

# Wholesale Australian Fixed Income Fund

## Quarterly Investment Report to 30 June 2008

### Fund performance

<b>Wholesale Australian Fixed Income Fund</b>					
	<b>3 mth%</b>	<b>1 yr %.</b>	<b>3 yr % p.a.</b>	<b>5 yr % p.a.</b>	<b>7 yr% p.a.</b>
Distribution return	2.1	5.2	5.3	5.0	5.8
Growth return	-1.4	-4.6	-2.8	-1.6	-1.3
<b>Total return<sup>1 &amp; 2</sup></b>	<b>0.7</b>	<b>0.6</b>	<b>2.5</b>	<b>3.4</b>	<b>4.5</b>
UBS Australian Composite Bond (All Maturities) Index	0.4	4.4	3.9	4.4	5.4

### Review and outlook

#### Market review

After a promising start, credit markets were once again overcome by volatility and uncertainty in the June quarter. With improving sentiment during March and April, we saw increased new issuance and relative spread stability. However, concerns regarding the financial crisis and a potential global economic slowdown persisted, and these were exacerbated by a renewed round of downgrades in the troubled monoline and investment bank sectors in mid June. Not surprisingly, credit spreads subsequently retraced giving up much of the gains made in recent months, with non-bank financials hit particularly hard. New issuance levels were reasonably robust in April and May, but stalled in June. Issuers still sounding the market in mid June were sidelined when the renewed bout of volatility hit.

Fears of a sharp global slowdown following the credit crunch prompted the Federal Reserve and ECB actions to inject liquidity into the financial system in the first quarter. With the crisis seemingly averted, attention moved to rising food and oil prices, swinging the pendulum back to inflation concerns, and whether there would be rate rises to remove the excess liquidity.

Many market pundits questioned whether the central banks around the world were behind the curve, and hawkish statements shortly followed from the Federal Reserve and the ECB sending global yields higher. At the end of the quarter, the 3 year bond yield was up 57 bp to 6.73%, while the 10 year yield rose 39 bp to 6.45%. Short end yields were higher, but the move was not as pronounced, as unlike other central banks, the RBA has been actively combating the spectre of inflation. Although the Q1 CPI data would have been higher than the RBA would have preferred, subsequent economic activity data has demonstrated that the rate hikes over the last year are beginning to take effect.

The softening of activity data has reduced the risk of further rate rises in Australia, and as a corollary, the move higher in short end yields was less marked than further up the curve. The yield on the September 90 day bank bill future rose 33 bp to 7.93%. Swap spreads contracted sharply in the first part of the June quarter. Most of the gains were unwound in the last three weeks of the quarter, as credit concerns and bank end of financial year balance sheet posturing saw a flood of pay side interest.

Over the quarter, the 3 year swap spread to bond narrowed 2 bp to 109 bp, while the 10 year swap spread narrowed 8 bp to 96 bp. Following the rescue of Bear Sterns in March, credit markets were full of optimism that the worst of the credit crunch was behind us. Risk

appetite returned to the market, and there was a flood of primary market deals that were absorbed. Itraxx contracted from 155 at the end of March to as low as 75 at the height of market optimism. The mood soured in June as credit agencies downgraded large bond insurers (MBIA and AMBAC), which subsequently triggered downgrades of structured credit issues with their bond insurance. By the end of June, Itraxx had finished 13 bp wider at 142 bp.

#### Fund review

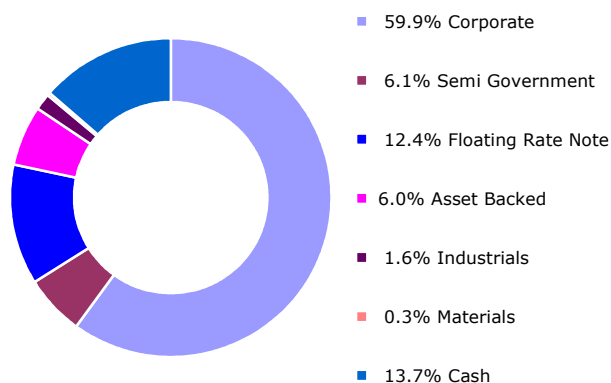
The fund outperformed the benchmark during the June quarter.

The portfolio's overweight credit exposure was maintained during the quarter and overall contributed negatively to the portfolio. Interest rate positioning also detracted from portfolio performance. Higher short term rates and a flatter yield curve over the quarter worked against the fund's long duration and curve steepener position. Our largest detractor was largely due to bonds issued by Lane Cove Tunnel. These bonds have credit enhancement through bond insurance, underwritten by MBIA. Deterioration of MBIA's perceived credit worthiness, and the underperformance of the Lane Cove Tunnel has pushed the market pricing down conspicuously. Also at the security level, our bought protection Countrywide CDS positions also detracted from performance. Australian government bond yields rose over the quarter, pushed higher by inflation fears in the US and Europe

#### Outlook

Alliance Bernstein Fixed Income Funds expects credit investment grade spreads to remain choppy and trade within a fairly contained range through the 3rd quarter. Alliance Bernstein believes overall spread levels should remain elevated as we transition from the financial sector/subprime crisis to a more challenging economic environment and markets are increasingly pricing in the worst case scenario for financial firms' write-downs and lower earnings forecasts. Against this backdrop, Alliance Bernstein Fixed Income expects the normalisation of credit spreads, such that financials trade (as they normally do) inside those of comparable non-financials spreads. The portfolio continues to use the current volatile environment to scale up into an overweight credit position. The portfolio is overweight financials and underweight non-financial corporates, with preference for higher rated credits from a relative value perspective. Financial institutions with strong credit ratings and a large and diversified revenue stream offer attractive value potential versus non-financial corporates. The portfolio continues to be positioned for a steeper curve and long duration.

## Portfolio analysis – Asset allocation



## Fund Information

### Fund Objective

The Fund typically holds a portfolio of fixed income and money market securities (fixed or floating) and derivative instruments.

The objectives are twofold: to provide unitholders with capital growth and an income return and to outperform the UBS Australian Composite Bond (All Maturities) Index, after costs and over rolling three year periods.

### Fund facts

Inception Date: August 1993

Fund Size (30 June 2008): \$75.0m

### Top five securities

Name of Security	% of Fund
Queensland Treasury Corp	3.1
Western Australia Treasury	2.9
CSR Limited	2.9
Countrywide Financial Corp	2.5
Bear Stearns COS	2.3
Total	13.8
Total number of securities	76

### Duration vs benchmark

	Duration (years)
Wholesale Australian Fixed Income Fund	4.01
UBS Australian Composite Bond Index	3.18

### Notes

- Past performance is not necessarily indicative of future performance. Performance figures are calculated using exit prices, are net of ongoing fees and expenses and assume distributions are reinvested and tax is not deducted. The Distribution return reflects total distributions paid from the Fund, while the Growth return reflects changes in the capital value of units.
- The Wholesale Australian Fixed Income Fund was closed to new investors on 25<sup>th</sup> April 2005.

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