

Fund Review at 30 September 2008

Fund total return [^]	1 month %	3 months %	6 months %	1 year %	2 year %	Inception (pa) %
Performance before fees	-10.1	-10.3	-19.2	-34.7	-12.4	-7.5
Performance after fees	-10.2	-10.6	-19.7	-35.5	-13.4	-8.6
Benchmark*	-8.7	-6.6	-12.7	-26.3	-8.5	-4.1
Excess return after fees	-1.5	-4.0	-7.0	-9.2	-4.9	-4.5

* EPRA NAREIT Global ex Australia Index Hedged in A\$

Top ten holdings	%
Unibail	8.2
Simon Property Group Inc	4.6
Aeon Mail Co Ltd	4.5
Federal Realty Invs Trust	3.2
Boston Properties Inc	3.1
Hysan Development Co Ltd	3.1
Sol Melia SA	2.9
Mitsui Fudosan	2.8
Vornado Realty Trust	2.7
Hongkong Land Holdings Ltd	2.6
Total number of stocks	46

Country weights	Fund %	Benchmark %
Asia (ex Japan)	23.7	13.7
Europe (ex UK)	22.9	12.2
Japan	10.0	13.6
North America	39.3	52.4
United Kingdom	3.9	8.1
Cash	0.3	-
Total	100	100

Distribution history	Cents per unit
June 2008	7.67
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	\$44.2 million
NAV unit price at review date	\$0.6455
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

Overview – Are We There Yet?

Markets around the world have become extremely volatile and the current level of volatility exceeds levels normally associated with a major financial and/or geopolitical crisis (Iran and Iraq conflicts, SARS, etc.) The real estate securities markets actually started to discount the economic slowdown resulting from this global crisis in confidence at the end of 2007 and have declined steadily throughout the year in most markets. As the property sector was the first to respond to the decline in credit market conditions and has fallen significantly below the value of their underlying property portfolios, it could be among the earliest to recover.

The Bad News

- Job losses may result in a loss of tenants or at least increases the chance that future rental rates will decline due to the layoffs. The impact of this is somewhat mitigated by the fact that in most of the world outside the US, sub-leasing is not an option and tenants are required to pay rent or face eviction. Consequently, this defers the impact of rising vacancy rates and declining rental rates. Layoffs are more difficult to achieve in Continental Europe, further deferring this impact.
- Forced sales of direct real estate may occur as lenders find it harder to fund themselves and are no longer able to

work with the borrower to facilitate an orderly asset sale.

- Working capital shortfalls resulting from cancelled lines of credit and reduced access to capital are starting to become apparent. As property companies are very capital intensive, most if not all require credit to operate their businesses and this has become far more difficult.
- Lack of financing is now affecting other businesses, leading to layoffs in the broader market, which will lead to reduced sales by retailers, home sales, and office space needs.

Transactions are rare, complicating valuations. During periods of financial uncertainty, buyers typically stay on the sidelines and wait for better pricing. Similarly, tenants are waiting for lower rates to sign leases or backing out of commitments due to economic conditions. Real estate brokers' golf handicaps have been declining steadily, a sure sign of a slow market.

China has been a major contributor to global growth, but its efforts over the past 3 years to slow growth by raising interest rates and reserve ratios began to take effect only in the 2nd quarter of this year – and the impact has been very significant. One of the primary objectives was to reduce the flow of capital to residential developers, and the program has resulted in many of the smaller developers going out of business. Growth in the region has also been slowed by the earthquake in the Szechuan region, the Olympics, Hungry Ghost Month (August), and the deteriorating global Marketplace for their exports.

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The Good News

- Declining supply. It is virtually impossible for any company to secure financing for a new development, so the risks to the property sector from additions to supply are rapidly diminishing – and this should be the case for many years to come.
- Historically low vacancy rates. While we expect vacancies to rise, most European and Asian markets are operating at cyclically low levels. Hong Kong, Tokyo, and Singapore office vacancies are 1-2%, while office vacancy rates for the major cities in Europe are in the 3-6% range for the best quality locations.
- Interest rates are declining – if you can get the financing. This will ultimately help to ease the burden on many companies.
- Rising construction costs. This has become a significant barrier to new construction even when the availability of capital is not an issue. The cost issue is further exacerbated by the prospects for declining rental rates in most markets, dramatically reducing profitability on development.
- Most properties in Europe and Asia are rented below market and will have some upside as these tenants renew their leases. In addition, rental contracts include an inflation adjustment, which provides upside to landlords in a declining cost environment. However, landlords will probably compromise on the rate of increase to accommodate tenants given the current economic situation.

- Leverage and interest coverage ratios are improving for most borrowers and this should continue for those companies that survive the current crisis.
- Companies are attractively priced on virtually any metric – Price/book, P/NAV, P/E, dividend yield – relative to any time in their histories. Hong Kong companies are now trading at levels far below those reached during the height of the Asian Crisis of 1997-8.
- Discounts to Net Asset Value are far greater than the underlying property values would suggest. In the UK where the index for property values (IPD) is most reliable, the UK REITs are trading at the widest spread below the IPD in 20 years. This eclipses the previous record that occurred when Canary Wharf was completed and saturated the market with space.

Response to the Crisis

Based on the current market conditions, we have been reducing holdings in companies with a higher percentage of development and further concentrating investments in the better managed companies with the highest quality real estate. We have also reviewed company refinancing risks, coverage ratios, and access to capital. On a weighted average basis, the international portfolios have a debt/total capitalization of 37% and interest coverage of 8.6 times (compared with a private equity real estate investment which would be 70% leveraged and 1.5-2 times interest coverage). While most companies have been de-leveraging, the sharp sell-off in share prices has offset the impact of their efforts to

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reduce debt, otherwise the average leverage would have been even lower.

At the property level, our valuation models have been adjusted to reflect increased cap rates (decreased values) and we have reduced or eliminated rental growth assumptions despite having tangible evidence that supports higher levels for both values and rental rates. After allowing for slower growth in the global economy and rising interest rates, the companies remain undervalued by 15-30% based on our analysis.

We have also been analyzing the banks in our markets to determine which are best positioned to survive the market trauma and of those, which banks have the most exposure to our property companies. Surprisingly, the Spanish banks are among the healthiest in Europe – notably BBVA and Santander – despite their home market housing market debacle. In each of our primary markets, there are at least two banks that are healthy from a capital adequacy perspective, while the others are in need of government funds. As the European Union is not a single market, each of the governments has determined how to respond to the crisis with the majority deciding to guarantee bank deposits and inject capital directly into the banks. In Asia, the banks and governments are liquid and the financial risk appears to be limited as compared with the rest of the world.

During the past 6-9 months, the companies that have performed best have been the Swiss and Belgian property

companies. The Swiss companies have benefited from a currency play (security of the Swiss Franc during periods of turmoil) and have limited development upside. While the companies are not necessarily conservatively leveraged, they are located in markets that have little or no growth potential which is perceived by investors today as limiting downside risk. As a result, these companies are trading at premiums to NAV (the only ones in the world) and the management teams are not highly regarded by investors in general. Based on our analysis of previous recessions and recoveries, these companies tend to suffer at the turning point while the development-oriented companies surge ahead. Consequently, we do not believe that investing in *overvalued, under-managed companies with no upside* potential makes sense for our investors in the long run, especially as we will never be able to predict the turning point.

Currently, the International portfolio strategy comprises companies that are undervalued and can be divided into risk categories based on development, refinancing risk, leverage and market cap. Low risk companies include those that have moderate or even no leverage, are dominant forces in their respective markets, and have ready access to capital. This category normally comprises 60-70% of the portfolio. Moderate risk companies have somewhat more leverage (less than 50% debt/total cap) and interest coverage of at least 3 times. These companies may have up to 25% of their NAV derived from development. This group will typically

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represent up to 25% of the portfolio. The high risk companies that remain in the portfolio after the recent market sell-off are those that have adequate access to debt capital, solid business strategy, and high quality management that is willing to communicate openly. We will limit these types of companies to 5% of the portfolio in the current environment. Historically, this latter category has provided our investors with returns of as much as 200-500% over a cycle.

Outlook

For those investors who invested during the past 12 months, you have taken the brunt of the downturn and may as well stay until the end of the movie. Note that real estate companies - unlike financial companies - have hard assets that have value at some level. In the case of Lehman and Bear Stearns, their headquarters buildings and real estate funds were the only truly valuable assets they had left after the financial assets evaporated.

For those investors considering adding or initiating a position in this sector, time is on your side – there is no need to rush headlong into the breach. Based on our review of previous downturns and recoveries, the markets go through a period of stabilization and then recover roughly 2 to 6 months afterward.

If you can't take the pain of the past few months and must sell, some of our clients have chosen to hedge this bet by selling half the position and averaging in at a later date.

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Regardless of your situation, the experience of previous recoveries would suggest that the upside can be substantial while the downside risk at this stage should be limited.

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.


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