

5 Year Anniversary:

Sustainable Alpha approach now mainstream with strong returns and over \$1.2 billion of funds

This year, the AMP Capital Investors Sustainable Future Australian Share Fund reached its five year anniversary. Consistent with our Sustainable Alpha approach, the Fund's investment team aims to outperform the universe of Australian share managers while addressing social and environmental issues.



Significant funds growth

Over its five year history, the Sustainable Funds (recently renamed Sustainable Alpha) team's investment approach has become increasingly regarded as a mainstream investment strategy by both institutional and retail investors. The team now manages over \$1.2 billion (as at 31 August 2006) with major superannuation funds and not-for-profit organisations accounting for over 70% of this inflow as part of their mainstream allocation.

Competitive performance

Performance of the Fund is very competitive against the broader universe of Australian share managers, outperforming its benchmark and the median manager over all major periods to 31 August 2006, as shown in the survey below. In addition, the Fund has been a top quartile performer over most periods.

Performance % to 31 Aug (before fees and taxes)

	3mths	1yr	2yr	3yr	4yr	5yr
SFAS*	3.77	27.19	27.66	25.00	21.04	17.27
ASX 200	3.70	20.25	25.28	22.12	18.17	13.96
Relative	0.07	6.93	2.38	2.89	2.87	3.31

Source: AMP Capital Investors, Mercer.

* SFAS refers to The Sustainable Future Australian Share Fund.

Integrated financial analysis

The team's Sustainable Alpha approach to stock selection systematically applies an extra layer of analysis. We integrate social and environmental assessment with financial measures to provide deeper insights into a company's growth and risk factors. Our process is supported by a dedicated in-house team of financial portfolio managers and social/environmental research specialists.

AMP Capital Investors was one of the early managers to pioneer this integrated approach as opposed to adopting a traditional screening strategy. In a statistical research study completed by AMP Capital in 2005, we tested our process in terms of its contribution to alpha generation (ability to generate excess returns above benchmark). The results showed that companies with higher ratings on corporate social responsibility outperformed the lower rated companies over 4 and 10 years to 31 December 2004.

Selecting industries aligned with sustainability imperatives

The team targets industries that are driven by sustainability imperatives – the environmental, social and governance forces that shape their future growth prospects. These industries include healthcare, renewable energy, mass transport, recycling, waste and water. Examples of growth drivers in these sectors include mandatory renewable energy targets, government recycling initiatives and water restrictions.

Corporate social responsibility leaders

Additionally, the team targets investment leaders in traditional sectors such as banking, insurance and property. These companies are assessed on corporate social responsibility measures and their strategies towards leadership in these measures. This assessment includes environmental management, community, workplace practices and corporate responsibility (such as corporate governance and human rights).

Active financial evaluation of companies

The team use active stock selection techniques in choosing companies for inclusion in the portfolio. No matter how attractive the environmental and social credentials of a company, if it does not satisfy relevant financial criteria, it will be excluded from the portfolio. Techniques used by the team to make this assessment include discounted cash flow, price earnings growth and earnings and price momentum.

A distinguishing feature is the team's Sustainable Alpha approach; a systematic incorporation of environmental and social issues when applying a range of these valuation techniques. The issues are considered within a risk and return framework. For example, a company's higher sustainable focus is factored in as a positive growth attribute while a company with a poor corporate social responsibility focus is penalised as a higher risk investment.

Breadth of expertise

The Sustainable Alpha team has six dedicated portfolio managers and environmental and social researchers. The team leverages from the resources of our combined Australian share teams and an independent body of experts which comprise the AMP Capital Sustainable Alpha Advisory Committee.

Lend Lease Corporation

Lend Lease Corporation (LLC) is an international group involved in project design, construction and maintenance, property development and property funds management. LLC operates in over 40 countries, with a significant presence in Australia, Asia, Europe, and the USA.

LLC provides real estate clients with a wide range of services through its global businesses Bovis Lend Lease, Actus Lend Lease and Delfin Lend Lease. With clients in 37 countries its services range from specialised construction solutions to the American military to the creation of large-scale urban centres in Australia. Development services extend to commercial, retail, multi-family and complex urban mixed-use projects with a strong retail focus.

Property construction is a high-risk and high-hazard industry. Worker's Compensation payments are higher in this industry than the economy average which means that companies in this industry start at a higher base labour cost. Along with the real and tragic risk to human life and health, the business risks associated with safety incidents are potentially significant to the performance of companies in this sector.

This year, LLC released its first company Sustainability Report which showed improving safety performance over the past three years¹. LLC has developed a solid safety management program, backed by a safety management system, reporting, auditing, and employees who are experts in the field. Its good performance was offset by a high number of workplace fatalities – 15 in the past 2 years – largely from falls. The fatalities have illustrated that some systems do not translate perfectly to different working environments, and LLC has begun to focus on safety culture as they extend operations into Eastern Europe and Asia. The Sustainable Alpha Team has been talking with senior managers at LLC to provide confidence that appropriate action is being taken.

¹ LLC reported a low (and declining) Lost Time Injury Frequency Rate (LTIFR). The LTIFR is a standard measure for the rate of workplace injuries. A lower LTIFR means fewer hours of lost time resulting from injuries.

research & engagement

The Australian Sustainable Alpha team (the Team) focuses its research on industry specific sustainability issues. These issues identify the growth profile of each industry based on sustainability drivers. Our research complements our rigorous corporate social responsibility assessment of companies within each sector. During the past 6 months, the Team completed industry specific sustainability analysis on two industries – Commercial Services and Property Developers – while also commencing research on the Transport sector.

In August, the company reporting season provided an opportunity for the Team to raise the issue of OH&S with companies. The objective of raising OH&S with companies is to communicate that OH&S is an issue that fund managers consider in assessing their companies and expect senior management to be on top of. The Team engaged on the OH&S issue with 21 companies across 10 sectors.

On the engagement front the team has been active with:

- **Reporting and Disclosure:** Ian Woods as a member of the Investor Group on Climate Change helped to coordinate reports by Australia's top 100 companies on carbon dioxide equivalent (CO₂-e) emissions, for the fourth edition of the Carbon Disclosure Project (CDP4). Nick Edgerton engaged with Transurban at its stakeholder engagement session about Sustainability reporting. Ian attended an Extractive Industry Transparency Initiative to encourage the Australian mining sector to become signatories of the Initiative.
- **Industries of the Future:** Mike Murray visited ABC Learning Headquarters and a childcare site, while Nick met with management to discuss improvements to quality systems and human resource management. Ian went on a site visit of a new biodiesel plant at Australian Biodiesel.
- **Corporate Social Responsibility:** Ian was involved in a stakeholder engagement session with Rio Tinto on Corporate Social Responsibility issues. Nick visited Lend Lease to discuss Environmental Sustainability at the property developer. Ian spoke on a panel for a Green Capital seminar on Short-termism. Ian participated on the ANZ Environment Roundtable to discuss sustainability and lending. Ian engaged with Santos about its mine-site explosion and mud-flow in East Java, Indonesia.
- **Sustainability:** Nick was invited to a focus group for the Australian Greenhouse Office's *Your Building* project. Ian and Nick attended a Sustainable Business Forum on Sustainability in China. Ian and Nick attended the launch of the Australian Conservation Foundation's research on the Finance sector and valuing the environment. Ian attended the launch of the Mirvac sponsored Sustainable Development school. Nick attended the launch of GPT's Ecological Footprint calculator.
- **OHS:** Nick and Ian visited Lend Lease to discuss safety performance and process (see adjacent Stock Story)
- **Corporate Governance:** Karin Halliday and Michael Anderson launched the August edition of the AMP Capital Corporate Governance Report, including a section on "Lost Proxy Votes" (profiled in this newsletter in the AMP Capital Corporate Governance section).
- **Climate Change:** Ian was a stakeholder participant in meetings with the National Emissions Trading Taskforce. Ian and Nick attended a seminar on Lessons from the EU Emissions Trading Scheme, while Nick attended a seminar on the National Emissions Trading Discussion Paper (both seminars at Blake Dawson Waldron). Ian attended the launch of the Climate Institute; presented to the CPA on Climate Change and Company Value; and had a policy discussion with an energy CRC on exploring a cross-sector and NGO position on climate change. Ian and Nick went to a CEDA seminar on the business case for early action to combat climate change. Nick attended a CEDA seminar by Malcolm Turnbull on water policy.
- **Uranium:** Ian, Nick and Will Riggall attended the Ethical Investment Association discussion panel on the sustainability of uranium.



AMP Capital Corporate Governance

AMP Capital takes the issue of corporate governance seriously, endeavouring to vote on all resolutions at all company meetings where we have the authority to do so.

In late 2005 we were led to question the integrity of the voting system when we identified instances where the 'against' or 'abstain' instructions lodged by AMP Capital alone had exceeded the number of such votes recorded by the company and disclosed to the ASX after the company meeting.

AMP Capital's further investigation showed that voting instructions had been 'lost' in over 4% of the instances where we had not supported resolutions. This number is worrying, and it may in fact only represent the tip of the iceberg as AMP Capital could only investigate the occasions on which it did not support resolutions and where it alone had a significant and therefore clearly visible shareholding – votes on smaller shareholdings or votes by other investors may also have been lost.

The proxy voting process for institutional investors in Australia is complex and highly manual. Company information and votes pass through many hands including the company, the registrar, the custodian (including various global and sub-custodians), the proxy-voting service-provider, the fund manager and the super-fund trustee – all on behalf of the (super) fund beneficiaries.

Our investigation identified that votes were 'lost' in two main ways, either as a result of data-entry and human errors (so far identified to be at the registry and/or company level), or as a result of late trading causing reconciliation difficulties and share registries then disregarding voting instructions on an entire shareholding. These findings mirrored a similar situation in the United Kingdom.

While no occasions were identified where the inclusion of AMP Capital's votes would have altered the outcome of the meeting, there is a definite risk that shareholders' views could be misrepresented.

AMP Capital acknowledges that the proxy voting process in Australia is complex and that any solution to this problem will require the involvement of all participants, including the ASX, fund managers, custodians, registrars, trustees and companies. As a result of our findings, IFSA hosted an industry Roundtable in June 2006 with the aim of identifying ways to improve the integrity and transparency of the proxy voting system. The meeting was well attended with representatives from a broad range of stakeholders keen to work together to solve this problem. Consequently, IFSA is now facilitating stakeholder-based Working Groups – including AMP Capital participation – to explore the opportunity for creating a direct electronic process for the delivery and processing of vote instructions, and to investigate opportunities for other regulatory and process changes.

profile



Karin Halliday
Manager, Corporate Governance

Karin was appointed to her current position as Manager – Corporate Governance in May 2000. Having first joined AMP in 1984, Karin spent much of her early career in investment management; primarily managing Australian share portfolios and at one stage being responsible for the entire Australian share component of AMP Capital's retail unit trusts.

In her current role Karin monitors the corporate governance activity of many Australian companies and also determines how AMP Capital will vote on behalf of its clients on all resolutions of 'investee' companies.

AMP Capital takes corporate governance seriously and believes that by adopting high standards in relation to corporate governance and social responsibility companies can, among other things, avoid potential damage to their earnings or reputation and also reduce the risk of corporate mismanagement and failure. Karin has found her portfolio management experience invaluable when engaging with companies on matters of corporate governance, especially as AMP Capital usually communicates with company Chairmen whenever it has not supported particular resolutions. The letters written by Karin have often led to constructive dialogue and many company Chairmen now make it a habit to 'touch base' with Karin and portfolio managers prior to formulating resolutions and/or prior to their AGMs.

AMP Capital is a recognised leader in governance activism in Australia and Karin's six-monthly newsletters cover emerging issues and AMP Capital's voting actions are highly regarded by clients and other interested parties. These newsletters can be found on our website <http://www.ampcapital.com.au/institutions/governance.asp>.



news

performance

The Sustainable Future Australian Share Fund (the Fund) has strongly outperformed the ASX 200 benchmark over the last 12 months. In the year to 31st August 2006, the Fund returned approximately 27% against the ASX 200 benchmark return of approximately 20% (before fees and taxes). Key sectors adding value included diversified financials, capital goods and telecommunications sectors.

Key stocks included emerging financial market players, Allco Finance Group and MFS which benefited from buoyant capital market conditions. Capital goods continued to prosper from demand for engineering and mining services. In telecommunications, the Fund did well by being significantly underweight as shifting technology and regulatory change pressured earnings.

Looking to industries of the future, the Fund's investment in Vision System's cancer detection equipment saw it finish the year up over 100%, with a bid for the company by global competitor, Ventana Medical Systems. Blood products company CSL achieved an annual return of about 50%. In media, new entrant Seek benefited from rapid growth for online advertising with its price increasing around 100%.

On the negative side, the Fund's underweight in utilities detracted from performance with AGL benefiting from a separation of its energy and infrastructure business. The outperformance of several mining companies also dragged on performance, with a number of these stocks not meeting our minimum sustainability criteria.

Looking ahead, we continue to seek out industries of the future companies as well as mainstream leaders – key new entrants into the Fund include IBA, a software provider to hospitals, and Energy Developments, an international provider of renewable energy.

Climate change continues to be hot topic with the release of the fourth edition of the Climate Disclosure Project (CDP4), the release of the National Emissions Trading Taskforce (NETT) Discussion Paper, and the Al Gore film *An Inconvenient Truth*.

- The international launch of CDP4 on 18 September detailed the results from the FT500. CDP4 marks the inaugural disclosure by the ASX100 and NZ50 companies, with the Australia and New Zealand edition launched on 17 October.
- The NETT discussion paper was released on 16 August, outlining the proposed national emissions trading scheme. The paper focuses on design issues and calls for submissions about these issues by 22 December.
- Meanwhile, *An Inconvenient Truth* was launched worldwide becoming the third highest grossing US documentary. The film, which highlights the issues of climate change, has received airings in the investment and NGO community in Sydney and Melbourne.

Alternative energy has generated political and investment community discussion, with two examples being nuclear energy and the use of ethanol blends in fuel. With a political call for a national debate on nuclear energy, and the Australian Government allowing the sale of uranium to China, the Ethical Investment Association held an Investment Industry Forum on "Investments and Uranium." Likewise, rising fuel prices (until very recently), promoted further discussion about the merits of ethanol blends, gaining political focus with the NSW Government indicating a mandated ethanol fuel component by 2011.



Carbon Neutral

The Sustainable Alpha team has gone carbon-neutral! With the help of Climate Friendly, the Team now neutralises its carbon emissions for all plane and taxi travel for business, and for office energy use. The program works by funding Australian and International renewable energy projects which provide Kyoto-compliant green energy credits, thereby driving demand for additional renewable energy projects.

Sustainable Responsible Investment Symbol



The Ethical Investment Association (EIA) manages the world's first certification program for providers of Sustainable Responsible Investment (SRI) and Ethical Investment products and services. Angus Dennis, SRI Specialist at AMP Capital, was actively involved in building the momentum behind the idea through leading an industry working group on the initiative. He also co-presented the findings and recommendations on the SRI Symbol to the EIA Board for approval.

The EIA Board and an independent accounting firm audited and approved the Sustainable Alpha Team as one of the inaugural recipient fund managers of the SRI Symbol. The EIA has followed up it's logo with the world's first online Ethical Investment course for Financial Advisers and Dealer Groups.

Important note: Investors should consider the product disclosure statement available from AMP Capital Investors Limited (ABN 59 001 777 591) for the Sustainable Future Australian Share Fund before making any decision regarding the Fund. Neither AMP Capital Investors, nor any other company in the AMP Group guarantees the repayment of capital or the performance of any product or any particular rate of return referred to in this document. Past performance is not a reliable indicator of future performance. While every care has been taken in the preparation of this document, AMP Capital Investors makes no representation or warranty as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided.

Sustainable Future Australian Share Fund

The Sustainable Future Australian Share Fund is available to Australian investors. The overall objective of the fund is to deliver superior returns to our clients by investing in companies that contribute to, benefit from and best adapt to the shift to an environmentally sustainable and socially responsible global economy.

Further information can be found on our website:

www.ampcapital.com.au or by contacting your adviser. Please note that you can subscribe to this newsletter on-line through our website.