

Period: 1st to 31st March 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 41.09% as we have taken the opportunity to buy stocks at favourable prices. The actual returns in March for the Retail and Wholesale funds were +3.47% and +3.48% respectively compared to +2.79% return of the S&P/ASX200. Returns for the quarter were +5.94% and +5.94% compared to +5.73% respectively.

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), Bendigo Bank (BEN), BHP Billiton (BHP), Bluescope Steel (BSL), Coca-Cola Amatil (CCL), Lion Nathan (LNN), Macquarie Bank (MBL), National Australia Bank (NAB), Orica (ORI), OneSteel (OST), Toll Holdings (TOL), Westpac Bank (WBC), and Woodside (WPL).

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

During the month, the shares that detracted from performance either due to low volatility or because they were displaying unrealized losses were Westfield (WDC) and Woolworths (WOW).

Bendigo Bank (BEN) was added to the portfolio.

The NavTraDE system resulted in increased weightings in: Westfield (WDC), Woolworths (WOW), and OneSteel (OST).

The NavTraDE system also resulted in decreased weightings in: Westpac Bank (WBC), Woodside (WPL), BHP Billiton (BHP), Toll Holdings (TOL), and Lion Nathan (LNN).

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

The Australian Share Market

The Australian stock market surged 3.7% in March.

Australian economic data continue to be positive. The stock market rose for the eighth consecutive month with the benchmark (S&P/ASX200 Index) rising by 3.73% in March.

The unemployment rate edged up to 4.6% due to high participation. Strong jobs growth was recorded in the resources and construction sectors.

The jobs market added 22,000 jobs in February, mostly full-time and driven by the resources and construction sectors. However, the unemployment rate edged up 0.1% to 4.6% as the participation rate gained 0.1% to 64.9%. Jobs vacancies fell to 2.3%.

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.

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

The headline inflation rose 0.5% in March, or 3.5% p.a., well above the Reserve Bank's target range of 2 to 3%. However, 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 probability of further rate rises in the year.

The housing market has been particularly strong, despite the fall in building approvals by 0.9% in January. New homes sales rose 2.9% in February while dwellings approvals surged 10.6% in the month to be up 10% over the year. A surge in investment interest helped total housing finance by value rise 3.3% in February.

Consumer spending and the housing market has continued strong growth in recent months.

Consumer sentiment is robust, fueled by wages growth and jobs security: average wages grew by 1.1% in the December quarter. Retail sales in February rose 0.9%, following a 0.8% increase the previous month. Consumer spending has risen 6.8% over the past twelve months.

The trade deficit was largely unchanged.

Australia recorded its 59th consecutive trade deficit, which edged up marginally from readjusted January data. Exports rose 2.1% to a new record high of \$18.5 billion on the back of mineral exports. Imports also rose 2.1% due to strong consumer sentiments.

In summary, the Australian real economy remains sound although clearly driven by the resources boom. Retail spending and the housing market have picked up due to wages growth and high employment. Interest rates are still relatively low although on a tightening bias, and demand for Australian minerals exports remains unabated.

The best performing sectors were Telecommunication Services; Food Beverage & Tobacco; Software & Services; and Retailing.

Most sectors performed well in March. The best performing sectors were Telecommunication Services (+9.2%); Food Beverage & Tobacco (+7.5%); Software & Services (+7.1%); and Retailing (+6.2%).

The worst performing sectors in the month were Real Estate (-3.6%); Consumer Durables & Apparel (-1.5%); and Insurance (-0.1%).

World markets were mostly up in March, despite concerns about the US economy.

The global stock markets mostly rose in March: the MSCI world index rose 1.6%; the S&P 500 index rose 1.0%, the Nasdaq edged up 0.2%, the FTSE recovered by 2.2%, the Nikkei 225 fell 1.8% and the Hang Seng rose 0.8%. A pattern is emerging to reveal strong outperformances from European stock markets, while US and UK bourses have underperformed. The Nikkei has been largely flat over the past twelve months. The standout performer has been Hong Kong, benefitting from strong Chinese economic growth.

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

The performances of major commodity prices were mixed in March; crude oil rose 6.7% as cold weather in the US boosted demand. Gold fell 1.4% as investors switched to the stock markets. Most base metals recorded small price gains except copper which jumped 16.1%. Zinc prices fell 5.5% and aluminium prices fell 3.3%.

The US economic data continues to show signs of a slowing economy. Despite strong jobs growth and consumer spending, the housing market continues to weaken and inflationary pressures are gaining pace.

GDP expanded by 3.3% in 2006, compared to 3.2% in 2005 and 3.9% in 2004. The December quarter US GDP estimate was upwardly revised from 2.2% p.a. to 2.5% p.a., mainly driven by personal consumption. However, business investment spending fell 3.1% p.a. in the quarter rather than the 2.4% p.a. estimate a month ago. That contrasted with a 10% jump in the September quarter. New homes building plummeted 19.8% after a 18.7% fall the previous quarter. 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.

In 2006 inflation rose 2.54%. While low by historical standards this is higher than the Fed's target of 2.0%. Core personal consumption expenditure inflation in February was at the high end of expectations, at 2.4% p.a. Inflation-adjusted consumer spending growth had slowed to 0.2% during the month, the weakest gain since August 2006. Consumer spending rose 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.

Although clearly driven by the consumer sector, the US is steadily improving its exports performance.

The US unemployment rate fell to a five-month low of 4.4% in March due to a sharp boost in hiring in the construction, retailers, education and health services segments. Personal incomes rose 0.6% in February against an unrevised 1.0% gain for January. Disposable income rose 0.5% after gaining 0.8% the previous month. Inflation-adjusted spending on durable goods slipped 0.1% during the month, the first decrease since August. Purchases of non-durable goods dropped 0.4%. Spending on services rose 0.5%.

Net investments in the US has turned negative for the first time since 1929.

The US trade deficit widened 8.2% in 2006 and now accounts for 6.5% of GDP. Net investments has turned negative for the first time since 1929, exposing the country to increased risk of capital withdrawal, asset price devaluation and recession. However, the current account deficit for the December quarter did show improvement, dropping by 14.6%, due mainly to the drop in global crude oil prices.

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.

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. In the December quarter, GDP grew by 0.9% after 0.6% the previous quarter. Employment increased by 0.3% in the fourth quarter and by 1.4% in 2006, the highest annual rate since 2001. Unemployment fell in January to 7.4%, its lowest level since 1993. The jobless rate in the region is forecast to fall from 7.7% in 2006 to 7.3% in 2007 and 7.1% next year. The UK GDP grew by 2.8% in 2006, and 0.7% in the December quarter. The unemployment rate was 5.5%, unchanged on the quarter but up 0.4% year on year.

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

The Chinese economic boom continues. First quarter GDP growth is now widely tipped to reach 11.0%. 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% p.a. in February after gaining 2.2% p.a. in January. Retail sales grew by 12.6% in 2006, the fastest since 1997.

Share Market Outlook

The US economy appears sound in the short term.

The immediate prospects for the US economy appear sound although there is some speculation of a risk of recession. The jobs market is buoyant as corporate profits remain relatively high. The recent surge in consumer confidence and high wages growth has fuelled inflation. The Federal Reserve Bank is now facing a situation of increasing inflation in a time of a cooling economy. The trade imbalance with China is causing increasing concerns. However, surprisingly, China's March trade surplus plunged 38.6% from a year earlier and was less than a third of near-record February data. Exports in March rose just 6.9%, with imports up 14.5%.

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

The Federal Reserve is balancing the need to raise interest rates to counter raising inflation and cutting interest rates to reduce recessionary risks which may help ease concerns about US economic growth and boost equity markets. The US Federal Reserve 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. 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. 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.

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. The housing market continues to defy gravity, 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 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.

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

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

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

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. Although rising, 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 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 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\$.