

Period: 1st to 30th November 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 November was 16.3% as we have taken the opportunity to buy stocks at favourable prices. The actual returns in November for the Retail and Wholesale funds were -2.06% and -2.03% respectively compared to the -2.96% 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), Bendigo Bank (BEN), Fairfax (FXJ), Lion Nathan (LNN), Macquarie Group (MQG), National Australia Bank (NAB), Publishing & Broadcasting (PBL), Rio Tinto (RIO), Santos (STO), Westpac Bank (WBC), and Woolworths (WOW).

The stocks that performed well this month and generated unrealized capital gains include AGL Energy (AGK), The ANZ Bank (ANZ), Bendigo Bank (BEN), Futuris (FCL), Lion Nathan (LNN), Rio Tinto (RIO), 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 Asciano Group (AIO), BHP Billiton (BHP), Boral (BLD), Bluescope Steel (BSL), Brambles (BXX), CSR Limited (CSR), Woodside (WPL).

The NavTraDE system resulted in increased weightings in: BHP Billiton (BHP), Westpac Bank (WBC), National Australia Bank (NAB), Woodside (WPL), and Wesfarmers (WES).

The NavTraDE system also resulted in decreased weightings in: Coles Group (CGJ), Bendigo Bank (BEN), and Rio Tinto (RIO).

During the month, Coles Group (CGJ) was removed from the portfolio following its acquisition by Wesfarmers (WES).

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

The Australian Share Market

The Australian stock market fell by 3.3% in November.

The stock market fell 3.27% in November (S&P/ASX200 Index) as the US economy continues to suffer from the sub-prime credit woes.

The Australian economy is still showing strong GDP growth due to the booming resources sector, strong jobs market, and buoyant retail market.

Australia's GDP grew 4.3% p.a. in the third quarter. Quarter-on-quarter GDP grew 1.0%, up from 0.7% in the previous quarter. Household consumption added 0.7% to overall GDP growth, with private non-farm inventories adding 0.3%, government consumption adding 0.2% and dwellings investment adding 0.1%. While dwellings investment seems to have abated, it is of some concern that was no contribution from private business investment or net exports. All the GDP growth seems to have been generated from consumption and inventories. Domestic final demand rose 5.5% p.a. in the September quarter, outstripping output growth of 4.3%, with the gap being met by a rise in net imports.

The unemployment rate has edged up in the past 2 months.

The unemployment rate rose to 4.5% in November, from a revised 4.4% in October, marking the second consecutive month it has risen. The participation rate was 65.3%, compared with 65.0% the previous month.

Retail sales appear to be flattening due to interest rate rises and high petrol prices.

Retail sales grew 0.2% in October compared to the 0.7% revised rise in September, the fifth consecutive month of rises. The small rise was only due to an unexpected 7% surge in recreational spending. Without it, retail sales growth would have been flat in October. The Reserve Bank maintained the overnight cash rate in December although it had indicated that inflation was above expectations.

The Reserve Bank raised interest rates by 0.25% in early November, citing inflationary pressures.

The annual inflation rate eased to 1.9% from 2.1% in the September quarter. Core inflation rose 0.9% quarter-on-quarter in the third quarter, the same as the second quarter and taking the year-on-year rate to 2.9%, close to the RBA's 3.0% upper limit. Much of the rise in inflation is derived from the surging oil price, even as the high A\$ offsets the price of imports. The A\$ has risen 12.1% against the US\$ in the past twelve months.

The housing market appears to be cooling due to recent interest rate rises, although construction is still strong.

The housing market appears to be cooling, although average house prices have risen 12.8% in the year to October. The number of approvals to build or renovate houses and apartments slipped 2.8% in October from the previous month. The number of loans for dwellings fell for the second month, slipping 0.7% in October after falling 2.0% in September. The total value of lending rose 1.7% in October while lending to owner-occupiers rose 1.1%. Housing construction rose 1.4% in the September quarter from the previous three months, when it declined 1.5%.

The trade deficit widened due to the strong A\$ and export capacity constraints.

Australia's trade deficit blew out to a record \$3.0 billion in October, caused by a 3.4% fall in exports and a 2.3% rise in imports. The fall in exports was largely due to a 6.0% rise in the A\$. Higher prices for petroleum pushed intermediate imports higher, offsetting falls in both consumption and capital goods imports.

China's demand for commodities continue strong.

The resources boom continues to drive the Australian economy. Retail spending increased due to rebounding consumer confidence. Interest rates are still relatively low and inflationary pressures have increased despite the higher A\$. Demand for Australian minerals exports remains strong.

The best performing sectors were Software & Services; Food & Drug Retailing; and HealthCare Equipment & Services.

The best performing sectors in November were Software & Services (+16.4%); Food & Drug Retailing (+3.4%); and HealthCare Equipment & Services (+2.4%).

World markets fell for the first time in three months due to concerns about the US credit market.

The performances of the global stock markets were generally down in November due to concerns about the US credit market: the MSCI world index fell 4.2%; the S&P 500 index fell 4.4%, the Nasdaq fell 6.9%, the FTSE fell 4.3%, the Nikkei slipped 6.3%; and the Hang Seng fell 8.6%.

The major commodities fell in prices in November.

Over the past year, Australia has performed better than the MSCI, rising 19.2% against the MSCI's 10.7% growth. However, the Hang Seng has risen 51.1% due to the China boom, while the Shanghai stock exchange has doubled that.

The US recorded strong GDP growth due to a resilient jobs market, buoyant retail sales, offsetting the weak housing market.

The price performances of major commodities were mostly weak in November due to concerns about the US subprime market affecting world economic growth. Prices for crude oil fell 5.9%; gold fell 1.7%; aluminium fell 0.9%; copper fell 10.4%; nickel fell 14.5%; lead fell 17.4%; and zinc fell 9.5%. Only tin prices rose by 2.2%. Over the past twelve months, lead (+82.1%), tin (+59.9%) and crude oil (+40.7%) made major price gains, while zinc (-42.4%) and nickel (+23.9%) fell in prices.

Despite the difficulties with the subprime credit market, the US real economy continues to show considerable strength. The September quarter GDP was revised upwards from 3.9% to 4.9% p.a., the fastest rate in four years. However, the growth was due largely to inventory building and improvements in the balance of trade, which could cause a fall in GDP growth in the next quarter. The housing market remained a drag on growth, subtracting a full percentage point from the growth rate; the seventh straight quarter that the sector had contracted. Consumer spending was revised slightly lower, growing at 2.7% p.a., while business investments were revised slightly higher to 9.4% p.a. Domestic supply increased 3.9% p.a. while domestic demand rose only 2.4%.

Real personal consumption expenditures increased 2.7% in the third quarter, compared with a rise of 1.4% in the previous quarter. The price index for gross domestic purchases increased 1.6% in the quarter, compared to the rise of 3.8% in the June quarter. Excluding food and energy prices, the price index for gross domestic purchases increased 1.7% in the third quarter,

US retail sales continue to grow as consumer confidence is unabated by the housing and credit concerns.

compared with an increase of 1.5% in the second.

Retail sales grew by 1.2% in November. On the back of a sharp rise in energy prices, CPI rose by 0.3% in October to be up 3.5% year-on-year, following a 2.8% year-on-year rise in September. The Federal Reserve cut the bellwether federal funds rate to 4.25% and trimmed the prime lending rate to 7.25%, the lowest level in two years, in an attempt to buffer the effects of the subprime credit market concerns, a slowing housing market, and increasing mortgage defaults.

The unemployment rate is steady even as income growth exceeds inflation.

The US unemployment rate held steady for the third consecutive month at 4.7% in November. The number of employed was 7.2 million, compared to 6.8 million employed and an unemployment rate of 4.5% the same time last year. Income growth was 5.9% year-on-year in the third quarter.

The US housing market is staging a very weak recovery.

The US housing market is staging a weak recovery with pending homes sales rising for the second month, rising 0.6% in October after growing by 1.4% in September. Existing homes prices rose 1.9% this year. New home sales are thought to have dropped by 25%, while new home starts fell 24%.

The US trade deficit improved on the back of strong export performance.

The trade performance in the September quarter improved considerably. Real exports of goods and services increased 18.9% in the September quarter, compared with a rise of 7.5% in the second. Real imports of goods and services rose 4.3%, compared to a decrease of 2.7% the previous quarter. Corporate profits decreased US\$19b in the third quarter, compared to an increase of US\$95 billion in the second quarter. This decline was due to a decline in domestic profits even as foreign-derived profit rose \$22b.

The UK economy appears quite resilient, with strong growth in the September quarter and a relatively healthy employment market, although the housing market continues to weaken.

The UK September quarter GDP was revised down 0.1% to 0.7%, or down from 3.3% p.a. to 3.2% p.a. The Bank of England cut interest rates by 0.25% to 5.5%, amid fears of the impact of the US housing crisis and global credit crunch on the UK market and economy, the first cut since August 2005. The UK housing market continues to weaken, with house prices falling for the fourth consecutive month in November, or to a nine-year-low. Average earnings increased by 4.0% in the year to October, down 0.1% from the previous month's rate. Retail sales slid 0.1% in October, compared with a 0.3% rise in September. The UK unemployment fell to 5.3% in October, the lowest level since 1975.

China's economy continues to expand, although inflationary pressures are increasing.

According to official estimates, China's GDP growth rate is expected to reach 11.2% in the fourth quarter, after rising 11.5% in the third quarter. The GDP growth rate for 2007 is expected to be around 11.4%. CPI is expected to increase by 5.9% in the fourth quarter, although official headline CPI is only expected to be around 4.5% for the year. The monthly CPI rate for November reached 6.9% p.a. on the back of higher energy and food prices. Food prices have increased 18% this year. China's retail sales surged 18.8% in November. Investment in the real estate sector is expected to grow 29.5% in 2007. Retail sales are expected to rise 16.4% this year.

Share Market Outlook

The US economy is slowing. Concerns over the mortgage market and risk of inflation should see volatility in the equity markets, particularly the banking sector.

The impact of the US subprime credit market will continue to be felt in the short term, although the Federal Reserve is taking steps to moderate its effects, particularly on the financial markets. The housing sector remains weak with further declines anticipated. Corporate profits from foreign markets continue to remain healthy. Employment is still very strong while wages growth continues at an above-inflation rate, helping to support consumer sentiments. The US export performance is continuing to improve, particularly in a weak US dollar environment. Due to the strong reliance on the consumer sector, inflation is likely to rise in the US from the falling US dollar. High crude oil prices are also of some concern for economic growth. A growth in GDP of between 2.5% to 3.0% is likely in 2007.

Growth in the global economy may have peaked. China is expected to grow at a slightly lower rate in 2008.

Barring political upheavals in the Middle East, the risks to the global economy are still low and suggest continued growth in 2007. Slowing US economic growth and increased geopolitical risks should see the US\$ weaken, which would help US exports relative to imports. A soft landing for the US economy is still anticipated. The risk of recession is increasing, although unlikely in the near term due to the strong employment market and consumer confidence. With the Japanese economy and the euro zone showing signs of slowing, growth in the global economy may have peaked, although the stronger than expected Chinese economy may help cushion the effects of a weaker US economy. However, post the Beijing Olympics, the Chinese construction industry should slow, and hence, 2008 economic growth may be dampened. The Chinese economy is presently growing at a 12 year high. This rate is likely to be unsustainable in the medium term. Inflation is increasing and the credit market is becoming overheated, with the risks of volatility increasing for the major bourses.

Australian economic fundamentals remain healthy. Inflation is increasing despite the relatively high A\$.

Australian economic fundamentals appear sound with continued economic growth likely in 2007. The unemployment rate is low, business profit outlook is sound, and the housing market remains buoyant. The resources sector should continue to dominate Australia's economic performance while the high A\$ impacts export manufacturing and offsets inflation. Chinese demand for Australian minerals remains strong for the foreseeable future. Nevertheless, due to concerns over the US economy, some volatility in the equity market is anticipated over the short term. Rising inflationary pressures, despite the high A\$, is likely to see further interest rate rises early next year. It is likely that the GDP growth rate will moderate in 2008. An interest rate rise is widely expected in February to curb inflationary pressures. Business confidence and capital investments appear to be slowing slightly, while the unemployment rate edges up, indicating a slower growth rate in 2008.

Australian economic growth is now expected to fall below 4% in 2008, although the resources boom is expected to continue for some time.

Demand from Far East Asian countries 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.

China's growth is now expected to exceed 11% in 2007 but moderating in 2008 to around 10.5% to 10.8%.

The risks to the world economy in the short term have increased due to uncertainty about the US credit market. However, the likelihood of a significant downturn in the world economy is still low in the short term, barring geopolitical events in the Middle East. The outlook continues to be positive in the short to medium term, although a slowdown is expected post the Beijing Olympics as construction activity moderates.

Resources companies should continue to benefit from strong Asian demand for commodities. Materials companies should 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. Retail stocks should continue to be supported by strong consumer sentiments and a strong A\$.

Lack of growth opportunities will see banks and diversified financials companies struggle to grow in line with the broader market. Negatives are expected from media stocks, hotels and companies associated with the rural sector. Industrial stocks are not particularly compelling as a sector, particularly as exporters must contend with a strong A\$.