

Adviser Edge Rating ★★★★★

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Product Summary

NAB Re-Strike Deferred Purchase Agreements – Series 4 and 6 (the Products) are Deferred Purchase Agreements (DPAs) issued by RBS Group (Australia) Pty Limited (RBS) that aim to provide investors with income and capital gain over a six-and-a-half year investment term. The performance of the Products is linked to the Risk Stabilised Aquantum Pegasus EL1 Strategy Index (the Reference Index), which is constructed by overlaying a volatility target strategy on top of the Aquantum Pegasus EL Excess Return Index (the Underlying Index). Investors can access the Products via a 100% investment loan from National Bank of Australia Limited (NAB) or other external lenders, or by using their own capital. The investment loan is separate from the Products, and Adviser Edge has not analysed the details of the loan in this report.

The Underlying Index is a market-neutral commodity index linked to the performance of a quantitative commodities strategy. The strategy is simple and constant, relying on a repeating pattern of changes in the shape of the forward curve of commodity futures contracts. Although it has only been a live traded index for one year commencing on 1 July 2009, the strategy is robust in back-tested data, back-filled to August 1997. Hedge funds have used a similar strategy successfully in live trading over the past years. The volatility target structure within the Reference Index will vary the level of exposure to the Underlying Index on a daily basis, depending on the maximum realised volatility of the Underlying Index observed on that specific calculation date and the last four consecutive calculation dates. The realised volatility on each business day is defined as the volatility of the Underlying Index over the previous twenty business days.

At inception, the issue price is \$1 per Unit. However, investors are only required to pay \$0.80 per Unit upfront. The Products will distribute a fixed coupon of 3.08% p.a., which will be reinvested back into the Products to increase the protection level at maturity, thereby equalling the issue price. Investors will also have the potential to receive annual variable coupons during the investment term, subject to the performance of the Reference Index, a high water mark, and a coupon hurdle rate.

At the end of the term, each Unit of investment will have a final value that is at least equal to the issue price, plus any increase in the Reference Index above the sum of all variable coupons paid during the term and the final hurdle rate. The calculation of the

Final Reference Index Value is subject to quarterly averaging in the final year of the investment term. At maturity, the issuer intends to deliver a basket of ASX-listed securities equal to the final value per unit. Alternatively, investors can choose to receive cash via the Agency Sale Option.

The capital protection (which includes reinvestment of the fixed coupon payments) is provided by NAB, while any variable coupons during the term, as well as capital gain at maturity, are provided by RBS. Although the Products have NAB as the capital protection provider, the investors are still subject to the joint credit risk of both RBS and NAB under the legal structure.

Analysis conclusion

In summary, cash-locked geared investors, and investors using their own funds, may find these to be low-risk Products with the potential for good growth if the underlying futures strategy continues to function for much of the next six-and-a-half years. The Products are unlikely to be attractive to investors seeking strong growth as for a direct equity product. Adviser Edge rates the Products well for three reasons.

Firstly, the quantitative testing demonstrated that the Products have an efficient structure which operates well with the Underlying Index. The dynamic volatility target strategy takes advantage of the accepted correlation of volatility and returns of the Underlying Index, and provides important downside protection while maintaining the potential to benefit from any rally in the Underlying Index.

The potential variable coupon payments can be seen as a profit lock-in mechanism, which has the effect of gradually securing gains for investors during the investment term. The fixed coupon payments provide investors with a minimum return even if the Reference Index fails to perform. The Underlying Index has an average historical realised volatility of 3.84% p.a.¹ If the volatility stays below 6% p.a., the Products would have a participation of more than 100% to the Underlying Index. Compared to other volatility target-style investment products, where the structure tends to limit volatility by reducing the average exposure to below 100%, these Products actually increase exposure and enhance investors' potential returns. The back-testing results are good, as

¹ The Underlying Index has been live since 1 July 2009. The historical performance back to August 1997 was back-filled using back-tested data.

the Underlying Index's strong historical performance and low volatility allow the Products to perform well in this structure.

Secondly, the Products provide Australian investors with unique and efficient access to the performance of the Aquantum Pegasus EL Excess Return Index (without any foreign exchange exposure), while providing full capital protection on the investment amount. The NAB investment loan also allows investors who currently have a loan facility tied up with another non-performing investment, such as a cash-locked structured product from previous years, to break away and regain exposure to this Reference Index.

Thirdly, the Products provide significant diversification benefit in a portfolio setting. By applying a volatility target overlay on top of a market-neutral absolute return strategy, the Products can potentially deliver consistent absolute returns while maintaining a low correlation to other asset classes.

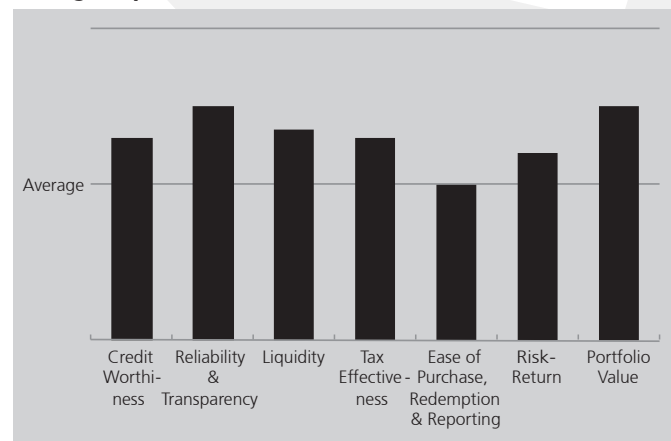
The Products have three primary drawbacks. Firstly, the Products have a complicated payoff structure. The Products have multiple layers of calculation, which make it difficult for investors to understand the behaviour and pricing of the Products in different scenarios. There are also multiple parties involved and they are vital for the continuation of the Reference Index. These entities include the Underlying Index Sponsor (Aquantum SARL), the Underlying Index hedging counterparty (RBS Group), and the Reference Index sponsor (the Royal Bank of Scotland plc). Should any of these entities be unable to continue fulfilling their role, the Products may be subjected to early termination with no guarantee of the minimum final value. Secondly, the potential capital gain at maturity is affected by both the averaging technique and the final hurdle rate. While the averaging technique reduces the volatility of the returns to the investors, it also dampens the maximum potential capital growth that the Products may achieve. In the case of this low volatility Underlying Index, that drawback should not be as significant as with standard equity underlyings. The third main difficulty for investors is the uncertainty surrounding the longevity of the underlying futures strategy. It is based on a long-standing anomaly in the commodity market which does not appear to be changing currently. However, it is a strategy that is easily replicable by other hedge funds or traders, leaving the possibility that in the future there may be such a large volume of transactions following the same strategy that excess returns will be reduced or removed. If this occurs, it will become necessary to change the Products' underlying strategy, the success of which will depend on Aquantum SARL (Aquantum) in particular.

Investors should acknowledge that fees of up to 3.65% p.a. (excluding the 15% performance fee) are charged on the Underlying Index and incorporated into the calculation of the Reference Index. The 15% performance fee is charged only on outperformance above the high water mark. Although the

Products do not explicitly charge any other fees on the volatility target structure, the fees have been implicitly built into the Products, and have been affected by other features including the coupon hurdle rate for variable coupons, and the final hurdle rate and averaging technique used to calculate the final value of the Products. The analysis in this report takes these fees into account, including the performance fee, finding nonetheless a promising return potential for the level of risk.

Investors should also acknowledge that the capital protection provider, NAB, only has a contractual relationship with the issuer in relation to the capital protection hedge. Investors do not have a contractual relation with NAB. Therefore, if the issuer becomes insolvent at maturity, the investors will become unsecured creditors of the issuer and will not have the right to directly receive the capital protected amount from NAB.

Rating snapshot



Investor Suitability

Adviser Edge considers the Products to be most relevant for investors who have a strong view regarding the ongoing performance of the Aquantum Pegasus EL Excess Return Index, and who believe that the index's volatility will remain low around the long-term average for the next six-and-a-half years.

Investors with an existing geared investment in another cash-locked structured product are suited to these Products, as the loan facility provided by NAB will fund up to 20% break cost from the existing investment and thereby allow investors to make a new investment with an equal notional exposure. The Products also offer all borrowed investors an efficient means of gearing into the Reference Index with a medium-term investment horizon. The Products represent an attractive investment for cash investors as the structure provides a definite limit to the risk of downturns in the Underlying Index, while providing a potential high income and growth investment profile. Investors with an existing portfolio may consider investing in the Products to achieve greater diversification.

In summary, cash-locked geared investors and investors using their own funds may find these to be low-risk Products with the potential for good growth if the underlying futures strategy continues to function for much of the next six-and-a-half years. The Products are unlikely to be attractive to investors seeking strong growth in the manner of a direct equity product.

Adviser Edge is not a taxation expert and does not advise on the tax effectiveness of these Products. However, the tax effectiveness will be an important pre-condition for an investor borrowing to invest. Investors should seek professional taxation advice regarding their specific circumstances.

NAB Re-Strike Deferred Purchase Agreements (Series 4 and 6) – Product Characteristics

Asset Class	Australian Equity		International Equity		Commodity	Hedge Fund
	Foreign Exchange		Volatility	Property		Fixed income
Borrowing	No	Partial	Full	Choice		Internal
Investment Horizon	< 1 year	1–3 years	3–5 years	5–7 years	> 7 years	> 10 years
Interim Cash Flow	Net cash outflow ¹		No cash flow		Net cash inflow ¹	
Counterparty Risk	Low		Medium		High	
Market Risk*	Low growth – low risk		Medium growth – medium risk		High growth – high risk	
Self-managed Super Funds	Yes			No		

* This refers to the Products in isolation, not the investor. The suitability to a particular investor depends on the investor's overall portfolio construction. A Low Risk product is closer to high grade fixed income, whereas a High Risk product is closer to direct equity.

¹ Fixed coupons are required to be reinvested back into the Products, yet investors will be liable to pay income tax in relation to the fixed coupons. If the Products do not distribute any variable coupons, investors would experience a net cash outflow for the tax paid on fixed coupons. A net cash inflow will occur when the variable coupon amount is greater than the individual investor's tax liability derived from the fixed coupon payment.

Product Details

Legal Structure

Product Name	NAB Re-Strike Deferred Purchase Agreements – Series 4 and 6
Issuer/Responsible Entity	RBS Group (Australia) Pty Limited
Custodian	RBS Group (Australia) Pty Limited
Capital Protection Provider	National Australia Bank Limited
Investment type	The Units are unlisted and close-ended deferred purchase agreements
Offer close date	30 September 2010 for Series 4, and 30 November 2010 for Series 6
Maturity	14 April 2017 for Series 4, and 14 June 2017 for Series 6 (approximately six-and-a-half years)
Liquidity	Monthly on the last business day of each month commencing on March 2011.
Delivery	A basket of Australian shares containing equal values of shares in the following companies: BHP Billiton Limited, Commonwealth Bank of Australia, Westfarmers Limited, Telstra Corporation Limited, and Woolworths Limited.
Minimum investment and loan amount	The minimum amount that an investor may invest is 20,000 Units, or \$16,000 with additional multiples of 1,000 Units or \$800.

Economic Features

Investment strategy	The Products provide varying levels of exposure to the Aquantum Pegasus EL Excess Return Index depending on the realised volatility of the index and the volatility targets predefined at the start of the investment.
Underlying Index	Aquantum Pegasus EL Excess Return Index. The FX risk of the Underlying Index is fully hedged.
Participation	The participation rate will vary between 0% and 145% depending on the realised volatility of the Underlying Index.
Capital protection	100% of the issue price at maturity. At inception, the issue price of each Unit is \$1.00. Investors are only required to pay \$0.80 per Unit and the remaining \$0.20 is paid by the investor over the investment term through the re-investment of the fixed coupon.
Distributions	The Products will pay a fixed coupon of 3.08% p.a. which must be re-invested. Investors also have the potential to receive annual variable coupons during the investment term, subject to a partial growth percentage, coupon hurdle rate and high water mark.
Capital gain at maturity	The Products may return a capital gain at maturity to the investors subject to the Final Reference Index Value, variable coupons paid during the term and 6.5% final hurdle rate.
Loan	An investment loan is provided by NAB. Investors can borrow up to 100% of the issue price per Unit for the purpose of investing \$0.80 per Unit, and using the remaining capital to break away from an existing non-performing investment. Investors also have the option of obtaining a loan from other external lenders to invest in the Products.

Fees

Ongoing fees	<p>There are no other ongoing fees charged by the Products apart from those charged on the Underlying Index. The Underlying Index may charge fees of up to 3.65% p.a. (excluding the 15% performance fee). The 3.65% fees include:</p> <ul style="list-style-type: none"> • 1.20% p.a. Access Costs which can vary from 1.00% to 1.75% p.a. • 0.95% p.a. Licensee Management Fee which can vary from 0.75% to 1.40% p.a. • 0.35% p.a. Licensor Management Fee which can vary from 0.30% to 0.50% p.a. <p>The 15% performance fee is charged only on the outperformance above the high water mark.</p>
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Product Highlights

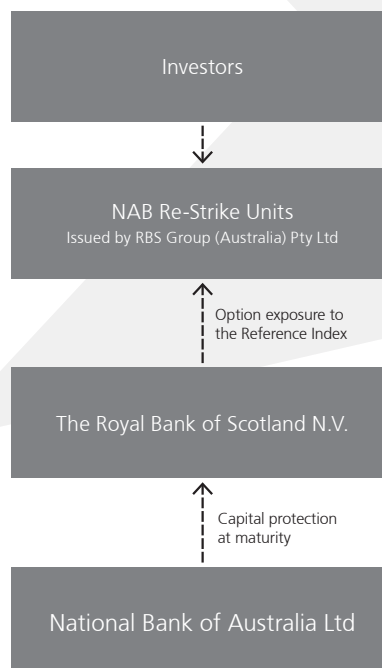
- The Underlying Index, the Aquantum Pegasus EL Excess Return Index, references a diversified portfolio of 24 commodity futures from various sectors including energy, metals, agriculture, and livestock. Based on two complementary systematic trading programs, simultaneous long and short positions are established in certain futures contracts with the aim of benefiting from convenience yield and liquidity premiums. The index is denominated in USD and is published daily.
- The Underlying Index uses 3.5 times leverage on both long and short positions for every US\$1 invested. Although the notional leverage is substantial, the two trading programs have offset positions in those months where both are able to be employed together. Therefore, the typical price movement of the underlying strategy is small.
- The two programs within the strategy are strictly rule-based, and are consistent over time. Program One (P1) takes long and short positions in all commodities in the Underlying Index, and aims to generate returns from liquidity premium. The program achieves this by shorting a near-term contract and buying a longer-dated contract to create a net position, which profits from a steepening positive (contango) futures curve. On the other hand, Program Two (P2) takes positions in certain commodities at certain times of the year to generate returns from the convenience yield. The program achieves this by buying a spot-month contract and shorting the next contract on the futures curve to create a net position which profits from a flattening or a movement towards a negative shaped futures curve (backwardation). The two programs are operating in tandem to create a more neutral position and to reduce the effect from the overall shape of the futures curve.
- The Underlying Index has only been live since 1 July 2009, and therefore has a track record of just over one year. The historical performance of the Underlying Index is back-filled by applying the same rules-based strategy to the commodities. The back-filled historical performance dates from August 1997.
- The Underlying Index is created and sponsored by Aquantum SARL. RBS Group acts as the hedging counterparty for the Underlying Index. Future Value Consultants Limited undertakes the role of Calculation Agent for the Reference Index. The Royal Bank of Scotland plc acts as the Index Sponsor for the Reference Index.²
- A committee comprised of members from Aquantum and RBS Group, is responsible for ensuring that the strategy of the Underlying Index continues to perform in accordance to its investment mandate. The committee meets semi-annually, or on an ad hoc basis in urgent circumstances, to review the liquidity and suitability of the commodity futures. The committee may replace or change allocations in some of the commodities if appropriate. This has not been necessary during the live period of the index.
- The Reference Index, the Risk Stabilised Aquantum Pegasus EL1 Strategy Index, applies a volatility target strategy to the Underlying Index after deducting the access cost, the licensee management fee, the licensor management fee and the performance fee. These fees may reach a total of 3.65% p.a., excluding the 15% performance fee which is charged only on outperformance above the high water mark. The volatility target strategy calculates the participation to the Underlying Index on a daily basis. The participation is determined by comparing the maximum realised volatility of the Underlying Index observed on that specific calculation date, and the previous four consecutive business days, to the target volatility predefined prior to the start of the investment. The realised volatility on each business date is defined as the annualised volatility of the Underlying Index over the recent twenty business days. Participation can range from a minimum of 0% to a maximum of 145%.
- According to the volatility targets, the Reference Index would have more than 100% participation to the Underlying Index, as long as the five-day maximum realised volatility of the Underlying Index is below 6%. If the maximum realised volatility falls below 4%, the participation would increase to 145%. Over the 13 years since August 1997, when the back-filled historical performance started, the average realised volatility of the Underlying Index is 3.84%. Over the same period, the realised volatility has remained below 6% in 91.5% of occurrences. As at 29 July 2010, the five-day maximum realised volatility of the Underlying Index was 3%.
- Investors can potentially receive up to three forms of returns, which include fixed coupon, variable coupon and capital growth at maturity. The issue price per Unit at inception is \$1 per Unit. However, the investors are only required to pay \$0.80 per Unit.
- Investors will receive annual fixed coupons of 3.08% p.a., regardless of the Reference Index's performance. However, all fixed coupons are required to be reinvested. The reinvestment of the fixed coupons will increase the capital protection from the initial investment of \$0.80 per Unit to \$1 per Unit at maturity. This represents a minimum return of 25% on the initial investment over the investment term. The investors are not subject to any additional fees in relation to the structure, which could offset against the fixed coupons.
- Investors may also receive annual variable coupons during the investment term. The variable coupon is determined by multiplying the partial growth percentage with the annual growth of the Reference Index above the high water mark and

² Refer to the technical appendix for details of the role of each entity.

- coupon hurdle rate. The partial growth percentage is determined by the issuer on the commencement date and will be set between 5% and 80%. As at the date of the PDS (16 August 2010), the partial group percentage would have been 40%. The high water mark is the highest level of the Reference Index on any of the previous annual observation dates known as the Coupon Determination Date. The Coupon Determination Dates for Series 4 are set annually on 14 October each year, commencing from 2011 to 2016. The Coupons Determination Dates for Series 6 are set annually on 14 December each year, commencing from 2011 to 2016. The coupon hurdle rate is determined by the issuer on the commencement date and will be between 0% and 10%. As at the date of the PDS (16 August 2010), the coupon hurdle rate was set at 5%. The distribution of fixed and variable coupons does not affect the daily valuation of the Reference Index.
- At maturity, the investors will have a minimum product value of \$1 per Unit, subject to NAB fulfilling its obligation to deliver the promised protection amount. The capital protected amount will be passed on from NAB to the investors through RBS, as the capital protection hedge is a contractual relationship between the issuer and the capital protection provider. In the event that the issuer became insolvent, there is possibility that investors will not receive the full capital protected amount at maturity even if NAB fulfils its obligation, as the issuer would not be able to distribute the capital protected amount to the investors.
 - Investors may potentially receive a capital growth based on the Final Reference Index Value. The Final Reference Index Value is the arithmetic average of the Reference Index values recorded on the five quarterly observation dates (also known as the maturity averaging dates) in the last year of the investment term. The increase in the Final Reference Index Value must exceed the sum of all variable coupons paid during the investment term plus the 6.5% final hurdle rate for the Products to deliver a final capital growth payout.
 - The five maturity averaging dates occur on a quarterly basis, starting from 12 months prior to the maturity date, and finishing at the maturity date. The averaging technique can have a positive or negative effect on the final return, depending on the behaviour of the Reference Index in the final year. If the Reference Index rallies in the final year then the averaging will harm the return from the Products. On the other hand, if the Reference Index falls in the final year, the averaging technique would have a similar effect as a profit lock-in mechanism.
 - The foreign currency exposure of the Products is fully hedged. The hedging cost is built in the structure and the investors are not required to pay any fees in relation to the hedging.

- The capital protection is provided by NAB. Therefore, if the Products' final value falls below the issue price, investors will be subject to the credit risk of NAB in providing the capital protection, and the credit risk of RBS in delivering the capital protected amount from NAB to the investors. On the other hand, as RBS is the provider of the performance contract, investors will only rely on the credit quality of RBS to deliver variable coupons and a final capital growth payout at maturity if the Reference Index performs strongly during the investment term.
- NAB is rated AA by S&P and Fitch, and Aa1 by Moody's.
- RBS is rated A by S&P, A1 by Moody's, and AA- by Fitch.
- The Deferred Purchase Agreements stipulate that the investors will receive a basket of ASX-listed shares at maturity. Alternatively, if the investors use the Agency Sale Option, the delivery assets are transferred and sold on their behalf in order to deliver cash.
- The Products offer a monthly buy-back facility. However, investors may be subject to significant break cost in the event of early redemption due to market movements. Geared investors may also be subject to loan break costs.

Transaction Flow Diagram



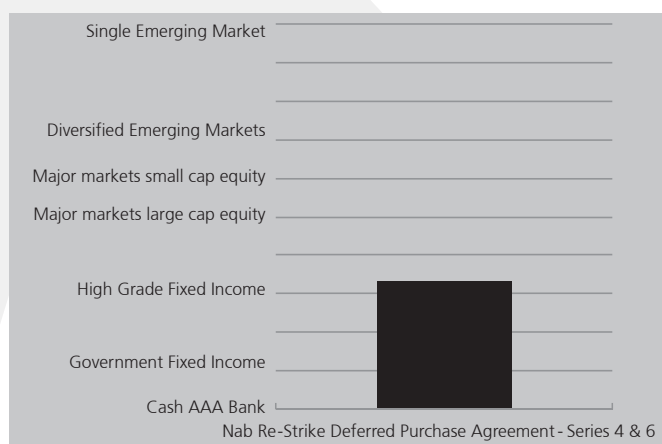
Asset allocation

If an investment into the Products commenced on 29 July 2010, the five-day maximum realised volatility of the Underlying Index would have roughly been 3%, resulting in an initial participation at the maximum level of 145% within the structure. As such, while the investors only have to invest 80% of the issue price for each Unit at inception, the structure would have provided the investors with an allocation equal to 145% of the issue price in the Underlying Index. This effectively represents over 180% leverage if compared to the initial investment.³ The allocation within the volatility target structure can change during the term of the investment, and can reach a low of 0% or a high of 145%.

Risk-return spectrum

The returns from the Products in most market environments are much less risky than a direct investment in a well-diversified, large capitalisation equity portfolio, and slightly more risky than high grade fixed income securities due to the following reasons:

- The Underlying Index is an absolute return market neutral strategy with a very low level of volatility.
- The volatility target overlay further limits the volatility of the Products although it can have a maximum geared exposure of 145% to the Underlying Index.
- The foreign currency exposure of the Products is fully hedged.
- The reinvestment of the fixed coupons during the term will increase the capital protection from \$0.80 per Unit to \$1 per Unit.
- The Products may lock in interim profit through the distribution of variable coupons.



Fat tail view

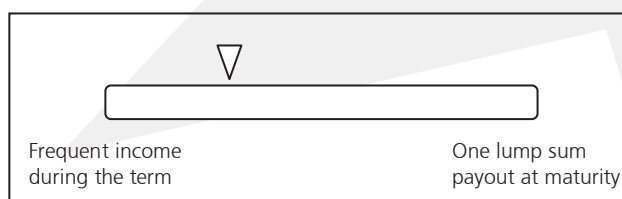
In the fat tail section, Adviser Edge focuses on the Products' downside fat tail, which is the probability of the Products returning below 0%, or below -20%. Adviser Edge believes that the Products have a low tail risk for non-geared investors, and an above average tail risk for geared investors who are using an investment loan.

The Products are seen to have a small tail risk for non-geared investors due the fact that even in the worst scenario the Products will still return a minimum of 3.08% p.a. through the distribution of the fixed coupons. Investors are not subject to any fees in relation to the structure, which could offset against the fixed coupons. As long as the capital protection provider fulfils its obligation and the issuer is still solvent, the investors will receive a minimum of \$1 per Unit at maturity (\$0.80 from initial investment, and \$0.20 from the fixed coupons). This represents a minimum return of 25% on the initial investment over the investment term.

A geared investment in the Products would still have an above average tail risk. In the worst scenario, investors may only receive the capital protected amount at maturity without any variable coupons during the term. The geared investors may lose all the interest expenses over the six-and-a-half year term, which could be substantial on a pre-tax basis.

Frequency of cash flow

The Products present investors with the opportunity to receive cash inflows during the investment term and at maturity. The investors have the potential to receive cash in relation to annual variable coupons in the first six years of the investment. At maturity, the Products will return the initial investment, all fixed coupon payments, and any potential final capital growth payout to the investors.



³ Assuming that an investor invested \$0.80 of the \$1.00 issue price. Leverage would be further compounded for geared investors.

Pros

Risk and return

- The Underlying Index has a transparent and clear rules-based investment strategy. The strategy would have performed remarkably well if it was applied to market over the last 13 years. The simultaneous long and short positions taken by the strategy will create a market-neutral position, which will minimise the volatility.
- The Products' structure fits well with the Underlying Index. The volatility target strategy ensures that investors will not be subject to cash lock. Furthermore, the overlay can provide leveraged exposure to the Underlying Index, and reduce losses when the Underlying Index experiences highly volatile downward trend. The strategy operates most efficiently on underlyings with low and stable volatility, and steady positive performance. Over the past thirteen years of back-tested and live performance, the Underlying Index has exhibited an extremely low average realised volatility of 3.84% p.a., and the realised volatility has remained below 6% in 91% of occurrences. The low level of volatility would increase the structure's exposure to the Underlying Index to above 100%. Unlike some other volatility target products, which tend to reduce the volatility of the reference asset by lowering the participation, these Products actually increase the volatility by having a geared exposure to the Underlying Index.
- The Products provide a good balance of income and capital gain. Based on the back-testing analysis, the Products would, on average, generate close to half of the total returns in the form of income derived from variable and fixed coupons, and the other half as capital gains.
- The variable coupon payments work as an efficient profit lock-in mechanism in periods of strong performance, securing early gains for investors.
- The back-testing of the Products showed that it would have been able to generate strong returns during most periods analysed. This is a result of robust historical performance and low volatility from the Underlying Index. Adviser Edge has conducted back-testing to examine the effectiveness of the structure when overlaid on top of the Underlying Index. Adviser Edge acknowledges that the Underlying Index's behaviour may change in the future, and that past performance should not be used as a guide for future performance.

Portfolio value

- The Products provide a means for cash-locked investors to regain market exposure, with the NAB loan facility funding up to 20% break costs.
- The Products provide innovative and unique market access to the Underlying Index. The volatility target strategy is also a well-known trading strategy to many advisers and investors.
- The Products could be used as a direct substitute for other absolute return strategies in a portfolio setting, as they could offer good returns with limited downside risk.
- The Underlying Index is an alpha-focused strategy that provides strong diversification benefits due to non-correlated returns.
- The Products' diversification is further improved by the currency hedging within the structure.

Credit worthiness

- The credit rating of the capital protection provider is at the high end of the current spectrum for banks. NAB is rated AA by S&P and Fitch, and Aa1 by Moody's.

Reliability and transparency

- Adviser Edge considers RBS to be experienced and reliable at providing volatility target-style investment products.
- RBS Group is a well-established structured product issuer, with a presence both in Australian and overseas. It has strong resources and the capabilities to support the operations of structured products.
- The Underlying Index is supervised by a committee which includes members from Aquantum and RBS Group. The committee meets semi-annually and is responsible for supervising the current operations and ongoing viability of the strategy.
- The underlying strategy itself is extremely transparent, and has performed in highly liquid markets.
- Although Aquantum is a relatively young firm, its founder has extensive previous experience in managing systematic trading programs and alpha-type strategies.

Cons

Risk and return

- The Underlying Index's strategy is simple and relatively easy to replicate. There is a possibility in the future that the Underlying Index may not perform as strongly as it would have in the past, due to the crowding-out effect created by large trading positions taken by other investors or funds adopting similar strategy.
- The Underlying Index does not incorporate a self-enhancing mechanism. This means that the strategy does not automatically evolve over time to adapt to new market environments. The back-testing shows that the strategy would have performed well in the past 13 years, but there is a possibility that a change in market conditions may make the strategy inefficient and obsolete. There is no clear replacement strategy available if this occurs, and a new solution would need to be found at that time.
- The Products have a relatively long investment term (six-and-a-half years), which ties up investors for a longer period of time than their current cash-locked investment and also increases the risk of an early maturity event occurring over the term.
- The coupon hurdle rate will reduce the amount of potential annual variable coupon or profit lock-in generated by the structure during the term.
- The 6.5% final hurdle rate can be seen as an additional 1% performance fee p.a., and will reduce the potential final capital growth at maturity.
- The fundamental theory of the volatility target strategy relies heavily on the negative relationship between realised volatility and future return. If this market behaviour breaks down, the Products may perform poorly.

Credit worthiness

- The capital protection hedge is a contractual relationship between the issuer and the capital protection provider. Investors do not have a contractual right to receive benefits directly from NAB. Therefore, investors may not be able to receive the full protection benefit in the event that the issuer becomes insolvent.
- The investment is subject to the credit risk of a number of parties. Although the performance is provided by RBS, should either the Underlying Index Sponsor (Aquantum) or the hedge provider (RBS Group) cease to be able to perform their roles, investors may be subject to an early maturity event, and in turn the risk of receiving redemption less than the minimum final value.

Reliability and transparency

- The Underlying Index Sponsor, Aquantum, is a young entity. It was established in 2009 by two key individuals, Thomas Morrow and Daniel Bain.
- If the strategy of the Underlying Index becomes inefficient or impractical at some point in time, the committee may need to formulate a new trading system to replace the existing strategy. The ongoing performance of the Underlying Index may then be influenced by the discretion of the committee, and remains subject to the key person risk of the Underlying Index Sponsor.
- Although the Reference Index's volatility target strategy is governed by pre-defined rules and formulae, the calculation methodology is complicated and difficult for investors to comprehend.

Tax Features⁴

- The investors will be required to fully reinvest the fixed coupons. As such, the investors will not receive any cash inflow in relation to the fixed coupons until maturity. However, investors would still incur income tax liabilities during the term, and may have to fund the amount using other sources of revenue.

Liquidity

- Investors may incur significant break costs due to market movements if the Products are redeemed before maturity. The break costs are common to most of the closed-ended structured products in the market, and are not specific to these Products.

⁴ Adviser Edge does not purport to be a taxation specialist and the comments made here are of a general nature based on the knowledge of Adviser Edge from previous publicly available structured products. All investors should seek specialised and personalised taxation advice regarding the Products. The comments throughout this product assessment assume that the investor is an Australian resident individual not carrying on a business in trading investments.

Summary of Quantitative Testing

Adviser Edge has conducted a number of quantitative analyses, and has reached the following conclusions.

- The Underlying Asset has a historical average volatility of 3.84% over the thirteen years of combined back-tested and live periods. This is much lower than the 6% volatility target required to gain 100% exposure in the structure. If the volatility of the Underlying Index remains below 4% at the historical average, the structure will have 145% exposure to the Underlying Index. The low level of realised volatility will increase the Products' exposure to the Underlying Index, and thus investors will benefit more from positive index movements. Unlike other volatility target-style products, which tend to reduce volatility by lowering participation to the reference asset in order to lower the cost of structuring the investment, these Products leverage the exposure and increase the volatility.
- Since the start of the back-tested data in August 1997, the realised volatility of the Underlying Index has only risen above 6% in 8.5% of occurrences. This means that in 91.5% of the historical period, the structure would have had an exposure of more than 100% to the Underlying Index. At the peak of the GFC in February 2009, the realised volatility of the Underlying Index had only risen to 6.8%, resulting in a participation of 80%.
- The Underlying Index is expected to have low volatility as long as the strategy continues to offset positions for each commodity. The market-neutral strategy should continue to work well with the volatility target structure, and should benefit investors through the leveraged exposure.
- The Products would have performed very well in most of the back-testing scenarios, generating an average net return of 21% p.a. including coupons and capital growth at maturity. The returns would have been sufficient to fully cover borrowing costs of an investment loan in most cases.
- The attribution breakdown of the historical total return from the Products indicates that 10% of the total return usually comes from fixed coupons, while variable coupons and final capital growth comprise 34% and 56% of the total return respectively.
- In calculating the annual variable coupon, the coupon hurdle rate represents a barrier for which the Reference Index must exceed the high water mark by more than 5% (indicative coupon hurdle as at the date of the PDS) before the Products deliver any variable coupon. The coupon hurdle rate may not represent a cost for investors if the Reference Index rallies during the whole term, as any gain which has not been locked in by the variable coupon earlier will be returned back to the investors in the form of capital gain at maturity. However, the coupon hurdle rate can have a negative influence, particularly in an up-and-down market scenario where the investors may not receive any capital gain at maturity and would have lower variable coupons during the term as a result of the coupon hurdle rate.
- The final hurdle rate at maturity represents an implicit performance fee charged by the issuer. The final hurdle rate will lower the capital gain by a total of 6.5%, or approximately 1% p.a.
- Scenario analysis concludes that the Products perform best when the Underlying Index gradually rises with low volatility during the term, as the Products would maximise the leveraged exposure to the Underlying Index and benefit from the consistent upswing (refer to Figure A5 in the Technical Appendix for hypothetical scenario).
- The Products also perform well if the Underlying Index falls sharply. The sudden increase in volatility would trigger the Products to lower their exposure to the Underlying Index, limiting further falls in value (refer to Figure A6 in the Technical Appendix for hypothetical scenario).
- The Products perform less favourably if the Underlying Index falls and then quickly recovers in a volatile 'v' shape manner. As the volatility remains at a high level after a big fall, the Products will benefit very little from the sudden recovery of the Underlying Index due to lower participation, resulting in a much worse performance compared to a direct investment in the same underlying over the positive return period (refer to Figure A7 in the Technical Appendix for hypothetical scenario).
- The Products perform worst when the Underlying Index demonstrates negative returns and low volatility at the same time. In that scenario, the Products would increase participation to the falling index value and result in a bigger loss (refer to Figure A8 in the Technical Appendix for hypothetical scenario).

Technical Appendix

Aquantum Pegasus Index

Aquantum SARL is a Luxembourg-based specialist provider of absolute return strategies. It developed the Pegasus indices, which are USD-denominated commodity market-neutral investment products that track the performance of an advanced commodity futures trading strategy. Each index references a large portfolio of commodity futures from various sectors. The Aquantum Pegasus EL Excess Return Index is an extra-liquid version of the Aquantum Pegasus Index. It relies on RBS Group, which acts as the hedging counterparty.

The Aquantum Pegasus EL Excess Return Index has demonstrated consistent and strong historical performance over the back-tested and live periods from August 1997 onwards. Since then, the index has generated a total growth of 726%, or a compound return of 16.5% p.a. Over the past two years, the index has performed well against the financial crisis, and has generated an annualised return of 6.9%. The index has returned a total of 6.0%, or 5.5% p.a. over the thirteen-month live period to August 2010.

Volatility targeting strategy

The Risk Stabilised Aquantum Pegasus EL1 Strategy Index (USD) is calculated and maintained by Future Value Consultants Limited (Reference Index Calculation Agent), based on a methodology

developed by The Royal Bank of Scotland plc (Reference Index Sponsor).⁵ Future Value Consultants Limited is a United Kingdom-based independent organisation that specialises in structured products and derivatives strategies, and acts as the index calculation agent for this Reference Index as well as 47 other indices. The volatility target strategy aims to deliver outperformance by increasing exposure to the Underlying Index in upward trends and decreasing exposure in downward trends (see PDS page 12 for details regarding the realised volatility level and exposure). Success of this strategy is hugely influenced by the correlation between future return and realised volatility. Fees of up to 3.65%p.a. (excluding the 15% performance fee which is charged only on the outperformance above the high water mark) are incorporated into the calculation of the Reference Index. These fees are deducted from the return on the Underlying Index (Aquantum Pegasus EL Excess Return Index).

Investors are reliant on Aquantum for the continued management of the strategy of the Underlying Index, on RBS Group for the liquidity provision and hedging operation, and on Future Value Consultants Limited for Reference Index calculation. Should any of these organisations cease to be able to provide their respective services, this may trigger an early maturity event.

⁵ The Reference Index is expressed in USD. However, in calculating the returns of the Products, the absolute value of the Reference Index is used and the currency is ignored. The Coupon and Maturity Value of the Products are calculated with reference to the absolute value increase in the Reference Index over the relevant investment term and, therefore, there is no exposure to any foreign currency.

Figure A1: Participation Rate and Volatility as at 13 August 2010

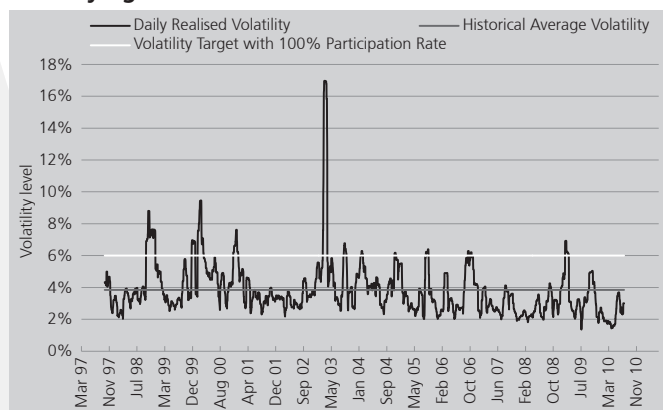
Lower	Upper	Participation Rate
0.00%	4.00%	145.00%
4.00%	5.00%	120.00%
5.00%	6.00%	100.00%
6.00%	7.50%	80.00%
7.50%	10.00%	60.00%
10.00%	15.00%	40.00%
15.00%	20.00%	30.00%
20.00%	30.00%	20.00%
30.00%	40.00%	10.00%
>40.00%		0.00%

Figure A2: Historical returns of the Underlying Index and Reference Index, as at 29 July 2010

	6 Months	1 Year	2 Years Annualised	3 Years Annualised	5 Years Annualised	7 Years Annualised
Underlying Index	1.4%	6.0%	6.9%	9.4%	13.9%	18.3%
Reference Index	-0.7%	2.5%	3.6%	6.6%	12.0%	16.1%
S&P GSCI Total Return Index	0.6%	-1.8%	-32.7%	-12.8%	-8.3%	0.5%
S&P 500 Index	2.6%	11.5%	-6.8%	-8.9%	-2.2%	1.5%

The Underlying Asset has performed well during the financial crisis. Over the last seven years, the strategy has returned an annualised return of 18.3% p.a. Although the Reference Index with the volatility target structure has a leveraged exposure to the Underlying Index in most circumstances, the performance was lowered by various fees, which may total up to 3.65% p.a. (excluding the 15% performance fee which is charged only on the outperformance above the high water mark).

Figure A3: Historical 20-business-day volatility of the Underlying Index



The long-term average of the 20-business-day rolling volatility is 3.84%, which is much lower than the 6% volatility target required for 100% participation in the Products. The historical volatility has risen above 6% in only 8.5% of cases.

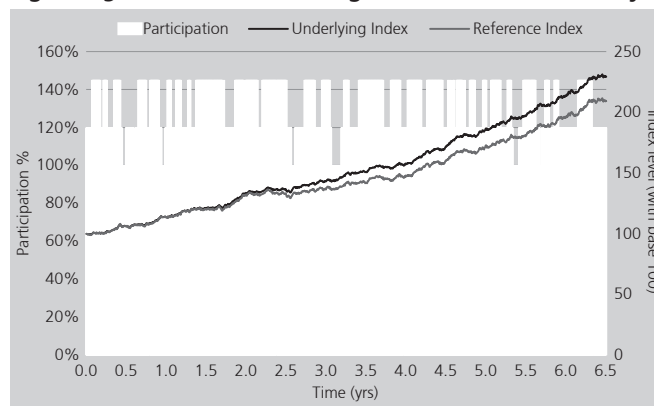
Figure A4: Back-testing of the Product

Attribution Analysis of Product Return	Total return over the whole term	Annualised return
Fixed Coupons	25.0%	3.5%
Average Variable Coupons	83.4%	9.8%
Average Capital Growth at Maturity	137.6%	14.2%
Average Total Return	246.0%	21.0%

The results of the back-testing shown in the above table were produced by considering 76 overlapping periods of six-and-a-half years, with the first period starting on 31 October 1997 and the last on 31 January 2004.

The table shows the breakdown of average back-testing return from the Products for a non-g geared investor. The analysis assumes that investors will only be required to invest 80% of the issue price per unit at inception. At maturity, the investors will receive an increase in protection equal to 20% of the issue price as a result of reinvestment of the fixed coupons. Therefore, relative to the initial investment, the total return from fixed coupons is 20/80, or 25%. The total return is the sum of returns from fixed coupons, variable coupons, and capital growth at maturity.

Figure A5: Scenario with strong return and low volatility*

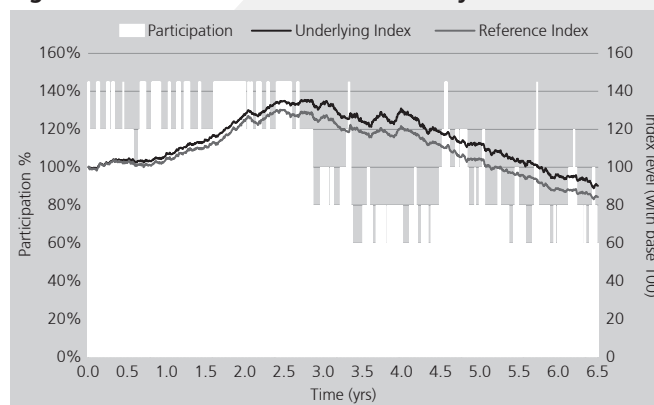


* This figure represents a hypothetical case specifically chosen by Adviser Edge to demonstrate the behaviour of the Products in different scenarios. It is not taken from the past performance of the Underlying Index. A partial growth percentage of 40% and a coupon hurdle rate of 5% are used in the payoff calculation.

As demonstrated by Figure A5, the Products perform best in an environment with high returns and low volatility. The low level of volatility allows a higher participation to the Underlying Index, and therefore the Products benefit more from the upside rally. In this scenario, the Underlying Index has an average realised volatility of 3.96% and the participation has remained above 100% for the whole term. Assuming that the initial investment is \$80 for a non-g geared investor, the total variable coupon distributed during the term is \$27, or 34% of the initial investment, and the final capital growth payout at maturity is \$62, or 78% of the initial investment.

Note that the Reference Index still underperforms the Underlying Index in a favourable scenario because the Reference Index takes into account all the fees, whereas the Underlying Index does not.

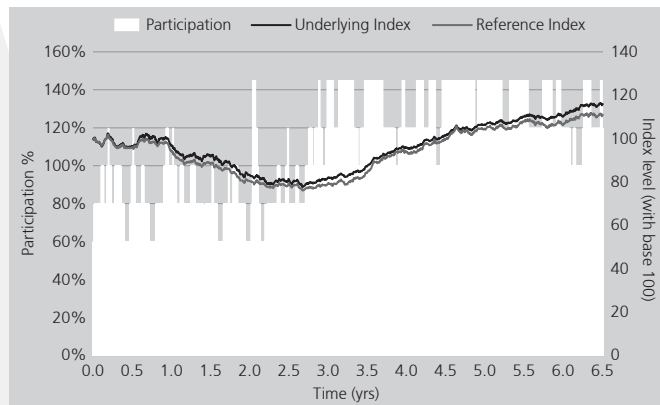
Figure A6: Scenario with fall after a rally*



* This figure represents a hypothetical case specifically chosen by Adviser Edge to demonstrate the behaviour of the Products in different scenarios. It is not taken from the past performance of the Underlying Index. A partial growth percentage of 40% and a coupon hurdle rate of 5% are used in the payoff calculation.

If the Underlying Index falls dramatically, the increasing volatility will reduce the Products' participation rate and limit the extent of further drops in strategy value. In this case the Products would have returned a total variable coupon of \$6, or 8% over the term. There is no capital gain at maturity, as the Final Reference Index Value has fallen below the initial value of the Reference Index at inception. The Products would have performed better than the Underlying Index after fees as it returns the initial investment plus the fixed coupons at maturity while the Underlying Index suffers a capital loss.

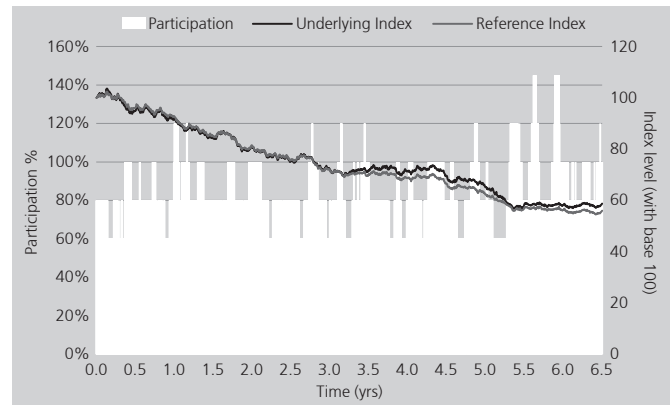
Figure A7: Scenario with recovery after a fall*



* This figure represents a hypothetical case specifically chosen by Adviser Edge to demonstrate the behaviour of the Products in different scenarios. It is not taken from the past performance of the Underlying Index. A partial growth percentage of 40% and a coupon hurdle rate of 5% are used in the payoff calculation.

The Products performs less favourably than a direct investment if the Underlying Index recovers quickly after a big fall. As the volatility of the Underlying Index remains at a high level, the Products' exposure to the Underlying Index's upside movement would be limited. In this case, the Products would not have generated any variable coupons during the term, as the Reference Index has failed to go above the high water mark and coupon hurdle rate at all Coupon Determination Dates. The Products would have returned a capital gain of \$2 at maturity after the final hurdle rate. Investors would also receive all fixed coupons with a value equivalent to 20% of the issue price.

Figure A8: Scenario with gradual fall*



* This figure represents a hypothetical case specifically chosen by Adviser Edge to demonstrate the behaviour of the Products in different scenarios. It is not taken from the past performance of the Underlying Index. A partial growth percentage of 40% and a coupon hurdle rate of 5% are used in the payoff calculation.

The Products performs worst if the Underlying Index has gradual and consistent falls. As the Underlying Index's volatility remains at a relatively low level, the Products may have a substantial or even leveraged exposure to the falling Underlying Index, thus amplifying the extent of loss. In this case, the Products would not have generated any variable coupon or capital gain for the investors, as there is no profit lock-in during the term, and the Final Reference Index Value has failed to rise above the initial value at inception. Although the Products perform worst in this type of market scenario, it is still much better than a direct investment in the same Underlying Index. A direct investment would result in a capital loss. However, the Products would still return a total gain of 25% on top of the initial investment to the investors as a result of the fixed coupons.

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Report Date

27 August 2010