

MLC Fund Performance Update – October 2010

Below is an edited transcript of a video recorded on 7 October 2010, 2010 by MLC Investment Strategist John Owen.

September was definitely a better month for investors as market returns were broadly positive. US economic data was better than expected and reassuring comments by US authorities that they would act to avoid a feared double dip recession certainly helped sentiment. Our Investment Strategist Brian Parker focuses on these and other important economic developments and the outlook from here in another recording on this website.

For global shares, all of the major markets recorded strong gains. The US S&P500 Index increased by 8.8% in local currency terms while Japan's Nikkei and the UK's FT100 were both up by 6.2% for the month. Despite the sovereign debt problems in Europe which continue to lurk just below the surface, the German and French markets increased by 5.1% and 6.4% respectively. It's good to see positive numbers but remember market returns have now see-sawed into positive and negative territory for four consecutive months so volatility has certainly been the norm.

In line with generally positive market returns around the globe, the MSCI World Index return in September was +7%. Note though this is on a hedged basis. Because of the strength of the Australian currency, with our dollar up by 8.5% versus the US dollar in the last month, the MSCI World Index return on an unhedged basis was only +0.5% for September.

The return of the MLC global shares strategy unhedged and pre fees and tax was +1% for the month with Sands Capital, Tweedy Browne, Walter Scott and Harding Loevner the contributors to the strategy's outperformance. For the year, the MLC strategy returned +0.8% unhedged and pre fees and tax. This was 1.5% higher than the index return, thanks largely to Sands Capital's and Tweedy Browne's exceptional returns versus the index.

Let's look now at the Australian share market which was up by 4.8% for the month. Just as we have seen with many offshore markets, the performance of the Australian market continues to be volatile with monthly returns alternating between positive and negative outcomes for four consecutive months. For the year, the market's +0.7% return is barely in positive territory.

In September, MLC's Australian shares strategy returned +4.8% before fees and tax which was in line with the index return. Seven of MLC's ten appointed managers outperformed the index with Wallara and Dimensional the best performers. Interestingly, these managers have very different investment styles so stock selection has been more important in determining whether individual managers have out or underperformed.

For the year, MLC's Australian shares strategy returned -0.6% before fees and tax and this was 1.3% below the index return. JCP Investment Partners and Northward were the only managers to outperform. Stock selection strategies that benefited both managers over the year were an underweight exposure to financial companies such as banks and a significant holding in gold producer Newcrest Mining.

As for global listed property, the hedged index return was +4.9% in September and +21.8% for the year. As we saw with global shares, the strength of the Australian dollar has resulted in a substantial performance gap between the hedged and unhedged index return in both periods to 30 September. Note that MLC's strategy is fully hedged so investors have been quarantined from the impact of the rising dollar.

In September, the hedged MLC strategy return was +6.7%. This was 1.8% higher than the hedged index return with Morgan Stanley the principal driver of this outperformance. For the year, the MLC strategy returned +23.4% on a hedged basis and this was 1.6% better than the hedged index return. It's great to see that all three of the appointed managers – Morgan Stanley, LaSalle and Resolution Capital - outperformed over the year.

Just quickly on the Australian listed property sector, the Australian index return was -0.9% in September and -4.5% for the year. Resolution Capital which manages the strategy outperformed in both periods.

Now let's review bonds where we actually saw some negative returns emerge from lower risk, investment grade bonds in Australia and overseas. In Australia, the market's pricing of bonds reflects the likelihood of the Reserve Bank raising

the official cash rate. Remember that when bond yields are rising, bond prices are falling and vice versa. So, in September, the increase in yields has resulted in a negative return from Australian bonds for the month.

And overseas, we also saw negative returns on investment grade bonds, but for very different reasons. The US government's quantitative easing measures have increased the availability of cash in the market which has pushed bond values lower, particularly those with shorter maturities.

Not all bond markets recorded negative outcomes. Other sectors such as high yield, inflation linked bonds, cash and emerging markets were positive for the month which helped returns, particularly in Horizons 3 to 5 funds which have more exposure to these sectors of the debt market. Note also that we remove the risk of currency fluctuations regarding the investments we have in offshore bonds and this approach has been beneficial as the Australian dollar continues to rise.

Let's now look at aggregate MLC fund returns. Preliminary and unaudited performance estimates suggest that the Superannuation Fundamentals version of the MLC Balanced Fund returned +2.3% for the month of September after fees and tax while the MLC Growth Fund returned +2.8%. The one year returns of both funds remain in positive territory though as we also commented last month, they are lower than those that were reported earlier this year. In the year to 30 September, again based on preliminary and unaudited estimates, the MLC Balanced Fund returned +5% and the MLC Growth Fund returned +4.1% after fees and tax.

As we have suggested in the past, it's a good idea to keep an eye on the MLC website as we continually prepare articles and other material that are explicitly designed to help you in your conversations with clients. We're currently preparing September quarter fund commentaries and these will be available to you later this month.

Until next month, bye for now.

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