

MLC Australian Share Growth Style Fund

September 2008 Annual Commentary

Executive Summary:

Share market conditions remain weak with the Australian share market index (the S&P/ASX300 Accumulation Index) falling by 27.1% in the year to 30 September 2008. Market conditions were particularly weak in the September quarter as investor confidence was shaken by the failure or near failure of major financial institutions in America, Europe and the UK. Expectations that the financial market crisis will adversely impact global growth, corporate earnings and resource commodity prices have also caused our market to weaken.

MLC's Australian Share Growth Style Fund was not immune from the market weakness, which was broadly based and impacted most of the market's sectors and stocks. However, the strategy's return of -26.4% for the year to 30 September was marginally better than the market's. The strategy's ownership of selected resource companies detracted from returns as expectations of global recession and commodity price weakness have grown. However, their adverse return impact was cushioned by ownership of companies such as Navitas, Queensland Gas Company and Woolworths.

Late in June 2008, the Fund's manager strategy was adjusted from three to two via the termination of Concord Capital. While MLC retains a high conviction in Concord, reducing the number of managers to two (JF Capital Partners and Wallara) is expected to accentuate and help maintain the Fund's pronounced style characteristics. The remaining two managers have pronounced style characteristics while still providing diversification of insight.

Objective

Your fund aims to provide long-term growth from an actively managed portfolio of Australian shares with a bias towards a growth style of investing.

The table below details how your fund performed up to 30 September 2008:

FUND NAME	1 yr (%)	2 yrs (% pa)	3 yrs (% pa)	5 yrs (% pa)	7 yrs (% pa)	10 yrs (% pa)
MLC MasterKey Superannuation – Australian Share Growth Style Fund [^]	-23.1	-0.8	3.5	N/Av	N/Av	N/Av
MLC MasterKey Super – Australian Share Growth Style Fund [^]	-23.1	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Super Fundamentals – Australian Share Growth Style Fund [^]	-22.7	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Business Super – Australian Share Growth Style Fund [^]	-23.1	-0.8	3.5	N/Av	N/Av	N/Av
MLC MasterKey Allocated Pension – Australian Share Growth Style Fund [*]	-27.2	-2.4	2.8	N/Av	N/Av	N/Av
MLC MasterKey Term Allocated Pension – Australian Share Growth Style Fund [^]	-27.2	-2.4	2.8	N/Av	N/Av	N/Av
MLC MasterKey Pension – Australian Share Growth Style Fund [^]	-27.1	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Pension Fundamentals – Australian Share Growth Style Fund [^]	-26.6	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Unit Trust – Australian Share Growth Style Fund (including MLC MasterKey Investment Service) [*]	-27.7	-2.8	2.2	N/Av	N/Av	N/Av
MLC Wholesale – Australian Share Growth Style Fund (including MLC MasterKey Investment Service Fundamentals) [*]	-26.9	-1.8	2.9	N/Av	N/Av	N/Av

N/Av: Returns for this period are not available, because the fund has not existed for this period of time.

[^]Returns are after management fees and taxes

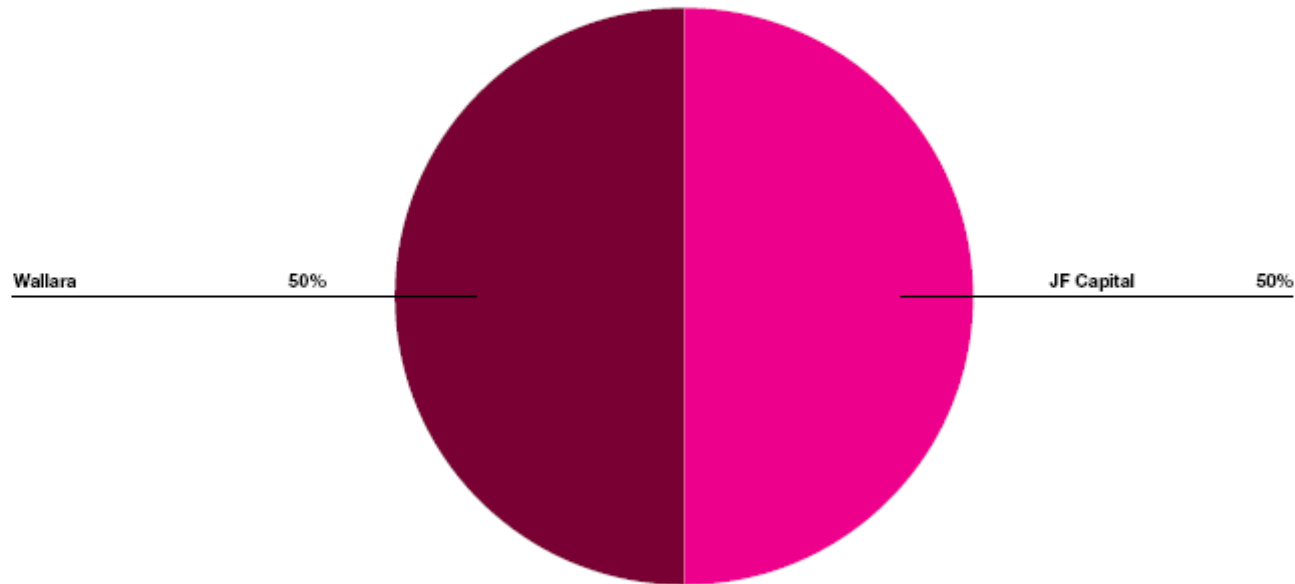
^{*}Returns are after management fees and before tax



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Your fund is invested across 2 managers, with different but complementary growth styles of investment. The diagram below shows the strategic manager allocation of your Australian Share Growth Style Fund.

MLC Australian Share Growth Style Fund¹



¹ Strategic manager weights as at 30 September 2008

MLC Australian Share Growth Style Fund

Market Commentary

Over the year to September, Australian Real Estate Investment Trusts (A-REITs) have been the worst performing of the major asset classes (-42%) followed by Australian shares (-27%) hedged global REITs (-22%) and unhedged global shares (-17%). REITs, traditionally a defensive asset class, have been plagued by concerns over excessive debt levels in the sector and concerns over the level of risk inherent in some of those vehicles. In contrast, truly defensive assets, such as Australian bonds (+8%), cash (+8%) and global bonds (+7%) posted solid returns.

Throughout the past year or so, investors became increasingly concerned about the possible impact of the US sub-prime mortgage crisis on the US and global economies, and about the health of financial institutions. The uncertainty over just who has exposure to sub-prime loans and in what size has made it harder for even high quality institutions to obtain funds from the money markets. All of this unsettled global share markets, and the Australian share market was not immune. What we now face is much more than just a US sub-prime mortgage crisis, or a US housing crisis – this is a global financial crisis.

During September, the crisis in the US financial system came to something of a head. Institutions such as the investment banks Merrill Lynch and Lehman Brothers, the world's largest insurer AIG, and key US mortgage lenders Fannie Mae and Freddie Mac have been taken over, nationalised, or sent into bankruptcy. Institutions in the UK and Europe have faced similar difficulties. In response, a package of measures was (eventually) steered through the US Congress that would allow the US Treasury to acquire distressed assets from financial institutions, and hopefully free up the supply of credit, which has been severely curtailed as a result of the crisis.

More recently (since the end of the September quarter) the Reserve Bank of Australia reduced official interest rates by an aggressive 100 basis points – the first cut of that magnitude in around 16 years. The RBA's move was followed by rate cuts from the US Federal Reserve, the European Central Bank, the Bank of England, the Swiss National Bank, the Bank of Canada, and the Swedish Riksbank. In addition measures have been announced in the UK, Europe, and most recently in the US under which taxpayers will take equity stakes in banks in the latest efforts to recapitalise the financial sector.

Despite the best efforts of the US Federal Reserve and Treasury, it is now highly likely that the US economy has

fallen into recession. Elsewhere, economic indicators in Europe and Japan have also taken a turn for the worse. While there are certain to be relative winners and losers in the current environment, no economy is likely to be totally immune from the effects of what is clearly a global financial crisis.

In Australia, our economy has slowed over the course of 2008. Consumer demand in particular, has slowed significantly – in fact the volume of consumer spending fell in the June quarter for the first time in 15 years. While consumer spending and housing activity appear set to remain quite weak for a while yet, demand for Australia's key resource exports continues unabated, and there remains a massive pipeline of investment projects – largely, but not exclusively in the resources sector – that are likely to underpin Australia's economic growth. The RBA's recent rate cut, together with further rate cuts over the coming months should provide further support to consumer spending and housing activity over the coming year. At time of writing, the Australian Government's has announced that it will guarantee all Australian banks deposits for a period of three years, in a move which broadly mirrors similar moves offshore. Rather than reflecting any significant problems in the Australian banking system, the move is largely designed to put Australian banks on an equal footing with their global counterparts as they compete for funding.

The fact that the economic environment continues to worsen has serious implications for both the health of the financial system and for assessments of value in bond and share markets. So far, efforts at repairing financial institutions' balance sheets have focused on the damage done by the downturn in the US property market. However, as growth weakens, credit issues are likely to emerge in other sectors of the economy. Corporate credit markets have sold off aggressively on fears of wider credit problems. While buying opportunities do appear to be presenting themselves in these markets, it is unclear if enough bad news has been factored into current prices.

In share markets, traditional measures of valuation suggest shares offer excellent value at current levels. However, past corporate earnings are not going to be sustained in the face of a global slowdown or recession, and consensus forecasts for corporate earnings – both here in Australia and elsewhere – look far too optimistic. Nevertheless, our investment managers are taking advantage of greatly improved value on offer, in both the Australian and global share markets.

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We have no way of knowing when the turmoil in world financial markets will come to an end, just as it is well-nigh impossible to identify when such crises are likely to start. We do know that crises of varying magnitudes and durations happen regularly, and that every crisis (financial or otherwise), every recession and every bear market comes to an end. When that happens, share markets not only recover lost ground, but inevitably move higher. We also know that crises provide opportunities for long-term investors to acquire quality assets at beaten-down prices – opportunities that our investment managers are taking during this time.

At the end of the day, the share market is a snapshot of the businesses that comprise the economy. Over time, those businesses profit from meeting the needs of their customers, pay dividends, and reinvest in order to grow. Share markets mostly reflect that reality. Extended periods where share markets fail to deliver are rare, but they have happened. Consequently, not everybody can or should have all their eggs in the basket labelled 'shares'.

Our best defence against not knowing the unknowable is to diversify our investments as widely as possible, take enough risk in our portfolios to enable us to meet our clients' return objectives and to, as much as possible, fully understand the risks attached to every investment we make.

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Strategy Commentary

After recording its first negative financial year return since 2002-03, the Australian share market weakened further in the September quarter. In an environment of considerable upheaval in global financial markets and uncertainty, it is perhaps not surprising that the Australian market (as measured by the S&P ASX300 Accumulation Index) fell by 10.7% in the September quarter. This was similar in magnitude to the falls recorded by other major markets though it was by no means as bad as some Asian markets which recorded larger falls. For the year to 30 September, the Australian share market has fallen by 27.1%.

It is worth remembering that long term investors in Australian shares still have positive double digit returns to show for their investment discipline, despite the negative return in the last twelve months. The Australian share market in the five years to 30 September 2008 has increased by 12.3% per annum.

The causes of the market's weakness have already been well documented. Initially an adverse reaction to the US sub-prime mortgage crisis, market participants have become increasingly nervous about the fluidity of the global credit market. These concerns were realized in the September quarter when US mortgage lenders Fannie Mae and Freddie Mac were rescued by the US government and many of America's major investment banks either failed (Lehman Brothers) or needed rescuing (e.g. Merrill Lynch effectively sold itself to bank of America). Similar rescues were needed in the UK and Europe with Lloyds TSB buying Britain's largest mortgage lender, HBOS, and the British Government nationalizing mortgage lender Bradford and Bingley.

Predictably, these events have undermined confidence in the global financial system. The US Government's US\$700 billion rescue package failed to kick-start markets. Now markets are becoming increasingly concerned about the impact of the credit market upheaval on the real economy. Expectations of a global economic recession have grown and there are associated concerns about the outlook for corporate profits.

The market weakness was widespread. With the exception of the Energy sector, all sector indices recorded negative one year variations.

The sector hit hardest in the year was Real Estate Investment Trusts. The impact of tight credit markets and the associated challenges faced by some of the trusts to refinance short-term debt commitments caused the sector to fall by 40%.

This was closely followed by Consumer Discretionary which has fallen by 40% due to deteriorating retail sales and consumer sentiment. Stocks such as Harvey Norman (-48%) and Fairfax Media (-44%) were weak. In contrast, the Consumer Staples sector fell by a relatively modest 11.6% as stocks such as Woolworths (-8%) were treated less harshly because of their lower exposure to consumer's discretionary spending.

Other sectors that performed relatively well were those that aren't tied to the financial or economic cycle. For instance, the Healthcare Index fell by only 2.1% (CSL +4%, Resmed +10%) while Information Technology was down by 1.2% (Computershare +0.1%).

Resource stocks have weakened as expectations of global economic recession have increased. BHP Billiton fell by 30% in the year while its takeover target Rio Tinto was down by 21%. Gold stocks delivered mixed results. Lihir Gold fell by 29% but Newcrest Mining was down by only 1%. In contrast, the Energy index was up by 5.2%. Santos was one of the few stocks to increase in value over the year (+27%) and Woodside Petroleum managed to record a marginally positive 2.0% share price variation for the year despite a falling oil price late in the quarter.

Financials ex LPTs (-30.8%) was another sector in the spotlight. Clearly, a more stringent regulatory regime and subsequent strength in Australian banks' capital positions has so far helped Australia avoid the extraordinary events we have recently seen in the US, UK and European financials sectors. Nonetheless, bank share price performances have been weak. ANZ (-37%) and National Australia Bank (-39%) were marked down more than Westpac (-25%) and Commonwealth Bank (24%) due, in part, to their greater offshore exposure.

The return of the MLC Australian Share Growth Style Fund in the year ended 30 September 2008 was -26.4%. While negative in an absolute sense, the Fund return was marginally better than market.

The strategy's continued exposure to resource companies was less positive from a returns perspective compared to recent quarters. The strategy remains strongly overweight Rio Tinto, which fell by 22% - a negative return but not as bad as the market's. However, other resource based companies tended to detract from returns versus market. For example, Sino Gold Mining (a company exploring for and producing gold in China) fell 43% and Independence Group NL was down by 59%.

However, some stock holdings did perform well versus index including Woolworths (-8%), AGL Energy (-14%) and Sonic Healthcare (-16%) while Queensland Gas

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Company (+53%) and Navitas recorded positive absolute returns.

The composition of the Fund's manager strategy is designed to achieve a portfolio of Australian shares with a specific and pronounced 'growth' style bias. To ensure the Fund maintains its pronounced and stable style characteristics through time, MLC adjusted the composition of the manager panel in the June quarter. Concord Capital, who previously managed 30% of the Fund's assets, had their mandate withdrawn leaving JF Capital Partners and Wallara Asset Management to manage 50% each of the Fund assets. These managers

have pronounced style characteristics while still providing diversification of insight.

Note: Please refer to the appendix for manager return tables.

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APPENDIX

Australian Share Growth Style

MANAGER	1 yr (%)	2 yrs (% pa)	3 yrs (% pa)	5 yrs (% pa)	7 yrs (% pa)	10 yrs (% pa)
JF Capital Partners	-26.2	-1.2	4.4	14.9	N/Ap	N/Ap
Wallara Asset Management	-27.0	-2.1	3.2	12.5	N/Ap	N/Ap
MLC Australian Share Growth Strategy	-26.4	-1.1	4.1	13.0	N/Ap	N/Ap
S&P/ASX 300 Accumulation Index	-27.1	-1.6	3.9	12.3	10.6	10.2

Notes to table:

The performance reported in the above tables is before fees and taxes

N/Ap: Returns for this manager are not applicable, because the manager was not appointed to the fund for this period of time.

Disclaimer:

Please note that all figures reported in this fund commentary are before management fees and taxes, unless otherwise mentioned.

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