



## DDH Fixed Interest Fund

### Performance Report for the Quarter Ended 30 September 2009

#### Investment objective

The DDH Fixed Interest Fund invests in the QIC Australian Fixed Interest Fund which aims to exceed the performance of a portfolio of highly rated Australian fixed interest securities by investing in a diversified, medium risk portfolio of Australian and international higher yielding fixed interest securities and derivatives.

#### Commentary and outlook

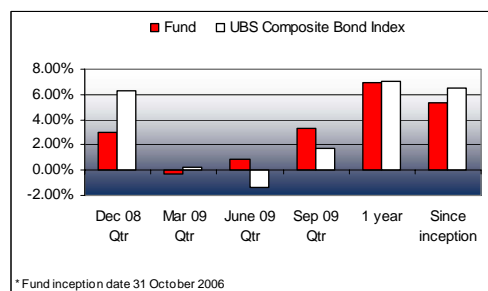
The performance of the DDH Fixed Interest Fund is set out below. Refer to the attached performance report from QIC. Please note that the performance figures quoted in QIC reports relate to the underlying QIC wholesale funds.

#### Performance

	3 months %	6 months %	1 year %	2 year % p.a.	Since Inception % p.a.	QIC Fund Since Inception % p.a.
Total return	3.31	4.16	6.98	6.39	5.35	7.70
Growth return	2.00	0.06	-1.00	-0.03	-1.01	
Distribution return	1.31	4.10	7.98	6.42	6.36	
Benchmark	1.76	0.41	7.07	7.72	6.54	7.61

#### Performance notes:

1. DDH Fixed Interest Fund inception date - 31 October 2006.
2. QIC Australian Fixed Interest Fund inception date - June 1994.
3. DDH fund returns are calculated after fees have been deducted and assuming reinvestment of distributions. No allowance is made for tax.
4. QIC fund returns are before investment management fees.
5. Fund benchmark - UBS Composite Bond Index



#### Unit Price as at 30 September 2009

Entry price (ex distribution)	\$0.9715
Exit price (ex distribution)	\$0.9707

#### Income distribution

The distribution for the quarter ended 30 September 2009 is 1.25 cents per unit. Details of the final tax components of the distribution will be advised to unitholders after 30 September 2009.

#### Asset allocation

	As at 30-09-09 (%)
Australian fixed interest	100

# QIC Australian Fixed Interest Fund

## Fund details at 30 September 2009



### Profile

Description	The Fund is a domestic fixed interest portfolio that is actively managed by the QIC Global Fixed Interest team to lift returns and minimise risk.
Objective	To outperform the UBS Composite Bond Index by 0.80% per annum.
Inception	June 1994
Size	AUD \$299.6 million

### Performance

Gross period returns (%)

Period	Fund	Benchmark
1 month	1.63	0.72
3 months	3.64	1.76
Financial year to date	3.64	1.76
1 year	8.37	7.07
3 years	6.14	6.27
5 years	6.13	5.87
7 years	6.00	5.72
Since inception	7.70	7.61

### Market Overview

While global economic sentiment continued to improve through the September quarter, this to some degree is merely an improvement from very dire expectations. Recent economic data has also reinforced that the various fiscal measures aimed at boosting consumption and housing in a number of economies has had the desired effect.

The US economy is showing that it is slowly returning to positive growth, following the deepest recession since the Great Depression. Consumer confidence has begun to improve, evidence of house price stabilisation is beginning to emerge and the residential construction sector is recovering from all-time low levels. Although the unemployment rate continues to rise and is likely to reach 10% in coming months, there is a clear slowing in the pace of job losses. That said, policy makers still recognise the vulnerability of the US economy at present and remain committed to extreme policy stimulus to ensure that the recovery takes hold.

Global inflation rates plummeted during the quarter, with the headline US inflation rate reaching an all-time low of -1.9% (year-on-year) in July. Core inflation rates continue to move gradually lower, which is consistent with the downturn in the labour market and pullback in wages growth.

With policy makers globally recognising the need to maintain extraordinarily stimulatory policy settings for some time, conditions are providing a rare 'sweet spot' for all asset classes. Global credit spreads narrowed, and most are now back to levels that existed prior to the collapse of Lehman Brothers. Globally, bond yields fell across the curve during the quarter, ten year yields in the US fell 0.23% to 3.30% and fell 0.09% to 3.59% in the UK. The rally in short-dated UK bonds was particularly aggressive, with the two year yield falling 0.45% during the quarter to 0.89%, near its all-time lows.

Global credit markets produced another very strong quarter of performance. In the US, investment grade indices posted their second best quarter of performance ever, outpacing duration-neutral Treasuries by 5.61%. High yield also posted its second strongest ever quarter, returning 14.22%. This continued rally in credit markets has been driven by improving liquidity and a refocus on fundamentals. Through the quarter investors recognised that credit offered strong expected risk adjusted returns against a backdrop of an improving global economy. Cash was subsequently allocated to credit from equity and money market funds, with retail investors being attracted to the high yield market. The improvement in credit markets resulted in the primary market becoming very active with a range of issuers completing new deals over the quarter.

Dataflow in Australia surprised to the upside during the quarter. In particular, there was clear evidence that the government's fiscal package had a particularly significant impact on consumer spending and sentiment more broadly in recent months. In addition, more signs of strength in the residential sector emerged with house prices showing upward momentum, particularly in the first home buyer segment of the market. Businesses also became more upbeat about the economic outlook. Although remaining subdued, investment and hiring intentions have improved. The improved domestic dataflow, alongside signs of 'green shoots' globally, meant the Reserve Bank of Australia (RBA) has concluded that

the current 'emergency' level of cash rates at 3% is no longer appropriate.

In stark contrast to offshore developments, Australian bond markets sold off sharply during the quarter as the RBA moved first to a neutral bias and then to a tightening bias. The two year yield jumped 0.40% during the quarter to 4.38% and has risen almost 2.0% from its lows of around 2.5% earlier this year.

Following the lead from offshore markets, the Australian credit market performed strongly, however, primary issuance in Australia remains more subdued than offshore. Australian issuers instead took the opportunity to issue longer dated securities into offshore markets rather than issue domestically. The Australian banks have been the most active in issuing new debt.

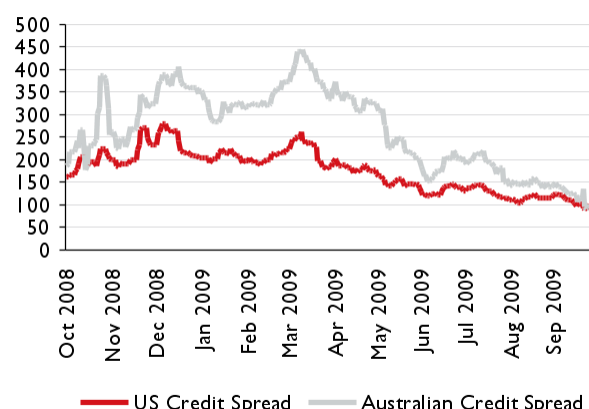
Australian Cash, 3 Year and 10 Year Bond Yields (%)



US Cash, 2 Year and 10 Year Bond Yields (%)



Investment Grade Credit Spreads (Derivative Indices) (basis points)



## Performance Drivers

During the quarter the UBS Composite Bond Index benchmark returned 1.76% while the Fund returned 3.64%, outperforming by 1.88%. The Fund's overweight credit strategies, particularly major domestic banks and defensive infrastructure loans were the key drivers to outperformance.

The Fund was positioned in expectation that interest rates will be lower for longer. However, the better than expected global economic data and change in RBA rhetoric removing further rate cuts meant that interest rate positioning detracted from the quarters active return.

Contribution to active performance (versus the benchmark) for the Fund is shown below:

### Macro Interest Rates and Credit

#### Positive Contribution

- New Zealand yield curve flattener
- Long defensive high yield
- Long Australian and US duration positions

#### Negative Contribution

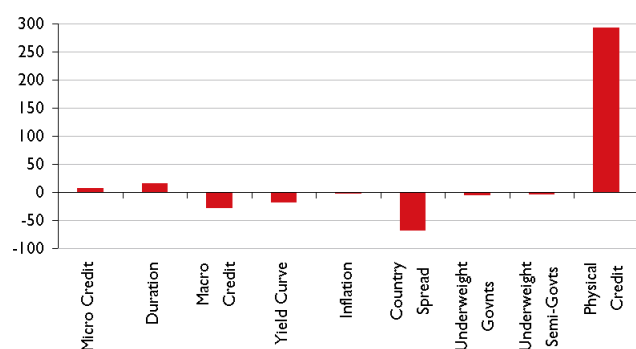
- Australian versus US country spread in expectation that the differential between Australian and US bond yields will increase.
- UK versus EUR country spread
- UK yield curve flattener
- Short European investment grade credit
- Long US investment grade credit versus short US high yield credit
- Australian yield curve flattener

### Micro Credit

### Positive Contribution

- Overweight selected US and Australian financials
- Overweight defensive high yield loans
- Long selected financial names versus short selected industrial names

**Active performance attribution by strategy for the quarter (basis points)**



## Outlook

The Global Fixed Interest (GFI) team expects that the worst of the global economic downturn is now behind us. The trajectory of the recovery is likely to remain modest by historical standards, and the medium term outlook will be hampered by various headwinds. However, while another 'event' in financial markets can't be ruled out there are growing reasons to believe that a double-dip in the real economy is unlikely without early policy withdrawal.

It is clear that global growth will recover impressively during the second half of 2009, boosted in part by a large swing in the global inventory cycle and significant fiscal measures designed to increase household spending. By their nature, the contributions to growth from these components will prove fleeting, and growth is likely to step back in the first half of 2010. But there are signs of improvement in underlying final demand beginning to emerge that mean the major economies can continue on a modest recovery path. Firstly, the amount of monetary and fiscal stimulus currently existing is unprecedented in modern times. The impact of such stimulus should not be underestimated. Secondly, while deleveraging in the banking system is likely to continue, restricting the access of credit to the broader economy, many of the earlier excesses in household balance sheets and within the US housing market are well through their adjustments.

In the US, household savings rates have risen, while improving consumer confidence is pointing to a recovery in consumer spending in coming quarters. Household income remains weak, but with the labour markets likely to begin to recover in early 2010, a recovery in

household spending is expected. US house prices appear to have stabilised in recent months, after falling sharply over the past two years. The significant pool of foreclosed homes on banks' balance sheets will ensure a cap on house price rises, but homebuilders are becoming more confident and housing starts have risen impressively off exceptionally low levels. Corporate activity appears to be improving also, with profits recovering, boosted by aggressive cost-cutting. Business investment appears to be rising modestly following the sharpest downturn in fifty years. With capacity utilisation around historically low levels, there is little need to aggressively expand, but with existing capital stock having been depleted through the downturn, growth can occur in coming quarters from replacement capital expenditure.

The economic downturn in Australia has so far been less severe than we had expected. The aggressive monetary and fiscal stimulus has clearly had the desired effect of boosting spending and confidence among Australian businesses and consumers. Moreover, strong demand from China has kept export volumes robust at a time when demand from the rest of the world collapsed. Australia is experiencing a significant terms of trade shock due to sharp falls in commodity prices, and this will weigh on the economy through weaker profits and incomes. However the stronger than expected recent dataflow, particularly the improved outlook for business investment, has resulted in an upgrade to GFI's gross domestic product (GDP) and consumer price index (CPI) forecasts for Australia, particularly for 2010. While the second half of 2009 is likely to show some weaker momentum for investment and consumer spending, partly the result of fiscal fade, the sharp improvement in business confidence suggests that the economy is set to strengthen in 2010.

It is becoming clear that the current 'emergency' level of the cash rate at 3% is no longer appropriate, given the economy's better than expected performance and improved outlook. We expect the RBA to raise cash rates by 50bpts before year end and up to 4% by mid 2010. The back up in Australian yields has been particularly aggressive, and GFI is positioned for markets to reassess of how quickly the RBA will be able to move rates to neutral and beyond during 2010.

The 2009 calendar year to date has already seen record net issuance in corporate bonds, across both investment grade and high yield. While the pace of issuance is likely to slow in the fourth quarter, it is clear that an unprecedented amount of credit risk will have been absorbed by the market. Life insurers, private pensions, and retail are the main sources of demand for credit.

While we consider the former two likely to continue adding risk, retail flows tend to be more fickle. Nonetheless, the combination of a slowdown in supply and continued demand is expected to support credit spreads.

The general improvement in the global economy and the ability of businesses to refinance and issue new debt has lead to a rapid improvement in the default outlook for 2010. GFI's outlook has now been revised to expect a single digit default rate in 2010. Some market commentators are currently lowering their expectations to below 5%. Company specific issues are expected to become more important over the remainder of the year as investors take more time to consider which companies are expected to outperform.

## Portfolio Positioning

### Interest rate strategies

Country Spread	Long European versus short UK interest rate country spread
Duration	Long Australian duration in short end of yield curve
Inflation	AU inflation
Yield Curve	UK flattener, NZ flattener, US flattener

### Credit strategies

Credit Strategies	The Fund is overweight financials, particularly in the short end of the credit curve.
High Yield	We have exposure via a unit holding in QIC Global Credit Opportunities Fund.
Issuer and Security Selection	In terms of the largest active individual issuer positions, the Fund is overweight Westpac, Morgan Stanley, Woolworths and ANZ Bank.
Macro Credit	Outright long investment grade credit
Micro Credit	The Fund has a number of long/short relative value derivative strategies across single names and bespoke portfolios,
Structured Credit	The Fund holds a small number of investment grade positions with exposure predominately to loans in the US and Europe.

### Asset composition (%)

Asset	Fund	Benchmark
Corporate	73.44	33.48
Semi-Govt.	18.06	33.00
Cash	5.50	0.00
Comm. Govt.	3.00	33.52

### Maturity composition (%)

Maturity	Fund	Benchmark
0-1 Year	16.48	12.49
1-3 Years	20.33	31.61
3-5 Years	10.78	24.71
5-7 Years	13.67	9.85
7+ Years	38.74	21.34

### Rating composition (%)

Rating	Fund	Benchmark
AAA	35.36	78.18
AA	23.61	13.38
A	22.00	6.17
BBB	15.13	1.98
Sub-Investment Grade	3.90	0.00
Not Rated	0.00	0.29

### Modified duration

	Years
Fund	3.47
Benchmark	3.39

### Notes:

- Returns greater than one year are annualised.
- Past performance is not a reliable indicator of future performance.
- The benchmark to June 1998 was the UBS Semi-Government Bond Index.
- Fund composition tables may not total 100% due to rounding.

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