

What is the Fixed Interest investment option?

AGEST allows all members to invest in one or any combination of 12 investment options.

The Fixed Interest option is one of those options.

What are Fixed Interest investments?

Fixed interest investments (sometimes called "fixed interest securities" or "bonds") are loans made by one entity to another, with an obligation upon the borrower to repay the loan at a future date. For example governments, companies and individuals all need to borrow money from time to time.

Lenders include investors like banks, superannuation funds and individuals. Investors typically lend money to borrowers in return for regular interest payments (often called "coupons") throughout the term of the loan, at an agreed rate of interest. At the end of the loan (the "maturity date"), the lender is repaid their original sum invested.

Investment Objective

To outperform the target return.

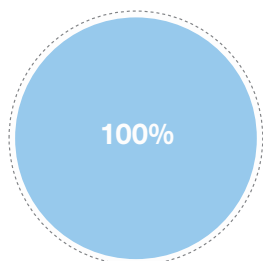
Target Return

Consumer Price Index (CPI) plus 1.5% per annum over the investment timeframe (3 years +)

Strategic Asset Allocation (SAA)

The SAA percentages below indicate where investments in this option will usually be made.

However, market movements, new investment opportunities and irregular levels of cash flow mean that we cannot always strictly adhere to our SAA percentages. We have set 'ranges' within which this option will usually invest, however at times these ranges may be exceeded due to factors beyond the fund's control.



Investment sector	SAA %	Range %
Fixed Interest	100	95-100
Cash	0	0-5
Total	100	

	SAA %	Range %
Foreign currency hedging	100	95-100

Overview of this investment option

Inception date	1 October 2003
Current assets	\$526.9 million
Unit prices at 31 March 2012	Pension accounts 1.460755 Non-pension accounts 1.376803
Number of investment manager products used in this option	4
Number of individual investments in this option	More than 200
Investment costs	0.17%
Performance fees	0%
Total investment costs	0.17%

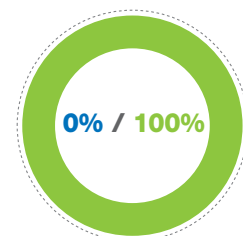
Investment Profile (SAA)

Investment Risk: Low

Negative returns expected in 1 out of every 20 years.

Growth - assets upon which a capital gain is expected over the long term.

Defensive - assets which are expected to produce regular income and, in some cases, capital gain.

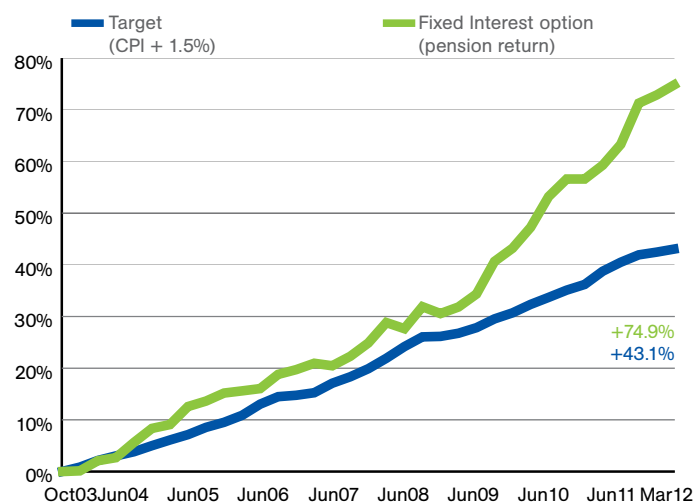


Investment performance *

	Pension accounts	Non-pension accounts
3 months	1.17%	1.02%
1 year	9.80% pa	8.31% pa
3 years	9.98% pa	8.29% pa
5 years	7.65% pa	6.42% pa
Since inception	6.80% pa	5.72% pa

* Figures above are the returns received by members, net of all investment related fees, based on relevant unit prices. Non pension account returns are also net of investment taxes. No investment tax applies to pension accounts.

Cumulative investment performance



How we invest the assets in this investment option

We use professional investment management firms to manage our fixed interest investments for us. We use the same managers for fixed interest in both the Fixed Interest option and the pre-mixed options.

How is the return in this option achieved?

The returns for members in this option will be mainly affected by:

- ▶ current market interest rates, how they are changing and how they are expected to change
- ▶ the ability of the borrower to repay the debt and make regular interest payments to the investor.

Whilst it may seem a contradiction in terms, not all "fixed interest" investments have a fixed rate of interest; however they generally have a fixed formula for calculating interest. For example, you may borrow money from the bank at a variable rate of interest, described as "the bank bill rate plus 2%". This means that, when the bank bill rate changes, so does the amount of interest paid by you. In this example, the bank is the lender.

The following numerical example may help you understand how a fixed interest investment typically works.

Let's say you have \$100 to invest and you decide to buy a ten year corporate bond with interest payable at 5% per annum, annually in arrears. In this case, the flow of money would be:

- ▶ you lend \$100 to the company issuing the bond
- ▶ you receive \$5 in interest payments at the end of every year for ten years
- ▶ you receive back your original \$100 at the end of the ten years.

The return is fixed at 5% per annum if the investment is held to maturity and the borrower is able to meet its obligations.

If the borrower is unable to pay interest payments and/or pay back the loan at the end of the bond period (that is, they 'default' on the terms of the loan), then the return will be less than 5% (and will be negative if the loan cannot be repaid in full).

Investment managers used for this option

For full details of AGEST's investments with these managers please see the investments section of our website.

Investment Managers	% of option
BlackRock	87%
Hastings Fund Management	3%
PIMCO	10%
Members Equity Bank	<1%
	100%

Which fixed interest investments does AGEST hold?

AGEST's fixed interest investments are selected and managed by the investment managers noted above. They invest across many types of securities, both in Australia and overseas. The types of securities held include government and semi-government bonds, inflation-linked securities, mortgage backed securities and corporate bonds.

The allocation of our portfolio amongst these types of securities varies from week to week as market conditions change.

Foreign Currency Hedging

This option contains overseas assets and therefore has exposure to foreign currencies. However, all of this exposure is currently hedged back to Australian dollars for us by investment managers.

The level of hedging can alter at any time and was 100% as at the date of this report.

Portfolio Characteristics

	Exposure (% of Portfolio)		Average duration of investments (years)
	Current	Range	
Australian	50	0-100	3.6
Overseas	50	0-100	5.4
Total	100		4.5

Sector Exposures	% of option
Government	42%
Semi-government	31%
Corporate	27%
	100%

Regional Allocations	% of option
Australia	50%
Asia ex-Japan	<1%
Japan	8%
North America	25%
Europe, ex UK	12%
United Kingdom	3%
Emerging Markets	2%
Supranational (eg IMF)	<1%
	100%

Credit Estimates	% of option
AAA	62%
AA	20%
BBB+ to AA- (Investment grade)	14%
Sub investment grade	4%
	100%

What is the biggest influence on fixed interest investments?

The investment performance of this option is heavily influenced by the expectations of movements in interest rates, which can result in both positive and negative returns over short periods of time.

This risk is often forgotten by fixed interest investors. Like any investment or asset, the market value of a fixed interest investment (that is, what you can sell it for today) depends on what else is on offer. You will not be able to sell a bond for \$100 if a more attractive bond (eg. higher interest payments and/or a more secure borrower) is also available for \$100.

Therefore you should expect fluctuations in the returns in this investment option and returns can be negative.

For example, when current interest rates rise, existing bond prices fall, because the new bonds on offer have higher interest payments. That is bad news for holders of existing bonds, because they can only sell their bonds at a lower price than before.

However when interest rates fall, existing bond prices rise because those bonds become more attractive than the new bonds on offer at lower interest rates. That is good news for holders of those bonds, because they can sell their bonds at a higher price than before.

So holding fixed interest investments may result in negative returns when interest rates are rising and coupons are insufficient to offset capital losses.

So how does a negative return arise if an investor like AGEST has no intention of selling the bond before its maturity date?

We have noted above how a negative return will occur if a bond is sold at a loss, however losses (on paper) also occur even when bonds are not sold.

This is because superannuation funds are required (under accounting standards) to value their investments at market value. This means that we cannot say that a bond is worth \$100 (its maturity value) if we could only sell it today for (say) \$95. Remember that a fall in value will occur if a more attractive bond can be bought for \$100.

When the market value of a bond falls, a negative return (on paper) occurs for that period.

Whether we intend to hold the bond until its maturity date is irrelevant under accounting standards. It's the bond's current market value which is important, and this valuation flows through to the calculation of the investment return each month.

However, as one nears the investment's maturity date, you would expect the value of the bond to increase towards \$100, so you would then get a positive return. That is, ignoring interest payments, any early negative returns should be offset by later positive returns.

Tax treatment

Investment earnings on non-pension accounts in a superannuation fund are taxed at 15%. For the Fixed Interest option however, this tax may be slightly reduced if capital gains tax concessions apply (where eligible assets are sold after being held for over 12 months).

The effective rate of tax payable in the Fixed Interest option is usually 15%.

This tax has already been deducted from the non-pension accounts investment performance and unit price shown on page 1 of this report.

Other important information

- ▶ This report has been prepared by AGEST Super Pty Ltd, the Trustee of AGEST. The Australian Securities & Investments Commission (ASIC) has granted an Australian Financial Services Licence (No. 233707) to AGEST Super Pty Ltd. This allows the Trustee to provide superannuation products to members and prospective members of the fund. The contents of this quarterly report are of a general nature and have been prepared without taking into account your particular financial needs, circumstances or objectives. You should assess your own financial situation and read AGEST's Combined Product Disclosure Statement and Financial Services Guide before making an investment decision.
- ▶ Past performance should not be taken as an indication of future performance.
- ▶ The past performance of an investment option is based on the asset allocation and investment management style used in each investment option in the past. The Trustee may change these features at any time in the future, within the ranges specified in the fund's Product Disclosure Statement (PDS), so past performance may be of little relevance to the future.

The investment objective, target return, investment profile and asset allocation shown in this report for this investment option are indicative only and are based on the investment expectations of each investment sector, using long term assumptions about capital markets as obtained by the Trustee from sources including investment management companies and professional investment advisers.

Based on these assumptions, the Trustee believes that the asset allocation set by the Trustee is suitable for this investment option, given its investment objective, and that the asset allocation is likely to enable the target return to be achieved over the period stated. However the future performance of this investment option cannot be guaranteed, as investments can move up and down,

sometimes sharply and without warning, over both short and long periods of time.

The expected number of years of negative returns in every 20 years is based on the above mentioned long term assumptions. Actual performance may be different from these assumptions.

- ▶ Investment managers are paid for their investment management services to the fund. Most managers are only paid a fixed fee (usually calculated as a percentage of assets under management). However, some managers receive a fixed fee plus a variable performance based fee where the fixed fee is lower than would otherwise be the case. The calculation of the performance based fee varies between managers and investment sectors, however the calculation is typically a small percentage (eg.10%) of the manager's outperformance above a pre-determined benchmark plus an additional margin.

For example, if an Australian shares manager who is remunerated on a performance fee basis achieves a 15% return (after base fees) compared to the Australian ASX200 return of say 10%, and the margin above which a performance based fee is paid is 3%, then the manager will receive a performance based fee which is a small percentage of their 2% performance above the 13% (10% benchmark plus the 3% margin).

Further queries can be directed to:

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