

# **Morgan Stanley FX Alpha Fund**

ARSN 127 428 782

## **Annual report - 30 June 2010**

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This financial report covers Morgan Stanley FX Alpha Fund as an individual entity.

The Responsible Entity of Morgan Stanley FX Alpha Fund is Macquarie Investment Management Limited (ABN 66 002 867 003). The Responsible Entity's registered office is Mezzanine Level, No. 1 Martin Place, Sydney, NSW 2000.

## Directors' report

The directors of Macquarie Investment Management Limited ("MIML"), a wholly owned subsidiary of Macquarie Group Limited, the Responsible Entity of Morgan Stanley FX Alpha Fund, present their report together with the financial report of Morgan Stanley FX Alpha Fund ("the Trust") for the year ended 30 June 2010.

### Principal activities

The Trust invests in unlisted unit trusts and derivatives in accordance with the provisions of the Trust Constitution.

The Trust did not have any employees during the year.

There were no significant changes in the nature of the Trust's activities during the year.

### Directors

The following persons held office as directors of Macquarie Investment Management Limited during the year or since the end of the year and up to the date of this report:

B N Terry  
 N Roderick (resigned 29/03/2010)  
 R Cartwright  
 V Malley  
 C Vignes  
 M Rady (resigned 01/02/2010)  
 C Swanger (appointed 08/02/2010)  
 T Graham (appointed 29/03/2010)

### Review and results of operations

During the year, the Trust continued to invest funds in accordance with target asset allocations as set out in the governing documents of the Trust and in accordance with the provisions of the Trust Constitution.

#### Results

The performance of the Trust, as represented by the results of its operations, was as follows:

	Year ended	
	30 June 2010	30 June 2009
Operating profit/(loss) before finance costs attributable to unitholders (\$)	<u>367,063</u>	<u>137,279</u>
<i>Distributions</i>		
Distribution paid and payable (\$)	<u>359,756</u>	<u>117,300</u>
Distribution (cents per unit)	<u>7.12</u>	<u>3.98</u>

### Significant changes in state of affairs

In the opinion of the directors, there were no significant changes in the state of affairs of the Trust that occurred during the financial year under review.

### Matters subsequent to the end of the financial year

No matter or circumstance has arisen since 30 June 2010 that has significantly affected, or may significantly affect:

- (i) the operations of the Trust in future financial years, or
- (ii) the results of those operations in future financial years, or
- (iii) the state of affairs of the Trust in future financial years.

## **Directors' report (continued)**

### **Likely developments and expected results of operations**

The Trust will continue to be managed in accordance with the investment objectives and guidelines as set out in the governing documents of the Trust and in accordance with the provisions of the Trust Constitution.

The results of the Trust's operations will be affected by a number of factors, including the performance of investment markets in which the Trust invests. Investment performance is not guaranteed and future returns may differ from past returns. As investment conditions change over time, past returns should not be used to predict future returns.

Further information on likely developments in the operations of the Trust and the expected results of those operations have not been included in this report because the Responsible Entity believes it would be likely to result in unreasonable prejudice to the Trust.

### **Indemnification and insurance of officers and auditors**

No insurance premiums are paid for out of the assets of the Trust in regards to insurance cover provided to either the officers of Macquarie Investment Management Limited or the auditors of the Trust. So long as the officers of Macquarie Investment Management Limited act in accordance with the Trust Constitution and the Law, the officers remain indemnified out of the assets of the Trust against losses incurred while acting on behalf of the Trust. The auditors of the Trust are in no way indemnified out of the assets of the Trust.

### **Fees paid to and interests held in the Trust by the Responsible Entity or its associates**

Fees paid to the Responsible Entity and its associates out of Trust property during the year are disclosed in note 11 of the financial statements.

No fees were paid out of Trust property to the directors of the Responsible Entity during the year.

The number of interests in the Trust held by the Responsible Entity or its associates as at the end of the financial year are disclosed in note 11 of the financial statements.

### **Interests in the Trust**

The movement in units on issue in the Trust during the year is disclosed in note 6 of the financial statements.

The value of the Trust's assets and liabilities is disclosed on the statement of financial position and derived using the basis set out in note 2 of the financial statements.

### **Environmental regulation**

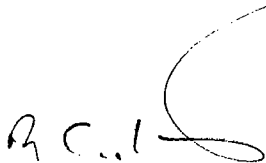
The operations of the Trust are not subject to any particular or significant environmental regulations under a Commonwealth, State or Territory law.

**Directors' report (continued)**

**Auditor's independence declaration**

A copy of the Auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 5.

This report is made in accordance with a resolution of the directors.

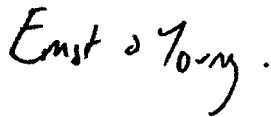
A handwritten signature in black ink, appearing to read 'R Cartwright', with a large, sweeping flourish extending upwards and to the right.

R Cartwright  
Director

Sydney  
3 August 2010

## Auditor's Independence Declaration to the Directors of Macquarie Investment Management Limited, as Responsible Entity for Morgan Stanley FX Alpha Fund

In relation to our audit of the financial report of Morgan Stanley FX Alpha Fund for the financial year ended 30 June 2010, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

A handwritten signature in black ink that reads 'Ernst & Young'.

Ernst & Young

A handwritten signature in black ink, appearing to be 'G. McKenzie'.

Graeme McKenzie  
Partner  
3 August 2010

**Statement of comprehensive income**

	Notes	30 June 2010 \$	30 June 2009 \$
<b>Investment income</b>			
Distributions from unit trusts		179,916	156,015
Net gains on financial instruments held at fair value through profit or loss	5	<u>245,231</u>	<u>16,975</u>
<b>Total net investment income</b>		<u>425,147</u>	<u>172,990</u>
<b>Expenses</b>			
Responsible Entity's fees	11	55,858	34,972
Other operating expenses		<u>2,226</u>	<u>739</u>
<b>Total operating expenses</b>		<u>58,084</u>	<u>35,711</u>
<b>Operating profit</b>		<u>367,063</u>	<u>137,279</u>
<b>Finance costs attributable to unitholders</b>			
Distributions to unitholders		(359,756)	(117,300)
(Increase) in net assets attributable to unitholders	6	<u>(7,307)</u>	<u>(19,979)</u>
<b>Profit for the year</b>		<u>-</u>	<u>-</u>
<b>Total comprehensive income for the year</b>		<u>-</u>	<u>-</u>

*The above statement of comprehensive income should be read in conjunction with the accompanying notes.*

**Statement of financial position**

	Notes	30 June 2010 \$	30 June 2009 \$
<b>Assets</b>			
Cash and cash equivalents	7	21,356	9,391
Receivables		3,028	3,393
Financial assets held at fair value through profit or loss	8	<u>46,347,956</u>	<u>13,799,181</u>
<b>Total assets</b>		<u>46,372,340</u>	<u>13,811,965</u>
<b>Liabilities</b>			
Distributions payable		43,675	673
Other payables		5,104	4,428
Responsible Entity fees payable	11	47,664	8,978
Financial liabilities held at fair value through profit or loss	9	<u>39,078,441</u>	<u>10,798,980</u>
<b>Total liabilities (excluding net assets attributable to unitholders)</b>		<u>39,174,884</u>	<u>10,813,059</u>
<b>Net assets attributable to unitholders - liability</b>	6	<u>7,197,456</u>	<u>2,998,906</u>

*The above statement of financial position should be read in conjunction with the accompanying notes.*

**Statement of changes in equity**

	<b>30 June 2010 \$</b>	<b>30 June 2009 \$</b>
<b>Total equity at the beginning of the year</b>	-	-
Total comprehensive income for the year	-	-
Transactions with owners in their capacity as owners	-	-
<b>Total equity at the end of the year</b>	<u>-</u>	<u>-</u>

Under Australian Accounting Standards, net assets attributable to unitholders are classified as a liability rather than equity. As a result there was no equity at the start or end of the year.

*The above statement of changes in equity should be read in conjunction with accompanying notes.*

**Statement of cash flows**

	Notes	30 June 2010 \$	30 June 2009 \$
<b>Cash flows from operating activities</b>			
Proceeds from sale of financial instruments held at fair value through profit or loss		622,900	742,970
Purchase of financial instruments held at fair value through profit or loss		(4,472,804)	(723,082)
Dividend received		-	-
Interest received/(paid)		717	(192)
Other income received		8,370	4,849
Responsible Entity's fees paid		(24,961)	(48,878)
Payment of other expenses		(3,158)	(242)
<b>Net cash outflow from operating activities</b>	12(a)	<u>(3,868,936)</u>	<u>(24,575)</u>
<b>Cash flows from financing activities</b>			
Proceeds from applications by unitholders		7,467,691	48,340
Expenses paid on behalf of unitholders		(3,484,041)	(15,063)
Distributions paid		(98,130)	(854)
Expenses paid on behalf of unitholders		(10,356)	-
<b>Net cash inflow from financing activities</b>		<u>3,875,164</u>	<u>32,423</u>
<b>Net increase in cash and cash equivalents</b>		<b>6,228</b>	<b>7,848</b>
Cash and cash equivalents at the beginning of the year		9,391	965
Effects of foreign currency exchange rate changes on cash and cash equivalents		<u>5,737</u>	<u>578</u>
<b>Cash and cash equivalents at the end of the year</b>	7	<u><b>21,356</b></u>	<u><b>9,391</b></u>
Non-cash financing activities	12(b)	<b>207,593</b>	104,196

*The above statement of cash flows should be read in conjunction with the accompanying notes.*

## 1 General information

This financial report covers Morgan Stanley FX Alpha Fund ("the Trust") as an individual entity. The Trust was constituted on 20 September 2007.

The Responsible Entity of the Trust is Macquarie Investment Management Limited (the "Responsible Entity"). The Responsible Entity's registered office is Mezzanine Level, No. 1 Martin Place, Sydney, NSW 2000. The financial report is presented in Australian currency.

During the year, the Trust continued to invest funds in accordance with target asset allocations as set out in the current offer document and in accordance with the provisions of the Trust Constitution.

The financial statements were authorised for issue by the directors on 2 August 2010. The directors of the Responsible Entity have the power to amend and reissue the financial report.

## 2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated in the following text.

### (a) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board and the *Corporations Act 2001* in Australia.

The financial report is prepared on the basis of fair value measurement of assets and liabilities except where otherwise stated.

#### *Compliance with International Financial Reporting Standards (IFRS)*

The financial statements have been prepared in accordance with the Australian Accounting Standards Board and International Financial Reporting Standards as issued by the International Accounting Standards Board.

### (b) Financial instruments

#### (i) Classification

The Trust's investments are categorised as at fair value through profit or loss. They comprise:

- Financial instruments held for trading

These include derivative financial instruments including foreign currency forward contracts. The Trust does not designate any derivatives as hedges in a hedging relationship.

- Financial instruments designated at fair value through profit or loss upon initial recognition

These include financial assets that are not held for trading purposes and which may be sold. These are investments in unlisted trusts.

Financial assets and financial liabilities may be designated at fair value through profit or loss at inception if they are managed and their performance evaluated on a fair value basis in accordance with the Trust's documented investment strategy. The Trust's policy is for the Responsible Entity to evaluate the information about these financial assets on a fair value basis together with other related financial information.

Loans and receivables/payables comprise amounts due to or from the Trust.

#### (ii) Recognition/derecognition

The Trust recognises financial assets and financial liabilities on the date it becomes party to the contractual agreement (trade date) and recognises changes in fair value of the financial assets or financial liabilities from this date.

Investments are derecognised when the right to receive cashflows from the investments have expired or the Trust has transferred substantially all risks and rewards of ownership.

## 2 Summary of significant accounting policies (continued)

### (b) Financial instruments (continued)

#### (iii) Measurement

##### (a) Financial assets and liabilities held at fair value through profit or loss

Financial assets and liabilities held at fair value through profit or loss are measured initially at fair value excluding any transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately. Subsequent to initial recognition, all instruments held at fair value through profit or loss are measured at fair value with changes in their fair value recognised in the statement of comprehensive income.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Trust would receive or pay to terminate the contract at the statement of financial position date taking into account current market conditions (volatility and appropriate yield curve) and the current creditworthiness of the counterparties. The fair value of a forward contract is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at the valuation date.

Investments in unlisted unit trusts are recorded at the redemption value per unit as reported by the managers of such trusts.

##### (b) Loans and receivables

Loan assets are measured initially at fair value plus transaction costs and subsequently amortised using the effective interest rate method, less impairment losses if any. Such assets are reviewed at each statement of financial position date to determine whether there is objective evidence of impairment, such as a significant or prolonged decline in the fair value below carrying amount.

If any such indication of impairment exists an impairment calculation is undertaken and any impairment loss is recognised in the statement of comprehensive income as the difference between the asset's carrying amount and the present value of the revised estimated future cash flows discounted at the original effective interest rate.

If in a subsequent period the amount of an impairment loss recognised on a financial asset carried at amortised cost decreases and the decrease can be linked objectively to an event occurring after the write down, the write down is reversed through the statement of comprehensive income.

### (c) Net assets attributable to unitholders

Units are redeemable at the unitholders' option and are therefore classified as financial liabilities. The units can be put back to the Trust at any time for cash based on the redemption price. The fair value of redeemable units is measured at the redemption amount that is payable (based on the redemption unit price) at the statement of financial position date if unitholders exercised their right to put the units back to the Trust.

### (d) Cash and cash equivalents

For the purpose of presentation in the statement of cash flows, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions and bank overdrafts. Bank overdrafts, if any, are shown separately on the statement of financial position.

Payments and receipts relating to the purchase and sale of investment securities are classified as cash flows from operating activities, as movements in the fair value of these securities represent the Trust's main income generating activity.

### (e) Investment income

Interest income and expenses are recognised in the statement of comprehensive income for all financial instruments that are not held at fair value through profit or loss using the effective interest method. Interest income on assets held at fair value through profit or loss is included in the net gains/(losses) on financial instruments. Other changes in fair value for such instruments are recorded in accordance with the policies described in note 2(b).

## 2 Summary of significant accounting policies (continued)

### (e) Investment income (continued)

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts throughout the expected life of the financial instrument, or a shorter period where appropriate, to the net carrying amount of the financial asset or liability. When calculating the effective interest rate, the Trust estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Trust distributions are recognised on an entitlements basis.

### (f) Expenses

All expenses, including Responsible Entity's fees are recognised in the statement of comprehensive income on an accruals basis.

### (g) Income tax

Under current legislation, the Trust is not subject to income tax provided the taxable income of the Trust is fully distributed either by way of cash or reinvestment (ie unitholders are presently entitled to the income of the Trust).

Financial instruments held at fair value may include unrealised capital gains. Should such a gain be realised, that portion of the gain that is subject to capital gains tax will be distributed so that the Trust is not subject to capital gains tax.

Realised capital losses are not distributed to unitholders but are retained in the Trust to be offset against any realised capital gains. If realised capital gains exceed realised capital losses, the excess is distributed to unitholders.

### (h) Distributions

In accordance with the Trust Constitution, the Trust distributes its distributable (taxable) income, and any other amounts determined by the Responsible Entity, to unitholders by cash or reinvestment. The distributions are recognised in the statement of comprehensive income as finance costs attributable to unitholders.

### (i) Increase/decrease in net assets attributable to unitholders

Income not distributed is included in net assets attributable to unitholders. Movements in net assets attributable to unitholders are recognised in the statement of comprehensive income as finance costs.

### (j) Foreign currency translation

#### *i) Functional and presentation currency*

Items included in the Trust's financial statements are measured using the currency of the primary economic environment in which it operates (the "functional currency"). This is the Australian dollar, which reflects the currency of the economy in which the Trust competes for funds and is regulated. The Australian dollar is also the Trust's presentation currency.

#### *ii) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translations at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income.

## 2 Summary of significant accounting policies (continued)

### (j) Foreign currency translation (continued)

The Trust does not isolate that portion of gains or losses on securities and derivative financial instruments that are measured at fair value through profit or loss and which is due to changes in foreign exchange rates from that which is due to changes in the market price of securities. Such fluctuations are included with the net gains or losses on financial instruments at fair value through profit or loss.

### (k) Due from/to brokers

Amounts due from/to brokers represent payables for securities purchased and receivables for securities sold that have been contracted for but not yet delivered by the end of the year. A provision for impairment of amounts due from brokers is established when there is objective evidence that the Trust will not be able to collect all amounts due from the relevant broker. Significant financial difficulties of the broker, probability that the broker will enter bankruptcy or financial reorganisation, and default in payments are considered indicators that the amount due from brokers is impaired.

### (l) Receivables

Receivables may include amounts for interest and trust distributions. Trust distributions are accrued when the right to receive payment is established. Interest is accrued at the reporting date from the time of last payment in accordance with the policy set out in note 2(e) above. Amounts are generally received within 30 days of being recorded as receivables.

Receivables include such items as Reduced Input Tax Credits (RITC) and application monies receivable from unitholders.

### (m) Payables

Payables includes liabilities and accrued expenses owing by the Trust which are unpaid as at year end.

The distribution amount payable to unitholders as at the reporting date is recognised separately on the statement of financial position when unitholders are presently entitled to the distributable income under the Trust's Constitution.

### (n) Applications and redemptions

Applications received for units in the Trust are recorded net of any entry fees payable prior to the issue of units in the Trust. Redemptions from the Trust are recorded gross of any exit fees payable after the cancellation of units redeemed.

### (o) Goods and Services Tax (GST)

The GST incurred on the costs of various services provided to the Trust by third parties such as investment management fees have been passed onto the Trust. The Trust qualifies for RITC at a rate of 75% hence investment management fees and other expenses have been recognised in the statement of comprehensive income net of the amount of GST recoverable from the Australian Taxation Office (ATO). Accounts payable are inclusive of GST. The net amount of GST recoverable from the ATO is included in receivables in the statement of financial position. Cash flows relating to GST are included in the statement of cash flows on a gross basis.

### (p) Use of estimates

The Trust makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

## 2 Summary of significant accounting policies (continued)

### (p) Use of estimates (continued)

For the majority of the Trust's financial instruments, quoted market prices are readily available. However, certain financial instruments, such as over-the-counter derivatives or unquoted securities are fair valued using valuation techniques. Where valuation techniques (for example, pricing models) are used to determine fair values, they are validated and periodically reviewed by experienced personnel of the Responsible Entity, independent of the area that created them. Models are calibrated by back-testing to actual transactions to ensure that outputs are reliable.

Models use observable data to the extent practicable. However, areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

For certain other financial instruments, including amounts due from/to brokers and accounts payable, the carrying amounts approximate fair value due to the immediate or short-term nature of these financial instruments.

### (q) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2010 reporting periods. The directors' assessment of the impact of these new standards (to the extent relevant to the Trust) and interpretations is set out below:

#### (i) AASB 9 *Financial Instruments* and related amendment AASB 2009 11 replacing AASB 139 *Financial Instruments: Recognition and Measurement*

The Australian Accounting Standards Board has now issued AASB 9 Financial Instruments which altered the classification and measurement of financial instruments. Under the new standard only two possible classifications arise, rather than the four existing classifications currently available under AASB 139 Financial Instruments: Recognition and Measurement, and will result in all financial assets being measured at amortised cost or fair value through profit or loss, or through other comprehensive income. Financial liabilities are currently excluded from the scope of this standard. The standard is mandatorily applicable for annual reporting periods beginning on or after 1 January 2013. The Trust has not adopted this standard early and is still assessing the full impact of this standard.

## 3 Financial risk management

### (a) Strategy in using financial instruments

The Trust's activities expose it to a variety of financial risks: market risk (including price risk and foreign exchange risk), credit risk and liquidity risk.

The Trust's overall risk management programme focuses on ensuring compliance with the Trust's governing documents and law and seeks to maximise the returns derived for the level of risk to which the Trust is exposed. The Trust uses derivative financial instruments to alter certain risk exposures.

Financial risk management is carried out by the investment management department under policies approved by the Responsible Entity's senior managers or by the board of directors of the Responsible Entity (the Board). External managers are appointed via Investment Management Agreements to carefully select securities and other financial instruments within specified limits.

### (b) Market risk

#### (i) Price Risk

It is director's view that price risk for the Trust's securities is a function of interest rate risk, foreign exchange risk, credit risk and liquidity risk.

### 3 Financial risk management (continued)

#### (b) Market risk (continued)

##### (ii) Foreign exchange risk

The Trust holds both monetary and non-monetary assets denominated in currencies other than the Australian dollar. The foreign exchange risk relating to non-monetary assets and liabilities is a component of price risk. Foreign exchange risk arises as the value of monetary securities denominated in other currencies will fluctuate due to changes in exchange rates.

The table below summarises the Trust's exposure to foreign exchange risk.

30 June 2010	Australian Dollars A\$	US Dollars A\$	Euro A\$	Japanese Yen A\$	British Pounds A\$	Other currencies A\$	Total A\$
Cash and cash equivalents	21,034	256	-	-	25	41	21,356
Other receivables	3,028	-	-	-	-	-	3,028
Financial assets held at fair value through profit or loss	8,022,729	19,068,605	420,957	1,103,966	158,714	17,572,985	46,347,956
Responsible entity fees payable	(47,664)	-	-	-	-	-	(47,664)
Distributions payable	(43,675)	-	-	-	-	-	(43,675)
Other payables	(5,104)	-	-	-	-	-	(5,104)
Financial liabilities held at fair value through profit or loss	<u>(372,627)</u>	<u>(20,126,671)</u>	<u>(290,290)</u>	<u>(338,114)</u>	<u>(226,131)</u>	<u>17,724,608)</u>	<u>(39,078,441)</u>
<b>Net assets attributable to unitholders - liability</b>	<u>7,577,721</u>	<u>(1,057,809)</u>	<u>130,667</u>	<u>765,852</u>	<u>(67,392)</u>	<u>(151,583)</u>	<u>7,197,456</u>
<b>30 June 2009</b>	<b>Australian Dollars A\$</b>	<b>US Dollars A\$</b>	<b>Euro A\$</b>	<b>Japanese Yen A\$</b>	<b>British Pounds A\$</b>	<b>Other currencies A\$</b>	<b>Total A\$</b>
Cash and cash equivalents	9,350	-	-	-	25	16	9,391
Other receivables	3,393	-	-	-	-	-	3,393
Financial assets held at fair value through profit or loss	3,215,398	5,403,865	549,864	184,442	70,199	4,375,413	13,799,181
Responsible entity fees payable	(8,978)	-	-	-	-	-	(8,978)
Distributions payable	(673)	-	-	-	-	-	(673)
Other payables	(4,428)	-	-	-	-	-	(4,428)
Financial liabilities held at fair value through profit or loss	<u>(433,917)</u>	<u>(5,390,922)</u>	<u>(648,015)</u>	<u>(90,977)</u>	<u>(142,702)</u>	<u>(4,092,447)</u>	<u>(10,798,980)</u>
<b>Net assets attributable to unitholders - liability</b>	<u>2,780,145</u>	<u>12,943</u>	<u>(98,151)</u>	<u>93,465</u>	<u>(72,478)</u>	<u>282,982</u>	<u>2,998,906</u>

The Trust is not exposed to foreign exchange risk as majority of its monetary assets are denominated in Australian dollars.

### 3 Financial risk management (continued)

#### (b) Market risk (continued)

##### *(iii) Interest rate risk*

The Trust's interest bearing financial assets expose it to risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows.

The majority of the Trust's financial assets and liabilities are non-interest bearing. As a result, the Trust is not subject to significant amounts of risk due to fluctuations in the prevailing levels of market interest rates. Any excess cash and cash equivalents are invested at short-term market interest rates.

#### (c) Credit risk

Credit risk arises from the Trust's investment in underlying trusts, cash and cash equivalents, deposits with banks, counterparties to derivatives and other financial institutions and amounts due from brokers. None of these assets are impaired nor past due but not impaired.

The Trust restricts its exposure to credit losses by:

- managing exposure to any single issuer to ensure diversification
- monitoring the credit risk by limiting the term of exposure.

In accordance with the Trust's policy, the risk management area of the Investment Manager monitors the Trust's credit position on a daily basis. The Compliance Committee of the Responsible Entity reviews any identified exceptions to internal risk policies and procedures on a quarterly basis.

#### (d) Liquidity Risk

The Trust is exposed to daily cash redemptions of redeemable units. It therefore invests the majority of its assets in unlisted trusts that have daily unit pricing and can be readily disposed of.

In accordance with the Trust's policy, the risk management area of the Responsible Entity monitors the Trust's liquidity position on a daily basis. This is managed by seeking to ensure that alternative sources of funding are available.

The Compliance Committee of the Responsible Entity reviews any identified exceptions to internal risk policies and procedures on a quarterly basis.

Subject to the Corporations Act 2001 and the Trust's Constitution, redeemable units are redeemed on demand at the unitholder's option (Note 2(c)). All other liabilities are payable within 30 days except for forward contracts that are settled within 60 days.

#### (e) Fair value estimation

The carrying amounts of the Trust's assets and liabilities at the end of each reporting period approximate their fair values.

The Trust has adopted the amendments to AASB 7, effective 1 July 2009. This requires the Trust to classify fair value measurements using a fair value hierarchy that reflects the subjectivity of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

### 3 Financial risk management (continued)

#### (e) Fair value estimation (continued)

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

The table below sets out the Trust's financial assets and liabilities (by class) measured at fair value according to the fair value hierarchy at 30 June 2010. Comparative information has not been provided as permitted by the transitional provisions of the new rules.

As at 30 June 2010	Level 1 \$	Level 2 \$	Level 3 \$	Total balance \$
<b>Financial assets</b>				
Financial assets held for trading:				
- Derivatives	-	39,098,242	-	39,098,242
Financial assets designated at fair value through profit or loss at inception:				
- Unlisted unit trusts	-	7,249,714	-	7,249,714
<b>Total</b>	<u>-</u>	<u>46,347,956</u>	<u>-</u>	<u>46,347,956</u>
<b>Financial liabilities</b>				
Financial liabilities held for trading:				
- Derivatives	-	39,098,242	-	39,098,242
<b>Total</b>	<u>-</u>	<u>39,098,242</u>	<u>-</u>	<u>39,098,242</u>

### 4 Auditor's remuneration

During the year the following fees were paid or payable for services provided by the auditor of the Trust:

	30 June 2010 \$	30 June 2009 \$
<b>Audit services</b>		
Audit and review of financial reports	4,300	7,358
Other audit work under the <i>Corporations Act 2001</i>	290	1,400
Total remuneration for audit services	<u>4,590</u>	<u>8,758</u>

Audit fees are paid out of the Responsible Entity's own resources.

## 5 Net gains/(losses) on financial instruments held at fair value through profit or loss

Net gains/(losses) recognised in relation to financial instruments held at fair value through profit or loss:

	30 June 2010 \$	30 June 2009 \$
Net gains on financial instruments held for trading	112,187	11,315
Net gains on financial instruments held for trading	-	5,660
Net gains on financial instruments designated as at fair value through profit or loss	<u>133,044</u>	<u>-</u>
Net gains on financial instruments held at fair value through profit or loss	<u>245,231</u>	<u>16,975</u>

## 6 Net assets attributable to unitholders

Movements in number of units and net assets attributable to unitholders during the year were as follows:

As stipulated within the Trust Constitution, each unit represents a right to an individual share in the Trust and does not extend to a right to the underlying assets of the Trust. There are no separate classes of units and each unit has the same rights attaching to it as all other units of the Trust.

	30 June 2010 No.	30 June 2009 No.	30 June 2010 \$	30 June 2009 \$
Opening balance	3,027,943	2,874,608	2,998,906	2,826,391
Applications	7,406,296	48,014	7,467,691	48,340
Redemptions	(3,472,603)	-	(3,484,041)	-
Units issued upon reinvestment of distributions	208,160	105,321	207,593	104,196
Increase/(decrease) in net assets attributable to unitholders			<u>7,307</u>	<u>19,979</u>
Closing balance	<u>7,169,796</u>	<u>3,027,943</u>	<u>7,197,456</u>	<u>2,998,906</u>

### Capital risk management

The Trust manages its net assets attributable to unitholders as capital, notwithstanding net assets attributable to unitholders are classified as a liability. The amount of net assets attributable to unitholders can change significantly on a daily basis as the Trust is subject to daily applications and redemptions at the discretion of unitholders.

The Trust monitors the level of daily applications and redemptions relative to the liquid assets in the Trust.

## 7 Cash and cash equivalents

	30 June 2010 \$	30 June 2009 \$
Cash at bank	<u>21,356</u>	<u>9,391</u>
	<u>21,356</u>	<u>9,391</u>

## 8 Financial assets held at fair value through profit or loss

	30 June 2010 Fair value \$	30 June 2009 Fair value \$
<b>Held for trading</b>		
Derivatives (note 10)	<u>39,098,242</u>	<u>10,813,610</u>
Total held for trading	<u>39,098,242</u>	<u>10,813,610</u>
<b>Designated at fair value through profit or loss</b>		
Unlisted unit trusts	<u>7,249,714</u>	<u>2,985,571</u>
Total designated at fair value through profit or loss	<u>7,249,714</u>	<u>2,985,571</u>
<b>Total financial assets held at fair value through profit or loss</b>	<u>46,347,956</u>	<u>13,799,181</u>
	30 June 2010 Fair value \$	30 June 2009 Fair value \$
<b>Comprising:</b>		
<b>Derivatives</b>		
Foreign currency forward contracts	<u>39,098,242</u>	<u>10,813,610</u>
Total derivatives	<u>39,098,242</u>	<u>10,813,610</u>
<b>Unlisted unit trusts</b>		
Units in money market trusts	<u>7,249,714</u>	<u>2,985,571</u>
Total unlisted unit trusts	<u>7,249,714</u>	<u>2,985,571</u>
<b>Total financial assets held at fair value through profit or loss</b>	<u>46,347,956</u>	<u>13,799,181</u>

An overview of the risk exposures relating to financial assets at fair value through profit or loss is included in note 3.

## 9 Financial liabilities held at fair value through profit or loss

	30 June 2010 Fair value \$	30 June 2009 Fair value \$
<b>Held for trading</b>		
Derivatives (note 10)	<u>39,078,441</u>	<u>10,798,980</u>
Total held for trading	<u>39,078,441</u>	<u>10,798,980</u>
<b>Total financial liabilities held at fair value through profit or loss</b>	<u>39,078,441</u>	<u>10,798,980</u>

## 9 Financial liabilities held at fair value through profit or loss (continued)

	30 June 2010 Fair value \$	30 June 2009 Fair value \$
<b>Comprising:</b>		
<b>Derivatives</b>		
Foreign currency forward contracts	<u>39,078,441</u>	<u>10,798,980</u>
Total derivatives	<u>39,078,441</u>	<u>10,798,980</u>
<b>Total financial liabilities held at fair value through profit or loss</b>	<u>39,078,441</u>	<u>10,798,980</u>

An overview of the risk exposures relating to financial liabilities at fair value through profit or loss is included in note 3.

## 10 Derivative financial instruments

In the normal course of business the Trust enters into transactions in various derivative financial instruments with certain risks. A derivative is a financial instrument or other contract which is settled at a future date and whose value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable.

Derivative financial instruments require no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

Derivative transactions include a wide assortment of instruments, such as forwards, futures and options. Derivatives are considered to be part of the investment process. The use of derivatives is an essential part of the Trust's portfolio management. Derivatives are not managed in isolation. Consequently, the use of derivatives is multifaceted and includes:

- hedging to protect an asset or liability of the Trust against a fluctuation in market values or to reduce volatility
- a substitute for trading physical securities
- adjusting asset exposures within the parameters set in the investment strategy, and adjusting the duration of fixed interest portfolios or the weighted average maturity of cash portfolios.

While derivatives are used for trading purposes, they are not used to gear (leverage) a portfolio. Gearing a portfolio would occur if the level of exposure to the markets exceeds the underlying value of the Trust.

## 10 Derivative financial instruments (continued)

The Trust holds the following derivative instruments:

### (a) Forward currency forward contracts

Forward currency forward contracts are primarily used by the Trust to gain a foreign currency exposure. The Trust agrees to receive or deliver a fixed quantity of foreign currency for an agreed upon price on an agreed future date. Forward currency contracts are valued at the prevailing bid price at the reporting date. The Trust recognises a gain or loss equal to the change in fair value at the reporting date.

The Trust's derivative financial instruments at year-end are detailed below:

30 June 2010

	Contract/ notional '000	Fair Values	
		Assets \$	Liabilities \$
<b>Buy</b>			
Foreign currency forward contracts - United States Dollar (USD)	16,110,396	19,068,606	-
Foreign currency forward contracts - Philippines Pesos (PHP)	53,126,272	1,356,124	-
Foreign currency forward contracts - Euro (EUR)	290,310	420,957	-
Foreign currency forward contracts - Turkish Lira (TRY)	2,841,247	2,122,247	-
Foreign currency forward contracts - Taiwan New Dollars (TWD)	43,912,181	1,617,724	-
Foreign currency forward contracts - New Zealand Dollar (NZD)	489,161	398,147	-
Foreign currency forward contracts - Singapore Dollar (SGD)	1,103,527	935,739	-
Foreign currency forward contracts - Columbian Pesos (COP)	138,440,781	85,477	-
Foreign currency forward contracts - Russian Rubles (RUB)	3,634,036	137,718	-
Foreign currency forward contracts - Australian Dollar (AUD)	773,561	773,015	-
Foreign currency forward contracts - Other		<u>12,182,488</u>	-
		<u>39,098,242</u>	-
<b>Sell</b>			
Foreign currency forward contracts - United States Dollar (USD)	17,004,107	-	20,126,671
Foreign currency forward contracts - Taiwan New Dollars (TWD)	83,333,033	-	3,069,946
Foreign currency forward contracts - Euro (EUR)	200,191	-	290,290
Foreign currency forward contracts - Singapore Dollar (SGD)	2,369,856	-	2,009,451
Foreign currency forward contracts - Philippines Pesos (PHP)	24,347,248	-	621,654
Foreign currency forward contracts - Australian Dollar (AUD)	372,724	-	372,627
Foreign currency forward contracts - Chilean Pesos (CLP)	266,323,840	-	575,396
Foreign currency forward contracts - Canadian Dollars (CAD)	892,619	-	994,277
Foreign currency forward contracts - Turkish Lira (TRY)	1,429,265	-	1,068,281
Foreign currency forward contracts - New Zealand Dollar (NZD)	806,146	-	656,035
Foreign currency forward contracts - Other		-	<u>9,293,813</u>
		-	<u>39,078,441</u>
		<u>39,098,242</u>	<u>39,078,441</u>

## 10 Derivative financial instruments (continued)

30 June 2009

	Contract/ notional '000	Fair Values	
		Assets \$	Liabilities \$
<b>Buy</b>			
Foreign currency forward contracts - United States Dollar (USD)	4,369,213	5,403,865	-
Foreign currency forward contracts - Philippines Pesos (PHP)	37,534,583	963,956	-
Foreign currency forward contracts - Euro (EUR)	316,977	549,864	-
Foreign currency forward contracts - Turkish Lira (TRY)	613,071	492,822	-
Foreign currency forward contracts - Taiwan New Dollars (TWD)	12,681,126	478,022	-
Foreign currency forward contracts - New Zealand Dollar (NZD))	462,209	370,172	-
Foreign currency forward contracts - Singapore Dollar (SGD)	335,839	286,977	-
Foreign currency forward contracts - Columbian Pesos (COP)	437,377,632	251,833	-
Foreign currency forward contracts - Russian Rubles (RUB)	6,240,879	247,280	-
Foreign currency forward contracts - Australian Dollar (AUD))	229,827	229,827	-
Foreign currency forward contracts - Other		<u>1,538,991</u>	-
		<u>10,813,610</u>	-
<b>Sell</b>			
Foreign currency forward contracts - United States Dollar (USD)	4,357,376	-	5,390,922
Foreign currency forward contracts - Taiwan New Dollars (TWD)	2,554,916	-	963,246
Foreign currency forward contracts - Euro (EUR)	373,566	-	648,015
Foreign currency forward contracts - Singapore Dollar (SGD)	672,810	-	574,898
Foreign currency forward contracts - Philippines Pesos (PHP)	18,695,176	-	480,319
Foreign currency forward contracts - Australian Dollar (AUD))	433,917	-	433,917
Foreign currency forward contracts - Chilean Pesos (CLP)	139,076,425	-	323,798
Foreign currency forward contracts - Canadian Dollars (CAD)	255,429	-	272,009
Foreign currency forward contracts - Turkish Lira (TRY)	305,180	-	245,534
Foreign currency forward contracts - New Zealand Dollar (NZD)	239,529	-	191,878
Foreign currency forward contracts - Other		-	<u>1,274,444</u>
		-	<u>10,798,980</u>
		<u>10,813,610</u>	<u>10,798,980</u>

## 11 Related party transactions

### Responsible Entity

The Responsible Entity of Morgan Stanley FX Alpha Fund is Macquarie Investment Management Limited (MIML), a wholly owned subsidiary of Macquarie Group Limited.

### Key management personnel

The following persons held office as directors of MIML during the year or since the end of the year and up to the date of this report:

N Roderick (resigned 29/03/2010)  
R Cartwright  
V Malley  
C Vignes  
M Rady (resigned 01/02/2010)  
C Swanger (appointed 08/02/2010)  
T Graham (appointed 29/03/2010)  
B N Terry

No amount is paid by the Trust directly to the directors of the Responsible Entity. Consequently, no compensation as defined in AASB 124 "Related Party Disclosures" is paid by the Scheme to the Directors as Key management Personnel.

### Key management personnel unitholdings

At 30 June 2010 no key management personnel held units in the Trust (2009: Nil).

### Key management personnel loan disclosures

The Trust has not made, guaranteed or secured, directly or indirectly, any loans to the key management personnel or their personally related entities at any time during the reporting period.

### Responsible Entity's fees and other transactions

For the year ended 30 June 2010, in accordance with the Trust Constitution, the Responsible Entity received a total fee of 1.20% of net asset value (inclusive of GST, net of RITC available to the Trust) per annum (2009: 1.20%).

All expenses in connection with the preparation of accounting records and the maintenance of the unit register have been fully borne by the Responsible Entity.

All related party transactions are conducted on normal commercial terms and conditions. The transactions during the year and amounts payable at year end between the Trust and the Responsible Entity were as follows:

	30 June 2010	30 June 2009
	\$	\$
Management fees for the year paid by the Trust to the Responsible Entity	<u>55,858</u>	<u>34,972</u>
Aggregate amounts payable to the Responsible Entity at the reporting date	<u>47,664</u>	<u>8,978</u>

\* Where the Trust invests into other schemes managed by the Responsible Entity, the Responsible Entity's fee is calculated after rebating fees charged in the underlying schemes.

## 11 Related party transactions (continued)

### Investments

The Trust held investments in the following schemes which are also managed by MIML or its related parties:

	Fair value of investment		Interest held		Distributions received/receivable	
	2010	2009	2010	2009	2010	2009
	\$	\$	%	%	\$	\$
Macquarie Treasury Fund	<u>7,249,714</u>	<u>2,985,571</u>	0.23	0.08	<u>179,916</u>	<u>157,366</u>
Total	<u>7,249,714</u>	<u>2,985,571</u>			<u>179,916</u>	<u>157,366</u>

No distributions receivable remain unpaid as at 30 June 2010 (2009: \$Nil).

### Other transactions within the Trust

Apart from those details disclosed in this note, no directors of the Responsible Entity have entered into a material contract with the Trust since the end of the previous financial year and there were no material contracts involving director's interests subsisting at year end.

The bank accounts for the Trust are held with Macquarie Bank Limited. Fees and expenses are negotiated on an arm's length basis for all transactions with related parties.

## 12 Reconciliation of profit/(loss) to net cash inflow/(outflow) from operating activities

	30 June 2010	30 June 2009
	\$	\$
<b>(a) Reconciliation of profit/(loss) to net cash inflow/(outflow) from operating activities</b>		
Profit/loss for the year	-	-
Increase in net assets attributable to unitholders	7,307	19,979
Distribution income reinvested	(179,916)	(156,015)
Net gains on financial instruments held at fair value through profit or loss	(245,231)	(16,975)
Proceeds from sale of financial instruments held at fair value through profit or loss	622,900	742,970
Purchase of financial instruments held at fair value through profit or loss	(4,472,804)	(723,082)
Distributions to unitholders	359,756	117,300
Net change in receivables and other assets	366	(3,393)
Net change in payables and other liabilities	<u>38,686</u>	<u>(5,359)</u>
<b>Net cash outflow from operating activities</b>	<b><u>(3,868,936)</u></b>	<b><u>(24,575)</u></b>

### (b) Non-cash financing and investing activities

During the year, the following distribution payments were satisfied by the issue of units under the distribution reinvestment plan

	<u>207,593</u>	<u>104,196</u>
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As described in note 2(i), income not distributed is included in net assets attributable to unitholders. The change in this amount each year (as reported in (a) above) represents a non-cash financing cost as it is not settled in cash until such time as it becomes distributable (ie taxable).

### **13 Events occurring after year end**

No significant events have occurred since year end which would impact on the financial position of the Trust disclosed in the statement of financial position as at 30 June 2010 or on the results and cash flows of the Trust for the year ended on that date.

### **14 Contingent assets and liabilities and commitments**

There are no outstanding contingent assets and liabilities or commitments as at 30 June 2010 and 30 June 2009.

## Directors' declaration

In the opinion of the directors of the Responsible Entity:

- (a) the financial statements and notes set out on pages 6 to 25 are in accordance with the *Corporations Act 2001*, including:
  - (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and
  - (ii) giving a true and fair view of the Trust's financial position as at 30 June 2010 and of its performance for the financial year ended on that date; and
- (b) there are reasonable grounds to believe that the Trust will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors.



R Cartwright  
Director

Sydney  
3 August 2010

## Independent auditor's report to the unitholders of Morgan Stanley FX Alpha Fund

We have audited the accompanying financial report of Morgan Stanley FX Alpha Fund, ("the Fund") which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration.

### ***Directors' Responsibility for the Financial Report***

The directors of the Responsible Entity, Macquarie Investment Management Limited, are responsible for the preparation and fair presentation of the financial report in accordance with the Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 2(a), the directors also state that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the fund's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the fund's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

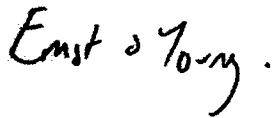
### ***Independence***

In conducting our audit we have met the independence requirements of the *Corporations Act 2001*. We have given to the directors of the Responsible Entity a written Auditor's Independence Declaration, a copy of which is included in the directors' report.

**Auditor's Opinion**

In our opinion:

1. the financial report of Morgan Stanley FX Alpha Fund is in accordance with the *Corporations Act 2001*, including:
  - (i) giving a true and fair view of the financial position of Morgan Stanley FX Alpha Fund at 30 June 2010 and of its performance for the year ended on that date; and
  - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.



Ernst & Young



Graeme McKenzie  
Partner  
Sydney  
3 August 2010