portfolio construction

CONFERENCE

Constructing debt securities portfolios in a lower growth (and yield) environment

Stuart Piper
Portfolio Manager
MLC Investments

25 August, 2010

Disclaimer

This information has been provided by MLC Limited (ABN 90 000 000 402) a member of the National Group, 105-153 Miller Street, North Sydney 2060. This material was prepared for advisers only.

MLC Investments Limited ABN 30 002 641 661 is the issuer of interests in each fund of the MLC MasterKey Unit Trust and MLC Nominees Pty Limited ABN 93 002 814 959 is the issuer of MLC MasterKey Superannuation and the MLC Allocated Pension. Information about the MLC MasterKey Horizon Series is available in the current Product Disclosure Statement (‘PDS’) or other disclosure document, copies of which are available upon request by phoning the MasterKey Service Centre on 133 433 or on our website at mlc.com.au. Persons should consider the relevant PDS in deciding whether to acquire, or to continue to hold, this product. Persons wishing to acquire an interest in this product must complete the application form attached to the relevant PDS.

Any advice in this communication has been prepared without taking account of individual objectives, financial situation or needs. Because of this you should, before acting on any information in this communication, consider whether it is appropriate to your objectives, financial situation and needs. You should obtain a Product Disclosure Statement or other disclosure document relating to any financial product issued by MLC Investments Limited (ABN 30 002 641 661) and MLC Nominees Pty Ltd (ABN 93 002 814 959) as trustee of The Universal Super Scheme (ABN 44 928 361 101), and consider it before making any decision about whether to acquire or continue to hold the product. A copy of the Product Disclosure Statement or other disclosure document is available upon request by phoning the MLC call centre on 132 652 or on our website at mlc.com.au.

An investment in any product offered by a member company of the National group does not represent a deposit with or a liability of the National Australia Bank Limited ABN 12 004 044 937 or other member company of the National Australia Bank group of companies and is subject to investment risk including possible delays in repayment and loss or income and capital invested. None of the National Australia Bank Limited, MLC Limited, MLC Investments Limited or other member company in the National Australia Bank group of companies guarantees the capital value, payment of income or performance of any financial product referred to in this publication.

Past performance is not indicative of future performance. The value of an investment may rise or fall with the changes in the market. Please note that all return figures reported are before management fees and taxes, and for the stated.

The specialist investment management companies are current as at 26 March 2010. Investment managers are regularly reviewed and may be appointed or removed at any time without prior notice to you.

Contents

Investment objectives

- **Capital preservation and income**
  - default risk; mark to market risk and tolerance for a negative annual return; inflation protection
- **Diversification**
  - correlation with other asset classes
- **Liquidity**
  - portfolio rebalancing and expenditure

Portfolio construction

- **Debt sector risk and return**
  - long-term historical perspective
  - total return patterns and risk of loss
  - excess return patterns and starting yield levels
  - volatility of sovereign bond and credit returns

Debt sector risk and return

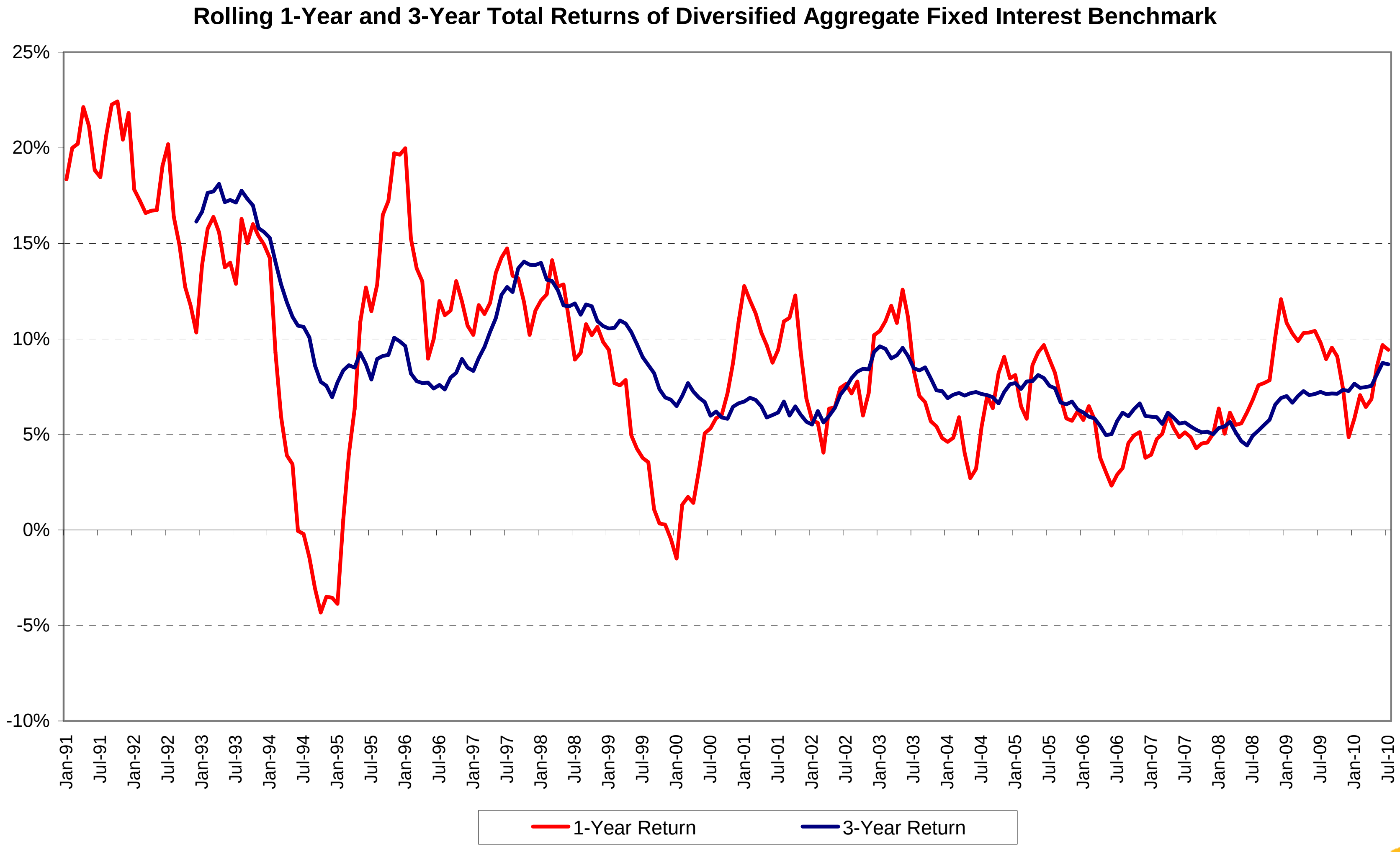
- Long-term historical perspective

Fixed Income Sector As of July 2010	Returns (%pa)		Risk (%pa)	
	Since July 2000	Since April 1991*	Since July 2000	Since April 1991*
UBS Bank Bill Index	5.54%	5.97%	0.33%	0.42%
UBS Australian Composite Index, 0-3 yrs	6.10%	7.13%	1.33%	1.89%
Barclays Capital Global Aggregate Index, 1-3 yrs (A$ hedged)	6.93%	7.23%	1.03%	1.22%
UBS Australian Composite Index	6.39%	8.15%	2.92%	4.13%
UBS Australian Government Inflation Linked Index	6.51%	7.88%	4.82%	5.54%
Barclays Capital Global Treasury Index (A$ hedged)	8.00%	8.69%	2.85%	3.06%
Barclays Capital Global Aggregate Index (A$ hedged)	8.31%	8.88%	2.81%	3.06%
Barclays Capital US Corporate Index(A$ hedged)	9.12%	9.13%	6.52%	5.79%
Barclays US High Yield Index (A$ hedged)	9.19%	9.96%	12.14%	9.44%
JP Morgan EMBI+ Index (A$ hedged)	12.34%	11.56%	10.93%	15.33%
Diversfied Equities Benchmark	3.14%	8.39%	13.05%	12.28%
Hypothetical Sector Allocations				
'Low Risk Portfolio' 30% UBS Bank Bill Index/42% UBS Composite, 0-3 yrs/28% BCGA, 1-3 yrs (A$ hedged)	6.15%	6.81%	0.82%	1.12%
'Market Risk Portfolio' 50% UBS Australian Composite / 50% BCGA Index (A$ hedged)	7.36%	8.53%	2.59%	3.29%

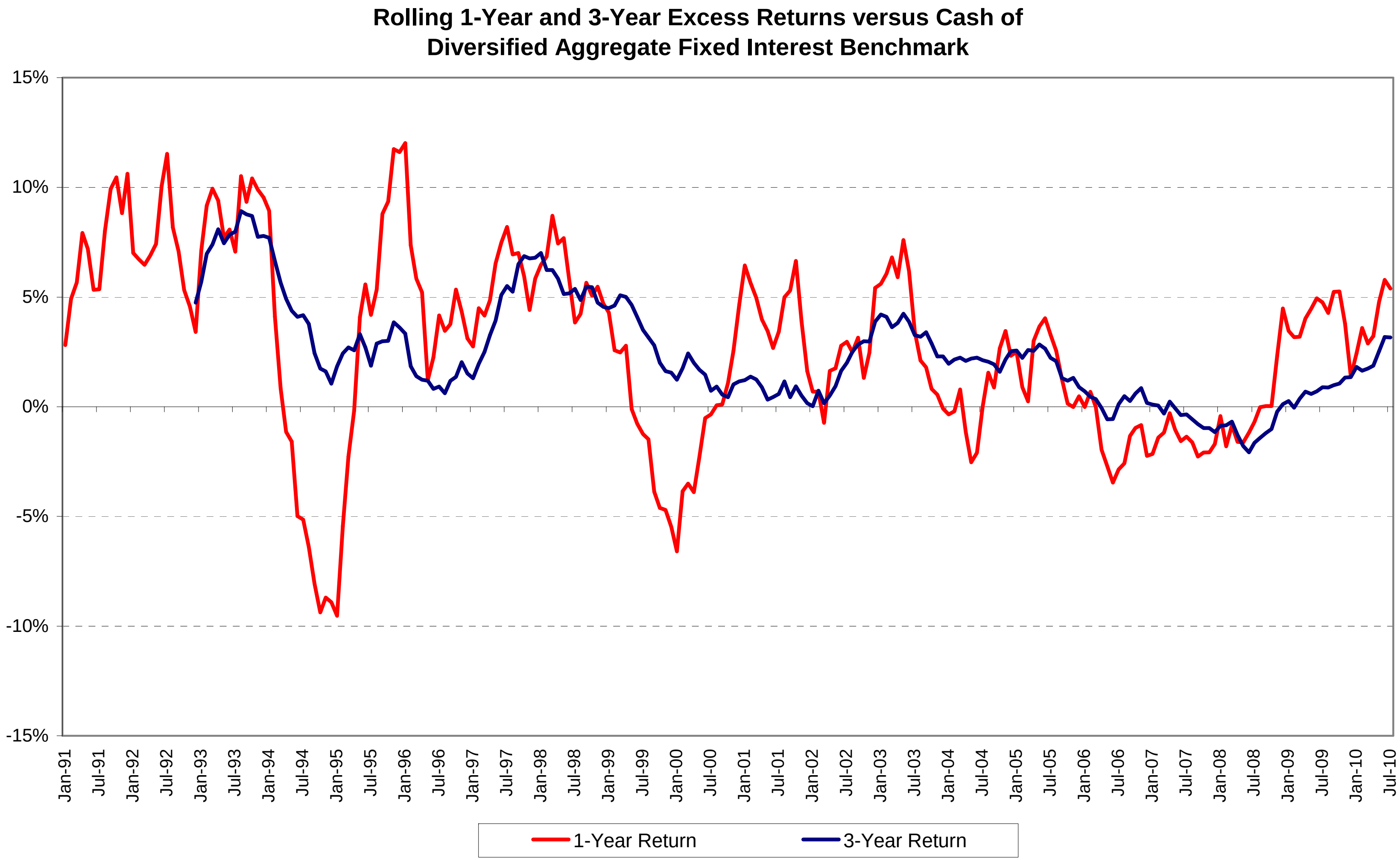
**** JP Morgan EMBI+ Index (A$ hedged) since Jan-1994***

Debt sector risk and return

- Total return patterns and risk of loss

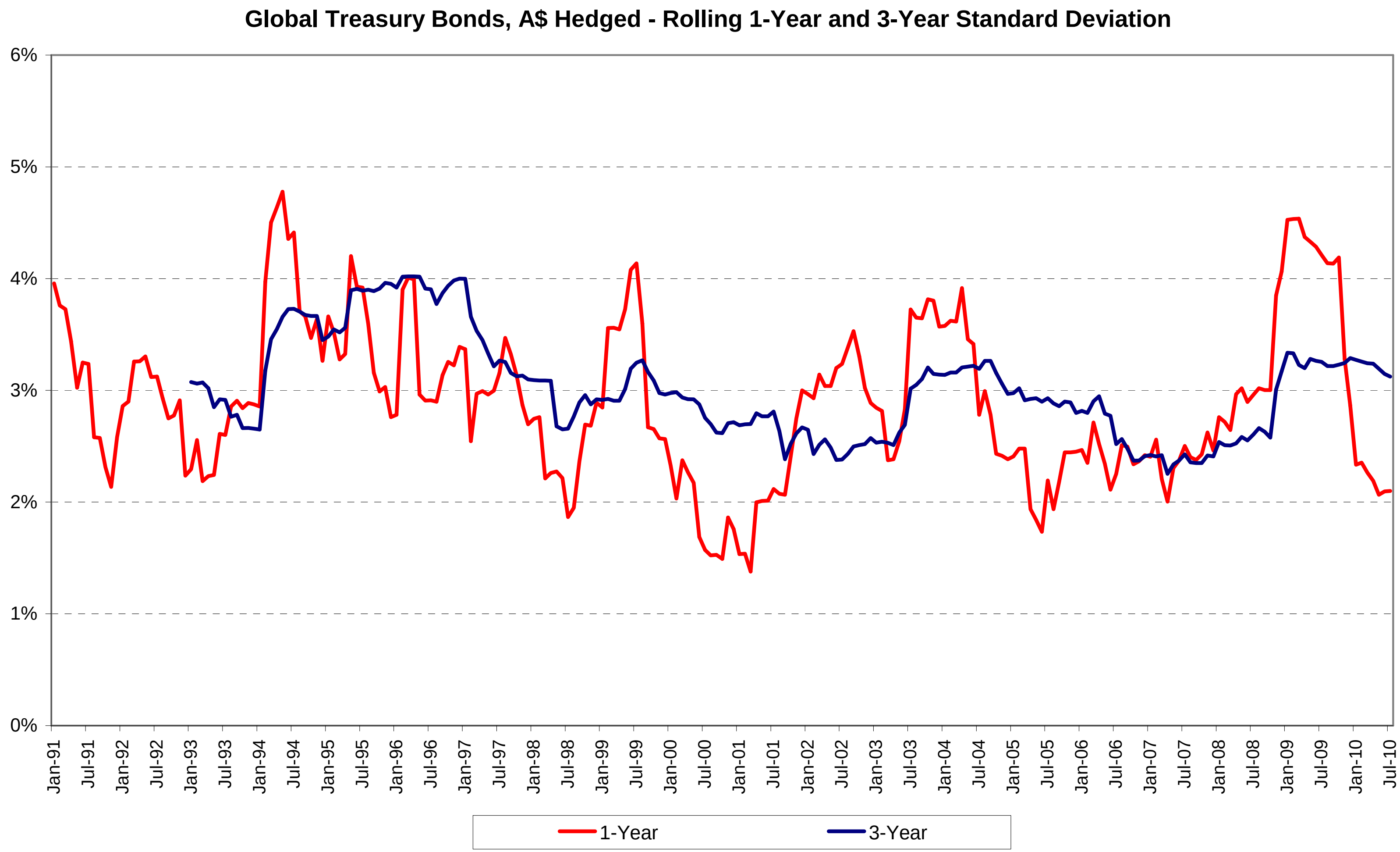


Debt sector risk and return
- Excess return patterns



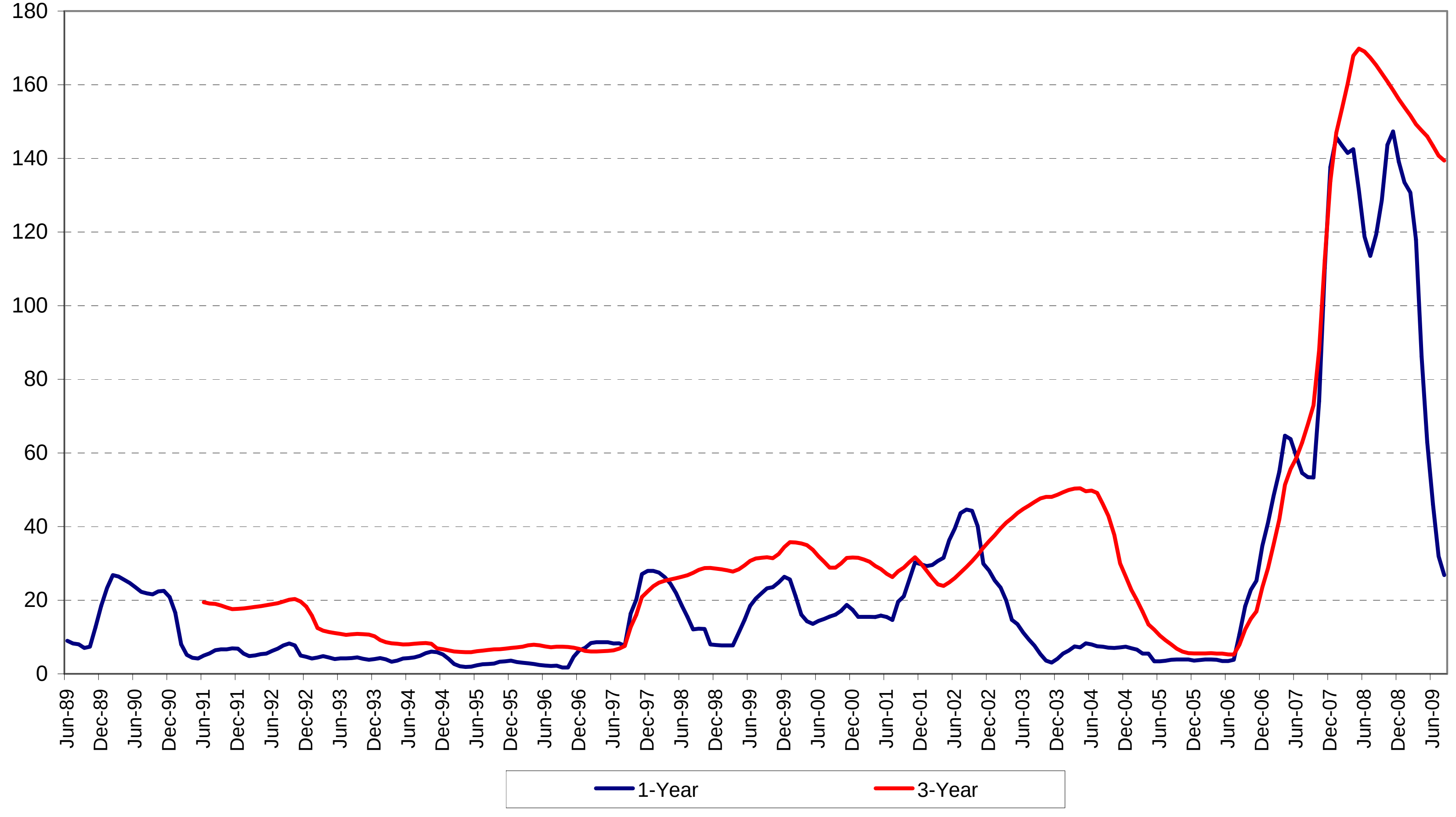
Debt sector risk and return

- Volatility of sovereign bond returns



Debt sector risk and return
- Volatility of credit excess returns

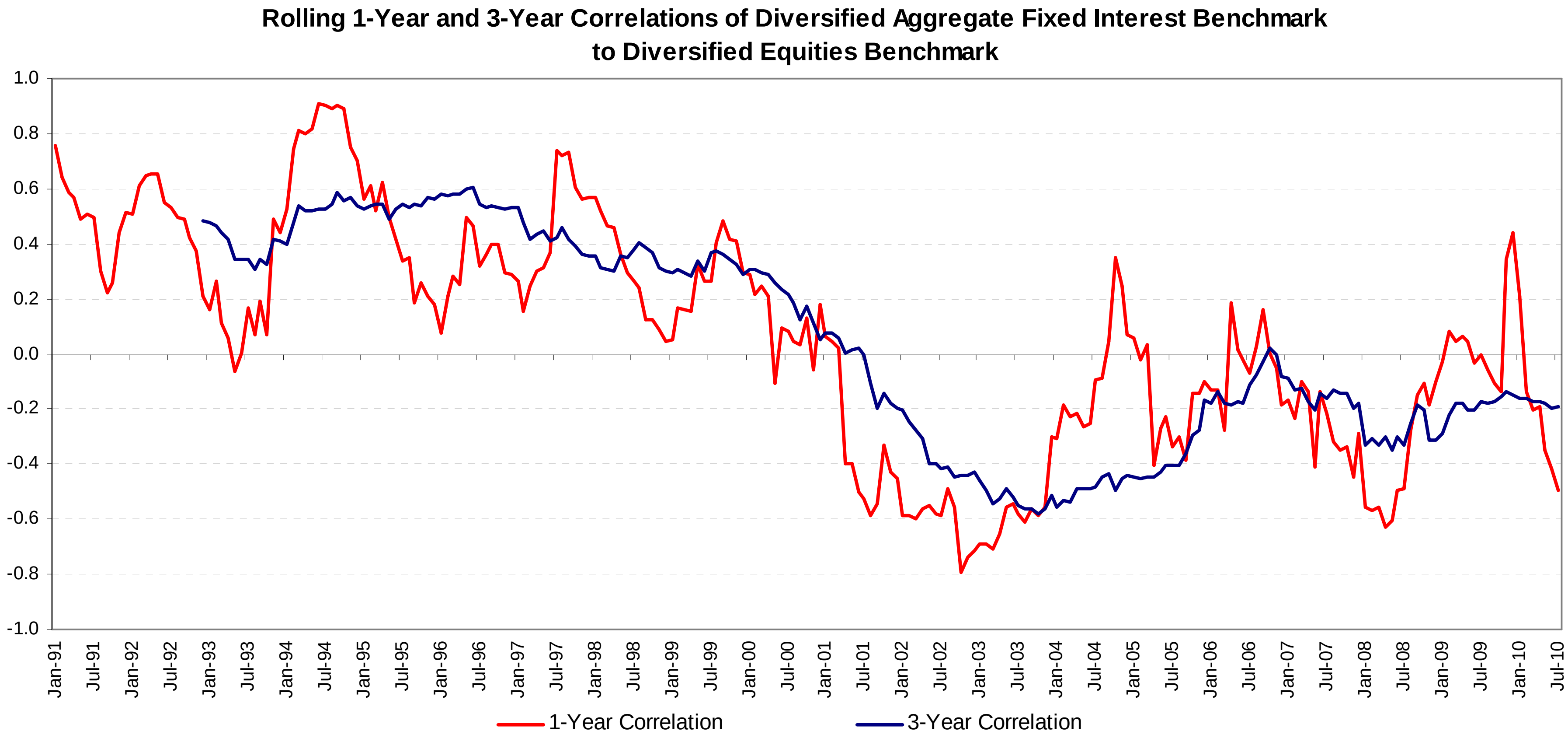
US Investment Grade Corporate Bonds: Rolling 1-Year and 3-Year Standard Deviation of Option Adjusted Spreads



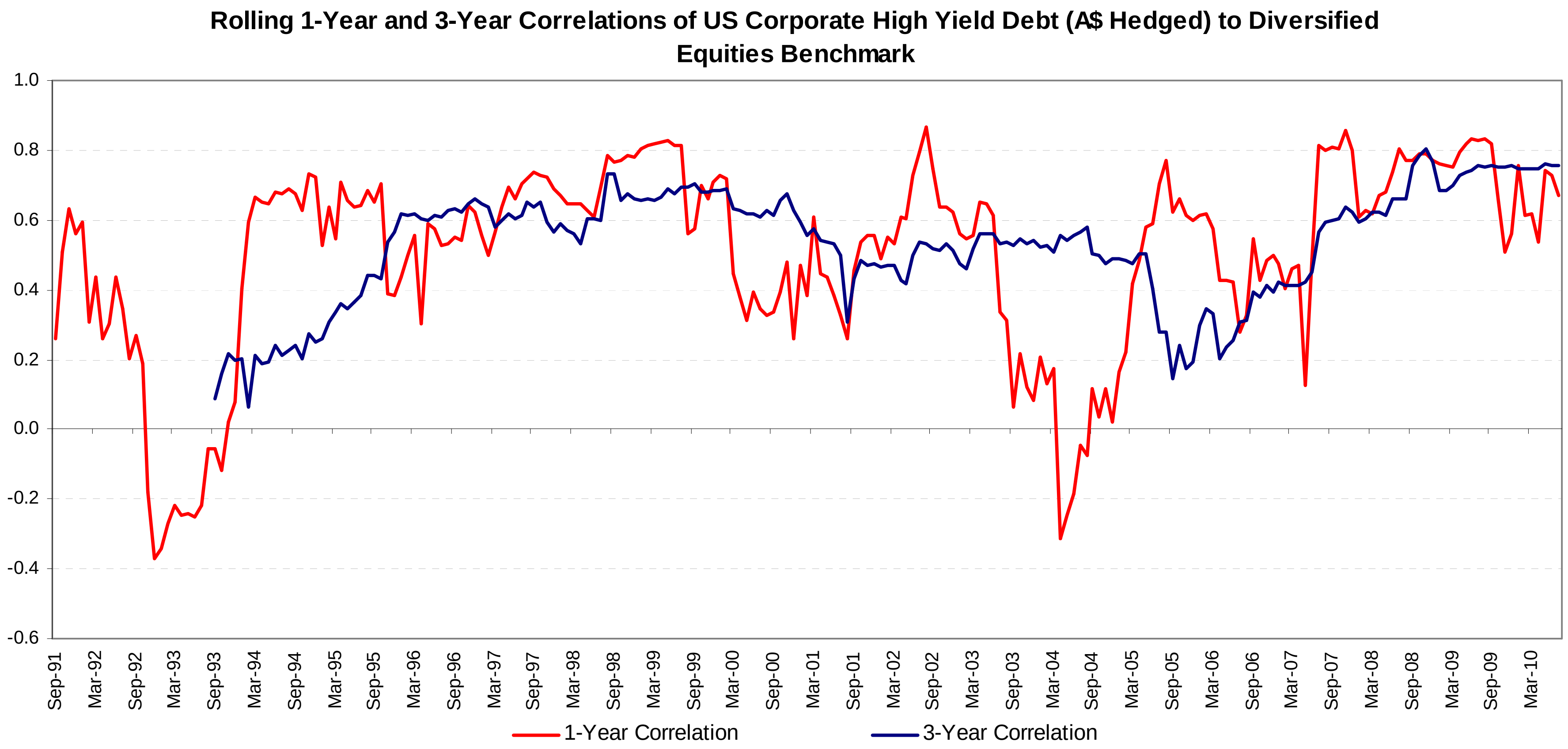
Portfolio construction

- **Debt sector risk and return**
  - long-term historical perspective
  - total return patterns and risk of loss
  - excess return patterns and starting yield levels
  - volatility of sovereign bond and credit returns
- **Correlations with other asset classes**
  - preserve capital under severe equity downturns, deflation and inflation
  - behaviour of investment grade and non-investment grade assets during severe equity market downturns
  - behaviour of nominal bonds and inflation-linked bonds under deflation scenarios

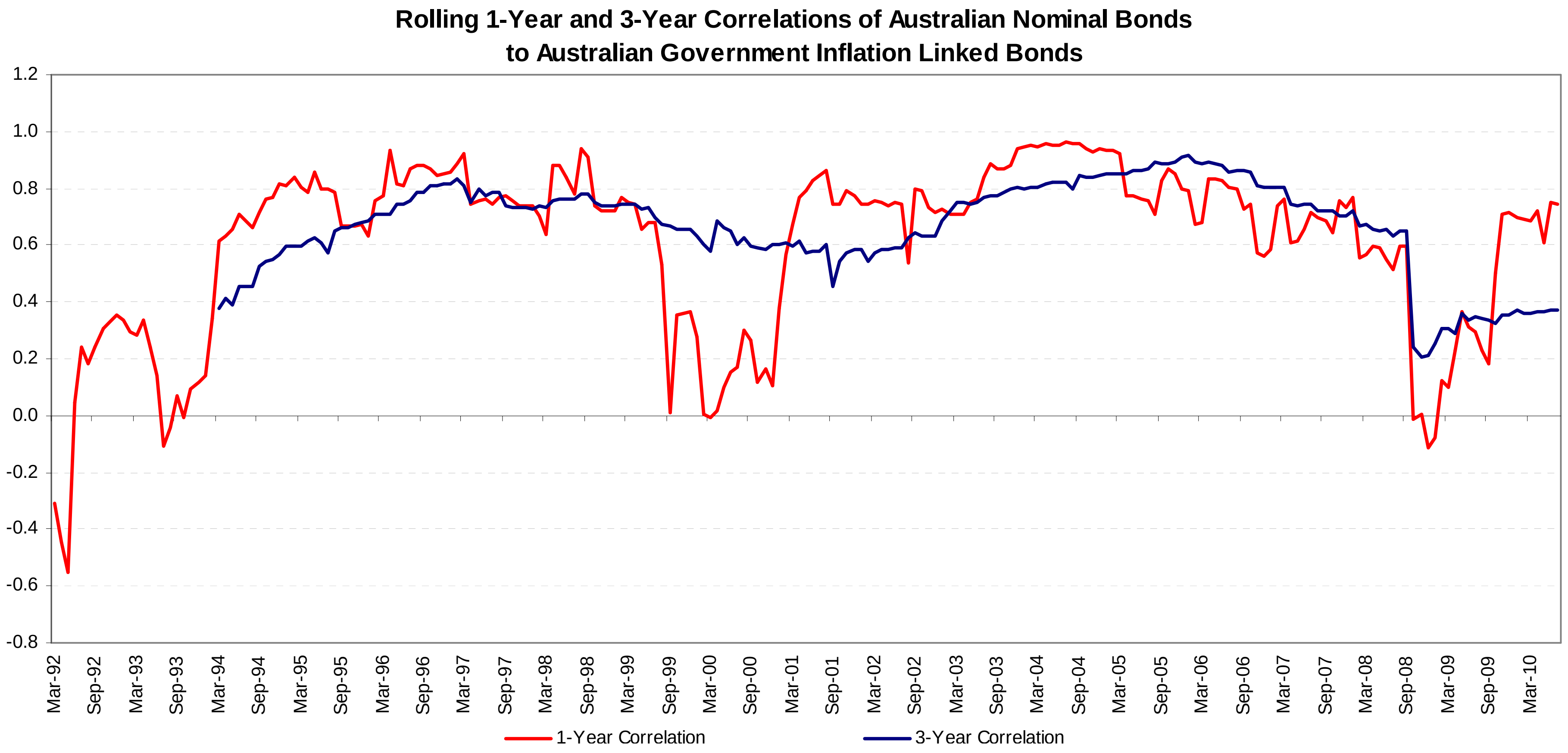
Correlations with other asset classes
- Preserve capital under severe equity downturns



Correlations with other asset classes
- Behaviour of non-investment grade assets during severe equity market downturns



Correlations with other asset classes
- Behaviour of nominal bonds and inflation-linked bonds under a deflation scenario



Portfolio construction

- **Debt sector risk and return**
  - long-term historical perspective
  - total return patterns and risk of loss
  - excess return patterns and starting yield levels
  - volatility of sovereign bond and credit returns
- **Correlations with other asset classes**
  - preserve capital under severe equity downturns, deflation and inflation
  - behaviour of investment grade and non-investment grade assets during severe equity market downturns
  - behaviour of nominal bonds and inflation-linked bonds under deflation scenarios
- **Implementation considerations**
  - specialist vs broad discretion managers/products

Market outlook and strategy

- **Global GDP and Inflation**
  - consensus forecasts show weak growth and low inflation in G5 countries; downward revisions in prospect

Global Consensus Forecasts			
GDP Growth	2009	2010F	2011F
G5#	-3.5	2.4	2.3
Emerging Markets	1.6	6.8	5.9
Global	-2.4	3.4	3.1
CPI Inflation	2009	2010F	2011F
G5#	-0.1	1.4	1.4
Emerging Markets	3.6	4.7	4.4
Global	0.7	2.1	2.1
# US, Euro-area, Japan, UK, Canada			
Source: Thompson Financial, Datastream, MLC, IMF			

Market outlook and strategy

- **Global GDP and Inflation**
  - consensus forecasts show weak growth and low inflation in G5 countries; downward revisions in prospect
- **Fiscal deterioration**
  - poor Debt/GDP ratios in most developed economies
  - significant re-rating of sovereign credit risk in peripheral Europe

Year	**General Government Gross Financial Liabilities as % GDP SADJ**			
	United States	Japan	Germany	Australia
2000	54.5	135.4	60.4	24.7
2001	54.4	143.7	59.7	21.8
2002	56.8	152.3	62.1	19.8
2003	60.1	158.0	65.3	18.3
2004	61.1	165.5	68.7	16.6
2005	61.4	175.3	71.1	16.1
2006	60.9	172.1	69.2	15.3
2007	61.9	167.0	65.3	14.3
2008	70.4	173.8	68.8	13.6
2009	83.0	192.9	76.2	19.2
2010	89.6	199.2	80.9	23.4
2011	94.8	204.6	84.2	25.9

Source: Datastream

Market outlook and strategy
- Fiscal deterioration

Sovereign credit default swaps

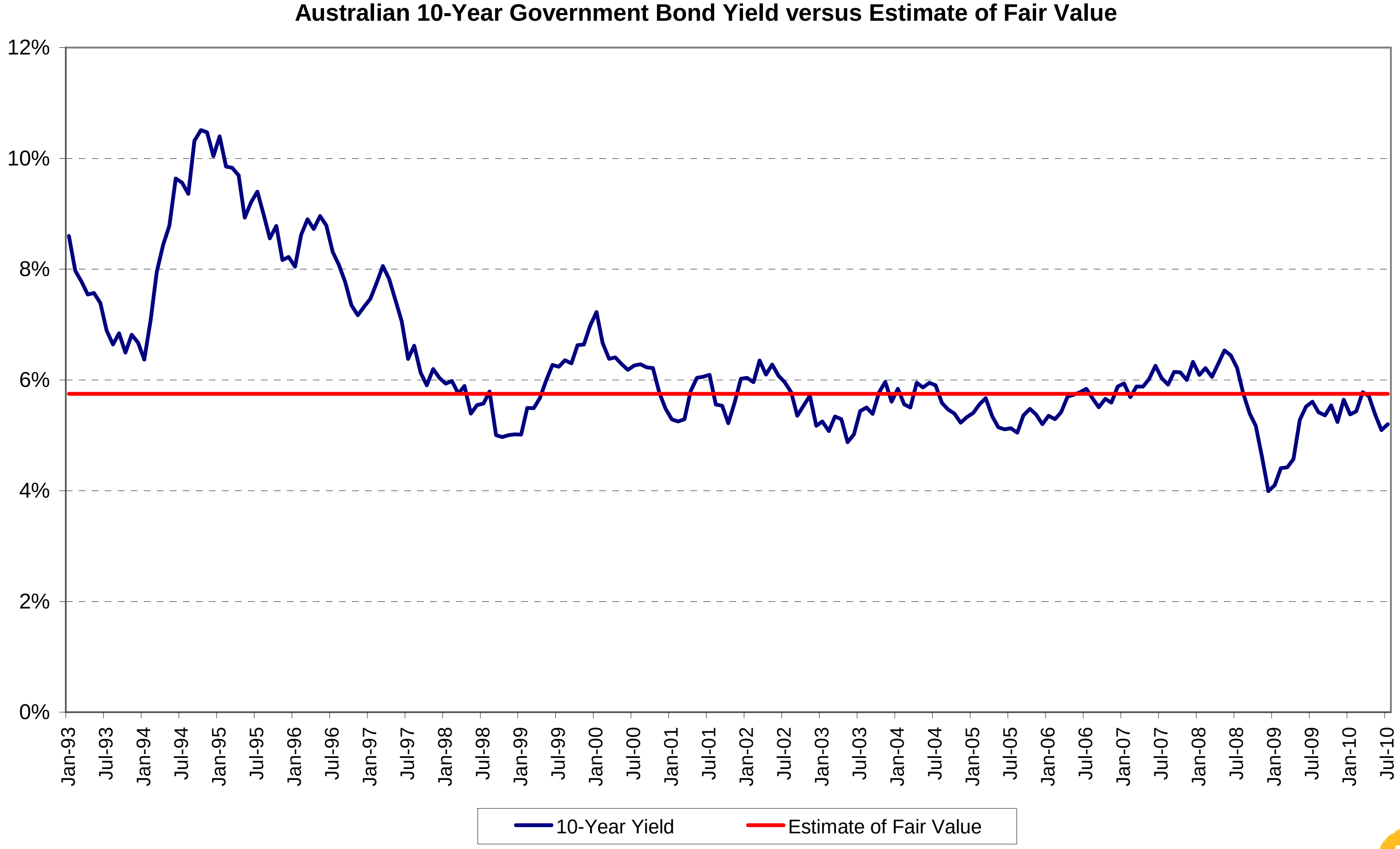
Greek crisis precipitated significantly wider CDS spreads in Spain & Portugal during Q2 2010; wider CDS spread levels reflected deterioration in government finances and drove yields higher

5 Year CDS (bps pa)	Jun-09	Sep-09	Dec-09	Mar-10	High	Low	**Jun-10**	**Change since Jun-09**	**Change since Mar-10**
Australia	60	31	40	39	69	27	**57**	**-3**	**18**
US	35	21	38	41	63	20	**38**	**3**	**-4**
Japan	47	45	68	67	100	37	**90**	**44**	**23**
Germany	31	21	26	32	60	19	**44**	**13**	**12**
France	32	23	32	46	100	42	**93**	**61**	**47**
UK	71	44	83	77	101	71	**78**	**6**	**1**
Spain	81	67	113	119	275	116	**266**	**185**	**148**
Portugal	68	52	92	145	461	45	**331**	**264**	**186**
Greece	131	122	283	343	1126	313	**1126**	**995**	**783**

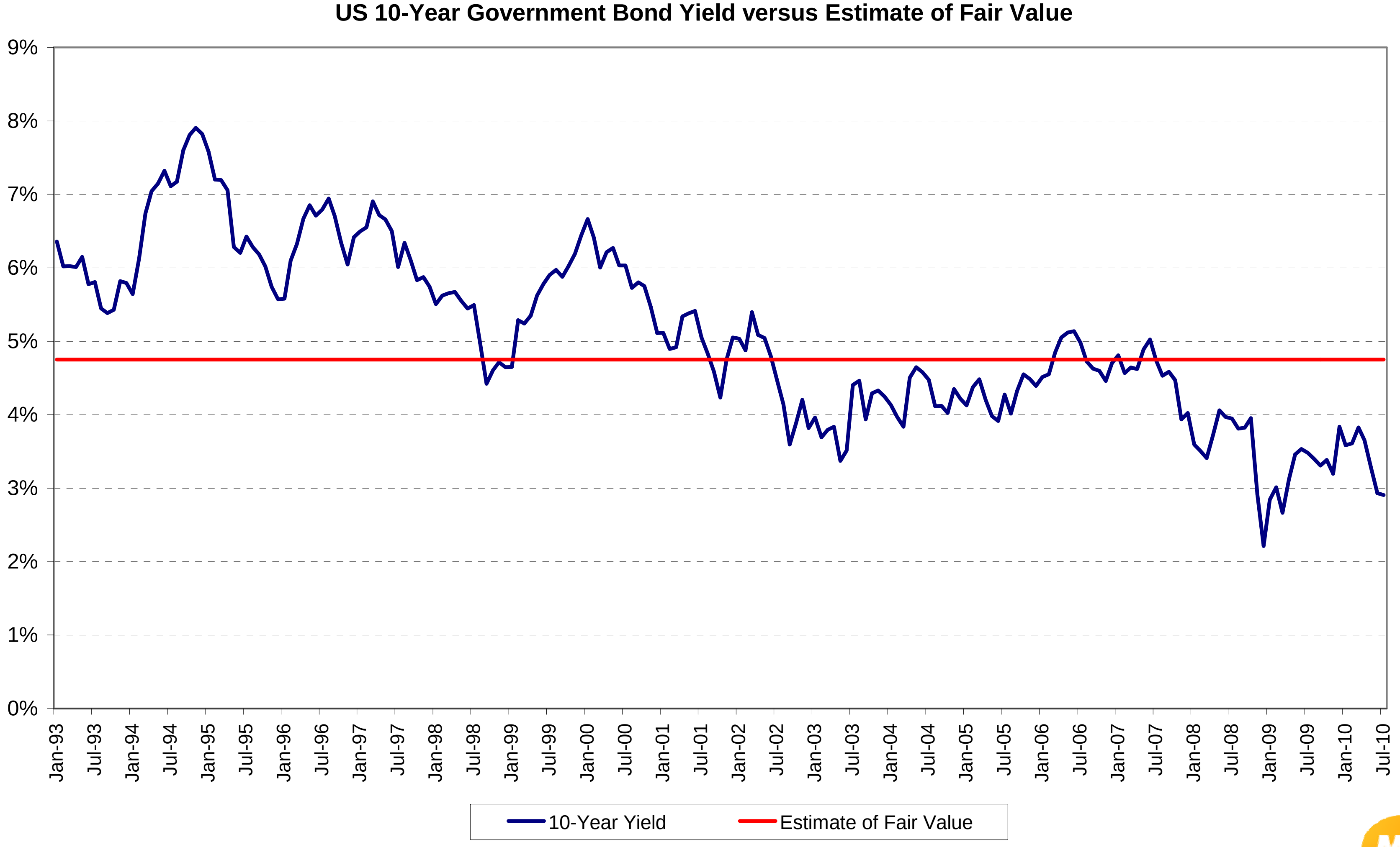
Market outlook and strategy

- **Global GDP and Inflation**
  - consensus forecasts show weak growth and low inflation in G5 countries; downward revisions in prospect
- **Fiscal deterioration**
  - poor Debt/GDP ratios in most developed economies
  - significant re-rating of sovereign credit risk in peripheral Europe
- **Valuations**
  - G3 sovereigns at extreme levels of overvaluation; Australia at the lower end of the historic range
  - Investment grade credit attractively valued; non investment grade credit fairly priced but very vulnerable to equity market weakness

Market outlook and strategy
- Valuations

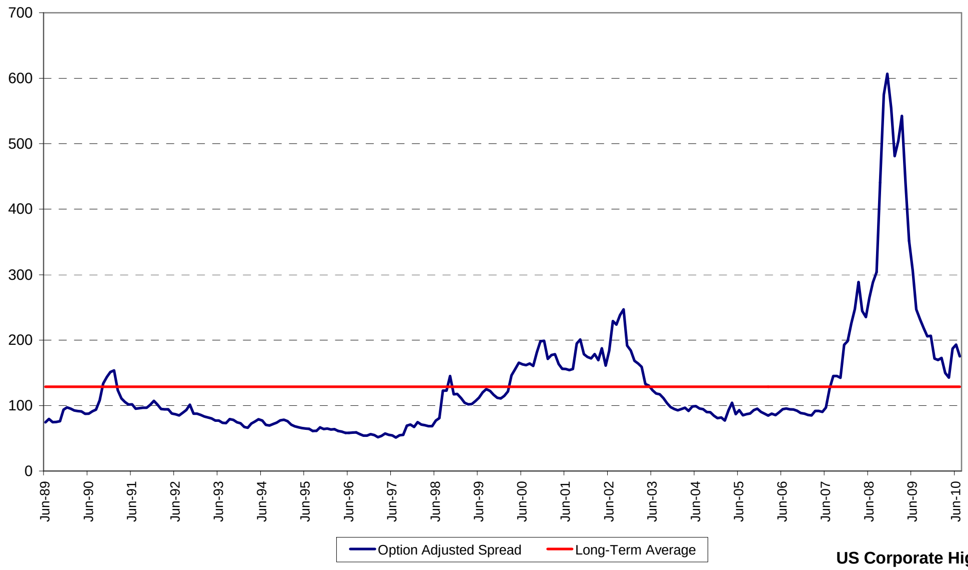


Market outlook and strategy
- Valuations

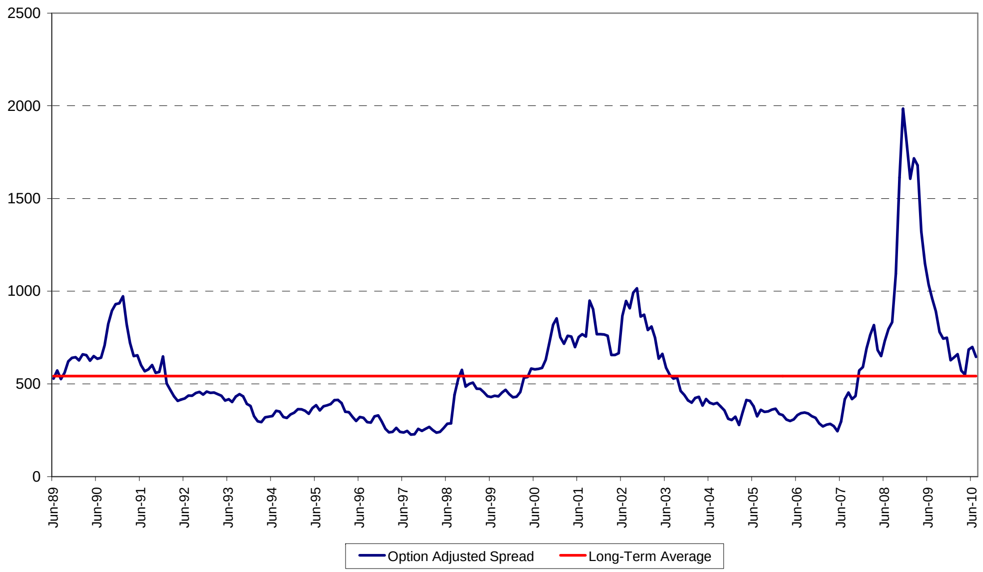


Market outlook and strategy
- Valuations

US Investment Grade Corporate Bonds: Option Adjusted Spread v Long-Term Average



US Corporate High Yield Bonds: Option Adjusted Spread v Long-Term Average



Market outlook and strategy

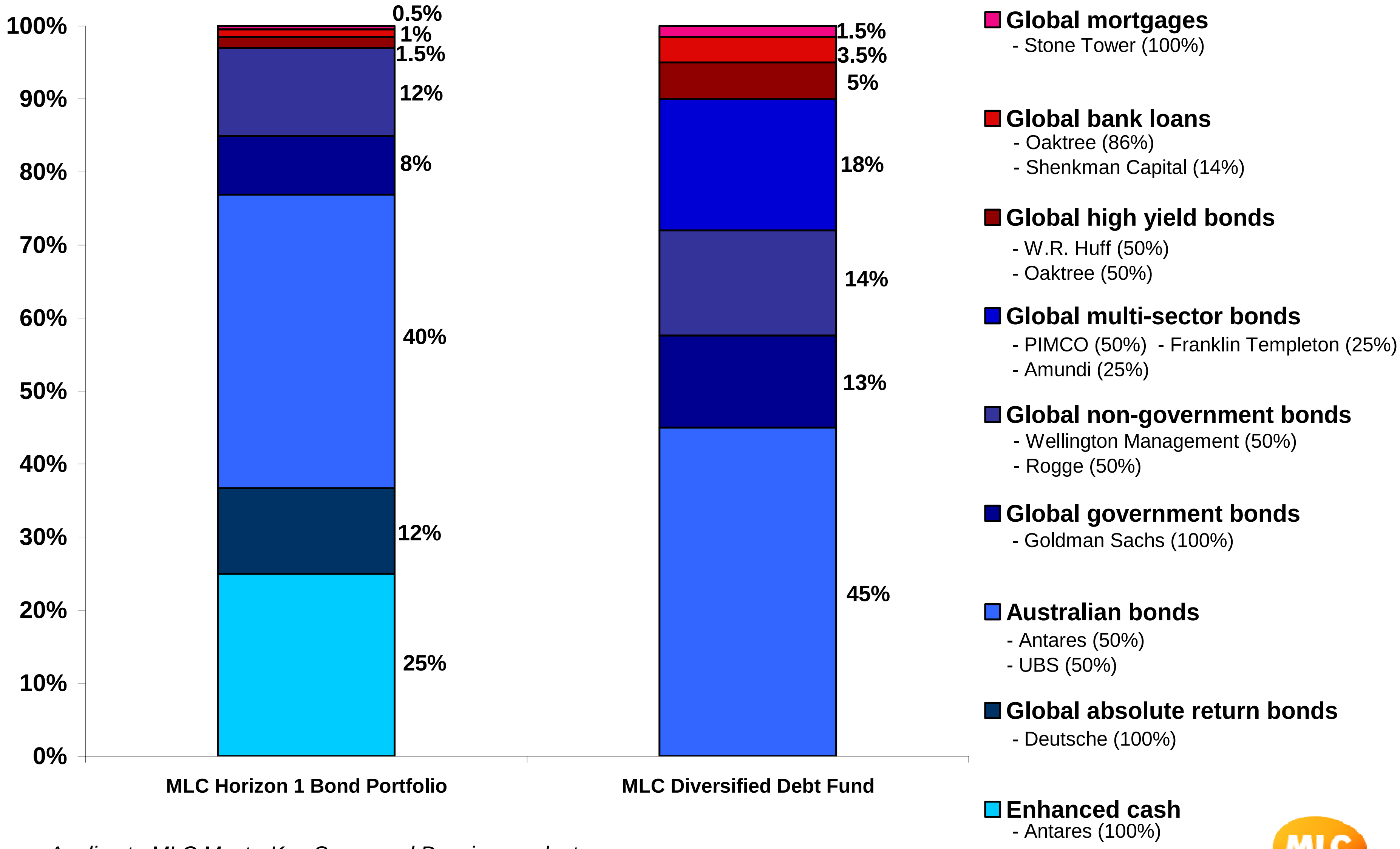
- **Global GDP and Inflation**
  - consensus forecasts show weak growth and low inflation in G5 countries; downward revisions in prospect
- **Fiscal deterioration**
  - poor Debt/GDP ratios in most developed economies
  - significant re-rating of sovereign credit risk in peripheral Europe
- **Valuations**
  - G3 sovereigns at extreme levels of overvaluation; Australia at the lower end of the historic range
  - Investment grade credit attractively valued; non investment grade credit fairly priced but very vulnerable to equity market weakness
- **Portfolio positioning**
  - reduce/eliminate G3 sovereign risk and equivalents in favour of Australian cash and/or bonds and selected emerging markets (e.g. Korea, Brazil)
  - overweight investment grade credit/neutral non investment grade credit

MLC's debt funds

Strategy Comparisons

Strategy	Horizon 1 Super		Div Debt Fund	
	Weight (%)	Duration (yrs)	Weight (%)	Duration (yrs)
Domestic Enhanced Cash	25.00	0.00	0.00	0.00
Domestic Composite	40.20	1.03	45.00	3.14
Global Absolute Return	11.70	0.00	0.00	0.00
Global Government	8.04	0.96	12.60	-0.94
Global Non Government	12.06	2.08	14.40	4.61
Global Multi Sector	0.00	0.00	18.00	5.17
Global Extended Credit	3.00	2.53	10.00	2.53
Total Nominal	**100.00**	**0.74**	**100.00**	**3.14**
Domestic Inflation linked	0.00	0.00	0.00	0.00
Total Nominal + Inflation Linked	**100.00**	**0.74**	**100.00**	**3.14**
Note: duration columns are not additive				

MLC's debt funds
Target allocations to debt sectors



Applies to MLC MasterKey Super and Pension products

As at 31 July 2010

portfolio construction

CONFERENCE