

**Presenting
debate on
contemporary
and emerging
portfolio
construction
issues**



portfolio
construction

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15 & 16 August 2007 | AJC Convention Centre, Randwick, Sydney

I've been thinking about...

Trends in investment markets

Paul Taylor - Head of Aust Equities, Fidelity International

Todd Canter - MD, LaSalle Investment Management

Scott Berg - Portfolio Mgr, Intl Equities, T.Rowe Price

Dominic McCormick - CIO, Select Asset Management

Tim Farrelly - Principal, farrelly's



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Australian shares over the long term

Portfolio Construction Conference

Paul Taylor

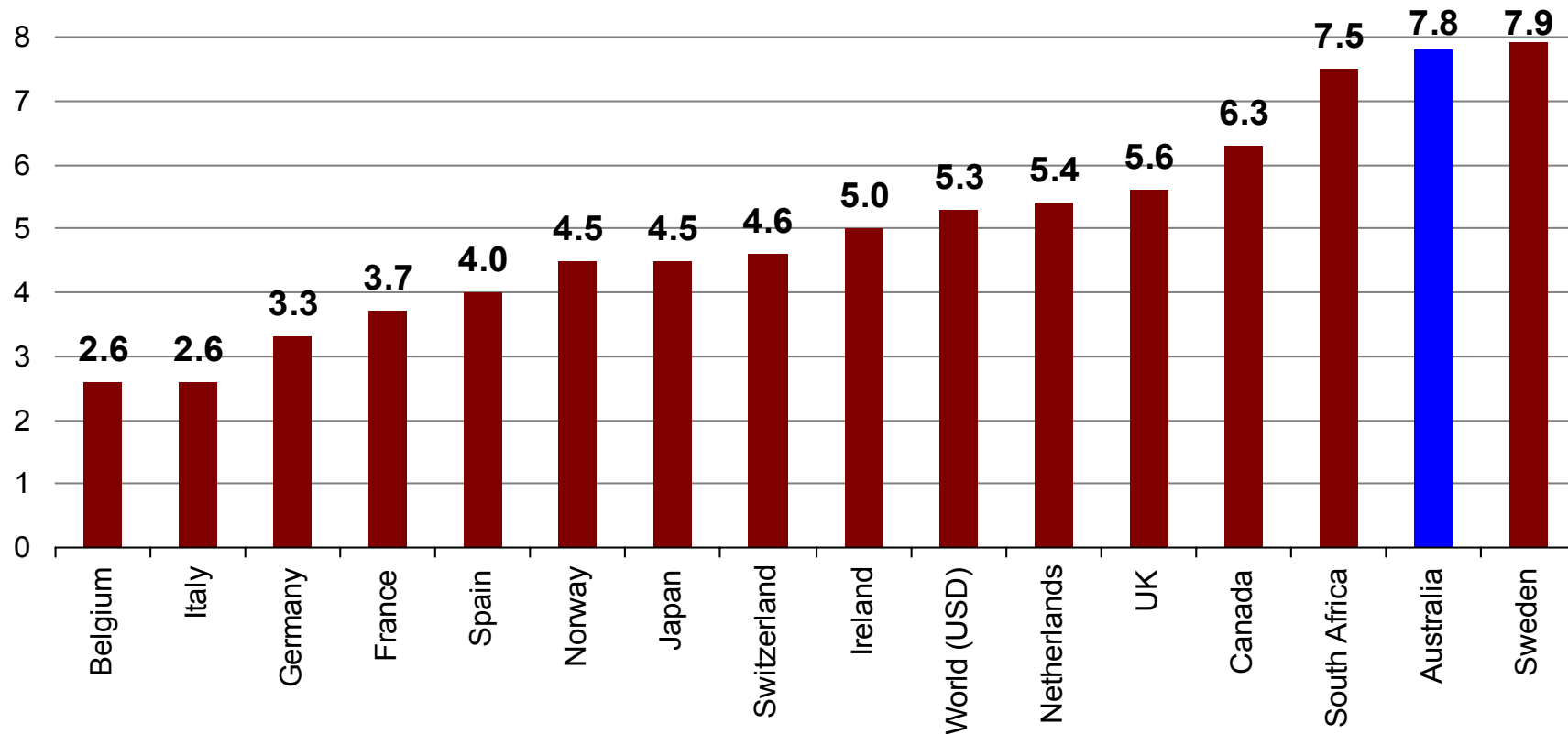
Portfolio Manager, Fidelity Australian Equities Fund

August 2007

The outlook: a longer-term view



Annualised real rates of return on major share markets from 1900 to 2006 (% pa)



Source: LBS Global Investment Returns Yearbook 2007, chart 14

Why Australia's share market has shone

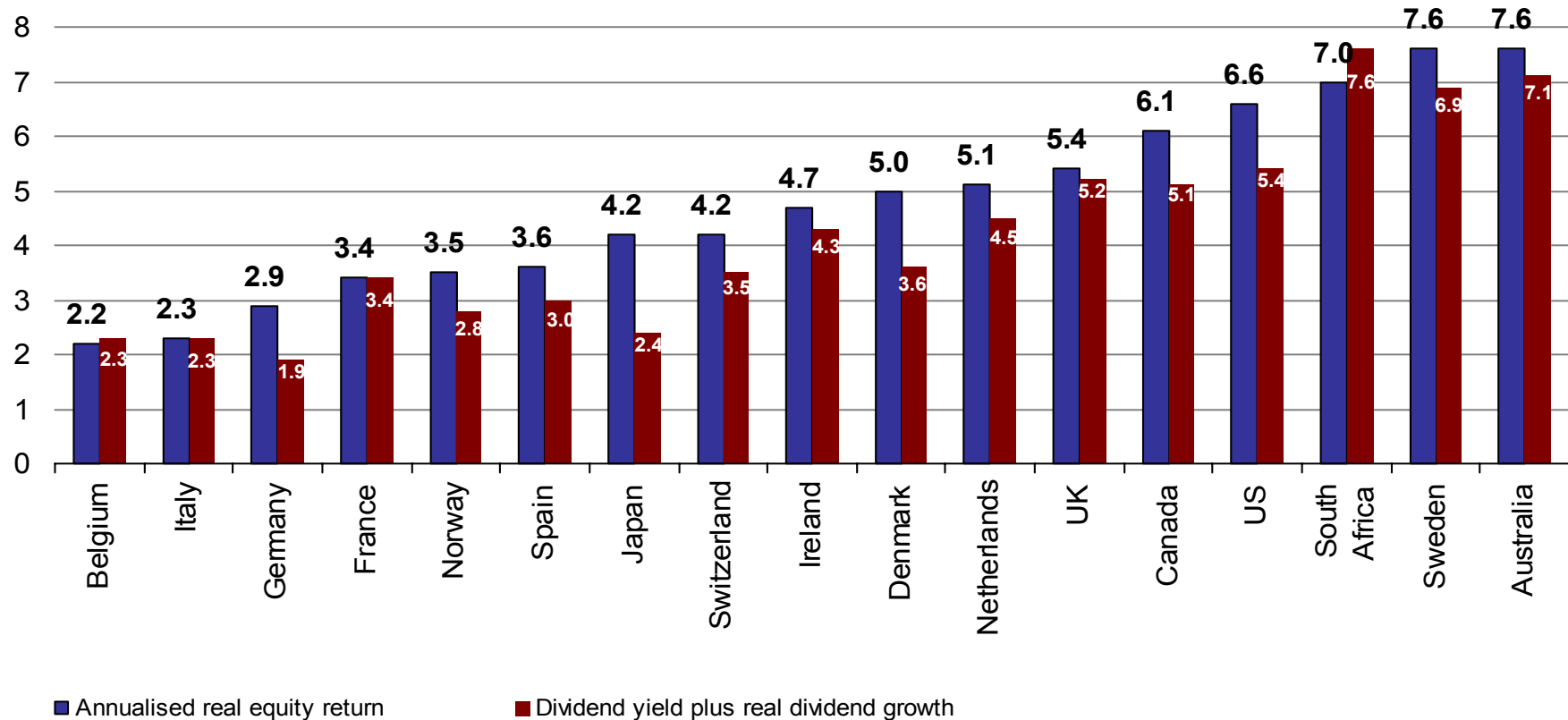


- High population growth has underpinned economic growth
- Abundant natural resources gave us products to sell
- Good corporate governance gave people the confidence to invest
- There have been sound companies to invest in
- A culture of high dividend payouts forces companies to be disciplined

The correlation between equity returns and dividends



Annualised dividend yield plus growth, compared with local returns from 1900 to 2004 (% pa)



Source: Dimson, Marsh and Staunton (London Business School) 2005

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Scott Berg

Portfolio Manager, Intl Equities,
T.Rowe Price



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A Snapshot of the World

As of 30 June 2007

	Share of Global Market Cap	Share of Global GDP	Share of Estimated 2007 Global GDP Growth	Estimated 2007 GDP Growth	Estimated 2007 EPS Growth	Estimated 2007 Price-to-Earnings
European Union	31%	22%	25%	2.7%	10.0%	14.3X
North America	47%	29%	16%	1.9%	9.1%	16.0X
Japan	9%	8%	5%	2.2%	11.6%	19.4X
Emerging Markets	9%	27%	45%	7.0%	17.6%	14.9X
Total	\$53.1 Trillion	\$51.5 Trillion	91 ¹ %	4.4%	11.6%	15.6X

¹ Does not total 100% as residual percentage is derived outside regions that are shown.

Source: MSCI, IMF and UBS.

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Trends in investment markets

Todd Canter – Managing Director,
LaSalle Investment Management



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Long-Term Outlook for Property Securities

Country	Current Dividend	L-T EPS Growth	Change in Multiple	L-T Expected Total Return
Australia	6%	4%	Flat to Down	10%
U.S.	4.5%	5% to 6%	Up from current levels	10% to 12%
Global	4%	6%	Up from current levels	10% to 12%



Existing REIT Valuation Attractive Across the Globe

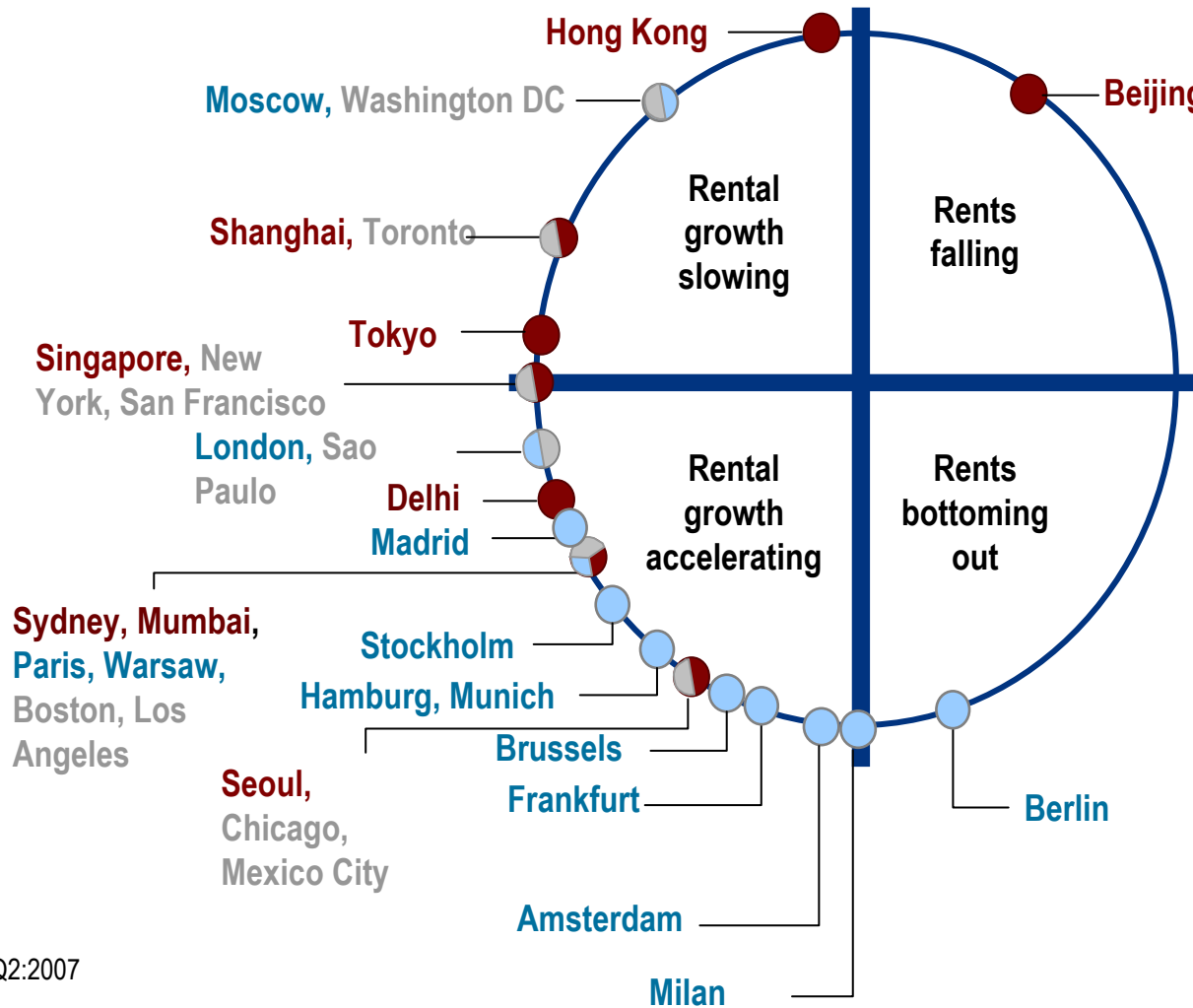
<u>Region</u>	<u>Portfolio NAV Premium/Discount</u>
Globe	-13.7%
United States	-17.8%
Canada	-13.4%
Continent	-6.4%
Britain	-28.9%
Australia	1.7%
Hong Kong	10.1%
Singapore	-9.2%
Japan	-3.4%

- REITs across the globe trading below long-term NAV average
- Strong net operating income (NOI) growth will help offset potentially higher cap rates



Rental growth seen in nearly all regions

Asia-Pacific
Europe
Americas



Data is as of Q2:2007

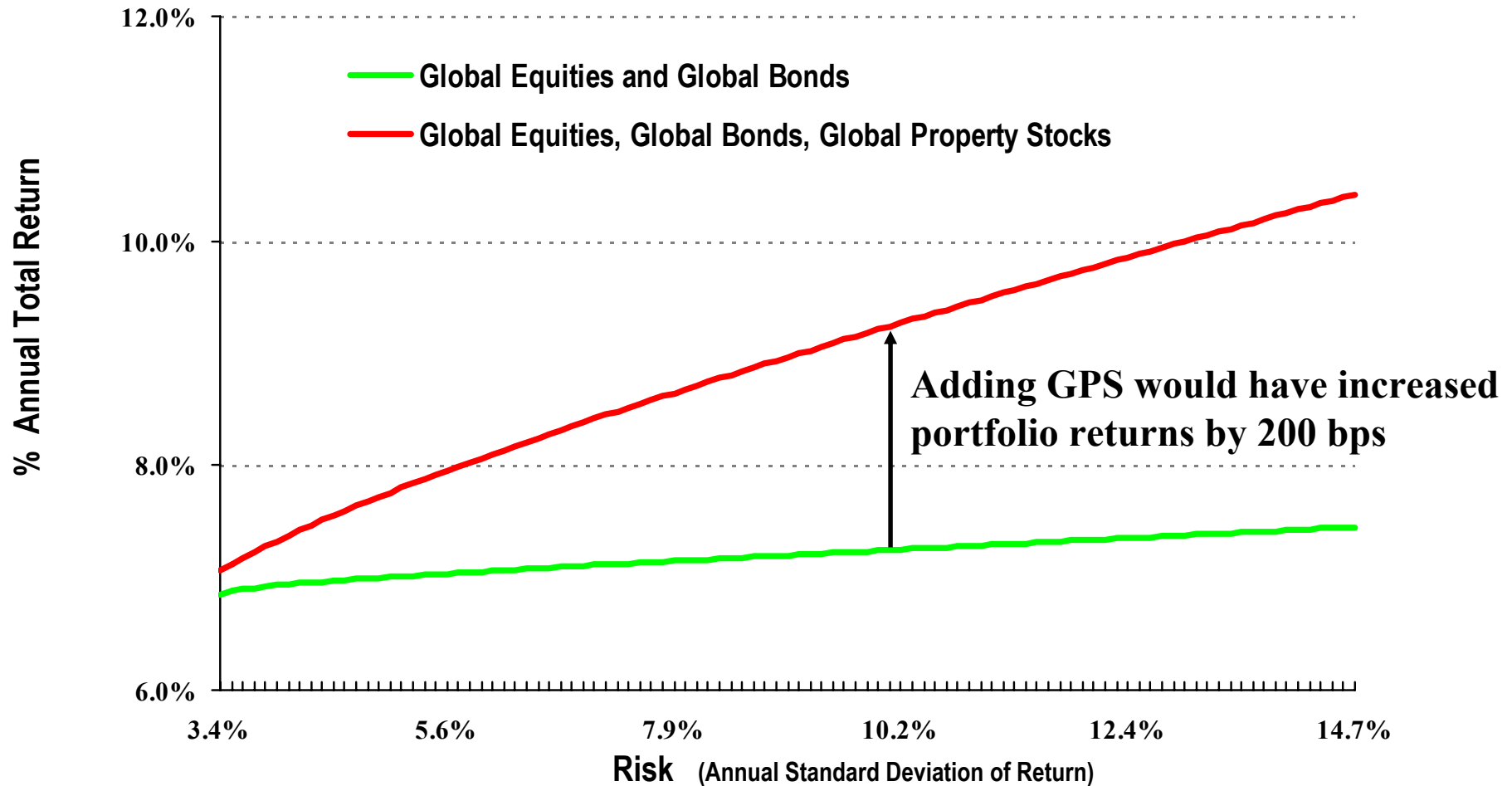
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Global Property Stocks: Added Return Without Added Risk

Optimal Mixed Asset Portfolio; Risk vs. Return – 1990 to 2007



Source: JP Morgan Global Government Bond Index; MSCI World Index; UBS Investors Index January 1990 to January 2007. All returns in local currencies.

Global Real Estate Securities in a Mixed-Asset Portfolio

- **Attractive investment opportunity**
 - Strong growth prospects
 - Ample market liquidity
 - Value-added management
- **They have earned their way into a portfolio**
 - Strong returns with lower volatility than broad market equities
 - Low correlations with other asset classes
 - Diversification benefits versus other asset classes
 - Attractive current yields
- **Effective and efficient method to secure a true globally diversified real estate portfolio**

I've been thinking about...

Trends in investment markets

Dominic McCormick - CIO,
Select Asset Management



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**The long-term return outlook
for Fund of Hedge Funds**

**Dominic McCormick
Chief Investment Officer**

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nati
vethin
king.

Some common myths re the returns & risks of Fund of Hedge Funds (FoHFs)

- FoHFs are high risk
- you should expect high returns from FoHFs
- individual hedge fund “blow ups” and fund closures are always bad for FoHF investors
- fees are too high to achieve reasonable returns
- you need to fully understand the underlying strategies/managers before investing in FoHFs
- it is easy to select and manage a portfolio of hedge funds

While many individual hedge funds are high risk most FoHFs are low risk!

- volatility of returns (typically 2-4% SD versus 10%+ for shares)
- drawdown periods (maximum drawdowns typically 2-5% versus 20-50% for sharemarkets)
- diversification (typically 10-15 strategies and 30-100 managers)
- return diversification in difficult times for mainstream markets

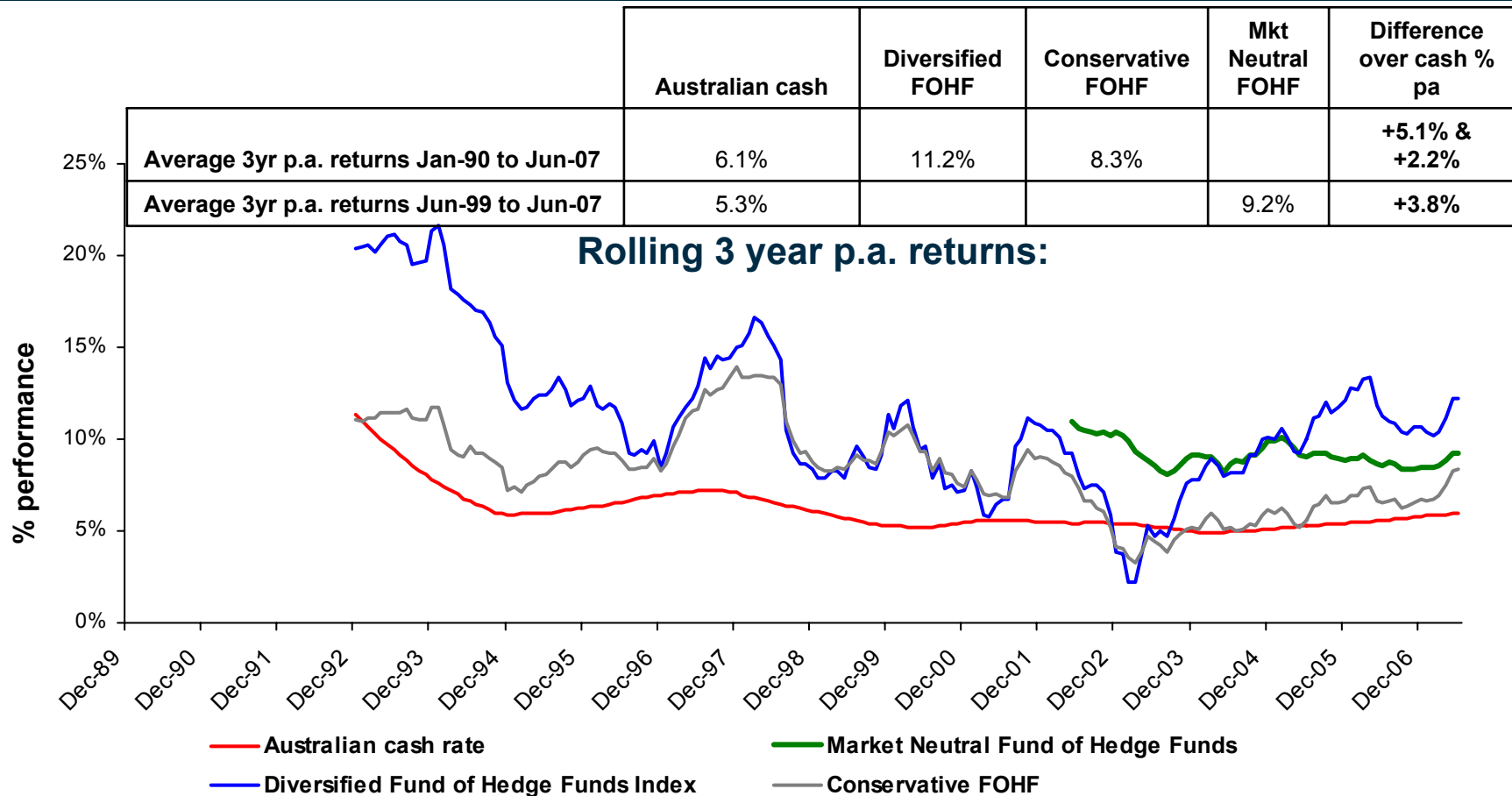
Therefore (unleveraged) FoHFs can fit in the defensive component of portfolios

If low risk what sort of return should one expect? (Medium-long term)

- more than cash and bonds (~6%pa)
- less than equities (with ERP of 5%-6%pa ~11-12%pa)
- less than higher risk alternatives – infrastructure, private equity (~10%-13%pa)

Fair expectation cash/bonds plus 2-4%pa = 8-10%pa

Have FoHFs delivered this?



Australian cash rate: UBS Australian Bank Bills Index, Diversified Fund of Hedge Funds: HFRI Fund of Funds Composite Index (hedged into AUD), Conservative Fund of Hedge Funds: HFRI Conservative Fund of Funds Index (hedged into AUD), Market Neutral Fund of Hedge Funds: Gottex Market Neutral Fund (Class C - AUD). Source: Bloomberg, Hedge Fund Research Inc (HFRI).

Can they keep delivering returns? The fee hurdle

For FoHF to achieve	Return needed from underlying hedge fund manager
6%	12.3%
8%	15.1%
10%	17.9%
12%	20.6%
14%	23.4%

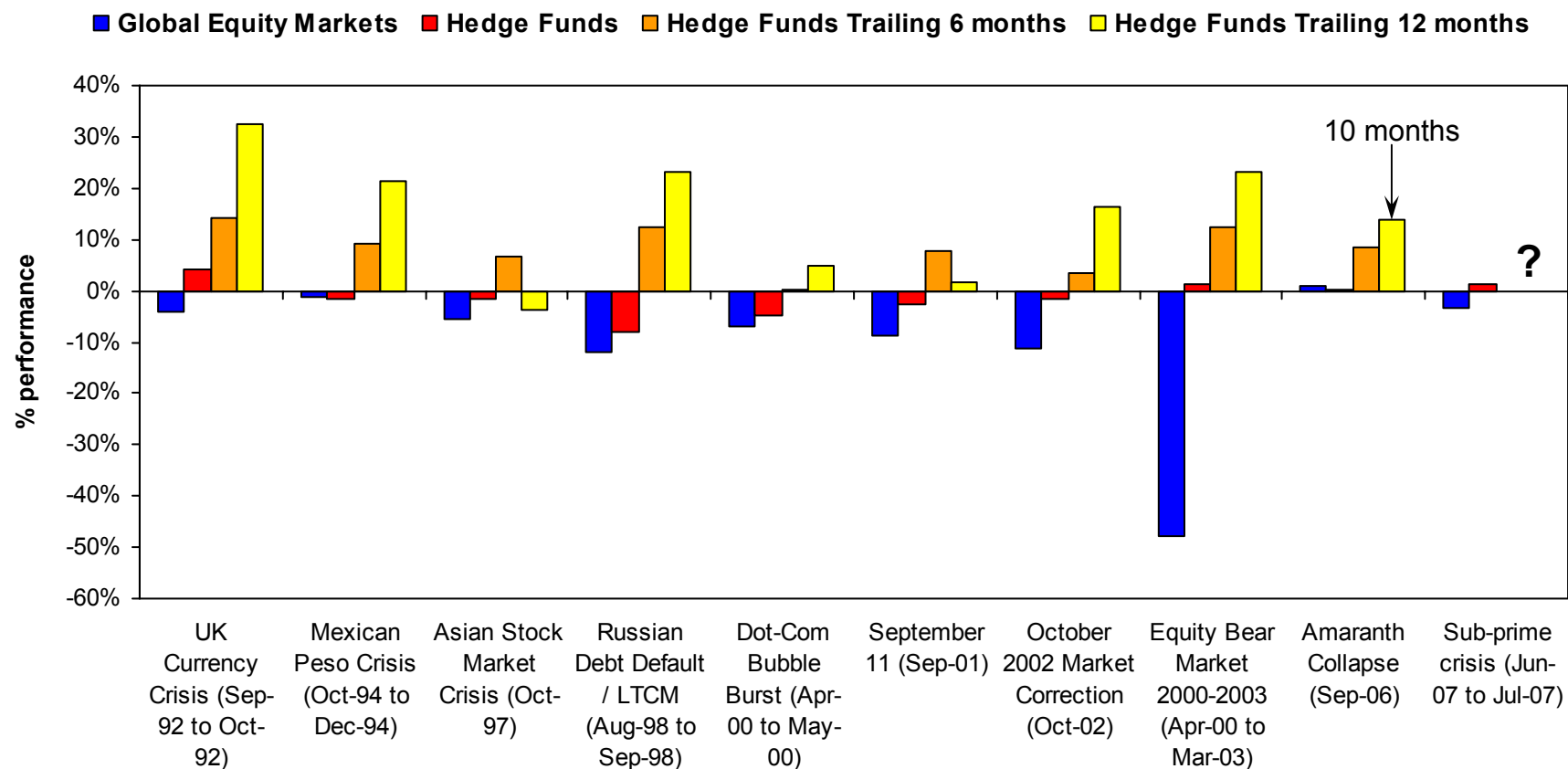
Assumes: 1.5% and 20% at underlying fund level

1.5% & 10% at FoHF level

Can they keep delivering returns?

- some strategies returns correlated to economic/financial market activity
- essential to avoid underperforming strategies and major fund blowups
- shakeout/closure of some funds could reduce competition for investment ideas
- periods of market stress/dislocation create better opportunities for future returns

Hedge fund performance following crisis



Global Equities: MSCI World Index in USD terms, Hedge Funds: HFRI Fund Weighted Composite Index (USD). Source: Bloomberg, Hedge Fund Research Inc (HFRI).

August 2007

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Why active & experienced management is necessary to achieve these returns

- complexity of many strategies and funds
- avoidance/minimisation of fund “blow ups” key value add of FoHFs
- as with conventional funds some individual hedge funds become too large/complacent
- industry is very dynamic – new opportunities in strategies and managers emerging

To get access to the best hedge funds at the right times you need to invest in the best FoHFs

FoHF products/strategies that may not measure up (in my view)

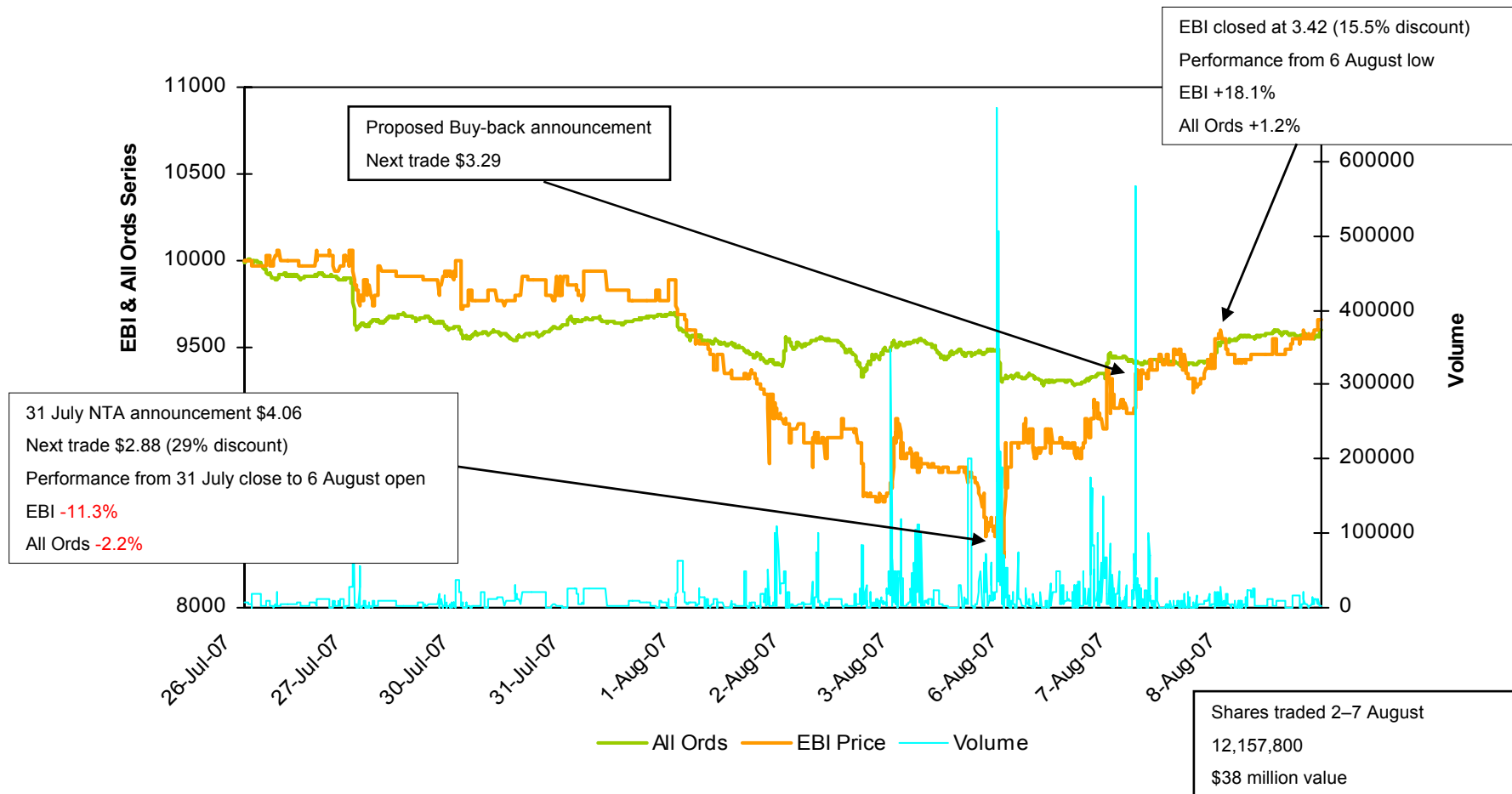
- passive investable indices
- hedge fund replication products
- many structured capital guaranteed FoHF products
- heavily leveraged FoHFs
- direct gearing into FoHFs

Investors/advisers who shouldn't (or wouldn't) invest in FoHFs

- those who can successfully run a diversified portfolio of hedge funds/specialist investments themselves
- those happy with cash/term deposit returns (or with investment horizon <2-3 years)
- “realists” who can handle 15-40% drawdowns (more if geared) and extended periods of poor returns from a fully invested equity portfolio
- “optimists” who expect 15%-20% pa equity and property returns indefinitely with little risk
- those who believe in the Efficient Market Theory

EBI – Inefficient Markets in Practice

(10 Days: 26 July – 8 August 2007)



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Trends in investment markets

Tim Farrelly – Principal, farrelly's



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Presentation to PortfolioConstruction Conference 2007

Long term forecasting

August 2007

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Which portfolio is most like the one you use?

	1. The traditional	2. Income seeker	3. The contrarian	4. New Breed	5. The patriot
Australian Equities	35%	38%	22%	24%	47%
International equities	20%	5%	32%	24%	5%
Listed property	10%	25%	9%	8%	10%
Hedge Funds	0%	0%	15%	40%	5%
Fixed Interest	25%	20%	18%	3%	25%
Cash	10%	12%	4%	1%	8%
Total	100%	100%	100%	100%	100%

Long run returns-an example

EPS

PE

Price

Contribution

\$1.00

10

\$10.00

5%pa

Income

+

**Income
Growth**

+

PE effect

5%pa

Total

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Long run returns-an example

EPS	PE	Price	Contribution	
\$1.00	10	\$10.00	5%pa	Income
				+
			+7%pa	Income
				Growth
				+
\$2.00	10	\$20.00		PE effect
			<hr/>	<hr/>
			12%pa	Total

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Long run returns-an example

EPS	PE	Price	Contribution	
\$1.00	10	\$10.00	5%pa	Income
				+
			+7%pa	Income
\$2.00	10	\$20.00		Growth
				+
			+7%pa	PE effect
\$2.00	20	\$40.00		
			<hr/>	<hr/>
			19%pa	Total

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Long run returns-an example

EPS	PE	Price	Contribution	
\$1.00	10	\$10.00	5%pa	Income
				+
			+7%pa	Income
				Growth
				+
			-7%pa	PE effect
\$2.00	5	\$10.00		
			<hr/>	<hr/>
			5%pa	Total

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**I've been thinking about...
movement of markets**

DEBATE... Au EPS



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I've been thinking about...

Inputs	Long term average	Last decade
Australian Equities: Real EPS growth ¹	0.9%pa ¹	7.9%pa

Can this go on?

Australian Profit Share Of GDP



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**I've been thinking about...
movement of markets**

DEBATE... Int'l EPS

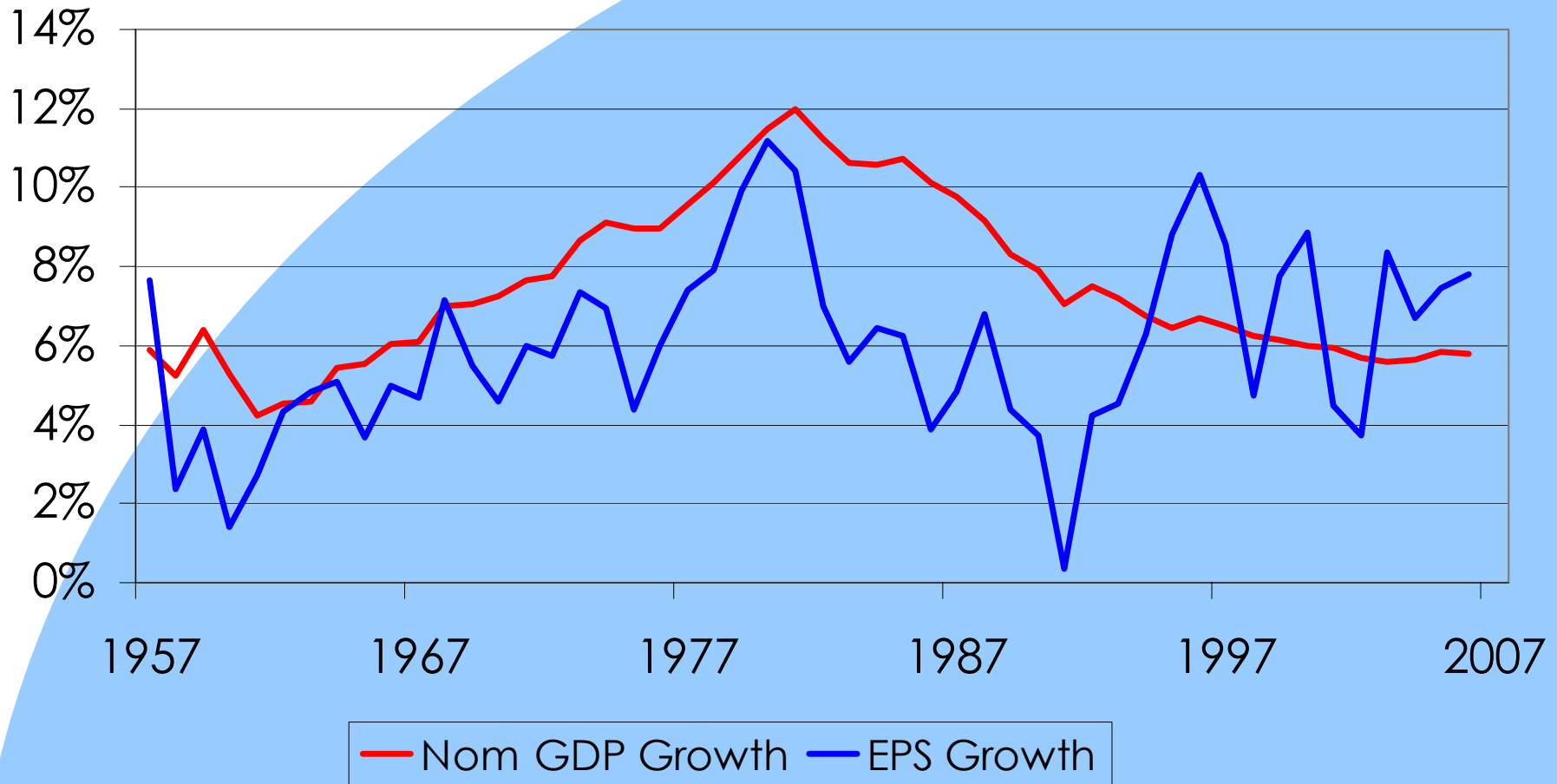


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Inputs	Long term average	Last decade
Australian Equities: Real EPS growth ¹	0.9%pa ¹	7.9%pa
World Equities Real EPS growth ¹	0.8%pa ¹	5.1%pa

US GDP v EPS Growth



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**I've been thinking about...
movement of markets**

DEBATE... Au & Int'l PEs

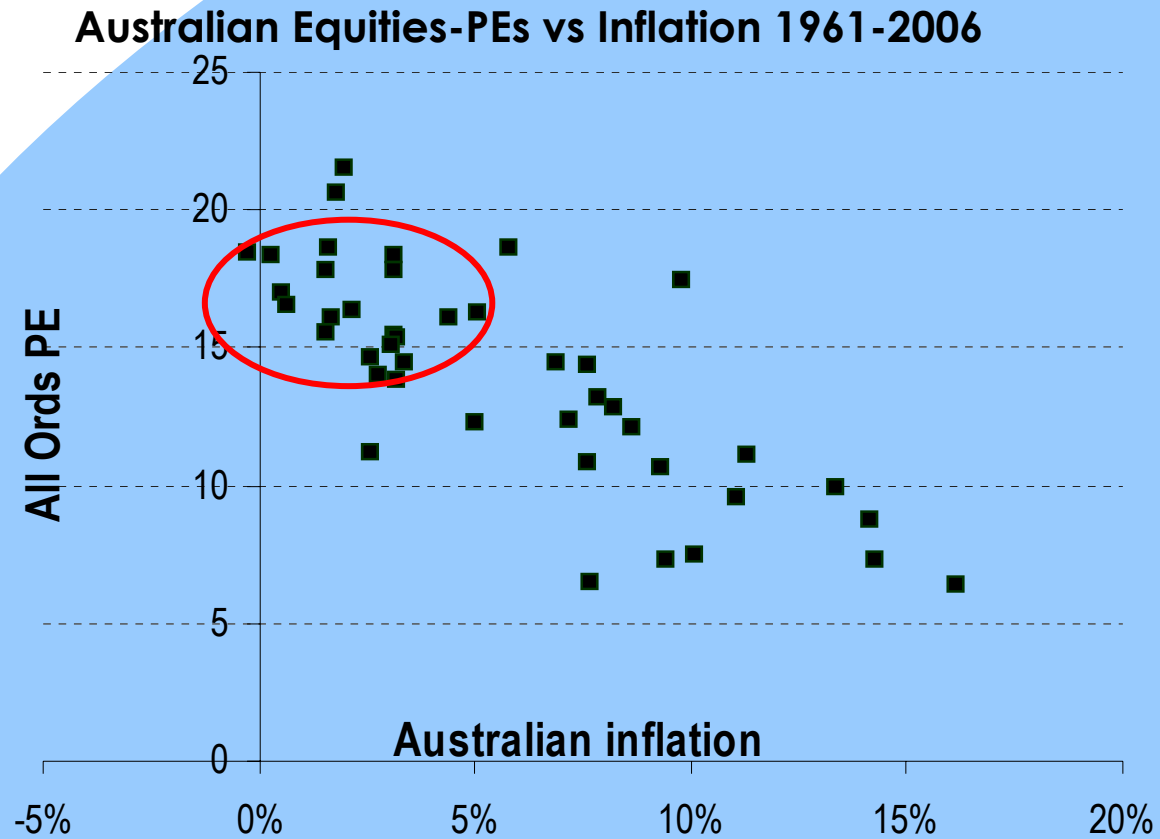


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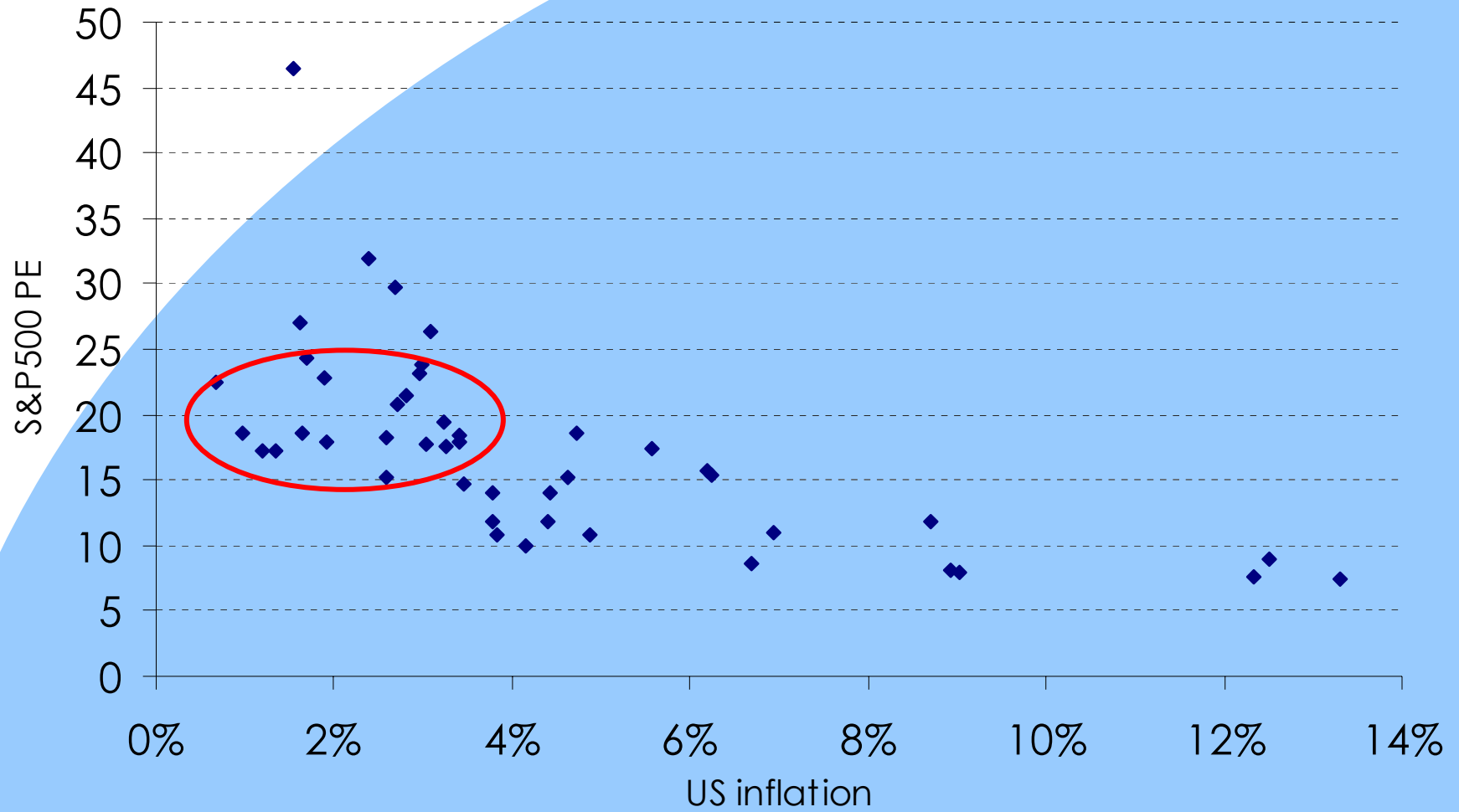
I've been thinking about...

Inputs	Long term average	Last decade	Current
Australian Equities: Real EPS growth ¹	0.9%pa ¹	7.9%pa	Na
World Equities Real EPS growth ¹	0.8%pa ¹	5.1%pa	Na
Australian PE ratios	14.2x ²	17.8x	16.0x
US PE ratios	14.1x ¹	25.3x	15.6x

Where will PE's be in 2017?



US PE vs Inflation 1961-2006



I've been thinking about...

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Australian Equities: Real EPS growth ¹	0.9%pa ¹	7.9%pa	Na
World Equities Real EPS growth ¹	0.8%pa ¹	5.1%pa	Na
Australian PE ratios	14.2x ²	17.8x	16.0x
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Australian LPTs : Real dividend growth	-0.5%pa ³	+1.9%pa	na

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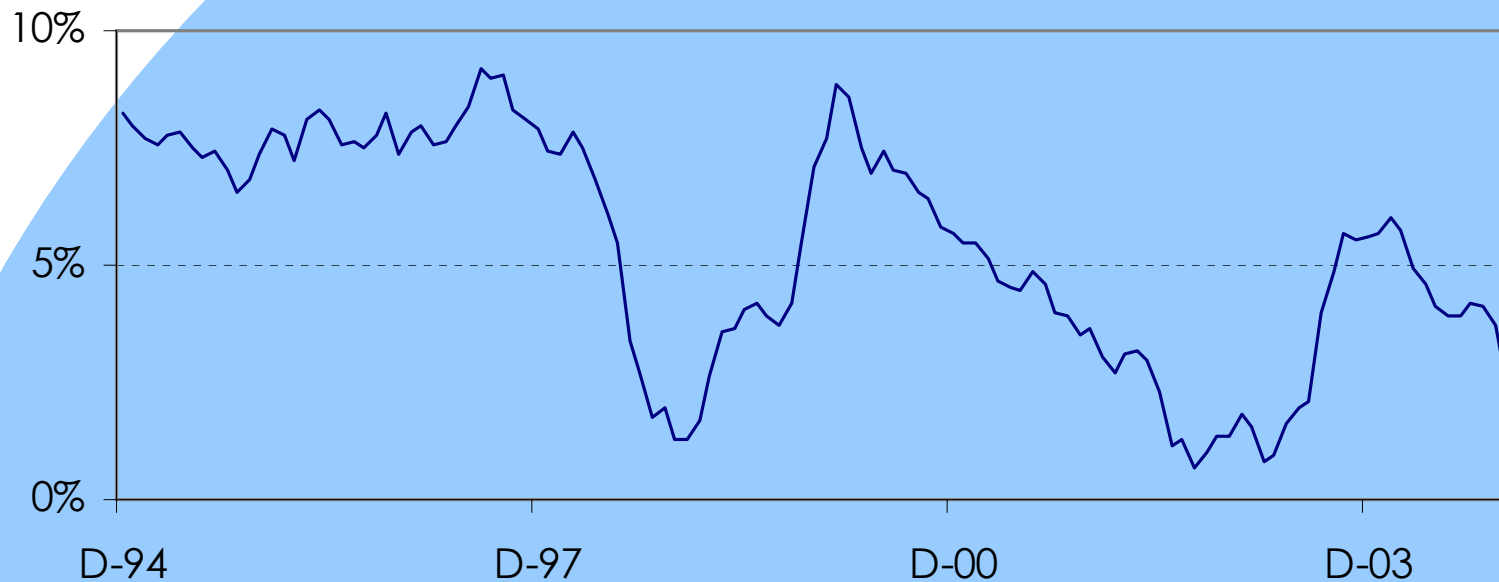
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Australian LPTs : Real dividend growth	-0.5%pa ³	+1.9%pa	Na
Australian LPTs : Yields	8.4%pa ³	7.1%pa	5.6x

I've been thinking about...

Inputs	Long term average	Last decade	Current
Australian Equities: Real EPS growth ¹	0.9%pa ¹	7.9%pa	Na
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US PE ratios	14.1x ¹	25.3x	15.6x
Australian LPTs : Real dividend growth	-0.5%pa ³	+1.9%pa	Na
Australian LPTs : Yields	8.4%pa ³	7.1%pa	5.6%
Hedge Fund of funds : Return vs cash	+4.5%pa ⁴	+3.9%pa	na

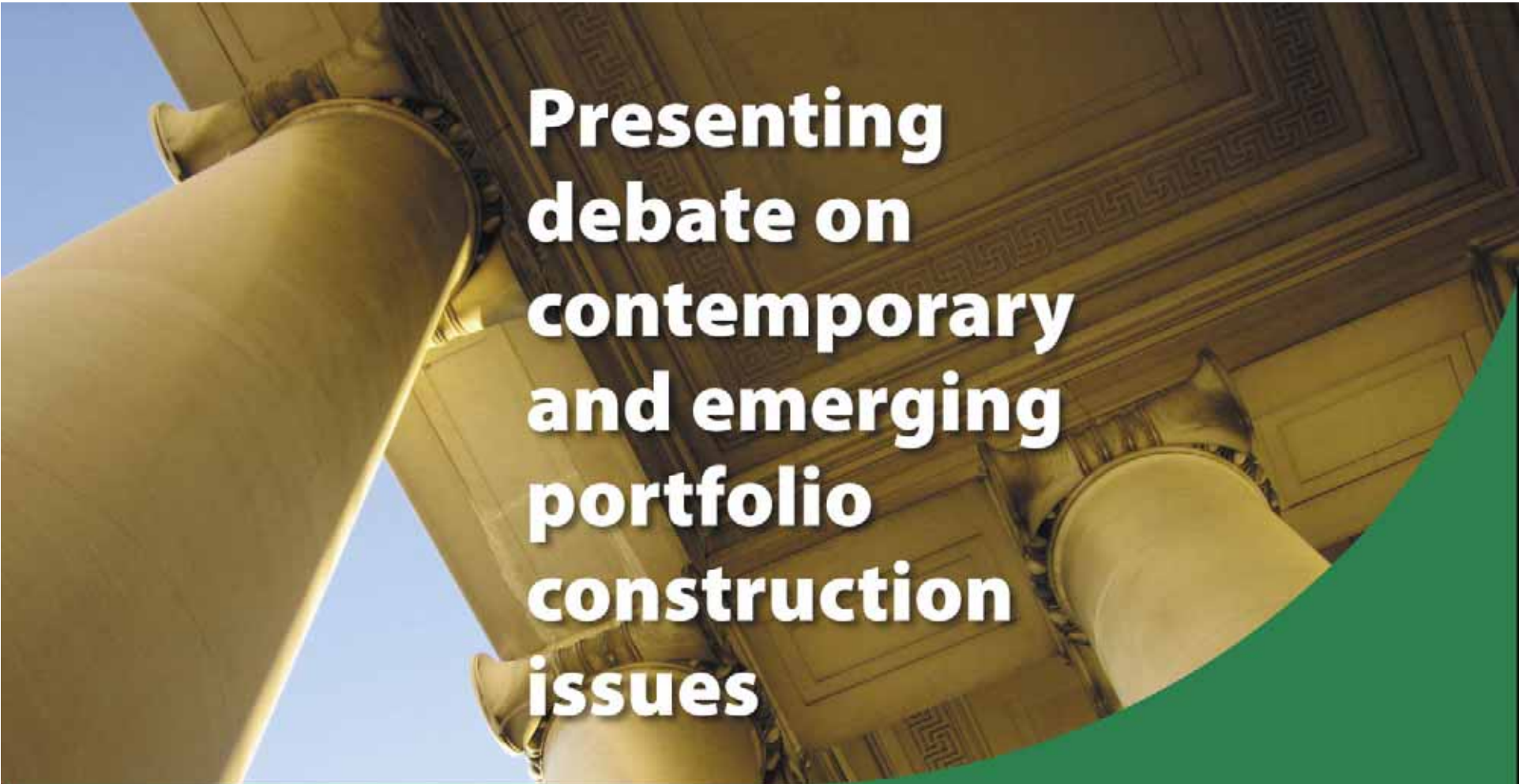
Hedge funds finding the going tougher...

Rolling Five Year DHFOF v Cash



Source : Hedge Fund Research data

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