**MLC MasterKey Investment Service**
**MLC MasterKey Unit Trusts**

# MLC Distributions Update – February 2010

The following table outlines the cents per unit (cpu) distributions paid for the February 2010 quarter and 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 after the individual fund commentaries to answer more general queries you may have on distributions.

| Fund | Feb 10 Quarter cpu | Nov 09 Quarter cpu | Feb 09 Quarter cpu |
|---|---|---|---|
| MLC Horizon 1 – Bond Portfolio (only through MKIS) | 0.33 | 0.67 | 0.64 |
| MLC Horizon 2 – Income Portfolio | 0.39 | 0.64 | 0.61 |
| MLC Horizon 3 – Conservative Growth Portfolio | 0.15 | 0.32 | 0.26 |
| MLC Horizon 4 – Balanced Portfolio | 0.14 | 0.22 | 0.27 |
| MLC Horizon 5 – Growth Portfolio | 0.05 | 0.13 | 0.18 |
| MLC Horizon 6 – Share Portfolio[2] | - | - | - |
| MLC Horizon 7 – Accelerated Growth Portfolio[2] | - | - | - |
| MLC Australian Share Fund | 0.37 | 1.03 | 0.89 |
| MLC Australian Share Value Style Fund | 0.31 | 0.61 | 0.95 |
| MLC Australian Share Growth Style Fund | 0.02 | 0.64 | 0.11 |
| MLC IncomeBuilder™ | 1.15 | 1.85 | 2.00 |
| MLC Global Share Fund[2] | - | - | - |
| MLC Global Share Value Style Fund[2] | - | - | - |
| MLC Global Share Growth Style Fund[2] | - | - | - |
| MLC Property Securities Fund | 0.81 | 0.35 | 0.72 |
| MLC-Platinum Global Fund[2] | - | - | - |
| MLC Capital International Global Share Fund[2] | - | - | - |
| MLC-Vanguard Share Index Fund | 0.81 | 1.89 | 2.29 |

## Individual Fund Commentaries

### MLC Horizon Series

The distributions for these portfolios are largely based on the exposure to and distributions from the underlying asset sectors.

[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 2010.

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*MLC Horizon 1 –Bond Portfolio*
The portfolio delivered a quarterly distribution of 0.33 cpu, a reduction when compared to last quarter. This comprised of interest earned on the portfolios' investments in cash (approximately 30% of the portfolio) and predominantly highly rated Australian and global bonds. Most of the rebound in bond markets occurred prior to the last quarter which is why the income distribution was slightly lower this quarter. When compared to the distribution in February 2009, income received from cash is also much lower as the Reserve Bank of Australia slashed cash rates throughout much of 2009.

*MLC Horizon 2–Income Portfolio*
The majority of the quarterly distribution of 0.39 cpu was comprised of interest earned from the allocation to Australian and global bonds and cash (approximately 70% of the portfolio). The allocation to property (approximately 13% of the portfolio) was also a main contributor to the distribution. The distribution is however still lower compared to the same time last year due mainly to the lower interest earned on debt securities and the lower dividends from Australian shares. Most companies are still wary of the current economic conditions.

*MLC Horizon 3 –Conservative Growth Portfolio*
The relatively small distribution is representative of lower dividends from shares and interest received on the debt portfolios compared to last year. The majority of the quarterly distribution of 0.15 cpu was comprised of interest earned from the allocation to Australian and global bonds (approximately 50% of the portfolio). The 21% allocation to Australian shares was also a contributor to the distribution, however both domestic and foreign interest income still remain low due to low cash rates and yields.

*MLC Horizon 4 –Balanced Portfolio*
The quarterly distribution of 0.14 cpu comprised of interest earned on the portfolios' investments in bonds (approximately 30% of the portfolio) and dividends from Australian shares (approximately 31% of the portfolio). The relatively small distribution is representative of lower company dividends and interest received on the debt portfolios. Any income received from global shares (approximately 32% of the portfolio), after adjusting for the currency impacts from hedging, are held until the end of the year so are not represented within the inter-year distributions.

*MLC Horizon 5 –Growth Portfolio*
The low distribution is representative of lower company dividends and interest received on the debt portfolios. While interest earned on the portfolios' investments in bonds (approximately 15% of the portfolio), dividends from Australian shares (approximately 35% of the portfolio) and a small portion from tax deferred income all contributed to the distribution. Due to its higher allocation to global shares (approximately 44% of the portfolio), the portfolio generally has reduced distributions during the year, with any income from global shares to be paid at the end of the year after adjusting for the currency impacts from hedging.

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*MLC Horizon 6 –Share Portfolio*
*MLC Horizon 7 –Accelerated Growth Portfolio*
These funds only distribute at the end of the financial year in May 2010.

## Australian Shares

*MLC Australian Share Fund*
*MLC-Vanguard Share Index Fund*
Lower company dividends continue to contribute to lower distributions when compared to the same time last year. This quarter's distributions are lower than the previous quarter due to it being a historically lower dividend payment period. Overall company dividends continue to be impacted by difficult and uncertain economic conditions.

*MLC Australian Share Growth and Value Style Funds*
Due to each fund being biased to particular style characteristics of companies in the Australian sharemarket, the level of distributions for each style fund will vary when directly compared. This quarter saw value style companies providing greater dividends than growth style companies. Overall however, company dividends continue to be impacted by difficult and uncertain economic conditions.

*MLC IncomeBuilder™*
Lower company dividends are still contributing to the lower distribution of 1.15 cpu for the quarter compared to last year. This quarter's distribution is lower than the previous quarter due to it being a historically lower dividend payment period. On a rolling 12 month basis the underlying income is down 34% when compared with the corresponding 12 month period ending February 2009. While this decline is not ideal it is consistent with companies preserving their capital by lowering dividends during uncertain economic conditions.

## Global Shares

The global share funds only distribute at the end of the financial year in May 2010.

## Property Securities

*MLC Property Securities Fund*
Even though this quarter's distribution of 0.81 cpu is slighter higher than the same time last year, the relatively low distribution is still consistent with most property trusts preserving their capital and strengthening their balance sheets. This is therefore reflected in reduced income being paid out to investors.

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### 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've been reduced this quarter.

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 in the February quarter?
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:

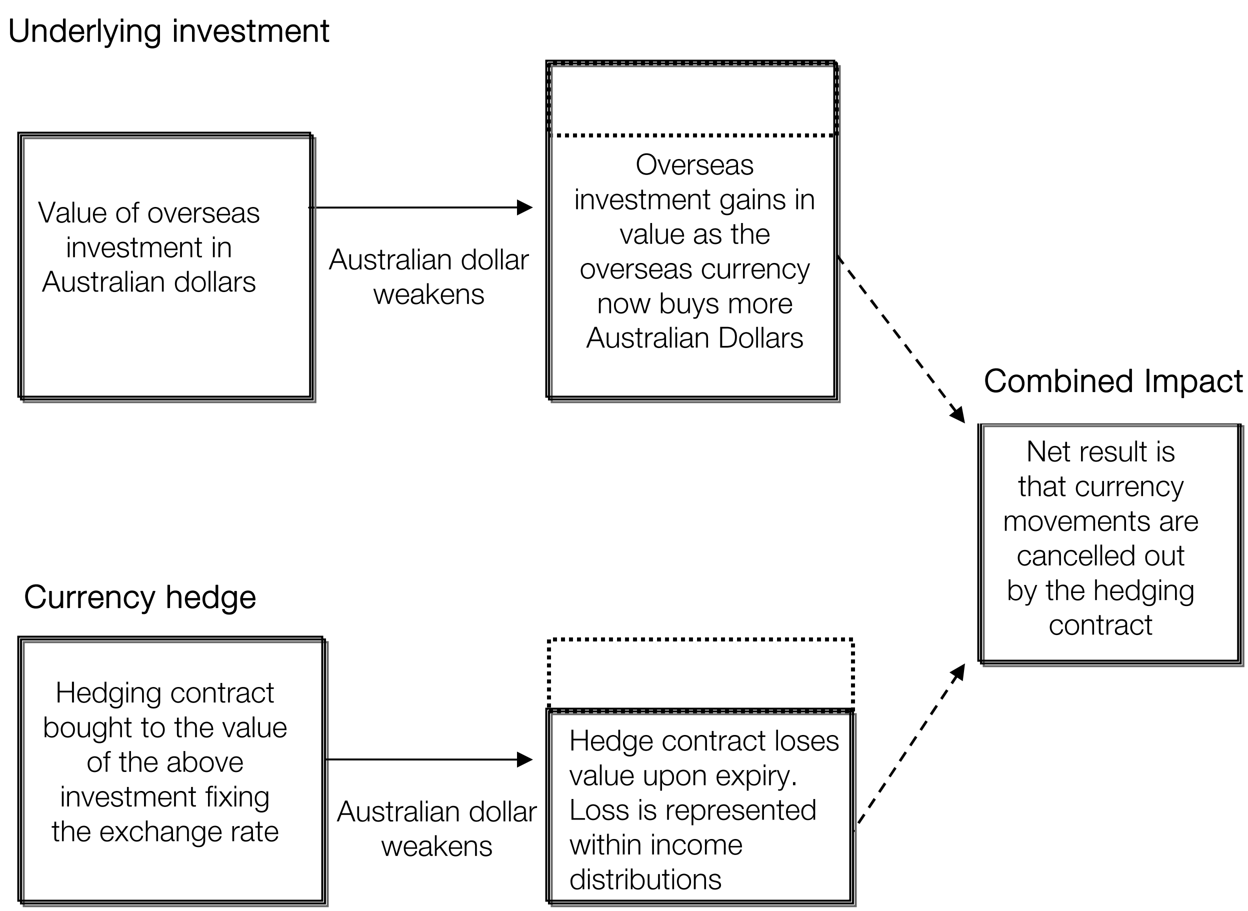
- lower company earnings. This means funds which invest in shares have received low levels of dividends so there's less to distribute to investors
- lower rates of interest on cash investments, and
- a decline in the value of the Australian dollar in 2008. Funds that invest overseas and hedge currency exposure to the Australian dollar suffered currency losses. Recent gains in the Australian dollar have helped to reduce these losses (this only impacts global property and global debt for the quarter as global shares distribute income at the end of the financial year).

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 equity markets have rebounded significantly, company earnings are still lagging behind. 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 been improving 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. Overall however, most companies are still 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 hedging your 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, as we've seen recently, the reverse occurs. The value of unhedged global assets held by Australian investors fall, but the value of the sold 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 three months. 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.

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.

Gains in the Australian dollar throughout 2009 have helped reduce these losses from hedging contracts for the financial year ending May 2010.

### Q. How long will lower distributions last?

A. We are confident that as the market continues to recover, so will the levels of company dividends and in turn, investor's distributions. However, a recovery to previous levels of distributions will take time to return, as funds that have hedged currency exposure to the Australian dollar still have currency losses on those contracts carried over from last year.

More Q&As are available on the Market Watch website to answer any general questions you may have on distributions.

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### Important Information: