INVESTMENT ADVISORY COMMITTEE

INVESTMENT PERFORMANCE SUMMARY
FOR YEAR ENDED 31 DECEMBER 2010

Finance
& Business
Services
Introduction

The strategic goal of The Australian National University (ANU) is to advance knowledge through excellence in research, education and community engagement. In the pursuit of this goal the University seeks to protect and grow its financial assets to provide a sound financial platform to ensure its capacity to deliver over the long haul. The assets are managed by ANU Investment Office under advice from the Investment Advisory Committee (IAC), a sub-committee of the Finance Committee. The IAC reports to Finance Committee and through it to University Council.

Investment objective

The University Investment Objective is to obtain the maximum possible long term return on the available capital consistent with achieving a minimum return to the University of Consumer Price Index plus 4.0 per cent over rolling five year periods and ensuring a negative annual real return occurs less frequently than once every six years on average. Over the shorter term, it is recognised that there will be periods when investment returns do not meet this objective. Accordingly the University also aims to achieve returns (after fees and tax) that are in excess of the median return of other funds with comparable risk and return profiles as measured by independent industry surveys over three year periods. The portfolio will contain sufficient liquid assets to pay the financial obligations of the Long Term Investment Pool (LtIP), including those relating to the Commonwealth Superannuation Scheme, as they fall due.

Due to the global financial crisis which adversely affected returns in 2008, the LtIP did not achieve its goal of CPI plus 4 per cent for the most recent five year period but it has been achieved for all periods longer than five years. All other requirements stated in the above objective were achieved or exceeded.

Funds under management

The University’s realisable investment assets at 31 December 2010 were $1,237.1 million. Of this total, $778.2 million was invested through LtIP, a balanced fund with exposure to all the major asset classes including local and overseas equities, property, fixed interest, alternative investments and cash. The major account holders within the LtIP include a reserve to ensure its capacity to deliver over the long haul. The assets are managed by anu Investment Office on behalf of account holders with shorter term investment horizons such as General Recurrent funds and various Special Purpose funds.

Management of funds

The University maintains a professionally staffed Investment Office located within the Finance and Business Services Division. This office is responsible for the day-to-day management of the funds and for preparing investment strategy recommendations, asset allocation and investment policy papers for consideration by the IAC.

The IAC was established in 1968 to review the management and financial performance of the University’s investment operations and to advise Finance Committee accordingly. In addition, the IAC provides advice on matters of investment policy and operational guidelines. The IAC conducted four meetings during 2010.

At its meetings the IAC reviews the investment strategy and asset allocation settings for the LtIP. The University’s investment management model is strongly weighted to internal investment management with approximately 80 per cent of the $1,237.1 million held at 31 December being directly invested by the ANU Investment Office. The remaining 20 per cent is placed with external fund managers in areas that require specialist expertise or where the University seeks some additional diversification. This model has delivered superior returns over a long time period via its lower cost structure, better control of asset allocations and its capacity to act in a timely manner through a proactive decision making process. The University has a long history of adding value in its internally managed investments compared to industry benchmarks and commercial peer managers as verified by independent performance reviews.

Membership of the IAC comprises the Vice-Chancellor, the Chair of Finance Committee, the Chief Finance Officer and up to seven persons with expertise in finance and investments. The independent specialists in 2010 were Mr Tim Crommelin (Chair, Executive Chairman RBS Morgans), Emeritus Professor Allan Barton (former ANU Pro Vice-Chancellor and Treasurer, and former Dean Faculty of Economics and Commerce), Professor Tim Brailsford (Executive Dean, Business, Economics and Law at University of Queensland), Mr Jim Service (Managing Director JG Service Pty Ltd), Mr Ottmar Weiss (various company director and committee roles) and Dr Geoff Warren (Senior Lecturer at the School of Finance, Actuarial Studies and Applied Statistics, ANU College of Business and Economics).
Investment highlights for 2010

Total fund performance

(Annualised) for periods ended 31 December 2010

- 2010 Return: The investment return in 2010 was 5.9 per cent (after the management expense ratio of 0.2 per cent). The benchmark return, the median return of the SuperRatings (SR) Pension Fund Crediting Rate Survey (Balanced Option), was 4.9 per cent. This ranked the University in 33rd place in the SR Survey of 100 funds for 2010. Strong contributions were made by fixed interest with 10.4 per cent return for the year, cash 8.1 per cent and alternative investments 6.8 per cent.

- Strong Long-term Relative Performance: SR data demonstrates ANU has performed strongly against peers longer-term. SR placed ANU 33rd of 87 funds in its data base over three years, 8/68 for five years, 2/50 for seven years and 1/19 for 10 years, domestic equities 5/64 for three years, 1/52 for five years and 1/32 for seven years, fixed interest 9/38 for one year, 8/25 for five years, 4/14 for seven years, and overseas equities 15/64 for three years, 17/46 for five years and 6/25 for seven years.

- Strong Long-term absolute Performance: Over the 10 year period to 31 December 2010 the LTIP has achieved a compound return of 7.7 per cent, domestic equities 12.2 per cent and fixed interest 6.3 per cent.
Asset allocation

The asset allocation at 31 December 2010 compared to the average exposure in the SuperRatings Funds Survey is provided in the chart below. The University maintained a higher exposure to domestic equities, fixed interest and cash than the average SR balanced manager. ANU had less exposure to overseas equities and alternative investments. The overall exposure to risk assets was lower than the average balanced manager.

Portfolio composition

as at 31 December 2010

<table>
<thead>
<tr>
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<th>ANU</th>
<th>SuperRatings Funds Survey</th>
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<tbody>
<tr>
<td>Equity (Domestic)</td>
<td>37.0</td>
<td>30.6</td>
</tr>
<tr>
<td>Equity (Overseas)</td>
<td>9.7</td>
<td>21.9</td>
</tr>
<tr>
<td>Fixed Interest</td>
<td>18.3</td>
<td>16.3</td>
</tr>
<tr>
<td>Property</td>
<td>10.9</td>
<td>10.1</td>
</tr>
<tr>
<td>Alternative Investments</td>
<td>15.7</td>
<td>15.4</td>
</tr>
<tr>
<td>Cash</td>
<td>11.1</td>
<td>5.7</td>
</tr>
<tr>
<td>Other</td>
<td>1.3</td>
<td>0.0</td>
</tr>
</tbody>
</table>

ANU had a slightly above-average monthly standard deviation of returns in 2010 but this was compensated with strong returns relative to risk over one, three and five years. SR noted in its 2010 review that ANU consistently recorded a top quartile information ratio over all periods measured.

Markets & strategy in 2010

The equity indices in most developed economies provided reasonable returns for investors in 2010. The German stock market rose 16 per cent, the UK index was stronger by 9 per cent and the US S&P 500 index was up nearly 13 per cent. Notable exceptions to this favourable outcome were Australia which recorded a slightly negative movement in the ASX 300 price index of 2 per cent and Japan which recorded a negative movement of 3 per cent. However the previous year (2009) the Australian share market was one of the best performing markets in the developed world with a return of 33 per cent. Investors in the major developed bond markets received strong positive gains in 2010 as yields fell on the back of central bank buying, low cash rates and a flight to quality away from the peripheral bond markets of southern Europe. The property and alternative asset class sectors also provided good investment returns for the year.

The world economy bounced back strongly in 2010 with growth of 5.0 per cent compared to -0.5 per cent in 2009. Advanced economies grew at 3.0 per cent in aggregate and the developing economies expanded by 7.3 per cent based on data compiled by the International Monetary Fund. Germany and Japan were the strongest of the advanced economies whilst the US, at 2.8 per cent, was somewhat slower than what might have been anticipated given the severity of the preceding recession. A feature of the recovery was the continuation of high unemployment in many developed economies.

The Australian economy advanced 2.7 per cent for the year and continued to see good employment growth and low unemployment. The Reserve Bank of Australia (RBA) increased rates in four increments of 0.25 per cent through 2010 to bring the official cash rate up to 4.75 per cent by the end of the year. By contrast the US Federal Reserve (Fed), the Bank of England (BoE), the Bank of Japan and the European Central Bank maintained record low cash rates through the year. The Fed and the BoE also continued with bond purchase programs to support government bond yields in an effort to stimulate credit expansion and economic growth.

Commodity prices increased over the course of 2010 boosting Australia’s terms of trade and supporting a significant appreciation of the Australian dollar $A. The higher $A was generally seen as detrimental to Australian exporters and import competing industries. On the other hand a higher $A was beneficial for dampening inflationary pressures on imported consumer goods, investment equipment and oil. Higher interest rates and commodity prices exacerbated the two-speed economy effect, as a booming capital investment program related to mining and infrastructure projects was offset by weaker consumer spending.

The University maintained a relatively defensive investment strategy and asset allocation stance in 2010 with a strong bias to Australian assets and a higher than average allocation to fixed interest and cash. The strong performance of the defensive assets in the portfolio provided protection from the disappointing performance of the domestic equities sector. This enabled the LTIP to provide a creditable investment return in a difficult environment and to significantly outperform the median return of its peer comparison group.
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