

## MLC – Capital International Global Share Fund June 2008 Quarterly Commentary

The MLC Capital International Global Share Fund aims to provide long term growth from an actively managed share portfolio selected from share markets around the world.

The table below details how your portfolio performed up to 30 June 2008:

FUND NAME	1 yr (%)	2 yrs (% pa)	3 yrs (% pa)	5 yrs (% pa)	7 yrs (% pa)	10 yrs (% pa)
MLC MasterKey Superannuation – Capital International Global Share Fund^	-16.7	-6.5	1.3	2.9	-3.7	N/Av
MLC MasterKey Superannuation (Five Star) – Capital International Global Share Fund^	-17.1	-7.0	0.8	2.4	-4.2	N/Av
MLC MasterKey Super – Capital International Global Share Fund^	-16.9	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Super Fundamentals – Capital International Global Share Fund^	-16.4	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Business Super– Capital International Global Share Fund^	-16.7	-6.5	1.3	2.9	-3.7	N/Av
MLC MasterKey Allocated Pension –Capital International Global Share Fund^	-19.2	-7.8	0.9	2.9	-4.2	N/Av
MLC MasterKey Allocated Pension (Five Star) – Capital International Global Share Fund^	-19.7	-8.4	0.3	2.2	-4.9	N/Av
MLC MasterKey Term Allocated Pension – Capital International Global Share Fund^	-19.2	-7.6	0.9	2.9	-4.2	N/Av
MLC MasterKey Pension – Capital International Global Share Fund^	N/Av	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Pension Fundamentals – Capital International Global Share Fund^	N/Av	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Unit Trust – Capital International Global Share Fund (including MLC MasterKey Investment Service)*	-19.3	-7.9	0.9	2.9	-4.4	N/Av
MLC Wholesale – Capital International Global Share Fund*	-18.2	-6.8	2.1	4.1	-3.2	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

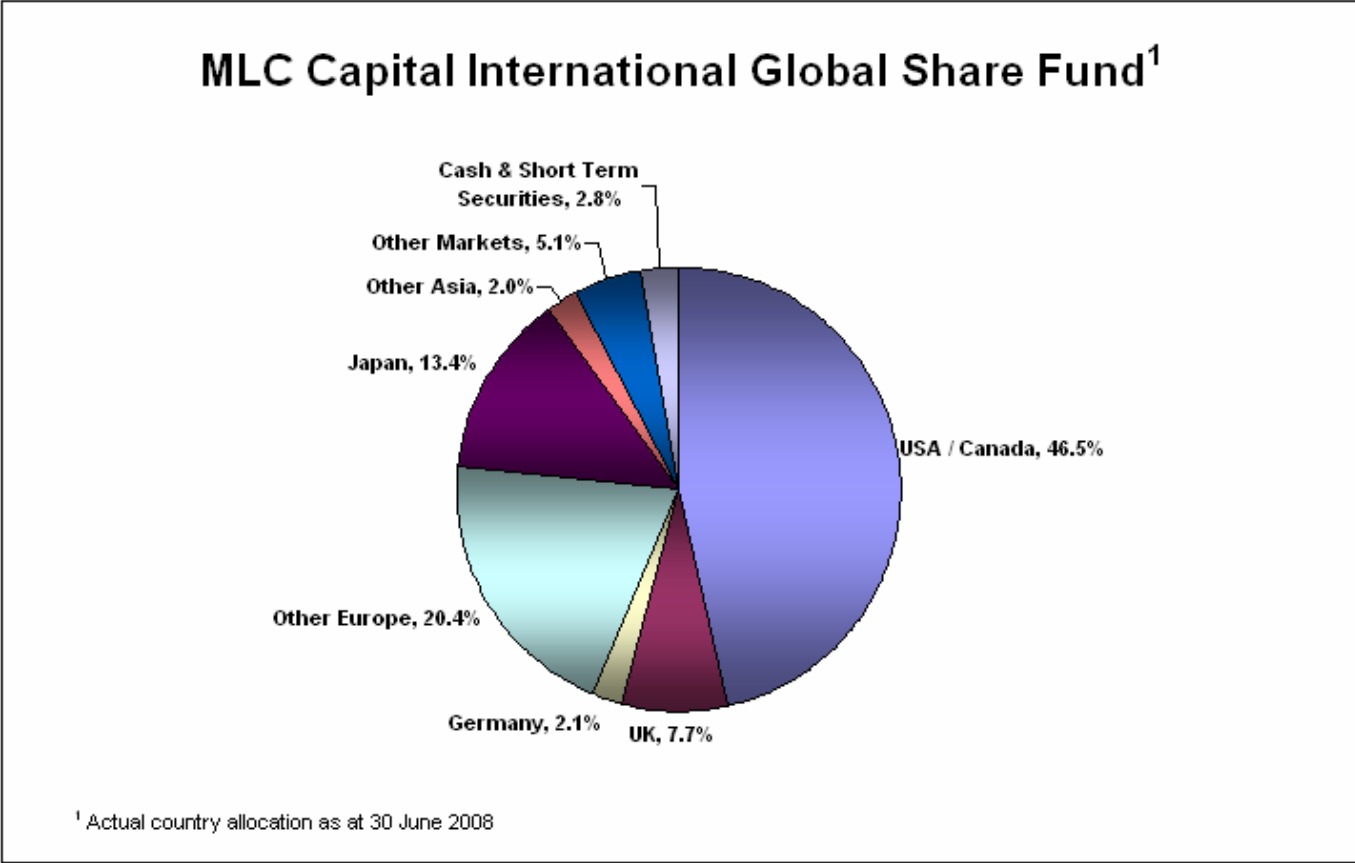
\* Returns are after management fees



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The diagram below shows the actual country allocation of your Capital International Global Share Fund.



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The table shows the performance of each of Capital International and the MSCI World Index:

MANAGER	Quarter (%)	1 yr (%)	2 yrs (% pa)	3 yrs (% pa)	5 yrs (% pa)	7 yrs (% pa)	10 yrs (% pa)
Capital International – Global Strategy	-4.7	-17.7	-6.0	3.3	5.4	-2.5	N/Av
MSCI World Index \$AUD	-6.2	-20.6	-7.1	1.4	4.8	-3.2	0.2

N/Av: Returns are not available because the fund did not exist during this period of time.

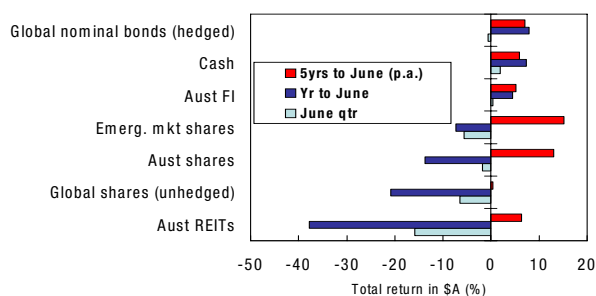
NB. The performance reported in the above table is before fees and taxes.

### Market Commentary

#### Major asset class performance

The chart below shows the performance of the major asset classes over the June quarter and the year ending 30 June 2008.

#### A year to forget for local share investors, after several years of amazing returns

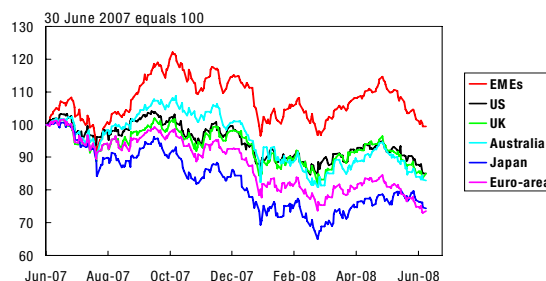


Overall returns for diversified funds were negative for the quarter and sharply negative over the year to June. While it has clearly been a disappointing year for investors, it is important to bear in mind that this result follows four consecutive financial years of double-digit returns.

World share markets have remained under considerable selling pressure. On several occasions during the year, share markets attempted a recovery, most recently following the bail-out of investment bank Bear Sterns, engineered by the US Federal Reserve. However, concerns over the outlook for the world economy and the

health of the financial sector soon re-emerged.

#### World share prices since the end of June 2007



Real Estate Investment Trusts (REITs) were the worst performing asset class for both the June quarter and the year. Global bond markets benefited from a series of official rate cuts from the US Federal Reserve, as well as an environment of heightened risk-aversion, where government bonds were one of the sought after safe havens, along with gold and other commodities. In contrast, corporate bonds, particularly high yield debt securities performed poorly over the year on concerns that a deteriorating world economy would adversely impact credit quality. Over the June quarter however, these securities staged something of a recovery – spreads over US Treasuries narrowed somewhat from their recent peaks seen in March, but we are nevertheless still seeing spreads close to their widest in five years.

The Australian Government bond market ran against this global trend, with yields rising over the past year. The Reserve Bank of Australia raised official interest rates on four occasions. Domestic spending growth had been running at an unsustainably rapid pace at a time when key underlying inflation measures have exceeded the RBA's target range. Official cash rates in Australia now stand at 7.25%, their highest level in over ten years.



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### So what caused sharemarkets to drop?

The falls seen in July and August 2007 were the result of the sub-prime mortgage crisis in the United States. The root cause lay in some of the riskier securities traded in US fixed income markets. Mortgage-backed securities, based on residential mortgages, have been around for a long time. However, over the last few years, home lenders have been increasingly willing to lend money to 'sub-prime' borrowers, who may have either little in the way of a deposit, or reasonable credit history, or even ability to repay loans. While traditional US mortgages have tended to have fixed interest rates, many of these 'sub-prime' mortgages have been sold with variable interest rates. Increasingly, these kinds of mortgages have been packaged-up and sold to investors. When US interest rates rose, a number of these borrowers defaulted on their loans. This in turn depressed the prices of these mortgage-backed securities.

In addition to problems facing home borrowers, it is now clear that a number of investors in these securities either failed to understand, or failed to adequately price, the risk attached to them. In doing so, they were prepared to buy these securities and accept a yield that was simply way too low. In the case of some high-profile hedge funds that have gotten into difficulty, the problem has been compounded by borrowing money to invest in these securities.

Investors became increasingly concerned about the possible impact of the US housing downturn on the US and global economies. Along with this, 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.

In mid-August, Australian and some world share prices bounced back sharply. Aggressive action by the world's central banks, led by the European Central Bank and the US Federal Reserve restored some measure of calm to money markets. However, over the remainder of 2007, and for most of the March quarter 2008, it became clear that the effects of the crisis on the economy and financial markets were likely to be more prolonged than earlier thought. Conditions in US and global money markets have shown little improvement despite the Fed increasing its efforts to inject liquidity. In March, the crisis claimed perhaps its largest scalp with the collapse

of US investment bank Bear Sterns, and its subsequent Fed-assisted takeover by JP Morgan.

Following that bail-out, sentiment in financial markets improved for time, but with a few weeks, a run of soft economic data, as well as sharply higher oil and other commodity prices produced a renewed slide in share markets.

What began as a US sub-prime mortgage crisis, morphed, over the course of the year into a full-blown global financial crisis, which has, and will continue to have profound implications for the world economy and financial markets over the coming year and beyond.

### Economy

Despite the best efforts of the US Federal Reserve, it is now highly likely that the US economy has either fallen into recession, or is close to doing so. Housing indicators have generally continued to worsen. Residential building activity has now declined for nine consecutive quarters. House prices are still declining. Measures of business and consumer sentiment are either at or close to recession levels, and the unemployment rate has continued to drift higher. However, signs of weakness in consumer spending, and other categories of demand have only recently started to appear, and seem to have much further to run.

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. Sentiment survey data in Europe, the UK and Japan, as well as key leading economic indicators, have already turned down signalling the likelihood of weaker growth ahead.

Despite signs of slower growth, the European Central Bank clearly signalled towards the end of the June quarter that it remained concerned about stubbornly high Euro-area inflation, and was like to raise interest rates in the near future. Early in July, the ECB acted, raising official European interest rates by 0.25% - the first such rate increase since June 2007.

Across Asia, the more open economies of South East Asia are likely to be hardest hit by a US recession. Much of their exports are ultimately dependant on US



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consumer and business demand – a good percentage of those exports are intermediate goods and components that are funnelled via China to customers in the major economies. Chinese exports, while still growing at a double-digit annual pace, have nevertheless slowed over the recent quarters. However, we are yet to see any meaningful, broad-based slowdown in Asia's exports.

The Chinese economy is likely to be a relative winner in the current environment. While China's export growth seems likely to weaken further, domestic spending is not likely to slow dramatically, despite efforts by the Chinese authorities to tighten monetary policy settings over the past year.

Despite the prospect of further weakness in global growth, financial markets became increasingly concerned about the prospect of higher inflation. Record high oil prices – over the year to end June, the world price of oil has doubled – as well as elevated prices for a range of other key commodities were increasingly viewed as a threat to inflation – and not simply because of their impact on headline rates.

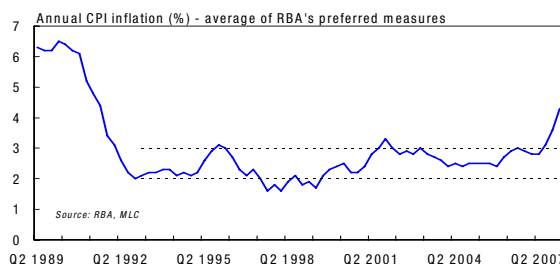
Over the past decade or more, temporary boosts to headline inflation resulting from higher oil or other commodity prices were tolerated largely because they were temporary and hence did not pose a threat to core or underlying inflation. Moreover, the major central banks of the world won plaudits for their apparent success in both slaying the inflation dragon (or at least keeping her heavily sedated) and allowing the world economy to grow at a decent pace. The stagflation of the 1970s – a period of both higher inflation and stagnant economic growth – was a topic for the history books.

Now, the threat of stagflation and what the world's central banks can do about it are the subjects of much debate. During 2008, the behaviour of financial markets seems decidedly stagflation-like: higher bond rates (albeit from very low levels) higher oil and other commodity prices, and weaker share prices.

In Australia, economic growth had, until recently, accelerated fuelled by strong growth in business investment and a resurgent consumer. Employment growth has remained very strong, and the unemployment rate declined further. These developments did little to assuage the Reserve Bank's concerns about inflationary pressures in the economy, at a time when the RBA's

preferred measures of inflation had already drifted towards the upper end of their target range. More recently, these inflation measures have moved significantly above the Bank's ceiling.

### The RBA's worst 'miss' since the start of inflation targeting



As a consequence, the RBA went against offshore trends by tightening monetary policy over the past year.

During the course of 2008, it has become increasingly clear from the economic data that a slowdown in domestic spending is underway. Consumer confidence has fallen sharply, while business surveys show that overall trading conditions, confidence, and hiring intentions have all declined. While retail sales showed a rebound in May, there has been little growth in overall retail spending since the end of 2007. While the RBA still has a slight bias to tighten further, a deteriorating global and domestic environment, as well as the fact that Australian interest rates are already at reasonably high levels (at least by the standards of the past decade) should keep the Bank on hold for the remainder of this year. At this point, there is a real risk of a more pronounced slowing in the economy; one that would require the Bank to ease monetary policy over the coming year.

*(All returns are quoted in Australian Dollars)*

### Portfolio Commentary

Continued tightening of credit markets were a drag on most developed markets. Weak outlooks and soaring agricultural, food and fuel prices further drove US recessionary concerns which only encouraged negative sentiment across markets globally and in some instances saw the emergence of stagflation concerns. The AUD gained ground once again during the quarter, fluctuating between 90 and 96 US cents, before closing out the



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quarter up around 6% at a little below 96 US cents. Over the same period the MSCI World Index was down 6.2%. Against this backdrop the Capital International closed down 4.7%, outperforming the index by approximately 150 basis points. The key driver of this outperformance was strong stock selection and overweight exposure to the Materials sector, in particular in Canada, as well as positive stock selection in the United States and underweight exposure to Financials. On the negative side, stock selection in Utilities, Industrials and Japan hampered results somewhat.

### Major Stock Contributions

✓ What Helped	✗ What Hurt
Potash Corp	Barrick Gold
Canadian Natural	Veolia Environnement
Cleveland Cliffs	Holcim
Millenium	Genentech
Schlumberger	America Movil
Peabody Energy	United Parcel Service
Fluor	BAE Systems
Weatherford	Target

### Materials

Maintaining a recent theme, the portfolio's materials holdings were again amongst the key positive drivers due to both stock selection and the overweight exposure. Particular strength was evidenced again in the Canadian holdings. Chemicals holding, Potash (Canada) returned 43% for the quarter as a result of continued wealth expansion in China and speculation that climbing prices for corn will lead to higher demand and prices for crop nutrient. Meanwhile, Monsanto (US) was up 8%. Yara International (Norway) continued to produce strong performance closing out the quarter up 47%. Metals and Mining holdings provided solid gains over the same period with Cleveland-Cliffs (US) returning a remarkable 89% whilst BHP Billiton (UK) was up 22%.

### Energy

Energy was the strongest sector this quarter. Performance was driven by growth in both the Energy Equipment & Services and Oil & Gas industries which gained 20% and 12% over the quarter respectively. Within the portfolio strong stock selection, again in Canada and North America further added to returns with names such as Canadian Natural Resources gaining 36%, Schlumberger (US) up 18%, and Peabody Energy

(US) up a massive 64% over the quarter. Weatherford International (US) was another significant contributor to portfolio outperformance with a return of 30%. Norwegian oil services company Seadrill, which provides offshore rigs, rose a further 10% reflecting continued rising day rates for rig hire.

### Information Technology

Overall, stock selection in Information Technology contributed positively to performance once again this quarter. Although there was some softness in the performance of communications equipment holding Cisco (US) which was down 8% for the quarter, there were also some significant outperformers. Electronic equipment and instruments producer Jabil Circuit (US) provided tremendous gains of 66% after exceeding analysts' earnings estimates and outlining programs to drive accelerating revenue growth, whilst Internet company Google (US) also put in a solid performance, up 14%. Japanese software and gaming company Nintendo was up 5% whilst Agilent Technologies (US) and Apple (US) were up 13% and 11% respectively.

### Industrials

Key holdings which detracted from performance included General Electric (US), down 31%, United Parcel Service (US), down 19% and UK Aerospace holding BAE Systems off 12%. Sharing the negative sentiment within the Aerospace and Defence industry was US giant Boeing, dropping 16% amidst company announcements of further delays in production and delivery of the 787 Dreamliner of over 27 months. France's Schneider Electric fell 18% for the quarter.

### Japan

Japan saw weak returns over the quarter. The market lagged on investor concerns about continued weak domestic demand. Within the portfolio, Japanese banks, diversified financials and Telecomms were notably weak, along with information technology stocks. On the banking and financials front, Mizuho and Nomura were down 18% and 5% respectively. Wireless telecomm Softbank was down -12%. Information Technology holdings Yahoo Japan was down 23% whilst Tokyo Electronic and Murata both fell 10%.



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### **Disclaimer:**

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

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