insight

3 February 2010

talking points December Quarter 2009 ipac Diversified Investment Strategies

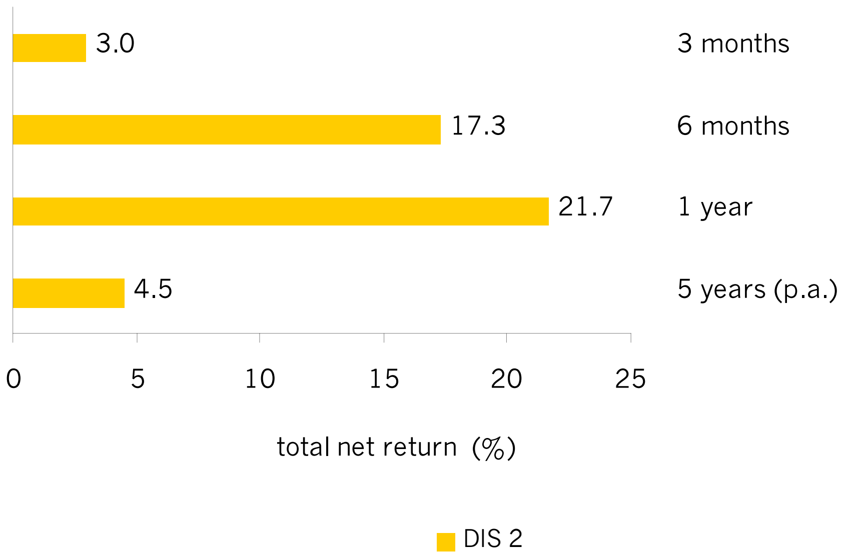
2009 was a good year to be invested

ipac provides talking points each quarter that highlight how the Diversified Investment Strategies are being managed to achieve long term outcomes for investors. While the December quarter is the focus of this document, we have put the performance in a full year context where appropriate.

strong absolute returns and competitive performance

ipac's Diversified Investment Strategies fully participated in the market recovery

The turnaround in performance since March 2009 has been dramatic. The Diversified Investment Strategies were **fully liquid** through the Global Financial Crisis and fully participated in the recovery. Our liquidity meant we took advantage of opportunities as they emerged. While there is still some way to go, strong recent returns have improved long term performance.



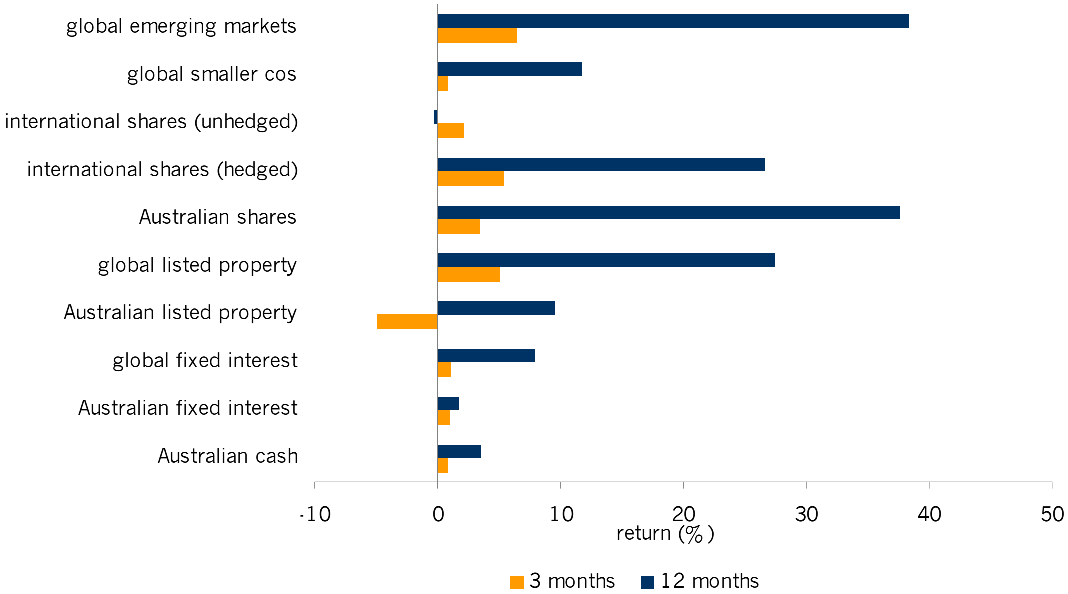
source: ipac. Past performance is not indicative of future performance

Performance in 2009 was competitive with the Morningstar average and peers

The Diversified Investment Strategies delivered competitive performance in the 2009 calendar year. The annual return of 21.7% for Diversified Investment Strategy 2 (DIS 2) **compares favourably with the Morningstar average** for multi-sector products with 60-80% in growth assets. The Morningstar average was 18.1% for the year to 31 December 2009.

Performance was competitive with multi-manager peers. Data suggests that funds like the Diversified Investment Strategies outperformed funds with significant exposures to unlisted assets. Funds with a focus on unlisted assets were negatively impacted by downward re-valuations of these exposures in 2009. Meanwhile listed markets had a strong 2009.

every asset class added value for the year



Double-digit returns were the norm for growth assets in 2009

source: UBSA Composite Bond (All Maturities) Index, Barclays Capital Global Aggregate (hedged) Index, S&P/ASX 300 A-REIT Index, UBS Global Investors Index in A$ Hedged Net Div, S&P/ASX 300 Accumulation Index, MSCI World ex-Australia Indices (hedged and unhedged – ipac's international share exposure is 50% hedged), MSCI World Small Cap Unhedged (A$) Index, MSCI EM in A$ (with div reinvested). Data as of 31 December 2009. Past performance is not indicative of future performance.

Portfolio performance **benefited from the enhancements to the portfolio in 2009** and the skill of ipac's managers. Key drivers of performance for the year were:

~ Portfolios captured the strong return from domestic and global share markets.

~ Increased diversification was beneficial – global property, global emerging markets, international smaller companies and alternative asset strategies have all added value in 2009.

~ Active management came to the fore. Manager performance was particularly strong in the smaller asset classes where managers used their information advantage to enhance the significant index return.

~ Positions in corporate credit helped performance. Diversified Investment Strategy 1 (DIS 1) portfolio bounced back sharply (up 16.6% in 2009).

If corporate earnings surprise on the upside then portfolios could perform particularly well over the next few years

After a stellar rise from the March low to the end of September 2009, share markets consolidated the gains in the December quarter. Further rises will be more measured with **returns expected to be more in line with medium to long term averages**.

As market sentiment continues to recover, correlation between investment markets will fall back to more normal levels. In this environment, there are good prospects for active managers to add value. Indeed, if corporate earnings surprise on the upside, there is scope for client portfolios to perform particularly well over the next few years.

shares continue to rebound

Australian shares

Exposure to the Chinese growth story continued to support the Australian sharemarket, particularly Resource stocks. The Australian sharemarket was up 37.6% in 2009 (3.4% in the December quarter). The sector return was 3.2% for the quarter and 36.6% for 2009. The sector participated in the strong performance of the Materials sector and broadly **kept pace with the market**.

A benefit of the recent restructure of the Australian shares sector is a broader spread of active risk positions. These positions **leverage insights with different time horizons** and different investment approaches based on fundamental, quantitative and market derived signals.

The sector rode the positive wave of investor momentum for JB HiFi and Challenger Financial

Market driven insights identify stocks with price momentum to take advantage of this positive sentiment. An example is the overweight position in **JB HiFi**. JB HiFi continued to help performance in the December quarter. The stock ended the year at $22.60, up from $19.86 at 30 September and $9.35 at the start of 2009.

Challenger Financial became a significant overweight in the December quarter as increased investor appetite for the stock was detected. Challenger Financial is an investment management firm with a focus on annuities. Investors decided that Challenger had been oversold. Challenger's share price rose 24% over the quarter benefiting sector performance.

Among the more fundamentally driven overweight positions are Amcor and James Hardie. Both are investments with a longer term horizon. They made a positive contribution to return in the December quarter.

Amcor is one of the world's largest packaging companies operating in 24 countries with $A9.5 billion in annual sales (year to 30 June 2009). Key products include PET plastic containers for beverage applications, flexible packaging for the food and healthcare markets, tobacco packaging, corrugated boxes and a North American distribution business.

Amcor and James Hardie were long term holdings based on fundamental research that benefited the portfolio in the December quarter

The recent acquisition of Alcan Packaging from Rio Tinto was regarded by ipac manager, Schroder Investment Management, as a move that offered significant synergies. Schroder's said the acquisition highlighted that the business continues to invest its capital wisely.

James Hardie is an international building materials company and a global leader in fibre cement, one of the world's fastest growing building products. Fibre cement is used in the exterior and interior of buildings, from exterior cladding and internal lining, to fencing, bracing and decorative finishes. James Hardie's annual revenue is approximately $A1.5 billion from operations that span Australia, New Zealand, the Philippines and the United States.

The overweight position in James Hardie reflected the view that the stock had been oversold on concerns about the currency impact on its earnings and the continued doldrums of the US housing market. The managers believed it was a fundamentally sound business that was selling at an attractive price.

international shares

The MSCI World ex-Australia hedged index was up 26.7% in 2009 including 5.4% in the December quarter. A surging Australian Dollar impacted on the unhedged return over the year. The unhedged index returned 2.1% for the quarter and -0.3% in 2009. For diversification and risk management, ipac has a 50:50 combination of hedged and unhedged international equity exposures in diversified portfolios.

ipac's international shares managers collectively added value for the December quarter and the 2009 year

ipac's international shares managers collectively outperformed for the quarter and the year. Diversification of manager approaches was beneficial over both periods. At the sector level, overweights to the outperforming Information Technology and Consumer Discretionary sectors helped performance.

In the December quarter, the growth managers, Alliance Growth and GMO, benefited from a market that suited this style of investing. Arrowstreet's quantitative process and the mathematical approach of Enhanced Information Technologies also added value. While the December quarter did not suit the deep value style of LSV, this manager had a strong year overall adding 4% above the index. Bernstein Value also performed solidly in 2009.

The rally since the March low was characterised by relief that companies that were under pressure had survived the GFC. In the December quarter, there was a greater focus on corporate fundamentals as investors made judgements on the companies better placed for the future. This focus on fundamentals played to the **research strengths of ipac's managers**.

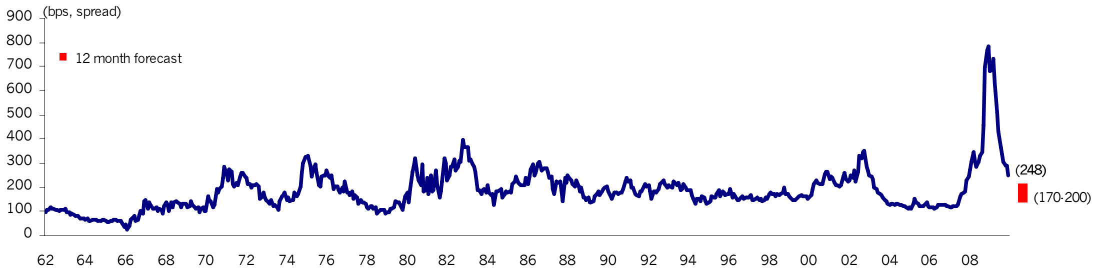
A good example of this key theme was the performance of the Nissan Motor Company, an overweight holding in the international shares portfolio.

The sector was well positioned to benefit when the market began to focus on corporate fundamentals in the December quarter

Nissan Motor Company is headquartered in Japan and listed on the Nikkei. The share price collapsed when the automotive industry was under pressure at the height of the GFC. The share price fell to $US5.59 in February last year. The share price surged from March to September as the market decided that car markers would survive. In the December quarter, the market began to sort the wheat from the chaff. At the start of January 2010, the share price hit its 52 week high of $US17.95.

Nissan will make a loss of $40 billion Yen for the year ending March 2010 impacted by the GFC on its debt funding and sales. There are signs that the worst is behind it. In recent earnings guidance the loss was revised down on the back of improved sales. Nissan has increased its market share in key markets. Sales in China have hit new records. Nissan upgraded its net revenue for the year to 7 trillion Yen and its operating profit to 120 billion Yen. These fundamental qualities were attractive to ipac's managers and this judgement was rewarded in 2009.

exposure to corporate bonds continued to help return



Source: ipac, Bloomberg

Exposure to corporate credit provided significant benefit in 2009 particularly for the DIS 1 and DIS 2 portfolios

The graph above shows the credit spread for US BBB rated corporate bonds relative to sovereign bonds over the very long term. ipac maintained existing positions in corporate credit when spreads blew out during the GFC. The quality of these exposures had the portfolio well placed when the market stabilised. Credit spreads remain elevated and ahead of the forecast for the next 12 months providing scope for further gains. Some credit positions have been reduced to **lock in recent gains**.

ipac's liquidity meant we could to take advantage of the credit market dislocation to invest in other opportunities that emerged during the crisis. These new exposures also **helped return in 2009**.

enhancing portfolios

The portfolios are well placed to continue recovery. We expect to benefit from the 2009 enhancements and the strategic use of active managers in key asset classes.

In 2010, we will **continue to diversify portfolios** and access new opportunities, including further staged investments in alternative assets. While ipac has an eye for new opportunities, we will maintain close scrutiny of the current managers to ensure they retain their investment edge and business strength.

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