

# australian**ethical**

## MANAGED INVESTMENTS

### – the year in brief

year ended 30 June 2009

*The year in brief* is a summary of information contained in the annual report of the Australian Ethical managed funds. If you would like a copy of the full annual report: download it from [www.australianethical.com.au/annual-reports-managed-funds](http://www.australianethical.com.au/annual-reports-managed-funds)  
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investment + superannuation

# 2008–09 a year to remember and not to forget

Investors and investment managers will look back at 2008–09 as one of the toughest years for investing in more than 75 years. It is sobering to be reminded of just how close the international banking system was to collapse in the last quarter of 2008. The demise of Lehman Brothers in the US and the subsequent bail out of some of the world's largest financial institutions should be a reminder that nothing is too big to fail. Nevertheless, the US and UK governments decided that a number of institutions were too critical to the workings of the international capital markets and the public good to be allowed to go under. This has created a moral dilemma where it appears that poor investment and management decisions are effectively underwritten by governments. I hope tax payers have the last laugh and the equity in these companies, now owned by governments, treble in the coming years. There are many lessons to be learned.

## Long-term positive returns still in tact

Our funds have survived the year a little battle scarred but without substantial damage. We are making good headway in returning them to profitability in the good market conditions we have seen since the start of March 2009, led by the coordinated monetary and fiscal policy easing of governments around the globe. I am very pleased to report that in 2008–09, four out of five of our funds outperformed their market benchmarks, some quite substantially. It means

that the single digit losses (–2% to –9%) experienced over the year by the Balanced, Equities and Larger Companies Trust, place our funds at a considerable advantage in being able to return to profitability. It also means that any small losses this year have not substantially dented our long-term positive return to investors.

## Better companies – better markets

Australian Ethical has again been active this year in engaging companies and government on a range of issues including Renewable Energy Target, CPRS, environmental and social impacts as well as corporate governance. We subscribe to the view that managing business ethically results in better outcomes; financially, environmentally and socially in the long-term. The market dislocation we have seen in the past year provides an excellent opportunity for companies to implement sustainable ways of doing business. Our investments are uniquely placed to benefit from this shift.

Martin Halloran – Chief Investment Officer.

## Australian Ethical Balanced Trust

The Balanced Trust returned –5.4% over the year compared to –12.6% for its benchmark, the Morningstar Multisector Peer Group, and –24% for the broader S&P/ASX 200 Index.

The trust held a higher than typical stake in the domestic healthcare sector which provided superior performance for the whole year. The trust avoided the fallout from the bursting of the mining sector bubble. It also had no equity exposure to the large banks during the financial crisis.

30 June 2009	Australian Ethical Balanced Trust		Australian Ethical Equities Trust	
<b>Performance</b>				
Total return	Trust returns (%)	Morningstar Multisector Balanced Neutral <sup>†</sup>	Trust returns	ASX Small Industrials Index
1 year (%)	–5.4	–12.6	–2.1	–21.6
3 years (% pa)	–2.0	–2.9	5.2	–11.7
5 years (% pa)	3.5	2.9	9.7	0.8
Since inception	6.6	6.3	9.4	–4.1
	All figures expressed as compound annual returns			
<b>Earnings</b>				
Full year	Cents per unit	Return* (%)	Cents per unit	Return* (%)
Distributions	3.2	3	0.7	0.5
Unit value change	–9.3	–8.3	–3.8	–2.6
Net earnings result (total return)	–6.0	–5.4	–3.2	–2.1
	*assumes reinvestment of distribution			
<b>Asset allocation</b>				
<ul style="list-style-type: none"> <li><span style="color: blue;">■</span> Cash</li> <li><span style="color: purple;">■</span> Debt equity instruments</li> <li><span style="color: red;">■</span> Shares – Australia and NZ</li> <li><span style="color: orange;">■</span> Shares – international</li> <li><span style="color: yellow;">■</span> Shares – small companies</li> <li><span style="color: lightgreen;">■</span> Interest-bearing investments</li> <li><span style="color: green;">■</span> Interest-bearing loans</li> <li><span style="color: cyan;">■</span> Property</li> </ul>	Fund size: \$219.7 million 		Fund size: \$191.3 million 	
	Includes investments in other Australian Ethical Trusts			

The biggest detractor from overall performance was the small exposure to the listed property sector and to regional banks. The smaller banks suffered in the competition for funding due to the government guarantee on deposits, wholesale borrowing and increases in bad debt provisions.

The fixed income portion of the portfolio (>35%) performed very solidly over the year. The investments were mostly short dated highly-rated debt securities. We have continued to buy well rated bonds over the course of the year and these have since appreciated in value as credit concerns dissipated in the last quarter of the financial year.

The international equities exposure (15%) declined in value in-line with the market, but has rebounded and substantially outperformed in the last three to six months of the financial year.

### Australian Ethical Equities Trust

The Equities Trust returned -2.1% over the year compared to -21.6% for its benchmark, the S&P/ASX Small Industrials Index.

This significant outperformance was largely driven by favourable stock selection as well as the trust's focus on the defensive healthcare and utilities sectors, which tend to outperform in negative markets.

One of the strongest performing shares was coal seam gas explorer Pure Energy, which significantly benefited from a takeover battle between Arrow Energy and British Gas. Takeovers also pushed-up shares in MYOB, St George Bank and Queensland Gas Corporation.

The strongest investments were in the defensive healthcare and utility sectors. Standouts included Cochlear, Primary Healthcare and utility APA Group. In the energy sector Origin Energy performed well.

The biggest detractors from overall performance included Savcor, which was punished as its Chinese mobile phone component business disappointed. Viridis Clean Energy was de-rated on the back of debt concerns. Melbourne IT underperformed because of reduced global renewals of domain names and higher operational costs.

Photo courtesy Vestas Wind Systems AS



#### Vestas Wind Systems AS

Vestas began wind turbine manufacturing in 1979, and is now a market leading producer of wind power solutions. The company has an extensive portfolio of turbines which are suited to specific conditions and requirements.

### Australian Ethical Large Companies Share Trust

### Australian Ethical World Trust

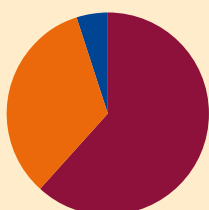
### Australian Ethical Income Trust

Trust returns	S&P/ASX 200 Industrials Index	Trust returns	MSCI World measured in AUD	Trust returns	CPI + 2%
-9.3	-14.3	-18.6	-16.0	3.4	3.1
-5.2	-6.5	na	na	4.5	4.6
4.1	3.3	na	na	4.7	4.9
7.8	6.9	-18.7	-33.1	4.5	4.9

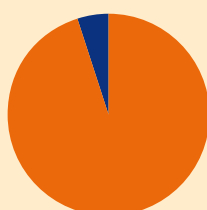
August 07 – June 09

Cents per unit	Return* (%)	Cents per unit	Return* (%)	Cents per unit	Return* (%)
0.0	0.0	0.0	0.0	4.2	4.5
-13.5	-9.3	-15.4	-18.6	-1.1	-1.1
-13.5	-9.3	-15.4	-18.6	3.2	3.4

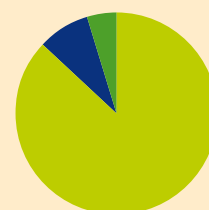
Fund size: \$109.2 million



Fund size: \$6.0 million



Fund size: \$30.2 million



## Australian Ethical Large Companies Share Trust

The Large Companies Share Trust returned -9.3% over the year compared to -14.7% for its benchmark (comprised of 65% S&P/ASX 200 Industrials and 35% MSCI World in Australian dollars). This significant outperformance was largely driven by its focus on the defensive healthcare and utilities sectors, as well as a strong contribution from industrial shares.

Among the strongest performing shares were Australian healthcare companies Cochlear, Sonic Health and Ramsay Health Care. Danish wind turbine manufacturer Vestas, the UK rail companies (industrials), Origin Energy and APA Group (utilities) were also strong performers.

The biggest detractor from overall performance was the large stake in the defensive consumer staples and telecommunications sectors. These sectors contain some large companies that performed strongly but Australian Ethical ruled them out of the portfolio on ethical grounds.

### Cochlear Ltd

Cochlear Ltd supplies approximately 70 per cent of the world market in cochlear implants for profoundly hearing-impaired people. Almost half of the implant recipients are children.



Photo courtesy Cochlear Ltd

## Australian Ethical World Trust

Led by finance stocks, global markets declined drastically over September and October 2008, and dipped further over February 2009. In US dollars, the global benchmark MSCI Index declined 50% from June 2008 to March 2009. However, a recovery seemed to emerge over April and May. Chinese production and US housing figures started to look 'less bad', and the share markets anticipated a rebound

in company earnings for 2010. Over the year, in US dollars, the global benchmark MSCI Index ended 29% lower.

The currency exchange rates were favourable for the translation back into Australian dollars, which mitigated some of the loss. The MSCI Index in Australian dollars fell only 16% for the year. In comparison, the World Trust unit price fell 18.6%. The trust suffered from particularly large falls in its renewable energy investments in October 2008.

Renewable energy stocks underperformed this year due to a decline in energy demand and prices. Companies reported large falls in orders for wind turbines and solar panels globally. Uncertainty around the US carbon pricing policy and the UN climate change talks later this year in Copenhagen has held the sector back.

In the second half of the year, the trust's investments in stock exchanges recovered, particularly the Hong Kong and Singapore exchanges. New York and NASDAQ stock exchanges were added to the portfolio for geographical diversification. The trust also benefitted from US cyclical stocks rebounding off their lows, including United Natural Foods, Whole Foods Market, Sims Metal Management and LKQ Corp.

The World Trust is no longer available for investment. The World Trust invested through the Australian Ethical International Equities Trust - and that trust will be offered for retail investment from 1 October 2009.

## Australian Ethical Income Trust

In 2009 the Australian Ethical Income Trust returned 3.4%, having recorded a 5.0% return in the previous year. The decline in the return against the previous year was driven by the Reserve Bank responding to the global financial crisis with a dramatic series of cuts to interest rates.

The trust was positioned almost entirely in shorter duration deposits and securities so the action by the Reserve Bank was reflected quickly in the returns provided through bank deposits. As the credit crisis intensified, the market demanded a higher yield from debt investments and so prices began to move down. The investments held by the trust are valued by reference to market prices, so the value of trust investments fell because of this market aversion to risk.

The introduction of the government guarantee for deposits under \$1 million and healthy competition for deposit funding amongst banks has helped the trust receive better rates on its deposits through the latter half of the year. Its short positioning with these deposits and its holdings in floating rate investments (such as AAA rated mortgaged-backed securities) will allow it to take advantage of increasing interest rates as the economy recovers.

## 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.australianethical.com.au](http://www.australianethical.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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