

**FUND PERFORMANCE:**

The Fund gained **11.20%** (net of all fees) for the June Quarter. The All Ordinaries Accumulation Index rose 3.94% in this period. For the seven months ending June 30th 2005 the Fund gained **25.56%** (net of all fees). The fund will pay a **1.98** cents per unit distribution for this period, along with a 0.42 cents per unit allocation of franking credits. See the table on page 5 for the Funds performance since inception on a monthly basis.

**BIG PICTURE:**

**End of Year Multi Choice Exam:**

*Please attempt all questions.*

**Question 1**

Volatility in stock markets is...

- A) Really frightening for investors and fund managers alike
- B) Totally normal – we should all sleep easy
- C) Topical this quarter only
- D) A reason to sell

**Question 2**

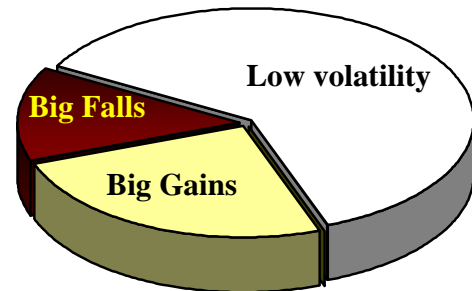
If a trader missed the best 10 months of share performance over 22 years, his performance would be...

- A) Totally normal – he could sleep easy
- B) Down significantly!
- C) A bit below the index
- D) Pretty good if he / she was a snappy trader

If you picked B&B you are correct! As you would be if you picked B&B (Babcock & Brown) on the day they listed. More on Babcock later. Firstly we will justify our exam marking methodology.

**ANSWER 1 (B) Volatility is totally normal**

*294 months from Jan 1981 – June 2005 ASX All Ordinaries Accumulation Index*

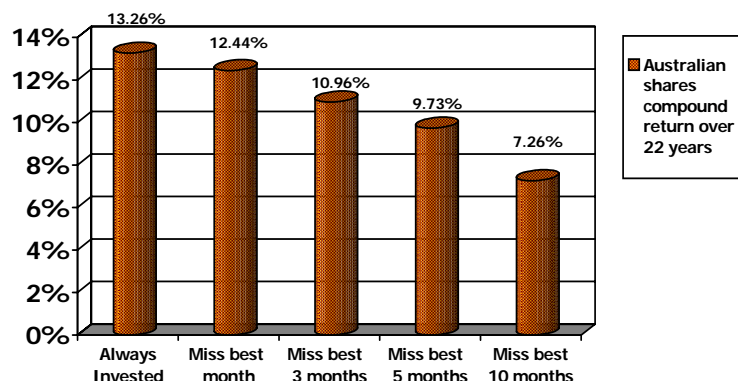


*Source: Bloomberg*

Our study found that investors should expect the market to be highly volatile at least a third of the time. 113 of 294 (38.5 %) months had high volatility. (We define high volatility as greater than 4% gain or loss in a month). Of the 113 high volatile months, 40 months (13.6 %) had big falls and 73 months (24.9%) had big gains. Interestingly 12 of these had falls and gains of more than 10% in a single month!

**ANSWER 2 (B) Down Significantly!**

*Australian share market January 1980 until December 2002 (263 months)*



*Source: Frank Russell Australia: Australian Financial Review 12/04/2003*

We present *Answer 1* as long-term empirical evidence of the normality of volatility. In this context, the Australian share markets volatility over the past two months has had a significant impact on our portfolio.

***“expect the market to be highly volatile at least a third of the time”***

We view this volatility as normal. And it presents opportunities. It is not something a long-term investor with a consistent investment process should fear.

Normally, we would not comment greatly on short-term results. However, the June 2005 quarter results provide an excellent example of volatility. We had a 15% swing within the quarter alone, including the 5% fall in April. We highlight this since the statistics do suggest that it will happen again. Being armed with this knowledge removes the surprise factor.

The historic “Frank Russell” data in *Answer 2* also highlights volatility. And it underlines the merit of long-term investment. The trader who sold out and missed the best 10 months in a 22 year period nearly halved his or her return. Investors and traders alike often sell out in periods of uncertainty created by volatility.

***“opportunities are thrown up by volatility”***

The key take away point is that your investment in the Selector Fund is likely to remain volatile in the short term and that as Manager of the Fund we expect this. It is our roll to communicate this to our investors. We believe it is part and parcel of successful long-term investing. Importantly as Manager, by accepting this fact and by embracing it, we remain alert to opportunities where others see fear.

It is also at these volatile points that our process and inherent investment disciplines are most valuable. We stick to the plan. We continuously review our positions and our group of future potential investment targets, using our live dynamic modelling, by attending meetings and reading widely. And we aim to pounce on the

right opportunities for the right reasons when they unfold.

Longer term, the opportunities that are thrown up by volatility, if selected correctly, should significantly outweigh the short term pain felt when our unit price dips. We know that volatility will occur. It is our job however, to get the stock selection correct.

Moreover, this is how we see the financial year 2005-06 unfolding – volatile - with opportunities for those who continue the search. **SFM**

### **A QUALITATIVE APPROACH**

Outstanding CEO's seem to run outstanding businesses. In the June quarter we were fortunate enough to spend time with Gail Kelly from St George, Allan Moss from Macquarie Bank and Chris Roberts from Cochlear. While there is no substitute for quantitative research – qualitative research is equally as important. Here are a couple of thoughts from our meetings with management.

### **FOUR BANK COMMENTS**

Gail Kelly. Her address to a group of fund managers in June, left us in no doubt (again) that she is a standout performer amongst her peers. You can hold St George and sleep soundly while Gail is at the helm – and our view is that she is very committed and not leaving any time soon. We highly recommend going along to a St George AGM to hear Gail speak – for young aspiring businesswomen it is a must!

***“strong comparative advantage....  
it is likely to survive the next bout  
of volatility”***

In contrast, it was cold comfort to hear ANZ's CFO state that IFRS (new international accounting standards to be adopted in the coming financial year) will have no real earnings per share impact even though the changes have not been modelled against historic numbers. We understand UK banks have seen an 8 – 10% earnings downgrade as a result of IFRS to date.

Macquarie Banks' Allan Moss impressed – Macquarie is setting itself apart on the world stage by partnering with dominant players in new regions rather than attempting greenfield operations. Macquarie has a strong deal pipeline and unlike most Wall Street banks will not reduce headcount in a tough market – this shows the high regard for human capital. Interestingly if you add together Macquarie Banks market capitalization with that of all its listed satellites it would rank around 23<sup>rd</sup> largest company in the world!

***“Phil Green of Babcock and Brown is not a slick presenter”***

Phil Green Managing Director of Babcock and Brown is not a slick presenter, yet his story is compelling. Like Macquarie they have a comparative advantage in intellectual capital. The way to measure this is to look at the bonus line paid to executives. It will remain at 50% of profit before tax. It seems large and it is, but it is precisely what will drive the business to higher levels.

Companies that have a strong comparative advantage like Macquarie, Babcock, Aristocrat and Cochlear rarely appear cheap. And selling these companies and others like them because the market seems sure to correct sometime in the future is rarely a successful strategy. If the company you own has unique qualities that make it great it is likely to survive the next bout of volatility. **SFM**

**An hour with Dick McIlwain, CEO Unitab**

Dick McIlwain is a refreshingly likeable chap. He is laid back and straightforward. The first insight he offered us was that Unitab was expensive when it listed in 1999 at \$2.05. The market agreed and soon after marked Unitab down to \$1.85.

This is an interesting point. As Unitab hovers around the \$14 mark today, six years after listing, it still appears expensive. The price reflects a built in takeover premium and a very

highly regarded manager in Dick amongst other things. The reality is that you do not often get to buy good companies cheap.

***“you do not often get to buy good companies cheap”***

Good businesses have unique characteristics. Unitab for example is the sole provider of wagering services in Queensland, South Australia and the Northern Territory of which the latter two acquisitions have delivered outstanding results for the group. Secondly, Unitab achieves +40% EBITDA margins on its gaming business (monitoring over 100,000 slot machines in Qld & NSW) where it is paid per machine to monitor machine payout ratios in accordance with gaming legislation in both states. Unitab has also added to this, the NSW linked jackpot business acquired from Tabcorp during 2004. With some 4,000 machines now linked and the company sharing in the pool, a move towards 5,500 to 6,000 machines would make this an exceptional business.

To complete the trifecta, in the past month we also visited Aristocrat in Sydney and Tattersall's in Victoria. Aristocrat is one of the few examples of a great business that did get cheap. In contrast, and not unlike Unitab, we suspect that Tattersall's may be viewed as expensive from day one.

***“takeover premiums are counter productive and a bit silly”***

We have no doubt that Tattersall's would be a good fit with Unitab. And Unitab has an “open door” philosophy - always prepared to look at situations. That said we are certain of only one thing. Dick McIlwain is likely to “left foot” the market and his peers at least one more time before he hands over the reigns at Unitab.

The last insight he offered - Dick thinks takeover premiums are counter productive and a bit silly.... even in his own stock. While that may be true, it is not the only reason that Unitab has appeared expensive from \$2.05 through to \$14+. **SFM**

**COMPANIES VISITED DURING THE LAST QUARTER:**

Month	Company Name	Code	Month	Company Name	Code
April	Patrick Corporation	PRK	June	Vision Group (site visit)	VGH
	Bill Express	BXP		AAV Limited (AGM)	AAV
	Transpacific Industry Group	TPI		Alumina	AWC
	Select Managed Funds	SEM		Zinifex	ZFX
	Count Financial	COU		Smorgon Steel	SSX
	Investor Group	IGP		Onesteel	OST
	Salmat	SLM		Macarthur Coal	MCC
	AAV Limited	AAV		Excel Coal	EXL
	Mortgage Choice	MOC		Centennial Coal	CEY
	iiNet	IIN		Newcrest Mining	NCM
	Buka Minerals	BKA		Woodside Petroleum	WPL
	Strathfield Group	SRA		Santos	STO
	Customers Limited	CUS		Oil Search	OSH
	SFE Corporation (AGM)	SFE		Origin Energy	ORG
	May	Genepharma Australasia		GAA	Caltex
Aristocrat (AGM)		ALL	Australian Worldwide Exploration	AWE	
Seek		SEK	ARC Energy	ARQ	
Corporate Express		CXP	Tap Oil	TAP	
DCA Group		DVC	Commonwealth Bank	CBA	
Sigma		SIG	ANZ Bank	ANZ	
Cochlear		COH	Westpac Bank	WBC	
Flight Centre		FLT	Macquarie Bank	MBL	
Australian Pharmaceutical		API	Babcock & Brown	BNB	
Macquarie Infrastructure Group		MIG	Challenger Financial Services	CGF	
Harvey Norman		HVN	AXA Asia Pacific	AXA	
ROC Oil (AGM)		ROC	Perpetual Trustees	PPT	
SFE Corporation		SFE	Bendigo Bank	BEN	
Macquarie Capital Alliance		MCQ	Bank of Queensland	BOQ	
Virgin Blue (AGM)		VBA	SAI Global	SAI	
Patrick Corporation		PRK			
Petsec Energy		PSA			
Aristocrat		ALL			
Acrux		ACR			
Agenix		AGX			
Bone Medical		BNE			
Peptech		PTD			
Pharmaxis		PXS			
Babcock & Brown (AGM)		BNB			
Tattersall's Limited (site visit)		TTS			

**“Infrastructure is a grubby little business and we don’t want them to get dirty.”**

*Allan Moss CEO Macquarie Bank – on why Wall Street has stayed away from infrastructure deals*

**IN THE NEWS:**

The Weekend Australian Financial Review www.afr.com

+ 38 July 2-3, 2005

**SMART MONEY**

**INTERROGATION**

**Tony Scenna**  
director  
Selector Funds Management

**Who are you and why should I give you my money?**  
I am one of three founders of Selector, along with Corey Vincent and our chairman, Martin Greenberg, a former partner at Babcock & Brown, so my money is in the business. In 2003, we tested and ran our systems in a model portfolio for more than a year before kicking off our two funds. Net of all expenses we returned 33 per cent in that first year. The driver for us is twofold: a desire to control how the business is run; and being prepared to back ourselves with our bottom-up stock selection.

**What are you going to do with my money?**  
We'll invest it in the same place we put our own money. We are great believers in sticking to our core strengths and for that reason we only invest in Australian equities. We hold concentrated holdings in companies, believing that it is better to hold a few outstanding ones rather than a large number of average businesses. We would expect to hold a company for a reasonable period of time. We don't short sell or jump around like hedge funds. We have 17 investments at the moment and the fund is 92 per cent invested.

**If I'd invested \$10,000 in your funds, a) three months ago, b) 6 months ago, c) 1 year ago, what would it be worth now, net of fees?**  
a) \$10,811  
b) \$11,727  
c) Not applicable

**Name your best and worst calls.**  
Aristocrat is an example of both our best and worst calls. Buying at \$4.50 in early 2003 only to see it plunge below \$1 was numbing. That said, we stepped up to the plate a few times as the price was smashed down by some reckless behaviour. The market panics too quickly and it reacts too quickly. [Aristocrat is now trading at more than \$10.] We also look fondly on our first trip to Pharmaxis headquarters just after they listed in late 2003. We discovered a strong management team and a well-defined business plan trading close to cash backing. It's hit every important milestone since listing. An investor can't ask for much more, and we are patient investors.

**What do independent researchers think of you, and what do you think of them?**  
They hate us because we fit outside the box and we love to hate them because of their narrow approach.

**MONTHLY PERFORMANCE DATA:**

Month Ending	Unit Price	SF Gain %	SF Monthly %	All Ord Accum Index (AOAI)	AOAI Gain %	AOAI Monthly %
30-Jun-05	\$1.2556	25.56%	11.62%	24,146	14.68%	4.46%
31-May-05	\$1.1249	12.49%	5.35%	23,115	9.46%	3.41%
30-Apr-05	\$1.0678	6.77%	-5.43%	22,352	6.16%	-3.78%
31-Mar-05	\$1.1291	12.91%	0.72%	23,231	10.33%	-0.74%
28-Feb-05	\$1.1210	12.09%	4.68%	23,405	11.17%	1.80%
30-Jan-05	\$1.0709	7.09%	2.16%	22,992	9.20%	1.33%
31-Dec-04	\$1.0483	4.82%	2.33%	22,690	7.77%	3.01%
30-Nov-04	\$1.0244	2.44%	2.44%	22,028	4.63%	4.63%

\* Note – Unit prices are struck on a monthly basis; intra-month prices are indicative only

Unit prices and performance are independently calculated by DDH Graham Limited  
[www.ddhgraham.com.au](http://www.ddhgraham.com.au)

**Disclaimer:**

Selector Funds Management Limited or any related entity does not guarantee the repayment of capital or any particular rate of return from the Fund. Past performance is no guarantee of future performance. This report does not constitute financial advice and readers of the report should consult their financial advisers before making any further investment in or withdrawal from the Fund.

**Performance to 30 June 2005**

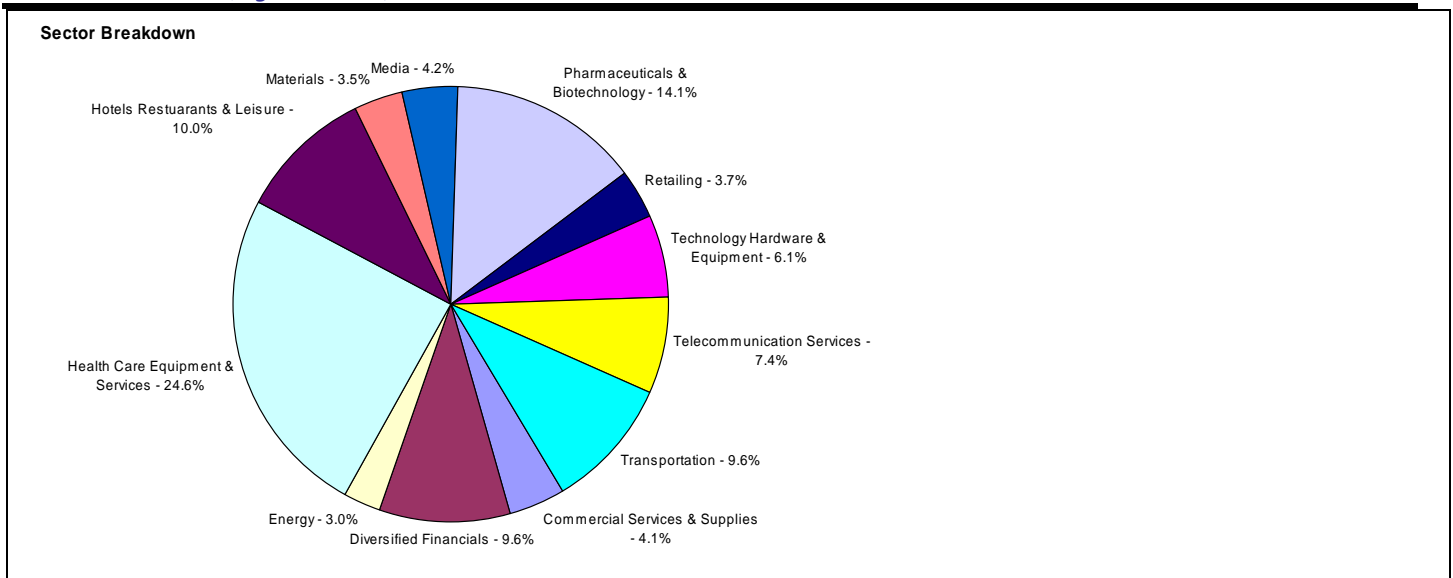
(inception November 2004)	June Qtr	Inception
Income/distribution %	1.98	1.98
Growth %	9.22	23.58
<b>Total return* %</b>	<b>11.20</b>	<b>25.56</b>
All Ordinaries Accumulation Index %	3.94	14.68

**Unit price 30 June 2005**

Entry price	\$1.2587
Exit price	\$1.2525
<b>Post Distribution:</b>	
Entry price	\$1.2389
Exit price	\$1.2327

\* Total Returns are based on mid price and are calculated after all fees have been deducted with distributions reinvested and no allowance made for tax. Past performance is not a reliable indicator of future performance.

**Investments (by sector) 30 June 2005**



**Disclaimer:**

Initial applications for units can only be made on an application form attached to the Selector Funds Management Limited Information Memorandum dated 1 July 2003. Selector Funds Management Limited or any related entity does not guarantee the repayment of capital or any particular rate of return from the Trust. Past performance is no guarantee of future performance. Investment returns have been calculated in accordance with normal industry practice utilising movements in unit price and assuming reinvestment of all distributions of income and realised profits. This report does not constitute financial advice and readers of the report should consult their financial advisers before making any further investment in or withdrawal from the Fund. Tables and charts in this report are as accurate as possible on the date of publication. Due to volatility of underlying assets of the fund and other risks associated with investing, returns can be negative particularly in the short term.