidence in the coming winter months.

Continued growth is likely to see a worsening current account balance, with 1.5% of GDP being set aside for the hurricane relief. The trade deficit is also likely to worsen as the US relies more on imported crude oil following the hurricane disruptions. Net long-term capital inflows remain resilient and more than sufficient to fund the rising trade deficit.

Business confidence remains sound. Durable goods orders are rising. While capital goods spend, excluding military orders, is falling, this is more than offset by continued strong military expenditure. Factory orders remain high as evidenced by the 2.5% increase in November.

The risks to the global economy are low and suggest 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, and the booming Chinese economy is fuelling US demand for consumer goods. Consumer sentiments, fuelled by fiscal stimulus and the wealth effects of strong equity and housing markets should continue to support the US market.

Australian economic fundamentals appear sound in the short term and most analysts predict continued growth in 2006. The unemployment rate is low, inflationary pressures are contained, business profit outlook is good, and equity markets continue to reach new records. It is likely that the risks to the housing market have moderated and housing demand appears on the upturn. Consumer confidence has steadied as the impact of high oil prices has not been severe. 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\$ remain the US\$, Australian monetary policy and commodity prices. Demand from China for Australian commodities should support the A\$, but this is likely to be more than offset by the growth in the US economy and higher US interest rates. A softer A\$ should aid exporters at the expense of importers. Revenues and profits for materials companies should continue to benefit from high commodity prices and increasing production.

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 Chinese growth story continues to fuel economic growth in the rest of the world. Chinese inflation is remarkably low considering high credit growth and consumer spending. The risks to the world economy in the short to medium term are unchanged and include a sharp correction in the US stock market from inflationary and currency devaluation fears stemming from an unexpected worsening of the twin deficits. Fears of higher oil prices have abated and the general outlook is positive.

Australian economic fundamentals remain sound. Inflationary pressures are low 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.

The labour market appears buoyant but may have passed its peak. Consumer confidence should improve due to the continued wealth-effects of strong stock and housing markets.

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

Energy stocks should retreat from recent highs. Resources companies may

The banking sector should continue to benefit from high economic activity. Energy companies should see volatility from fluctuating oil prices. Resources companies may benefit from further global demand, higher production, and a

benefit from a falling A\$. Retail and transportation stocks will be negatively affected by continued high oil prices.

falling A\$. Materials companies should benefit from the resilience of the housing market. Infrastructure companies may benefit from higher traffic numbers associated with strong economic activity.

Negatives are expected from retail stocks, wine stocks and companies associated with the rural sector. Transportation companies should feel the effects of higher fuel prices. 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 for imported steel and recent capacity additions leading to cheaper global steel prices. Industrial stocks are not particularly compelling as a sector, however exporters will benefit from a falling A\$.