

australian**ethical** **Managed Funds**

2010–11 year in review



1800 021 227 • www.australianethical.com.au



australian**ethical** 
investment + superannuation

2010–11 Year in brief

The financial year to 30 June 2011 produced reasonable returns despite market volatility associated with the ongoing debt concerns in the US and Europe.

The broad Australian market returned 11.7 per cent. Overseas markets performed well but the strong Australian dollar diminished our overseas returns.

There has been a lot of media attention devoted to the European debt crisis and the political deadlock in the US over the raising of their debt ceiling to 16.4 trillion dollars. Prospects for Australian investors over the next 12 months are however more dependent on how well emerging economies like China and India sustain their strong growth. Opinions are divided on this, with optimists pointing to China's recent record of uninterrupted strong growth and pessimists pointing to its 6.5 per cent inflation rate and to debt issues at the local government level. China's growth rate is likely to slow in the face of these domestic issues and a weak global economy.

Australian shares

Our investments in smaller Australian companies performed very well over the year, especially in the telecommunications services and healthcare sectors. However, many of our portfolios faced a headwind as they had no investments in the booming mining sector (due to the environmental damage they can cause). Whilst this lack of exposure to a strong industry will sometimes impact our short-term performance, over the longer term, periods of specific industry sector strength tend to be offset by sustained periods of strong performance by ethical investments, often with lower volatility of returns.

International shares

It was a disappointing year for our international renewable energy and energy efficiency companies. Little progress

was made by many overseas governments towards increasing the share of energy derived from renewables, in part due to the attention paid to mounting debt problems. Japan's nuclear tragedy however led many to reassess the relative role that renewable energy can play in reducing greenhouse gas emissions.

Property and fixed interest

In addition to the introduction of longer duration fixed interest investments over the last 12 months (for example government and corporate bonds); our Balanced Trust now has exposure to additional commercial property after the purchase of Lawley House in Canberra.

Lawley House was constructed in 1948 and is located near Lake Burley Griffin and close to Canberra's parliamentary precinct. The property is leased to the Commonwealth until June 2022 with a further five year option. It will provide an initial yield of 8.7 per cent.

Looking ahead to 2012

The recent retreat in world share markets continues to make investors feel anxious. In taking a long term view we can see this time as an opportunity.

Australian Ethical's portfolios remain well placed to take advantage of a shift towards renewable energy and energy efficiency over the long term. The recently announced carbon tax package, that included \$10 billion of funding for a Clean Energy Finance Corporation, was a promising development.

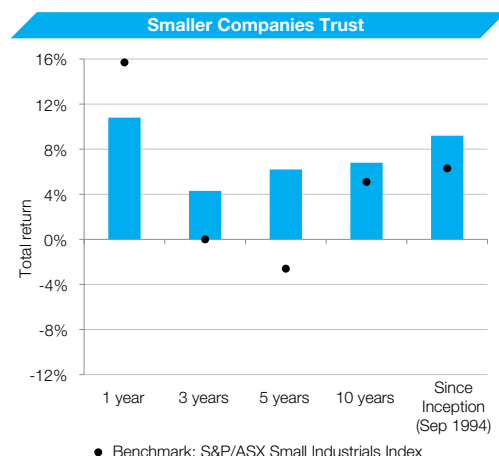
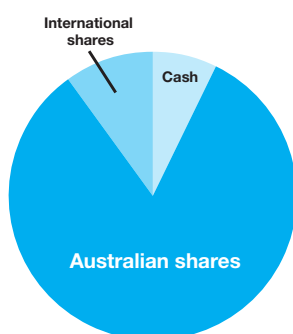
In terms of opportunities for shares we are seeing further examples of high quality smaller companies with zero debt and solid recurring earnings that we believe are significantly undervalued by the market.

James Jordan
Chief investment officer

Smaller Companies Trust

The Smaller Companies Trust returned 10.7 per cent over the year, underperforming its benchmark, the ASX/S&P Small Industrials index which returned 15.7 per cent.

The smaller Australian shares in the portfolio performed well with enterprise hosting company Macquarie Telecom contributing strongly, as did a number of smaller biotech names including wound healing company Tissue Therapies and pain therapy company QRX Pharmaceutical. Our international holdings underperformed mainly due to the solar sector being sold down. We have increased exposure to larger Australian shares as in turbulent financial markets larger companies which typically have more resilient business models tend to outperform. We have been and will continue to selectively add smaller companies as opportunities present themselves over the next year.

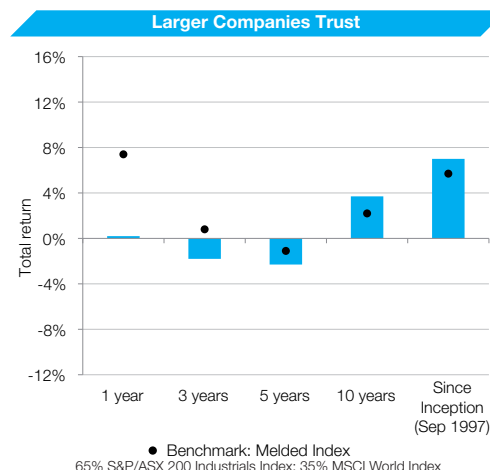
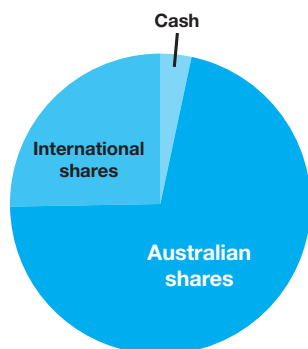


Larger Companies Trust

The Larger Companies Trust returned 0.2 per cent over the year, underperforming its benchmark's return of 7.4 per cent. Both our Australian and international shares dragged down returns.

Pharmaxis was the largest drag on performance, its share price fell 60 per cent over the year after its respiratory therapy 'Bronchitol' was knocked-back for drug approval in Europe. The European appeal decision is due in October 2011.

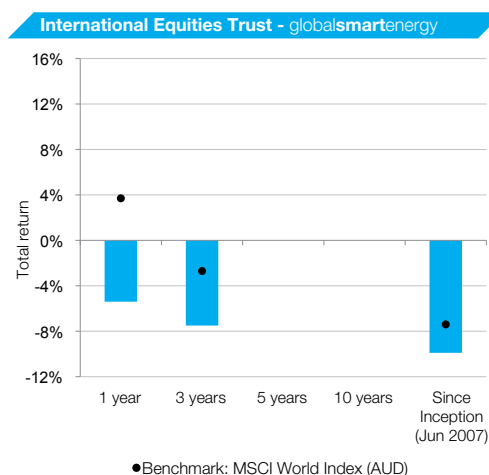
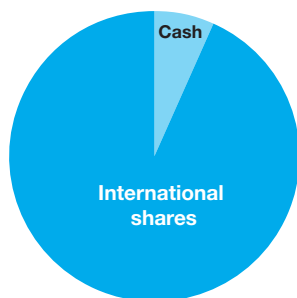
Our holdings in Brambles, Charter Hall Office Trust, Ramsay Healthcare and Sonic Healthcare all contributed positively to relative performance. The fund's international investments which represent almost 30 per cent of the fund, underperformed due to renewable energy and cleantech companies being sold down.



International Equities Trust

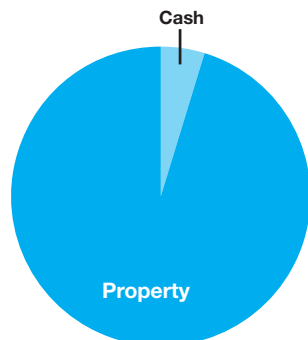
The International Equities Trust returned -5.4 per cent over the year underperforming its benchmark the MSCI World Index which returned 3.7 per cent. Our exposure to renewable energy (solar and wind), smart grid and LED technology were the principle source of underperformance.

Recycling and transport stocks had a positive impact on performance. TOMRA Systems enjoyed strong trading conditions and pushed deeper into machine eye technology.

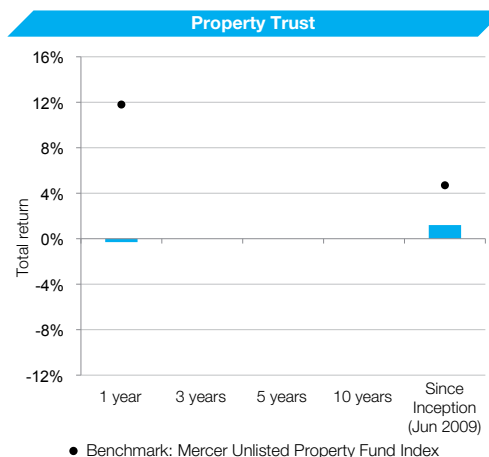


Property Trust

The Property Trust returned -0.4 per cent of the year underperforming its benchmark which returned 9.1 per cent. The underperformance was due to some early vacancy in the Allara Street property which has now been addressed and acquisition costs.



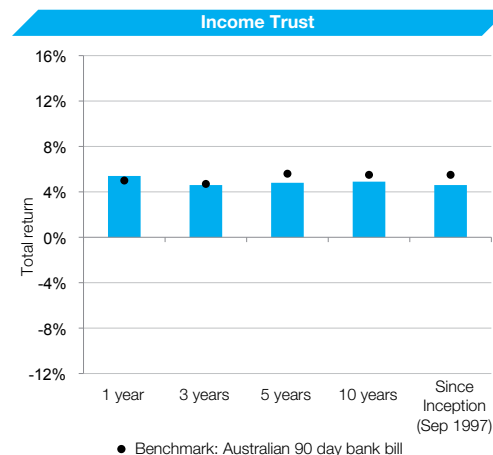
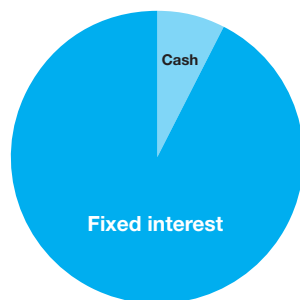
In May the Property Trust purchased Lawley House in Canberra. Constructed in 1948 it is located close to Canberra's parliamentary precinct. The property is leased to the Commonwealth until June 2022.



Income Trust

The Income Trust returned 5.4 per cent over the year, outperforming its benchmark, the 90 Day Australian Bank Bills rate's return of 5.0 per cent.

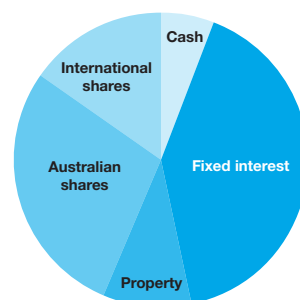
The Fund has maintained a large holding in term deposits (guaranteed under the Government's Financial Claims Scheme), some Government Guaranteed wholesale debt issues and some exposure to Australian Mortgage Backed Securities.



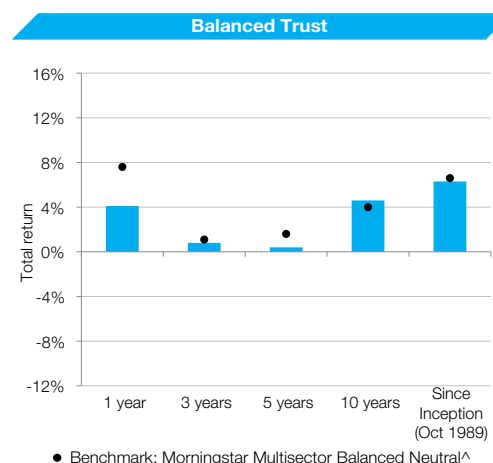
Balanced Trust

The Balanced Trust returned 4.1 per cent over the year underperforming its benchmark, the Morningstar Multisector Balanced Peer Index, which returned 7.6 per cent.

Smaller Australian shares and income were the main positively performing asset classes during the year, while the main detractor to absolute performance was the fund's holding in larger domestic shares. The overall Australian share portfolio rose 6.5 per cent during the year to 30 June 2011, compared to an increase of 11.9 per cent by the S&P/ASX 200 index. A second factor explaining the relative performance of the fund was the international shares portfolio. Although



we are underweight in international shares compared to the index, (15.0 per cent compared to 18.7 per cent), international shares in the fund faced a difficult year returning -4.1 per cent against a 2.7 per cent increase in the MSCI World Index.



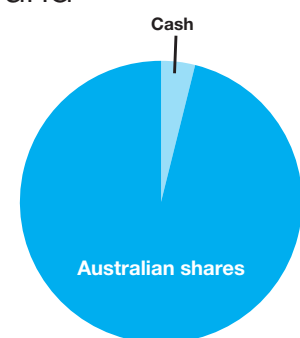
Climate Advocacy Fund

The Climate Advocacy Fund returned 6.8 per cent over the year, underperforming its benchmark the S&P/ASX 200 Index which rose 11.7 per cent.

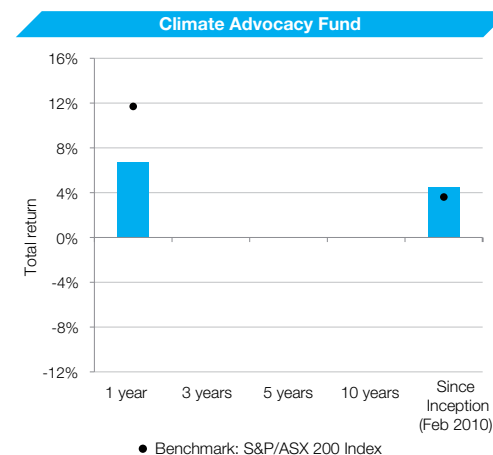
Woodside Petroleum, Aquila Resources, Paladin Energy and Oil Search were the chosen companies for Australia's first shareholder resolutions. The focus was on disclosure of emissions and strategies to manage climate change risk.

Paladin Energy and Aquila Resources chose not to allow the shareholder resolutions to be voted on at their AGMs. However the companies agreed to provide greater disclosure around carbon emissions. The fund withdrew the Oil Search resolution after they agreed to adopt a target for reduced greenhouse gas emissions as set out in the proposed resolution.

Woodside failed to list the fund's preferred resolution but accepted a revised resolution. As a consequence,



the first ever resolution to an ASX-listed company on climate change issues was considered at the AGM. The resolution attracted a vote in favour of about 6 per cent of shareholders with 3 per cent abstaining. Whilst this appears to be a small number, it represents a significant result compared to the size of the fund's holding in Woodside and shows how increased engagement resolutions of this nature will lead to positive outcomes and momentum.



Returns to 30 September 2011

Managed funds	3 month return (%)	1 year return (%)	3 year return (% pa)	5 year return (% pa)	10 year return (% pa)	Since inception
Balanced	-4.9	-3.1	-1.5	-1.0	4.1	6.0
Smaller Companies	-11.7	-8.0	0.1	3.0	6.4	8.3
Larger Companies	-12.0	-14.4	-7.0	-5.1	3.4	5.9
International Equities	-17.5	-21.2	-14.1	-	-	-13.3
Income	0.9	4.9	4.4	4.7	4.8	4.6
Property	1.7	0.6	-	-	-	1.8
Climate Advocacy	-11.0	-10.7	-	-	-	-3.4

Past performance is not a reliable indicator of future performance. Performance figures are calculated using exit prices and 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 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. Australian Ethical® is a registered trademark of Australian Ethical Investment Ltd.

© 2007 Morningstar Research Pty Ltd. All rights reserved. To the extent that the above constitutes general advice by Morningstar, this advice has been prepared by Morningstar Research Pty Ltd ABN: 83 062 096 342, AFSL: 243 161 and does not take account of your objectives, financial situation or needs. Before acting on any advice, you should consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. Please refer to Morningstar's Financial Service Guide (FSG) for more information at www.morningstar.com.au/fsg.asp and consider the product disclosure statement before making a decision to acquire the financial product.