

Period: 1st to 28th February 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 February was 40.1% as we have taken the opportunity to sell stocks at favourable prices. The actual returns in February for the Retail and Wholesale funds were both +0.88% compared to the +1.02% 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), Boral (BLD), Macquarie Bank (MBL), Lion Nathan (LNN), Orica (ORI), OneSteel (OST), Westpac Bank (WBC) and Woolworths (WOW).

The stocks that performed well this month and generated unrealized capital gains include The ANZ Bank (ANZ) and Bluescope Steel (BSL).

During the month, the shares that detracted from performance either due to low volatility or because they were displaying unrealized losses were Toll Holdings (TOL), Iluka Resources (ILU), and Great Southern Plantations (GTP).

Oil Search Limited (OSH) was added to the portfolio.

The NavTraDE system resulted in increased weightings in: BHP Billiton (BHP), Rio Tinto (RIO), Wesfarmers (WES) and Toll Holdings (TOL).

The NavTraDE system also resulted in decreased weightings in: Woolworths (WOW), Bluescope Steel (BSL) and Lion Nathan (LNN).

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

The Australian Share Market

The Australian stock market rose 1.0% in February.

The Australian economy continues to grow. Despite some concerns about the Chinese stock market, the Australian equity market rose 1.02% in February (S&P/ASX200 Index), the seventh monthly rise since July.

The unemployment rate fell to a 31-year low of 4.5%. 300,000 jobs were created in 2006.

The unemployment rate fell to a thirty-one-year low of 4.5% in January. The growth in jobs is about 2.8% p.a. with the resources sector leading the way with a growth rate of 3.8% p.a. Net employment gain in 2006 was around 300,000. Job vacancies rose 3.4% in February from the previous month.

GDP was up 1.0% in the December quarter, well above consensus forecasts of a 0.6% rise. Annual GDP growth quickened to 2.8% from 2.2% in the third quarter. Household spending added 0.7% to growth, as did business and government investment and corporate inventory stocks. These more than offset the 1.3% drag from the trade deficit. Manufacturing achieved 1.9% growth in the quarter, while mining rose 3.0% and construction 4.2%.

Retail sales fell in February after January's unexpected rise, and the housing market was aided by the increasing attractiveness of rental yields.

The Reserve Bank has maintained benchmark interest rates steady at 6.25%, although the strong employment environment, recovering housing market, and GDP growth have increased the risks of further rate rises in the year.

Australia's CPI dropped 0.1% in the fourth quarter after gaining 0.9% in the previous three months, for an annual increase of 3.3%. However, it is expected to have escalated to around 3.5% p.a. to be well above the RBA's range of 2-3%.

The three modest interest rate rises in 2006 have had no significant impact

The trade deficit improved due to falling consumer spending and greater export volumes. The rural sector continues to drag as the drought continues.

on the housing market. Building approvals unexpectedly fell 0.9% in January, seasonally adjusted. Private sector house approvals fell 2.2% in the month, while other dwelling approvals rose by 2.6%. Total credit provided to the private sector by financial intermediaries rose 1.3% in January following an upwardly revised 1% rise in December.

In February consumer spending as measured by the Cashcard index fell 0.6% following a 0.9% rise in January. Consumer spending has risen 4.4% over the past twelve months and 1.2% in the quarter, the fastest in two and a half years. Average incomes are 4.2% higher, while the growth in employment means the total wage income rose by 7.4%. However, the total interest bill for the year rose 20%.

The trade deficit narrowed again to A\$876 million from A\$1.38 billion in December. Exports rose 2% and imports dropped 1%. Farm shipments declined 1% following the 4% drop in December. Exports of non-rural goods, including coal and manufactured goods, increased 3%, while services exports rose 1%. Imports fell in every major category with capital goods falling the most with 3%.

In summary, the Australian real economy remains sound although clearly driven by the resources boom. Retail spending is slowing while the housing market is resilient. Employment is strong, interest rates are still relatively low although on a tightening bias, and demand for Australian minerals exports remains unabated.

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The best performing sectors in February were Pharmaceuticals & Biotechnology (+11.8%); Food & Drug Retailing (+11.1%); Software & Services (+6.7%); and Retailing (+4.1%).

The worst performing sectors in the month were Health Care Equipment & Services (-4.6%); Food Beverage & Tobacco (-3.5%); Technology Hardware & Equipment (-3.0%); and Real Estate (-1.6%).

World markets were mostly down in February to the Chinese stock market correction.

The global stock markets mostly fell in February due to the flow-on effects of the Chinese stock market correction: the MSCI world index fell 0.7%; the S&P 500 index fell 2.2%, the Nasdaq fell 1.9%, the FTSE slipped 0.5%, the Nikkei 225 rose 1.3% and the Hang Seng fell 2.3%. The performance of the commodity prices were strong in February; crude oil rose 6.2% as cold weather in the US boosted demand. Gold rose 2.2% on the back of weaker stock markets. The base metals were led by nickel (+13.6%); lead (+10.4%) and tin (+9.4%).

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

After signs of slowing in the previous quarter, the US economy recovered in the December quarter. Real GDP increased by 2.2% p.a. in the quarter compared to 2.0% p.a. the previous quarter, mainly driven by personal consumption. Real personal consumption expenditures rose 4.2% in the quarter, compared with a rise of 2.8% in the third. The consumer sector now accounts for 72% of GDP.

The price index for gross domestic purchases increased 0.2% in the December quarter. The CPI rose 0.2% in January on surging food and medical costs. Core CPI, excluding volatile food and energy prices, increased 0.3% in January. The Federal Reserve Bank has forecasted core inflation to be in a range of 2.0% to 2.25% for 2007.

The US economic data shows signs of a slowing economy.

Consumer spending and the housing market have slowed. However, jobs growth has weakened while the risk of recession has slightly increased.

The U.S. unemployment rate fell to 4.5% in February even as employers slowed their new hiring pace. Employers added only 97,000 new jobs to their payrolls in February, the fewest in two years. The weak monthly performance was attributed to the construction industry, which slashed 62,000 jobs because of bad weather, and the manufacturing sector, which continued to cut jobs as a result of the troubled housing and auto industries. Average hourly earnings rose 0.4% in the month. In the past year wages have grown by 4.1%.

Although clearly driven by the consumer sector, the

The US trade deficit narrowed 3.8% in January due to record-breaking export growth. Real exports of goods and services rose 10.5% in the fourth quarter, compared with a rise of 6.8% in the third. Real imports of goods and services fell 2.2%, in contrast to a rise of 5.6% the previous quarter.

US is steadily improving its exports performance.

The Federal Reserve has maintained the benchmark interest rate at 5.25% p.a. since June 2006. While it has cautioned that some inflation risks remain, the likelihood is that inflationary pressures have moderated, taking the heat of further interest rate rises in the near future. In fact, there is more speculation that the interest rate may be cut to counter the risks of recession.

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

The Eurozone economies grew by 0.9% in the December quarter after 0.6% the previous quarter. GDP grew 2.6% in the Eurozone in 2006 compared to 1.4% in 2005. The trade performance of the Eurozone economies also improved, with exports growing by 3.7% compared to imports growth of 1.9% in the fourth quarter. Household consumption rose 0.6%. However, the unemployment rate is still relatively high at 7.5%. The UK unemployment rate fell to a two-and-a-half-year low of 5.5% due to strong jobs growth. The UK economy expanded 2.7% in 2006 due to the boom in the banking industry. In Japan GDP grew by 1.2% in the fourth quarter, after adding 0.1% in the previous quarter. Year on year growth in GDP was 2.3%.

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

China's economy continued to surge. GDP growth in 2006 was 10.7%, the most since 1995, as exports boomed with the monthly trade gap at record highs. However, there are recent signs of a rise in inflation. Consumer prices rose 2.7% from a year earlier after gaining 2.2% in January. Producer prices increased 2.6% in February, the smallest gain in nine months, as the cost of crude oil fell. China's retail sales rose 15% year on year in February, fueling much of the economic growth, driven largely by excess bank liquidity.

Share Market Outlook

The US economy appears sound in the short term.

The immediate prospects for the US economy appear good although there is some speculation of a risk of recession. The jobs market is buoyant as corporate profits remain relatively high. Inflationary pressures have eased as consumer spending moderates and the housing market cools. The US trade imbalance should not be a problem in the short term as it is a major driver of Chinese growth. The trade deficit is not causing undue concern so long as the other engine of world growth, China, is prepared to fund its growth through exports to the US. At present around 50% of China's exports are to the US. However, the deficit remains a drag on GDP.

Australian economic fundamentals remain sound. Inflationary pressures are rising and leading to the possibility of interest rate rises in the first half of 2007.

The US Federal Reserve is unlikely to raise interest rates soon as it has moderated its core CPI and GDP growth forecasts. Core CPI is expected to advance by 2.25% in 2007 and by 2.2% in 2008. However, this has to be counterbalanced by the risk of a short and shallow recession. The yield curve is now inverted and is a reasonable forward indicator of recessionary risks. The unemployment rate should rise a tad from current lows as US corporations become more cautious, pushing up the rate from 4.5% to around 4.9%. There is some risk to the financial sector due to the weak housing market.

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.

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. 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. A soft landing for the US economy is still anticipated while the corporate sector appears healthy, inflationary pressures have abated, and a crash in the housing market seems unlikely.

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.

Australian economic fundamentals appear sound in the short term with continued economic growth likely in 2007. The unemployment rate is low, business profit outlook is sound, and equity markets continue to reach new records. It is likely that the risks to the housing market have moderated and may be turning around. The government has slashed its economic growth forecast to the slowest in six years, due to the worst drought in a century cutting farm output by 20%. 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.

Demand from China for Australian commodities should support the A\$ particularly as the US\$ weakens. A stronger A\$ should aid importers 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. Although rising, Chinese inflation is remarkably low considering high credit growth and consumer spending. More governmental curbs on bank liquidity may be necessary to reign in the economy.

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

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

The risks to the world economy in the short to medium 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.

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%.

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

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\$.