Fund Update

Asset Allocation Alpha Fund

MAY 2010

BLACKROCK

Market Outlook

- The past month was extremely volatile with a major wash out in risk assets and concomitant rally in the major government bond markets (outside the troubled peripheral European bond markets).
- The issues which undermined risk assets were a virtual re-run of the issues which caused the correction in markets in January/ February this year. In particular:
  - The fiscal crisis in peripheral Europe;
  - The risk of a hard landing in China; and
  - Political risk in the post bail-out global economy.
- Outside these issues, the fundamentals for investing in risk assets are generally very attractive.
  - The global economic recovery is on track led by the developing economies, most notably China.
  - There has also been a tentative recovery in the major developed economies (with the strongest performer being the US).
  - Profit growth is very strong and mostly beating expectations handsomely in the major markets.
  - Valuations are generally supportive of risk assets
- In FX, the 'riskier currencies' (such as the Australian dollar, Canadian dollar, Indian Rupee and Brazilian Real) are generally favoured by attractive relative yields and much sounder economic fundamentals.
- On the less supportive side, while the leading indicators of economic growth are still positive they have rolled over to some extent (and these inflection points can sometimes drive a major turnaround in markets, most recently in March 2009).
- At this stage, we expect a 'soft landing' consistent with a mid-cycle slowdown. Macro policy settings are still extremely supportive, yield curves are very steep and it is very early in the economic cycle. Moreover, double dips in the global economy are often forecast, but rarely happen.
- That said, we are in an extreme environment and we still believe a flexible mindset is warranted.
- The exit strategy from current extreme macro-economic policy settings was always going to be problematic.
- Indeed, the first stage of the exit strategy has occurred with the winding down of some of the US Federal Reserve's emergency liquidity programs and the end of the buying program under the quantitative easing policy in the US and the UK. Combined with the pick-up in global economic activity, this is effectively tightening liquidity conditions and might be contributing to the recent volatility in markets.
- In addition, even though fiscal policy is yet to be tightened significantly (outside the distressed economies in peripheral Europe) the impact of fiscal policy on the global economy is transitioning from a major positive over the past year to neutral, and it will become a significant negative in 2011.
- Of course, the private sector could normally be expected to take up the slack at this stage of the cycle as labour markets and capital expenditure recover. Indeed, that process appeared to be underway prior to the recent market turbulence.
- The focus of the sovereign debt crisis has been the peripheral European economies which are faced with a horrible set of policy choices. The fiscal tightening required to stabilise public debt will only exacerbate the recession in these economies bringing with it political unrest and further stress on the banking system.
- To make things even worse these economies are generally chronically uncompetitive within Europe with labour costs having grown at a very fast pace compared with the core economies over the past decade.
- The European Union and the European Central Bank (ECB) finally got out in front of the crisis with a massive package of support which resolves the liquidity crisis in these economies (at the expense of another dose of moral hazard), but not necessarily the solvency issues.
- The second round effects of the peripheral European sovereign debt crisis on economic growth will be determined by:
- The extent to which markets force an early tightening of fiscal policy on countries with unsustainable fiscal deficits.
- The confidence effects of the recent falls in risk assets and whether this undermines the putative recovery in private sector demand.
- In the meantime, the recent trend weakness in the Euro appears bound to continue although the path may become jagged as the consensus favouring Euro weakness is staggering.
- Another major issue for markets to contend with this year has been political risk as the backlash from the Global Financial Crisis continues.
- The financial sector in particular is in the firing line with the considerable risk that credit growth is impaired by the measures adopted by national parliaments and the Bank for International Settlements under Basle 3.
- Finally, the cyclical risk in China will remain a key focus in coming months as evidence builds that the economy is slowing. This should be a welcome development, but there will naturally be some concern that a slowdown in growth turns into a hard landing. We expect the slowdown in growth to be benign, but it will take some months to get some visibility on economic growth in 2011 in China.

Performance Review as at 31/5/10

	Class C Units Net	Class D Units Net	Gross	Benchmark*	Out-performance^
1 Month	-0.45%	-0.40%	-0.37%	0.38%	-0.75%
3 Month	3.11%	3.23%	3.57%	1.05%	2.52%
6 Month	-1.90%	-1.65%	-1.07%	2.08%	-3.15%
1 Year	1.09%	1.58%	2.47%	3.75%	-1.28%
2 Year (pa)	15.33%	16.88%	20.81%	4.80%	16.01%
3 Year (pa)	–	20.44%	25.46%	5.60%	19.86%
Since Inception (pa)#	14.18%	15.97%	20.15%	5.79%	14.36%

Class C – 12/5/2008; Class D – 29/5/2006; Gross – 28/2/2006.

Past performance is not a reliable indicator of future performance. Total net Fund returns shown are prepared on an exit-to-exit basis (ie. include all ongoing fees and expenses and exclude tax). Total gross returns and benchmark performance figures shown are gross (ie. do not include expenses, fees or tax).

^ Shows the difference between gross return and benchmark return, and should be considered relative to the target return of the Fund.

* UBS Australia Bank Bill Index.

About the Fund

Investment objective

To maximise total returns by implementing a diverse range of global tactical asset allocation strategies within a flexible but disciplined risk management framework.

The Fund aims to provide investors the benefits of an active asset allocation process which could either be combined with specialist sector funds or used as a total return fund.

The Fund targets a return of 12 percentage points above the UBS Australia Bank Bill Index over rolling 3 year periods, gross of fees. There is no guarantee that we will achieve this target. Most, if not all, of the Fund's returns are likely to be in the form of income rather than capital gains.

Fund strategy

The Fund implements tactical asset allocation strategies. The strategies adopted are thematic, concentrating on exploiting trends, likely developments and mis-pricing in global asset markets.

The strategies adopted encompass equity, cash, fixed interest, property, commodity and currency markets. Trades executed to implement these strategies may be based on an expectation of the direction of a particular market or focus on relative values between and within regions, asset classes, sectors, currencies and instruments or some combination thereof.

In selecting appropriate trades for the Fund, particular emphasis is placed on being able to execute strategies in a targeted, cost efficient and risk controlled manner. Futures, swaps and options are extensively used in this process although at times physical instruments and securities may be held. The Fund's benchmark is the UBS Australia Bank Bill Index in Australian Dollars (AUD).

However, in aiming to add value the Fund will take currency positions away from this AUD denominated benchmark. Any asset class or sector exposures are opportunistic, reflecting the themes and strategies being pursued. Exposures to asset classes, sectors, currencies and instruments will involve "net short" or "net long" positions and at times these will be substantial.

Designed for investors who...

- Seek a Fund which offers the potential for high absolute returns.
- Seek exposure to asset allocation strategies which are typically overlooked in an increasingly sector specialised world.
- Have a long-term investment horizon and a tolerance for significant volatility in investment returns in the short-term.

Fund Positioning at Month End

- The Fund's positions have been pared back substantially in the wake of the volatility during May.
- Stop losses were exercised on short duration positions in the UK, Germany and Australia.
- Expectations of tightening in the major developed economies have been pushed back again as a result of this set back in risk assets and also the ongoing low inflation prints in the US, Euro-area and Japan.
- Profits were taken on the long gold vs Euro and GBP positions and also on the short Euro positions.
- Profits were also taken on the long A$ vs Euro position and the Fund exited the long A$ and Canadian dollar vs Japanese Yen positions as the risk environment turned adverse.
- Finally, stop losses were exercised in the equity relative value positions (long Nasdaq vs Russell 2000 and long resources vs ASX200).
- At the end of the month active risk levels were low. It is most likely that this fall in risk assets is corrective rather than the start of a new bear market, but after such a long rally with minimal corrections it is more likely that this consolidation phase lasts for a few months rather than one month.

In the directional risk strategies, the Fund's positions include:

- Equity/Cash – neutral.
- Bond/Cash – short US 10 year inflation breakeven.
- Commodity/Cash – neutral.

In the relative value risk strategies, the Fund's positions include:

- Bond/Bond – short Australia vs long New Zealand; US eurodollar curve steepener; long sovereign risk in Australia vs short sovereign risk in France.
- Equity/Equity – long Eurostoxx vs short Spain.
- Equity/Bond – neutral.
- Commodity/FX – neutral.
- FX – long US dollar vs Japanese Yen; long AUD vs Euro; long Brazilian Real vs Chilean Peso.

Performance Review

The major contributors to performance

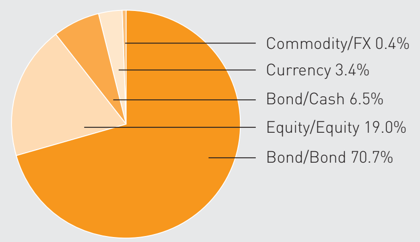
- Commodity/FX (reflecting long gold vs Euro and GBP).
- FX (primarily reflecting short Euro positioning against the US dollar, short Australian dollar vs the USD and Canadian dollar partially offset by detractions from long US dollar vs Japanese Yen and Long Australian dollar and Canadian dollar vs Japanese Yen).

The major detractor from performance

- Bond/Cash strategy (reflecting short UK, Germany in the long end and short Australia and UK in the short end.
- Bond/Bond (primarily due to Canadian curve flattener).
- Equity/Cash (long Japan).
- Equity/Equity (long Nasdaq vs small cap in the US and long resources vs ASX200 in Australia).
- Other strategies were close to neutral for the month.

The graph below shows the marginal contribution to portfolio risk by strategy.

Portfolio risk by strategy



If you have any queries relating to any of this information or to obtain a copy of the Product Disclosure Statement (PDS) for the Fund, please contact your relationship manager. Alternatively, if you have a query relating to the wholesale funds, please contact Distribution Services on 1300 658 766, or please call Adviser Services on 1300 366 101 if you have a query relating to our retail fund range.

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