

Adviser update

August 2011

From the desk of the Chief Investment Officer

The recent volatility experienced by Australian and international share markets has received significant media attention. As a result, investors can become concerned about how their funds are performing and whether they should act in response to this volatility.



James Jordan - Chief Investment Officer

Long-term investors should not be concerned

Whilst it is true that there has been a steady stream of bad news over the last month, and indeed the past few days, it is important to state clearly that long-term investors should never be panicked by a few days of significant market volatility. One of the most convincing findings from research on financial markets is that the returns earned following a time of relative market crisis are typically higher than the returns earned following a time of market boom.

Therefore, if a long term investor's decision to be invested in a given asset class or strategy is well founded, it is unlikely to be a good idea for that investor to retreat from that asset class or strategy in the midst of a market crisis.

What has caused the recent market turmoil?

The main reason for the recent market activity has been the ongoing debt crises in the US and Europe and, in particular, the US Government's struggle in getting consensus agreement on raising the debt ceiling (and associated spending cuts). This was exacerbated by the historic downgrade of the US credit rating which has made

investors understandably nervous, causing a certain degree of market stress and the volatility witnessed globally.

Whilst it is true that the main Australian and global stockmarket indices (e.g. S&P/ASX200 and MSCI World) have fallen recently, it is also true that those who have their investments diversified across a range of asset classes such as cash, bonds and direct property will have only a partial exposure to falls in equity markets. Some of those other assets, especially high quality Australian bonds, have been gaining in value while equity markets fall.

What does this mean for Australian Ethical investors and superannuation members?

Australian Ethical has a seasoned investment team that has been through times of market crisis before, most recently during the Global Financial Crisis of 2008, the Dot.com mania in 2000 and the Asian Financial Crisis in 1997, and we believe that our ethical investment strategy has shown over the past 25 years that it has an edge in times like these.

Our team is monitoring its investments closely, as we always do, and acting prudently where we see opportunities that are consistent with the ethical investment mandate that has been entrusted to us. For example, we are already seeing further examples of high quality smaller companies with zero debt and solid recurring earnings that we believe are significantly undervalued by the market.

Therefore, investors should remain focused on their long term objectives and on the benefits of investing ethically, and not on short-term fluctuations and associated headlines.

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Paul Smith and Adam Kirk join Australian Ethical

Australian Ethical has brought in Paul Smith and Adam Kirk to drive its business development, client relationships and communication activities.

Paul joins Australian Ethical as General Manager, Strategy and Communications. Paul has a background in actuarial consultancy, where he specialised in superannuation and investments working with UK pension fund clients on asset allocation strategies and investment manager appointments. He then moved into marketing initially with Schroders in the UK where he managed a large re-branding project, and in Australia where he has worked with a number of organisations and not for profits in marketing, communications and strategy assignments including time as National Marketing Manager for Carbon Planet.

Paul has a unique mix of skills in investments, superannuation, marketing and a passion for sustainability, ethics and our values.

Adam Kirk has taken on the role of General Manager, Business Development. Adam has extensive experience in leading and managing business development and client relationship teams in superannuation and retail funds management. Adam comes to us from Australian Catholic Super where he led the business development, marketing and advice teams. Prior to this his career includes time with Colonial First State and Skandia where he was responsible for marketing two of the most popular superannuation master trust platforms in the market. He has also worked for a time as an adviser with a corporate superannuation consulting firm leading a team that developed seminar, education and support programs for members of employer funds.

Adam's skills and experience will be invaluable to us as we focus our energies on our superannuation and as we navigate the rapidly changing environment in superannuation over the coming years.



Adam Kirk -
Business Development

Climate Advocacy Fund – Australia's first climate change shareholder resolution

Australian Ethical's Climate Advocacy Fund has passed some significant milestones in pursuing its first round of climate change shareholder resolutions.

For 2010 11 the Climate Advocacy Fund proposed resolutions to four companies requesting disclosure of carbon emissions, strategies to reduce emissions and also capital investment assumptions around future carbon prices and their impact on long term investment decisions.

The AGMs of two of these companies, Aquila Resources and Paladin Energy, were held in November 2010. Both companies refused to put the resolutions to a vote at their AGMs. However, after the AGM both companies agreed to publish carbon emission reports.

The AGMs of the other two companies, Oil Search and Woodside Petroleum, were held in April 2011.

Oil Search responded positively to the engagement from the Climate Advocacy Fund. The resolution was withdrawn before the AGM after Oil Search announced new plans to manage their carbon risk and to publish targets for reducing their greenhouse gas emissions. The positive engagement from Oil Search is a strong lead for other Australian companies to follow.

Woodside Petroleum declined to table the Climate Advocacy Fund's first, preferred shareholder resolution asking it to disclose its carbon price assumptions. Instead, Woodside obliged the Climate Advocacy Fund to opt for a second type of resolution that required a change to the company's constitution and would have needed 75 per cent of shareholders to support the resolution.

The resolution put to the Woodside AGM on 20 April 2011 was the first climate change shareholder resolution to be voted on at an Australian company AGM. The resolution failed with around 6 per cent of shareholders voting for the resolution.

The Woodside resolution marked an opportunity for other super funds to show that they walk the talk on climate change. While the resolution received key support from the

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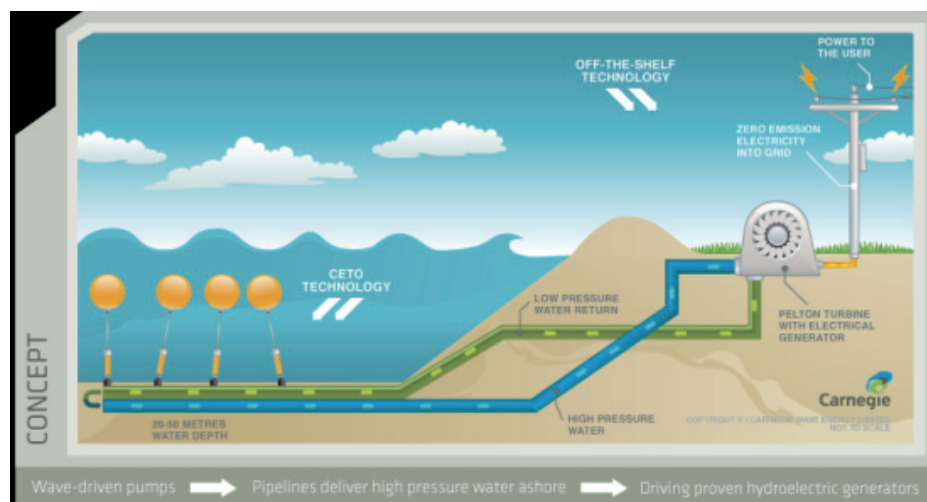
Australian Council of Super Investors who recommended that their members support the resolution, only a handful of super funds went on to vote for the resolution.

Significantly, some super funds who are signatories to the Carbon Disclosure Project and the UN Principles for Responsible Investment failed to support the resolution.

The Climate Advocacy Fund is a passively managed index fund suiting investors who seek a financial return in line with the S&P/ASX 200. It invests in the largest 200 companies on the Australian stock market based on their economic footprint. It has produced a return of 4.5% per annum since its inception in February 2010 until 30 June 2011, compared to the S&P/ASX200 return of 3.6%. It is available as both a managed fund and super option.

New companies added to portfolios

Australian Ethical has recently added Carnegie Wave Energy and Tennant Company to its portfolios.



Carnegie Wave Energy is a wave energy technology developer. Its propriety CETO Wave Energy Technology generates renewable energy from the natural motion of waves. The company has just begun producing energy at what is the Southern Hemisphere's first commercial scale wave power farm located near Garden Island off the West Australian Coast.

Carnegie's CETO wave energy system is distinct from most other wave energy systems in that it is anchored to the sea floor and cannot be seen from the shore. Submerged buoys are tethered to seabed pump units. When waves cause the buoys to move, this drives the pumps, which in turn pressurise water that is delivered ashore through a pipeline. The high-pressure water drives hydroelectric turbines, generating electricity.

The potential worldwide usable energy that could be extracted from waves has been estimated at 2 Terawatts, equivalent to the current worldwide installed capacity for electricity generation. Only a tiny fraction of this is currently being used. The World Energy Council identified Australia's southern margin (from Perth to Hobart) as one of the world's most promising sites for wave-energy generation.

Tennant Company was founded in 1870 in the USA and engages in the design and manufacture of cleaning solutions worldwide. Tennant's vision is to be a global leader in chemical-free cleaning and other technologies to help create a cleaner, healthier world.

Tennant is in the business of 'green cleaning' without chemicals. The eco-cleaning segment appears to be the focus and fastest growing area for the business.

Tennant patented the ec-H2O chemical free cleaning technology using only water to clean. The ec-H2O option is available on many of Tennant's scrubbers and sweepers and has driven a 65% rise in sales from equipment with this option. Water is electrified to oxygenate the water and then it is charged. The water becomes activated and assists in the breakdown of dirt when cleaning. The cleaning process results in just water and dirt. There is no need for chemicals and is an efficient use of water for cleaning purposes, keeping potent chemicals out of waterways and public spaces.

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Returns

Returns to 30 June 2011	3 mth	1 yr	3 yr (p.a.)	5 yr (p.a.)	Since inception (p.a.)
Smaller Companies Trust	-6.5%	10.8%	4.3%	6.2%	9.2%
S&P / ASX Small Industrials	-4.7%	15.7%	0.0%	-2.6%	6.3%
Larger Companies Trust	-6.9%	0.2%	-1.8%	-2.3%	7.0%
Melded Benchmark	-2.5%	7.4%	0.8%	-1.1%	5.7%
International Equities Trust	-9.1%	-5.4%	-7.5%	-	-9.9%
MSCI World (AUD)	-2.6%	3.7%	-2.7%	-	-7.4%
Balanced Trust	-2.5%	4.1%	0.8%	0.4%	6.3%
Morningstar Multisector Balanced	-0.8%	7.6%	1.1%	1.6%	6.6%
Property Trust	-3.9%	-0.3%	-	-	1.2%
Mercer Unlisted Property	n/a	n/a	-	-	n/a
Climate Advocacy Fund	-2.8%	6.8%	-	-	4.5%
S&P / ASX200 Accumulation	-4.0%	11.7%	-	-	3.6%