

*Economic and
Investment Market
Strategy Report*

September 2007

This report has been prepared by St.George Investment Solutions, on behalf of Securitor.



Executive Summary

Economic Overview

Australian Economic Review

- Surging business investment helped propel the second quarter GDP to an impressive 4.3% annualised increase.
- Although the headline CPI declined in the second quarter, the RBA still remains concerned over the rising trend in underlying inflation.

Global Economic Review

- Strong exports and rising business spending saw US second quarter GDP growth adjusted upwards from an initial 3.4% annualised to a revised 4.0%.
- Second quarter Japanese GDP growth slowed as private consumption halved from the previous quarter.
- Although the Japanese unemployment rate is almost at a 10 year low, wage increases remain subdued, frustrating the BoJ in its desire to raise interest rates.
- Second quarter Eurozone GDP growth was the weakest for two years, with construction and manufacturing sectors hampering growth.
- U.K. GDP growth accelerated in the second quarter, as consumer spending and business services (particularly financial services) buoyed the economy.
- China's CPI unexpectedly jumped to 5.6% in July from a year earlier, as food costs soared.

Financial Markets Overview

Global Equity Markets

- Global equity markets endured a wild ride, sliding early on sub-prime and credit worries before recovering in the second half of August, as the US Federal Reserve cut the discount rate to calm markets and combat the credit crunch.
- The US equity market regained all their early losses to end the month higher, while the European and Asian equity markets were unable to fully recuperate from their falls from the beginning of August, with both finishing lower.
- The World MSCI Price Index (in local currency terms) fell 0.2% during the month and declined 4.4% on a rolling 3-month basis.

Australian Equity Market

- The ASX All Ordinaries Accumulation index rose 1.7% in August, outperforming other developed equity markets. Local shares had an extremely volatile month, falling sharply initially as the fallout from the US sub-prime market rout continued. The market rebounded after the US Federal Reserve acted to calm jittery investors.
- Large caps outperformed small caps in August as volatility set in. Industrial shares beat resource stocks over the month as metals prices weakened on speculation that a halt in US economic expansion will potentially reduce demand for commodities.

Fixed Income

- The Australian bond market rallied in August, as investors became more risk averse, seeking the relative safety of sovereign debt in the domestic bond market.
- Global bonds (hedged) performed better than Australian domestic bonds in July. The UBS Composite Bond (All Maturities) index returned 0.9%; while the JP Morgan Global Government Bond Index posted a 1.5% return.

Listed Property Trusts

- The S&P/ASX 200 Property Trust Accumulation index rose 8.4% in August, outperforming the All Ordinaries Accumulation index by 6.7%.

Currency

- The Australian dollar declined 3.7% against the USD and by 6.2% against the Yen in August.

Executive Summary

Asset Allocation Overview

- Included in this report is our most recent June 2007 quarterly review of the recommended tactical asset allocation positions. Table 1 below presents our recommended tactical asset allocation positions for the Balanced Fund.
- Our medium-term return forecasts are calculated on currently available data forecasts for assets prices one-year on from the date of our review. However, given the nature of financial asset markets, our forecasts of financial asset prices may be reached well before or later than the forecast date, as financial asset market prices tend to move in a non-linear path and are subject to variety of extraneous factors that cannot be factored into our model. Readers and investors must be cautioned that commonsense, skill, experience and prudence must prevail when attempting to time the entry and/or exit points for various financial assets in order to implement tactical asset allocation decisions.
- Following the completion of our review, we have increased our International Shares exposure to “Moderate Overweight” and further reduced our exposure to Listed Property still maintaining the “Strong Underweight” position. Our overall exposure to growth assets has been increased from a “Moderate Underweight” to a “Slight Underweight” setting, relative to our long-term strategic asset allocation.
- Our increased allocation to International Shares has come about due their relative attractiveness in total return terms. Typically, financial asset markets become more volatile after a mid cycle pause. We also believe that equity markets remain vulnerable to sharp bouts of weakness and strength as investor appetite for risk fluctuates wildly during the next phase of this business cycle.
- Our allocation to Australian equities remains unchanged at “Slight Underweight”. Our bottom-up and top-down analysis of the Australian stock market points to the market being a shade over fair value at prevailing levels. The strong terms-of-trade being presently experienced has helped Australian corporates retain strong earnings growth while demand for resources and materials continues to dominate our equity market.
- We continue to view the domestic Listed Property sector as being over-valued and believe that the sector is vulnerable to any sharp rise in domestic bond yields. Another negative factor is the continued allocation of capital away from the domestic listed property market and into global listed property. Our allocation to the Australian Listed Property sector has been reduced further and we continue to maintain the “Strong Underweight” position.
- We have targeted the Australian Dollar to maintain the 0.8200 to 0.8400 levels versus the USD, before a period of weakness unfolds. Given the current speculative frenzy in holding high yielding currencies, we will not be surprised if the currency should move into a 0.8700 range in the very near-term. We expect the Australian Dollar to weaken towards the 0.79 or even to a lower level by the end of 2007.
- We have increased our exposure to International Bonds (hedged) from “Slight Underweight” to “Neutral” and increased our exposure to Australian Bonds from “Moderate Underweight” to “Neutral”. The market has largely discounted higher short-term rates and any further weakness in bond markets would prompt us to overweight this asset class given the structural demand for long-term assets by global pension funds and insurance companies. Our Cash exposure has been significantly reduced, with this exposure being redirected toward the improved return prospects of fixed income security asset classes and International Shares.
- For the Balanced Fund, our current position are; “Slight Underweight” Australian Shares, “Moderate Overweight” International Shares, “Strong Underweight” Listed Property, “Neutral” International Bonds, and “Neutral” Australian Bonds, “Slight Overweight” Mortgage Funds and “Slight Overweight” Cash. Detailed asset allocation tables for the five risk tolerance portfolios (Defensive, Moderate, Balanced, Growth and High Growth) are provided in Section 3.2, and across tax profiles in Section 5.

Table 1: Recommended Asset Allocation Positions for Balanced Fund, Q3 2007

Asset Class	Strategic Benchmark	Range		Current Tactical Position	Current Tact (Q3) (%)	Previous (Q2,07) (%)	Change
		Min	Max				
Australian Shares	36	25	46	Slight Underweight	33	33	-
International Shares	25	16	36	Moderate Overweight	31	27	+4
Listed Property	9	0	18	Strong Underweight	4	5	-1
Sub-Total Growth	70	58	82		68	65	+3
International Bonds - hedged	8	0	16	Neutral	8	6	+2
Australian Bonds	12	0	24	Neutral	12	7	+5
Mortgage Funds	5	0	10	Slight Overweight	6	7	-1
Cash	5	0	20	Slight Overweight	6	15	-9
Total	100				100	100	

Source: St George Investment Solutions

Financial Market Performance Table

Table 2: Market Movements to end-August 2007

	Latest Level	% Change:		
		1 Month	Rolling 3mth	Rolling 12mth
Equity Markets (Price)				
World MSCI Local Currency	1138.4	-0.2	-4.4	12.2
US S&P 500	1474.0	1.3	-3.7	13.1
MSCI Asia Pac Fr ex Japan	479.9	0.2	7.2	34.9
All Ordinaries Index	6248.3	1.0	-1.5	23.0
S&P/ASX 200 Listed Property	2417.8	7.4	-4.2	15.2
	Latest Level	1 Month	Rolling 3mth	Rolling 12mth
Fixed Income (change in basis points terms)				
Aus 90 day bill	6.87	25	52	68
Aus 10 year bond	5.91	-11	-10	30
US 90 day Treasury bill	3.91	-28	-6	-38
US 10 year bond	4.54	-23	-35	-19
Aus – US 10 yr spread (bp)	137	12	25	48
Currency Market				
A\$/US\$	0.8186	-3.7	-1.0	7.2
A\$ TWI	66.2	-3.8	-1.2	3.9

Source: Datastream, St George Investment Solutions

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1. Economic Overview

Surging business investment helped propel second quarter GDP to an impressive 4.3% annualised increase.

1.1 Australian Economic Outlook

Confounding analysts who had forecast a 0.5% rise in Q2 GDP and helped by a 4.5% surge in business investment the economy for the 3 months ending 30th June expanded 0.9%, equating to annualised GDP growth of 4.3 % (3.7% E). This was the fastest growth in three years, during the sixteenth consecutive year of expansion. The non-farm sector of the economy experienced its strongest quarterly growth for ten years, while as expected, agriculture, forestry and fishing detracted from growth. Apart from the dramatic increase in business investment, household spending remained robust in the second quarter and the strength of the quarter's public spending surprised most analysts. Indeed, some public infrastructure developments have had to be delayed due to a shortage of both labour and materials. As long as the economy weathers the recent credit market turbulence well and China's demand remains steady, the RBA will likely opt to maintain its current tightening bias. For the second consecutive month, Retail Sales were strong rising 0.9% in July's, which were almost double analysts' expectations. Rising wages of about 4% per annum since the second half of 2005 and unemployment near 30-year lows helped sustain robust domestic demand. The late August release of Private Sector Credit growth saw annualised borrowing growth remaining above 15% in July. The Westpac / Melbourne Institute index of leading indicators for June pointed to strong economic growth being sustained well into 2008.

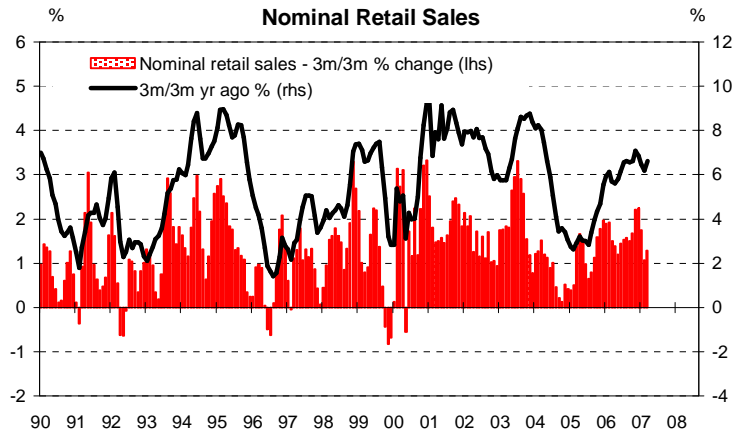
Although the headline CPI declined in the second quarter, the RBA still remains concerned about the rising trend in underlying inflation.

Although the second quarter's CPI only increased 2.1% from a year earlier, appreciably lower than the 2.4% increase of the preceding quarter, underlying inflation as measured by the RBA's trimmed mean measure almost doubled in the second quarter to 0.9%. After the second quarter CPI was released, financial market analysts increased their inflation forecast for the twelve months to June 30th 2008 from 2.5 to 2.7%. Trade Union economists meanwhile, left their CPI estimate unchanged at 3% for the same period. The RBA's inflation forecast was revised upwards in the mid-August release of its latest Statement on Monetary Policy. The central bank now forecasts underlying inflation will pick up from 2.5% to 3.0% by year's end, with both headline and underlying inflation "near the top of the 2% - 3% target range" in 2008.

The July unemployment rate of 4.3% was unchanged from the previous month, but still almost at a 33 year low. Mining companies keep hiring workers to meet the demands of the global commodity boom while retailers keep hiring while they enjoy excellent trading conditions due to strong consumer spending. Not unsurprisingly, the second quarter's Wage Cost Index rose 1.1%, (not an alarming increase from the first quarter's 1.0% increase) but reflecting an annual wage increase of 4.0%, quite close to the RBA's ceiling of 4.5%.

The RBA decided to increase the cash rate by 25 basis points to 6.5% during its scheduled meeting in August. The RBA decided that a more restrictive monetary policy setting was necessary due to the recent pick up in the pace of domestic demand, high capacity utilisation and strong business and consumer confidence leading to higher than anticipated underlying inflation. Although the strong dollar had some dampening effect on prices, the RBA decided stronger economic conditions were

likely to put upward pressure on inflation. The RBA injected nearly \$5bn into the banking system in just one day in mid-August at the height of the sub-prime credit market difficulties, the increase in liquidity helping stabilise the market. The unwinding of carry trades associated with volatile markets causing large swings in the dollar.



Source: DataStream, St George Investment Solutions

Strong exports and rising business spending saw the second quarter GDP revised upwards from 3.4% to 4.0%.

1.2 US Economic Overview & Outlook

The end of August release of revised Q2 GDP saw the annualised rate of growth revised up to 4.0% from the initial estimate of 3.4%. Strong exports and rising business spending propelled the economy to its best growth figure in more than a year. A bigger increase in exports and a smaller gain in imports narrowed the trade deficit. However, with the recent drying up of mortgage credit likely to prolong the housing market's deep slump, many analysts are already cutting their economic growth forecasts for the remainder of the year. The early September release of the ISM manufacturing report, a good leading indicator as to the effect the housing slowdown is having on the economy, reported the index had fallen to 52.9% from 53.8% in July. A slowdown, but definitely not a collapse in manufacturing activity.

Consumer spending increased quite appreciably in July even though home sales fell, an indication that rising incomes are sustaining demand as the housing recession lingers. Personal Income rose 0.5% (0.3% E) in July from the previous month, while Personal Spending increased 0.4% in July, a significant improvement on the preceding month's paltry increase of just 0.1%. Unsurprisingly, most consumer sentiment indexes posted substantial drops in the weeks immediately after the credit market turmoil. Both the ABC/Washington Post and Reuters/Uni of Michigan indices posted at least one year lows in their mid to late August consumer sentiment readings.

Manufacturers continued to increase output in Q2, having started the year in a fairly subdued state as they scaled back inventories. The international economy is buoyant and the domestic economy appears at the moment to be fairly resilient to the housing sector weakness. Industrial production is expected to increase appreciably, although its July monthly increase of

just 0.3% was rather subdued. The late August release of a large increase in July's Durable Goods Orders of 5.9% (1.0% E) confirmed that the economy was buoyant as it entered into the recent bout of financial market volatility.

Sales of new homes unexpectedly rose 2.8% in July, reversing two month's of declines. However, nationwide housing starts in July fell by 6.1%, their lowest level in more than ten years; the South being particularly effected. Alarmingly, the stock of unsold properties (excluding new ones) is at fifteen-year highs, with any increase in interest rates this figure could get higher. The respected Case-Shiller USA National Home Price Index had its largest fall in the three months ending June since its inception in 1987. Shiller, creator of the index observing, "the pullback in the US residential real estate market is showing no signs of slowing down."

Consumer prices rose just 0.1% in July from the preceding month, the smallest increase in nearly a year as food and gasoline prices slowed. Annualised headline inflation dipped to a 2.4% increase in July, while annualised July Core CPI (ex-food & energy) remained unchanged at 2.2%. The Fed's favourite inflationary gauge, CORE PCE rose at an annual rate of 1.9% in July, unchanged from the previous month and close to the top of the central bank's preferred inflation ceiling of 2.0%. Core producer prices (ex-food & energy) rose just 0.1% in July, the smallest increase in three months. However, July's headline producer prices rose quite appreciably due to higher costs for gasoline and natural gas, pushing up July's annualised PPI to 4.0% (3.4% E).

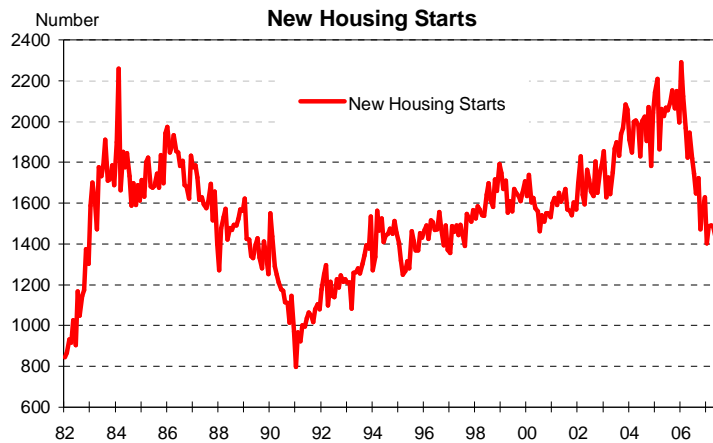
Although initial unemployment claims held relatively steady in late July to the middle of August, July's unemployment rate of 4.6% was slightly above the market estimate and probably signals the start of a slight upwards movement in the jobless rate as the effects of the recent sub-prime related bout of volatility work their way through the economic system. Indeed, market analysts are now predicting a 4.7% jobless rate by the end of this year. Wages increased 3.9% in July from a year earlier, unchanged from June's annualised gain.

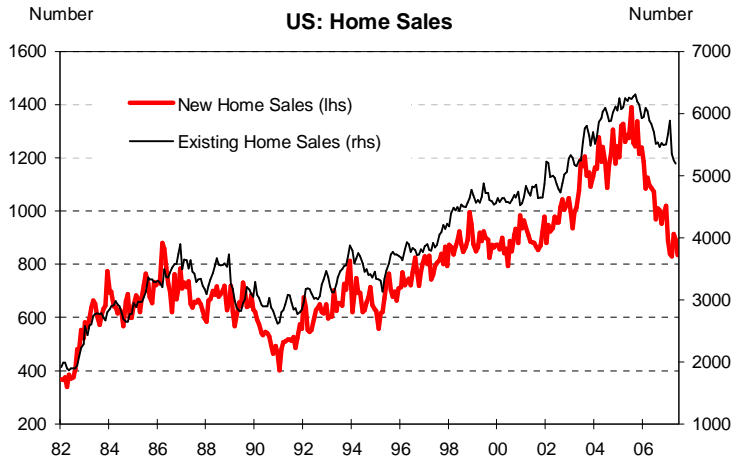
After interest rates were left unchanged for the ninth consecutive meeting at the regular FOMC in early August, Federal Reserve Chairman Bernanke reported that the economy had grown "moderately" in the first half of this year and was set for continued moderate growth over the coming quarters. Solid growth in employment, rising wages and a robust global economy were the key drivers underpinning the current expansion. Although core inflation had improved slightly, Bernanke stressed that a "sustained moderation in inflationary pressures has yet to be convincingly demonstrated," adding that the FOMC's predominant policy concern remains that inflation will fail to moderate as anticipated. The FOMC agreed that downside risks to the growth forecast had increased, acknowledging recent financial market volatility, the associated tightening in credit conditions for some households and businesses, and the on going housing correction as potential sources of concern.

In a surprise move, on August 17th the Federal Reserve lowered the interest rate it charges banks. The reduction in the discount rate from 6.25% to 5.75% was an acknowledgement of the need to contain the sub-prime mortgage collapse that began in June. Deteriorating financial market conditions coupled with tighter credit conditions and a general rise

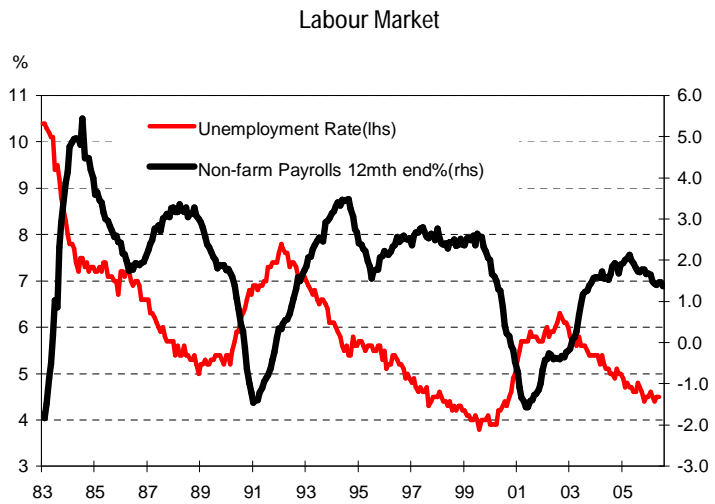
in uncertainty all “having the potential to restrain economic growth” were cited as justifications for the unexpected discount rate cut. The FOMC assured the markets that, “The committee is monitoring the situation and is prepared to act as needed to mitigate the adverse effects.” This was the first unanticipated cut in borrowing costs between scheduled FOMC meetings since 2001.

Over the last weekend in August, at the major gathering of central bankers and economists held each year in Jackson Hole, USA, Fed Chairman Bernanke reassured markets that the Fed would “act as needed” to contain “the adverse effects that may arise from the disruptions in markets.” As of early September, the markets are anticipating a 25 basis point cut in the Federal Funds Rate to be announced at the conclusion of the September FOMC.





Source: DataStream, St George Investment Solutions



Source: DataStream, St George Investment Solutions

Second quarter GDP slowed as private consumption halved from the previous quarter.

1.3 Global Outlook

JAPAN

GDP slowed more than anticipated in the second quarter, increasing at annualised rate of just 0.5% (0.9% E), a noticeable slowdown from the first quarter's 3.3% year on year rise. For the second quarter, exports gained 0.9% (0.6% E), while imports only rose 0.8%, exactly a half of analysts' forecast. Unsurprisingly, June's current account surplus increased by 48% on an annualised basis. Private consumption in the second quarter slowed to a 0.4% rise from a 0.8% increase in January-March. GDP is forecast to grow by approximately 2.5% as we approach the year's end, ending the year at 2% and then sliding to 1.5% annualised GDP growth for the first half of 2008. Although private consumption slowed to a 0.4% increase in the second quarter from a 0.8% rise in the first, companies capital spending rebounded to 1.2% in Q2 from the rather anaemic 0.3% in the first.

Retail Sales fell more than expected in July, casting doubt over the strength of consumer spending amidst meagre wage rises and concern as to the outlook for the US economy. July's retail sales fell 2.2% from a year earlier, nearly three times the median forecast of the anticipated fall. In seasonally adjusted terms, July's retail sales fell 2.4% from the previous month. Government officials blamed the general weakness in consumer spending on the recent earthquake that dramatically upset car production and an unusually large typhoon that deterred consumers from shopping. Although July's Industrial Production surprisingly fell 0.4%, a tad more than the expected minus 0.3%, this was mainly due to earthquake damage disrupting production at automakers Toyota and Honda. Indeed, a recent government survey of employers conducted in August revealed that companies are planning to increase quarterly machine orders for the first time this year in the three months ending September 30th.

Core (ex-fresh food) consumer prices declined for the sixth straight month in July, falling as expected 0.1% from a year earlier, while headline consumer prices were unchanged for the month, after falling 0.2% in June. Core CPI (excluding fresh food) is likely to remain negative (around minus 0.1%) until the start of next year, confounding the Bank of Japan's desire to increase short-term interest rates.

Although the unemployment rate is almost at a 10 year low, wage increases remain subdued, frustrating the BoJ in its desire to raise interest rates.

July's unemployment rate of 3.6% (3.5% E) was the lowest jobless rate since February 1998, while the job-to-applicant ratio, showing how many positions are available for each job seeker, remained unchanged at 1.07. Although the job market is very strong, it is failing to ignite consumer spending as wage growth is very subdued. Indeed, monthly wages fell 1.9% in July, their eighth consecutive monthly fall and the most rapid rate of decline for more than three years.

As expected, after its scheduled late August monetary policy meeting, the BoJ left the overnight cash rate unchanged at 0.5%. The central bank revealed it did not expect the turmoil in the world's financial markets to hurt global growth and that the Japanese economy "was expanding moderately". This confirms analysts' predictions that once the current sub-prime turmoil has calmed down, the BoJ would resume its "normalisation" bias by increasing interest rates. Although the anticipated rate hike is now expected to be delayed until early next year, economic

uncertainties have increased, with many forecasters expecting Japan to experience a period of slightly below trend economic growth sometime in the first half of next year as a direct consequence of both the recent slowdown in US consumer spending and some unravelling of the yen carry trade.

A major risk to the anticipated rate hike would be a continuation of the recent decline in consumer spending. In a late August statement, BoJ governor Fukui seemed more concerned about the dangers of “resource misallocation” in the major cities’ housing markets than about dangers from the sub prime market. The 71-year governor acutely aware of the potential for low interest rates to fuel risky investments leading to inevitable asset bubbles. The new Finance Minister does not share the BoJ inflation outlook. In his first major speech, he observed that the economy had yet to come out of deflation and the central bank should coordinate policy with the government to stop prices declining and encourage growth.

The solitary BoJ policy board member in favour of an immediate rate rise due the strong economy, Mr Mizuno, revealed that a cut in US rates would alter his monetary stance, although the current bout of financial instability “went beyond rational repricing of risk” and he did not expect the US would decelerate dramatically adding that Japanese exports were supported by strong demand from other market, anyway.

Although the dramatic mid-August fall in the overnight call rate from 0.5% to 0.06%, a gesture of solidarity with the ECB and the Federal Reserve due to liquidity concerns emanating from the sub-prime saga, saw initial concerns of a potential liquidity crisis hitting the Japanese financial system, in hindsight, the actions by the BoJ were seen as being more symbolic rather than a response to a genuine credit crunch in Japan. Analysts concluding that Japan, along with most of Asia, was insulated from the US sub-prime lending fallout.

EUROZONE

Eurozone second quarter GDP growth was the weakest for two years, with construction and manufacturing sectors hampering the expansion.

The Eurozone economy grew at its weakest rate in nearly 2 years in the second quarter, hampered by weakness in the construction and manufacturing sectors. Q2 GDP increased by just 0.3% (0.5% E) from the previous quarter, when it grew 0.7%. In August the European Commission revised its Eurozone growth forecasts for the year’s remaining quarters; Q3 growth is forecast to be 0.6% and Q4 growth slowing to a 0.5% increase. From a year earlier, the region’s economic growth slowed to 2.5% in Q2, quite a decline from the robust Q1 growth figure of 3.1%. With the strong Euro hindering the region’s exporters, the recent weakness in manufacturing is forecast to continue into Q3. The European Commission forecasting the Eurozone will grow 2.6% this year, a tad weaker than the decade high figure of 2.7% reported for 2006.

Although the Q2 German economic growth figure of 0.3% was slightly below forecasts, having increased 0.5% in the previous quarter, this was mainly attributable to a 4.8% fall in construction spending, the largest decline in a decade. Q2 consumer spending rose 0.6% from the previous three months and is forecast to contribute substantially to the present expansion, allowing the German economy to be far less reliant upon the contributions of its export industries to the nation’s economic health. The recent weaknesses in the normally reliable consumer and business

sentiment surveys is seen to be more of a knee jerk reaction to the current financial market conditions rather than to a change in outlook towards the current benign business environment. Indeed, although July's Retail Sales figures were a touch weaker than expected, this was primarily due to the weather being 50% wetter than the historical mean: August Retail sales figures are expected to rebound strongly. In mid-August, at the same time as global credit markets experienced extreme volatility, the Bundesbank commented, "recent developments in financial markets are currently no reason to quash the belief that the German economic outlook is still favourable."

French GDP growth unexpectedly slowed in Q2, mainly as a result of a lack of growth in business investment, probably a direct consequence of the Euro's recent appreciation. Interestingly, Italy and Spain both recently reported weaker than expected Q2 GDP growth figures, and although Germany accounts for about a third of the Eurozone economy, pressure is mounting from the French and Latin-bloc members of the Eurozone for the German based ECB to cease any further tightening in monetary policy.

German inflation in August increased at an annual rate of 1.9%, unchanged from the previous month, even as food prices jumped. Although for the second consecutive month inflation is at the upper limit of the ECB's range, the recent stable German CPI figures may allow the ECB from holding off from its signalled September rate rise. However, with the rise in the cost of oil since earlier this year, increasing metal prices and recent ominous upswings in import costs, inflation is forecast to rise, offsetting any benefits from the strong euro.

German unemployment fell in August for the 19th month. OECD analysis shows the German jobless rate was just 6.4% in June, and forecasts the unemployment rate will fall to 6.0% next year. Falling unemployment coupled with higher wages, Q2 annualised wages increased 3.4% from the previous quarter's impressive 7 year high of 3.6%, are enabling domestic consumption to expand consistently, more than countering any potential ill effects that the strong euro may have on the nation's exporters. ECB President Trichet has indicated the past eight- rate increases by pledging "strong vigilance" on inflation. He used these same two words in early August when signalling that rates would be increased at the scheduled ECB September meeting. Interestingly, immediately after the recent credit market worries, Trichet retracted his remark, stating the ECB was not "pre-committed" to higher rates. He further added, "What I said on August 2nd was before market turbulences."

In coordinated action, between August 9th and 14th, the ECB and other major central banks injected more than US\$350bn of extra funds into money markets to smooth lending between banks.

GDP growth accelerated in the second quarter as consumer spending and business services (particularly financial services) remained robust.

U.K.

Second quarter GDP accelerated 0.8% from the first quarter, driven by consumer spending and business services, particularly financial services. Consumption rose 0.8% in Q2, the strongest figure for nearly a year and Q2 business services grew 1.5%. In July the IMF upgraded its 2007 UK economic growth forecast to 2.9%, revised figures confirmed the economy expanded 2.8% in 2006. Although the mid-August release of July's Retail Sales figures showed a startlingly large monthly increase of 0.7% (0.1% E), representing an annualised increase of 4.4% (3.4% E), the increase was largely attributable to the nation's largest retailers slashing prices in an attempt to lure shoppers during the wettest summer months on record. Consumer activity within the UK economy may currently appear robust, but analysts are warning of a moderation in demand as tighter credit conditions emerge in the slipstreams of the sub-prime fallout, and the lagged effects of recent interest rate rises and the imminent resetting of a large number of fixed rate mortgages feed into the system. With the recent turmoil in global credit markets likely to crimp bank's profits and with consumers yet to experience the full impact of the past five interest rate increases within a year, growth prospects are clouding over

Inflation – The doves in the Bank of England's MPC finally got the news they had been waiting for with the release of the July inflation report. Over the month, consumer prices fell at their quickest rate for over seven years and it was the first time since March 2006 that inflation had fallen below its 2% target. Although the unexpectedly large fall in the annualised CPI from 2.4% in June to 1.9% in July (2.3% E) initially stunned commentators, the decline's primary drivers were nothing to coo about. Britain's high streets have been slashing prices to attract increasingly reticent shoppers for much of this year and the past five interest rate increases since the current normalisation process began in August last year are beginning to bite consumer activity. The PPI saw prices rise for an eighth month in July, as food costs rose 0.5% on the month, the impact of the recent floods expected to distort prices. BoE governor King Aug 8th "the main upside risk" to inflation is that companies become more confident about raising prices." leading into BoE report...

Unemployment fell to its lowest level in more than two years in July, confirming the BoE's jobs forecast, as the strongest economic growth for more than three years prompts companies to ease capacity constraints by hiring new staff. Although the unemployment rate is at almost historic lows, surprisingly, the mid-August release of Q2 2007 wages data reported average earnings including bonuses rose at an annual rate of just 3.3%, the smallest increase since June 2003. So far a record influx of migrants has tempered wage demands and expanded the work force.

After the scheduled early-August MPC meeting the Bank of England left interest rates unchanged but revealed in its August Quarterly Inflation Report that it suspected economic growth might slow from a previously forecast 3% to about 2.5% in the medium term as past interest rate increases took effect and hinted that short term interest rates would rise 25 basis points to peak at 6% by the end of this year. This increase in rates would see inflation falling back to its 2% target by the middle of next year. Towards the end of August, the central bank warned that the proportion of households having trouble paying their mortgage had risen to 7.7%, the highest level since 1995. Research from accountants Grant

Thornton alarmingly confirming the trend by revealing the total stock of consumer debt owed by British families to be larger than the countries' GDP, this landmark moment actually having occurred late last year. Mortgage lender Nationwide warned in a mid-August statement that house prices are forecast to drop dramatically, falling into line with wage inflation next year. With release of the strong Q2 growth figure, futures markets indicate a rate hike from 5.75% to 6% by Dec 31st. The UK money supply (M4) unexpectedly grew by 13% in July (12.6% E) from a year earlier, it is still well below the 16-year high of 14.4% experienced last September although some policy makers adamantly believe it is a precursor to future inflationary pressures.

BoE governor King stated after the August MPC that the recent "tremors in financial markets" had played a significant part in the bank's decision to leave rates unchanged but added that the turmoil in credit markets had not been an "international financial crisis" of the type that could cause major damage to the UK economy. The central bank head admitted that "it is impossible at this stage to judge how large and how persistent this tightening of credit conditions is likely to be."

CHINA

The Consumer Price Index unexpectedly jumped to 5.6% in July from a year earlier as food costs increased significantly.

The Consumer Price Index jumped 5.6% (4.6% E) in July from a year earlier, the fastest pace since early 1997, after rising 4.4% in June. Food costs, representing some one third of the consumer price index, rose 15.4% in July. Due to a shortage of pigs (the staple meat source in China) meat and poultry prices rose 45% in July from a year earlier and egg prices climbed 31% for the period, while bad weather damaged many crops adding to further upwards price pressures.

Although this dramatic increase in inflation is mainly food-driven (non-food inflation actually falling 0.9% in July) and may drop fairly rapidly once the present price disruptions have abated, the central bank stated in its latest second-quarter report on monetary conditions that consumer price gains are not exclusively from "temporary factors" and that "the direction of inflationary risk is up," indicating that the authorities believe wage gains, energy costs and expectations of price increases have the potential to broaden inflationary pressures. As a direct consequence of its undervalued currency and the correspondingly enormous trade surplus, there is an excess of money circulating in the domestic economy causing an inflationary price spiral. M2, the central bank's measure of cash and bank deposits, grew at an annualised rate of 18.5% in July, its fastest pace in more than a year. For 2006 the average monthly increase in the CPI was 1.5% and although the central bank is aiming to keep the CPI below 3% this year, this desired ceiling on consumer price increases is increasingly looking to be unattainable and quite unrealistic.

Central Bank – Beijing is very concerned about the hostile public reaction to rising food prices being reported throughout China. In its latest Second Quarter Monetary Report the central bank states its need for "new instruments" to soak up the current excess liquidity in the financial system, but unfortunately gives no indication of what these new instruments will be. Meanwhile, in response to the July CPI figure and to stabilise inflation, on August 21st the People's Bank of China raised its key-lending rate by 18 basis points to 7.02% and simultaneously raised the one-year deposit rate 27 basis points to 3.6%. Interestingly, by raising

lending rates less than deposit rates, the central bank signalled that it was not explicitly slowing economic growth but rather targeting the flood of savings leaving bank deposit accounts for the very buoyant domestic equity markets. Ominously, in early August, for the first time ever, the two domestic bourses had a combined market capitalisation greater than China's GDP. Analysts expect at least one and perhaps two more bouts of interest rate tightening before the end of this year

Developments – In interesting developments in late August, the Chinese authorities finally permitted mainland investors to buy securities listed on the Hong Kong stock exchange, whose markets, unlike the mainlands, are integrated with the global economy. Investors now being allowed to hold non-domestic shares in their own accounts and with no limit on the size of shareholdings. These new rules, mooted to come into operation in early September, will help liberalise China's capital account and also help cool the surging domestic stock market, as identical shares to those listed in Hong Kong trade at almost a 50% premium in the mainland bourses. Additionally, Chinese investors are now permitted to investment in foreign securities indirectly, by means of structured products offered by large financial services companies, which are limited in what they are able to invest in.

1.4 Special Report (a)

“The Straw That Broke The Camel's Back” The Subprime Saga

The Backdrop:

Within a capitalistic economic structure, financial asset markets and financial institutions assist individuals and groups of individuals in performing a myriad of important functions. Some basic functions include; the provision of competitive advice and superior savings avenues; the creation of efficient ways to spend these savings or borrowed funds; assisting in retirement planning and the protection and enhancement of financial wealth; the provision of competitive advice and the creation of cost efficient opportunities to raise capital and to insure against future risk, to name but a few.

There are many participants in the market place. “Financial intermediaries” are a key group of market participants, presently playing a major role in enabling the market place to function efficiently. In many instances, this group has replaced the traditional trading banks as key financiers, advisors, providers and originators of financial instruments. Financial intermediaries use their market skill, innovative capabilities, market reputation and the strength of their respective balance sheets to carve out “niche” positions in the market place. However, unlike the traditional trading or savings banks, these intermediaries rely on the market place to provide them with sufficient capital to function efficiently and profitably.

The savings and spending gap and implications:

Over the past one and a half decades, a growing gap has emerged between global aggregate savings and global aggregate spending. The integration of global financial, labour and product markets has made this “glut” of excess capital more pronounced as capital has moved across geographic and political borders with hardly any obstacles. There has also been an acute shortage of global financial assets. The supply of financial assets

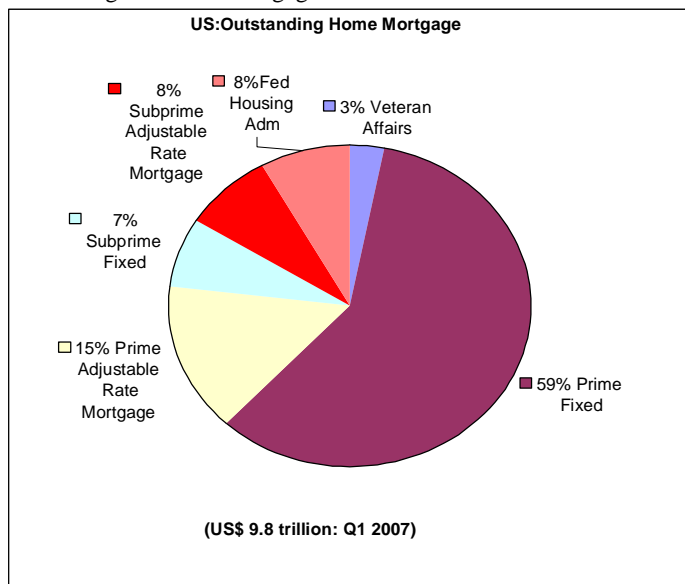
has had a hard time in keeping up with the demand for “store of value” and collateral from households, corporations, governments, insurance companies and financial intermediaries.

The current savings glut, historically low financial market volatility, central bank transparency, low volatility in economic data, a fall in global risk premiums, relative global socioeconomic and geopolitical stability and the relentless search for higher yield and returns by investors has given financial intermediaries the incentive to create financial instruments that will help close the gap between global aggregate savings and global aggregate spending. However, given that the sum of all this activity would net-out to be “Zero”, the observable impact has been a steep rise in most financial asset prices, a sharp increase in synthetic financial asset products and a fall in the quality of high risk financial instruments, as evidenced by the sharp contraction of the yield spread between sovereign and other credit products.

The exponential growth in financial derivative products, coupled with financial leverage and the much mentioned “carry trade” has ultimately led to high risk markets “collapsing under their own weight”. The resulting “risk aversion” has spread to almost all financial asset markets. This phenomenon is typical in open and free markets, where the age-old combination of “greed and fear” acts to push markets to extreme valuations in either direction. It is estimated that the value of outstanding financial derivative contracts as at the end of March 2007 was close to US\$300 trillion versus a global economy that is estimated to be around US\$45 trillion. While the rapid growth in financial derivative products by themselves is not a problem, it is the magnitude of “leverage” that these products contain and encourage that is at the crux of the present predicament. It is estimated that financial derivatives account for nearly 80% of current global liquidity.

The US Home Mortgage Market:

A favourable cocktail of low interest rates, rising house prices and a marked rise in residential property ownership resulted in a sharp increase in the US household leverage in the post-Dotcom bubble years. The following chart highlights the composition of some US\$ 9.8 trillion of outstanding US home mortgages as at the end of March 2007:



Source: Moody's & St George Investment Solutions

Financial innovation and the huge investor appetite for yield set the stage for the subprime-lending boom. From a moderate 3% of total mortgages outstanding in 2002, subprime lending surged to 15% of total outstanding mortgages at end of March 2007. The gradual tightening of official rates that began at the 30th June 2004 Federal Open Market Committee meeting, marked the turning point in the liquidity cycle and the delinquency rates for subprime mortgages had begun to move higher by mid-2005. Further tightening and the softening of house prices set the scene for an increase in delinquencies, defaults and foreclosures. The subprime market was at the epicentre of the global credit markets and was the “straw that broke the proverbial camel’s back”

The Subprime Mortgage Chain:

As the surge in the subprime lending business attracted greater competition, mortgage originators lowered credit standards in order to sustain lending volumes. This led to a sharp increase in the number of loans with little documentation, poor repayment or servicing capabilities and high loan-to-value ratios.

The subprime mortgage chain begins with the mortgage originator granting the loan either directly to the individual borrower or through a network of brokers. Portfolios of loans are then sold wholesale to the underwriter by the mortgage originator. The underwriter, often an investment bank / financial intermediary repackages the loans and sells them to the end investor in tranches with different levels of risk, such as senior, mezzanine or equity. These packaged products (with the exception of the equity tranche) would most likely be rated “investment grade” by rating agencies and attract asset-starved investors seeking both higher yield and return. The tranches of bonds with a highly rated triple “A”, having a repayment priority, remained at the top of the capital structure while the lower tranches with triple “B” or triple “B minus” ratings earned much higher interest rates on their debt in order to compensate investors for the considerably higher risks residing in these securities.

To facilitate the sale of the higher risk tranches, financial intermediaries repackaged many triple “B” mortgage backed securities and even more of the triple “B minus” tranches into new securities called mezzanine collateralized debt obligations or CDO’s, which were sold to institutional investors. In some cases, not only is the very structure of the product leveraged but some financial institutions also lent funds to investors encouraging them to buy these assets and then lodge them as collateral against the loan.

Volatility & Risk Aversion:

While the deck of cards continues to fall around us, market volatility and risk aversion continue to climb. The following chart depicts the rise in the volatility of the US S&P 500 Index:



Source: Bloomberg & St George Investment Solutions

One of the principal ways in which increased volatility impacts financial asset prices is due to the fact that volatility is a key input in most financial asset pricing models that measure “financial risk”. As volatility rises, the amount of risk that can be borne will decrease, forcing the “involuntary” liquidation of underlying assets. This type of risk aversion is quite natural, sensible and logical on the part of an investor but has the capacity to exaggerate price movements when it is done collectively in the market place. This phenomenon is called the “fallacy of composition effect”, where individual investors do the right thing but collectively their actions are detrimental to the market place and to the health of the asset class. The spill over effect from this type of market action is that passive investors enter the market place to liquidate assets that keep falling in price, further exaggerating downward price action forcing all levels of investors to do the same. Credit downgrades by rating agencies also impact asset prices in a similar fashion, where forced liquidation sets off a “domino effect” in asset prices.

Response by the Monetary Authorities:

Both the recent fall in equity market prices and the widening of credit spreads have combined to tighten financial market conditions. Given that the transmission mechanism of official monetary policy in a developed and open economy is essentially via financial asset market prices, many market commentators believe that tight financial conditions will force monetary authorities to cut official interest rates in the near future.

A Central Bank is, first and foremost, the lender of last resort to the financial system. It is; therefore, quite logical for them to take preemptive action in the face of a threatened breakdown in the orderly functioning of the financial system as it is the central bank’s duty to keep the markets functioning. However, this is not to say that it is the central bank’s duty to keep asset prices rising.

Apart from the lender of last resort function, central banks would be fully aware of the recent volume of corporate debt issued to retire equity and leverage existing real balance sheets, rather than to support economic growth through capital investment. During the recent Leveraged Buy-Out (LBO) flurry, funds raised in the credit markets were largely devoted to the purchase and restructuring of existing assets, not for the purpose of creating new assets.

We believe that most central banks will stay on the side lines during the current market turmoil because they have long lamented the “conundrum” type of liquidity excesses that ran counter to continued rate hikes. Tightening financial conditions would be perceived as a natural, welcome and belated adjustment at this stage of the economic and business cycle.

The outlook:

In our opinion, the character of financial markets has changed to reflect a maturing economic and business cycle. Market volatility typically rises during this phase of the cycle as financial market participants adjust their risk / return expectations while businesses adjust their mix of capital investments versus labour market hiring, inventory levels and forward order books.

In our opinion, the gap that still exists between aggregate global savings and the acute shortage of financial assets will continue to support financial asset market prices. Investors are likely to witness market corrections of the magnitude seen recently for many more years. This is a self-correcting mechanism in a free and open market. Once investors recognise this pattern early as being part of the prevailing economic and business cycle, they will have to adjust their investment horizon and strategies accordingly. Portfolio diversification, prudent tactical and strategic asset allocation, thorough and careful hiring of skilled and experienced fund managers, and skilful risk budget allocation are some of the initiatives that will help survive this next phase of the market cycle.

On a medium term outlook, we still prefer equities to bonds and in particular prefer large cap growth stocks. The premium between emerging market equities and bonds versus developed market equities and bonds will gradually fade over time, making strategic allocations towards emerging markets help deliver superior diversification benefits. The global commodity super cycle has a long way to go given the shift in global growth towards emerging economies, their capital investment needs and the usual demand that accompanies the industrialisation of emerging economies.

We will continue to be cautious with leveraged trades as the near term risks still favour more adjustments in financial asset prices as the de-leveraging process gradually unfolds. Some high yielding currencies are also vulnerable to this adjustment. We are also mindful of the possibility of near-term geopolitical uncertainties and the possible introduction of legislation by various key global authorities who feel that they need more accountability and transparency within the financial market structure in order to avoid the structure from heading towards a systemic collapse.

1.4 Special Report (b)

“The US Federal Reserve Bank is forced into the scene – Market Update 20th August 2007”

Quote of the day: “Lend freely against good collateral at a penalty rate” – Walter Bagehot – Economist 1826-1877

Fed Action:

The US Federal Reserve reduced the rate of interest it charges banks via the discount window (The Fed Discount rate) by 0.50% (from 6.25% to 5.75%) on Friday, 17th August and acknowledged for the first time that an extraordinary policy shift was needed to contain the prevailing rout in global financial asset markets, highlighting the rising threat to economic growth. However, the Federal Funds rate was left unchanged at 5.25%. This is the rate at which the Fed conducts open market operations for which the collateral has to be the very best of securities such as Treasury debt or Agency securities. Typically there is a 1% gap between the Discount Rate and the Fed Funds Rate.

It was revealed that the Board of Governors met via a conference call at 6:00 PM on Thursday, 16th August to accept a request made by the New York and San Francisco Fed banks to cut the discount rate.

“Financial market conditions have deteriorated and tighter credit conditions and increased uncertainty have the potential to restrain economic growth,” the accompanying statement, read.

One should never forget that the Fed was created, in response to the 1907 financial crisis, to ensure sufficient elasticity in the supply of money and credit and to forestall potential subsequent financial crises.

In contrast, the Bundesbank evolved from the Bank Deutscher Lander to fight inflation after the hyperinflation experienced in the inter-war years.

What has the Fed achieved?

In a clever, innovative and masterful exercise of central banking the Fed took action that addresses the problems of the moment and advances three important policy goals: -

1. Retain the anti-inflation discipline of macroeconomic monetary policy
2. Encourage a trend towards more discerning and discriminating credit judgement in financial markets.
3. Relieve the blockage that has emerged in markets in recent weeks as a variety of securities became progressively more difficult to value, price, finance and transact.

It appears that the 5.25% Fed Fund rate may be considered by the Fed to be a neutral rate that assists the authorities to achieve its anti-inflation goals. On the other hand, lowering the Discount Rate encourages placement at the Fed’s discount window of collateral that cannot otherwise comfortably find a home, precisely the class of collateral that have been seizing up lately. Indeed, the Fed specifically listed “Home mortgages and related assets” as acceptable collateral. This expanded range of collateral compared to the Fed’s open market operation, means that the Fed’s discount officers will exercise a prudent credit posture in

determining how much they will lend against the security of any given collateral. This process will help re-establish benchmarks of valuation that private financial market participants can use for their own purposes, helping restore appropriate pricing of credit risk. The Fed also in a clever and innovative move, extended discount window borrowing, allowing 30-day financing instead of a standard overnight loan with the extension of the facility being at the discretion of the borrower.

The Fed's Board sets the "Discount rate" at which rate it lends funds to eligible depository institutions. The Federal Open market Committee (FOMC) sets the "Federal Funds Rate" and this is the rate at which institutions that have either excess or a shortfall of reserve funds at the Fed, borrow or lend funds to each other. We do not expect the Fed Funds rate to change from its present 5.25% level at the next FOMC meeting scheduled for Tuesday, 18th September, unless Friday's action does not relieve market conditions, but believe that the Fed might announce "an easing bias" thereby letting subsequent financial asset market price movements ease financial conditions, through which monetary policy is transmitted to the real economy.

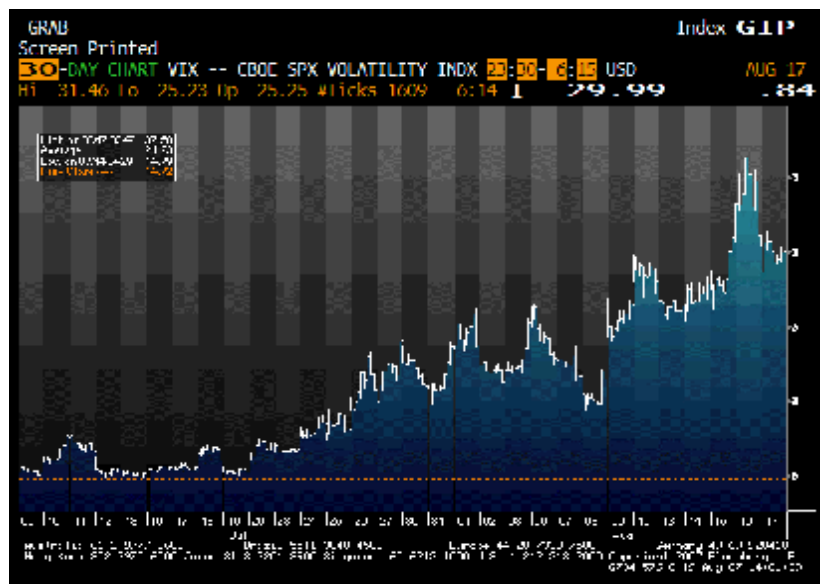
Similar Fed actions in the past:

There were four episodes of "inter-meeting" rate cuts by the Fed in the recent past.

1. 15th October 1998 – A 25 basis point cut, in the second of three easing moves following Russia's default and the Long-Term Capital Management crisis.
2. 3rd January 2001 – A 50 basis point cut, the first step of what turned out to be a long and deep easing phase in response a to deteriorating economic phase.
3. 18th April 2001 - A 50 basis point cut, the fourth dropping the fund rate in response to weakening growth (deflation).
4. 17th September 2001 – A 50 basis point cut in the wake of the September 11, terrorist attacks.

What prompted Fed action?

The S&P 500 30-day volatility chart is an example of the degree of heightened risk averseness and uncertainty that had been prevailing in global equity markets over the past few weeks.



Source: Bloomberg & St George Investment Solutions

The unwinding of the Yen carry trade resulted in the Yen strengthening as illustrated in the following one-month currency return chart.



Source: Bloomberg & St George Investment Solutions

The combined forces of higher volatility and unwinding of the carry trade led to a sharp, significant, and mostly involuntary reduction of risk across global financial markets leading to a “credit crunch” that threatened a total dislocation of global financial markets.

Market Reactions immediately after the Fed’s move:

- 1. Stocks** - The Fed’s action ignited a rally in stocks from Europe to the US, the S&P 500 index climbing 2.5% to 1,445.94 while the Dow Stoxx 600 Index of European shares rose 2.1%. The reaction in Asian/Pacific markets that were closed during the Fed’s announcement should be a strong rebound in prices.
- 2. Bonds** - The 2-year Treasury note advanced the most since September 2005 falling from a high of 4.988% on 6th of July to 4.18% on 17th August. It fell from 4.41% at the start of the week (13th August) to close at 4.189% on Friday, 17th. The 3-month Treasury bill fell the most in a week since October 1987 as risk-averse investors looked for safety and security. The T/bill yield fell from 4.54% on Monday, 13th August to 2.88% on Friday, 7th August. The yield was at 4.98 at the start of the month.
- 3. Commodities** - The Goldman Sachs/S&P commodity index was up 7.118 points on Friday with agriculture up 1.23%, precious metals up 1.48%, energy up 1.35%, industrials up 2.82% and livestock up 1.39%. The index closed at 489.071 having started the week at 491.466 and the month at 515.941.
- 4. Credit Markets** – Top rated asset-backed commercial paper maturing 20th August yielded 5.99% on Friday, 17th, 39 basis points more than the yield quoted the previous day. A measure of risk in the financial markets, the gap between the safest US debt (three month Treasury Bills) and the three month London Interbank offered Rate (LIBOR) also known as the TED Spread (Treasury / Euro Dollar Spread) rose to 1.77%. This was last seen during the 1998 collapse of Long-Term Capital Management LP.
- 5. Currencies** - The currency table highlights currency movements versus the Yen as carry trades continue to be unwound.

Our Take:

1. There is a strong debate/discussion at the Fed regarding the potential growth rate or the speed limit of the economy. The Fed's "Green Book" revealed that the reversion of labour productivity towards its historical mean and the sluggish growth of the US workforce have reduced the potential growth rate to around 2 ½% to 2 ¾%. The Fed is also concerned that inflation and inflation expectations have risen to levels that can threaten long-term gains made on this front over the years. It's the primary goal of the Fed to engineer growth towards potential and contain inflation. The Fed believes that it is "Monetary Policy" and not market forces that can contain inflation.
2. There is a growing body of agreement among central bankers that the supply side dynamics (cheap labour and an abundance of cheap capital) that helped contain inflation through "disinflation" is over; globalisation has run its course. Hence, their determination to act now to preserve gains made on inflation.
3. Actions by the Fed, The European Central Bank (ECB), Reserve Bank of Australia (RBA) and tough talk by the Bank of England (BOE), reveal a common guiding principle among this new generation of central bankers – a strong reluctance to feed moral hazard into the financial markets and a desire to instil market discipline and a more thorough appreciation of credit risk. It is the central banks' duty to keep the markets functioning, but it is not their duty to keep asset prices rising or to rescue bad judgements. With that in mind, we think that the Fed will be extremely reluctant to ride to the market's rescue barring a calamity in the financial system or clear indication that the real economy is in fact imperilled.
4. We believe that there will be a slowdown in global growth later this year and into 2008. We expect the Fed and other central banks to gradually ease policy in response to this slowdown and a gradual decline in inflation.

How are we positioned?

Our fixed income portfolios had been restructured to reflect our concerns about the unsustainable levels of narrow credit spreads relative to sovereign debt. We had also been in close consultation with our managers regarding these risks, encouraging them to modify the portfolio structure prudently. Standish Mellon, Boston, our global fixed income – credit manager had no exposure to the sub-prime mortgage sector, while the portfolio benefited via the purchase of relatively inexpensive protection. The manager was underweight mortgages and had a defensive portfolio positioning prior to the commencement of market turmoil.

2. Financial Market Developments

Global equity markets plummeted for the first half of August before rebounding as the US Federal Reserve and world central banks intervened.

The sell off in global equity markets from late July continued throughout the first half of August as the fallout from the US sub-prime market crisis spread. A round of negative financial stories including hedge fund failures, asset backed commercial paper concerns, mortgage company weakness and worries that a widening credit crunch may hurt consumer spending and economic growth combined to send global equities markets tumbling. However, equity markets calmed and partly recovered in the second half of August as global central banks soothed the credit crunch by injecting larger than normal amounts of liquidity into banking systems around the world. In the US, Federal Reserve intervened by cutting the discount rate and pledged to prevent the credit market rout from hampering domestic economic expansion. Stock markets received a further boost when US President George Bush announced plans to stem foreclosures linked to sub-prime mortgages.

Australian shares outperformed all other major developed global equity markets. US equity market regained all their early losses to end the month higher, while the European and Asian equity markets finished lower.

2.1 Global Equity Markets

The World MSCI Price Index (in local currency terms) moved 0.2% lower in August and has now recorded a 4.4% decline on a rolling 3-month basis. On a rolling 12-month basis, the benchmark measure has risen 12.2%.

Market weakness at the beginning of August saw financial stocks suffer the greatest loss after lenders were unable to re-finance their loans as the credit crunch set in and brokers fell on the increasing amount of hedge fund failures. Other weak performers included miners and oil producer on speculation that an economic slowdown could reduce demand for commodities at a time when supply is abundant.

In the US, the NASDAQ Composite Index moved 2% higher over the month and managed to outperform both the S&P 500 index (+1.3%) and the Dow Jones Industrial Average (+1.1%). US markets stabilised and climbed after Federal Reserve cut the discount rate and pledging to prevent the credit market rout from slowing economic expansion. President Bush's announcement of plans to stem foreclosures gave equities markets a further boost.

Japanese equities plunged before recovering slightly in the second half of August. The TOPIX 500 index in price terms slid 5.6%, underperformed all of major global equity markets. Credit fears and subsequently the potential slowdown in economic expansion and consumer spending were the main catalyst for the Japanese equity market's weakness. It is believed any slowdown would weigh on Japanese exporters and potentially prove to be another obstacle for raising interest rates.

US shares rose in August after Federal Reserve intervened by cutting the discount rate and pledging to prevent the credit market rout from slowing economic expansion. Markets received a further boost when President Bush announced plans to stem foreclosures.

Japanese equities plunged on credit fears.

European shares dropped in August, with Germany's DAX posting the strongest return.

European equities dropped in August, with the exception of the German equity market which outperformed the main European bourses. European equity markets trended lower early in the month following the lead from Wall St before regaining some lost ground. For the month, Germany's DAX index added 0.7%, UK's FTSE 100 index shed 0.9% and French CAC 40 lost 1.5%.

While global markets experienced weaknesses, the Chinese stock market was largely immune to any outside influences. The Shanghai Stock Price Index continued to strengthen, soaring 16.7% over the month and creating fresh highs along the way. Stronger than expected growth and higher earnings releases led to market optimism supported the equity market. Chinese financial shares led the advance, going in the opposite direction of their global peers.

The Shanghai index has now risen 27% over the last 3 months and a phenomenal 214.65% over the last 12 months. In comparison, India's Bombay SENSEX 500 index performance over the 12 months is modest, with a gain of 34.5%.

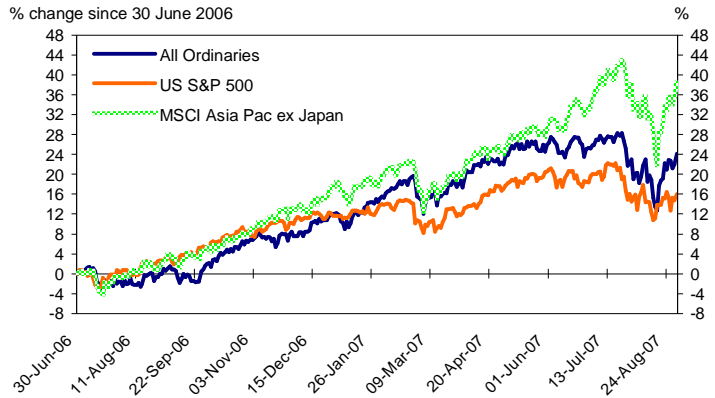
Most other Asian markets fell with the exception of Hong Kong as they were able to capitalise on the strong support from bullish stock markets from mainland China. The MSCI Asia Pac (ex Japan) index decreased 1.9% while the Hong Kong Hang Seng index surged 3.45% over August.

Table 3: Global Equity Market Price Indices * (% change to end August 2007)

	Monthly % D	Rolling 3 months % D	Rolling 12 months % D	Year-to-date % D
MSCI World	-0.2	-4.4	12.2	17.4
US S&P 500	1.3	-3.7	13.1	18.1
US NASDAQ	2.0	-0.3	18.9	17.7
German DAX	0.7	-3.1	30.4	41.2
UK FTSE	-0.9	-4.8	6.7	12.2
Japanese Nikkei	-3.9	-7.3	2.7	2.8
MSCI Asia ex Japan	-0.9	10.7	41.5	87.1
Aus All Ords	1.0	-1.5	23.0	32.7
French CAC	-1.5	-7.2	9.6	20.3

Source: Datastream; * local currency terms

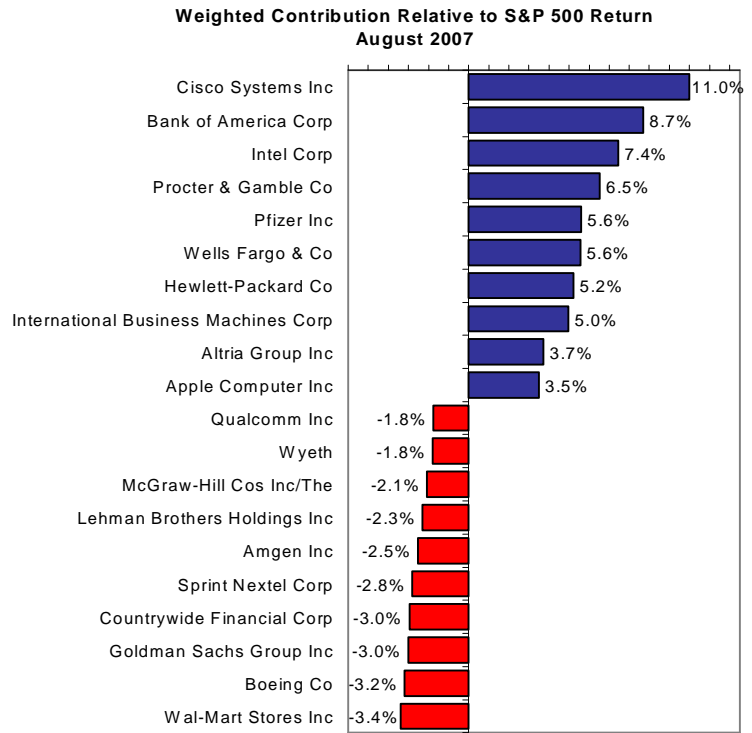
Chart 5: Equity Market Performance (% change since 30 June 2006)



Source: Datastream, St George Investment Solutions

Chart 6: U.S. Market Performance – Best and Worst Contributors to Index Return

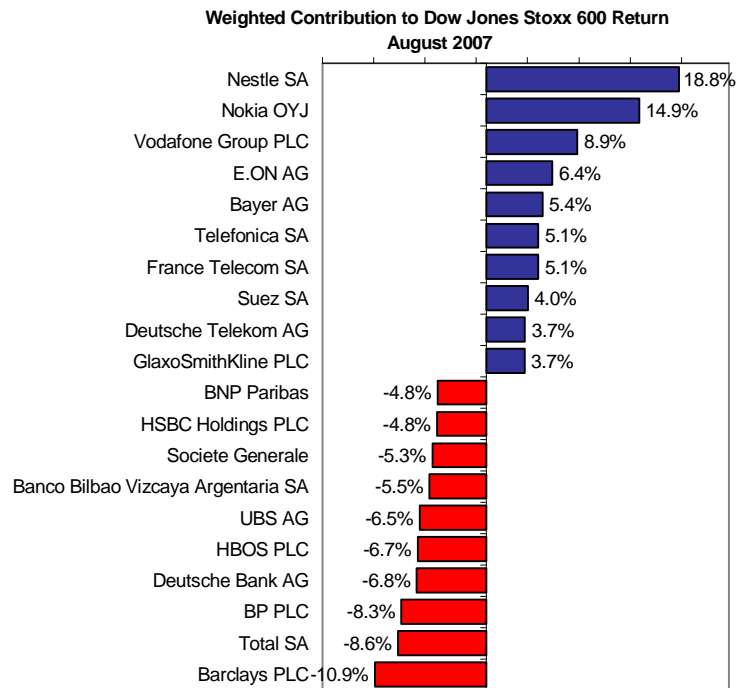
The US S&P 500 Price Index advanced 1.3% in August (up 18.72 points).



Source: DataStream, St George Investment Solutions

Chart 7: Europe Market Performance - Best and Worst Contributors to Index Return

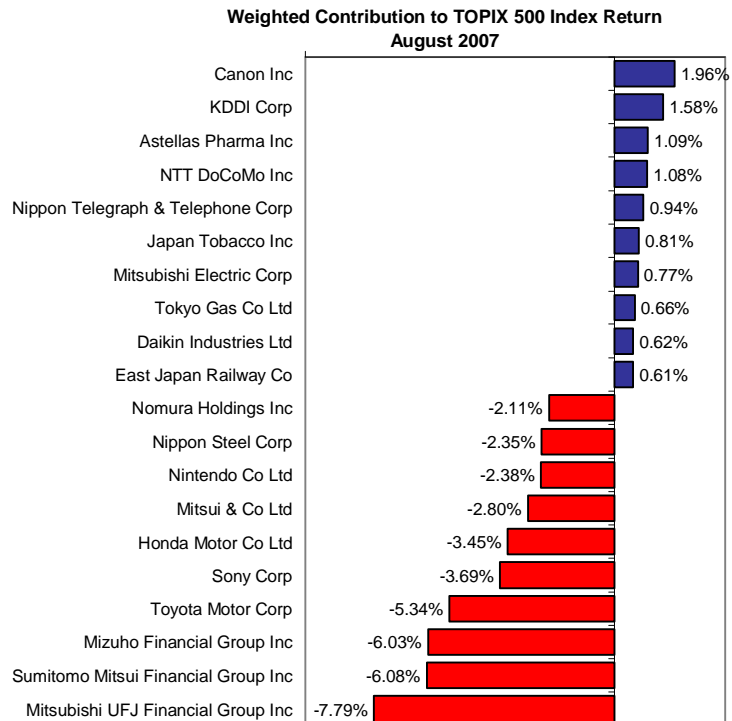
The European Dow Jones Stoxx 600 Price Index retreated 1.1% in August (down 4.13 points).



Source: DataStream, St George Investment Solutions

Chart 8: Japanese Market Performance - Stock Contributors by Index Points

The Japanese Topix 500 Price Index fell 5.6% in August (down 76.13 points).



Source: DataStream, St George Investment Solutions

2.2 Australian Equity Market

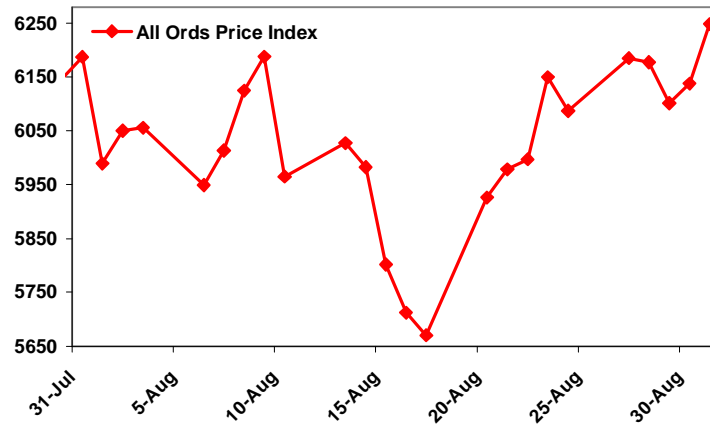
Australian shares finished higher in a volatile August.

The Australian share market finished higher after a volatile August due to the ongoing fallout of the US sub-prime market crisis. Markets seesawed early in the month, before plunging mid month as the spectre of a credit crunch, emanating from the US sub-prime rout, became a reality. At its worst the market was down 12% from its July high. However a rebound in US markets and solid reporting season lifted the market in the second half of the month to erase all of the earlier losses. The benchmark S&P/ASX 200 Accumulation index added 2.4% outperforming all other developed markets.

The global credit crunch spread quickly, Australian mortgage lenders were unable to refinance their loan books as credit spreads widened and hedge funds stopped withdrawals. Liquidity dried up as investors placed more premium on risk and markets started falling. However towards the end of the month, investors became less risk averse and liquidity once again flowed into risky assets after cash injections by central banks around the world and reassurances from the US Federal Reserve that it will maintain growth in the world's largest economy.

Investment banks bore the brunt of the sub-prime market and credit crisis, while property securities made a recovery. The outbreak of equine flu and possible cancellation of race meets weighed heavily on the gaming industry.

Chart 9: All Ordinaries Price Index - Daily Closing Values for August, 2007



Source: DataStream, St George Investment Solutions

Large caps significantly outperformed small caps over the month.

Large cap stocks performance surpassed small cap stocks over the month and 3 months, however small caps have out performed large caps over the six month and 1 year periods. The ASX Small All Ords Accumulation index retreated 3.9% in August and 4.8% over the last three months, underperforming the ASX 100 Accumulation index by 7% and 4.5% respectively over the same periods. Over the last 12 months, the ASX Small All Ords Accumulation index has returned 33% compared with 26.7% for the ASX 100 Accumulation index.

Industrials outperformed resources over August.

Industrial shares outperformed resources stocks in August, but resources still have the upper hand over the quarter. The S&P/ASX 200 total return measure of resource shares advanced 0.7% and 8.2% for the month and 3 month respectively, while the same measure for industrial shares added 3% over the month and lost 2.1% over the quarter.

Sector and Stock Performance – August 2007

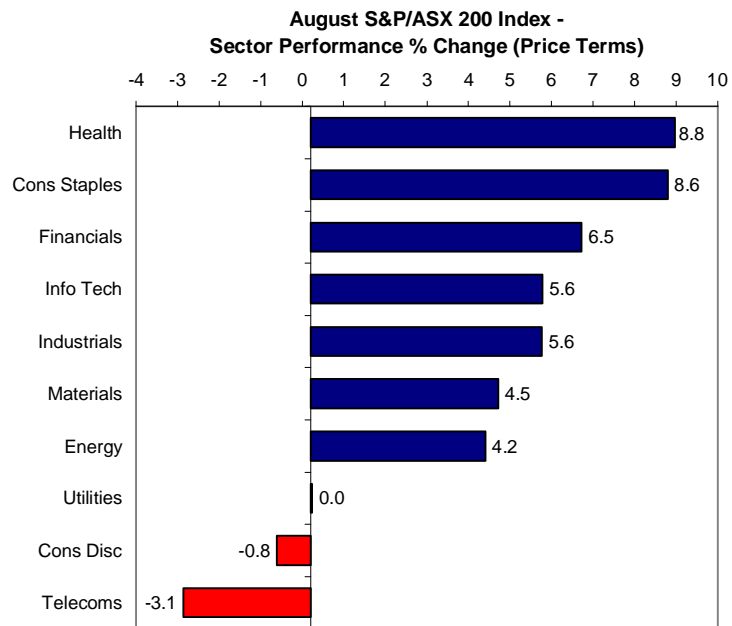
Healthcare led positive performing sectors in August.

Eight out of ten sectors achieved positive performances. Healthcare led positive performing sectors in August, while the telecommunications and consumer discretionary sectors were the main drag on performance.

The Healthcare sector gained 8.8% over August for the best performance among the sectors in the Australian market. The proposed takeover of **Symbion Health** by **Healthscope** dominated headlines again. Symbion Health ended 0.2% higher after the ACCC announced that it will not oppose the proposed takeover. **Ansell's** jumped 11.6% after reporting sales growth of 15%. **CSL** surged 10.4% after reporting profit results, which beat analysts' forecasts. **Sonic Healthcare** gained 2%, the company's results were in line with consensus and it continues to position itself for further growth via an equity raising and acquisitions.

Consumer staples sector was the second largest gainer. Shares of retailer **Woolworths** jumped 11.1%, reaching fresh highs along the way following another solid result. Rival **Coles Group** continued to track lower as uncertainty surrounds **Wesfarmers'** bid given its declining share price. **Metcash** rallied 6.5% after it revised FY08 guidance. **Coca-Cola Amatil** and **Foster's Group** both enjoyed price appreciations on the back of stronger profit results. Coca-Cola added 5.5% while Foster's lifted 9.1%.

Chart 10: ASX 200 GICS sectors (price return for August 2007)



Source: Iress, St George Investment Solutions

A measure of financial shares in the S&P 200 index added value during August, increasing 6.5% as a group. Major banks ended higher, **National Australia Bank** surged 4.1%, **Westpac** gained 3.8%, **ANZ** put on 2.4% and the **Commonwealth Bank** put on 1.6% despite reporting FY07 results that were below expectations. Insurers experienced mixed results. **AXA**, **AMP**, and **QBE** rose 2.6%, 4.6% and 16.3% respectively after they all reported solid earnings. **Insurance Australia Group** plunged 11.8% as it announced a weak FY07 profit. Fund managers and mortgage lenders suffered as a result of the crisis in the sub-prime and credit markets.

Macquarie Bank lost 11.2% after the investment bank said investors in two of its funds may lose 25% of their money. Shares of **Rams Home Loans Group** plummeted 55.4% as the lender was unable to refinance maturing notes due to a lack of market liquidity and also after it said earnings may fall due to rising financing costs.

Information technology rebounded in August. **Computershare** recovered 4% as its FY07 beat analysts' forecasts. The company's on market buyback was increased to 45 million shares from 25 million shares.

Industrial stocks advanced 4.6% in August. **Dyno Nobel** rose significantly after **Incitec Pivot** confirmed it has acquired a 13% strategic stake and it intends to explore further opportunities with the board and management. **Brambles** soared on strong profit growth and the announcement that it had built stakes in both **Asciano Group** and **Toll Holdings**.

Materials stocks experienced extraordinary volatility, free falling after base metal prices fell sharply as speculator scrambles for safety.

Materials stocks experienced extraordinary volatility, free falling after base metal prices fell sharply as speculator scrambles for safety. Zinc and uranium stocks like **Zinifex** and **Paladin** retraced. Other material stocks finished well above their mid month lows after stronger profit reports. Large miners supported the index measure, **Rio Tinto** and **BHP Billiton** ended August on a positive note after both companies reported strong results during the month.

The realisation that Hurricane Dean would not affect oil production in the Gulf of Mexico and the credit market turmoil forced oil prices and oil producers lower on speculation that it would slow global growth and reduce demand for oil at a time when inventory was plentiful. **Oil Search**, **AWE**, **Roc Oil** and **Tap Oil** all traded lower.

The utilities sector was flat. **AGL** and **Babcock & Brown Infrastructure** rose after reporting strong results. However **APA Group** tumbled despite strong revenue growth.

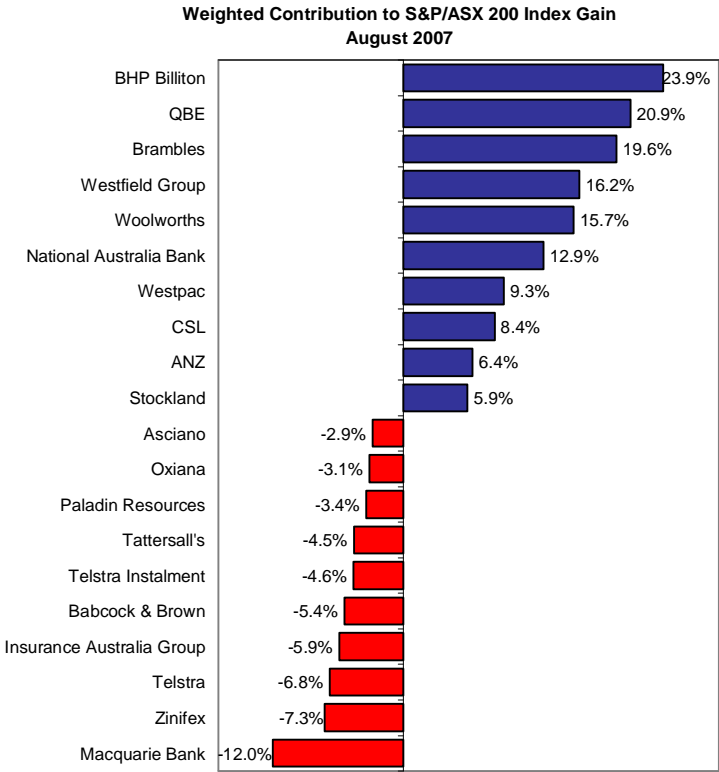
Consumer discretionary stocks mostly fell. **Publishing & Broadcasting**, **Fairfax** and **APN News & Media** all declined following their FY07 results. Shares of **News Corporation** were steady as the Australian dollar depreciated against the greenback. The international media company's fourth quarter profits were in line with consensus with solid momentum across all businesses. **Austar United Communications** weakened as its stocks were negatively impacted by higher tax expenses. **West Australian Newspapers** continued to perform solidly, its net profit rose 17.9% and was well ahead of analysts' estimates. The spread of equine flu in the racing industry weighed on betting companies. **Tabcorp**, **Centrebet** and **Tattersall's** all fell as they faced an A\$8 million drop in earnings from the halt to horseracing. Tattersall's shares also declined because the gaming firm's profit was below analysts' estimates.

The telecommunications sector had the worst performance in August, driven lower by Telstra.

Telecommunication was the worst performing sector in August. Shares of **Telstra**, **Telstra instalments** and **Telecom New Zealand** were punished by investors after their FY08 outlooks were below expectations. However **SingTel** surged, limiting the sector's decline after good contributions from its Singaporean business and **Optus**.

Chart 11: Australian Market Performance - Stock Contributors by Index Points

The S&P/ASX 200 price index added 1.7% in August. (Up 103 points).



Source: DataStream, St George Investment Solutions

Domestic property securities outperformed the broader market over the month of August.

2.3 Listed Property Trusts

Domestic Property Trusts outperformed the broader market over August as investors became risk averse and sought safer investment options.

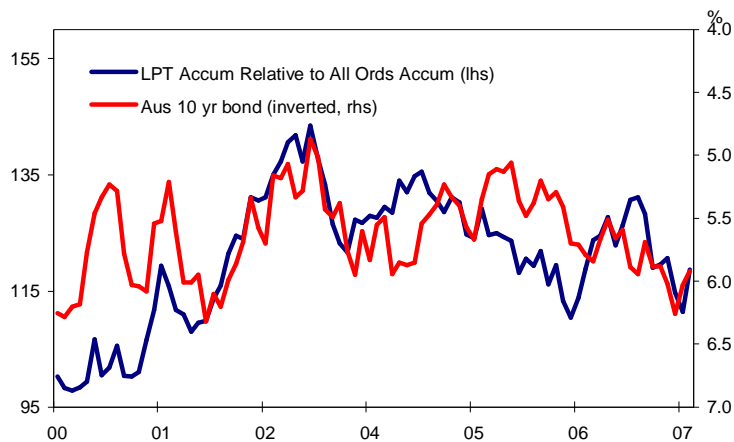
The S&P/ASX 200 Property Trust Accumulation index surged 8.4% in August, outperforming the All Ordinaries Accumulation index by 6.7%. Over a 3-month period, listed property posted a fall of 1.9% whilst on a rolling 12-month basis, the sector returned a robust 21.1%, but still underperformed the All Ordinaries by 6.8%.

The LPT sector is offering an estimated 2008 cum-adjusted dividend yield of 5.7%, a 120 basis point discount to 90-day bank bill rates (6.9%) and a 20 basis point discount to 10-year bonds (5.9%). This is well below the average spread over the last five years. However, this narrowing spread partly reflects the higher growth expectations for the sector as a result of stapled securities.

On a sector level, the Leaders were the strongest performers with a return of 10.1%, followed by Industrials and Retail property sectors. Real Estate Managers & Developers and Diversified although providing positive returns but still underperformed the broad property sector.

Westfield Group benefited from a flight to quality in the toughest month the equities market has seen since the September 11 terrorist attacks. Stockland also benefited as investors flocked to high quality defensive stocks. Goodman Group lifted after it reported the strongest result of the leaders. While on the downside Reckson New York Property Trust and Rubicon Europe Trust Group were punished for an average profit result and being exposed to the credit markets respectively. Centro Shopping America Trust traded poorly after the announcement of the expected merger with Centro Retail Group.

Chart 12: Relative Performance of LPT's & the Australian 10 Year Bond Yield



Source: Datastream, St George Investment Solutions

2.4 Fixed Interest

Australian bonds yields were dominated by widening credit concern from the US.

Global credit market turmoil in August caused Australian investors to flee towards the comparative safety of the government bond market. Bond yields fell across all maturities, although the decline in Australian bond yields were not as dramatic as that of the US. Australian investors expect an increase in Australian interest rates, while investors expect the Federal Reserve to ease interest rates during its scheduled 18th September FOMC meeting. The benchmark UBS Composite Bond (All Maturities) Index moved 0.7% higher over the month whilst on a rolling three-month basis, the index has returned a lacklustre 0.3%. This index has underperformed the bank bill index by 1.3% over the past three-months and 1.9% over the past 12-month period.

The RBA raised the cash rate by 25 basis points to 6.50% after its scheduled August 8th Monetary Policy Meeting. On August 13th, in its latest Statement on Monetary Policy, the RBA announced it had upgraded its inflation forecast and thus strengthened its rate tightening bias. In the aftermath of this inflationary upgrade, markets priced in a 46% chance of a further rate hike before the end of the year, although later developments in the international credit markets caused these odds to lengthen.

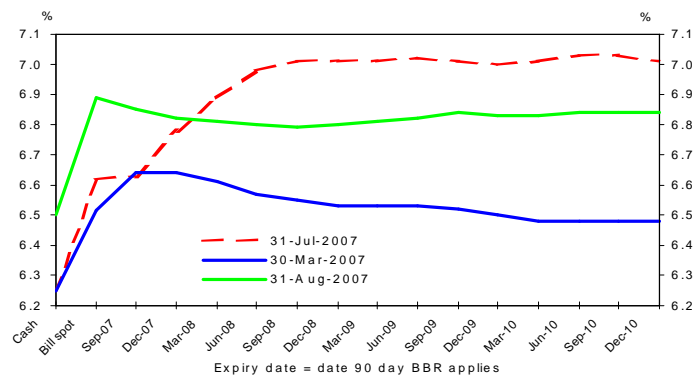
Yields for one-month and three-month bank bills rose by 34 basis points and 27 basis points respectively by the end of August. Reflecting the increase in volatility caused by the sub-prime related worries, one month bank bills traded in a range between 6.51% and 6.87% for the month, while three month paper traded in a 6.60% to 6.95% range for the period. Australian 10 year bonds finished August at a yield of 5.92%, 11 basis points below their July close

In the US, 10 year bonds ended August yielding 4.51%, a significant fall from their end of July close of 4.80%. After cutting the discount rate in mid-August by 50 basis points as a result of sub-prime worries, the accompanying statement by the Fed suggested that the downside risk to growth had increased and bonds rallied anticipating a rate cut.

The underperformance of Australian bonds relative to US bonds in August caused the Australian-US ten year bond spread to widen by 18 basis points to 141 basis points by month's end, while in the short end the two year spread widened 32 basis points to 216 basis points for the same period as investors began factoring in the next anticipated rate increase by the RBA.

Yields rose at the short-end of curve in anticipation of an interest rate hike.

Chart 13: Financial Market's Interest Rate Expectations



Source: Iress, St George Investment Solutions

Fears over the US sub-prime housing sector saw the unwinding of carry trades.

Heavy selling of the A\$ occurred in mid-August, forcing the RBA to intervene in the currency markets to support the A\$.

This chart highlights the cumulative percent change in selected cross rates versus the US\$, since June 30 2006. A rise in the line represents an appreciation in the local currency versus the US\$

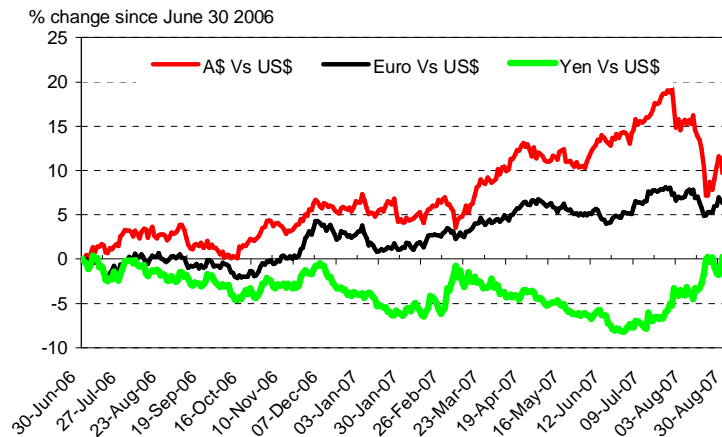
2.5 Currency

Currency markets continued to experience increased volatility in August, as fears over the US sub-prime market continued and risk aversion amongst investors remained elevated. As in the previous month, throughout August there were large unwinding of carry trades, which involved the A\$. Fears of slower global economic growth due to sub-prime mortgage worries and concerns over the affect of increased volatility, particularly equity market volatility, on “growth” or commodity currencies, saw the A\$ weaken against the major global currencies.

The Australian dollar fell heavily against all major currencies in August. The A\$ fell 4.0% against the US\$, 6.2% against the Yen, 3.6% against the Euro, 3.3% against Sterling, 3.3% against the Swiss Franc. On a trade-weighted basis, the A\$ fell 3.8%. Against the other commodity currencies, the A\$ appreciated 4.4% versus the NZ\$, but fell 4.9% against the Can\$.

Selling of the A\$ reached a crescendo over August 16-17, forcing the RBA to intervene in the currency markets to prevent further disorderly and adverse market movements of the A\$. On August 17 the A\$ fell to its monthly intra-day low of US\$0.7676, representing a 13.4% retracement from its July 25 peak, and 9.9% lower than its US\$0.8516 level at the beginning of August. The decline in the A\$ over August was much larger than the normal falls associated with unwinding of carry trades due to the larger and broader participation by investors than at any time in the past and the very aggressive selling by hedge funds who have significantly larger funds under management than before.

Chart 10: Cross Rates Versus the US\$ (% change since June 30 2006)



Source: Datastream, St George Investment Solutions

Growth asset classes rebounded in August to beat performances of defensive assets.

Domestic listed property trusts outperformed all asset classes in August.

Growth assets outperformed in August after central banks and government corrective actions and strong profit results combined to lift investor optimism.

2.6 Benchmark Performance

Growth asset classes rebounded to outperform the traditional defensive asset classes, as markets became less risk averse in the second half of August on the back of central bank and government interventions. A strong reporting season also supported growth assets with investors abandoning the defensive asset in favour of more risky assets.

Listed Property Trust outperformed all other asset classes in August. The S&P/ASX 200 Property Trusts Accumulation Index powered ahead 8.4%, out doing the All Ords and the World MSCI index in local currency terms. The Australian dollar weakened against the greenback, assisting the performance on unhedged global equities over the month. In Australian dollar terms, the World MSCI moved 5.3% higher.

Australian equities endured an extremely volatile August to finished higher. The All Ordinaries Accumulation Index rose 1.7% by month end.

Global government bonds were the weaker asset class at the end of August as investor left the safety of fixed income investments and again sought out riskier assets in hope of higher returns. The global bond market as measured by the JP Morgan Global Government Bond Index posted a positive 1.5% in August. Whilst the Australian bond market, as measured by the UBS Composite Bond (All Maturities) index posting a modest 0.5% return over the month.

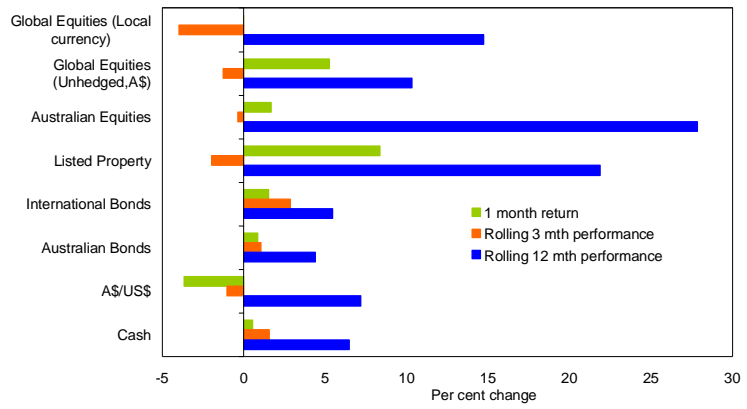
The Australian dollar weakened against most major currencies. Carry trade currency positions were unwound as risk aversion became paramount with liquidity drying up during the credit crunch.

Table 4: Performance to August 2007*

	% Change over:		
	Month (%)	Rolling 3 Months (%)	Rolling 12 Months (%)
World MSCI (local currency)	0.0	-4.0	14.7
World MSCI (A\$)	5.3	-1.3	10.3
All Ordinaries Index	1.7	-0.3	27.9
Listed Property Trusts	8.4	-1.9	21.9
JP Morgan Global Government Bond (hedged)	1.5	2.9	5.5
UBS Aus Composite Bond – All Maturities	0.9	1.1	4.4
A\$/US\$	-3.7	-1.0	7.2
UBS Aus Bank Bill Index	0.5	1.6	6.5

* Total return (accumulation) Indices. Source: Datastream, Iress, St George Investment Solutions

Chart 15: Benchmark Performance to End August 2007



Source: Datastream, St George Investment Solutions

3. Asset Allocation Implications

Our regular quarterly in-depth review of our current asset allocation positions, versus the portfolios' strategic (long-term) benchmarks was concluded in early July 2007.

The changes made from the previous quarter were to increase the portfolios' exposure to International Shares, Australian Bonds and International Bonds for the Defensive, Moderate, Balanced and Growth portfolios. Offsetting these increases have been a reduction in allocation to Listed Property, Mortgage Funds and Cash. This changes our overall exposure to growth assets from a "Moderate Underweight" to a "Slight Underweight".

We have increased our exposure to International Shares, with the allocation towards this asset class moving to "Moderate Overweight". Our exposure to Australian Shares remains unchanged at "Slight Underweight".

We have increased our exposure to International Bonds and Australian Bonds, with the allocation positioning for both of these asset classes moving to "Neutral". This move is a result of recent increases in global bond yields. For the Defensive, Moderate, Balanced and Growth portfolios we have decreased our exposure to Cash with the allocation positions moving to "Slight Overweight" from "Strong Overweight".

Early indications, based on surveys and data releases from a majority of developed and emerging economies, point to a significant revival in global economic growth over the coming quarters.

3.1 Tactical Asset Allocation Positions & Rationale

As anticipated by us, global economic growth is now re-emerging from an inventory driven mid cycle slowdown. Early indications, based on surveys and data releases from a majority of developed and emerging economies, point to a significant revival in global economic growth over the coming quarters.

Financial asset market prices now reflect this change in outlook and investor sentiment, particularly in global fixed income prices. Markets now speculate on no change, a slight upward shift or perhaps even a restrictive policy regime in a majority of countries in the near future, with the majority leaning towards a tighter policy regime. Our views differ somewhat from the broad market consensus because of what we believe to be a contemporary approach to monetary policy settings presently being pursued by a majority of monetary authorities.

Financial innovation and financial market disintermediation, the integration of major global economies and financial asset markets, clarity, transparency and openness of central bank policy, exponential growth in financial derivative usage and leverage, low volatility and amplitude of economic data, the near mobility of factors of production and the impact of financial asset prices on investor and consumer behaviour have all combined to create a more complex set of variables that a modern central bank has to cope with. Central bankers must not only assist in the moulding and engineering of a healthy environment of non-inflationary growth but also gain and retain sufficient global investor confidence and credibility, in order to steer the domestic economy towards a desired outcome within the context of an integrated and complex global structure.

We agree with consensus that this increased focus on global dynamics increases the chances of synchronised monetary policy trends in major and emerging economies. However, we differ on the magnitude and

timing of such changes. We believe that global and domestic financial conditions are very important in setting monetary policy because financial asset market prices have a major impact on the behaviour of consumers and investors. Key to this is the pattern of discretionary spending in the case of consumers and capital spending in the case of corporations. Quite often, financial asset market prices act as an “automatic” stabiliser to the magnitude and extent of savings, borrowing, spending and investment in an economy.

We believe that financial asset market prices will do a reasonable degree of monetary tightening or loosening for the authorities, making their job easier. In the current context, the authorities will only have to do modest or cosmetic changes to monetary policy, should money market yields and bond yields remain elevated and credit market spreads continue to move wider, relative to sovereign yields.

Global employment growth during the past few years has been remarkably firm despite the recent economic slowdown. This has been caused by the substitution of labour for capital. Massive corporate investment in capital stock in the mid to late 90’s is now being replaced with modest capital spending and increased hiring of labour. This trend is likely to be a cyclical phenomenon with shifting global demographic dynamics also playing a minor role at present. The new spurt in global growth will most likely add further pressure to already tight levels of resource utilisation, leading to global monetary authorities retaining a bias towards tighter monetary policy or actually tightening policy. We expect a modest upward shift of around 0.25% in Australia, USA and the UK, around 0.50% increase in Canada and Europe and a 0.75% to 1.00% hike in Japan during the second half of this year and into next year. Policy tightening in emerging economies will most likely follow a similar pattern with China in particular keen to engineer a slowdown in both capital spending and speculative flows into the domestic stock market.

The fall in labour productivity in the US highlights that potential growth has slowed to around 2.5% p.a. However, productivity in Europe, Japan and Europe has been moving higher along with sharp productivity growth being recorded in China. A fall in productivity and a declining workforce can have a medium to long-term detrimental impact on the economic growth trajectory of the US. Although the US current account deficit continues to be in record deficit, the size, liquidity and depth of the US financial asset markets continue to attract large pools of global savings due to a chronic shortage of global financial assets. There are early indications that this huge imbalance between aggregate global savings and aggregate global investments may be narrowing due to direct investment projects such as community development and infrastructure projects being pursued by creditor nations. A diversification of global savings away from financial assets to direct assets will tend to shift financial asset prices lower.

The US should register solid growth over the next few quarters while outside the US, the underlying improvement in economic conditions across most developed and emerging economies is quite impressive. Japan continues to make progress in moving out of deflation, while China remains a solid demand engine for the Asian region as a whole. Commodity producers like Australia continue to benefit from significant terms-of-trade improvements. Perhaps the most impressive recent development comes from Europe, where a broad-based domestic demand recovery is underway. While resource utilisation rates are high elsewhere, nowhere are the constraints on growth binding as they are in the US.

Solid domestic demand, high commodity prices and better economic management are supporting growth in Latin America, Asia and Emerging Europe.

In terms of global growth, we anticipate global GDP to be around 3.9% to 4.2% in 2007 and moving into a 4.3% to 4.6% range by 2008.

Australian Shares

Our current positions are:

For Australian shares, our exposure remains unchanged at “Slight Underweight” for the Defensive, Moderate, Balanced and Growth portfolios.

... Slight Underweight Australian shares

Our bottom-up and top-down analysis of the Australian stock market points to the market being a shade over fair value at prevailing levels. Our analysis points to global equity markets being vulnerable to extreme volatility during the unfolding phase of this current global business cycle. The strong terms-of-trade position has helped Australian corporates retain strong earnings growth while demand for resources and materials continues to dominate our equity market. We doubt if there will be any meaningful decline in demand for resources and materials given the massive infrastructure projects that are underway in leading emerging economies.

In the short-term the market is highly vulnerable to typical market volatility around the August to October period. The trend into the end of year is likely to be positive after a period of seasonal weakness. On a medium to long-term basis, changes made to superannuation benefits and investments by the “Future Fund” will benefit our equity market. We do not anticipate any distinct style or market cap to be in vogue, but rather expect bottom up stock picking to provide investors with good returns. We believe that materials, retailing and services should provide good returns.

... Moderate Overweight International shares

International Shares

We have increased our exposure to International Shares to “Moderate Overweight” from “Slight Overweight” exposure for the Defensive, Moderate, Balanced and Growth portfolios.

Typically, financial asset markets become more volatile after a mid cycle pause. We also believe that equity markets remain vulnerable to sharp bouts of weakness and strength as investor appetite for risk fluctuates wildly during the next phase of this business cycle. While the next leg of the economic growth cycle appears to be underway, we feel that corporate earnings growth peaked late last year.

Irrespective of market volatility, strong sales growth and steady margins will ensure solid earnings growth in the short to medium-term. The sharp rise in corporate bond yields, in most cases returns are now higher than the equity earnings yield, will make equities less attractive than they were over the past years. These forces will dominate equity market performance making stock selection and regional allocation the key to superior investment returns.

We favour Asian, European and key emerging markets from a strategic standpoint due to economic growth potential being greater in these regions. However, increased market volatility will have a greater impact

on emerging market returns and create greater uncertainty in the short to medium term. We like the Japanese market from a medium to long-term point of view due to the great potential for out-performance from this market but remain cautious due to the dominance of foreign investors in this market. If our outlook for increased volatility is correct, from a tactical and strategic point of view we would favour large caps with a modest tilt towards a growth style bias. The key reason for the slight increase in the exposure to International equities is the relative attractiveness in total return.

In the short-term the market is highly vulnerable to typical market volatility around the August to October period. The trend into end of year is likely to be positive after a period of seasonal weakness.

... *Strong Underweight Listed Property.*

Listed Property Trusts

We have reduced our exposure for Listed Property Trusts and maintained the “Strong Underweight” position for the Defensive, Moderate, Balanced Growth and High Growth portfolios.

The outlook for domestic listed property is not that positive as the market appears overvalued given the negative outlook for bonds. This is even more apparent given that the dividend yield in listed property is below the sovereign 10-year bond yield. Increased asset allocation towards this sector by investors seeking a higher yield appears to have run its course. However, our outlook for global listed property is more positive as the newly created listed property markets expand, become more transparent and attract increased amounts of global capital that is seeking both higher returns and efficient portfolio diversification.

...*Neutral International Bonds.*

International Bonds

We have changed our exposure for International Bonds (Hedged) from “Slightly Underweight” to “Neutral” for the Defensive, Moderate, Balanced and Growth portfolios.

The market has largely discounted higher short-term rates and any further weakness in bond markets would prompt us to overweight this asset class given the structural demand for long-term assets by global pension funds and insurance companies. While the Japanese bond market is more vulnerable to further weakness, the structural demand for long dated fixed income securities by domestic investors will continue to provide a steady level of support to the domestic bond market.

We believe that the bellwether US ten-year note will remain in a 5% to 5.25% range in the short-term and then drift towards the 5.50% level, where we will look to increase our exposure to defensive assets.

Global credit spreads are most likely set to widen versus sovereign debt as corporate debt issuance and risk aversion gathers pace. Higher yielding emerging market local currency debt and foreign currency debt will find good demand as investors reach out for superior yields.

In the long-term, we believe that global bonds are now in a secular bear trend but will remain confined to a narrow range in the short to medium-term.

... Neutral Australian bonds

Australian Bonds

We increased our exposure from “Moderate Underweight” to “Neutral” for Australian bonds for the Defensive, Moderate, Balanced and Growth portfolios.

Australian bonds have now reached what we believe to be “fair value”. We see the ten-year yield trading around the 6.00% to 6.75% range with any weakness towards the higher end presenting us with a great opportunity to over-weight this asset class. The ten-year spread with the US is likely to remain around the 1.00% to 1.25% level, with a bias to remain at the top end of the range for most of the year. In the short-term, we anticipate the sovereign/corporate spread widening as risk appetite wanes and investors seek safe investments such as sovereign bonds. However, while we believe that the credit market is vulnerable to significant bouts of weakness due to the re-assessment of “risk” by global investors, the fundamental backdrop will remain in favour of higher yielding credit instruments once nervous investors bail out. The reason for this trend is twofold. One, being the demand for steady and higher coupon incomes by the “baby boomer” generation and a large pool of liquidity still looking for a home while the huge imbalance between aggregate global savings and aggregate demand for global investments remains.

... Slight Overweight Mortgage Funds

Mortgage Funds

We have slightly reduced our allocation from “Moderate Overweight” to “Slight Overweight” for Mortgage Funds.

... Slight Overweight Cash

Cash

We have significantly reduced our exposure from “Strong Overweight” to “Slight Overweight” position for the Defensive, Moderate, Balanced and Growth portfolios.

Australian Dollar

Our favoured outlook has been that the US Dollar will remain weak during the first half of 2007 and then strengthen against major currencies into end of year. We believe that we are at that point where the US Dollar will gather upward momentum and strength, particularly now that investors have changed their views on future US monetary policy. We had targeted the Australian Dollar to reach the 0.8200 to 0.8400 level before a period of weakness unfolds. Given the current speculative frenzy in holding high yielding currencies, we will not be surprised if the currency should move into a 0.8700 range in the very near-term. We expect the Australian Dollar to weaken towards the 0.79 or even to a lower level by end of 2007. The Australian Dollar is also likely to weaken against most major currencies, in particular against Asian currencies. We suggest that investors gradually take off currency hedges on their overseas investments with the optimal hedge being around the 25% to 35% of overseas investments.

Table 5: Asset Class Return Forecasts*

	Long-term return (SAA)#	Income Component (SAA)	Growth Component (SAA)	Medium-term return (as at Q3 2007)**
International Shares (35% Hedged for Medium-term outlook)	9.2	2.0	7.2	11.4
Australian Shares	11.0	3.8	7.2	9.8
Listed Property Trusts	8.8	6.0	2.8	4.9
International Bonds (hedged)	6.7	6.7	-	6.6
Australian Bonds	6.5	6.5	-	6.2
Mortgage Funds	6.3	6.3	-	6.9
Cash	6.0	6.0	-	6.4

* Gross Returns. Source: St George Investment Solutions

Long-term return outlook for International Shares incorporates 35% Hedged return and 65% Unhedged return.

** Medium-term return outlook for International Shares incorporates 35 % Hedged return and 65% Unhedged return.

Our medium-term return forecasts are calculated on the current available data forecasts for assets prices one-year on from the date of our review. However, given the nature of financial asset markets, our forecasts of financial asset prices may be reached well before or later than the forecast date, as financial assets market prices tend to move in a non-linear path and are subject of to a variety of extraneous factors that cannot be factored into our model. Readers and investors must be cautioned, that commonsense, skill, experience and prudence must prevail when attempting to time the entry and/or exit points for various financial assets in order to implement tactical asset allocation decisions.

3.2 Current Asset Allocation Positions Across Portfolios

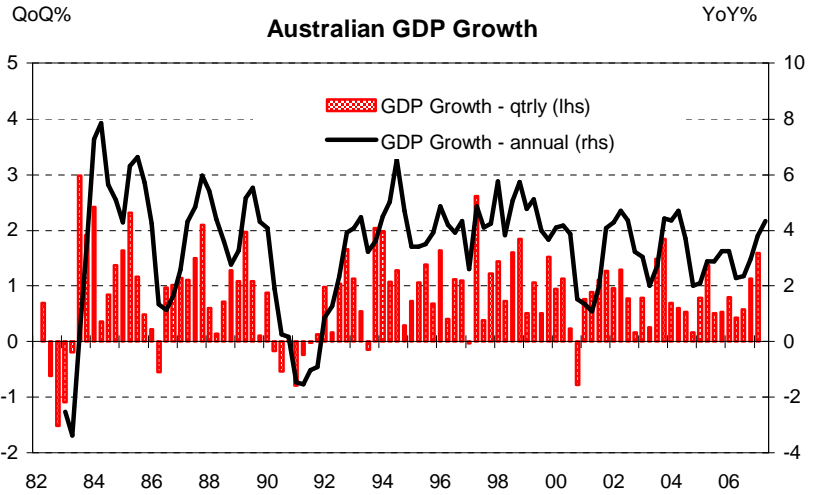
Table 6: Recommended Asset Allocation Positions, Q3 2007

Asset Class	Strategic Benchmark	Range		Current Tactical Position (Q3 06)	Current Tact (Q3) (%)	Previous (Q2 06) (%)	Change from Previous
		Min	Max				
Defensive							
Australian Shares	16	10	22	Slight Underweight	14	14	-
International Shares	9	4	15	Moderate Overweight	13	11	+2
Listed Property	5	0	10	Strong Underweight	1	1	-
International Bonds -hedged	15	0	30	Neutral	15	14	+1
Australian Bonds	20	5	35	Neutral	20	14	+6
Mortgage Funds	20	10	30	Slight Overweight	21	22	-1
Cash	15	0	30	Slight Overweight	16	24	-8
Moderate							
Australian Shares	28	19	36	Slight Underweight	25	25	-
International Shares	16	9	24	Moderate Overweight	21	18	+3
Listed Property	6	0	12	Strong Underweight	2	2	-
International Bonds -hedged	10	0	20	Neutral	10	8	+2
Australian Bonds	15	0	30	Neutral	15	9	+6
Mortgage Funds	15	5	25	Slight Overweight	16	17	-1
Cash	10	0	25	Slight Overweight	11	21	-10
Balanced							
Australian Shares	36	25	46	Slight Underweight	33	33	-
International Shares	25	16	36	Moderate Overweight	31	27	+4
Listed Property	9	0	18	Strong Underweight	4	5	-1
International Bonds -hedged	8	0	16	Neutral	8	6	+2
Australian Bonds	12	0	24	Neutral	12	7	+5
Mortgage Funds	5	0	10	Slight Overweight	6	7	-1
Cash	5	0	20	Slight Overweight	6	15	-9
Growth							
Australian Shares	42	29	54	Slight Underweight	38	39	-1
International Shares	31	20	44	Moderate Overweight	39	33	+6
Listed Property	10	0	20	Strong Underweight	4	6	-2
International Bonds -hedged	4	0	8	Neutral	4	3	+1
Australian Bonds	8	0	16	Neutral	8	4	+4
Mortgage Funds	0	0	5	Slight Overweight	1	1	-
Cash	5	0	15	Slight Overweight	6	14	+8
High Growth							
Australian Shares	50	36	64	Neutral	50	49	+1
International Shares	45	32	60	Moderate Overweight	50	51	-1
Listed Property	5	0	10	Strong Underweight	0	0	-
International Bonds -hedged	0	0	0	-	0	0	-
Australian Bonds	0	0	0	-	0	0	-
Mortgage Funds	0	0	0	-	0	0	-
Cash	0	0	0	-	0	0	-

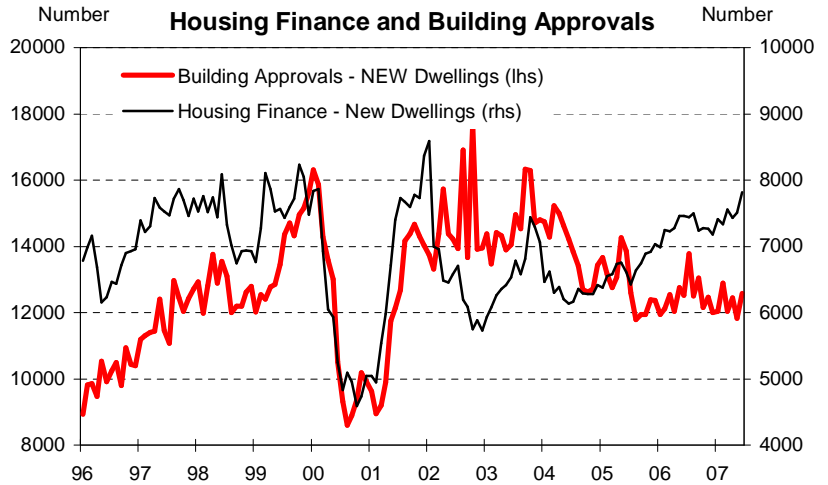
In our process, a tactical asset allocation position can be one of seven states relative to the strategic benchmark – strong underweight, moderate underweight, slight underweight, neutral, slight overweight, moderate overweight, or strong overweight. Source: St George Investment Solutions

4. Economic Chart Set

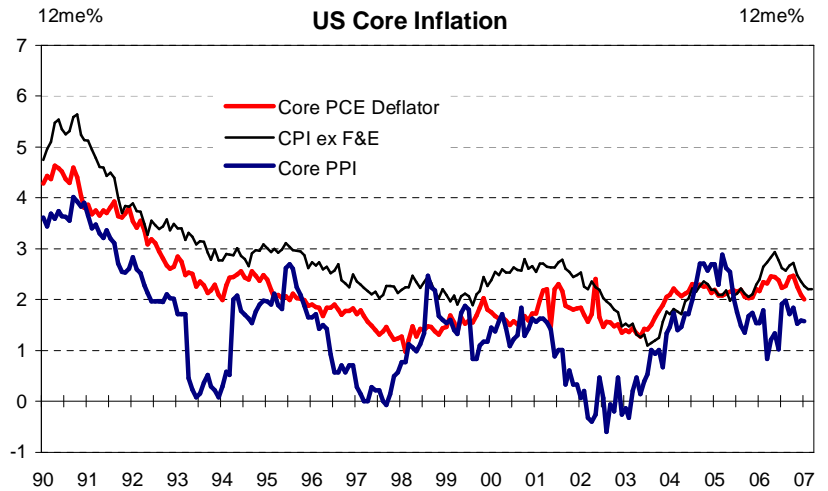
Australia's economy remains strong due to the continuing strong global demand for commodities.



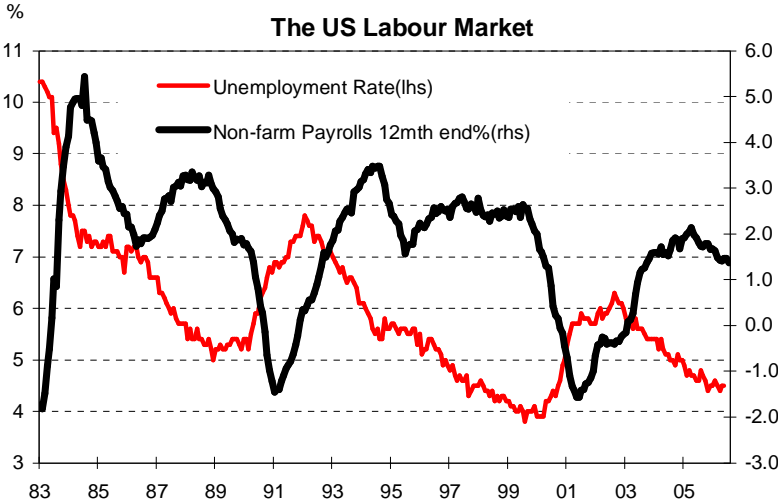
Australia's building approvals continue to improve from March's surprising decline.



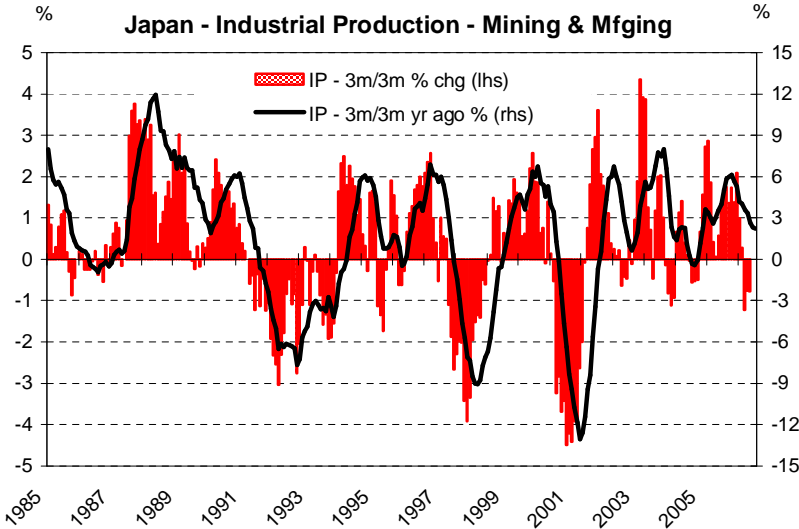
Apart from immediate concerns stemming from the sub-prime mortgage sector, the Federal Reserve's predominant policy concern remains the risk that core inflation fails to moderate.



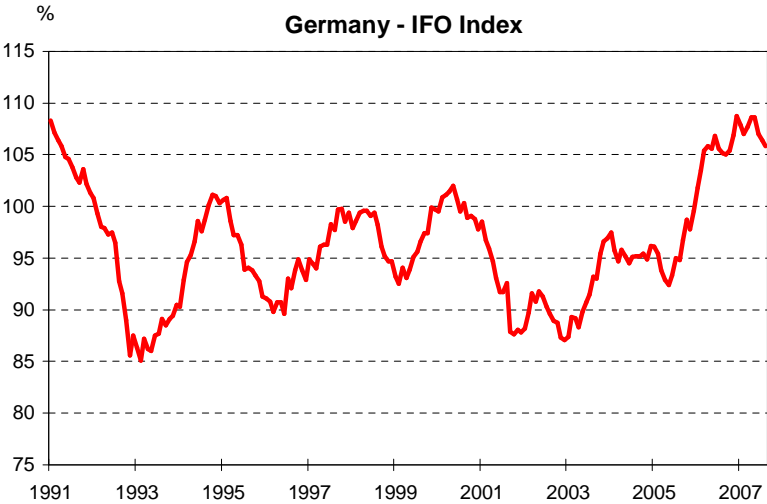
The US unemployment rate remains near record lows, although the jobless rate is expected to rise towards the year's end.



Japan's industrial production is forecast to pick up after falling in sympathy with the year's earlier subdued US GDP outlook.

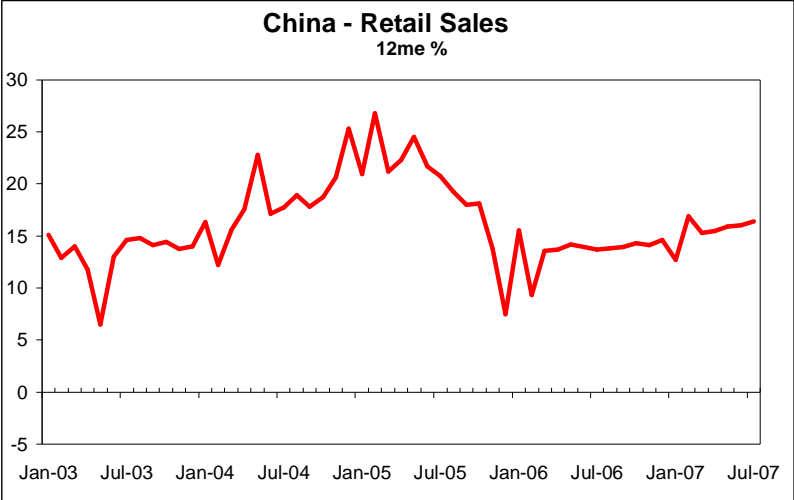


Recent German business and consumer confidence readings were rather subdued due to credit market concerns and the strong euro.



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China's retail sales continue to post strong gains as the economy accelerates towards the 2008 Olympic games.



5. Asset Allocation Across Tax Profiles

Table 7.1: Net of Tax at 0%

Investor Risk Profile ¹	Strategic Allocations					Current Tactical Allocations				
	A	B	C	D	E	A	B	C	D	E
Australian Shares	16	28	36	42	50	14	25	33	38	50
International Shares	9	16	25	31	45	13	21	31	39	50
Listed Property	5	6	9	10	5	1	2	4	4	0
Sub-Total Growth Assets	30	50	70	83	100	28	48	68	81	100
International Bonds -	15	10	8	4	0	15	10	8	4	0
Australian Bonds	20	15	12	8	0	20	15	12	8	0
Mortgage Funds	20	15	5	0	0	21	16	6	1	0
Cash	15	10	5	5	0	16	11	6	6	0
Total Assets	100	100	100	100	100	100.0	100.0	100.0	100.0	100.0

Table 7.2: Net of Tax at 7%

Investor Risk Profile ¹	Strategic Allocations					Current Tactical Allocations				
	A	B	C	D	E	A	B	C	D	E
Australian Shares	15	27	35	41	49	13	25	32	37	49
International Shares	9	16	26	32	46	13	21	32	40	51
Listed Property	6	7	9	10	5	1	2	4	4	0
Sub-Total Growth Assets	30	50	70	83	100	27	48	68	81	100
International Bonds -	16	10	8	5	0	16	10	8	5	0
Australian Bonds	19	15	12	7	0	20	15	12	7	0
Mortgage Funds	20	15	5	0	0	21	16	6	1	0
Cash	15	10	5	5	0	16	11	6	6	0
Total Assets	100	100	100	100	100	100.0	100.0	100.0	100.0	100.0

Table 7.3: Net of Tax at 15%

Investor Risk Profile ¹	Strategic Allocations					Current Tactical Allocations				
	A	B	C	D	E	A	B	C	D	E
Australian Shares	14	27	34	39	48	13	25	31	35	49
International Shares	9	16	27	33	46	13	21	34	42	51
Listed Property	7	7	9	11	6	1	2	4	4	0
Sub-Total Growth Assets	30	50	70	83	100	27	48	69	81	100
International Bonds -	16	11	9	6	0	16	11	8	6	0
Australian Bonds	19	14	11	6	0	20	14	11	6	0
Mortgage Funds	20	15	5	0	0	21	16	6	1	0
Cash	15	10	5	5	0	16	11	6	6	0
Total Assets	100	100	100	100	100	100.0	100.0	100.0	100.0	100.0

Table 7.4: Net of Tax at 31.5%

Investor Risk Profile ¹	Strategic Allocations					Current Tactical Allocations				
	A	B	C	D	E	A	B	C	D	E
Australian Shares	13	25	32	37	47	12	23	29	33	48
International Shares	10	17	28	34	46	14	22	35	43	52
Listed Property	7	8	10	12	7	1	3	4	5	0
Sub-Total Growth Assets	30	50	70	83	100	27	48	68	81	100
International Bonds –	18	13	11	7	0	19	13	11	7	0
Australian Bonds	18	13	10	5	0	18	13	10	5	0
Mortgage Funds	19	14	4	0	0	20	15	5	1	0
Cash	15	10	5	5	0	16	11	6	6	0
Total Assets	100	100	100	100	100	11	23	29	35	47

Table 7.5: Net of Tax at 48.5%

Investor Risk Profile ¹	Strategic Allocations					Current Tactical Allocations				
	A	B	C	D	E	A	B	C	D	E
Australian Shares	12	23	31	36	46	11	21	28	33	48
International Shares	11	18	28	34	46	16	24	35	43	52
Listed Property	7	9	11	13	8	1	3	5	5	0
Sub-Total Growth Assets	30	50	70	83	100	28	48	68	81	100
International Bonds –	19	14	12	8	0	19	14	12	8	0
Australian Bonds	17	12	9	4	0	17	12	9	4	0
Mortgage Funds	19	14	4	0	0	20	15	5	1	0
Cash	15	10	5	5	0	16	11	6	6	0
Total Assets	100	100	100	100	100	100	100	100	100	100

1. A = Defensive; B = Moderate; C = Balanced; D = Growth; E = High Growth
Source: St George Investment Solutions

6: Market Performance Summary

Market Performance - Month Ending 31 August 2007

Statistics close out time: 9/3/07 8:04

		Close	Month	3 Months	365 Days	P/E ratio	DY 12m
Stock Market Price Indices							
Australia	S&P/ASX 200	6,247.20	1.68%	-1.05%	22.13%	15.4	3.5
	S&P/ASX Small Ords	3,772.30	-4.16%	-5.71%	28.19%	17.4	3.4
	All Industrials	9,155.11	0.29%	-5.15%	17.51%	15.0	4.1
	All Resources	5,288.59	-1.60%	5.70%	28.71%	15.6	1.9
	Listed Property Trusts	2,417.80	7.41%	-4.17%	15.21%	7.6	5.6
United States	Dow Jones Industrials	13,357.74	1.10%	-1.98%	17.37%	16.0	2.2
	S&P 500 Composite	1,473.99	1.29%	-3.70%	13.05%	16.9	1.9
	NASDAQ Composite	2,596.36	1.97%	-0.31%	18.89%	36.5	0.7
	NYSE Comp	9,596.98	0.44%	-3.82%	14.41%	14.7	2.3
Asia							
Japan	Nikkei 225	16,569.09	-3.94%	-7.31%	2.65%	35.0	1.2
	Tokyo (Topix)	1,608.25	-5.59%	-8.45%	0.11%	30.4	1.3
Hong Kong	Hang Seng	23,984.14	3.45%	16.23%	37.90%	16.2	2.5
Singapore	Singapore Straits Times	3,392.91	-4.36%	-3.37%	36.68%	12.9	3.6
Europe							
Germany	Dax Index	7,638.17	0.71%	-3.11%	30.35%	13.4	2.6
France	CAC 40	5,662.70	-1.54%	-7.23%	9.64%	14.7	3.0
UK	FTSE 100	6,303.30	-0.89%	-4.80%	6.73%	12.5	3.9
	DJ Euro Stoxx 50	4,294.56	-0.49%	-4.83%	12.76%	12.4	3.4
Euro	Bloomberg European 500	268.14	-1.02%	-5.20%	11.60%	13.9	3.1
	MSCI EAFE in \$A	#N/A RI Tim	-1.70%	-5.35%	10.72%	#N/A N Ap	#N/A N Ap
World							
	MSCI World in \$US	#N/A RI Tim	-0.08%	-3.04%	16.97%	#N/A N Ap	#N/A N Ap
	MSCI World (local currency)	#N/A RI Tim	-0.25%	-4.42%	12.19%	#N/A N Ap	#N/A N Ap
Exchange Rates							
\$A/\$US		0.8176	-4.58%	-1.86%	6.07%		
\$US/GBP		2.0169	-0.92%	1.50%	5.81%		
\$US/Euro		1.3629	-0.45%	1.23%	5.96%		
\$US/Yen		115.8720	2.83%	5.26%	0.18%		
\$A/GBP		0.4054	3.71%	3.34%	-0.23%		
\$A/Euro		0.5999	4.15%	3.07%	-0.10%		
\$A/Yen		94.7305	7.21%	6.78%	-5.86%		
Commodities							
	Goldmans Cmnty Index	6,067.40	-4.19%	4.38%	-8.06%		
	CRB Cmnty Futures Indx	308.79	-2.96%	-1.71%	-5.12%		
	Gold US\$/oz	\$ 673.30	1.18%	1.59%	5.97%		
	CrudeOil (WTI) US\$/bbl	\$ 74.04	-5.33%	15.67%	21.28%		
Interest Rates & Bond Yields							
	SSB World Govt I#N/A RI Tim		7.05%	5.83%	-0.72%		
	(non \$A - Hedged \$A)						
Australia							
	3 Mo Bank Bill indx (mid)	6.890	0.272	0.532	0.693		
	Austn Govt Bonds 3 Year	6.203	-0.190	0.004	0.407		
	Austn Govt Bonds 10 Year	5.918	-0.113	-0.097	0.250		
United States							
	US 3 Month Treasury Bill	4.111	-0.717	-0.675	-0.900		
	US Treasury 3 Year Bond	4.148	-0.256	-0.786	-0.539		
	US Treasury 10 Year Bond	4.531	-0.155	-0.423	-0.195		
	US Treasury 30 Year Bond	4.823	-0.043	-0.235	-0.050		
Japan							
	3 Mo CD Rates	0.550	0.000	0.050	0.275		
	JP Govt 3 Year Bond	0.941	-0.158	-0.139	0.197		
	JP Govt 10 Year Bond	1.613	-0.187	-0.140	-0.017		

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St George Investment Solutions Team

Patrick Farrell

General Manager – St George Investment Solutions
farrellp@stgeorge.com.au

Felix Stephen

Senior Investment Strategist
stephenf@stgeorge.com.au

Dustin Adams

Senior Research Analyst
adamsd@stgeorge.com.au

Mark Vrkic

Senior Research Analyst
vrkicm@stgeorge.com.au

Nick Valcas

Quantitative Analyst
valcasn@stgeorge.com.au

Dimitra Voutas

Portfolio Manager
voutasd@stgeorge.com.au

Andrew Dowie

Economist
dowiea@stgeorge.com.au

Victor Zheng

Analyst
zhengv@stgeorge.com.au

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