

Ausbil Dexia Limited

Australian Emerging Leaders Fund

Investment Report June Quarter 2010

AUSBIL DEXIA LIMITED
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A Member of the Dexia Group

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Money does not perform. People do.



Executive Summary

Review

Portfolio performance for the June Quarter 2010 was -12.16% versus the benchmark return of -11.01%.

The Australian equity market closed 11.2% lower for the June quarter, which has left the market down 10.1% for the calendar year to date, but up 13.1% for the 2009/10 financial year. The equity market was driven by concerns over sovereign debt and a slowing global economic recovery. Domestically, the uncertainty around the proposed Resource Super Profits Tax (RSPT) weighed on the market. In company news, mining companies reacted forcefully to the government's RSPT proposal, and as the end of the financial year approached many companies updated the market on earnings, whilst Telstra reached a non-binding agreement to participate in the government's National Broadband Network initiative. Noteworthy corporate events included; a successful bid by Newcrest Mining for Lihir Gold, a bid from Bright Foods for CSR's sugar and renewables business and the announcement by Foster's Group of its intention to demerge its wine business.

Portfolio

At a sectoral level, the Portfolio benefited from its relative positioning in the Energy, Materials and Telecommunications sectors. Conversely positions in the Healthcare, Consumer Discretionary and Financials (ex REITs) sectors detracted from performance.

At a stock level, the active positions in Mineral Resources, CSR, Bradken and Pan Australian Resources were the largest positive contributors to relative performance. The nil holding in Downer EDI also benefited. The major performance detractors to the Portfolio were overweight positions in AWE Limited, Kagara Zinc, Wotif.com and Flight Centre.

Outlook

Whilst a more subdued growth outcome is likely, the market has moved to price in a very bearish scenario. Current consensus earnings price the market at 10.9 times the FY11 forecast – almost a 30% discount to historical trading norms. The market will undoubtedly repeg earnings assumptions in the wake of the forthcoming August reporting season and the risk is for some downward adjustment to this forecast, which currently rests at +25.3% year on year EPS growth. However with such a large discount embedded in prices valuation support is likely to emerge and the market should begin to focus on the level of underlying earnings recovery, rather than the immediate direction of earnings adjustments. FY12 is still being viewed as a further recovery year with +13.2% built into assumptions and resulting in a single digit PE of 9.6 times. The hiatus of foreign direct investment appears to have been somewhat alleviated at a corporate level with the emergence of a new government and consequent scrapping of the proposed RSPT, however offshore investor flows are likely to be slow to return as the market maintains a watchful stance on an uncertain domestic political landscape. Aside from the distractions of politics, the domestic economy remains very buoyant with strong employment and GDP data continuing to flow. The global backdrop has weighed significantly upon domestic market outcomes despite the strong Australian macroeconomics. A reasonable result season and a refocus on the supportive underlying metrics should prove to be the catalyst for a domestic market rerating.

Market Review

The Australian equity market closed 11.2% lower for the June quarter, which has left the market down 10.1% for the calendar year to date, but up 13.1% for the 2009/10 financial year. The equity market was driven by concerns over sovereign debt and a slowing global economic recovery. Domestically, the uncertainty around the proposed Resource Super Profits Tax (RSPT) weighed on the market. In company news, mining companies reacted forcefully to the government's RSPT proposal, and as the end of the financial year approached many companies updated the market on earnings, whilst Telstra reached a non-binding agreement to participate in the government's National Broadband Network initiative. Noteworthy corporate events included; a successful bid by Newcrest Mining for Lihir Gold, a bid from Bright Foods for CSR's sugar and renewables business and the announcement by Foster's Group of its intention to demerge its wine business.

In economic news the RBA raised cash rates by 50 basis points to 4.50% over the quarter; however the cash rate was left on hold in June. GDP rose 0.5% quarter on quarter and the core measure of CPI rose 3.0% year on year, which is at the top end of the RBA's target band of 2-3%. Employment rose by 92,000 from March to May, and the unemployment rate declined to 5.2%. Consumer sentiment and the NAB Business confidence index both fell from February to May.

In commodities, base metals (CRB Index -13.9%) and spot oil (TWI -9.7%) closed lower over the quarter, reflecting concerns over the strength of Chinese demand as well as wavering confidence in developed world growth recovery prospects. Spot gold gained (+12.1%) in USD terms over the quarter, supported by increased risk aversion.

Within the market capitalization bands the large stocks (represented by the S&P/ASX 50 index) declined 11.2%, whilst the mid cap stocks (represented by the S&P/ASX Mid Cap Index) declined by 10.8% over the quarter.

At a sector level, defensive sectors such as Telecommunications (+6.8%), REITs (-1.5%) and Consumer Staples (-4.5%), were the best performing sectors with major moves by Telstra (+8.7%), Coca-Cola Amatil (+6.3%) and Foster's Group (+6.8%).

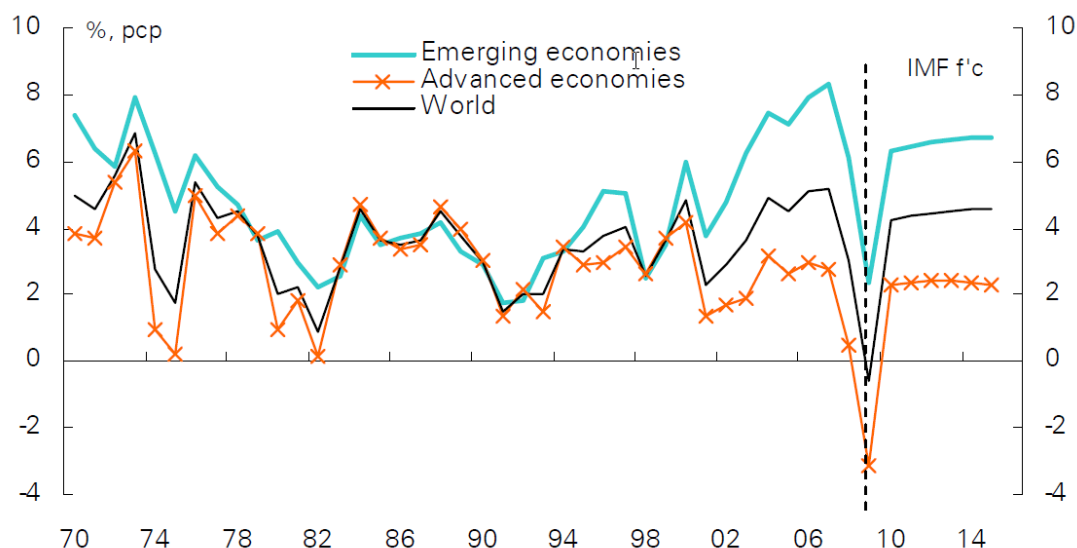
Industrials (-18.9%), Financials ex REITs (-13.2%) and Information Technology (-12.6%) underperformed over the period with Ausenco (-59.1%), Downer EDI (-52.4%), Westpac (-23.7%) and Isoft Group (-71.1%) all under significant pressure.

Significant dispersion of stock valuations is creating opportunities

Global share markets continued to lack confidence during the last month of the domestic financial year. Even though the global economy is showing signs of improvement, recent economic data suggests the pace of growth may be slowing, while the uncertainty regarding European sovereign debt continues to overhang the European economy. In Australia, the Federal Government's Resources Super Profits Tax ('RSPT') proposal and the public advertising battle with the Mining industry has not assisted with market confidence. This uncertainty has led to falls in equity market share prices and has resulted in a significant dispersion of stock valuations.

The Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) continue to point to economic expansion, albeit at a different pace across countries and regions. Economic activity continues to improve in the US, Japan and notably China. Market impressions regarding China's growth prospects most recently oscillate between unsustainable and slowing. We expect China GDP growth to slow from low double digit to high single digit growth. Meanwhile, the weaker Euro economies remain under pressure with the fiscal spending cuts aimed in addressing outstanding sovereign debt likely to result in positive, albeit lower GDP growth. Germany is an exception, with the weaker euro dollar assisting their export competitiveness. Overall, the rate of global GDP growth is likely to slow. The Chart below illustrates the continued level of GDP growth and the extent of the potential slowdown.

World GDP Growth



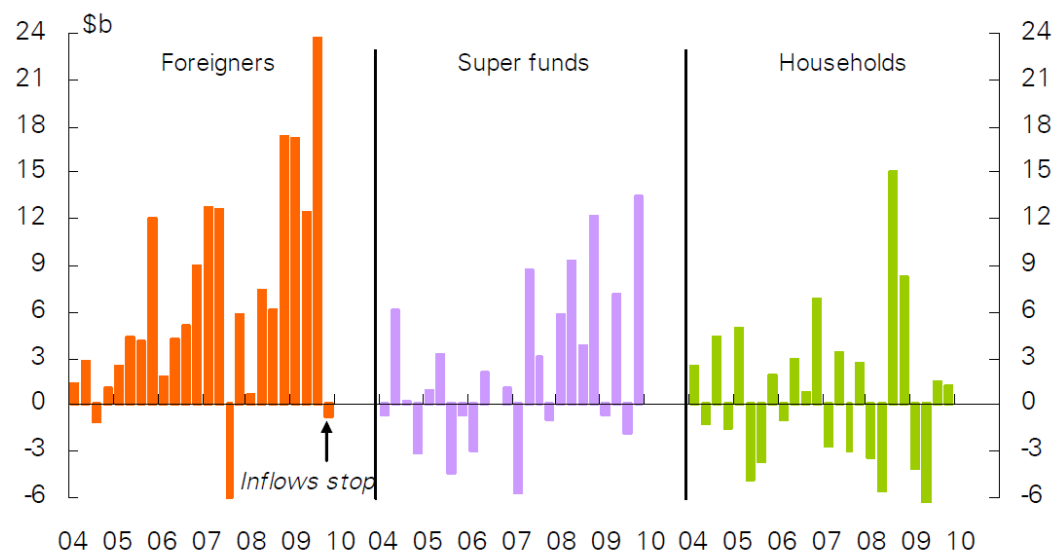
Source: IMF

In Australia, the announcement of the proposed 'RSPT' in late April was anticipated by the market but the punitive parameters were a surprise for all investors, especially international equity investors. Anecdotally, this has resulted in an increased domestic political risk premium. There was additional anecdotal evidence from our discussions with market participants that international equity investors sold out of Australian shares as a result of this political uncertainty. The chart below illustrates how international investors were

Australian Equities

already withdrawing from Australia prior to the 'RSPT' announcement. As a result of the proposed RSPT, the public relations battle between the Federal Labour Government and the Mining industry resulted in the sensational replacement of Prime Minister Kevin Rudd. However, at the time of writing this report, the new Gillard Government had agreed to a compromise with the mining industry.

Equity Market Inflows



Source:ABS

The slowdown in global GDP growth has in some instances led to equity market earnings revisions. In addition, the equity market volatility has also led to a magnified dispersion of sector PE relative valuations. The share prices of companies that display defensive earnings characteristics currently trade on a PE relative multiple that suggests a 40% premium to market. Conversely, cyclical industrial stocks are trading at share prices that reflect a 20-30% PE relative discount to market, while selective REITs are trading at share prices below conservative net tangible asset valuations. However, the most significant discount is seen in the Resources sector where share prices have been adversely impacted by global GDP growth concerns, China growth concerns, and by the proposed 'RSPT'. This PE relative discount ranges from 40% to 60% to market, with smaller resources stocks displaying the largest discounts.

In summary, global equity markets are concerned with the rate of global GDP growth and there is increased anxiety about a possible double dip recession scenario – an event which we still view as being less likely. The Australian equity market has been influenced by the softening macro economic environment and by the political concerns regarding the introduction of the 'RSPT'. However, the Australian Federal Government seems to have found a resolution to the proposed tax with the Australian mining industry. Due to this macroeconomic and political backdrop, we find that there are significant valuation dispersions across the market that are creating attractive medium to longer term investment opportunities in a number of sectors.

Strategy and Outlook

Strategy

The global economic recovery is at an apparent inflexion point with some recent US data on the disappointing side and Europe likely to continue to be hamstrung by sovereign debt concerns within member countries. The situation being pondered by the market is whether the global economy dips into a secondary contractionary phase – the so-called double dip recession, or whether the pullback is merely a downward adjustment to the upward trajectory of the recovery. On balance we still favour the latter outcome as the most likely and have adjusted the Portfolio accordingly, with a clear growth orientation still evident in tilts, albeit at trimmed levels. Positive tilts have carried over from last month in key cyclical sectors whilst underweight tilts are still evident in the traditionally defensive sectors but we have taken some steps to de-emphasise the extent of these negative tilts.

Outlook

Whilst a more subdued growth outcome is likely, the market has moved to price in a very bearish scenario. Current consensus earnings price the market at 10.9 times the FY11 forecast – almost a 30% discount to historical trading norms. The market will undoubtedly repeg earnings assumptions in the wake of the forthcoming August reporting season and the risk is for some downward adjustment to this forecast, which currently rests at +25.3% year on year EPS growth. However with such a large discount embedded in prices valuation support is likely to emerge and the market should begin to focus on the level of underlying earnings recovery, rather than the immediate direction of earnings adjustments. FY12 is still being viewed as a further recovery year with +13.2% built into assumptions and resulting in a single digit PE of 9.6 times. The hiatus of foreign direct investment appears to have been somewhat alleviated at a corporate level with the emergence of a new government and consequent scrapping of the proposed RSPT, however offshore investor flows are likely to be slow to return as the market maintains a watchful stance on an uncertain domestic political landscape. Aside from the distractions of politics, the domestic economy remains very buoyant with strong employment and GDP data continuing to flow. The global backdrop has weighed significantly upon domestic market outcomes despite the strong Australian macroeconomics. A reasonable result season and a refocus on the supportive underlying metrics should prove to be the catalyst for a domestic market rerating.

The Emerging Leader market segment continues to be penalised in the current flight to safety but the fundamental story remains positive. The well capitalised domestic corporate landscape is likely to result in moves to consolidate market share and open up growth options via merger and acquisition activity. In combination with new IPOs and some secondary market placements, the mid and small cap space is likely to be a very active market segment, particularly once confidence and clarity on future domestic and global growth prospects returns. Ultimately the “emerging leaders” should be a major beneficiary of the ongoing improvement in domestic (and to a lesser extent, global) macroeconomics and provide good leverage to recovering cyclical earnings.

Portfolio Overview

Portfolio Return

| Period | Portfolio Return% | | Benchmark % | Out/Under Performance% | |
|--|-------------------|--------|-------------|------------------------|-------|
| | Gross | Net | | Gross | Net |
| Three Months | -12.16 | -12.44 | -11.01 | -1.15 | -1.42 |
| One Year | 18.69 | 17.06 | 11.63 | 7.06 | 5.43 |
| Three Years p.a | -6.08 | -7.64 | -13.00 | 6.92 | 5.36 |
| Five Years p.a | 7.55 | 6.09 | 2.68 | 4.87 | 3.41 |
| Seven Years p.a | 16.44 | 14.59 | 9.67 | 6.77 | 4.92 |
| Since Inception p.a. Date: Dec 2006 | 14.56 | 12.82 | 8.90 | 5.66 | 3.92 |

Top 10 Stocks

| Name | Portfolio% | Index % | Tilt % |
|-------------------------|------------|---------|--------|
| Mirvac | 4.38 | 2.82 | 1.56 |
| Seek | 4.21 | 1.49 | 2.72 |
| Mineral Resources | 4.11 | 0.19 | 3.92 |
| Bank of Queensland | 3.81 | 1.44 | 2.37 |
| Alumina | 3.68 | 2.46 | 1.23 |
| James Hardie Industries | 3.42 | 1.77 | 1.65 |
| Harvey Norman | 3.34 | 1.23 | 2.11 |
| David Jones | 3.18 | 1.40 | 1.78 |
| REA Group | 3.03 | 0.00 | 3.03 |
| CSR | 3.01 | 1.69 | 1.32 |

Portfolio Sector Tilts

| Name | Portfolio% | Index % | Tilt % |
|------------------------|------------|---------|--------|
| Energy | 3.11 | 9.76 | -6.65 |
| Materials | 26.41 | 21.84 | 4.56 |
| Industrials | 20.86 | 16.80 | 4.06 |
| Consumer Discretionary | 26.11 | 15.39 | 10.72 |
| Consumer Staples | 1.07 | 4.30 | -3.24 |
| Healthcare | 1.05 | 7.15 | -6.10 |
| Financials (x LPT) | 8.97 | 6.96 | 2.01 |
| LPTs | 9.60 | 12.38 | -2.78 |
| IT | 0.00 | 1.05 | -1.05 |
| Telecommunications | 2.03 | 0.57 | 1.47 |
| Utilities | 0.00 | 3.80 | -3.80 |
| Cash | 0.79 | 0.00 | 0.79 |
| Total | 100.00 | 100.00 | - |

Portfolio Activity

Major Purchases & Sales for June Quarter 2010

| Purchases | Sales |
|-------------------------|----------------|
| Miclyn Express Offshore | Asciano Group |
| Citadel Resources | Boart Longyear |

In April there were no significant purchases. The Portfolio sold Asciano Group (as the stock graduated to the S&P/ASX 50 Leaders Index) during the month with the proceeds reallocated across the Portfolio.

The Portfolio purchased Miclyn Express offshore (MIO) during the month of May. MIO is a leading offshore oil and gas service vessel company across Asia and the Middle East and has a 30 year track record of service to the offshore industry. MIO's attractions include its strong market reputation and customer relationships, large diversified young fleet of 104 vessels, and position to take advantage of opportunities to significantly grow its business in Thailand, Indonesia, Malaysia, Australia and Qatar. The Portfolio sold Boart Longyear during the month with the proceeds reallocated across the Portfolio.

In June the Portfolio purchased Citadel Resources (CGG). CGG is an emerging producer, focused on base metals and gold in the Kingdom of Saudi Arabia and is currently drilling two gold projects in Saudi Arabia. The flagship Jabal Sayid copper and gold project is on track for commissioning in mid 2011. CGG's attractions include; its low capital and operating costs, exploration upside and miner friendly initiatives put in place by the Saudi Arabian government, plus the potential for an improvement in the copper price. There were no significant sales for the month.

Contact Details

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