

**Period: 1<sup>st</sup> to 30<sup>th</sup> April 2007**

### **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 April was 46% as we have taken the opportunity to sell stocks at favourable prices. The actual returns in April for the Retail and Wholesale funds were both +3.02% and +3.03% respectively compared to the +2.85% 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), Boral (BLD), Macquarie Bank (MBL), Lion Nathan (LNN), National Australia Bank (NAB), Orica (ORI), OneSteel (OST), Publishing & Broadcasting (PBL), Toll Holdings (TOL), Tabcorp (TAH), and Wesfarmers (WES).

The stocks that performed well this month and generated unrealized capital gains include The ANZ Bank (ANZ), Fairfax (FXJ), Orica (ORI), OneSteel (OST), Publishing & Broadcasting (PBL), Rio Tinto (RIO), and Santos (STO).

During the month, the shares that detracted from performance either due to low volatility or because they were displaying unrealized losses were Bendigo Bank (ASX), Foster's (FGL), Iluka Resources (ILU), and Woodside (WPL).

Telstra Limited (TLSCA) was added to the portfolio.

The NavTraDE system resulted in increased weightings in: Westpac Bank (WBC), Toll Holdings (TOL), and Telstra (TLSCA).

The NavTraDE system also resulted in decreased weightings in: National Australia Bank (NAB), Wesfarmers (WES), Westfield (WDC), and Orica (ORI).

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

### **The Australian Share Market**

**The Australian stock market rose for the ninth consecutive time in April.**

**The unemployment rate fell to a 33 year low of 4.4% even as participation increased.**

**GDP growth is around 2.8% p.a., driven by resources exports, housing construction and consumer spending.**

The Australian economy appears very healthy at present and forecasts are bullish. The stock market rose for the ninth consecutive month with the benchmark (S&P/ASX200 Index) rising by 2.85% in April.

The Reserve Bank has estimated that non-farm GDP is presently growing at 3.25% p.a, with the drought accounting for a fall of 0.75%. Australia's GDP grew a seasonally adjusted 2.8% p.a. in the fourth quarter, up from 2.2% in the third quarter, due mainly to construction, mining, manufacturing, and household spending.

Due largely to the rise in the AUD, the RBA has reduced its 2007 inflation from 2.75% to 2.5%. Annual inflation cooled to 2.4% in the first quarter, falling within the central bank's target range of 2 to 3% for the first time in a year. Consequently the RBA has maintained benchmark interest rates steady at 6.25%. The probability of a further interest rate rise later this year has also declined. Wages grew by 1.1% in the last quarter or 4.25% p.a., just below the 4.5% the RBA considers to be inflationary. Retail sales soared 2.0% in the first quarter, the largest increase in more than three years, and now accounts for 23% of GDP. Department stores sales rose 3.6%, recreational goods sales rose 2.3%, while hospitality increased 1.0%.

The unemployment rate has declined to a record 4.4% in April, the lowest in 33 years. Total employment rose 0.48%, with part-time jobs growth outstripping full-time jobs growth by about three to one. The participation rate was 64.9%, compared with an unrevised 64.8% in March. Home

***Consumer spending has increased sharply due to strong wages growth, high employment and low housing affordability.***

building approvals rose 9.0% in February but slumped 11.4% in March due to a 29.2% drop in apartments construction. Private houses construction was flat in March, edging up 0.1%. House prices have increased 8.6% nationally over the past year.

***The trade deficit doubled due to cyclones affecting mineral exports.***

Australia's trade deficit more than doubled to A\$1.62 billion from A\$728 million in February. Exports dropped 4% due mainly to cyclones affecting mineral exports and the drought impacting farm exports. Imports rose 1% although consumer goods imports declined 4%.

***The best performing sectors were Retailing; Diversified Financials; Capital Goods and Pharmaceuticals & Biotechnology.***

In summary, the Australian economy remains healthy although clearly driven by the resources boom. Retail spending has picked up due to wages growth and high employment. Interest rates are still relatively low and inflationary pressures have eased with the higher AUD. Demand for Australian minerals exports remains unabated.

***World markets were mostly up in April.***

The best performing sectors were Retailing (+7.7%); Diversified Financials (+6.3%); Capital Goods (+6.2%) and Pharmaceuticals & Biotechnology (+6.0%).

The worst performing sectors in April were Health Care Equipment & Services (-3.4%); Software & Services (-2.1%); Food Beverage & Tobacco (-1.5%); and Consumer Durables & Apparel (-1.3%).

***The price performances of major commodities improved due to continued demand for mineral commodities from China.***

The global stock markets mostly rose in April: the MSCI world index rose 4.2%; the S&P 500 index rose 4.3%, the Nasdaq rose 4.3%, the FTSE rose by 2.2%, the Nikkei 225 edged up 0.7% and the Hang Seng rose 2.6%. The performances of major commodity prices were strong in April; crude oil slipped 0.2%. Gold recovered by 3.1%. All base metals recorded price gains with copper (+12.7%), zinc (+12.5%) and nickel (+10.1%) leading the way.

Economic data showed growth beginning to slow in the US. GDP growth in the US slowed to 1.3% p.a. in the first quarter compared to 2.5% p.a. in the previous quarter due to the housing slump. US home-building dropped by 17% in the past year and accounted for a fall in GDP by 1%.

***The US economic data continues to show signs of a slowing economy. Jobs growth has slowed, consumer sentiment is weak and the housing slump is becoming more evident.***

Consumer sentiment has also dampened, contributing to lower economic growth. Retail spending edged up only 0.3% in April even though average personal income rose 0.7%. Inflation also rose higher than expected. Core prices, excluding food and energy, rose at a rate of 2.2% p.a. in the March quarter, up from the 1.8% pace in the previous quarter. Overall prices rose 3.4% p.a. compared to a 1.0% decline in the December quarter.

Unemployment rose to 4.5% in April from 4.4% in March. The jobs growth rate was the lowest since November 2004. Average weekly earnings edged down by 0.1% over the month. Over the year, average hourly and weekly earnings grew by 3.7 and 3.4% respectively. The Federal Reserve has maintained the benchmark interest rate at 5.25% p.a. since June 2006. While inflation has risen above the target range, there is speculation that the interest rate may be cut to counter the risks of recession.

***US export performance has improved, although offset by high oil imports.***

The trade deficit shot up in March to the highest level in six months, driven by a big jump in imported oil to be up 10.4% from February. Oil imports grew 17.6%. Rising gasoline prices also dampened retail sales. The trade imbalance with China improved slightly, falling 6.4%, due to higher US exports. Exports rose 1.8% while imports rose 4.5%, both the second highest levels on record.

***The Eurozone economies are showing strong economic growth, offsetting weakness in the US economy.***

The Eurozone economies showed their strongest growth rate since 2000, with GDP expanding by 2.6% in 2006, compared to 1.4% in 2005. The prospects are for a similar growth rate in 2007. Unemployment is trending down and has reached its lowest level since 1993. Although the jobless rate is still quite high at above 7%, wages growth of around 4-5% is putting some pressure on inflation.

***Fundamentals look sound and bode well for continued demand for Australian mineral imports.***

The Chinese economic boom continues. First quarter GDP growth is reached 11.1% p.a., up from 10.4% the previous quarter. China's trade surplus ballooned 88% in the first four months of 2007, adding to concerns about excess liquidity and an overheating economy. While still relatively low, China's inflation accelerated to 3.3% in March, the highest in more than two years, and more than the central bank's target of 3%.

## **Share Market Outlook**

***The US economy appears sound in the short term with corporate profits from international sales helping to offset weakness in the housing market.***

Economic indicators suggest a slowing US economy, with some prospects for recession. There is a possibility that the Fed will cut interest rates later this year. US corporations are increasing their share of global trade, decoupling themselves from the domestic market. The overseas revenue share of S&P500 companies has risen from almost 30% in 2001 to almost 50% in 2006. Hence it is expected that the US should continue to benefit from the global economic boom, and a resilience of the US financial markets should help offset potential Chinese sell-down of its US treasury holdings.

***Australian economic fundamentals remain healthy. Inflationary pressures have moderated on the back of a rising AUD.***

While there have been recent concerns about the sustainability of the US economy, commodity prices should be supported by the robustness of the European and East Asian economies. Australia's mineral exports to Japan and China are now at record highs and trending upwards. The risks to the global economy are still low and suggest continued growth in 2007, although at a slightly lower pace than in 2006. Slowing US economic growth and increased geopolitical risks should see the US dollar weaken which would help US exports relative to imports. A soft landing for the US economy is still anticipated while the corporate sector appears healthy. Growth in the Eurozone is now expected to surpass that of the US in 2007 and may act as a buffer to maintain the global growth momentum.

***Economic growth is likely to remain around 3.0% despite the drought due to healthy domestic fundamentals and the continuing strength of the global economy.***

Australian economic fundamentals appear sound in the short term with continued economic growth likely in 2007, particularly with the fiscal stimulus from the 2007-08 federal budget. The unemployment rate is low, business profit outlook is sound, and equity markets continue to reach new records. The housing market is still buoyant, though with increasing concerns about its sustainability in a modestly rising interest rate environment. The government has slashed its economic growth forecast to the slowest in six years due to the impact of the drought. However, the resources sector should continue to dominate while the consumer sector slows and a high A\$ impacts export manufacturing. Chinese demand for Australian minerals remains strong for the foreseeable future.

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

Demand from China for Australian commodities should support the A\$ particularly as the US\$ weakens. A stronger A\$ should aid importers (especially retailers) at the expense of exporters. Revenues and profits for materials companies should continue to benefit from high commodity prices and increasing production. The Chinese economic boom continues to fuel economic growth in the rest of the world.

***European and East Asian economies should offset weakness in the US economy.***

The risks to the world economy in the short term are largely unchanged, although there is increasing speculation of a risk of a short and mild recession in the US at the end of 2007. The Federal Reserve has forecast the economy to grow by 2.5% to 3.0% in 2007 and 2.75% to 3.0% in 2008.

***Resources companies should continue to benefit from strong Chinese demand for commodities. Banks and materials companies should benefit from high economic activity.***

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 4.0% to 4.5% in 2006, and is expected to grow by 4.0% this year. China's GDP growth is now expected to be around 10 to 11%.

The banking sector should continue to benefit from high economic activity. Resources companies may benefit from further global demand and higher production but will have to contend with a stronger 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. Retail stocks should continue to be supported by strong consumer sentiments and a strong A\$.

Negatives are expected from wine stocks and companies associated with the rural sector, although the drought is widely expected to break this year. Industrial stocks are not particularly compelling as a sector, particularly as exporters must contend with a strong A\$.