



DFA Australia Limited

(Subsidiary of Dimensional Fund Advisors LP.)

- Dimensional manages two share portfolios for MLC:
 - **Australian shares**, since 2002
 - **Global shares**, since 2005
- Manages AUD \$215 billion, across the company, as at 30 June 2011.
- 30 years of funds management experience.

Dimensional is a privately owned company. Their model of investing is based not on speculation but on the science of capital markets. Decades of research guide the way. Dimensional's mission is to deliver the performance of capital markets and increase returns through state-of-the-art portfolio design and trading.

Why has MLC chosen Dimensional?

Dimensional have distinctive philosophical beliefs and a disciplined investment process based on ground-breaking academic research. The companies in their portfolios are different from most investment managers as they are based on quantitative analysis rather than fundamental research of companies. Their portfolios are "deep value" and tend to invest more than others in smaller companies. The portfolio is a "high conviction" portfolio designed specifically for MLC.

Philosophy on investing

Innovations in financial markets research over the last fifty years are the keystone of a belief system that guides Dimensional's approach to investing. Companies compete with each other for investment capital, and millions of investors compete with each other to find the most attractive returns. This competition quickly drives prices to fair value, ensuring that no investor can expect greater returns without bearing greater risk.

Dimensional believe everything learned about expected returns in the equity markets can be summarized in three dimensions. The first is that stocks are riskier than bonds and have greater expected returns. The performance among different stocks is largely driven by the two other dimensions: small company/large company and value/growth. They believe small cap and value stocks outperform because they are cheaper as they generally carry greater underlying risk. The lower prices these stocks can be bought for gives investors' opportunity for greater returns as compensation for bearing this risk.

Successful investing means not only capturing risks that generate expected return but reducing risks that do not. Avoidable risks include holding too few securities, betting on countries or industries, following market predictions, and speculating on "information" from rating services. To all these, diversification is the antidote. It washes away the random fortunes of individual stocks and positions your portfolio to capture the returns of broad economic forces.

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Investment process

Inherent in Dimensional's investment process is a degree of academic rigour that is not found in most active managers' processes. Their process is supported by:

Scientific Approach: Portfolios are based on rigorous academic research conducted predominantly by Professors Eugene Fama and Kenneth French, and rational expectations theory. Dimensional's view is that financially less healthy companies offer higher expected returns than financially healthy companies because the risks associated with these companies are higher; i.e. higher returns are the reward for taking higher risks. Their research concluded that equity risk takes two main forms, "size" (small companies are riskier than large companies) and value (value companies are riskier than well run growth companies). Dimensional's portfolios are therefore designed to capture higher returns by focussing on riskier companies. Based on this approach Dimensional produces portfolios with pure and consistent exposure to these risk factors. In respect of the MLC mandate Dimensional provides a global equity portfolio with a pronounced value bias.

Risk vs Reward Focus: Dimensional's view is that investors should only take risks if being rewarded for taking those risks is a reasonable expectation. Dimensional defines risk in terms of a company's cost of capital – i.e. the higher the cost of capital the higher the risk and expected return. Dimensional's view is that the safer the company the lower the return expectations, that safe companies tend to have a low cost of capital, and that these safe companies tend to be medium to large sized growth stocks with sound business models and very strong prospects. Hence Dimensional's investment rationale for focussing on value stocks as a means of generating an excess return, is the reward for taking higher risk.

Discipline: MLC has appointed Dimensional to run a value portfolio. This portfolio is designed specifically for MLC, with the global shares portfolio covering stocks listed in both developed and emerging markets. Dimensional applies a series of filters to company selection, resulting in an investable universe of global deep value stocks, for the global shares portfolio, and an investable universe of deep value Australian stocks for the Australian shares portfolio. The main filters are based on the company's size, liquidity, ownership and clarity of capital structure along with the company's "book to market ratio", which is the primary fundamental measure of value they use within their company selection processes.

In order to provide concentrated value exposure in the portfolio, the stock selection process will only buy stocks with a high book to market ratio relative to their peers.

Innovation: Dimensional's objective is to build a broadly diversified portfolio that adds value through portfolio structure (i.e. a bias towards value) and innovative trading techniques. Dimensional manage and trade the portfolio in a fashion designed to enhance returns. Inherent in this aspect of their process is an acute level of tax awareness, which adds value by enhancing the tax efficiency of their returns.

Portfolio construction

Once market capitalisation and value filters have been applied and the investable universe of stocks has been determined, eligible securities are run through a qualitative screening process. The qualitative screening process eliminates companies with conflicting asset characteristics from the portfolio. There are currently over 30 qualitative criteria that would eliminate a company from the portfolio. These screens include company specific filters such as closed end investment companies, limited partnerships, companies in bankruptcy, ADR's and those that lack sufficient liquidity for cost effective trading.

After the exclusion rules are applied, a "buy list" is generated which includes those companies that meet Dimensional's criteria and are eligible for purchase in the strategy. A patient and price conscious trading approach is then applied to determine which securities are purchased and when. Unlike either an index fund manager or a manager who picks stocks, Dimensional never has to purchase a particular stock. This flexibility allows them to avoid chasing stocks or buying at the asking price. In addition, they explicitly take price momentum into account. In essence, they imply an increase to the cost of selling securities that have done relatively well over the past 6 months and imply an increase to the cost of buying securities that have done relatively poorly. This implied cost has the effect of delaying the timing of the transaction. While they incorporate price momentum into their trading strategy they do not let momentum



induce them to trade, rather high price momentum can stop them from trading. This patient and price conscious trading technique allows them the flexibility to trade when it is deemed necessary and appropriate.

Investment people

The key people involved with MLC's portfolio are:

Name	Qualifications	Position (Title)	Responsibilities	Location	Years with Company	IM Experience
Graham Lennon	MBA, Grap Dip (App. Fin)	Head of International Portfolio Management, Vice President,	Member of Investment Policy Committee, Australian, Int'l Equities and Fixed Income	Sydney	16 years	16 years
Stephen Garth, PhD	PhD	Portfolio Manager, Vice President	Australian, International Equities and Fixed Income	Sydney	10 years	10 years
Rob Ness	MComm	Portfolio Manager, Vice President	Australian, International Equities and Fixed Income	Sydney	8 years	8 years
Karen Umland	MBA, CFA	Senior Portfolio Manager, Vice President	Member of Investment Policy & Investment Committee, International Equities	Santa Monica	18 years	21 years
Stephen Clark	MBA	Head of Portfolio Management	Member of Investment Policy Committee & Chairman of Investment Committee	Austin	10 years	14 years
Eduardo Repetto	PhD	Co-CEO, Chief Investment Officer, Vice President, Head of Research	Member of Investment Policy & Investment Committee, Research	Austin	11 years	11 years
Henry Gray	MBA	Head of Global Equity Trading, Vice President	Member of Investment Policy & Investment Committee, International Equities	Santa Monica	16 years	20 years
Thomas Reif	B.Ec, FIA	Portfolio Manager	Portfolio management activities and research and marketing for equity portfolios.	Sydney	1 Year	17 years
Murray Cockerell	MBA	Portfolio Manager	Day-to-day portfolio management activities in domestic and, international equity and foreign exchange	Sydney	3 years	4 years

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