

Generally, the Australian Ethical trusts held up well in what were highly turbulent global financial markets in the half-year ending December 2007. All the Australian Ethical trusts outperformed their respective benchmarks over the six months. The volatility in the global markets over the past six months was triggered by a crisis in credit markets (so-called sub-prime debt), weak economic data from the United States and subsequent fears of a possible recession in the United States.

## Australian Ethical Balanced Trust

The Balanced Trust has investments across domestic and international stocks, property and debt securities. The Trust returned 1.2% over the period, ahead of an index of its peer group (the Morningstar Peer Group Retail Investment Trusts Multisector – Balanced Index) which rose by 0.3%. The Trust generally invests its domestic equity portfolio in quality high-yield stocks, but even these were not immune to the downturn on the Australian share market. However, investments in other asset classes offset the weaker domestic share returns during the period.

The Balanced Trust remains among the best in the Multisector Balanced fund category over a long-term horizon of five to ten years. The Trust has achieved this long-term performance with a risk profile that is low relative to much of its peer group.

### New investments

#### Domestic

The Trust invested in the Prime Retirement & Aged Care Property Trust, which owns retirement villages and aged care assets. The Trust did not invest in any new debt issuer during the period.

#### International

The Trust increased its crossholding in the Australian Ethical International Equities Trust (wholesale), which is considered the most efficient mechanism for it to access a well-diversified 'green' international equities exposure.

### Top performers

- Danish wind turbine manufacturer Vestas Wind Systems (+51.6%)
- Australian medical devices company Resmed (+23.2%)
- United States based metering company Itron (+23.1%)

- Australian hearing implant manufacturer Cochlear (+22.8%)
- United States based natural food distributor United Natural Foods (+19.3%)

## Australian Ethical Equities Trust

Over the six-month period, the Equities Trust held steady with a return of -0.1%, outperforming its benchmark S&P/ASX Small Industrials Index, which fell heavily (-6.8%). The Trust's performance can be attributed to a well-diversified portfolio and a focus on quality small-cap stocks which were less affected by the global fears. The Trust's portfolio shift towards international stocks and away from domestic stocks over the half year also helped returns hold up relatively during a period where small companies in the Australian market fell more than world indices.

### New investments

#### Domestic

- Pulse Health, which provides hospital, home care, nursing, aged care and disability support services
- A coal seam, methane and conventional gas explorer Metgasco
- Savcor Group, which operates an industrial technology business that specialises in surface coating and surface protection technologies in various technology sectors.

#### International

- Spanish wind power company Iberdrola Renovables, which also operates in the United States, the United Kingdom and parts of Europe
- Singapore-based waste water management company Hyflux

(...continued on the next page)

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- United States-based information technology services provider Citrix Systems.

## Top performers

- Australian software solutions provider Hansen Technologies (+57.9%)
- Danish wind turbine manufacturer Vestas Wind Systems (+51.6%)
- United Kingdom-based socially responsible fund manager Impax Group (+46.5%)
- Australian risk management solutions provider Green Cap (+35.0%)
- Australian Internet protocol communication services provider Intrapower (+25.0%).

## Australian Ethical Large Companies Share Trust

The Large Companies Share Trust returned 1.1% over the half-year outperforming the -0.7% of its benchmark S&P/ASX 200 Industrials – which monitors the performance of the largest 200 companies listed on the Australian Securities Exchange, excluding mining stocks. This index is used since the Australian Ethical Charter tends to exclude most mining stocks either on the basis of environmental damage, waste of non-recurring resources, and/or contribution to the generation of pollution. Over the period of six months, the Trust was positioned for a downturn in the Australian market through an increase in international exposure by about 3.0%, a reduction in domestic equities exposure by about 5.0% and a defensive accumulation of cash. The Trust operates a well-diversified portfolio holding domestic and international equities with a minimum market capitalisation (a measure of company size) of A\$1 billion (or equivalent in foreign currency).

## New investments

### Domestic

There were no new investments in this category during the period as the Trust increased its holdings in its existing international portfolio to achieve greater diversification and better access to companies offering strong social and environmental positives.

### International

- United States-based LKQ Corporation, which sells recycled automobile parts to various mechanical repair shops, insurance and extended warranty companies
- French green electricity provider EDF Energies Nouvelles, which produces electricity through wind power, hydro power, solar power and biomass
- Italian hearing aid manufacturer Amplifon, which operates throughout Europe.

## Top performers

- United Kingdom-based public transport company Stage Coach Group (+56.0%)
- Hong Kong-based public transport company MTR Corporation (+55.0%)
- Danish wind turbine manufacturer Vestas Wind Systems (+51.6%)
- United States-based geothermal power company Ormat Technologies (+46.0%)
- Japanese correspondence education provider Benesse Corporation (+33.6%).

## Australian Ethical World Trust

(inception date: 2 August 2007)

The World Trust began operating in August 2007 and returned about 0.4% since inception, slightly better than the MSCI World Index which returned about 0.2% over the period of five months to 31 December 2007. The Trust directly invests in the Australian Ethical International Equities Trust (wholesale), which makes the actual investments and holds shares in highly ethical companies involved in renewable energy, recycling, public transport, bicycle manufacturing, water management, healthcare and other socially responsible areas.

Some companies that the wholesale Australian Ethical International Equities Trust invests in are:

- Getinge (Sweden) – develops, manufactures and sells equipment and systems for sterilisation and disinfection. The company markets to the pharmaceuticals industry, hospitals, dental clinics and laboratories. The company manufactures in the United Kingdom, France, the United States and Australia
- Q-Cells (Germany) – has its core business in the development, production and sale of mono and polycrystalline silicon-based solar cells
- Impax Group (United Kingdom) – an investment management and financial advisory business focused on the environmental markets sector
- Osaka Gas (Japan) – processes and supplies natural gas in the Kansai region. The company also provides gas and energy products for residential, commercial, and industrial customers. Osaka Gas also constructs and maintains gas supply lines and sells gas appliances.

## Top performers

(over five months to 31 December 2007)

- United Kingdom-based public transport company Stage Coach Group (+56.0%)
- Hong Kong-based public transport company MTR Corporation (+55.0%)

- Danish wind turbine manufacturer Vestas Wind Systems (+51.6%)
- United States-based geothermal power company Ormat Technologies (+46.0%)
- Japanese correspondence education provider Benesse Corporation (+33.6%).

## Australian Ethical Income Trust

The Income Trust returned 2.5% over the half-year – a very stable performance considering the volatile state of the markets. This is consistent with the low standard deviation of returns (the main measure of fund risk used in the finance industry) this fund has now exhibited for the past seven years – one of the lowest standard deviations of all managed funds in the country.

Australian Ethical aims to manage the Trust so as to achieve returns reflecting current interest rate levels with very low volatility. The majority of the Trust's investments are in short-term high-quality AAA rated securities or senior debt of Australia's regional banks. Despite the low-risk (volatility) profile, the Trust's returns remain fully comparable (top quartile for most published time periods) with other funds in the Morningstar Australian Bonds category.

### Since December 2007

Investors will be aware that January 2008 has seen the worst falls on world stock markets in many years. And since November 2007 the Australian stock market has had its worst run in over a quarter of a century. Naturally, all the Australian Ethical trusts which hold equities are being affected, and investors will have noticed the impact on unit prices.

A key message, which cannot be emphasised enough, is that equities investing is for the long term and investors should avoid being spooked by a period of market falls. Stock markets go up and, for periods, they can also go down substantially. Historically, over long enough timeframes, the share market has yielded good returns, but with periods of short-term loss. The graph below shows movements in the Dow Jones index over the last 27 years.

The lesson from history is that investors who have not let short-term pain panic them out of the market have generally ended up doing well.

As an example, the last significant market dislocation was in early 2002 – the Australian market fell about 15%. Australian Ethical investors who stuck with their investments ended up with the following returns over the next five years:

	Balanced Trust (%)	Equities Trust (%)	Large Companies Share Trust (%)
2002–03	7.0	4.8	3.8
2003–04	13.0	14.3	20.6
2004–05	15.0	19.7	23.8
2005–06	9.5	14.2	16.0
2006–07	10.6	36.9	16.0

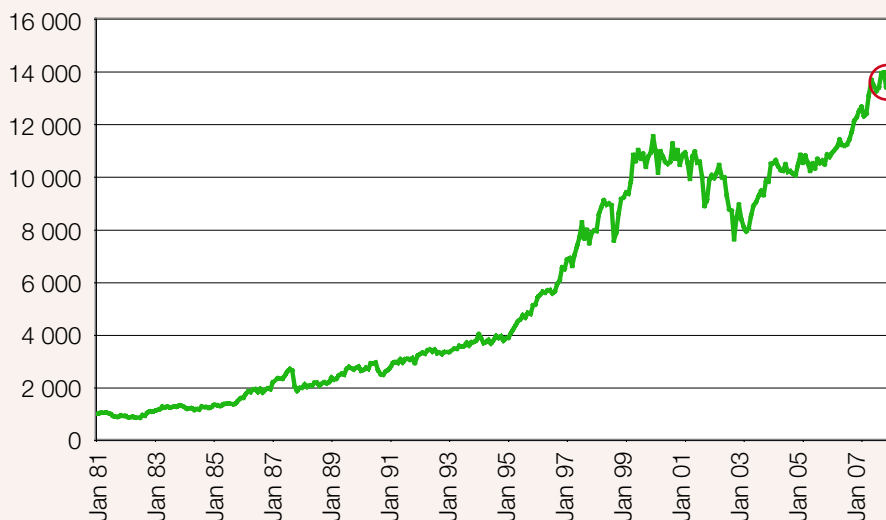
In last April's *Aim High* newsletter, I said the following:

'...we have been experiencing what has been one of the longest and strongest bull runs in the history of the share market. I think it is now four years in a row of double-digit rises and I am guessing that most people are happy with their returns over that period. But I worry that after a long period like that people start to assume that the run will go on forever and that investing in equities portfolios like the Equities Trust and the Large Companies Trust doesn't involve risk. It does. Sooner or later we will run into a downturn. So I want to emphasise that investing is a long-term endeavour and that people should be prepared for ups and downs over the life of an investment.'

I was worried that people might get overconfident during the bull market but this message applies even more during a downturn, when people should not allow short-term losses to panic them.

*David Ferris*

**Dow Jones Industrial Average**



A longer view of the Dow Jones index highlights the context of recent market falls.

Source: Bloomberg Finance

## Key performance indicators to 31 December 2007

Fund size \$m      1 year return (%)      3 year return (% pa)      5 year return (% pa)      Since inception (% pa)      Inception year

### Trust

Balanced	258.8	4.8	8.3	11.2	8.2	1989
Equities	212.8	16.7	16.6	18.8	11.9	1994
Large Companies	153.1	5.3	12.8	16.7	12.5	1997
World	5.8	Inception date 2 August 2007			0.4*	2007
Income	25.8	5.2	5.1	5.0	4.6	1997

### Super

Balanced	127.8	4.6	7.7	10.3	8.8	1998
Equities	89.7	15.1	15.3	17.0	12.7	1998
Large Companies	66.7	5.0	12.0	15.4	12.9	1998
World	1.4	Inception date 6 July 2007			-0.2*	2007
Income	12.5	4.4	4.3	4.3	4.0	1998

### Pension

Balanced	16.5	4.9	8.6	11.5	9.5	1999
Equities	5.3	17.5	17.4	19.2	13.3	1999
Large Companies	4.8	5.2	13.1	16.8	12.0	1999
World	<1	Inception date 6 July 2007			0.2*	2007
Income	1.4	4.9	5.0	5.0	5.0	1999

### Benchmarks

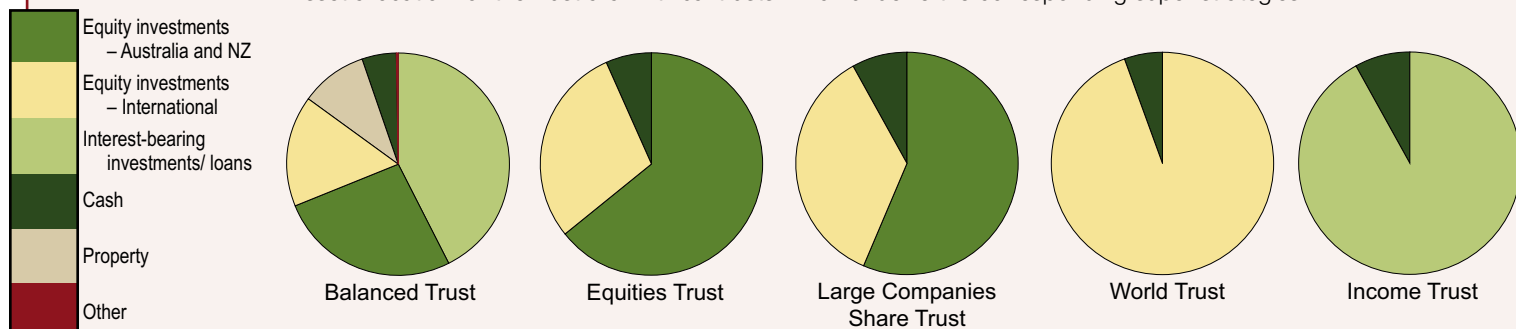
1 year return (%)      3 year return (% pa)      5 year return (% pa)      Since inception (% pa)

Balanced	Morningstar Peer Group Retail Investment Trusts Multisector Balanced Index	4.8	9.5	10.1	8.1
Equities	S&P/ ASX Small Industrials Index	7.6	16.5	21.4	11.1
Large Companies	S&P/ ASX 200 Industrials Index	8.1	16.7	18.0	12.8
World	MSCI World Index (unhedged AUD)	-1.48	9.10	7.43	0.2*
Income	CPI + 2%	4.8	5.0	4.8	4.9

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## Asset allocation as at 31 December 2007

Asset allocation for the Australian Ethical trusts which underlie the corresponding super strategies.



Past performance is not a reliable indicator of future performance. Total returns are calculated using exit prices. Total returns take into account ongoing management fees and trust or fund expenses, except that the annual super fund member fee of \$41 is not included. For the trusts, total returns are calculated as if distributions of income have been reinvested. They do not take into account tax that may be payable on the distribution of income. For the fund, total returns are calculated taking into account taxation on fund earnings and capital gains. Neither the return of capital nor the performance of a trust or the fund is guaranteed. \*Figures showing a period of less than one year have not been adjusted to show an annual total return. Figures for periods of greater than one year are on a per annum compound basis. The latest available performance figures can be obtained from our website [www.austethical.com.au](http://www.austethical.com.au) or by calling 1800 021 227. Units in the trusts are offered and issued by Australian Ethical Investment Ltd (AEI) ABN 47 003 188 930, AFSL 229949. Interests in the superannuation fund (registration number R1004731) are offered by AEI and issued by the trustee of the fund, Australian Ethical Superannuation Pty Ltd ABN 43 079 259 733, RSEL L0001441. Product disclosure statements are available from our website or by calling us and should be considered before deciding whether to acquire, or continue to hold, units in the trusts or interests in the fund.