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Fund Update - Institutional Clients

December 2011

Tyndall Enhanced Cash Fund

Fund Objective

The Fund aims to outperform the UBSA Bank Bill Index (before fees).

Fund Details - 31 December 2011

Responsible Entity	Tyndall Asset Management Limited
APIR Code	SUN0039AU
Fund Size	$ 1139.78 million
Unit price	$1.0503
Minimum Initial Investment	$500,000
Inception Date	30 November 1995

The unit price is ex price, ie month end soft close unit price, net of distribution. Entry and exit fees do not apply.

Fund Performance to 31 December 2011

	Fund (%)	Index (%)	Excess Return (%)
1 month	0.41	0.40	0.01
3 months	1.26	1.22	0.04
6 months	2.30	2.47	-0.17
1 year	5.56	5.00	0.56
3 years p.a.	5.63	4.38	1.25
5 years p.a.	5.82	5.48	0.34
10 years p.a.	5.76	5.44	0.32
Since inception p.a.	5.81	5.57	0.24

Fund and index returns are gross unit price returns and represent the total return.
Index = UBSA Bank Bill Index

Market Commentary

The Reserve Bank of Australia (RBA) lowered rates at the start of the month by 0.25% to 4.25%. The minutes indicated that the decision to cut again was almost entirely based on the European situation. They stated that domestic data did not suggest any strong need to cut interest rates but given the unpredictability of Euro zone developments and the expectation that inflation would remain within their target band over the next couple of years, "members felt that there was scope for a modest reduction in the cash rate at this meeting".

Shorter-term bank bill rates fell in December, as the market continued to price further aggressive rate cuts. The 1-month rate fell to 4.50% from 4.71%, the 3-month rate to 4.48% from 4.60%. On the other hand, the 6-month rate rose slightly to 4.43% from 4.40%.

The dollar slipped below parity again mid-month but ended December at US$1.02. The first few days of January saw it increase even further with optimism and a bit of risk appetite following good global manufacturing data. Whether this performance can be sustained throughout the month is uncertain and will depend on upcoming data releases and their impact on market sentiment.

Fund Performance

The Fund returned 0.41%, which was 0.01% over the bank bill benchmark return in December. European leaders' inability to give indications of how they will resolve the Euro zone problems continued to be the backdrop. Rating agencies made a substantial number of negative comments on European Monetary Union members. However, credit spreads shrugged off the deluge of bad news and mostly moved slightly tighter. This was due to various efforts by the central banks to ease bank liquidity, including a concerted effort by the central banks to provide cheap US dollar swap lines and the European Central Bank's provision of 3-year long-term repo facilities. Given generally poor sentiment towards European banks, these measures were intended to ward off the risk of a liquidity crisis similar to that following the collapse of Lehman Brothers. Short- to medium-term US banks and financials outperformed significantly as a result of the central banks' easing actions. FRN credit outperformed short-term bank bills this month.

December continued to see the implementation of S&P's new bank rating methodology. The Australian majors were all downgraded by one notch to AA-. These downgrades were, if anything, slightly positive since they were highly anticipated and removed uncertainty. Bendigo Bank was upgraded by one notch to A- but Bank of Queensland was downgraded one notch to BBB. These rating changes did not have a significant impact on the Fund because it was positioned for and expected these downgrades on the back of S&P's criteria changes.

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Outlook

Market pricing continues to be extremely aggressive, forecasting deep rate cuts. Our view still remains that the RBA is likely to be cautious about when and by how much it cuts rates. We believe that it may well cut rates by another 0.25% over the next few months to 4.00%, but that the domestic economic data will constrain it from cutting further. In its December minutes, the RBA did note the strength of current domestic data–a major investment boom is in progress, the overall economy is expanding in line with trend and Australia's main trading partners are still recording solid growth.

The reason given for the follow-up cut was Europe and the uncertainty surrounding it. This is where we see the potential threat to our current rates forecasts.

If Europe finally implements credible solutions to the debt problems, then the RBA would be unlikely to cut rates below our base case. However, if Europe's situation continues deteriorating, then rates could fall further than we currently envisage. In our view, European politicians will not allow the euro to disintegrate, as the consequences are likely to be disastrous for the entire Euro zone.

As we mentioned last month, the other factor to keep a wary eye on is the currency, which has been flirting with the US$1 mark for a while, but largely been sitting above it. The Australian dollar is helping to control inflation at the moment–so much so that the RBA would probably not have been able to make its recent rate cuts if the Australian dollar had been behaving as we have historically expected in times of global turmoil. If the domestic currency were to fall significantly (which we think unlikely given its behaviour over the past months) then inflation could start spiralling up again. Unless the economy took a turn for the worse at the same time (again unlikely), then the RBA would find it extremely difficult to justify lowering the cash rate to the levels the market is predicting.

Sector Allocation

(including top 2 stocks)	Maturity	Fund %
Floating Rate Notes		43.59
Colonial Finance	2012	2.02
Australia & New Zealand Banking Group	2013	1.96
Mortgage Backed Securities		40.69
Reds Trust	2016	1.46
Crusade Trust	2013	1.29
Subordinated Debt		2.29
Australia & New Zealand Banking Group	2012	1.15
Westpac Banking Corporation	2012	0.88
Unit Trusts		14.23
Tyndall Cash Fund		14.23
Cash		-0.80
Total Allocation		100.00