

**Period: 1<sup>st</sup> to 31<sup>st</sup> August 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 August was 33% as we have taken the opportunity to sell stocks at favourable prices. The actual returns in August for the Retail and Wholesale funds were +1.93% and +1.95% respectively compared to the +1.68% 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 Bendigo Bank (BEN), BHP Billiton (BHP), Bluescope Steel (BSL), Brambles (BXB), Santos (STO), Westpac Bank (WBC), Wesfarmers (WES), and Woolworths (WOW).

The stocks that performed well this month and generated unrealized capital gains include The ANZ Bank (ANZ), Boral (BLD), Brambles (BXB), Coca-Cola Amatil (CCL), Futuris (FCL), Foster's (FGL), Lion Nathan (LNN), Macquarie Bank (MBL), National Australia Bank (NAB), Publishing & Broadcasting (PBL), Westpac Bank (WBC), Woolworths (WOW), 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 Asciano Group (AIO), CSR Limited (CSR), Fairfax (FXJ), Great Southern Plantations (GTP), Iluka Resources (ILU), Macquarie Bank (MBL), OneSteel (OST), Tabcorp (TAH), Telstra (TLSCA), and Toll Holdings (TOL).

The NavTraDE system resulted in increased weightings in: Woodside (WPL) and Santos (STO).

The NavTraDE system also resulted in decreased weightings in: BHP Billiton (BHP), Macquarie Bank (MBL), Woolworths (WOW), Westpac Bank (WBC), and Brambles (BXB).

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

### **The Australian Share Market**

**The Australian stock market rebounded by 1.68% in August.**

The stock market rebounded by 1.68% in August (S&P/ASX200 Index) as the market shrugged off the initial reaction to the US credit market woes.

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

The Australian GDP grew by 0.9% in the June quarter, compared to 1.6% the previous quarter. Compared to the previous year, the June quarter GDP growth was 4.3% versus 3.8% in the March quarter. The strong result was on the back of a surge in investments. New business investment was 13.3% higher than the previous year. New engineering construction investment grew 6.6% in the quarter and was 28.5% higher through the year. Investment now accounts for 28% of GDP, driven by a rise in corporate profits of 16.8%.

**Inflation expectations are softer due to slower wages growth, despite the strong jobs market.**

The unemployment rate for August held steady for the third month at 4.3%, and only slightly higher than the May result of 4.2%, the lowest since 1964. The participation rate edged up 0.1% to 65.1%. The wage cost index for the June quarter was a seasonally-adjusted 1.1% higher than in the March quarter and up 4.0% year-on-year, to be slightly below the RBA comfort zone of 4.5%. This compares to the 3.75% wages growth rate in 2005 and 4.5% in 2006.

**The unemployment rate remained near record lows.**

Consumer confidence was at a record high due to strong economic fundamentals, including low unemployment and the wealth effects of strong equity and housing markets. Retail sales continued to rise strongly, by 0.9% in July after growing by 1.4% in June. Department stores sales surged 5.7% in July.

**The Reserve Bank**

Australia's consumer price index rose 2.1% year-on-year in the June quarter.

***raised interest rates by 0.25% in early August and held them steady into September.***

Core inflation rose to 2.6% p.a. from 2.5% p.a. in the previous quarter. Inflation rose 0.5% in August following a 0.6% increase in July, pushing the annual CPI to 2.1%. Consequently, the Reserve Bank raised benchmark rates 0.25% to 6.50% on August 8. The Reserve Bank has lifted its forecast for underlying annual inflation from 2.5 to 3.0%, the top of its target range, indicating interest rates could rise further.

***The housing market is softening as prior investments dry up.***

After several months of higher than expected growth due to exploitation of superannuation tax rules, the housing market softened in July. Total new lending commitments fell by 17.2% in July compared with June. Finance for the purchase or construction of owner-occupied dwellings and alterations and additions slipped by 7.7%. Commercial housing finance plummeted 21.2% in July after surging 30% in June.

***The trade deficit improved due to strong exports performance and lower imports.***

Australia's trade position improved considerably in July. The trade deficit narrowed to \$756 million in July from a revised \$1.737 billion dollars in June as resources exports surged. This was due to a 3% fall in imports and a 2% rise in exports. Aluminium shipments leapt 35% in July from June. Zinc shipments soared 87% and lead exports almost tripled. Sales of wheat and other grains gained 5%. Exports of meat rose 2%.

***China has overtaken Japan as Australia's largest trading partner.***

China is now Australia's largest trading partner. In the year to July, Australia's trade with China increased 20% to \$50.5 billion, just edging out Japan as Australia's major trading partner for 36 years.

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 unabated.

***The best performing sectors were Commercial Services & Supplies; Pharmaceuticals & Biotechnology; and Real Estate.***

The best performing sectors in August were Commercial Services & Supplies (+12.1%); Pharmaceuticals & Biotechnology (+10.4%); and Real Estate (+7.0%).

The worst performing sectors in the month were Technology Hardware & Equipment (-35.1%); Diversified Financials (-9.6%); Hotels Restaurants & Leisure (-5.6%); and Telecommunication Services (-5.6%).

***World markets were mixed in August as fears over the US credit and housing markets continued.***

The performances of the global stock markets were mixed in August: the MSCI world index slipped 0.3%; the S&P 500 index rose 1.3%, the Nasdaq rose 2.0%, the FTSE fell 0.9%, the Nikkei 225 fell 3.9% while the Hang Seng rose 3.5%.

The major commodity fell in prices in the month except gold and lead; crude oil fell 5.4%, aluminium fell 7.4%, copper fell 7.1%, nickel fell 4.1%, tin fell 5.1% and zinc fell 14.5% due to concerns about the US economy. Gold edged up slightly by 0.4% while lead prices rose 5.3%.

***The price performances of major commodities were mostly down although still strong due to continued demand for mineral commodities from China.***

The US economy grew strongly in the second quarter, with GDP growth revised up from 3.4% to 4.0%. Exports rose 7.6%, compared with an increase of 1.1% in the previous quarter. Imports fell 3.2%, in contrast to a rise of 3.9% in the first quarter. Consumer spending, which accounts for about 70% of overall economic activity, was up 1.4%, much slower than the 3.7% rise in the first quarter. Retail sales excluding cars rose a modest 0.3% in August compared to 0.2% growth the previous month.

Residential fixed investment dropped 11.6% in the June quarter, the sixth consecutive quarterly decline, although the fall was not as steep as the 16.3% drop recorded in the March quarter.

***The US economic data are mixed with the jobs market strong, retail sales buoyant while the housing market remains in the doldrums.***

Inflation rose a revised 4.2%, the fastest pace in a year. Core inflation rose 2.0% in the second quarter, compared to the previous year, down from 2.4% p.a. in the March quarter. After the credit markets froze in early August, the Federal Reserve cut its discount rate for direct loans to banks by half a percentage point, but maintained its key federal funds rate at 5.25% for over a year.

The unemployment rate was unchanged at 4.6% in August while the labour force participation rate dipped to 65.8%. Shedding jobs in August were the manufacturing, construction and local government education sectors; job growth continued in health care and food services.

*The US trade deficit narrowed slightly on the back of strong export performance.*

The US trade deficit narrowed in July to US\$59.2 billion from US\$59.4 billion in June. Aided by a weak US dollar and strong overseas economic growth, exports increased 2.7% in July to a record US\$137.7 billion, the fifth consecutive monthly gain. Exports rose 11.3% for the year to date compared with the same period in 2006. High oil prices helped push imports to a record US\$196.9 billion, up 1.8% from June. Total imports rose 4.2% in the first seven months of 2007, compared with an 11.3% gain for exports.

*The Eurozone economy appears to be growing slower than previously expected.*

In the eurozone, GDP growth was 0.3% in the June quarter compared to 0.7% in the previous quarter. The CPI was steady at 1.8% in the year to August. Household consumption rose 0.5% in the second quarter compared to no growth the previous quarter. The unemployment rate was stable at 6.9% in July. The European Commission has downgraded the 2007 GDP growth forecast for France from 2.4% to 1.9%, and for Germany from 2.5% to 2.4%.

Japan's GDP fell 1.2% p.a. in the second quarter, the first contraction in three quarters. The unemployment rate edged down from 3.7% to 3.6% in July, the lowest level since December 1997. Core consumer prices, which exclude volatile fresh-food prices, fell by 0.1% in the year to July.

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

The Chinese economic continues to expand. GDP growth soared to 11.5% year-on-year in the first half of 2007. The Shanghai Composite stock index has climbed 93% year-to-date. Inflation is rising; higher food costs contributed to a 6.5% p.a. rise in the monthly CPI, more than doubling the official target of 3.0% p.a. As a consequence, the People's Bank of China raised the one-year lending rate to 7.02% in August. China's trade surplus expanded 33% to US\$24.97 billion in August, the second highest monthly surplus on record, with exports climbing 22.7% compared to imports which rose by 20.1%.

**Share Market Outlook**

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

US economic growth is slowing due to a slowing housing market and concerns over the subprime credit market. Employment is still very strong as is consumer confidence. Most analysts predict a growth rate of between 2.5% to 3.0% in 2007. The US export performance is continuing to improve, particularly in a weak US dollar environment. The OECD has reduced its forecast for US growth to 1.9%. It also predicts that tightening credit and further home-construction declines will send the economy into a near-recession, with growth hovering at just above 1% through 2008's first three months. The unemployment rate is expected to rise to 5.2% by mid-2008, up from the current 4.6%. Home values will continue to fall by 10 to 15%. The Federal Reserve may cut official interest rates in the fourth quarter. Concerns over the US mortgage market and the increased risk of recession should see volatility in the equity markets in the coming months.

***Growth in the global economy may have peaked as the Japanese and Eurozone economies also showing signs of slowing.***

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. Barring political upheavals in the Middle East, 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 although the risk of recession is increasing. With the Japanese economy and the Eurozone 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.

***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. It is also possible the drought may have broken which should support the agricultural sector. 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 later in the year.

***Economic growth is now expected to reach 4% due to healthy domestic fundamentals and the continuing strength of the global economy.***

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%.***

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. The World Bank has raised its growth forecast for the Chinese economy from 10.4% to 11.3% in 2007 and 10.8% in 2008.

***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\$. Strong investments will help capital goods companies.

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\$.