



**Analyst(s):** Kelly Napier; Nathan Bode

## Standard & Poor's View

Standard & Poor's Fund Services rates this fund four stars. This reflects our high conviction that the manager will consistently generate risk-adjusted returns in excess of relevant investment objectives and relative to peers.

We have increased conviction in this offering and have upgraded the fund. The key individuals managing the fund are unchanged since our last review. Additionally, La Trobe has continued to add to its commercial lending team over time in line with FUM growth and has made appropriate appointments that reflect a mix of experience and skill sets. La Trobe has also initiated a program of cross training its institutional and fund underwriters to manage loan deal flow. This ensures resources are not overstretched and credit quality can be maintained.

The fund has continued to benefit from the tightening in the arrears and loan-maturity management process implemented two years ago. At the time it resulted in a meaningful decrease in non-performing loans, and the trend has continued. The portfolio now exhibits relatively low arrears and borrowers are taking less time to rectify their loan accounts or to obtain refinance at maturity. Still, there are some outliers which are persistently non-performing, but these are limited to a few cases and are not material or detracting from overall performance.

Performance has been consistently strong over all periods, delivering a meaningful premium over the high-yield benchmark, without taking on unrewarded risks. Exposure to vacant land, construction, and development has decreased illustrating that attractive returns can be achieved from lending against traditional security types. Although the fund is included in the high-yield peer group, we note that it is at the lower end of the high-yield risk spectrum.

The fund has experienced strong inflows over the past 12 months which have been invested in higher-yielding mortgages and enhanced performance rather than detracting through a "cash drag". The fund's structure and minimum investment term means the manager can effectively manage liquidity to remain as close to fully invested in mortgages as possible. For this reason, we are comfortable La Trobe can manage any further increases in FUM without detracting from performance.

## Investor Suitability

- This fund is suitable for investors seeking capital stability and an investment return exceeding cash over an investment cycle.
- It is suitable for investors seeking a slightly more aggressive mortgage exposure than a conventional fund. The fund is expected to demonstrate higher risk-return characteristics due to a high exposure to low-documentation (low-doc) or near-prime loans.
- The 12-month term structure better matches assets and liabilities, but investors should remain aware of the asset and liability mismatch associated with mortgage funds in general.
- Investors should have a medium-term investment horizon.

## Key Strengths

- La Trobe is a specialist low-doc lender with a long track record managing low-doc loans.
- New lending at higher yields has continued due to strong net inflows over the past 12 months, and resources have been added.
- The 12-month minimum investment-term structure better manages assets and liabilities and provides clarity to investors and less constraints on fund liquidity.
- The fund structure provides the ability to be close to fully invested in mortgages without having a cash drag from strong inflows.
- A premium over the high-yield mortgage fund benchmark has been delivered over three and five years.

## Key Weaknesses

- A handful of non-performing loans have been in arrears or past maturity for a long time.
- The head of funds management has the highest-level delegated lending authority but has a limited lending and credit background. However, this is partly mitigated by the required sign-off matrix and his litigation experience.
- The "interest income" reserve has increased despite an improvement in the quality of the loan book. It provides a buffer for investors remaining in the fund, but represents a cost for investors exiting before losses are realised.

## Risks

- Low-doc borrowers can be more susceptible to an economic downturn resulting in a higher reliance on security as an exit strategy in a default scenario, though with a similar security position.
- As for all mortgage funds, future performance is highly dependent on economic conditions, property market fundamentals, liquidity, and credit quality.

<b>APIR code</b>	LTC0002AU	<b>Investment manager</b>	La Trobe Financial Services Pty Ltd
<b>Fund status</b>	Open	<b>Redemption Policy</b>	Minimum 12-month investment term
<b>Inception date</b>	Oct. 1, 2002	<b>Distribution Frequency</b>	Monthly
<b>Responsible entity</b>	La Trobe Financial Asset Management Ltd	<b>Return Objective (%)</b>	Target 7.8% at Dec. 31, 2010
<b>Peer group</b>	Australian Fixed Interest - Mortgages High Yield	<b>Average portfolio turnover (yrs)</b>	3.3
<b>Benchmark</b>	UBS Bank 0+ Yr TR AUD	<b>Number of Loans</b>	468
<b>Investment style</b>	-	<b>Mortgages (%)</b>	93
<b>Multi manager</b>	No	<b>Fixed Interest (%)</b>	N/A
<b>Fund Size (\$A)</b>	114.96 .mil (at March 31, 2011)	<b>Cash (%)</b>	7
<b>Minimum investment (A\$)</b>	1000	<b>Release authorised by</b>	Leanne Milton
<b>ICR / MER (%)</b>	1.4		



## Objectives, Fees and Features

The fund's stated objective is to outperform the UBS Australia Bank Bill Index after fees and charges over a period of one year.

The broader objective is to provide investors with a medium-term investment (subject to a 12-month minimum term) delivering stable and predictable income from investing in a diversified portfolio of mortgages and cash. Soon the fund will move to adopt S&P's benchmark for the high-yield mortgage fund peer group—the UBS Australia Bank Bill index plus 1.5%. This is a better benchmark for the fund given the higher risk-return nature of low-doc loans for which a premium can be extracted. It also provides investors with a better indication of the fund's risk-return characteristics.

Given La Trobe's aim of providing a stable A\$1.00 unit price, an interest income reserve is in place. It is used as a provision for loan arrears and losses that may be incurred by the pooled option. The reserve is not a capital guarantee and investors shouldn't rely on it. However, capital losses incurred by the pooled option since inception in 2002 have been covered in full by the interest income reserve.

Distributions are paid monthly, based on the determined crediting rate set by the interest rate committee. The ICR of 1.4% per year is at the upper end of the peer group. Adviser trail commissions of up to 0.5% apply, but there are no upfront commissions. Loan establishment fees (generally 1.25% of the loan amount) go to the manager.

## Investment Philosophy and Style

La Trobe is a specialist near-prime lender operating in the niche low-doc segment of the lending market and offers investors a unique investment structure. Investors have a choice of four mortgage investment options suitable for different risk appetites. The four separate investment options have unique investment guidelines. Each investment option is created in such a way as to ensure that the underlying assets of each option are completely separate from the others. This rating applies to the pooled mortgages option.

The pooled mortgages option has been included in S&P's high-yield mortgage fund peer group. We classify high-yield mortgage funds as those investing in registered-mortgage assets secured by residential and commercial properties: where more than 30% of the portfolio in higher-risk investments such as low-doc loans, construction, development, or specialised property assets; and/or a stated maximum loan-to-value (LTV) ratio is in excess of 75%.

We have included this fund in the high-yield category due to the very high proportion of low-doc loans in the portfolio (87%). Low-doc loans offer a premium over full documentation loans and in our view, low-doc borrowers can be more susceptible to an economic downturn and therefore represent a higher-risk investment proposition. Prudently, La Trobe has limited low-doc borrowers to a lower maximum LTV of 66%. In classifying this fund in the high-yield peer group, we note that it is at the lower end of the high-yield risk spectrum.

For a number of years, the strategy has been to increase FUM to approximately A\$500 million across the four mortgage investment options. The result has been mixed, with the pooled option benefiting from strong inflows of A\$30 million over calendar 2010, but reductions in FUM across the other options (particularly select mortgages) such that overall FUM has remained steady. However, the pooled option is La Trobe's primary focus of the four types.

## Investment Team

### Structure

The La Trobe head office is in Melbourne. The manager's organisational structure is divided into three main areas: business development, finance and administration, and corporate governance. Committees determine key strategic and management issues. The committees include:

- Interest rate committee,
- Lending and credit committee, and
- Fund investment committee.

The lending and credit committee meets monthly and is chaired by head of credit Iain Pepper. It also comprises: Chris Andrews (head of funds management), Jason Gidman (fund portfolio manager), Bob Layh (credit manager for the fund), Darlene Musgrove (credit manager for institutional funding), Justin Coates (head of collections), and Bev Christou (head of lending operations). The lending and credit committee determines the lending policies, processes, and product development, as well as monitoring impairment reporting. The interest rate committee also meets monthly to consider interest rate management, hedging, loan funding, and pricing. It is chaired by Paul Wells (head of funding and strategy), and also includes Mr. Andrews, Greg O'Neill (managing director), Mr. Pepper, Rob Clough as chief financial officer, and Brian Ford, chief operating officer.

The fund-management unit is responsible for all aspects of the fund, including: underwriting, portfolio management, investment services, fund registry, investor liaison, and business development. We have seen La Trobe add to these resources over time as FUM has increased.

There have been no material changes to the team since our last review. Mr. Andrews remains the head of funds management and Mr. Gidman is still the portfolio manager. The only significant changes in senior management was the departure of the head of sales and the head of IT operations. An internal appointment was made to head up IT, and the sales personnel dedicated to the fund now report to Mr. Andrews.

### Key Investment Personnel

Name, Position	Years*	Experienced†
Chris Andrews, head of funds management	4	10
Paul Wells, head of funding and strategy	7	13
Jason Gidman, portfolio manager	18	16
Iain Pepper, head of credit	3	22
Average tenure with current firm	8	N/A
Average industry experience	N/A	15

\*Years with current firm. †Years of relevant industry experience.

### Portfolio Managers

As portfolio manager, Mr. Gidman is responsible for selecting pooled option mortgages. He has worked at La Trobe for over 16 years, having gained experience in a variety of mainly lending-related roles before being appointed to the portfolio manager's role in 2004. He continues to demonstrate a sound understanding of the underlying loan portfolio and the fund's position. Mr. Gidman provides consistency in management and is assisted day-to-day by assistant portfolio manager Kirk Jackson.

Supporting Mr. Gidman are Mr. Andrews and Mr. Wells. In late 2009, Mr. Andrews was appointed head of funds management. He joined La Trobe in 2006 as senior legal counsel, and over time his role became increasingly focused on the fund from a risk management and litigation perspective. Prior to joining La Trobe, he spent six years at Minter Ellison focused on litigation and risk management. As a member of the audit and risk committee, the lending and credit committee, and the interest rate committee, he is actively involved in the strategic management and



oversight of the fund. When Mr. Andrews was appointed to the executive, he inherited the highest loan approval authority—before this he had no approval authority. As is the case for underwriters, S&P would have preferred to see Mr. Andrews gradually increase his approval authority over time as his credit experience increased. However, the dual approval process, his membership of the lending and credit committee, and his experience as a litigation lawyer, partly mitigates this risk.

Mr. Wells's contribution to the fund and the wider group is important. Before joining La Trobe seven years ago, Mr. Wells spent two years at ANZ's investment bank in a corporate finance role relating to mid-tier public and private capital raisings. Before that, Mr. Wells was at PricewaterhouseCoopers.

#### Loan Origination, Credit and Administration Team

La Trobe sources loans from approximately 400 different origination sources across Australia. Credit assessment is undertaken by the team of seven underwriters who are dedicated to the fund. The complexity of the loan application is matched with the experience of the underwriter. Once settled, loans are administered in-house by La Trobe's designated administration team.

Mr. Pepper is the head of lending and has been since January 2008. He is responsible for the core lending operations and processes including: originations and business development, underwriting, settlement, administration, and discharge. Mr. Pepper has over 20 years' industry experience in the mortgage and lending sector, mainly with GE Capital. His roles and responsibilities have included start-ups of mortgage businesses, operational management, and credit risk management in Australia, the U.K., and Europe.

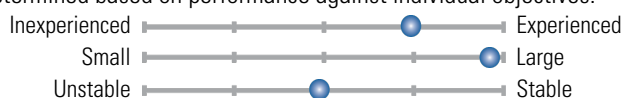
Positively, La Trobe has continued to augment its commercial lending team year after year in line with FUM growth. This ensures resources are not overstretched and credit quality can be maintained. La Trobe has been able to make appropriate appointments, representing a mix of experience and skill sets.

In late 2009, Mr. Layh joined as the credit manager, and the fund underwriting team of seven reports to him. Mr. Layh has over 30 years of finance and lending experience, and he is viewed as a good person to develop the junior underwriters, in conjunction with senior underwriter Steve Lawrence. In the past there has been a moderate degree of turnover at the junior underwriter level. To manage deal flow and increase the credit resources available to the fund, La Trobe has undertaken a program of cross-training institutional and fund underwriters. This initiative is viewed positively.

Operational support is provided in-house with most support resources located in the Melbourne head office with senior management. Mortgage help (arrear and mortgage management) continues to be based in the group's national administration centre at Traralgon in regional Victoria.

#### Alignment and Accountability

The executive team is experienced, and La Trobe has specifically identified the niche low-doc segment of the mortgage market as its target market. There is good delineation of responsibilities, with increasing specialisation and addition of resources as the business has grown. The organisation's culture remains conservative, and all staff members are remunerated with a base salary only. Increases in base salary are determined based on performance against individual objectives.



## Investment Process

### Overview

The manager's investment process is well documented and articulated and is aimed toward achieving a high level of client service for borrowers and investors. Group policies convey clear and appropriate processes from origination through to discharge, and the respective roles and responsibilities for the investment team are clear.

### Loan Origination

La Trobe's group originations for the 12 months to June 30, 2010 were A\$1.2 billion. La Trobe has a diverse origination base, and efforts are continually made to increase origination sources for all its products. There are two methods for originating new business: establishing relationships with recognised mortgage aggregators or direct accreditation of individual brokers. Mortgages are generally not sourced from the major commercial-mortgage originators, differentiating the fund from most other rated mortgage funds. This is not considered to be a disadvantage, as the diversified origination sources reduce reliance on any one originator. The fund's strong deal flow is evidence that this strategy works.

For referral of a borrower, loan introducers receive up to 0.5% in upfront commissions and up to 0.25% of the loan amount in trailing commission. For referral of an investor, investor introducers (which may include financial planners) receive 0.5% as a trailing commission. The relatively higher trail commissions reflect the average loan size close to A\$200,000. Authorised representatives receive a higher trailing commission if they are able to introduce the borrower and the investor. It is possible for a loan to be funded by both the select loan option and the pooled option, similar to a syndicated loan between third-party lenders. In all cases, the fund will have a first-ranking charge which will rank equally in an enforcement situation with other first-ranking charges.

### Credit Approval Process

There has been no change to the credit approval process since our last review. La Trobe undertakes risk assessment on all loans despite its low-doc focus. An underwriter within the fund lending team assesses each loan application before it is submitted to the designated credit-approval unit for at least dual approval. The complexity of the loan is matched with the experience of the underwriter. Credit approval authority is granted based on experience and group seniority. Seniority doesn't necessarily correlate to length of lending experience, but will be determined by the position held within the group. Loans are approved in accordance with the manager's lending policies. The larger the loan, the more signatures (and of more senior rank) are required to approve the loan, ensuring that La Trobe segregates approval responsibilities.

A borrower's creditworthiness is determined by a credit check through Veda Advantage, a letter from the borrower's accountant confirming the repayment ability, and a declaration from the borrower. La Trobe's lending standards are based on the borrower's character, capital position, and capacity to repay (based on net disposable income measured against industry standard benchmarks), the quality of the security offered, and obtaining a satisfactory independent valuation report.

The fund's panel solicitors, appointed in relation to the particular loan, undertake their legal due diligence and prepare the loan documentation, and must provide their certification before settlement can proceed. The solicitor attends settlement on behalf of the manager.



## Portfolio Management

Initially, loans are considered "select" loans and are settled in the cash and mortgages option if they comply with La Trobe's underwriting standards. There, they wait for longer-term funding from the other investment options.

If the loan does not meet with the pooled fund criteria, it may be offered to select-mortgage option investors. If the portfolio manager or any select-mortgage investors do not accept the loan, it will be declined.

From the cash and mortgages option, Mr. Gidman chooses loans, or parts of loans, for inclusion into the pooled mortgages option. In this sense, the pooled option may compete for loans that may also be possible select mortgages. The pooled option can effectively use the cash and mortgages option to manage funding liquidity—this is a key benefit of the structure, particularly in the current situation where the fund has experienced strong inflows yet still remained with a high exposure to mortgages. In more traditional mortgage fund structures, strong inflows are likely to result in a cash drag as a pipeline of suitable mortgages is sought to invest in.

Loans are recorded on the proprietary loan-administration system "CLASS", and La Trobe places loan and security documents in its custodial facilities once statutory stamp duty and registration have been completed. La Trobe's designated administration team manages all loans. Problem loans are dealt with by the mortgage-help team, based in Traralgon, under Mr. Coates. The fund has continued to benefit from the tightening of the arrears and loan-maturity management process two years ago, which has resulted in a more consistently low arrears level and a general reduction in the time it takes for borrowers to rectify their accounts or refinance at maturity. Still, there are some outliers which persistently feature on the non-performing loans list.

## Portfolio Risk Management (at Dec. 31, 2010)

	(%)	(A\$000's)
Loans in arrears and past due	1.68	1,703.6
Mortgagee in possession	0.48	483.6
Loan losses (past 12 months)	0.01	13.1

	Limit	Actual
Maximum portfolio exposure to variable rates (%)	100	92
Maximum portfolio exposure fixed rates (%)	60	8
Interest rate risk management used in portfolios?	N/A	No

## Risk Management

The fund has sector and geographic target investment ranges. Residential property has the widest range of 30%–80%. Commercial office and retail property can each account for 15%–40%, and industrial and rural property can be 5%–20% and 5%–15%, respectively. Lending against vacant land is permitted, but within 5%–10% of the mortgage portfolio. Development and construction lending is restricted to a maximum of 15% of the mortgage portfolio, and has been reduced from a maximum of 25%. The fund has only seven loans which accounted for A\$1.6 million (1.58% of mortgage pool). The fund has good geographic diversification with most exposure to the larger states of Victoria, New South Wales, and Queensland. All states are represented within their target ranges. The sector and geographic exposures represent a well-diversified fund.

Low-doc loans are made on the basis of first mortgages and generally have a maximum LTV ratio of 66%, although the manager may lend up to 75% against residential property. The maximum LTV ratio for commercial, industrial, or retail property is 70%. Rural and specialised properties are subject to the lower LTV limit of 66%. Construction lending is a

maximum of 70% of independent "as if complete" valuation to determine project feasibility. The maximum loan-to-development cost ratio is 80% (reflecting a 20% equity commitment). Funds are advanced on a cost-to-complete basis after independent verification.

A valuation panel is maintained and valuers are rotated after every second valuation of an asset. All properties are revalued at rollover. For specialised properties, the fund can obtain a revaluation at any time at the borrower's expense if it is considered necessary by the manager. Valuers are instructed by La Trobe.

The valuation process has been outsourced to ValEx, a company that provides valuation process-management services, including maintaining the panel. Valuers are monitored closely which is considered important given the necessity of being able to rely on an accurate valuation in the event of a work-out situation. With the possibility of higher rates of default for low-doc borrowers, there could be greater reliance on exit through the sale of the security property. The risks associated with this have been incorporated into lending policies through greater scrutiny of valuations and increased staff training.

Management of non-performing loans (in arrears and/or past due) is the responsibility of the mortgage-help team which is supported by the legal and compliance unit, headed by Philip Coghlan. Mortgage-help follows up arrears and defaults, manages the mortgagee-in-possession process, and advises if any provisions are necessary.

La Trobe has an internal audit team that periodically audits the functional business units. Separate to the internal audits, there is a dedicated fund operations manager and a dedicated training manager. The fund is externally audited annually by PricewaterhouseCoopers.

## Portfolio Review

The pooled option comprised a portfolio of 468 loans as of Dec. 31, 2010, almost 100 more loans than at our last review. The loans were diversified by geographic location and property sector. Characteristic of La Trobe's low-doc niche market, 87% of the mortgage book represented exposure to low-doc loans.

The weighted average LTV ratio was 60.5% at Dec. 31, 2010. At the same date, there were two loans with LTVs greater than 100% and these related to mortgagee-in-possession accounts where losses of A\$105,557 are expected. At the time they were written, they did not exceed the maximum 75% LTV. Since our last review, the fund's exposure to vacant land (4.01%) and construction and development loans (1.58%) has decreased. This is due to FUM growth and the decision not to add new exposure to that type of security as attractive returns can be obtained from other investment security types.

The fund's weighted average term to maturity had decreased from 7.75 years to 6.16 years as fewer new principal and interest (residential) loans were written in favour of commercial interest-only loans. Approximately 80% of loans had a term of less than three years remaining. Around 18% of the mortgage book had more than 15 years to run, but they would generally turn over before maturity.

The fund's average loan size is A\$216,000 and the fund's largest loan was A\$0.925 million, well below the 5% maximum allocation to a single loan. The lower average loan size reflects the fact that the fund can take parts of whole loans and is also a substantial lender to owner-occupiers. The fund's exposure to fixed interest rates had decreased over the past 12 months to 8% from 25%. No derivatives are currently used to manage interest rate exposure.

As of Dec. 31, 2010, 2.16% of the mortgage pool by value was classified as non-performing (12 loan accounts): either interest in arrears, past maturity, or mortgagee-in-possession. This number is an improvement on last year, even after taking into account FUM growth:



- 1.32% of the mortgage portfolio (six loans) was classified by the manager as being greater than 60 days interest in arrears. Of these six loan accounts, three were greater than 180 days in arrears but two were more than one year past their loan maturity date.
- One loan account (0.36%) was past maturity but up to date with interest payments. Subsequent to Dec. 31, 2010, the loan was renewed for a further term.
- Five loan accounts, representing 0.48% of FUM, were classified as mortgagee-in-possession. This was an improvement from last year when eight loan accounts (2.5% of FUM) were classed as mortgagee-in-possession. However, we note that some loans had been in a work-out situation for an extended period.

#### Portfolio Composition (at Dec. 31, 2010)

Asset Type	Portfolio Composition (A\$m)	Portfolio Composition (%)
Mortgages	101.4	93
Fixed interest	N/A	N/A
Total liquidity	7.4	7
Total fund size	108.8	100

Liquidity		
Cash	7.4	7
Other Short-term Investments	N/A	N/A
Line of credit/Fund gearing	N/A	N/A
Unfunded loan commitments	0.077	0.071

Source: La Trobe Financial Services Pty Ltd.

#### Key Fund Parameters and Lending (at Dec. 31, 2010)

Parameter	Limits	Actual
Maximum loan size (A\$,000)	1,000	925
Maximum % of portfolio to any one loan (%)	5	0.91
Minimum held in cash or liquid securities (%)	1	7
Maximum loan period permitted (years)	5 (40 for P&I)	2 (40 for P&I)
Weighted-average term to maturity (years)	-	6.16 (includes P&I)
Frequency of security property valuations (years)*	App/RO/material change	App/RO/material change
Maximum LVR** for non-residential loans (%)	70	-
Maximum LVR** for residential loans (%)	75	-

\*App—At application, RO—At rollover. \*\*LVR—Loan-to-value ratio.

#### Geographic Distribution (at Dec. 31, 2010)

Location	Mortgage Portfolio (%)	Target Ranges
Metropolitan	86.5	-
Non-metropolitan	13.5	-
Australian Capital Territory	-	0-10
New South Wales	21.42	0-45
Northern Territory	1.68	0-10
Queensland	22.63	0-40
South Australia	8.64	0-10
Tasmania	4.07	0-10
Victoria	31.41	0-45
Western Australia	10.16	0-20

Source: La Trobe Financial Services Pty Ltd.

#### Sector Distribution (at Dec. 31, 2010)

Sector	Mortgage Portfolio (%)	Target Ranges
Commercial Office	12.28	15-40
Industrial	11.6	5-20
Residential	51.45	30-80
Retail	14.79	15-40
Vacant land - interest serviced other sources	4.01	5-10
Construction/Development - residential	0.53	0-15
Construction/Development - residential subdivision without DA	1.06	0-15

Source: La Trobe Financial Services Pty Ltd.

### Liquidity Management

The target liquidity range is 1%–5% of FUM but at Dec. 31, 2010, liquidity was 7% of FUM and was held in cash awaiting settlement of mortgage investments and reinvestment into new loans. This fund's liquidity level will generally be lower than other rated mortgage funds which typically have a minimum of 10% of FUM allocated to liquid investments.

The manager closely monitors the maturity of loans and the maturity of investors' funds. To better match mortgage investments (assets) and unit holder withdrawals (liabilities) there is a minimum investment term of 12 months. If an investor wishes to withdraw from the fund at the 12-month anniversary they must give five business days' written notice, otherwise the investment will roll for a further 12-month term.

The minimum investment term helps liquidity management and the low average loan size enables the fund to remain close to fully invested in mortgages. The four options in the mortgage fund also assist with liquidity management, as loans can be settled by the cash-and-mortgages option before being transferred to the pooled mortgages option once funding is available. Further, the pooled mortgage option does not have to take 100% of the loan and can take a smaller portion, assisting with portfolio diversification.



## Performance

Overall, the mortgage fund sector is still constrained in its ability to take advantage of the improved lending conditions—in favour of lenders rather than borrowers—such as lending at lower LVRs with stronger lending covenants and at higher margins. While the wider sector continues to be characterised by investors' demand for access to capital, funds are not available to be invested into higher-yielding loans.

Future performance of mortgage funds is dependent on three critical aspects: credit quality, credit margins, and liquidity management.

La Trobe's experience has been different to the rest of the peer group. The fund has been the beneficiary of strong net inflows and effective liquidity management. Over the 12 months, three years, and five years to Dec. 31, 2010, the fund returned 7.82%, 7.79%, and 7.72% (net of fees) per year, respectively, compared to the benchmark return (UBS Australia Bank Bill Index plus 1.5%) of 6.16%, 6.73%, and 7.19%.

The fund's performance figures demonstrate that the manager has been able to deliver consistent returns to investors through the interest rate cycle that exceed the high-yield peer-group benchmark, over the medium and long term.

The fund has been able to increase its excess return over the benchmark (and conventional funds) by re-pricing its book as official interest rates change. The excess returns over the benchmark are attributed to the fund setting its own interest rate which does not automatically move in step with the benchmark (short-term interest rates), unlike the majority of mortgage funds. So when short-term interest rates decreased through late 2008 and into 2009, La Trobe was able to re-price its mortgage book (effectively increasing the margin). Then in 2010, interest rate increases were not passed on in full to borrowers. Instead, La Trobe exercised its discretion and carried out its intention to smooth returns to investors by not passing on rate decreases in full.

Throughout the 2010 calendar year approximately A\$87,000 was transferred to the fund from the interest income reserve. An amount of A\$13,128 was used to cover loan losses incurred by the fund. The remainder was used to smooth monthly distributions and related to only two months. La Trobe has no discretion over using the reserve to meet losses but can exercise its discretion in applying the reserve to smooth distributions.

Overall, the dollar value of the interest income reserve increased such that it was close to 1% of FUM at the end of 2010. The manager intends to reduce the reserve to around 0.8% of FUM and as FUM increases the reserve will dilute naturally. The lower percentage is considered more appropriate given the relative improvement in lending and market conditions, and the expected performance of the mortgage pool. The manager has identified potential loan losses of A\$105,557 relating to two loans. This amount can easily be covered by the A\$1 million plus reserve.

Importantly, the reserve needs to be closely managed to ensure it is sufficient in the event it is needed, but also that it is not excessive if the mortgage portfolio performs well so as not to penalise investors redeeming from the fund. We think that La Trobe is cognisant of this issue in the way it is managing the magnitude of the reserve.

## Management Group Profile

La Trobe Financial Group is a privately owned group, established in 1952, that is 100% owned by Greg O'Neill, who is chief executive officer. La Trobe Financial Services Pty Ltd. is the investment manager, main operating company, and custodian of the fund. The responsible entity is La Trobe Financial Asset Management Limited. La Trobe's head office and main business operations are located in Melbourne; some business operations are also in Traralgon in eastern Victoria.

The funds-management and institutional-mandate business divisions are separate operations. The mortgage fund is focused mainly on shorter-term commercial- and residential-oriented loans, and the institutional mandates are longer-term residential-oriented loans. The fund is distributed through 20 authorised representatives, numerous financial planners, and direct retail investors. La Trobe has been managing mortgages since 1952.

When the fund was established in 1993 (subsequently licenced in 1999) it was composed of select mortgages only, with an ancillary cash-holding account to enable investors to invest cash, pending reinvestment into new mortgages after discharge of their previous select mortgage. The fund has since been expanded to include the four investment options; cash and mortgages, pooled mortgages (the S&P rated fund), select mortgages, and special-situation mortgages. The pooled option was first offered in 2002.

## Funds Under Management

### Funds Under Management Table (at Dec. 31, 2010)

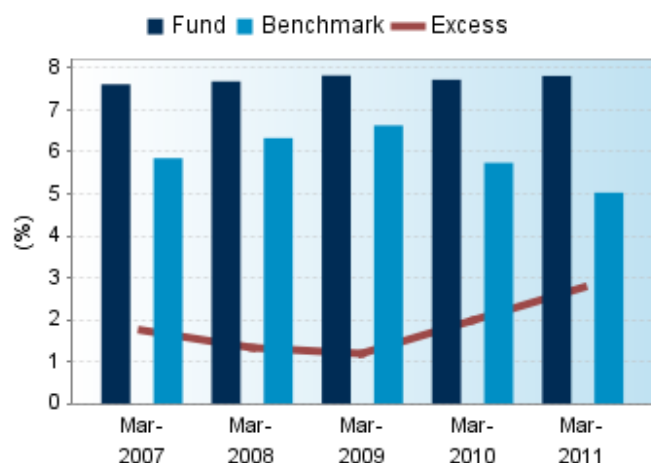
Current pool size (\$)	108.7 million
Total FUM in strategy (\$)	108.7 million
Total FUM across all asset classes (\$)	367 million
Net strategy flows over past 12 months (\$)	30.6 million

Source: La Trobe Financial Services Pty Ltd.



## Performance Analysis

### 3yr Rolling Returns, Over 5 Years



Source: La Trobe Financial Services Pty Ltd.  
Benchmark: UBS Bank 0+ Yr TR AUD.

### Annualised Net Returns % (at March 31, 2011)

	1 Year	3 Years	5 Years	10 Years
Fund performance (% p.a.)	7.94	7.81	7.74	-
Income (% p.a.)	7.94	7.81	7.74	-
Growth (% p.a.)	0	0	0	-
Benchmark performance (% p.a.)	4.87	5.03	5.65	-
Excess return (% p.a.)	3.07	2.78	2.09	-
Peer group return (% p.a.)	3.74	4.08	4.27	4.67
Standard deviation (%)	0.04	0.13	0.11	-
Sharpe ratio	-	9.5	5.84	-
Information ratio	-	7.62	5.47	-
Tracking error	-	0.36	0.38	-

Benchmark: UBS Bank 0+ Yr TR AUD.



## Fund Rating Philosophy

A star rating is a forward looking assessment of a manager's ability to consistently generate risk-adjusted returns (net of fees) in excess of both its relevant investment objectives and its peers.

## Fund Rating Process

In assigning a star rating to a fund, Standard & Poor's evaluates: the size, skill, and stability of the manager's investment team; the clarity, implementation, and risk management of the investment process; the fund's objectives, fee structure and portfolio characteristics; and the manager's business management.

## Fund Rating Definitions

**S&P FUND RATING**  
★★★★★ Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★★★★☆ Standard & Poor's has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★★★☆☆ Standard & Poor's has conviction that the manager will generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★★☆☆☆ Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★☆☆☆☆ Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
**ON HOLD** Issues that may affect the fund's management have emerged; and the fund rating is temporarily suspended, pending clarification.

**S&P FUND RATING**  
**SELL** Significant issues exist that potentially will adversely affect the fund's performance. Investors should consider obtaining advice on switching or redeeming funds.

**NEW** **Fund Rating Subscript**—here the investment process, fund manager, or the fund has a relatively short history, or the analytical team has changed significantly, but a relevant and demonstrable track record is shown on similar funds.

## Glossary of Terms

<b>Benchmark</b>	The standard (e.g. an index) by which an investment is measured against to evaluate performance.
<b>Excess Return</b>	Return of an investment relative to its benchmark.
<b>FUM</b>	Funds Under Management - The total value of the funds managed by an asset management firm.
<b>High Water Mark</b>	The highest net asset value (NAV) of a fund achieved to date. If the NAV of a fund falls below this level, no performance fee will be payable to the investment manager until this level is subsequently exceeded.
<b>Hurdle Rate</b>	A minimum rate of return that a fund must achieve before a performance fee can be charged. This can be the benchmark or the benchmark plus an additional fixed rate.
<b>Performance Fees</b>	A fee payable in excess of the ongoing management fee. There is often a hurdle rate and/or high watermark that must be reached before this fee is payable.
<b>ICR-Indirect Cost Ratio</b>	This is a ratio of indirect costs to the total investment in a particular fund expressed as a percentage. It includes the MER, expense recoveries, performance fees and other costs associated with running the fund.
<b>Information Ratio</b>	Is a measure of the relative reward for the relative risk taken (excess returns of an investment (above the benchmark) divided by the tracking error). A positive information ratio would indicate efficient use of risk by the manager.
<b>MER-Management Expense Ratio</b>	This ratio is a calculation of investment management, marketing, trusteeship, legal, accounting and auditing costs of a managed investment fund expressed as a percentage of a fund's net asset value. It is the ongoing charges for managing a fund.
<b>Peer Group Return</b>	The average return of the funds in the relevant S&P peer group.
<b>Sharpe Ratio</b>	Is a measure of risk-adjusted performance, measuring the absolute reward for the absolute risk taken (return of the investment less the risk-free rate (e.g. bank bills) divided by the standard deviation). The higher the Sharpe ratio the greater the efficiency produced by the manager.
<b>Standard Deviation</b>	Measure of the variability or volatility of the monthly returns of the fund.
<b>Tracking Error</b>	How closely a portfolio follows or "tracks" an index to which it is benchmarked. (the standard deviation of monthly excess returns against the benchmark).
<b>Ex Ante Trading Error</b>	Predicted or forecast of tracking error.
<b>Ex Post Trading Error</b>	Historical or actual tracking error.

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