

## Master Fund Quarterly Report – June 2010

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## Australian Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Australian Fund	1,763	-1.57	-9.04	-6.24	17.79	-1.92	-4.87	6.00	11.30
Benchmark*		-2.65	-11.20	-10.09	13.05	-5.10	-8.05	4.49	9.70

\* S&P/ASX 300 Accumulation Index

### Top 10 Stocks

Stock Name	%
BHP Billiton Limited	9.14
Westpac Banking Corporation	8.74
Commonwealth Bank of Australia	7.67
ANZ Banking Group Limited	6.74
Telstra Corporation Limited	5.46
Coal & Allied Industries Limited	5.31
Campbell Brothers Limited	3.64
Orica Limited	3.40
Woodside Petroleum Limited	2.76
Fletcher Building Limited	2.57
<b>TOTAL</b>	<b>55.43</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX 300 Accumulation Index fell by 11.2% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a selloff from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

Telecommunications was the only sector with a positive return over the period after news that Telstra (+8.7%) signed a non-binding agreement regarding their participation in the national broadband network. Property trusts (-1.5%) and consumer staples (-4.5%) also held up relatively well, in line with the risk aversion thematic which saw defensive stocks outperform the broader market. Industrials (-18.9%), financials (-15.1%) and information technology (-12.6%) were among the poorer performing sectors. Industrial companies fell due to weaker than expected quarterly results and profit downgrades from companies updating the market on earnings. The banks also fell on concerns over potential financial regulation and funding concerns.

### Portfolio Commentary

The Australian Share Fund outperformed its benchmark during the quarter.

Stocks the Fund is currently overweight include Coal & Allied Industries, Campbell Brothers and Westpac Banking Group. Coal & Allied is attractively valued with a strong balance sheet and sound management.

Campbell Brothers offers a strong growth profile at reasonable multiples. The Fund's underweight positions include BHP Billiton, Wesfarmers and Westfield Group Australia.

### **Stock Contributors**

Our overweight position to coal producer Coal and Allied (+3.4%) added to relative performance. The company released their quarterly report in May which highlighted lower coal production volumes as a result of decreased in-pit inventory, short term geotechnical issues and adverse weather conditions. Despite the lower production volumes, the company was able to maintain their yearly shipment guidance by successfully transferring their port allocation into the second half of the year. Furthermore, the company's production mix during the period allowed an increase in the sale of the more profitable semi-soft coal which should see a positive lift to their annual profit. We believe that the company is well placed to be a strong beneficiary of both the new quarterly pricing mechanic, and an increasing demand for coal.

Our overweight position to telecom giant Telstra (+8.7%) added to relative performance. The company's share price was influenced over the quarter by the potential agreement regarding the National Broadband Network. Rumours of an agreement being reached sent the company share prices up over April, before concerns over the agreement not being finalised saw their price retreat over May. A non-binding Heads of Agreement was finally signed in June, removing the uncertainty that overhung the stock. Shareholders are expected to approve the \$11bn deal in the first half of 2011. We currently remain overweight on Telstra. The company continues to pay large dividends and if the NBN deal is approved, Telstra will have access to significant levels of cash to fund future growth.

### **Stock Detractors**

Not holding shopping mall operator Westfield Group (+1.0%) detracted from relative performance. Westfield outperformed over the quarter, following positive offshore leads and encouraging macroeconomic indicators. Of note, United States (US) real estate investment trusts (REITs) saw meaningful gains during the start of the quarter as stronger than expected retail sales figures pointed to a broadening of the manufacturing-led US economic recovery. Westfield derives significant revenue from their offshore US investments. The company also reconfirmed its 2010 guidance over the period, and revealed plans for new development projects in Australia and the United States that could reach \$1 billion. Their dividend forecast of 64 cents per security was reaffirmed during their annual general meeting, with chairman and joint founder Frank Lowy stating that positive signs were emerging in the fundamentals of the economies in which Westfield operated. Despite their defensive qualities, we do not hold Westfield in the portfolio due to its current relative high valuation.

Our overweight position to Westpac Bank (-21.6%) detracted from relative performance. The company announced first half 2010 cash earnings up 30% to \$2,983 million, due to lower bad debts from institutional investors and improved earnings from wealth management. Westpac chief executive officer, Gail Kelly commented that the result reflected a much improved Australian economy and good momentum across all businesses. Westpac had also taken the opportunity to further strengthen its balance sheet. The company's share price fell however, marred by concerns of net interest margin compression resulting from increased funding pressure due to an expanded mortgage book in a market influenced by liquidity rationing. Despite these headwinds, we feel Westpac is one of the higher quality banks.

### **Outlook**

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. However, risks to short term earnings do remain as global growth concerns continue to impact market sentiment. The new deal revealed by the Government on the resources tax is much less onerous for the Australian mining industry. The impact of the tax on valuations is now estimated to be in the range of 0-5% instead of the 10-15% originally forecast. This resolution will provide greater certainty for equity markets. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.

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## Balanced Growth Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Balanced Growth Fund	847	-1.00	-3.84	-2.18	11.37	-0.34	-3.62	3.01	6.63
Benchmark*		-1.43	-3.42	-2.01	10.45	-0.49	-3.86	3.73	6.63

\* The Benchmark indices are calculated using a weighted combination of the following sector benchmarks: UBS Bank Bill Index, UBS All Maturities Composite Bond Index, S&P/ASX 300 Accumulation Index, MSCI World ex Aust Accumulation Index (A\$) and MSCI World ex Australia Accumulation Index (Hedged to \$A) (developed component) and MSCI Emerging Markets Index (A\$) (emerging markets component), UBS Australian Government 3 to 5 Year Bond Index and UBS Bank Bill Index plus 3%

### Top 10 Stocks

Stock Name	Country	%
BHP Billiton Limited	Australia	2.87
Westpac Banking Corporation	Australia	2.80
Commonwealth Bank of Australia	Australia	2.44
ANZ Banking Group Limited	Australia	2.15
Telstra Corporation Limited	Australia	1.75
Coal & Allied Industries Limited	Australia	1.73
Nestle SA	Switzerland	1.22
Campbell Brothers Limited	Australia	1.19
Westfield Group	Australia	1.16
Orica Limited	Australia	1.10
<b>TOTAL</b>		<b>18.41</b>

### Market Commentary

The MSCI World ex Australia index finished the quarter 4.8% lower. Financials were in the spotlight as SEC sued Goldman Sachs for allegedly misstating and omitting facts about collateralised debt obligations. In the US the Federal Reserve lowered its assessment of the economic recovery and there was a 16.4% fall in consumer confidence in June. In Europe, Moody's Investor Services downgraded Greece government bond ratings to junk status and Spain's current rating was placed on review. Commodity prices fell in response to the heightened economic uncertainty, with Oil down 16.5% from its recent high of \$88.45/bbl on May 3<sup>rd</sup>. Against this backdrop the Australian dollar fell 8.0% against the greenback, reducing the losses for domestic investors.

The Australian market was also down due to concerns about the global economy. In major domestic news, Kevin Rudd was ousted by Julia Gillard after proposing a new tax on resource profits. The new tax put pressure on our market early in the quarter. However after the change of Prime Minister a compromise was reached and this helped the market somewhat. Telstra reached an agreement with the NBN Co to participate in the rollout of the fixed national broadband network. The transaction is worth \$11 billion and includes payment for the decommissioning of Telstra's copper network and use of its infrastructure.

Credits came under significant pressure during the quarter driven mainly by sovereign debt concerns from the EU and financial regulatory changes in the US. This resulted in an increase in risk aversion and saw US bonds rally, with the ten-year yield finishing the month at 2.9%. The yield spread between the Greek and German ten-year bond has increased significantly during the second quarter, rising from 344 to 784 basis points. Non sovereign credit spreads also widened.

## Portfolio Commentary

The Balanced Growth Fund underperformed its benchmark during the quarter.

### Asset Allocation

TAA detracted marginally from performance over the quarter, with positive performance from our positioning in Australian bonds offset by underperformance from our positioning in Australian equities. We were underweight Australian equities in May as the market fell, which added value. However this was offset by overweight positions to Australian equities in April and May, when markets also fell.

We moved to an overweight position to Australian bonds over the quarter due a change in momentum and improvements in the cycle, from negative to neutral. Key to our neutral view of the bond cycle is declining local economic activity and falling long term US interest rates. These are seen as positive for the cycle and countered the negative effect of rising short term local rates.

### Stock Selection

Stock Selection was positive with Australian equities and fixed income beating their benchmarks. A key holding driving this within the Australian equities portfolio was result was Campbell Brothers. Campbell Brothers rallied due to an upbeat earnings announcement. The credit portfolio outperformed due to its holdings in property and local bank debt. Also benefiting the portfolio was where it was positioned on the yield curve in specific sub sectors and its strong running yield.

This was in contrast to the global portfolio, which underperformed. This was in part due to its holdings in the US drug store chain, Walgreen, which fell after reporting disappointing earnings. Walgreen continues to work on turning things around, focusing on costs and introducing beer and wine to its product range. The company also stands to benefit from a new wave of higher margin generic drugs coming to the market in 2011/12.

### Outlook

The persistence of European sovereign debt problems, the potential slowing of global growth and government intervention across the mining and health care sectors continue to impact sentiment in the local market. Since the fall from its recent peak in mid April 2010, the Australian equity market is now trading at below fair value and this is providing opportunities for investment in selected companies. The market remains particularly sensitive to any news which may impact earnings, and in this environment we continue to search for attractively valued, quality companies with a history of recurring earnings for inclusion into our portfolios.

Our outlook for credit is neutral. Despite the macroeconomic risks prevalent in the EU, economic data locally continues to remain sound and in the US economic data is supportive of a recovery. The credit metrics of domestic corporates continue to remain robust evidenced by ratings upgrades. Recent supply has been constrained and we envisage a strong month of maturities in July which will be a driver of credit demand. Despite a positive macroeconomic outlook and neutral valuations, technicals have turned negative. Recently market momentum has turned decidedly negative with regards to this measure and we cannot see volatility abating in the short term.

## Concentrated Equity Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Concentrated Equity Fund	943	-2.11	-9.59	-6.56	14.72	0.00	-3.18	7.24	11.37
Benchmark*		-2.65	-11.20	-10.09	13.05	-5.10	-8.05	4.49	9.70

\* S&P/ASX 300 Accumulation Index

### Top 10 Stocks

Stock Name	%
Commonwealth Bank of Australia	12.02
BHP Billiton Limited	11.22
Westpac Banking Corporation	8.19
Coal & Allied Industries Limited	7.25
Orica Limited	6.38
Telstra Corporation Limited	4.40
Rio Tinto Limited	4.22
Computershare Limited	3.41
Foster's Group Limited	3.31
ANZ Banking Group Limited	3.00
<b>TOTAL</b>	<b>63.40</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX 300 Accumulation Index fell by 11.2% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a selloff from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

Telecommunications was the only sector with a positive return over the period after news that Telstra (+8.7%) signed a non-binding agreement regarding their participation in the national broadband network. Property trusts (-1.5%) and consumer staples (-4.5%) also held up relatively well, in line with the risk aversion thematic which saw defensive stocks outperform the broader market. Industrials (-18.9%), financials (-15.1%) and information technology (-12.6%) were among the poorer performing sectors. Industrial companies fell due to weaker than expected quarterly results and profit downgrades from companies updating the market on earnings. The banks also fell on concerns over potential financial regulation and funding concerns.

### Portfolio Commentary

The Concentrated Equity Fund outperformed its benchmark during the quarter.

Stocks the Fund is currently overweight include Coal & Allied Industries, Orica and Commonwealth Bank of Australia. Coal & Allied is attractively valued with a strong balance sheet and sound management. Orica is well positioned to grow earnings over the next two years and will benefit from greater focus once Dulux has

been spun off. The Fund's underweight positions include National Australia Bank, Wesfarmers and Westfield Group Australia.

### **Stock Contributors**

Our overweight position to coal producer Coal and Allied (+3.4%) added to relative performance. The company released their quarterly report in May which highlighted lower coal production volumes as a result of decreased in-pit inventory, short term geotechnical issues and adverse weather conditions. Despite the lower production volumes, the company was able to maintain their yearly shipment guidance by successfully transferring their port allocation into the second half of the year. Furthermore, the company's production mix during the period allowed an increase in the sale of the more profitable semi-soft coal which should see a positive lift to their annual profit. We believe that the company is well placed to be a strong beneficiary of both the new quarterly pricing mechanic, and an increasing demand for coal.

Our overweight position to beverage producer Fosters Group (+6.8%) added to relative performance. The company performed well over the quarter, benefitting from the markets continued flight to companies with defensive earnings. Despite the improvements in the US wine market, the wine brands under Fosters Group continue to struggle. The biggest news for the company came towards the end of May when they announced their intention to demerge their beer and wine assets into separately listed entities. The beer business will focus on reinvesting in its key brands to continue positive earnings growth, whilst the wine business will look at brand rationalisation and vineyard divestment. The company also indicated that it expected its financial year 2010 earnings to be in line with consensus in the range of \$1.05 to \$1.08 billion. We see the demerger as a positive move as it should allow the true value of the beer business to be unlocked, and continue to be attracted to the company's defensive qualities.

### **Stock Detractors**

Not holding gold producer Lihir Gold (+42.4%) detracted from relative performance. Lihir Gold became the centre of focus during the period due to their immunity to the RSPT (offshore mines) as well as receiving a takeover offer from Newcrest Mining (NCM). The company claimed that the first offer of one NCM share for every nine Lihir Gold shares plus \$0.225 cash per Lihir share minus the interim dividend was inadequate. NCM came back in May with a revised Merger Implementation Agreement which was unanimously recommended by the directors of Lihir. Shareholders are expected to approve the merger in late July. During the period, the company also released production targets for their mines, revealing plans for significant increases in gold output. The company is not held in the portfolio as it is considered too expensive at this time relative to other stocks in our universe.

Not holding shopping mall operator Westfield Group (+1.0%) detracted from relative performance. Westfield outperformed over the quarter, following positive offshore leads and encouraging macroeconomic indicators. Of note, United States (US) real estate investment trusts (REITs) saw meaningful gains during the start of the quarter as stronger than expected retail sales figures pointed to a broadening of the manufacturing-led US economic recovery. Their dividend forecast of 64 cents per security was reaffirmed during their annual general meeting, with chairman and joint founder Frank Lowy stating that positive signs were emerging in the fundamentals of the economies in which Westfield operated. Despite their defensive qualities, we do not hold Westfield in the portfolio due to its current relative high valuation.

### **Outlook**

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. However, risks to short term earnings do remain as global growth concerns continue to impact market sentiment. The new deal revealed by the Government on the resources tax is much less onerous for the Australian mining industry. The impact of the tax on valuations is now estimated to be in the range of 0-5% instead of the 10-15% originally forecast. This resolution will provide greater certainty for equity markets. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.

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## Conservative Growth Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Conservative Growth Fund	198	0.06	-0.22	1.52	9.79	4.35	2.62	5.29	-
Benchmark*		-0.06	-0.12	1.23	8.91	3.52	1.64	5.04	-

\* The Benchmark indices are calculated using a weighted combination of the following sector benchmarks:

UBS Bank Bill Index, UBS All Maturities Composite Bond Index, S&P/ASX 300 Accumulation Index, MSCI World ex Aust Accumulation Index (A\$) and MSCI World ex Australia Accumulation Index (Hedged to \$A) (developed component) and MSCI Emerging Markets Index (A\$) (emerging markets component), UBS Australian Government 3 to 5 Year Bond Index and UBS Bank Bill Index plus 3%

### Top 10 Stocks

Stock Name	Country	%
BHP Billiton Limited	Australia	1.29
Westpac Banking Corporation	Australia	1.20
Westfield Group	Australia	1.15
Commonwealth Bank of Australia	Australia	1.06
ANZ Banking Group Limited	Australia	0.93
Telstra Corporation Limited	Australia	0.75
Coal & Allied Industries Limited	Australia	0.70
Stockland	Australia	0.52
Nestle SA	Switzerland	0.51
Australand Wholesale Property Fund No 6	Australia	0.49
<b>TOTAL</b>		<b>8.60</b>

### Market Commentary

The MSCI World ex Australia index finished the quarter 4.8% lower. Financials were in the spotlight as SEC sued Goldman Sachs for allegedly misstating and omitting facts about collateralised debt obligations. In the US the Federal Reserve lowered its assessment of the economic recovery and there was a 16.4% fall in consumer confidence in June. In Europe, Moody's Investor Services downgraded Greece government bond ratings to junk status and Spain's current rating was placed on review. Commodity prices fell in response to the heightened economic uncertainty, with Oil down 16.5% from its recent high of \$88.45/bbl on May 3<sup>rd</sup>. Against this backdrop the Australian dollar fell 8.0% against the greenback, reducing the losses for domestic investors.

The Australian market was also down due to concerns about the global economy. In major domestic news, Kevin Rudd was ousted by Julia Gillard after proposing a new tax on resource profits. The new tax put pressure on our market early in the quarter. However after the change of Prime Minister a compromise was reached and this helped the market somewhat. Telstra reached an agreement with the NBN Co to participate in the rollout of the fixed national broadband network. The transaction is worth \$11 billion and includes payment for the decommissioning of Telstra's copper network and use of its infrastructure.

Credits came under significant pressure during the quarter driven mainly by sovereign debt concerns from the EU and financial regulatory changes in the US. This resulted in an increase in risk aversion and saw US bonds rally, with the ten-year yield finishing the month at 2.9%. The yield spread between the Greek and German ten-year bond has increased significantly during the second quarter, rising from 344 to 784 basis points. Non sovereign credit spreads also widened.

## Portfolio Commentary

The Conservative Growth Fund underperformed its benchmark during the quarter.

### Asset Allocation

TAA detracted marginally from performance over the quarter, with positive performance from our positioning in Australian bonds offset by underperformance from our positioning in Australian equities. We were underweight Australian equities in May as the market fell, which added value. However this was offset by overweight positions to Australian equities in April and May, when markets also fell.

We moved to an overweight position to Australian bonds over the quarter due a change in momentum and improvements in the cycle, from negative to neutral. Key to our neutral view of the bond cycle is declining local economic activity and falling long term US interest rates. These are seen as positive for the cycle and countered the negative effect of rising short term local rates.

### Stock Selection

Stock Selection was positive with Australian equities and fixed income beating their benchmarks. A key holding driving this within the Australian equities portfolio was result was Campbell Brothers. Campbell Brothers rallied due to an upbeat earnings announcement. The credit portfolio outperformed due to its holdings in property and local bank debt. Also benefiting the portfolio was where it was positioned on the yield curve in specific sub sectors and its strong running yield.

This was in contrast to the global portfolio, which underperformed. This was in part due to its holdings in the US drug store chain, Walgreen, which fell after reporting disappointing earnings. Walgreen continues to work on turning things around, focusing on costs and introducing beer and wine to its product range. The company also stands to benefit from a new wave of higher margin generic drugs coming to the market in 2011/12.

## Outlook

The persistence of European sovereign debt problems, the potential slowing of global growth and government intervention across the mining and health care sectors continue to impact sentiment in the local market. Since the fall from its recent peak in mid April 2010, the Australian equity market is now trading at below fair value and this is providing opportunities for investment in selected companies. The market remains particularly sensitive to any news which may impact earnings, and in this environment we continue to search for attractively valued, quality companies with a history of recurring earnings for inclusion into our portfolios.

Our outlook for credit is neutral. Despite the macroeconomic risks prevalent in the EU, economic data locally continues to remain sound and in the US economic data is supportive of a recovery. The credit metrics of domestic corporates continue to remain robust evidenced by ratings upgrades. Recent supply has been constrained and we envisage a strong month of maturities in July which will be a driver of credit demand. Despite a positive macroeconomic outlook and neutral valuations, technicals have turned negative. Recently market momentum has turned decidedly negative with regards to this measure and we cannot see volatility abating in the short term.

## Diversified Growth Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Diversified Growth Fund	29	-0.53	-2.13	-0.30	10.52	2.37	-0.29	4.08	6.32
Benchmark*		-0.87	-2.13	-0.79	9.62	1.22	-1.62	3.93	5.99

\* The Benchmark indices are calculated using a weighted combination of the following sector benchmarks: UBS Bank Bill Index, UBS All Maturities Composite Bond Index, S&P/ASX 300 Accumulation Index, MSCI World ex Aust Accumulation Index (A\$) and MSCI World ex Australia Accumulation Index (Hedged to \$A) (developed component) and MSCI Emerging Markets Index (A\$) (emerging markets component), UBS Australian Government 3 to 5 Year Bond Index and UBS Bank Bill Index plus 3%

### Top 10 Stocks

Stock Name	Country	%
BHP Billiton Limited	Australia	2.27
Westpac Banking Corporation	Australia	2.11
Commonwealth Bank of Australia	Australia	1.87
ANZ Banking Group Limited	Australia	1.63
Telstra Corporation Limited	Australia	1.31
Coal & Allied Industries Limited	Australia	1.24
Westfield Group	Australia	1.21
Nestle SA	Switzerland	0.89
Campbell Brothers Limited	Australia	0.85
Orica Limited	Australia	0.80
<b>TOTAL</b>		<b>14.18</b>

### Market Commentary

The MSCI World ex Australia index finished the quarter 4.8% lower. Financials were in the spotlight as SEC sued Goldman Sachs for allegedly misstating and omitting facts about collateralised debt obligations. In the US the Federal Reserve lowered its assessment of the economic recovery and there was a 16.4% fall in consumer confidence in June. In Europe, Moody's Investor Services downgraded Greece government bond ratings to junk status and Spain's current rating was placed on review. Commodity prices fell in response to the heightened economic uncertainty, with Oil down 16.5% from its recent high of \$88.45/bbl on May 3<sup>rd</sup>. Against this backdrop the Australian dollar fell 8.0% against the greenback, reducing the losses for domestic investors.

The Australian market was also down due to concerns about the global economy. In major domestic news, Kevin Rudd was ousted by Julia Gillard after proposing a new tax on resource profits. The new tax put pressure on our market early in the quarter. However after the change of Prime Minister a compromise was reached and this helped the market somewhat. Telstra reached an agreement with the NBN Co to participate in the rollout of the fixed national broadband network. The transaction is worth \$11 billion and includes payment for the decommissioning of Telstra's copper network and use of its infrastructure.

Credits came under significant pressure during the quarter driven mainly by sovereign debt concerns from the EU and financial regulatory changes in the US. This resulted in an increase in risk aversion and saw US bonds rally, with the ten-year yield finishing the month at 2.9%. The yield spread between the Greek and German ten-year bond has increased significantly during the second quarter, rising from 344 to 784 basis points. Non sovereign credit spreads also widened.

## Portfolio Commentary

The Diversified Growth Fund performed in line with its benchmark during the quarter.

### Asset Allocation

TAA detracted marginally from performance over the quarter, with positive performance from our positioning in Australian bonds offset by underperformance from our positioning in Australian equities. We were underweight Australian equities in May as the market fell, which added value. However this was offset by overweight positions to Australian equities in April and May, when markets also fell.

We moved to an overweight position to Australian bonds over the quarter due a change in momentum and improvements in the cycle, from negative to neutral. Key to our neutral view of the bond cycle is declining local economic activity and falling long term US interest rates. These are seen as positive for the cycle and countered the negative effect of rising short term local rates.

### Stock Selection

Stock Selection was positive with Australian equities and fixed income beating their benchmarks. A key holding driving this within the Australian equities portfolio was result was Campbell Brothers. Campbell Brothers rallied due to an upbeat earnings announcement. The credit portfolio outperformed due to its holdings in property and local bank debt. Also benefiting the portfolio was where it was positioned on the yield curve in specific sub sectors and its strong running yield.

This was in contrast to the global portfolio, which underperformed. This was in part due to its holdings in the US drug store chain, Walgreen, which fell after reporting disappointing earnings. Walgreen continues to work on turning things around, focusing on costs and introducing beer and wine to its product range. The company also stands to benefit from a new wave of higher margin generic drugs coming to the market in 2011/12.

## Outlook

The persistence of European sovereign debt problems, the potential slowing of global growth and government intervention across the mining and health care sectors continue to impact sentiment in the local market. Since the fall from its recent peak in mid April 2010, the Australian equity market is now trading at below fair value and this is providing opportunities for investment in selected companies. The market remains particularly sensitive to any news which may impact earnings, and in this environment we continue to search for attractively valued, quality companies with a history of recurring earnings for inclusion into our portfolios.

Our outlook for credit is neutral. Despite the macroeconomic risks prevalent in the EU, economic data locally continues to remain sound and in the US economic data is supportive of a recovery. The credit metrics of domestic corporates continue to remain robust evidenced by ratings upgrades. Recent supply has been constrained and we envisage a strong month of maturities in July which will be a driver of credit demand. Despite a positive macroeconomic outlook and neutral valuations, technicals have turned negative. Recently market momentum has turned decidedly negative with regards to this measure and we cannot see volatility abating in the short term.

## Diversified Income Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Diversified Income Fund	162	0.85	1.74	5.23	12.75	3.56	2.24	-	-
Benchmark*		0.40	1.12	2.15	3.89	4.68	5.56	-	-

\* UBS Australian Bank Bill Index

### Portfolio Composition

<b>Core Component Ratings</b>	<b>95.88%</b>
Perpetual's Credit Income Fund (Af)	34.28%
Cash*	2.29%
AAA	28.28%
AA	8.58%
A	12.37%
BBB	10.08%
<b>Plus Component breakdown</b>	<b>4.12%</b>
1 <sup>st</sup> Registered Mortgages	0.55%
Mezzanine Mortgages	1.30%
BB	0.74%
B	0.59%
C	0.23%
NR	0.71%

\* Includes cash and short term bank securities.

### Market Commentary

Despite concerns about the sustainability of the economic recovery mounted amid softer-than-expected economic readings, domestic credit market remained broadly stable. Sovereign bond yields tumbled globally and spreads on riskier assets widened. Volatility and risk aversion increased during the quarter. European sovereign woes remained at the fore and steps aimed at easing fears did little to calm markets. Expectations for more muted Chinese growth further dampened market sentiment. Also adding to market anxiety were concerns surrounding the impact on banks of US financial reform legislation.

During the quarter local credits on the whole were resilient. Riskier assets across the credit spectrum did underperform, however, as the flight to safety premium remained elevated. Market anxiety and risk aversion also impacted the new issuance market with volumes dropping off significantly in the latter part of the quarter. Over the period, physical credit spreads again outperformed the synthetic index. The iTraxx Australia Synthetic Index (5 year margin on 25 major Australian banks and corporates) widened to a closing high of 146bps before ending the quarter 49bps wider at 135bps.

### Portfolio Commentary

The Diversified Income Fund outperformed its benchmark during the quarter.

As concerns about the sustainability of the economic recovery mounted amid softer-than-expected economic readings, credit markets advanced. Bond yields tumbled globally and spreads on risk assets also widened. Volatility and risk aversion increased during the quarter. European sovereign woes remained at the fore and steps aimed at easing fears did little to calm markets. Expectations for more muted Chinese growth further dampened market sentiment.

At a sector level, the portfolio benefited from RMBS as well as non-conforming RMBS, this was largely due to improved credit support from amortisation and strong market demand. The largest negative contributor to portfolio performance was the offshore banks which detracted 13bps from performance. This was driven by uncertainty over the impact of the US financial overhaul bill and the ongoing EU sovereign debt crisis weighing on market confidence. Since the September quarter of 2009, we have halved the portfolio's exposure to this sector, following increasing regulatory risk globally and a decline in its relative value over this period.

The current yield to maturity on the portfolio remains strong at 8.40% (3.78% above benchmark). The portfolio remains well positioned to take advantage of current credit markets.

### **Outlook**

Looking forward we have the pending release of the EU bank stress tests. It is expected that they will be announced on the 23rd of July. A year ago US banks released stress test results and immediately provided statements detailing their strategies to recapitalise. This triggered a strong rebound in the markets as it reduced uncertainty and restored confidence in the banking system.

At present it is difficult to know whether the markets will react in the same way. So far there has been little detail released on what the EU bank stress tests involve (whether they will include a sovereign default scenario) and how much transparency will be provided.

We also have the finalisation of the EU 440 billion emergency aid mechanism. It had been scheduled for launch on July 1 but was delayed due to Slovakia's newly elected government refusing to sign off on the agreement. EU leaders remain confident that it will be operational around the time the stress tests are released. This will ensure support will be provided in the event there is a fall out from the release of the results.

A general lack of clarity seems to be the main source of the market's anxiety. As a consequence investors are reluctant to take on risk. However locally, we expect demand for credit to remain resilient as there are significant (\$8bn) maturities in July. This is a positive dynamic as new supply has been constrained recently and investors will eventually look to redeploy capital. At present we remain neutral on the credit markets. Despite having a positive view on fundamentals we remain cautious as there is still limited transparency with regards to the capital requirement of banks due to regulatory changes in the financial markets the impact of fiscal fade on US and EU economies; and the method and outcome of the EU stress test.

Tempering this positive view on fundamentals are technicals. This measure has remained decidedly negative and will also weigh on sentiment.

## Ethical SRI Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Ethical SRI Fund	299	-3.97	-9.37	-4.40	36.69	9.99	-4.34	8.87	12.22
Benchmark*		-2.65	-11.20	-10.09	13.05	-5.10	-8.05	4.49	9.70

\* S&P/ASX 300 Accumulation Index

### Top 10 Stocks

Stock Name	%
Westpac Banking Corporation	10.32
Commonwealth Bank of Australia	10.22
National Australia Bank Limited	7.96
TPG Telecom Limited	7.13
ANZ Banking Group Limited	6.21
Telstra Corporation Limited	4.89
QBE Insurance Group Limited	3.98
Breville Group Limited	3.84
NIB Holdings Limited	3.29
McPherson's Limited	2.63
<b>TOTAL</b>	<b>60.47</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX 300 Accumulation Index fell by 11.2% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a selloff from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

Telecommunications was the only sector with a positive return over the period after news that Telstra (+8.7%) signed a non-binding agreement regarding their participation in the national broadband network. Property trusts (-1.5%) and consumer staples (-4.5%) also held up relatively well, in line with the risk aversion thematic which saw defensive stocks outperform the broader market. Industrials (-18.9%), financials (-15.1%) and information technology (-12.6%) were among the poorer performing sectors. Industrial companies fell due to weaker than expected quarterly results and profit downgrades from companies updating the market on earnings. The banks also fell on concerns over potential financial regulation and funding concerns.

### Portfolio Commentary

The Ethical SRI Fund outperformed its benchmark during the quarter.

Stocks the Fund is currently overweight include TPG Telecom, Breville Group and Westpac Banking Corporation. TPG is Australia's fastest growing broadband provider. Breville has strong brand names and prudent capital management. The Fund's underweight positions include BHP Billiton, Woolworths and

Wesfarmers. These three companies do not pass the socially responsible investment (SRI) screens and are therefore not held in the Fund.

### **Stock Contributors**

Our overweight position to telecom giant Telstra (+8.7%) added to relative performance. The company's share price was influenced over the quarter by the potential agreement regarding the National Broadband Network. Rumours of an agreement being reached sent the company share prices up over April, before concerns over the agreement not being finalised saw their price retreat over May. A non-binding Heads of Agreement was finally signed in June, removing the uncertainty that overhung the stock. Shareholders are expected to approve the \$11bn deal in the first half of 2011. We currently remain overweight on Telstra. The company continues to pay large dividends and if the NBN deal is approved, Telstra will have access to significant levels of cash to fund future growth.

Our overweight position to metallurgical and mineral testing services supplier Ammtec (+28.8%) added to relative performance. Ammtec rejected an offer from Campbell Brothers during the quarter, of \$3.35 cash per share or an all share alternative. The offer was made at a 33% premium to the closing price on that day, valuing the company at \$123 million. The Ammtec board rejected the offer, stating that the proposed offer undervalues the company and provides no recognition of expected trading conditions for financial year 2011 and beyond. Ammtec also provided earnings guidance during the period, expecting revenue of between \$73.3 and \$79.1 million.

### **Stock Detractors**

Not holding shopping mall operator Westfield Group (+1.0%) detracted from relative performance. Westfield outperformed over the quarter, following positive offshore leads and encouraging macroeconomic indicators. Of note, United States (US) real estate investment trusts (REITs) saw meaningful gains during the start of the quarter as stronger than expected retail sales figures pointed to a broadening of the manufacturing-led US economic recovery. Westfield derives significant revenue from their offshore US investments. The company also reconfirmed its 2010 guidance over the period, and revealed plans for new development projects in Australia and the United States that could reach \$1 billion. Their dividend forecast of 64 cents per security was reaffirmed during their annual general meeting, with chairman and joint founder Frank Lowy stating that positive signs were emerging in the fundamentals of the economies in which Westfield operated. Despite their defensive qualities, we do not hold Westfield in the portfolio due to its current relative high valuation.

Our overweight position to Westpac Bank (-21.6%) detracted from relative performance. The company announced first half 2010 cash earnings up 30% to \$2,983 million, due to lower bad debts from institutional investors and improved earnings from wealth management. Westpac chief executive officer, Gail Kelly commented that the result reflected a much improved Australian economy and good momentum across all businesses. Westpac had also taken the opportunity to further strengthen its balance sheet. The company's share price fell however, marred by concerns of net interest margin compression resulting from increased funding pressure due to an expanded mortgage book in a market influenced by liquidity rationing. Despite these headwinds, we feel Westpac is one of the higher quality banks. We are comfortable with our exposure to the company and believe it is well placed to deliver profit and dividend growth into 2011.

### **Outlook**

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. However, risks to short term earnings do remain as global growth concerns continue to impact market sentiment. The new deal revealed by the Government on the resources tax is much less onerous for the Australian mining industry. The impact of the tax on valuations is now estimated to be in the range of 0-5% instead of the 10-15% originally forecast. This resolution will provide greater certainty for equity markets. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.

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## Geared Australian Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Geared Australian Fund	379	-4.21	-21.75	-18.25	29.89	-19.51	-24.36	-1.40	10.78
Benchmark*		-2.65	-11.20	-10.09	13.05	-5.10	-8.05	4.49	9.70

\* S&P/ASX 300 Accumulation Index

### Top 10 Stocks

Stock Name	%
BHP Billiton Limited	9.29
Westpac Banking Corporation	8.89
Commonwealth Bank of Australia	7.77
ANZ Banking Group Limited	6.90
Coal & Allied Industries Limited	5.77
Telstra Corporation Limited	5.56
Campbell Brothers Limited	3.74
Orica Limited	3.46
Woodside Petroleum Limited	2.85
Fletcher Building Limited	2.70
<b>TOTAL</b>	<b>56.93</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX 300 Accumulation Index fell by 11.2% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a selloff from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

Telecommunications was the only sector with a positive return over the period after news that Telstra (+8.7%) signed a non-binding agreement regarding their participation in the national broadband network. Property trusts (-1.5%) and consumer staples (-4.5%) also held up relatively well, in line with the risk aversion thematic which saw defensive stocks outperform the broader market. Industrials (-18.9%), financials (-15.1%) and information technology (-12.6%) were among the poorer performing sectors. Industrial companies fell due to weaker than expected quarterly results and profit downgrades from companies updating the market on earnings. The banks also fell on concerns over potential financial regulation and funding concerns.

### Portfolio Commentary

The Geared Australian Fund significantly underperformed its benchmark during the quarter.

The underlying fund is currently overweight include Coal & Allied Industries, Campbell Brothers and Westpac Banking Group. Coal & Allied is attractively valued with a strong balance sheet and sound

management. Campbell Brothers offers a strong growth profile at reasonable multiples. The Fund's underweight positions include BHP Billiton, Wesfarmers and Westfield Group Australia.

### Stock Contributors

Our overweight position to coal producer Coal and Allied (+3.4%) added to relative performance. The company released their quarterly report in May which highlighted lower coal production volumes as a result of decreased in-pit inventory, short term geotechnical issues and adverse weather conditions. Despite the lower production volumes, the company was able to maintain their yearly shipment guidance by successfully transferring their port allocation into the second half of the year. Furthermore, the company's production mix during the period allowed an increase in the sale of the more profitable semi-soft coal which should see a positive lift to their annual profit. We believe that the company is well placed to be a strong beneficiary of both the new quarterly pricing mechanic, and an increasing demand for coal.

Our overweight position to telecom giant Telstra (+8.7%) added to relative performance. The company's share price was influenced over the quarter by the potential agreement regarding the National Broadband Network. Rumours of an agreement being reached sent the company share prices up over April, before concerns over the agreement not being finalised saw their price retreat over May. A non-binding Heads of Agreement was finally signed in June, removing the uncertainty that overhung the stock. Shareholders are expected to approve the \$11bn deal in the first half of 2011. We currently remain overweight on Telstra. The company continues to pay large dividends and if the NBN deal is approved, Telstra will have access to significant levels of cash to fund future growth.

### Stock Detractors

Our overweight position to Westpac Bank (-21.6%) detracted from relative performance. The company announced first half 2010 cash earnings up 30% to \$2,983 million, due to lower bad debts from institutional investors and improved earnings from wealth management. Westpac chief executive officer, Gail Kelly commented that the result reflected a much improved Australian economy and good momentum across all businesses. Westpac had also taken the opportunity to further strengthen its balance sheet. The company's share price fell however, marred by concerns of net interest margin compression resulting from increased funding pressure due to an expanded mortgage book in a market influenced by liquidity rationing. Despite these headwinds, we feel Westpac is one of the higher quality banks. We are comfortable with our exposure to the company and believe it is well placed to deliver profit and dividend growth into 2011.

Not holding gold producer Lihir Gold (+42.4%) detracted from relative performance. Lihir Gold became the centre of focus during the period due to their immunity to the RSPT (offshore mines) as well as receiving a takeover offer from Newcrest Mining (NCM). The company claimed that the first offer of one NCM share for every nine Lihir Gold shares plus \$0.225 cash per Lihir share minus the interim dividend was inadequate. NCM came back in May with a revised Merger Implementation Agreement which was unanimously recommended by the directors of Lihir. Shareholders are expected to approve the merger in late July. During the period, the company also released production targets for their mines, revealing plans for significant increases in gold output. The company is not held in the portfolio as it is considered too expensive at this time relative to other stocks in our universe.

### Outlook

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. However, risks to short term earnings do remain as global growth concerns continue to impact market sentiment. The new deal revealed by the Government on the resources tax is much less onerous for the Australian mining industry. The impact of the tax on valuations is now estimated to be in the range of 0-5% instead of the 10-15% originally forecast. This resolution will provide greater certainty for equity markets. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.

## Global Resource Fund (Class B units)

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Global Resource Fund Class B	0	-4.77	-11.41	-11.66	11.43	-	-	-	-
Benchmark*		-5.59	-9.46	-9.07	10.49	-	-	-	-

\* MSCI All Resources & ASX 200 Resources

### Top 10 Stocks

Stock Name	Country	%
BHP Billiton PLC	England	8.37
Rio Tinto PLC	England	6.38
Coal & Allied Industries Limited	Australia	6.01
Occidental Pete Corporation	United States	4.46
Chevron Corporation	United States	4.43
Freeport McMoRan Copper And Gold	United States	4.09
Cia Vale do Rio Doce	United States	3.99
Orica Limited	Australia	3.83
Xstrata PLC	England	3.81
Posco	United States	3.43
<b>TOTAL</b>		<b>48.80</b>

### Market Commentary

The MSCI Customised All Countries Resources Index fell for three consecutive months to end 9.5% lower over the quarter. Global markets continued to be impacted by European sovereign debt issues and concerns about the pace of growth in China and the United States. Risk aversion became a key thematic over the quarter, as investors looked for safe havens amidst uncertainty for global growth drivers.

Concerns over the proposed Resources Super Profits Tax (RSPT) affected most Australian resource companies over the quarter. Investor sentiment was hit hard from overseas investors, driving down both the Australian share market and the Australian dollar. The result of the RSPT saw an overhaul in the government as Prime Minister Kevin Rudd was replaced by the new PM Julia Gillard. The Australian government subsequently announced a revision to the former resources super profits tax.

The new minerals resource rent tax is a major compromise relative to the previous proposal and will only apply to companies in the iron ore, coal, oil and natural gas industries that make over \$50 million in profits. It will apply to the value of minerals extracted rather than the value added through profits. The larger mining companies will greatly benefit from this and from the certainty of the tax implications on future cash flows.

Most base metals fell over the period, with lead (-19.9%), nickel (-23.7%) and zinc (-26.6%) lead the fall. Gold was the exception, finishing up 11.5%. Despite the issues stemming from the Gulf of Mexico, Oil also fell during the quarter, ending 9.7% lower.

### Portfolio Commentary

The Global Resources Fund underperformed its benchmark during the quarter.

Relative to its custom benchmark, the Fund's largest overweight positions include Coal & Allied Industries, Orica and Occidental Petroleum. The Fund's largest underweight positions include Anglo American, Goldcorp Inc. and Newmont Mining Corporation.

**Stock Contributors**

Our overweight position to Australian coal miner Coal and Allied (+3.4%) added to relative performance. The company released their quarterly report in May which highlighted lower coal production volumes as a result of decreased in-pit inventory, short term geotechnical issues and adverse weather conditions. Despite the lower production volumes, the company was able to maintain their yearly shipment guidance by successfully transferring their port allocation into the second half of the year. Furthermore, the company's production mix during the period allowed an increase in the sale of the more profitable semi-soft coal which should see a positive lift to their annual profit. We believe that the company is well placed to be a strong beneficiary of both the new quarterly pricing mechanic, and an increasing demand for coal.

Our underweight position to petroleum manufacturer BP (-45.2%) added to relative performance. The company was in the spotlight over the quarter as an offshore oilrig on the Gulf of Mexico exploded and sank, causing the largest offshore spill in US history. On June 16, BP announced an agreed package of measures, including the creation of a \$20 billion fund to satisfy certain obligations arising from the oil and gas spill. As at June 28, the cost of the response to date amounts to approximately \$2.65 billion, including the cost of the spill response, containment, relief well drilling, grants to the Gulf states, claims paid, and federal costs. Despite the large drop in price over the quarter, we are uncomfortable holding BP due to the difficulty in quantifying the potential costs associated with the damage, along with the large ESG impacts.

**Stock Detractors**

Our overweight position to African-focused copper producer First Quantum (-33.1%) detracted from relative performance. The company reported their first quarter results over the period, highlighting the successful acquisition of the Ravensthorpe nickel project in Australia as well as prospecting licenses in Zambia. Higher Copper and Gold prices helped push earnings (pre acquisition) to \$2.04 per share, however the company recorded a decrease in production due to lower ore throughput and power disruptions. A Supreme Court ruling has also placed pressure on the company as mining rights and titles were given to a state-owned company 'SODIMICO', placing the tenure of two of First Quantum's projects at risk. We see compelling value in the company at current prices, with a strong balance sheet, excess cash and significant growth opportunities in their Nickel projects.

**Outlook**

Many companies are appearing attractively valued since the recent market fall. This has provided opportunities for the Fund. The upcoming reporting season should be positive, with mining companies expected to demonstrate strong free cash flows and earnings. Additionally, we anticipate the demand for commodities to be solid for the next 12-24 months. We continue to set our focus on companies with long mine lives, access to export markets, low costs and a broad customer base for inclusion into the portfolio.

## Industrial Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Industrial Fund	3,153	-2.52	-9.21	-7.86	13.43	1.93	-7.32	3.29	8.08
Benchmark*		-3.21	-11.26	-10.08	14.47	-1.05	-10.46	1.72	6.71

\* S&P/ASX 300 Industrials Accumulation Index

### Top 10 Stocks

Stock Name	%
Commonwealth Bank of Australia	12.66
Westpac Banking Corporation	11.59
ANZ Banking Group Limited	8.77
Telstra Corporation Limited	7.26
Orica Limited	4.96
National Australia Bank Limited	4.28
News Corporation	4.14
Woolworths Limited	3.21
Fletcher Building Limited	3.06
Reece Australia Limited	2.96
<b>TOTAL</b>	<b>62.89</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX 300 Industrials Accumulation Index fell by 11.3% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

Telecommunications was the only sector with a positive return over the period after news that Telstra (+8.7%) signed a non-binding agreement regarding their participation in the national broadband network. Property trusts (-1.5%) and consumer staples (-4.5%) also held up relatively well, in line with the risk aversion thematic which saw defensive stocks outperform the broader market. Industrials (-18.9%), financials (-15.1%) and information technology (-12.6%) were among the poorer performing sectors. Industrial companies fell due to weaker than expected quarterly results and profit downgrades from companies updating the market on earnings. The banks also fell on concerns over potential financial regulation and funding concerns.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a selloff from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

### Portfolio Commentary

The Industrial Share Fund outperformed its benchmark during the quarter.

Stocks the Fund is currently overweight include Orica, Fletcher Building and News Corporation. Orica is well positioned to grow earnings over the next two years and will benefit from greater focus once Dulux has

been spun off. Fletcher Building should benefit as New Zealand infrastructure and residential construction gains further traction. The Fund's underweight positions include National Australia Bank, Wesfarmers and Westfield Group Australia.

### **Stock Contributors**

Our overweight position to telecom giant Telstra (+8.7%) added to relative performance. The company's share price was influenced over the quarter by the potential agreement regarding the National Broadband Network. Rumours of an agreement being reached sent the company share prices up over April, before concerns over the agreement not being finalised saw their price retreat over May. A non-binding Heads of Agreement was finally signed in June, removing the uncertainty that overhung the stock. Shareholders are expected to approve the \$11bn deal in the first half of 2011. We currently remain overweight on Telstra. The company continues to pay large dividends and if the NBN deal is approved, Telstra will have access to significant levels of cash to fund future growth.

Not holding pallet manufacturer Brambles (-25.8%) added to relative performance. The company fell steadily over the quarter, with the only significant news being a trading update in early May. The company announced that they expected flat revenue growth for the 2010 financial year due to weak global economic conditions affecting their two largest markets (USA and Western Europe). Management stated that new business wins were unable to offset customer losses in CHEP USA (currently 39% of sales revenue), and that there were no visible signs on margin improvement. Despite the weakness in the US market, the company remained upbeat about growth in their CHEP Asia-Pacific, and highlighted new business wins in their Recall division. Brambles is not held in the Fund as it is currently considered too expensive, given the difficult economic conditions it operates under.

### **Stock Detractors**

Not holding shopping mall operator Westfield Group (+1.0%) detracted from relative performance. Westfield outperformed over the quarter, following positive offshore leads and encouraging macroeconomic indicators. Of note, United States (US) real estate investment trusts (REITs) saw meaningful gains during the start of the quarter as stronger than expected retail sales figures pointed to a broadening of the manufacturing-led US economic recovery. Westfield derives significant revenue from their offshore US investments. The company also reconfirmed its 2010 guidance over the period, and revealed plans for new development projects in Australia and the United States that could reach \$1 billion. Their dividend forecast of 64 cents per security was reaffirmed during their annual general meeting, with chairman and joint founder Frank Lowy stating that positive signs were emerging in the fundamentals of the economies in which Westfield operated. Despite their defensive qualities, we do not hold Westfield in the portfolio due to its current relative high valuation.

Our overweight position to Westpac Bank (-21.6%) detracted from relative performance. The company announced first half 2010 cash earnings up 30% to \$2,983 million, due to lower bad debts from institutional investors and improved earnings from wealth management. Westpac chief executive officer, Gail Kelly commented that the result reflected a much improved Australian economy and good momentum across all businesses. Westpac had also taken the opportunity to further strengthen its balance sheet. The company's share price fell however, marred by concerns of net interest margin compression resulting from increased funding pressure due to an expanded mortgage book in a market influenced by liquidity rationing. Despite these headwinds, we feel Westpac is one of the higher quality banks. We are comfortable with our exposure to the company and believe it is well placed to deliver profit and dividend growth into 2011.

### **Outlook**

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. Global growth concerns continue to impact market sentiment, as the sovereign debt problems in Europe and signs of possible slowing in China and the United States persevere. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.

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## International Share Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale International Share	240	-3.10	-5.18	-4.34	3.58	-3.70	-10.15	-2.17	1.30
Benchmark*		-4.15	-4.81	-3.75	5.22	-6.12	-11.46	-2.16	1.08

\* MSCI World ex-Australia Accumulation Index A\$

### Top 10 Stocks

Stock Name	Country	%
Nestle SA	Switzerland	4.55
Johnson and Johnson	United States	3.90
Wal Mart Stores Inc	United States	3.53
Novartis	Switzerland	3.49
Philip Morris International Inc	United States	3.40
Total SA	Europe	3.01
Hewlett Packard Company	United States	2.45
General Dynamics Corporation	United States	2.29
Emerson Electric Co	United States	2.17
Automatic Data Processing Inc	United States	2.15
<b>TOTAL</b>		<b>30.94</b>

### Market Commentary

The MSCI World ex-Australia index finished the quarter 4.8% lower, with consumer staples, consumer discretionary and telecom services the best performing sectors, while energy, materials and financials lagged the market. Financials were in the spotlight as SEC sued Goldman Sachs for allegedly misstating and omitting facts about collateralised debt obligations. In the US, the Federal Reserve lowered its assessment of the economic recovery and there was a 16.4% fall in consumer confidence in June. Fears that the global outlook will lead to a deflationary trend drove investors into safe haven treasuries. US bonds rallied in June with the ten-year yield finishing the month at 2.93%, its first time hitting these levels in 14 months. The yield spread between the Greek and German ten-year bond has increased significantly during the second quarter, rising from 344 to 784 basis points as Moody's Investor Services downgraded Greece government bond ratings to junk status. Spain's current Aaa rating was placed on review for a possible downgrade by Moody's as the country faces challenges in meeting fiscal targets. Commodity prices fell in response to the heightened economic uncertainty. Oil has fallen 16.5% from its recent high of \$88.45/bbl on May 3rd as concerns remained over a possible slowdown in economic growth in the US and China and the ongoing debt crisis in Europe.

### Portfolio Commentary

The International Share Fund underperformed its benchmark during the quarter.

**Stock Contributors**

Nestle has delivered organic sales growth of +5% or above in 17 of the last 21 years. In addition, its margins remained flat in just three of the last 14 years, while increasing by an average of 30bps in the other 11 years. The company recently announced a target to lift sales from Emerging Markets to 45% of total sales by 2020 (35% in 2010). In absolute terms, Nestle already has a substantial emerging market exposure at CHF35bn and its presence is accelerating and broadening with ten countries already generating annual sales in excess of CHF1bn. Brands are key to Nestle's success with 28 "billionaire brands" (<CHF1bn in sales), such as Nespresso, Pure Life, Maggi, Purina and Coffee-Mate, in various categories within Nestle's portfolio. Many of these brands continued to deliver strong growth, even in the more difficult consumer environment of 2009. In FY 2009, Nespresso grew over +20%, Pure Life, Coffee-Mate and Beneful all grew into double-digits and Purina grew in the high single-digits. Nestle is commencing a new CHF10bn buyback programme using proceeds from the completion of its stake in Alcon.

**Stock Detractors**

Walgreen reported quarterly earnings below expectations during the month. Its gross margin was weaker due to lower reimbursements from health insurers for drug prescriptions, and selling and administration expenses which grew faster than sales. Despite the difficult economic background, Walgreen is working very hard to improve the things that are in its control. The company is slowing its store growth from 8% in 2009 to 2.5-3.0% in 2011. In total, this reduces capital expenditure by \$1bn and lowers the earnings drag from new stores (which take about 2-3 years to break even). The "Rewire for Growth" cost-cutting initiative is on track to save a cumulative \$500 million, after costs, in 2010 and a cumulative \$1.0 billion in 2011. The company is rolling a store layout and the group of pilot stores, which has experienced the first set of changes, is showing a lift in sales of 2.6%. The introduction of beer and wine is also boosting sales and are a good traffic draw and lead to a bigger average basket size. The company stands to benefit from a new wave of higher margin generic drugs coming to the market in 2011/12. It is shareholder focused and has repurchased \$600 million under its \$2 billion share repurchase program (7.4% of market cap) that it commenced last October.

**Outlook**

If media mentions of double-dip recessions were a leading indicator of problems ahead, we would be in a true crisis. Talk of slipping back into negative economic growth has risen substantially in recent weeks. This has been prompted largely by a downturn in macro data and ongoing structural worries about the sustainability of the recovery. The trend of earnings revisions has also started to slow down. Currently, consensus estimates are calling for 34% global earnings growth in 2010 followed by 19% growth in 2011. We believe this is likely to prove unattainable. Corporate profitability is being boosted by cost cutting, and government stimulus. However both of these factors are likely to unwind due to the limits on the extent to which costs can be trimmed and the clear shift in focus to reining in government deficits. Until recently, cyclical tailwinds have been able to dominate structural concerns, particularly about the extent of corporate and personal indebtedness. Now that those tailwinds are fading, uncertainty about the sustainability of growth has risen, leading to increased volatility. While we expect a sustained (if weak) growth recovery, markets are like to remain jittery given the lack of visibility. For equity markets, slower earnings growth expectations need not translate in to market downside. Valuations have room to absorb slower growth expectations and to still allow for market upside. 2011 growth forecasts would need to go negative before the Global P/E ratio would hit 13x, implying a significant margin of safety built into current valuations. The current P/E is only 11x, indicating ample room for multiple expansion even with lower growth expectations. The portfolio is positioned towards those companies with favourable balance sheet and profitability metrics. Typically they are high RoE, and low leverage companies where EPS and DPS are stable and growing. High quality stocks are starting to outperform low quality stocks following substantial underperformance in 2009 and we expect this trend to continue in the second half of the year.

## Monthly Income Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Monthly Income Fund	704	0.36	1.09	2.19	4.31	4.61	5.15	5.61	5.67
Benchmark*		0.40	1.12	2.15	3.89	4.68	5.56	5.77	5.69

\* UBS Australian Bank Bill Index

### Fixed Interest Summary

Issuer Classification	0 to 6 Months	6 Months to 3 Years	3 to 5 Years	5 to 10 Years	Over 10 Years	Total
Bank	20.26%					20.26%
Corporate Bonds	8.02%	12.78%	1.14%	0.95%		22.89%
Mortgage Backed Securities						56.73%
Other						
International						0.12%
<b>Total</b>	<b>28.28%</b>	<b>12.78%</b>	<b>1.14%</b>	<b>0.95%</b>		<b>100.00%</b>

### Market Commentary

During the course of the June quarter, the Reserve Bank of Australia Board raised the official cash rate by 50 basis points in total to 4.5% providing an upward impetus on bank bill yields.

Following two further consecutive rate hikes in April and May, the RBA Board decided to leave the cash rate unchanged at its June meeting citing that borrowing rates were around their average levels of the past decade. At its July meeting, the Board again maintained its cautious stance on the economy amid doubts about the sovereign debt crisis leaving the cash rate unchanged at 4.5% for the second consecutive month.

Despite no meaningful change in cash rate expectations, bank bill yields rose slightly in June (0.40%) mainly due to a further elevation of bank funding concerns. Over the period the bank bills curve steepened with the 30-day rate increasing by 51bps to 4.75%, the 90-day rate increasing by 50bps to 4.92% and the 180-day rate gaining 34bps to 5.00%.

Lending margins for commercial properties stayed at relatively high levels due to the ongoing absence of lending among the majority of non-bank lenders.

### Portfolio Commentary

The Monthly Income Fund marginally underperformed its benchmark during the quarter.

#### Liquidity Pool

The Liquidity Pool is priced on a hold to maturity basis as such was not influenced by changes in margins prevalent in the credit market. The portfolio continues to provide yields that are consistent with a pool of liquid assets. The Liquidity Pool remains well diversified across fixed income securities with elevated cash levels and a short maturity profile.

#### Mortgage Pool

Market sentiment towards property remained soft during the quarter. We continue to stress-test the mortgage portfolio on a quarterly basis, using independently sourced data from Jones Lang LaSalle.

Perpetual's quality mortgage book showed little sign of deterioration during the period, both from a LVR and loans in arrears point of view. Moreover, interest rates remain at below normal levels. This is providing some support to the property market.

## Property Income Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Property Income Fund	16	-0.57	-1.51	-2.54	13.04	-11.66	-16.28	-3.32	-
Benchmark*		1.51	4.13	4.82	16.51	-7.95	-10.24	0.93	-

\* UBS Australian Government 3 to 5 Year Bond Index.

### Top 5 Stocks

Stock Name	%
Westfield Group	23.69
Stockland	10.81
Australand Wholesale Property Fund No 6	10.16
Goodman Australia Industrial Fund	6.76
Mirvac Wholesale Hotel Fund	6.55
<b>TOTAL</b>	<b>57.97</b>

### Market Commentary

The property sector ended the quarter lower with the S&P/ASX 300 Property Accumulation Index returning -1.5%. Despite the drop, property outperformed the broader market. In general trusts perceived as being riskier suffered this quarter due to an increase in risk aversion in all financial markets. Retail (+1.0%) was the strongest sub sector led by CFS Retail Property Trust (+4.1%), which rallied after its quarterly update. In its update the trust stated that there were only limited signs of stress across their portfolio. Their occupancy remains strong and retailers have committed to opening new stores. The diversified (-4.7%) sub sector was the weakest, due in part to the poor performance of the Ardent Leisure Group (-25.2%). Ardent Leisure Group was sold down due to a challenging competitive environment for its theme parks.

The Commonwealth Property Office Fund (+5.8%) was the strongest performing trust in the index. The Commonwealth Property Office Fund, benefited from its status as the only trust that just holds A Grade Australian office assets. This makes it popular with offshore investors who desire such an exposure. Centro Properties Group (-40.0%) which remains in financial distress, was the weakest performing trust in the index due to unfavourable currency movements.

Key developments in direct markets this month included the finalisation of a significant office lease negotiation by Commonwealth Property Office Fund. While details of the lease were not released, its finalisation was seen as a positive for the Sydney market. Another key development was the of Grocon's half-share interest in 163 Castlereagh St. in the Sydney CBD for a final price of \$333m. This transaction signalled a renewal in investor confidence in making large acquisitions.

### Portfolio Commentary

The Property Income Fund significantly underperformed its benchmark during the quarter.

With a blend of listed property securities and unlisted funds, the portfolio continued to benefit from the relatively steady returns of the unlisted property funds and the potential upside of A-REITs.

Positions that represented the largest portion of the portfolio's performance included its holdings in Westfield Group (+1.0%), CFS Retail Property Trusts (+4.1%) and Growth Point Properties Australia (+1.9%). Westfield saw strong performance early in the quarter following better than expected US retail sales and a strengthening job market. Growth Point Properties Australia benefited from increased investor demand due to its strong yield.

Positions which detracted from the portfolio's performance included Mirvac Group (-9.6%), Stockland Group (-4.1%) and Ardent Leisure Group (-25.2%). Mirvac came under pressure after undertaking a \$350m underwritten institutional placement, along with a \$150m security purchase plan for the acquisition of Westpac Office Trust. Stockland Group came under pressure due to concerns about the residential market.

### **Outlook**

The rally from the lows seen early last year demonstrates the strong upside in the A-REIT sector, particularly now that gearing levels and capital structures have broadly been addressed. However it is still important to carefully choose which securities to invest in. Some still have direct assets in offshore markets, many of which are still falling. While these falls may present opportunities for the astute investor, they present a very large problem for their current owners.

We believe in this environment that our insistence on holding quality trusts at attractive valuations will enable investors to benefit from the continued upswing in the sector, while minimising the risks associated with some of the more speculative vehicles.

Locally, direct markets have now stabilised and are showing some growth around the margins. Generally speaking more vehicles are looking to buy assets rather than sell them and some are slowly starting to re enter development activities. Demand remains strong for Australian unlisted assets from both domestic and offshore investors, suggesting that there may be upside if conditions continue to improve.

## Property Securities Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Property Securities Fund	38	-0.86	-1.94	-3.38	17.79	-19.41	-26.89	-10.29	-3.24
Benchmark*		-1.02	-1.54	-3.15	20.34	-16.54	-24.31	-8.34	-1.53

\* S&P/ASX 300 Property Trust Accumulation Index

### Top 5 Stocks

Stock Name	%
Westfield Group	38.07
Stockland	14.19
Mirvac Group	8.85
Goodman Group	6.81
CFS Retail Property Trust	5.47
<b>TOTAL</b>	<b>73.39</b>

### Market Commentary

The property sector ended the quarter lower with the S&P/ASX 300 Property Accumulation Index returning -1.5%. Despite the drop, property outperformed the broader market. In general trusts perceived as being riskier suffered this quarter due to an increase in risk aversion in all financial markets. Retail (+1.0%) was the strongest sub sector led by CFS Retail Property Trust (+4.1%), which rallied after its quarterly update. In its update the trust stated that there were only limited signs of stress across their portfolio. Their occupancy remains strong and retailers have committed to opening new stores. The diversified (-4.7%) sub sector was the weakest, due in part to the poor performance of the Ardent Leisure Group (-25.2%). Ardent Leisure Group was sold down due to a challenging competitive environment for its theme parks.

The Commonwealth Property Office Fund (+5.8%) was the strongest performing trust in the index. The Commonwealth Property Office Fund, benefited from its status as the only trust that just holds A Grade Australian office assets. This makes it popular with offshore investors who desire such an exposure. Centro Properties Group (-40.0%) which remains in financial distress, was the weakest performing trust in the index due to unfavourable currency movements.

### Portfolio Commentary

The Property Securities Fund underperformed its benchmark during the quarter.

Positions that contributed to the portfolio's performance over the month included its underweight positions in ING Industrial Fund (-14.0%), lack of holdings in Centro Properties Group (-40.0%) and underweight position in Charter Hall Office REIT (-9.4%). ING Industrial Fund was sold down over concerns about the debt attached to its Canadian joint venture. Charter Hall Office REIT came under pressure due to its high levels of debt and its US office assets.

Positions that detracted from performance included our underweight position to Commonwealth Office Property Fund (+5.8%), our overweight position in Mirvac Group (-9.6%) and our underweight position to Westfield Group (+1.0%). Mirvac came under pressure after undertaking a \$350m underwritten institutional placement, along with a \$150m security purchase plan for the acquisition of Westpac Office Trust. Westfield saw strong performance early in the quarter following better than expected US retail sales and a strengthening job market.

## Outlook

The rally from the lows seen early last year demonstrates the strong upside in the A-REIT sector, particularly now that gearing levels and capital structures have broadly been addressed. However it is still important to carefully choose which securities to invest in. Some still have direct assets in offshore markets, many of which are still falling. While these falls may present opportunities for the astute investor, they present a very large problem for their current owners.

We believe in this environment that our insistence on holding quality trusts at attractive valuations will enable investors to benefit from the continued upswing in the sector, while minimising the risks associated with some of the more speculative vehicles.

## Quantitative Investments Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Quantitative Investments Alpha Core Fund	91	-1.94	-11.30	-10.89	9.82	-8.30	-9.38	3.41	8.82
Benchmark*		-2.65	-11.20	-10.09	13.05	-5.10	-8.05	4.49	9.70

\* S&P/ASX 300 Accumulation Index

### Top 10 Stocks

Stock Name	%
BHP Billiton Limited	13.22
Commonwealth Bank of Australia	8.72
Westpac Banking Corporation	6.17
ANZ Banking Group Limited	4.88
Wesfarmers Limited	3.99
National Australia Bank Limited	3.92
Rio Tinto Limited	3.32
Woolworths Limited	3.25
Telstra Corporation Limited	3.22
Westfield Group	2.50
<b>TOTAL</b>	<b>53.19</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX 300 Accumulation Index fell by 11.2% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a sell-off from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

In other major corporate news, Fosters (+6.8%) is looking into the potential demerger of their beer and wine divisions after the company forecasted a \$1.3bn impairment against the wine business. Lihir Gold (+42.2%) received a board approved \$9.5bn takeover offer from Newcrest Mining (+6.9%) in which shareholders are expected to vote upon in late July. Meanwhile, National Australia Bank (-15.4%) is currently in discussions with the ACCC following the ACCC's decision to oppose the potential takeover for AXA Asia Pacific (-13.4%) over concerns that a tie up would lead to reduced competition.

### Portfolio Commentary

The Quantitative Investments Alpha Core Fund marginally underperformed its benchmark during the quarter.

Momentum was the dominant signal and drove the portfolio's strong relative performance. This countered the negative effects of the quality and earnings revision metrics.

Stocks which contributed to outperformance included our overweight position in Avoca Resources (AVO) and Centennial Coal (CEY). AVO, a smaller gold producer which was held overweight because of positive momentum and earnings revisions, rallied due to the increasing gold price.

Meanwhile CEY, which was also held overweight due to momentum, rallied after a takeover offer from Banpu.

Our overweight position in Downer EDI (DOW) detracted from relative performance over the quarter. DOW, which was overweight due to its momentum and earnings revision metric, fell heavily after its debt was downgraded.

## SHARE-PLUS Long-Short Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale SHARE-PLUS Long-Short Fund	68	-1.58	-7.09	-3.97	17.52	-2.98	-3.92	5.97	10.94
Benchmark*		-2.65	-11.20	-10.09	13.05	-5.10	-8.05	4.49	9.70

\* S&P/ASX 300 Accumulation Index

### Top 10 Stocks

Stock Name	%
BHP Billiton Limited	10.67
Commonwealth Bank of Australia	7.70
Westpac Banking Corporation	6.73
ANZ Banking Group Limited	6.17
Coal & Allied Industries Limited	5.61
National Australia Bank Limited	3.50
Orica Limited	3.24
Woodside Petroleum Limited	3.20
Campbell Brothers Limited	3.13
Telstra Corporation Limited	3.07
<b>TOTAL</b>	<b>53.02</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX 300 Accumulation Index fell by 11.2% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a selloff from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

Telecommunications was the only sector with a positive return over the period after news that Telstra (+8.7%) signed a non-binding agreement regarding their participation in the national broadband network. Property trusts (-1.5%) and consumer staples (-4.5%) also held up relatively well, in line with the risk aversion thematic which saw defensive stocks outperform the broader market. Industrials (-18.9%), financials (-15.1%) and information technology (-12.6%) were among the poorer performing sectors. Industrial companies fell due to weaker than expected quarterly results and profit downgrades from companies updating the market on earnings. The banks also fell on concerns over potential financial regulation and funding concerns.

### Portfolio Commentary

The SHARE-PLUS Long-Short Fund significantly outperformed its benchmark during the quarter.

A feature of this product is the ability to hold positions short. This cushioned the fall over the quarter as several of these positions combined with an average cash weight of 6.0% contributed to positive excess performance. On balance, short positions contributed approximately a third of the excess return.

Stocks the Fund is currently overweight include Coal & Allied Industries, Campbell Brothers and Reece Australia. Coal & Allied is attractively valued with a strong balance sheet and sound management. Campbell Brothers offers a strong growth profile at reasonable multiples. The Fund is underweight Wesfarmers and Rio Tinto, and short Cochlear and Leighton Holdings.

### **Stock Contributors**

Our overweight position to coal producer Coal and Allied (+3.4%) added to relative performance. The company released their quarterly report in May which highlighted lower coal production volumes as a result of decreased in-pit inventory, short term geotechnical issues and adverse weather conditions. Despite the lower production volumes, the company was able to maintain their yearly shipment guidance by successfully transferring their port allocation into the second half of the year. Furthermore, the company's production mix during the period allowed an increase in the sale of the more profitable semi-soft coal which should see a positive lift to their annual profit. We believe that the company is well placed to be a strong beneficiary of both the new quarterly pricing mechanic, and an increasing demand for coal.

Being short pallet manufacturer Brambles (-25.8%) added to relative performance. The company fell steadily over the quarter, with the only significant news being a trading update in early May. The company announced that they expected flat revenue growth for the 2010 financial year due to weak global economic conditions affecting their two largest markets (USA and Western Europe). Management stated that new business wins were unable to offset customer losses in CHEP USA (currently 39% of sales revenue), and that there were no visible signs on margin improvement. Despite the weakness in the US market, the company remained upbeat about growth in their CHEP Asia-Pacific, and highlighted new business wins in their Recall division.

### **Stock Detractors**

Our underweight position to shopping mall operator Westfield Group (+1.0%) detracted from relative performance. Westfield outperformed over the quarter, following positive offshore leads and encouraging macroeconomic indicators. Of note, United States (US) real estate investment trusts (REITs) saw meaningful gains during the start of the quarter as stronger than expected retail sales figures pointed to a broadening of the manufacturing-led US economic recovery. Westfield derives significant revenue from their offshore US investments. The company also reconfirmed its 2010 guidance over the period, and revealed plans for new development projects in Australia and the United States that could reach \$1 billion. Their dividend forecast of 64 cents per security was reaffirmed during their annual general meeting, with chairman and joint founder Frank Lowy stating that positive signs were emerging in the fundamentals of the economies in which Westfield operated. Despite their defensive qualities, we do not hold Westfield in the portfolio due to its current high valuation.

Our short position to gold producer Newcrest Mining (+6.9%) detracted from relative performance. The company performed well due to their strong rise in Gold prices which consolidated above US\$1,200/oz in June, driven by the sovereign debt crisis in Europe. Newcrest entered into a merger with Lihir Gold over the period, which is due for completion in September, subject to shareholders approving the transaction. The company is not held in the portfolio due to its current valuation which we consider expensive.

### **Outlook**

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. However, risks to short term earnings do remain as global growth concerns continue to impact market sentiment. The new deal revealed by the Government on the resources tax is much less onerous for the Australian mining industry. The impact of the tax on valuations is now estimated to be in the range of 0-5% instead of the 10-15% originally forecast. This resolution will provide greater certainty for equity markets. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.

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## Smaller Companies Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Smaller Companies	191	-1.87	-6.80	-6.88	24.48	-4.20	-9.06	5.85	10.57
Benchmark*		-3.73	-11.59	-12.98	11.18	-10.89	-14.20	2.74	9.18

\* S&P/ASX Small Ordinaries Accumulation Index

### Top 10 Stocks

Stock Name	%
Mineral Resources Limited	3.77
OrotonGroup Limited	3.50
Brickworks Limited	3.24
New Hope Corporation Limited	2.67
Oz Minerals Limited	2.58
ARB Corporation Limited	2.43
Slater & Gordon Limited	2.39
Reece Australia Limited	2.38
APN News & Media Limited	2.37
Iluka Resources Limited	2.35
<b>TOTAL</b>	<b>27.68</b>

### Market Commentary

The Australian market, as measured by the S&P/ASX Small Ordinaries Accumulation Index fell by 11.6% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment.

All sectors fell over the quarter, with consumer staples (-18.4%), industrials (-18.2%) and energy (-17.2%) leading the fall. Materials (-4.9%), telecommunications (-5.4%) and healthcare (-7.2%) held up relatively well. Companies that performed poorly over the quarter included iSoft Group (-69.9%) which fell following a weak trading update, and Elders (-69.5%) after the company made a heavy profit downgrade to their FY10 underlying profit. Gold stocks were the standout performers over the period following the strong rise in gold prices, with Eldorado Gold (+60.1%) and OceanaGold (+48.7%) leading the rise in small cap companies.

In local news, Prime Minister Kevin Rudd's proposed Resources Super Profits Tax (RSPT) heavily influenced the market. The potential impact on earnings and project certainty on both the mining companies and companies servicing this sector triggered a selloff from overseas institutions. The end of the quarter saw Kevin Rudd step down, and the sector was encouraged by conciliatory remarks made by the new PM, Julia Gillard. The Australian Dollar fell 8% to USD 84.5c, despite the RBA raising rates twice to 4.50%.

### Portfolio Commentary

The Smaller Companies Fund significantly outperformed its benchmark during the quarter.

Stocks the Fund is currently overweight include OrotonGroup, Mineral Resources and Brickworks. Oroton is a high quality company within the retail sector with evidence of solid organic growth. Mineral Resources is one of our preferred companies with exposure to resources and a balance sheet well placed to fund future growth. The Fund's underweight positions include ResMed, Ramsay Health Care and Macarthur Coal.

**Stock Contributors**

Our overweight position to storage solutions manufacturer Dexion (+65.2%) added to relative performance. The company was targeted for takeover during the quarter by GUD Holdings (GUD). Subject to satisfactory due diligence, GUD made an offer of 80 cents per share which reflected a 100% premium to the Dexion share price of 40 cents at close of trade on the 20 May 2010. The Dexion board unanimously recommended the takeover proposal, with the Bidders Statement expected to be sent to current shareholders in early July. We continue to hold Dexion overweight in the portfolio with the company having significant leverage to an improved operating environment.

Our overweight position to ore crushing company Mineral Resources (+9.0%) added to relative performance. The company's share price was affected by several key news items, along with news over the proposed Resources Super Profits Tax. Over the quarter, Mineral Resources acquired 27.5% of Perth based Midwest Vanadium for an undisclosed amount, gaining exposure to one of the world's largest known vanadium deposits through the Windimurra Vanadium project. Additionally, their subsidiary Crushing Services International was awarded a contract to provide crushing and processing services for Fortescue Metals Group Christmas Creek iron ore project in Western Australia. Finally, the company was involved in an unconditional off market takeover offer for Mesa Minerals. The company is well placed to fund their future growth with substantial cash flows and a strong balance sheet. They remain leveraged to rising iron ore and manganese prices, and continue to be one of our preferred companies in the resources sector.

**Stock Detractors**

Our overweight position to furniture manufacturer Fantastic (-45.9%) detracted from relative performance. The company announced a profit downgrade at the start of May, on the back of tightening of discretionary household spending as a result of continuing interest rate increases. Fantastic expects to generate a net profit of \$19-\$21 million for the year to 30 June 2010, an increase compared to last year, but lower than previous guidance. Sales in the third quarter were lower than previously expected, increasing by 1.3% over the previous corresponding period, but falling 4% on a like for like basis. Despite the downgrade, the company remains leveraged to a pickup in retail spending over the medium term. Fantastic remains a quality business, retaining a strong balance sheet with very little debt.

Not holding diversified mining financier Riversdale Mining (+16.6%) detracted from relative performance. The company had a flat start to the quarter, and held up well during the selloff in May due to their exposure to Coal. June was a key month for the company. The company announced an upgrade to their coal reserve as well as signing a memorandum of understanding with China's Wuhan Iron and Steel Company. Riversdale has agreed to sell 40% of their Zambeze coal project in Mozambique for US\$800m to further develop their project. Whilst the agreement has removed a lot of risk involved in the project, the company does not pass our quality filters due to their poor earnings history and hence we continue to not hold the stock.

**Outlook**

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. However, risks to short term earnings do remain as global growth concerns continue to impact market sentiment. The new deal revealed by the Government on the resources tax is much less onerous for the Australian mining industry. The impact of the tax on valuations is now estimated to be in the range of 0-5% instead of the 10-15% originally forecast. This resolution will provide greater certainty for equity markets. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.

## Split Growth Fund

### Total returns % (after fees)

Perpetual	Size \$m	1 mth	3 mth	6 mths	1 yr	2 yrs pa	3 yrs pa	5 yrs pa	7 yrs pa
Wholesale Split Growth Fund	40	-2.83	-6.71	-5.65	7.75	-1.04	-8.58	0.30	4.17
Benchmark*		-3.78	-7.35	-6.23	9.11	-3.83	-10.85	-0.44	3.45

\* The Split Growth Benchmark index is calculated using a 40/60 weighted combination of the following sector benchmarks: S&P/ASX 300 Industrials Accumulation Index and the MSCI World ex-Aust Accumulation Index A\$

### Top 10 Stocks

Stock Name	Country	%
Commonwealth Bank of Australia	Australia	4.95
Westpac Banking Corporation	Australia	4.53
ANZ Banking Group Limited	Australia	3.43
Telstra Corporation Limited	Australia	2.84
Nestle SA	Switzerland	2.74
Johnson and Johnson	United States	2.35
Wal Mart Stores Inc	United States	2.13
Novartis	Switzerland	2.11
Philip Morris International Inc	United States	2.05
Orica Limited	Australia	1.94
<b>TOTAL</b>		<b>29.07</b>

### Market Commentary

The MSCI World ex Australia index finished the quarter 4.8% lower. Financials were in the spotlight as SEC sued Goldman Sachs for allegedly misstating and omitting facts about collateralised debt obligations. In the US the Federal Reserve lowered its assessment of the economic recovery and there was a 16.4% fall in consumer confidence in June. In Europe, Moody's Investor Services downgraded Greece government bond ratings to junk status and Spain's current rating was placed on review. Commodity prices fell in response to the heightened economic uncertainty, with Oil down 16.5% from its recent high of \$88.45/bbl on May 3rd. Against this backdrop the Australian dollar fell 8.0% against the greenback, despite the RBA raising rates twice, reducing the losses for domestic investors.

The Australian market, as measured by the S&P/ASX 300 Industrials Accumulation Index fell by 11.3% over the quarter. The underlying theme for the period revolved around the rise in risk aversion, as key issues in both domestic and international markets affected investor sentiment. In political news, Kevin Rudd was ousted by Julia Gillard after proposing a tax on super profits earned by resource companies. In other major corporate news, Fosters (+6.8%) is looking into the potential demerger of their beer and wine divisions after the company forecasted a \$1.3bn impairment against the wine business. Meanwhile, National Australia Bank (+15.4%) is currently in discussions with the ACCC following the ACCC's decision to oppose the potential takeover for AXA Asia Pacific (-13.4%) over concerns that a tie up would lead to reduced competition.

### Portfolio Commentary

The Split Growth Fund outperformed its benchmark during the quarter.

Our overweight position to telecommunications giant Telstra Corporation contributed to relative performance. Telstra reached an agreement with the NBN Co to participate in the rollout of the fixed national broadband network. The transaction is worth \$11 billion and includes payment for the

decommissioning of Telstra's copper network and cable broadband service, and use of its infrastructure. Payments would be made progressively to Telstra. The agreement provides the framework for definitive agreements to be negotiated over the coming months and is a significant step towards the Government's vision for high-speed broadband.

Our holdings in the Swiss food giant, Nestle, had a strong quarter. Nestle held an investor seminar and provided an update on future prospects. Management re-confirmed their 2010 guidance for organic sales growth and an improvement in underlying EBIT margin. Management stated that Nestle is planning to achieve higher levels of sales growth in the future, driven in part by expansion in emerging markets. Also supporting Nestle was its commencement of a new CHF10bn buyback program using the proceeds from the completion of its stake in Alcon.

Our overweight position to Australia's oldest bank Westpac Banking Corporation detracted from relative performance. Over the quarter the company was impacted by concerns of net interest margin compression resulting from funding an expanded mortgage book in a market now influenced by liquidity rationing. Despite these headwinds, we feel Westpac is one of the higher quality banks. We are comfortable with our exposure to the company and believe it is well placed to deliver profit and dividend growth into 2011.

Walgreen, the US drugstore chain, reported quarterly earnings below expectations and detracted from performance. Its gross margin was weaker due to lower reimbursements from health insurers for drug prescriptions, and selling and administrations expenses which grew faster than sales. Despite the difficult economic background, Walgreen is working very hard to improve the things that are in its control. The company is slowing its store growth and continues to focus on costs. Walgreen also recently introduced beer and wine to its product range. This is boosting sales, increasing traffic and leads to a bigger average basket size. The company stands to benefit from a new wave of higher margin generic drugs coming to the market in 2011/12. It is shareholder focused and has repurchased \$600 million under its \$2 billion share repurchase program (7.4% of market cap) that it commenced last October.

## Outlook

Talk of slipping back into negative economic growth has risen substantially in recent weeks. This has been prompted largely by a downturn in macro data and ongoing structural worries about the sustainability of the recovery. The trend of earnings revisions has also started to slow down. While we expect a sustained (if weak) growth recovery, markets are like to remain jittery given the lack of visibility. For equity markets, slower earnings growth expectations need not translate in to market downside. Valuations have room to absorb slower growth expectations and to still allow for market upside. The portfolio is positioned towards those companies with favourable balance sheet and profitability metrics. Typically they are high RoE, and low leverage companies where EPS and DPS are stable and growing. High quality stocks are starting to outperform low quality stocks following substantial underperformance in 2009 and we expect this trend to continue in the second half of the year.

Value is emerging in the Australian share market with current volatility providing opportunity to acquire selected quality companies at more attractive valuations. Global growth concerns continue to impact market sentiment, as the sovereign debt problems in Europe and signs of possible slowing in China and the United States persevere. We continue to search for quality companies with strong balance sheets, sound management and a history of recurring earnings for inclusion into the portfolio.