

Bookmakers Super Fund

Investment Managers Review

September Quarter 2009

Investment & Economic Review

The performance of the Balanced Option of the Bookmakers Super Fund (BSF) improved in the September quarter, helped by resurgence in share prices. The Conservative Option continued to perform satisfactorily, though low interest rates will keep the returns at a modest level.

The liquidity within the BSF Fund remains constrained by the slow redemption of the mortgage portfolio. Some progress has now been made towards realisation of some mortgages; however it will still take some considerable time for this exercise to be completed.

The September quarter witnessed the continuation of the solid market and economic recovery that commenced in the June quarter. Stimulatory action by Governments and Central Banks around the world proved to be unambiguously positive. However this positive effect is likely to be somewhat short-lasting as the lingering economic reality of the financial crisis may curtail the pace of recovery in 2010.

In October the Reserve Bank of Australia raised the cash interest rate to 3.25% from the previous setting of 3%. This change in policy followed better than expected economic growth in Australia, and an expectation that Australia's major trading partners will perform more strongly than the OECD average in 2010. We now expect short-term interest rates to steadily rise as the legacy of the financial crisis continues to ease into 2010.

Thankfully the dreadful investor and consumer sentiment that prevailed in late 2008 and early 2009 has now eased. Financial collapses have become less frequent, and corporate balance sheets have been significantly strengthened.

A notable characteristic of late has been the rush by many listed companies to raise funds via share issues, and reduce debt accordingly. These raisings have often been far from equitable to shareholders, but have generally had the positive effect of improving debt to equity ratios. The downside of share issues is the consequential dilutive effect on earnings per share. Next year's profits will need to be divided into many more shares, and many companies will thus report lower earnings per share and dividends, even if their overall net profit is steady or rises. The emerging reality of this phenomenon may weigh on stock market performance in 2010.

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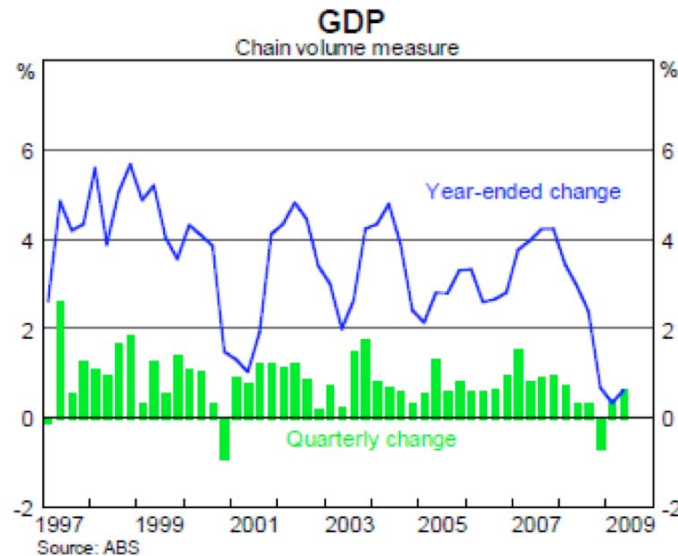
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Australia's Gross Domestic Product (GDP) has declined to a nominal rate of growth, but a significant recession, as is the case in much of Europe and the United States, has so far been avoided.



Australian GDP – Quarterly and Annual

We are now two years past the peak (October 2007) of the last investment and economic cycle. Full economic cycles tend to take between seven and ten years, so from the long term perspective it is reasonable to expect an economic lull for a while, before a period of more sustainable economic performance a few years hence. China will continue to assist our economic recovery as their GDP continues to grow at an outstanding rate of more than 8%. With the worst of the financial crisis behind us investment markets should remain supported and generally hold the improved levels of late.

Shares

The Australian stock market, as measured by the benchmark S&P ASX 200 Index, rose by 789 points or 20% during the quarter from 3955 to 4744 points. For the full year to 30 September the domestic market rose by 3.1%.

The stock market has had a roller-coaster year, but fortunately is now well past the capitulation point of March 2009 and prices have returned to more realistic levels reflecting the re-emergence of relief and optimism.

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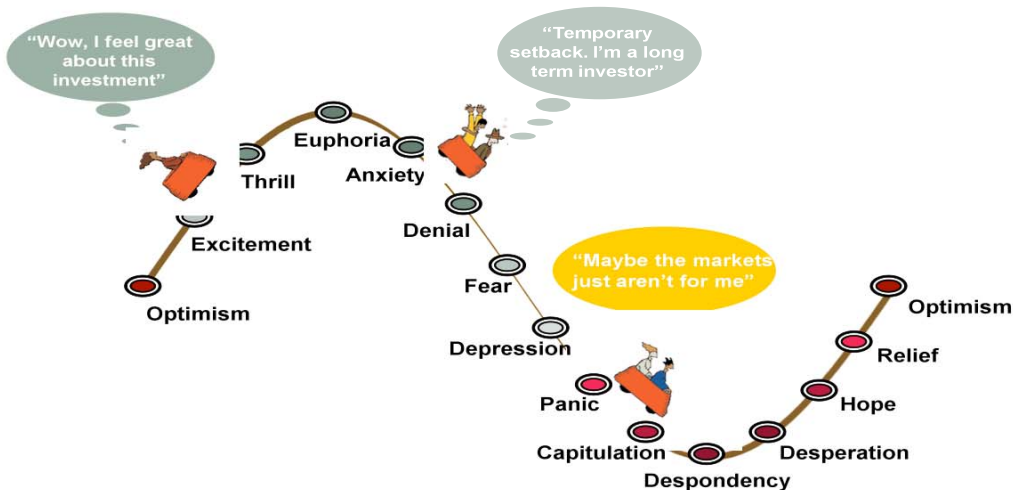
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Source: Westcore Funds/Denver Investment Advisors

Looking forward, the stock market will need to contend with the pressures of a mundane economic environment, the dilutive consequences of the numerous share issues and the more competitive returns offered by higher interest rates.

Translating these factors into a market forecast for 2010 suggests that a sideways market pattern may prevail for a while. Within this pattern there will be the usual up and down volatility. It is our expectation that the current strong rally in share prices will soon run out of steam, and a modest downwards correction is likely, probably prior to year end.

Share performance into 2010 will be also be driven by the capacity for companies to report reasonable profits and dividends, and this in turn will be dictated by the pace of economic growth. As economic growth will remain constrained share price appreciation may be modest, so it remains our strategy to recommend higher than usual levels of cash within portfolios, with the intent of acquiring more shares in leading companies either via discounted share offers or during periods of market weakness.

We have continued to reduce the number of shares within the BSF Balanced Option and to concentrate the portfolio mostly on the largest companies. The exposure to shares at quarter end was about 32% of the Fund, and has been reduced further in October to reflect our view that shares had become modestly overpriced. At quarter end the largest share investment of the Balanced Option were BHP Billiton, Commonwealth Bank, Westpac and National Australia Bank. The Conservative Option owns no shares.

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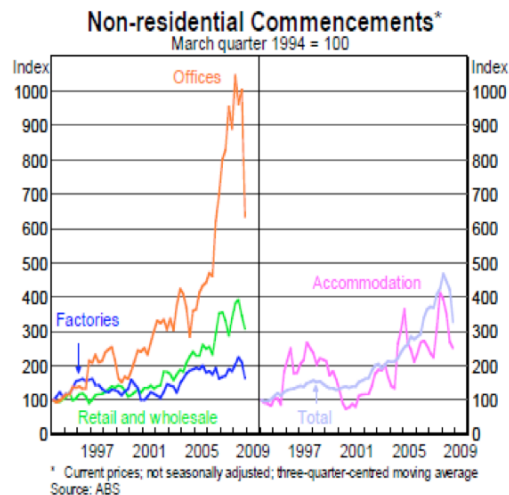
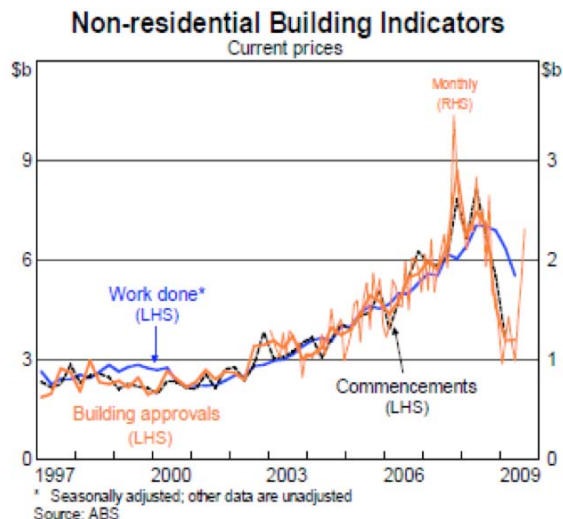
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Property

The market for commercial property appears to be nearing or already at the bottom of the down cycle and we see good value emerging over the next 12 months. Listed Real Estate Investment Trusts (REIT's) have shown pleasing resilience in the market since June 2009 and early signs of debt market support for this sector are encouraging. Furthermore, merger and corporate activity has recommenced in the sector and will continue into 2010.

The dilutive effect of large capital raisings in the REIT sector together with reluctance of REIT managers to provide earnings forecasts means caution and further review of the sector is warranted until these risks are clarified.

The two commercial properties owned by the BSF are fully tenanted and continue to perform satisfactorily. The residential properties controlled by the Fund pursuant to being mortgagee in possession are being prepared for sale.



Interest Rates

Interest rates have risen and will continue to rise into 2010. The 10 year Australian Government bond yield has already risen from the low point in January of 3.9% to the current level of 5.75%. The cash rate has been lifted for the first time in this cycle to 3.25%.

We expect the Reserve Bank to steadily raise short term interest rates during 2010 towards 5%, such that the yield curve gradually flattens. The yield curve represents the relationship between short term and long

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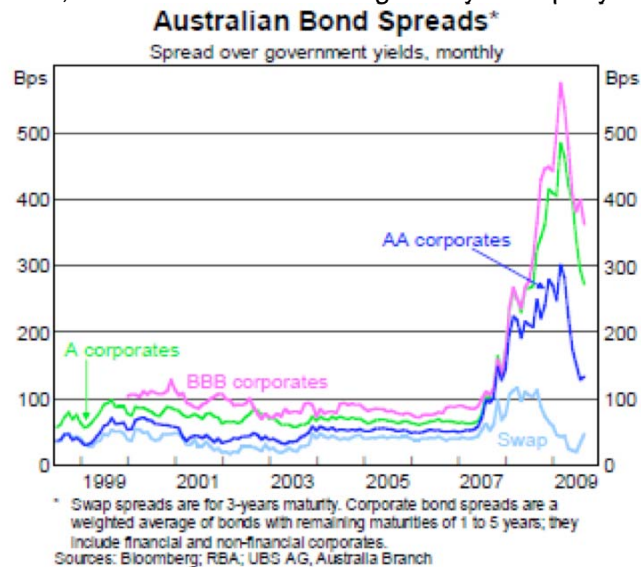
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term interest rates, and short term rates rising towards the long term level is a normal phenomenon during this stage of an economic cycle.

The most interesting aspect of interest rate markets lately has been the enormous blow-out in corporate spreads, and now some tentative signs of these spreads narrowing. The effect of this is that companies have had to pay a higher margin to borrow money, and this in turn has led to a frantic rush to raise equity instead. Credit spreads for 'A' rated corporations rose from the normal level of between 50 and 100 basis points to nearly 500 basis points, and are now contracting nearly as rapidly as they rose.



As spreads narrow the capital prices of some corporate debt rises, and this is evidenced in the price appreciation of many of the listed hybrid securities. We expect credit spreads to continue to narrow in 2010, but to not attain their previous low point till 2011, due to the lingering effect of the financial crisis.

The recent upwards pressure on longer term interest rates was coincident with the significant borrowings undertaken by the Federal Government to provide economic stimulus and to fund the large budget deficit.

Outlook

The recovery in asset prices and investor sentiment of late has occurred at a faster and more pleasing pace than could reasonably have been expected. Inevitably a rapid improvement needs to pause, and it is our expectation that such a pause is imminent as markets deal with the reality of rising interest rates and the residual consequences of the global financial crisis.

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2010 should be a satisfactory year, punctuated by periods of market volatility, both negative and positive. The major hurdle continues to be the lingering effect of the global financial crisis and, in particular, the likelihood of higher public sector debt, rising interest rates and lower company earnings per share.

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