

Period: 1st to 31st October 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 October was 38% as we have taken the opportunity to buy stocks at favourable prices. The actual returns in October for the Retail and Wholesale funds were +1.95% and +1.98% respectively compared to the +2.84% 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), BHP Billiton (BHP), Bluescope Steel (BSL), Brambles (BXB), Coca-Cola Amatil (CCL), Macquarie Bank (MBL), National Australia Bank (NAB), Publishing & Broadcasting (PBL), Rio Tinto (RIO), Santos (STO), Toll Holdings (TOL), Westpac Bank (WBC), Westfield (WDC), Woolworths (WOW), and Woodside (WPL).

The stocks that performed well this month and generated unrealized capital gains include AGL Energy (AGK), Coca-Cola Amatil (CCL), CSR Limited (CSR), Fairfax (FXJ), Lion Nathan (LNN), National Australia Bank (NAB), Orica (ORI), Publishing & Broadcasting (PBL), Telstra (TLSCA), Toll Holdings (TOL), Westfield (WDC), Wesfarmers (WES), 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 Asciano Group (AIO), Boral (BLD), Foster's (FGL), and Iluka Resources (ILU).

The NavTraDE system resulted in increased weightings in: Rio Tinto (RIO), Santos (STO), Foster's (FGL), and AGL Energy (AGK).

The NavTraDE system also resulted in decreased weightings in: Westpac Bank (WBC) and Woodside (WPL).

AGL Energy (AGK) was added to the portfolio.

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

The Australian Share Market

The Australian stock market rose by 2.8% in October.

The stock market rose 2.84% in October (S&P/ASX200 Index) even 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 non-farm economy grew by a rapid 5.2% in the year to June, while overall GDP rose 4.3% compared to 3.8% in the first quarter, mainly driven by consumption and the resources boom, with manufacturing now accounting for only 11% of GDP. Imports of capital goods surged 14% in August, driven by the mining sector. Real GDP expanded at a 3.8% p.a. rate in the June quarter, down from the rapid growth of 6.5% p.a. rate in the March quarter.

The unemployment rate rose for the first time since February, rising 0.1% to 4.3% in October from a revised 4.2% in September. The workplace participation rate was steady at 65.0%. The number of full-time jobs created rose almost 1%, offsetting a large drop in part-time employment.

Retail sales soared due to strong economic fundamentals.

Retail sales grew for the fourth consecutive month in September, rising 0.8% due to strong economic fundamentals, or 8.2% year-on-year. Retail sales rose a seasonally-adjusted 0.7% in August, after growing by 0.8% and 1.6% the previous two months. The Reserve Bank raised the overnight cash rate target 0.25% to 6.5% in August and a further 0.25% to 6.75% on November 7th. Real retail sales grew 1.6% in the September quarter.

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

The September quarter's headline inflation rate rose 0.7% after a 1.2% jump in the previous quarter. The annual inflation rate eased to 1.9% from 2.1%. 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 20.7% against the US\$ in the past twelve months.

The housing market is rebounding due to rising rents.

The Australian housing market may be feeling the effects of the recent rate rises. While average house prices grew by 3.5% in the September quarter, or 10.6% year-on-year, housing finance commitments for owner-occupied housing fell 2.4% in September. Total housing finance by value fell 2.7% in the month. Nevertheless, the annual price growth is running at its fastest pace since the beginning of 2004, reaching 10.6% in the 12 months to September. Building approvals surged a seasonally adjusted 6.8% in September due to rising rents. Over the year, building approvals were up 4.2%.

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

A combination of a high A\$, drought, and capacity constraints widened Australia's trade deficit in September to \$1.86 billion. Exports fell 4% while imports fell 3%. Non-rural and other goods exports fell 7% while rural goods exports rose 7% and services credits rose 1%. Imports of intermediate and other goods fell 7%, capital goods imports fell 1% and consumption goods imports rose 1%.

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 Food & Drug Retailing; Retailing; Capital Goods; Telecommunication Service; and Banks.

The best performing sectors in October were Food & Drug Retailing (+9.5%); Retailing (+8.8%); Capital Goods (+8.8%); Telecommunication Services (+7.1%); and Banks (+6.5%).

World markets continued its August gains with generally strong results across the board.

The worst performing sectors in the month were Utilities (-6.5%); Software & Services (-6.1%); and Insurance (-2.9%).

The price performances of major commodities were mixed, though crude oil and gold showed price increases.

The performances of the global stock markets were generally strong in October with only the Nikkei showing a slight decline: the MSCI world index rose 3.0%; the S&P 500 index rose 1.5%, the Nasdaq leapt 5.8%, the FTSE rose 3.9%, the Hang Seng surged 15.5% after rising 13.2% the previous month, while the Nikkei slipped 0.3%.

In the past twelve months all these indices have grown, with the lowest growth shown by Nikkei (+2.1%) while the largest growth was by the Hang Seng (+71.1%), reflecting the strong economic growth in China.

The price performances of major commodities were mixed in October. Crude oil continued to surge, rising 15.3% after the gain of 10.4% in September. Gold increased 6.0% after rising 10.0% in September on the back of a weakening US dollar. Aluminium (+2.0%), lead (+7.0%) and tin (+8.3%) rose in prices while copper (-5.0%), nickel (-0.5%) and zinc (-8.6%) fell in prices. Over the past twelve months, lead has surged in price by 122%, followed by tin (+61%) and crude oil (+60%). In the same period zinc recorded a 34.8% drop in price due to excess supply, particularly from Chinese secondary production.

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

The US GDP grew by a stronger than expected 3.9% in the September quarter, the strongest growth in quarterly GDP since a 4.8% increase during the first quarter of 2006. While the housing market woes dragged GDP growth by 1.05%, consumer spending continued to provide the impetus for growth, rising 3.0% after increasing 1.4% in the second quarter. Durable goods purchases rose 4.4% in the third quarter, after increasing 1.7% in the previous quarter. Non-durables spending rose 2.7%. Services spending climbed 2.9%. Overall, consumer spending contributed 2.1% to GDP in the September quarter after contributing 1.0% in the second quarter. Third-quarter business spending increased by 7.9% while Federal government spending increased 6.8%.

The price index for personal consumption expenditures rose by 1.7% after

increasing 4.3% in the second quarter. Inflation may be slowing with the GDP price index rising only 0.8% in the September quarter after increasing by 2.6% the previous quarter. US retail sales continue to remain buoyant although slowing, with October sales increasing 1.6%, the lowest October gain since 1995. CPI increased more than expected in September, rising by 0.3% due to higher food and energy prices.

The US unemployment rate held steady at 4.7% in October. The manufacturing sector has lost 275,000 jobs since June 2006, offset by gains in the professional and business services, health care and leisure and hospitality. Over the year, average hourly earnings rose by 3.8%, and average weekly earnings increased by 3.5%.

The US housing market continues to contract, with lower housing starts, sales, and prices.

The US housing market continue to contract. Sales of existing homes dropped 8% in September, the lowest on record since 1999. The national median house price dropped 4.2% from a year ago, or down 5.7% from August. The inventory of unsold houses rose 0.4% in the the month. At the same time, mortgage applications were slightly up even as home sales declined, indicating more difficult borrowing conditions. Housing starts plunged by 10.2% to a 14-year low in September. The Federal Reserve cut the overnight federal funds rate target by a half-percentage point to 4.75% in mid-September to shield the economy from the slumping housing sector.

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

Exports helped the US trade deficit to fall 0.6% in September to a two-year low as international demand for goods like aircraft engines and machines increased, aided also by the weak US\$. The trade deficit was down 7.4% from the same period a year ago. Over all, export sales rose 1.1% in September and are up 13.6% for the year. Imports rose 0.6% in September after a 0.7% decline in August. The price of exports also rose in October by 0.9%.

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

The UK GDP grew by 0.8% in the September quarter, compared to 0.7% the previous quarter. Over the past twelve months GDP grew by 3.3%, compared to 3.1% the previous quarter. The services sector grew at 1% in the quarter, while production growth slowed to 0.2% from 0.7% in the second quarter. The unemployment rate fell to a 2.5 year low of 2.6% in September. Wage growth accelerated to 3.7% in the quarter through August from 3.5% in July.

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

China's economy grew 11.5% in the September quarter, slightly less than the 11.9% increase in the second quarter, which was the fastest pace in 12 years. Exports contributed 21.4% of the GDP growth. In the first nine months, exports were up 27.1%. Investment contributed a whopping 41.6% of the GDP growth. In the year to September, fixed asset investment surged 25.7%, while property investments rose 30.3%. Retail sales contributed 37% to GDP growth. The year on year rise in the September quarter was 15.9%, or 2.4% higher than the previous year. Per capita income rose 13.2% in real terms for urban workers and 14.8% for rural workers.

Inflation climbed by 6.5% p.a. in October after rising only 6.2% p.a. in September. Food prices marked the biggest increase in October, rising 17.6%. Non-food prices rose 1.1% in the month, held down by a decline of 18.4% in the price of telecommunications equipment. In the year to October, average prices have increased 4.4%. The CPI growth for the first nine months was 4.1%, above the Government's target of 3%.

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. The banking sector is likely to face a major shakeup over its exposure to this market. The housing sector remains in doldrums, and the US economy shifts from its manufacturing base, causing an inevitable slowdown in the US economy. Employment is still very strong while wages growth remains healthy. 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 manufacturing sector continues to decline, while professional services expand. 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. With the slowdown in the US housing market and oversupply concerns, the prices of housing-related commodities may be affected. Post the Beijing Olympics, property investments in China may also slow. A weak US\$ is detrimental to the Eurozone economies as the US exports become more competitive.

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

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 while the corporate sector appears healthy although the risk of recession is increasing. 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 may 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.

Economic growth is now expected to exceed 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%. Inflation pressures are emerging, and a post-Beijing Olympics slowdown could emerge.

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. However, an anticipated post-Beijing Olympics slowdown coupled with high inflation may result in higher Renminbi and interest rates, thus contributing to slowing down the Chinese economy, albeit marginally at this stage.

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\$.