

australian**ethical**

MANAGED INVESTMENTS

- the year in brief

year ended 30 june 2008

The year in brief is a summary of information contained in the annual report of the Australian Ethical Investment trusts.

If you would like a copy of the full annual report:

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The year in brief

The financial year of 2007–08 saw the end of a ‘goldilocks’ phase in financial markets. In the goldilocks phase it had seemed to many that large fluctuations in economic growth were a thing of the past and that benign financial conditions would continue indefinitely. Many investors responded by borrowing ever larger amounts to fund the purchase of assets for which they paid ever higher prices. These assets included promises to repay mortgage borrowings by people in the US who had little chance of doing so unless house prices rose continually. At the beginning of 2007–08 a rush to offload holdings of such assets got underway. That rush for the exits caused prices of such assets to fall. Companies that had funded their holdings of such assets with short-term borrowings found themselves unable to obtain refinancing, as borrowings became a larger fraction of the now lower value of their assets. The effects cascaded through world financial markets, as companies threatened by insolvency offloaded liquid assets to repay short-term borrowings, so causing other asset prices to fall and insolvency problems to spread. This de-leveraging process, of assets sales and credit contraction accompanied by asset price falls, was a major feature of financial markets around the world in 2007–08.

US economic growth proved remarkably resilient in the face of this de-leveraging process. The US economy is not officially in recession, although it has slowed. Growth in many other economies around the world, including Australia, has also slowed.

Another major feature of financial markets during 2007–08 was rising prices for many commodities and energy. Due to our commitment to the Charter, the trusts lacked exposure to coal, oil and uranium. Most trusts benefited from investments in companies involved in the extraction of natural gas. Australian Ethical views natural gas as a transition fuel from highly polluting coal to a future focused on renewable energy.

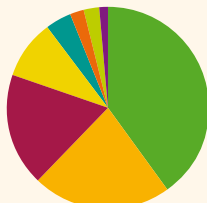
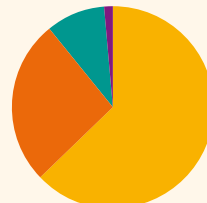
The Australian Ethical Trusts performed creditably in a year of poorly performing financial markets.

Market performance 2007–08	Return (%)
S&P/ASX All Industrials Index	-26.1
S&P/ASX Small Industrials Index	-36.52
MSCI World Index (AUD)	-23.6

In the year, foreign currency hedging was increased for the Equities, Large Companies and World Trusts so that approximately the full value of international equities held by these trusts is now hedged. This will be the hedging position for these Trusts for the foreseeable future. Foreign currency hedging in the Balanced Trust was reduced through 2008 and the value of international equities in this Trust will be unhedged in future.

Australian Ethical Balanced Trust

The Australian Ethical Balanced Trust returned -10.07% for the 2007–08 year, reflecting its more conservative mixture

30 June 2008	Australian Ethical Balanced Trust		Australian Ethical Equities Trust	
Performance				
Total return	Trust returns	Morningstar Multisector Balanced Market Index*	Trust returns	ASX Small Industrials Index
1 year (%)	-10.1	-6.7	-13.1	-36.5
3 years (% pa)	2.9	5.5	10.7	1.7
5 years (% pa)	7.2	8.0	13.1	10.2
Since inception	7.3	7.5	10.3	7.7
	All figures expressed as compound annual returns			
Earnings				
Full year	Cents per unit	Return* (%)	Cents per unit	Return* (%)
Distributions	4.7	3.6	3.2	1.8
Unit value change	-17.4	-13.7	-26.9	-14.9
Net earnings result (total return)	-12.7	-10.1	-23.7	-13.1
	*assumes reinvestment of distribution			
Asset allocation				
<ul style="list-style-type: none"> Equity – small caps Debt equity instruments Units in other Australian Ethical Trusts Equity investments – International Equity investments – Australia and NZ Property Interest-bearing loans Interest-bearing investments Cash 	<p>Fund size: \$231.6 million</p> 	<p>Fund size: \$188.9 million</p> 		

of asset classes, including around 40% in fixed interest investments.

Long-term results for the Balanced Trust remain solid, being 7.2% per annum over five years and 7.3% since inception.

The trust retains a balance between quality domestic and international stocks, property and interest-bearing investments (including a small proportion of private loans). All investments in the portfolio are screened against the Australian Ethical Charter.

Over the year, the trust sold down most of its direct investments in international equities and replaced them with units in the Australian Ethical International Equities (wholesale) Trust that provides an efficient mechanism for the trust to access a well-diversified international equities exposure.

The best performing investments of the trust over the year included Origin Energy, which returned 62% for the year and Vestas Wind Systems, which returned 70% for the year.

Vestas Wind Systems AS

Danish company Vestas began wind turbine manufacturing in 1979, and is now a global, market leading producer of high technological wind power solutions. With more than 25 years experience, the company has an extensive portfolio of turbines which are suited to specific conditions and requirements.

Australian Ethical Equities Trust

The Australian Ethical Equities Trust returned -13.13% for the 2007-08 year. This was a much smaller loss than could reasonably have been expected given the performance of the share market. The trust's benchmark, the S&P/ASX Small Industrials Index, for example, returned -36.5%. As a result, our Equities Trust ranks number one in its category over six months and over one year.

The Equity Trust's relatively strong performance was in large part due to its investments in companies in the production of natural gas (a low carbon transition fuel). Three such companies, Pure Energy (5.8% of the trust), Origin Energy (5.3% of the trust) and Arrow Energy (4.1% of trust) made up the three largest positions in the trust at 30 June 2008.

The best performing investments of the trust over the year were Pure Energy up 167%, Origin Energy up 62%, Arrow Energy up 31% and Hansen Technologies up 37%.

Pure Energy Resources Ltd

Coal seam gas now contributes to approximately 30% of Queensland's natural gas market. Natural gas is the least polluting fossil fuel and can immediately substitute for the use of coal-fired power.

Australian Ethical Large Companies Share Trust

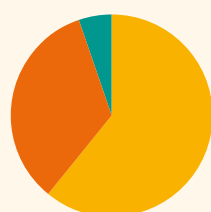
Australian Ethical World Trust

Australian Ethical Income Trust

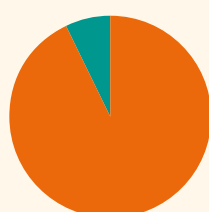
Trust returns	S&P/ASX All Industrials Index	Trust returns	MSCI World measured in AUD	Trust returns	CPI + 2%
-19.0	-26.1	na	-23.6	5.0	6.4
2.9	3.8	na	12.2	5.1	5.5
10.2	10.1	na	36.0	5.0	5.1
9.6	9.1	-17.3	-20.4	4.7	5.1
August 07 – June 08					

Cents per unit	Return* (%)	Cents per unit	Return* (%)	Cents per unit	Return* (%)
2.2	1.2	0.0	0.0	5.8	6.0
-37.1	-20.2	-17.3	-16.8	-0.1	-1.0
-34.8	-19.0	-17.3	-16.8	4.8	5.0

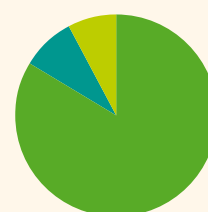
Fund size: \$122.1 million



Fund size: \$6.3 million



Fund size: \$26.8 million



Australian Ethical Large Companies Share Trust

The Australian Ethical Large Companies Share Trust returned -18.99% for the year. This is a disappointing result for any investment. It is comparable however to the two indices that best represent the types of shares that the Trust invests in – the S&P/ASX All Industrials Index that returned -26.1% for the year and the MSCI World Index in Australian dollars that returned -23.6% for the year. This trust focuses on companies on the Australian Securities Exchange (ASX) and overseas with a market capitalisation of over \$1 billion. Combined with a more conservative management style, the exclusion of smaller companies makes this trust less volatile than the Australian Ethical Equities Trust. The overseas shares provide access to some key ethical sectors (public transport, bicycles, wind power, solar power, recycling) which are in short supply on the ASX.

The negative performance of the Large Companies Trust in 2007–08 followed four consecutive years of double-digit returns (which over the previous four years were 16%, 16%, 23.8% and 20.6%). The trust's long-term returns remain competitive with other funds and with the market as a whole.

The best-performing investments of the trust over the year were Vestas Wind Systems up 70%, Origin Energy up 62%, metal recycler, Sims Group up 57% and the public transport company Stage Coach up 53%.

Sims Group Ltd

The Sims Group is the world's leading metals recycling company. Ancillary activities include secondary metals and plastic reprocessing, and interests in renewable energy. The company has also expanded into the recycling of electronics waste in Europe, the US and Australia, including the identification of products and components that can be reused, as well as the extraction of raw materials from the remaining waste. Metal recycling can result in significant pollution, however, and Australian Ethical continues to monitor the activities of this company.

Australian Ethical World Trust

The Australian Ethical World Trust commenced operation on 2 August 2007, and from that date until 30 June 2008 returned -17.33% compared with the MSCI World Index (measured in Australian dollars) that returned -20.4%.

At 30 June 2008, the Wholesale International Equities Trust, in which this trust holds units, had investments in 48 overseas companies providing a well-diversified international equities exposure, along with access to key ethical sectors (public transport, bicycles, wind power, solar power, recycling), which are in short supply on the ASX.

The best-performing investments of the Wholesale International Equities Trust over the year were Vestas Wind Systems up 70%, the public transport companies Stagecoach Group up 53% and MTR Hong Kong up 32.6%.

MTR Corporation Ltd

The Mass Transit Railway Corporation was established as a government body in 1975 to operate Hong Kong's commuter railway system. The company was privatised in 2000 as MTR Corporation Ltd, and continues to be focused on the provision of public transport. The company is also involved in the development of residential and commercial property projects associated with existing and new rail lines.

Australian Ethical Income Trust

The Australian Ethical Income Trust in 2007–08 returned 5.0%, after recording its highest-ever return of 5.3% in the previous year. The Income Trust has now recorded nine consecutive years of stable performance. Australian Ethical continues to manage the trust to achieve returns reflecting current interest rate levels with very low volatility.

As markets were very volatile and the interest rate curve was mostly inverse over the period (meaning that short-term yields were higher than long-term yields), the duration of securities in the portfolio was deliberately kept very short. The AAA-rated mortgage-backed securities in the trust were selected to have a very short-weighted average life in line with the overall portfolio approach of having short-dated or floating rate securities. This means there is little interest rate risk in the portfolio. It is expected that the trust's yield will move broadly in line with the level of interest rates.

To protect investors from credit risk the majority of the portfolio comprised high-quality bank debt and investment grade non-bank debt. Only 14% of interest-bearing securities were non-AAA rated securities (bank and non-bank issued).

Past performance is not a reliable indicator of future performance.

Performance figures are calculated using exit prices. Performance figures take into account ongoing management fees and trust expenses. Performance figures 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. Neither the return of capital nor the performance of a trust is guaranteed. Figures showing a period of less than one year have not been adjusted to show an annual 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 or by calling **1800 021 227**. Units in the trusts are offered and issued by Australian Ethical Investment Ltd ABN 47 003 188 930, AFSL 229949. A product disclosure statement is available from our website or by phone and should be considered before deciding whether to acquire, or continue to hold, units in the trusts. This information has been prepared without taking account of your individual investment objectives, financial situation or needs. Before acting on it, you should consider its appropriateness to your circumstances.

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