MLC MasterKey Investment Service
MLC MasterKey Unit Trusts

MLC Distributions Update – August 2010

The following table outlines the cents per unit (cpu) distributions paid for the August 2010 quarter for each of the MLC MasterKey Unit Trust investment options (including MLC MasterKey Investment Service[1] investments in the MLC MasterKey Unit Trust funds). A Q&A is also provided to answer more general queries you may have on distributions.

Fund	August 2010 quarter cpu	August 2009 Quarter cpu
MLC Horizon 1 – Bond Portfolio (only through MKIS)	0.36	0.00
MLC Horizon 2 – Income Portfolio	0.37	0.16
MLC Horizon 3 – Conservative Growth Portfolio	0.06	0.00
MLC Horizon 4 – Balanced Portfolio	0.41	0.00
MLC Horizon 5 – Growth Portfolio	0.22	0.00
MLC Horizon 6 – Share Portfolio[2]	-	-
MLC Horizon 7 – Accelerated Growth Portfolio[2]	-	-
MLC Australian Share Fund	0.15	0.19
MLC Australian Share Value Style Fund	0.16	0.37
MLC Australian Share Growth Style Fund	0.00	0.00
MLC IncomeBuilder™	1.21	1.15
MLC Global Share Fund[2]	-	-
MLC Global Share Value Style Fund[2]	-	-
MLC Global Share Growth Style Fund[2]	-	-
MLC Property Securities Fund	0.70	0.66
MLC-Platinum Global Fund[2]	-	-
MLC Capital International Global Share Fund[2]	-	-
MLC-Vanguard Share Index Fund	0.88	0.85

[1] Please note, MLC MasterKey Investment Service Fundamentals invests in MLC Wholesale funds, which have a June year end. Similarly, the MLC Long-Term Absolute Return Portfolio, MLC Diversified Debt Fund, MLC Global Property Fund and MLC Hedged Global Share Fund in MLC MasterKey Investment Service are accessed via the MLC Wholesale funds, and therefore also have a June year end. These products are therefore not covered by this communication.
[2] These investment options only distribute at the end of the financial year in May 2011.

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General Distribution Information

This Q&A may answer some of your questions about distributions for MLC MasterKey Investment Service and MLC MasterKey Unit Trust investment options and why they continue to be low.

Q. What are distributions dependent on?
A. Distributions are made up of income from the underlying investments held by the managed fund and paid to investors once fees are deducted. These investments could be shares, property, debt securities and/or cash. As such the distribution could include interest earned, franked and unfranked dividends, tax deferred income, rental income, and any realised capital gains (after offsetting any capital losses) made from selling investments that typically occur in the last quarter of the financial year. Currency can also impact income distributions on investments.

Q. Why do distributions continue to be low for many funds this year?
A. Distributions for investors dropped significantly in many funds during the global financial crisis and continue to be low because tough economic conditions are resulting in:

- lower company earnings. This means funds which invest in shares have received low levels of dividends so there's less to distribute to investors
- lower rates of interest on cash and bond investments, and
- a decline in the value of the Australian dollar in 2008. Funds that invest overseas and hedge currency exposure to the Australian dollar suffered large currency losses that year. Recent gains in the Australian dollar have helped to reduce these losses however due to tax rules limiting the amount of losses that can be paid-off each year, many funds that hedge currency continue to have significant currency losses which unfortunately will impact future distributions.

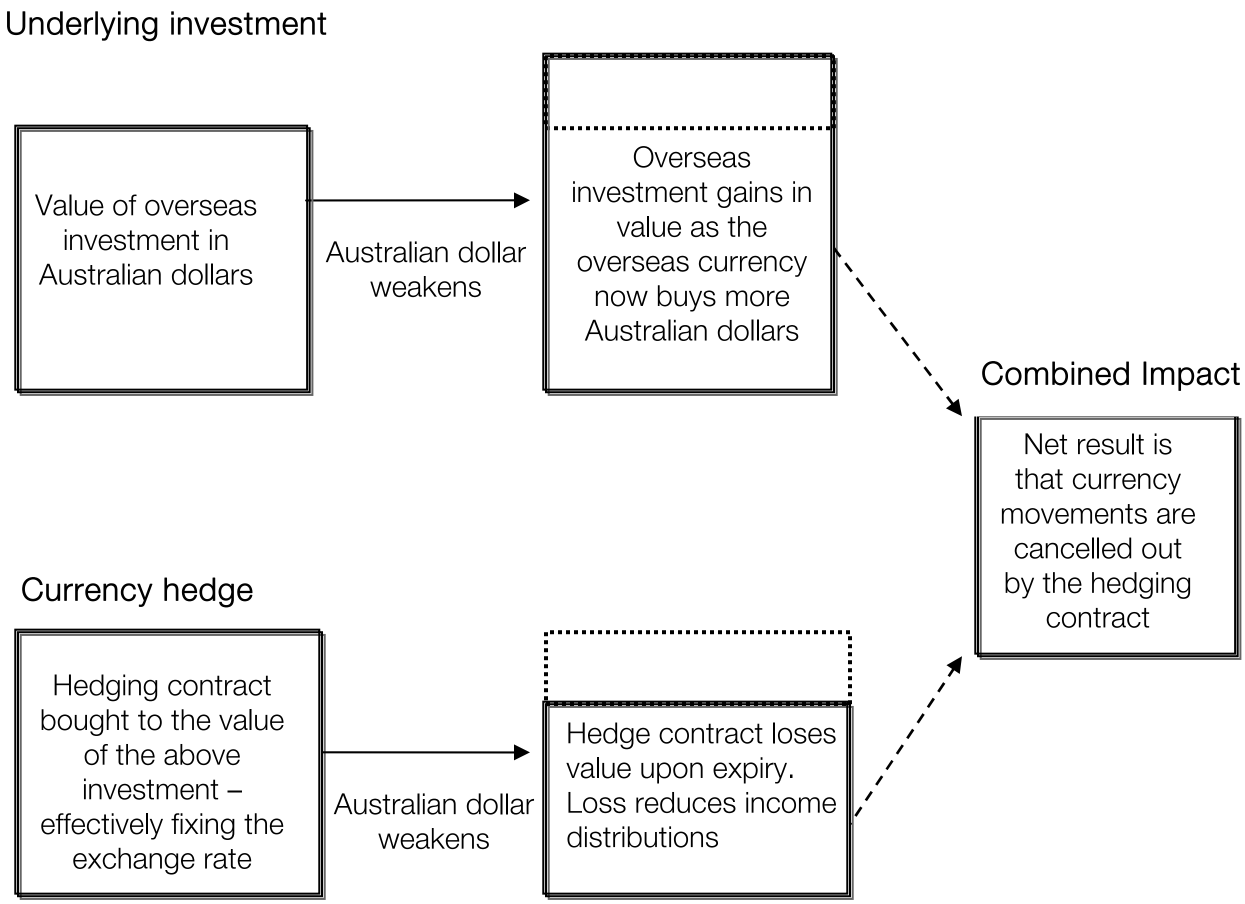
Q. Why are company dividend levels so low?
A. Lower company dividends could be a result of a number of factors including pressure on profit margins, poor sales and the need for companies to fund their businesses by retaining profits. Companies may choose not to pay dividends as it's cheaper for them to keep any profits, rather than raise money by borrowing. It's worth noting that even though share markets have rebounded significantly, company earnings are still lagging behind as the economy has not rebounded as strongly as share markets. This reduction in company earnings along with companies preserving their capital reflects the lower dividends passed through to investors.

Q. What about the recent market recovery?
A. The market has improved since March 2009 with the Australian dollar strengthening against most major currencies. Because of this, funds with investments overseas that hedge currency exposure, such as hedged global shares, global property and global debt securities have made recent gains from Australian dollar hedging contracts. A strong Australian dollar also means that income from unhedged overseas investments is worth less when it's converted back into Australian dollars.

Overall however, most companies are still suffering from reduced earnings and are wary of the economic outlook, and therefore continue to preserve capital and maintain more conservative dividends payout ratios.

Q. How does currency hedging provide protection from currency movements?
A. If you invest in funds that own non-Australian securities such as global shares, listed property and bonds, you'll be exposed to the impact of currency fluctuations on both your income and capital. This can impact the return you receive, both positively and negatively, depending on what currency exposure you have. Funds that have a currency hedging strategy help manage the impact of currency movements on your global exposures to smooth out the overall return on your investment, which includes distributions and capital growth.

When MLC hedges exposure to global investments, the intent is to remove the effect of currency losses and gains from your global exposures so returns are based on the performance of the underlying investment only. The example below explains how the hedging contract largely removes the impact of currency when the Australian dollar depreciates or weakens in value.[3]



[3] In practice, the value of the hedging contract may differ slightly from the underlying investment value so the investment may not be 100% hedged at all times.

When the Australian dollar rises the reverse occurs. The value of unhedged global assets held by Australian investors fall, but the value of the hedge contract rises. This increase in the hedge contract value compensates for the fall in value of the unhedged non-Australian assets.

The total return you receive is therefore only dependant on the performance of the underlying investments.

Q. How does currency hedging then impact income distributions?

A. Currency hedging can help smooth the impact of foreign currency fluctuations on an investor's total return. At MLC, the length of the hedging contract can vary and typically will last for one month. Any hedging gains or losses the fund realises when the hedging contract expires impact the income distributions for investors. Hedging gains or losses are treated as income and used to offset against other sources of income such as interest and dividends.

In 2008, we saw the Australian dollar falling quite dramatically through the year against major currencies. The Australian dollar fell sharply against the US dollar from highs above 98c to lows around 60c between July and October 2008, representing a decline in value of 40%. When the Australian dollar falls in value, the value of unhedged global assets owned by an Australian investor will increase in value. However, this also results in a loss on the sold hedge contract. Funds that used hedge contract to hedge the Australian dollar therefore suffered losses on these contracts during that period.

Recent gains in the Australian dollar have helped to reduce these losses however due to tax rules limiting the amount of losses that can be paid off each year, many funds that hedge currency are sitting on currency losses which unfortunately will impact future distributions to come.

Q. How will prior losses from hedging contract impact future distributions?

A. Unfortunately due to new tax changes in the treatment of foreign income that came into effect last year, losses that were obtained from hedging contracts in 2008 were not able to be fully paid back by reciprocating hedging contract gains that occurred last year. Only 20% of prior losses were able to be offset with gains due to the tax rules (rules stipulate that a maximum of 20% of foreign income losses occurring before 1 June 2009 can be paid back each year for up to 5 years). Excess gains on hedging contracts over the 20% were therefore forced to be paid out in the May year end distribution rather than offset against prior losses. This means that foreign income losses have been carried forward into this year, adversely impacting distribution from funds that have hedged global exposures.

Q. How long will lower distributions last?

A. Coming out of the GFC, company earning continue to be subdued which therefore flows through to dividends. Increases to overall dividends will not likely increase again until the confidence in the global and domestic economy returns. A recovery to previous levels of distributions will take time as funds that have hedged currency exposure to the Australian dollar still have currency losses on those contracts carried over from last year.

Fund Performance Commentaries

Further information on the performance of each of the funds is available on the performance and commentary section of mlc.com.au.
