

Fund Review at 31 December 2007

| Fund performance [^] | 1 month % | 3 months % | 6 months % | 1 year % | Inception (pa) % |
|-------------------------------|-----------|------------|------------|----------|------------------|
| Performance before fees | -4.8 | -12.3 | -12.6 | -9.9 | 5.8 |
| Performance after fees | -4.9 | -12.5 | -13.2 | -11.0 | 4.5 |
| Benchmark* | -4.3 | -10.3 | -9.5 | -9.5 | 5.4 |
| Excess return after fees | -0.6 | -2.2 | -3.7 | -1.5 | -0.9 |

[^] EPRA NAREIT Global ex Australia Index Hedged in A\$

| | | | | | |
|--------------------------|------|-------|-------|-------|-----|
| Benchmark** | -3.8 | -12.0 | -13.6 | -17.0 | 3.4 |
| Excess return after fees | -1.1 | -0.5 | 0.4 | 6.0 | 1.1 |

**UBS Global Real Estate Investors ex Australia Index Hedged (A\$)

| Top ten holdings | % |
|-------------------------------|-----------|
| Unibail | 5.5 |
| Orco Property Group | 2.7 |
| Simon Property Group | 2.7 |
| Hang Lung Properties | 2.5 |
| Kerry Properties | 2.5 |
| Risanamento Spa | 2.5 |
| Lifestyle International | 2.4 |
| Prologis | 2.4 |
| DIC Asset | 2.3 |
| Sol Melia | 2.3 |
| Total number of stocks | 53 |

| Country weights | Fund % | Benchmark % |
|-----------------|------------|-------------|
| North America | 25.4 | 43.3 |
| Europe (ex UK) | 23.4 | 12.6 |
| United Kingdom | 6.2 | 8.9 |
| Asia (ex Japan) | 28.7 | 21.4 |
| Japan | 7.1 | 13.8 |
| Cash | 9.2 | - |
| Total | 100 | 100 |

| Distribution history | Cents per unit |
|----------------------|----------------|
| December 2007 | 0.35 |
| September 2007 | 0.71 |
| June 2007 | 6.36 |
| March 2007 | 2.22 |
| December 2006 | 2.37 |
| September 2006 | 0.33 |

| Fund details | |
|--|--|
| Total funds under management | \$73.9 million |
| NAV unit price at review date | \$0.9704 (ex price) |
| Inception date | 29 March 2006 |
| Investment manager | European Investors Inc, New York |
| Suggested minimum investment timeframe | At least 3-5 years |
| Benchmark | EPRA NAREIT Global ex Australia Index Hedged in AUD |
| Management costs | 1.18% p.a. (inclusive of the net effect of GST) |
| APIR code | MAQ0463AU |
| Portfolio turnover | Approximately 15% - 25% per year |
| Buy/sell spread | 0.45% / 0.45% |
| Minimum investment | Indirect investors: refer to the operator of your service Direct investors: minimum initial investment \$50,000 |
| Distributions | Paid quarterly as at 31 March, 30 June, 30 September and 31 December |



Comment from European Investors Inc

The fallout from the sub-prime fiasco in the US continued to affect global markets throughout the fourth quarter and resulted in a sharp correction for all asset classes during November. As for the property sector in Europe, share prices are back to the end of 2004 levels despite the fact that rental rates have more than doubled since then and remain stable. Asian markets ex-Japan have enjoyed a strong rise in share prices for most of the year, but even these markets stumbled in November as a result of fears that the US economy would slide into a recession as well as profit-taking. Credit spreads widened dramatically and Central Banks worldwide began to inject liquidity directly into the banking sector when it became clear that the banks were not willing to lend to each other. The ECB pumped nearly \$500 billion into the financial markets, but the impact was relatively minor in the face of evaporating confidence in the rating agencies and the overall credit quality of nearly all borrowers. Volatility in all markets increased substantially and investors shifted assets to government bonds, where yields have declined steadily throughout the past two quarters. The yield on the 10-year government bonds in Europe has declined by as much as 90 basis points in the UK and 30 basis points in the rest of the region over the past 6 months.

A major setback that occurred late in the quarter as a direct result of the sub-prime fiasco affected the normally defensive Australian listed property trust market. A company, Centro, was attempting to refinance its recently purchased US retail portfolio and reported that it was having difficulties in securing funding. Investors immediately sold the stock, and the company's shares fell 80% in 5 days. While the company had purchased relatively risky shopping centres, the violent reaction by investors in this normally low beta, low volatility market was surprising to all. Although some of the listed property shares have recovered somewhat since then, investor confidence has clearly been shaken.

As we noted last quarter, the lack of liquidity and tightening of credit conditions has had the beneficial impact of severely limiting the potential for new supply in all markets. Speculative development is virtually impossible in the developed markets and the risk premium for lower quality assets has been fully restored after evaporating over the past 3 years. This rebalancing of risk in the property sector has resulted in the following outcomes:

- Property companies and REITs are now trading at discounts to NAV of as much as 40%
- Interest rates are declining in most markets
- Employment levels are relatively stable
- Vacancy rates for commercial properties are at historically low levels with limited prospects for new supply

The above characteristics were prevalent several years ago, but at that time, the US and UK economies were expanding more rapidly. Today, China and the other Asian markets are the primary drivers for global growth, while the US and UK economies are on the brink of recession. Adding to the favourable conditions that are developing across the property markets is the increased appetite among large institutions and sovereign wealth funds for real estate in general. These investors were previously unable to meet their property sector allocation targets as they were outbid by financial buyers like Blackstone, Carlyle and other highly leveraged opportunity funds. The new wave of investors include US pension funds and sovereign wealth funds from the Middle East and Asia, and we would expect that demand for property investment will minimize the potential for declines in commercial property values.

The most recent entrant into the sovereign wealth arena is China whose government is encouraging more outward investment of its USD 1.5 trillion surplus cash (foreign exchange reserves). These sovereign investors are helping the largest US and European investment banks survive the sub-prime crisis by injecting USD billions into companies like UBS, Citigroup, Morgan Stanley, Bear Stearns, and Merrill Lynch. They have also started to invest heavily into the UK and Singapore and we expect that this investment largesse will also extend to the US property market.

Market Review

UK. For the entire second half of 2007, the UK property sector has declined and property company share prices reached 2004 levels in mid-December – despite the fact that overall market rents have more than doubled over the intervening 3 year period. While the exact reasons for the decline are difficult to ascertain, we believe that the following factors had a significant impact:

- Negative Property Sector Fund Flows
- Sub-prime Crisis
- Rising Interest Rates
- House Price Declines

The fund flow issue is essentially a derivative of the three other factors that have also affected the US and other European markets, but the UK's unique property unit trust investment structures have exacerbated the decline in property shares in this market. Property unit trusts were developed to broaden the investor base for UK property and they have succeeded in attracting substantial amounts of both institutional and retail capital. The consequence of increasing concerns about valuations have led to redemptions by unit holders, and this has created a Northern Rock-like liquidity crisis for the funds. Given the illiquidity of the property assets, many institutional funds have deferred redemptions to avoid having to sell their assets in a hostile market environment, but this has caused unrest in the market and fuelled more selling.

For retail funds, the picture is worse, especially for those that purchased higher risk property to maximize yield, and which are now suffering during the current economic slowdown. As many of these unit trusts also own UK REITs, we have seen considerable selling pressure in the sector, as these have been first to be sold, partially explaining the current disconnect between prices and values. Curiously, these events highlight the attractions of REITs over open-ended funds for holding property, which is similar to the events in the US in the early 1990s, when the popularity of REITs flourished.

The sub-prime crisis, fear of an impending economic slowdown as well as concerns that the Bank of England would continue to maintain its restrictive monetary policy has caused investors, prospective tenants and landlords alike to defer major decisions on transactions until the situation becomes clearer. While banks have not ceased lending to the sector, terms and conditions have tightened and spreads have widened, especially for higher risk projects. The UK REITs and property companies are generally well-funded and have locked in their financing costs for the foreseeable future, but the smaller companies are encountering financing difficulties. We expect that this will lead to consolidation and public to private transactions as the stronger companies and other investors take advantage of the situation.

As for the overall health of the commercial property market in the UK, tenant activity held up well over the quarter, but is now more subdued and may remain so for the next few months as tenants assess the current economic situation. Fortunately, the recent market events have led to a reduction in new development starts, thereby reducing supply risk. On the investment side, a major Canadian pension fund purchased a 50% stake in a building owned by Land Securities for a 4.6% yield, slightly above where it might have been before the sub-prime crisis. Spreads for the highest quality properties have widened from 4.25% (initial yield) to 4.75%, but most potential sellers are holding property off the market, so indicative yield data is limited. Higher risk properties – suburban office and shopping centers – have experienced a much greater increase in yields of 100-200 basis points. International investors tend to purchase the higher quality buildings, and we would not expect this market to experience any further declines in value beyond the 10-15% fall from the peak levels of the first quarter of 2007.

Continental Europe. The property companies in Europe suffered the same fate as their UK counterparts despite the lack of involvement in the sub-prime mortgage business. Property market fundamentals continued to strengthen, but the prevailing negative sentiment weighed heavily on property stocks. Fears of rising interest rates on the Continent were

heightened by ECB President Trichet insisting on battling inflation despite clear signs that pan-European economic growth is slowing.

During the quarter, we re-underwrote all of our investments and spent much of our time in the field attempting to get more market confirmation of valuations and overall activity. We discovered that the further one gets from London and New York, the easier it is to get financing, although not as easy as it was prior to the summer. In fact, we found banks were more willing to lend to an Eastern European development project than an existing building (leased) in London. During the quarter, several office buildings were sold in emerging European cities at 5.5% yields, essentially lower rates of return than are currently achievable in the top markets in developed Europe. Due to the low level of vacancy in most major European cities, the downward pressure on property prices is much less than for London and its environs. For example, a building was sold in Paris at the end of November at a 4.2% yield despite its relatively poor location. Institutional buyers from Europe, the Middle East and Asia are known to be in the market looking to take advantage of the current financial market turbulence, but there is very little inventory available. The Nordic Region (Finland, Sweden, Denmark and Norway) is far removed from the sub-prime situation and are not experiencing financial gridlock or lack of activity. The property companies are fully priced, however, and the potential for growth in earnings appears to be fully discounted in the share prices.

Asia. As we noted in our last Outlook, Japan's property shares remain at depressed levels in response to fears about a US recession, despite improving property fundamentals and pan-Asian economic growth that has steadily increased in importance to Japan. Current market conditions that include high employment, very low vacancies in the major markets (Tokyo's office vacancy rate is 2.5%), and no meaningful additions to supply, would normally be expected to attract investor interest – but it has not been the case. Property companies are trading at steep discounts to NAV, and the NAVs are rising, unlike most other developed markets. While Japan does not have a sub-prime problem from an issuer perspective, many of their financial institutions have been investors in this paper and have been forced to take large write-downs. This has affected local market sentiment and may account for this market's lacklustre performance throughout the second half of 2007. The market also suffered from the effects of the enforcement of compliance with the newly instituted seismic codes, delaying new development. However, this has not dampened investor enthusiasm for direct property investment from Japanese or foreign funds.

Hong Kong and Mainland China continue to provide the best performance of any market during the quarter despite some profit-taking in November. In late December, the Chinese government announced a surprise interest rate increase in yet another attempt to alleviate inflationary pressures. This was the sixth interest rate increase this year and could begin to affect property company growth rates. Residential property prices have increased over 10% for the year across all of China, but some markets have been growing at nearly twice this pace. Hong Kong companies sold off in November and provided attractive re-entry points as the opportunities in this market remain very attractive. Despite the past few years of economic growth, the property sector did not provide enough supply to accommodate demand, and the resulting shortfall is resulting in rising lease rates and property prices.

The sub-prime situation is far removed from the Hong Kong market as the vehicle does not exist and the potential fallout from layoffs on Wall Street will be complemented by increased hiring in Hong Kong. Consequently, demand for both housing and office space from international companies is expected to continue to grow, and the city will also benefit from Mainland China demand for space. Further stimulating this market is the downward pressure on US interest rates which feeds directly into Hong Kong's cost of funds. Mortgage rates in Hong Kong are now 3.75%, especially attractive in the context of inflation that exceeds this level, resulting in negative real rates.

Singapore property markets sold off during the fourth quarter after initially recovering all the losses from the summer global market meltdown. This occurred despite rising prices on residential and commercial properties and steadily increasing rental rates as more international companies

move to this city state. Developers have been delaying releases of new projects in anticipation of rising prices, so the full benefit from these projects has been deferred to 2008. A German fund paid a record high price for a relatively low quality office building location on a ground lease for USD \$1300 per square foot. Unlike previous recoveries, the Singapore developers did not build sufficient space given the current demand levels, and this shortfall is expected to prevail for the next several years. As a result of the strong growth in underlying property values that is not reflected in the share prices of the companies, the average discount to NAV in Singapore is 15%.

Investment Activity and Outlook

As we noted in our last Outlook, we expected the Bank of England to temper its tough anti-inflation talk and lower interest rates, and the Bank responded to falling house prices by lowering rates at the end of the quarter. The Bank's willingness to consider reducing interest rates and increasing liquidity in the system to stimulate growth is very positive and should lead to a recovery in the property sector over the next several quarters. As we expect this recovery will be relatively protracted, we will add to our positions in the UK as and when there is more clarity on the upside potential for this market. In the meantime, we will stay on the sidelines.

As for the rest of Europe, we will be selectively adding to our positions in the strongest and best capitalized companies that are least affected by the potential for rate increases. We do expect that Trichet, the European Central Bank President, will soften his hawkish stance on interest rates once it becomes clearer that inflation is not the enemy, and that he is at risk of damaging the European economies. Italy and Spain have announced plans to liquefy their property markets by implementing a REIT structure in 2008 and this should encourage global investors to shift assets to these markets as conditions warrant. We will also focus on the opportunities in Russia and other Eastern European markets now that the euphoria in the local property company share prices has evaporated and valuations look more interesting.

In Asia, we will maintain our positions in the highest quality companies in Hong Kong, Singapore and China, but we will monitor market developments closely given these countries have experienced very strong performance relative to other markets throughout much of the year. Any profits we take from these countries will be re-invested in European opportunities as well as other Asian markets that have lagged. India will be a major focus for us in 2008 as this market is expected to continue to grow at a rapid pace relative to the developed markets. We are also reviewing opportunities in the Middle East and may invest in this region if the valuations are sufficiently compelling.

We have allowed cash levels to drift above 10% deliberately during the past several months of market turbulence, but we fully expect the current financial market gridlock to abate and will reduce cash back to our more normal levels of 3-5% - market conditions depending.

How the Fund is managed

European Investors Inc's (EII) investment approach for the Fund is based on the premise that investment in equity securities issued by global, listed real estate companies and trusts is an efficient and cost-effective way to obtain broad, indirect exposure to the real estate asset class.

Furthermore, as an asset class, real estate may offer several advantages such as historically low volatility relative to the broader equity markets and a low correlation with other asset classes.

EII will make asset-allocation decisions based on both:

- economic, geographic, real estate fundamental / sector factors (known as 'top down asset allocation'); and
- factors specific to each individual security (known as 'bottom-up security selection').

Although both facets of EII's approach are important, it is the 'bottom up' security selection process that will primarily drive the investment strategy for the Fund

^ Past performance is not a reliable indicator of future performance. The returns on the fund assume distributions are reinvested.

© Macquarie Professional Series is a registered trademark of Macquarie Bank Limited ABN 46 008 583 542 ('Macquarie').


Investments in the EII Global Property Fund ARSN 117 792 113 ('Fund') are offered by Macquarie Investment Management Limited ABN 66 002 867 003 ('MIML'). This information is general advice only and has been prepared without taking into account the individual objectives, financial situation or needs of any particular investor. Before making a decision to invest in the Fund on the basis of this information, investors should read the Fund's product disclosure statement ('PDS') and consider, with or without their financial adviser, whether it fits their objectives, financial situation and needs. Applications for units in the Fund can only be made on an application form contained in the current PDS.

Investments in the Fund are not deposits with or other liabilities of Macquarie Bank Limited ABN 46 008 583 542 or any Macquarie Group company and are subject to investment risk, including possible delays in repayment and loss of income or principal invested. None of Macquarie Bank Limited, MIML or any other Macquarie Group company guarantees the performance of the Fund or the repayment of capital from the Fund or any particular rate of return.

Any financial product advice provided by us is free of charge. MIML may receive remuneration for distributing financial products issued by other Macquarie Group companies.

How to contact Macquarie

Financial advisers


 1800 005 056

 Macquarie Professional Series
PO Box H111 Australian Square NSW 1215

Master trusts and wrap operators


 1800 214 616

 professionalservices@macquarie.com


 (02) 8232 9435

Prospective investors

 www.macquarie.com.au/professionalservices

 Call your financial adviser or
Macquarie on 1800 236 141

Institutional investors

 (02) 8232 7017

FORWARD thinking

