

MLC IncomeBuilder™

September 2008 Annual Commentary

Executive Summary:

Share market conditions remain weak with the S&P/ASX300 Accumulation Index falling by 27.1% in the year to 30 September 2008. The S&P/ASX200 All Industrials Accumulation Index performed slightly worse, falling by 28.2%. 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 and corporate earnings have also caused our market to weaken.

MLC IncomeBuilder was not immune from the market weakness, which was broadly based and impacted most of the market's sectors and stocks. However, the Fund's return of -25.3% for the year to 30 September was (whilst negative) not as severe as the market's. This margin of outperformance was due to Maple-Brown Abbott's stock selection which has favoured companies with balance sheet strength and who have reasonable earnings and dividend growth potential in what is clearly going to be a more difficult domestic and global economic environment in the foreseeable future.

MLC IncomeBuilder's 2008-09 distribution year has commenced with the declaration of a 1.91 cents per unit distribution for the August quarter. This compares favourably with the 1.42 cents per unit distribution in the previous year's first quarter.

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Objective

MLC IncomeBuilder™ aims to deliver a growing tax advantaged income stream from a portfolio with a focus on Australian industrial shares that have the potential to provide future growth in dividends.

The table below details how your portfolio 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 – IncomeBuilder™ ^	-24.3	-5.4	0.4	7.4	6.3	7.1
MLC MasterKey Superannuation (Five Star) – IncomeBuilder™ ^	-24.7	-5.9	0.0	6.9	5.8	6.6
MLC MasterKey Super – IncomeBuilder™ ^	-24.5	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Super Fundamentals – IncomeBuilder™ ^	-24.1	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Business Super – IncomeBuilder™ ^	-24.3	-5.4	0.4	7.4	6.3	7.1
MLC MasterKey Allocated Pension – IncomeBuilder™ ^	-25.7	-5.6	0.7	8.4	7.2	7.9
MLC MasterKey Allocated Pension (Five Star) – IncomeBuilder™ ^	-26.2	-6.2	0.1	7.7	6.5	7.2
MLC MasterKey Term Allocated Pension – IncomeBuilder™ ^	-25.7	-5.6	0.7	8.4	7.2	7.9
MLC MasterKey Pension – IncomeBuilder™ ^	-26.0	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Pension Fundamentals – IncomeBuilder™ ^	-25.6	N/Av	N/Av	N/Av	N/Av	N/Av
MLC MasterKey Unit Trust – IncomeBuilder™ *	-26.7	-6.8	-0.5	7.1	6.0	7.3
MLC Wholesale – IncomeBuilder™ (including MLC MasterKey Investment Service Fundamentals) *	-25.9	-5.9	0.4	8.1	6.9	8.2

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

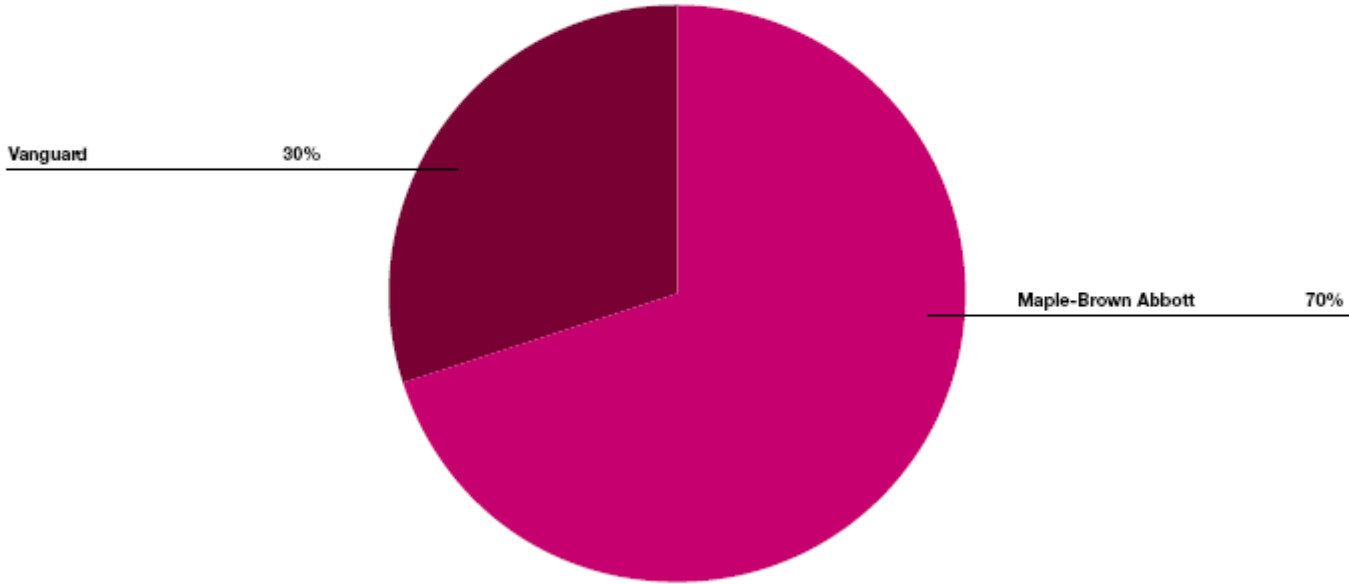
^Returns are after management fees and taxes

*Returns are after management fees and before tax

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Your fund is invested across a portfolio of Australian shares. The diagram below shows the investment manager allocation of your MLC IncomeBuilder™ Fund.

IncomeBuilder™¹



¹ Strategic manager weights as at 30 September 2008

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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.

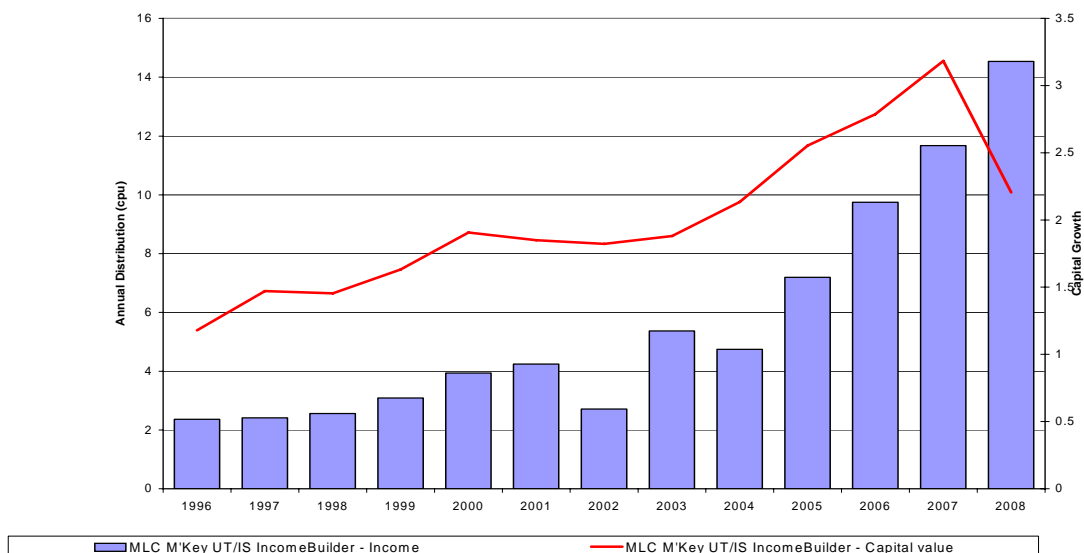
At the end of the day, the share market is a snapshot of the businesses that comprise the economy. Over time, those businesses profit from meeting the needs of their customers, pay dividends, and reinvest in order to grow. Share markets mostly reflect that reality. Extended periods where share markets 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

The below graph* shows the annual income for MLC MasterKey Unit Trust/Investment Service IncomeBuilder and growth in value since inception in 1995.



*Year to 30 September 2008

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 was as weak as it was. For the year to 30 September, the Australian share market has fallen by 27.1%. The S&P/ASX200 All Industrials Accumulation Index was slightly weaker, falling by 28.2%.

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 acquired by the US government and a number 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 initially 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%).

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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 where failures or near failures were frighteningly common. 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.

What have MLC IncomeBuilder's appointed managers been doing in this market environment?

Maple-Brown Abbott determines stock selection for 70% of the IncomeBuilder portfolio. Stock selection is a full-time responsibility which Maple-Brown Abbott fulfills in all market conditions. At the risk of oversimplifying, while market conditions have clearly been challenging, it really is business as usual for them (as it is for all our managers).

In the current environment, this entails:

- using the market volatility and weakness to acquire stock in companies that have attractive long-term prospects and return potential; and,
- reviewing portfolio strategies and stock selection and, where necessary, implementing portfolio adjustments that they believe are prudent and appropriate.

Maple-Brown Abbott has made some recent stock selection decisions to further underpin the quality of the portfolio. For example, the Brambles and Coca Cola Amatil positions have been increased because these companies have sound long term earnings and dividend growth prospects. The financial position of both companies is also considered to be strong.

Maple-Brown Abbott is also using the market weakness to acquire stock at attractive valuations. Aristocrat Leisure is an example. Maple-Brown Abbott also participated in the recent share placement by

Commonwealth Bank to fund the opportunistic acquisition of BankWest. This is a very good deal for Commonwealth Bank investors as it delivers to the bank an established retail network in Western Australia at an attractively low price and provides rationalisation opportunities from a cost perspective, which will eventually flow through to profits. An added attraction was the shares were placed at a substantial 15.8% discount to the prevailing share price.

MLC IncomeBuilder is a unique fund because its primary focus is on providing investors with a growing income stream. As the chart below shows, MLC IncomeBuilder has a very strong history of growing annual distributions. Since the Fund's inception in 1995, there has been only one year when IncomeBuilder failed to grow its underlying distribution. This is a sound result considering the many market and corporate earnings cycles that have been experienced over that period.

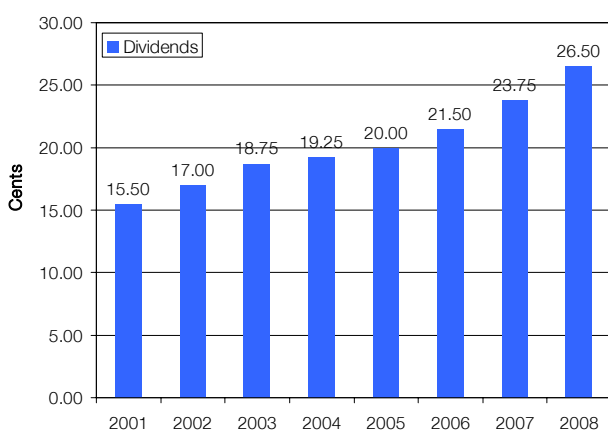
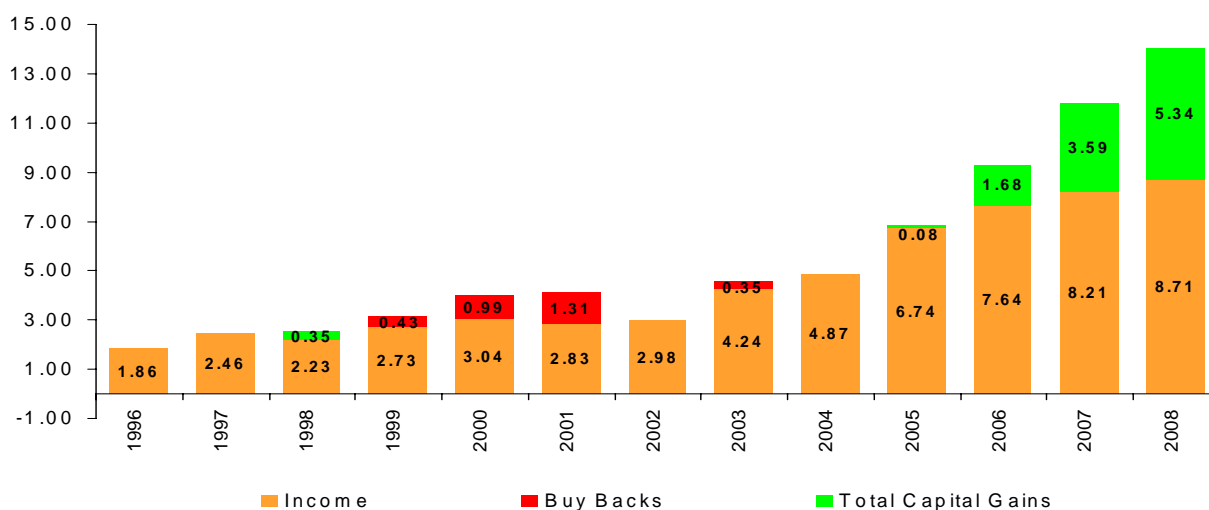
MLC IncomeBuilder's 2008-09 distribution year appears to have had a good start with the declaration of a first quarter distribution late in August of 1.91 cents per unit, which compares favourably with the 1.42 cents declared in the corresponding quarter last year.

The total return of MLC IncomeBuilder in the year ended 30 September 2008 was -25.3%. While negative in an absolute sense, the strategy return was 2.9% better than the All Industrials Index which fell by -28.2%. This margin of outperformance was due primarily to Maple-Brown Abbott's stock selection. As expected, Vanguard's return was in line with Index.

To achieve the income growth objective, MLC IncomeBuilder's stock selection tends to be biased to industrial companies (rather than resource based companies) as, over time, they have demonstrated a more consistent track record of growing dividends. This leads to a portfolio that comprises companies who have a history of growing dividends and the potential to continue growing them in the future.

An example of a typical IncomeBuilder investment is Fosters Group, a producer and marketer of alcoholic beverages in Australia and overseas. Fosters has been held in the IncomeBuilder portfolio for some time. As the accompanying diagram shows, Fosters has grown its annual dividend distributions for some years and this has contributed to IncomeBuilder's strong track-record of achieving its primary objective of growing income (Below graph - year to EOFY 08).

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In providing investors with a growing income stream, IncomeBuilder also aims to do so in a tax-advantaged manner by minimising distributable capital gains. While the strategy has a good history of providing tax advantaged income, some market events that can't be controlled by MLC's managers could result in the realisation and distribution of taxable capital gains. An example is corporate takeovers where stock must be sold and, by doing so, a capital gain may be realised. Nonetheless, the management of MLC IncomeBuilder is done with a high degree of tax awareness.

MLC has appointed two investment firms, Vanguard and Maple-Brown Abbott, to manage the IncomeBuilder strategy.

Vanguard manages 30% of the portfolio on an index basis, which delivers a portfolio that mirrors the stocks and their respective weightings within the S&P/ASX200 Industrials Index. Not surprisingly therefore, the -28.1% return by Vanguard was close to the All Industrials Index return.

The appointment of Vanguard is consistent with MLC IncomeBuilder's primary objective to grow income distributions in a tax effective manner because their index-based approach provides investors with access to the dividend income flowing from all the companies within the industrials market. Vanguard's index approach is also beneficial from a tax perspective as it typically entails very little portfolio turnover – high portfolio turnover as a result of frequent buying and selling can crystallise taxable capital gains.

Maple-Brown Abbott manages the remaining 70% of the portfolio on an "active" basis. This means that Maple-Brown Abbott restricts their stock selection to the companies that they believe are the most likely to contribute to MLC IncomeBuilder's objectives. Maple-Brown Abbott is perfectly suited to the IncomeBuilder mandate due to their investment approach which looks for attractively valued companies with dividend growth potential to be held for the long-term.

As with Vanguard, Maple-Brown Abbott's investment approach, which tends to be low turnover, is also beneficial from a tax perspective. Maple-Brown Abbott returned -24.2% in the year to 30 September 2008. Stock selection strategies that contributed to the margin of outperformance include Lion Nathan (+0.5%), Fosters Group (-15%), Coca Cola Amatil (-8%) and Telstra (-4%). Returns were enhanced by not owning Centro Properties Group, Macquarie Group (-56%) and Babcock and Brown (-608%).

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



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APPENDIX

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MANAGER	1 yr (%)	2 yrs (% pa)	3 yrs (% pa)	5 yrs (% pa)	7 yrs (% pa)	10 yrs (% pa)
Maple-Brown Abbott	-24.2	-5.0	1.3	9.1	7.9	N/Ap
Vanguard	-28.1	-5.3	1.3	9.2	7.8	N/Ap
IncomeBuilder Strategy	-25.3	-5.0	1.3	9.1	7.9	9.3
S&P/ASX 200 All Industrials	-28.2	-5.3	1.3	9.3	7.8	8.1

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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