

**Period: 1<sup>st</sup> to 31<sup>st</sup> October 2006**

### ***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 October was 38.5% as we have taken the opportunity to sell stocks at favourable prices. The actual returns in October for the Retail and Wholesale funds were both +2.75% compared to the +4.47% 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), Boral (BLD), Fairfax (FXJ), Macquarie Bank (MBL), Great Southern Plantations (GTP), Lion Nathan (LNN), National Australia Bank (NAB), Orica (ORI), Publishing & Broadcasting (PBL), Tabcorp (TAH), Toll Holdings (TOL), Westfield (WDC), and Wesfarmers (WES).

The stocks that performed well this month and generated unrealized capital gains include BHP Billiton (BHP), Bluescope Steel (BSL), Coca-Cola Amatil (CCL), Great Southern Plantations (GTP), Lion Nathan (LNN), Macquarie Bank (MBL), National Australia Bank (NAB), Toll Holdings (TOL), Westpac Bank (WBC), and Woolworths (WOW).

During the month, the shares that detracted from performance either due to low volatility or because they were displaying unrealized losses were Futuris (FCL), OneSteel (OST), Santos (STO), and Woodside (WPL).

The NavTraDE system resulted in increased weightings in: Westfield (WDC), Great Southern Plantations (GTP), and Woodside (WPL).

The NavTraDE system also resulted in decreased weightings in: The ANZ Bank (ANZ), BHP Billiton (BHP), and Tabcorp (TAH).

Great Southern Plantations Limited (GTP) was added to the portfolio.

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

### ***The Australian Share Market***

***The Australian stock market surged 4.5% in October after rising 0.8% in September.***

***The jobs market remained strong while the housing market showed some slight weakness due to recent interest rate hikes.***

***Retail sales also edged up as petrol prices waned.***

The Australian equity market surged 4.46% in October after rising 0.76% in September (S&P/ASX200 Index).

The economy expanded 0.3% in the June quarter, the slowest in three years, as companies depleted stockpiles and consumer spending slowed. Australia's economy grew 1.9% from a year ago, the slowest pace in five years. However, economic data were strong in October and led to the Reserve Bank raising official interest rates by 0.25% on 8 November. The unemployment rate fell to a 30-year low of 4.6% in October, despite a fall in the number of full-time jobs as the participation rate dropped further.

The September quarter CPI rose 0.9%, above market expectations, edging down the annual rate of inflation by 0.1% to 3.9%, despite falling fuel prices and effective wage constraints. Core inflation was just above 3.0%.

The retail market edged up 0.1% in September, or up 5.9% over the past twelve months. The continued strength in the housing market, easing petrol prices and a strong jobs market seem to have counterbalanced recent official interest rate rises. The housing market again continued its slow downward trend with both owner-occupier and investor approvals falling since June. The total value of housing finance commitments fell by 1% in September, ahead of the early November rate rise. The strength of the housing market seems centred on the mineral states of Western Australia and South Australia while the Eastern states stagnate.

***Australia's trade performance fell back slightly as mineral exports dipped.***

The September trade deficit was higher than expected, rising from \$324m in August to \$646m, driven by a 1% fall in exports while imports were unchanged. Minerals exports took a breather although still at a strong level, more than double that at the beginning of 2004. Over the past year, exports have surged 17% while imports have risen 11%.

***The best performing sectors were Materials; Media, Consumer Durables & Apparel; and Telecommunication Services.***

Overall, the Australian economy remains relatively strong. Some inflationary pressures are becoming apparent, consumer confidence is still buoyant, and the employment market is strong. The housing market, however, continues to cool, particularly the housing investment sector.

The best performing sectors in October were Materials (+9.04%); Media (+8.71%); Consumer Durables and Apparel (+7.56%); and Telecommunication Services (+6.64%).

The worst performing sectors were Food & Drug Retailing (-1.57%) and Automobiles & Components (-0.79%).

***World markets were up in September as oil prices fell for the second month.***

Global stock markets rose for the fourth consecutive month. The MSCI rose 3.6% in October and 19.2% over the past year. All major stock markets gained ground in October. The S&P500 rose 3.2%, the Nasdaq rose 4.8%, the FTSE rose 2.8%, the Nikkei 225 recovered by 1.7% and the HangSeng surged 4.5%.

The crude oil price continued its September retreat as concerns over oil supplies eased, and fell 6.7% in October. The gold price recovered slightly by 0.4%. The prices of all base metals rebounded, except for copper which fell 2.5%. The strongest gain was recorded for zinc which surged 27.7%. The rise in base metals prices has been due to strong demand as well as to the devaluation of the US dollar.

***US economic data were mixed. GDP growth was weaker than expected, impacted by a slowing housing market. However, inflationary pressures have moderated despite strong wages growth.***

The latest US GDP estimate was softer than expected, at an annualized rate of 1.6% in the third quarter, its weakest pace in more than three years due to a slumping housing market. This is a full 1.0% below that recorded for the June quarter. The economy has grown 2.9% in the past year, the slowest year-over-year growth in three years.

Residential investment had the largest negative impact on third-quarter growth. Housing subtracted 1.1% from third-quarter growth. Investments in housing fell 17.4% in the third quarter, the largest decline since the first quarter of 1991. Net imports also subtracted from the GDP figure. Real exports of goods and services increased 6.5% in the third quarter, compared with an increase of 6.2% in the second. However, real imports of goods and services increased 7.8%, compared with an increase of 1.4 percent in the previous quarter.

***Retail sales improved due to falling fuel prices and a strong jobs market.***

The unemployment rate fell to a five year low in October; slipping 0.2% to 4.4%. Average hourly earnings rose 0.4%. Over the year, average hourly earnings have risen by 3.9%. Inflationary pressures from a strong jobs market were allayed with benign CPI data. A large fall in energy prices helped pull U.S. consumer prices down by 0.5% in September, while core inflation rose only 0.2%. The Federal Reserve held rates steady for the third consecutive month, even though the core inflation figure of 2.4% exceeds its comfort zone of 1 to 2%. US retail sales rose 1.3% in October, to be up 3.4% for the year, on the back of positive economic factors.

US trade data were positive in September: The deficit narrowed by 6.8% from a record the prior month as crude oil prices fell and growing economies abroad spurred demand for American goods. Total imports of goods and services fell 2.1% while exports rose 0.5%. The US trade deficit with China rose \$1 billion to an all-time high of \$23 billion. Imports from China increased to a record \$27.6 billion while exports fell to \$4.6 billion.

***China's economic growth rate is now the fastest in more than a decade with yet another record trade surplus.***

China's trade surpluses continue to mount, bringing the country's foreign exchange reserves to almost \$1 billion by the end of September, up 28.5% year-on-year. China's economy is expected to grow by 9.5% in 2007. GDP growth slowed from 11.6% in the June quarter to 10.4% in the September quarter. Despite the impressive economic growth rate, inflationary pressures are relatively low: CPI only rose 1.4% year-on-year in October.

## **Share Market Outlook**

**Australian economic fundamentals remain sound. Inflationary pressures are slowly increasing. Economic growth is likely to remain around 3% due to healthy domestic fundamentals and the continuing strength of the Chinese economy.**

**The risk of a US recession may be receding as the economy slows, and may have dampening effects on global growth in the next 2-3 years.**

**The key drivers of global growth remain the US and China. While the US economy cools, the Chinese economy continues to drive the world economy.**

**Resources companies may benefit from rising production and prices. Banks should benefit from continued economic growth.**

**Ongoing problems are expected in the telco and rural sectors.**

The US economy is clearly slowing due mainly to a slowdown in the housing market spreading to other sectors. The housing slowdown is deepening and jobs growth has slowed. However, the corporate sector and business investment remain relatively strong and should help support GDP growth of around 2.5% in 2007. The inflationary pressures of the past two years have been curbed following seventeen successive interest rate rises. Recent wages growth has exceeded inflation and may stimulate consumer confidence. The strong equity market, low inflation expectations, and falling fuel prices should also support the retail sector.

A recession in the US economy is unlikely in the short-term, as most economic fundamentals are sound despite the weakening housing sector. Recent commodity price increases may be starting to flow through to global inflation as the China-driven inflation downturn may have reached its trough.

A slowdown in the US economy will flow on to the global economy as the US economy accounts for around 20% of the world economy. The short-term impact is likely to be offset by economic growth from the recovering euro zone, Japan, and China's neighbours. The euro zone grew by 2.6% over the past four years while Japan is presently growing at around 3% p.a. The outlook for the euro zone is relatively positive despite some concerns as to the sustainability of economic growth: while unemployment has fallen, the tightening labour market is stimulating inflation. In Japan, the main concerns are also inflation and interest rates, and economic growth may have slowed in the second quarter to around 2.2% p.a.

The outlook for the Australian equity market remains positive in the short term. The Australian economy is expected to continue growing, largely driven by the strong resources sector. Unemployment is at record lows, the housing market continues to grow in several states, and consumer confidence is resilient. A further interest rate rise later in the year is now unlikely. Business investment remains strong particularly in mining, transport and construction. However, the outlook for the rural sector is not positive due to anticipated drought conditions.

Most analysts expect China's growth rate to slow marginally in the coming year with stricter government controls over monetary supply to curb excessive investment. China is already the world's biggest consumer of steel, copper, aluminium, cement, iron ore and zinc, and the second largest consumer of crude oil. Demand for world commodities should continue with anticipated capital investments, especially in the lead up to the Beijing Olympics.

The risks to the world economy in the short to medium term have increased slightly. The likelihood of a downturn in the world economy is still relatively low. The outlook for the world economy is positive in the short term, albeit with signs of rising inflation and slowing growth.

The Resources sector should continue to drive the stock market. Energy stocks should see high volatility due to geopolitical and supply issues. Sectors able to harness general economic activity such as Banks and Infrastructure should also benefit. However, if interest rates rise sometime through the next year, Banks may face consumer and housing credit issues. The wealth effects of buoyant housing and equity markets should support Materials companies, and the resurgent consumer confidence is likely to boost retail companies.

Manufacturing and telecommunication should remain relatively weak. Tourism and other related industries may benefit from resurgent consumer confidence in the summer months. The rural sector remains unappealing.