

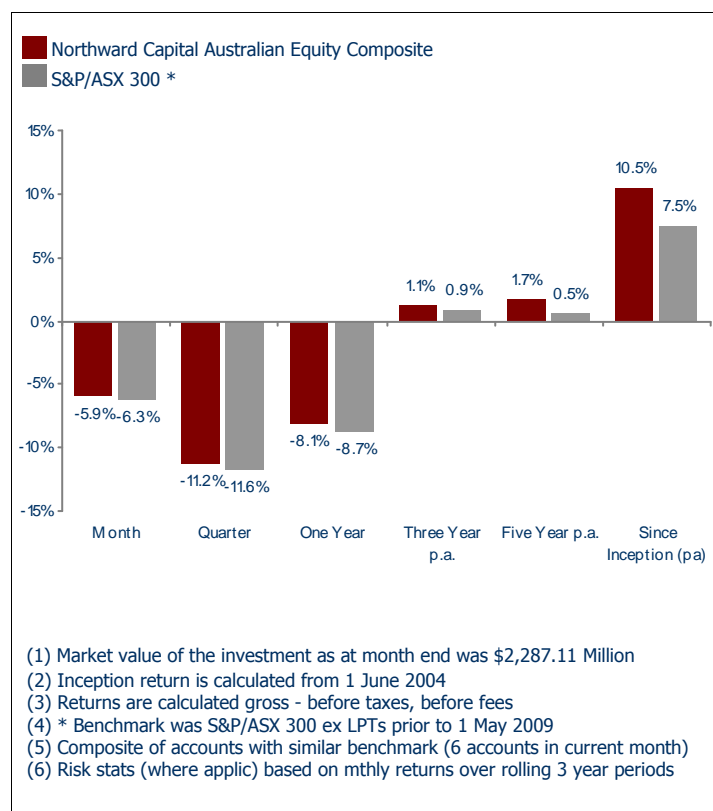
Fund Results

Portfolio Results	Quarter
Northward Capital Australian Equity Composite	-11.16%
S&P/ASX 300 *	-11.65%
Value Added	0.49%

Stock Contributors	Overweight (+) Underweight (-)
Transurban Group	+
Macarthur Coal Ltd	Not held
News Corp CDI	+
Fortescue Metal	Not held
Resmed	+

Stock Detractors	Overweight (+) Underweight (-)
Telstra	Not held
Wesfarmers	-
Ivanhoe Australia Ltd	+
Rio Tinto	+
Henderson Group	+

Risk Information	
Standard Deviation	15.3%
Tracking Error	3.1%
Information Ratio	0.1



Market Review

Volatility remained a feature of markets during the September quarter, with equity markets continuing to bear the brunt of risk aversion. Investors became increasingly concerned about the potential of a recession emerging in Europe/US and the impact on emerging markets. The Australian equity market (ASX 200) remained under renewed pressure with Resource stocks declining on the back of weaker commodity prices. Investor focus during September was once again centred on Europe and possible solutions to resolve the financial crisis facing the region in the face of Greece possibly defaulting, while the US Fed's "operation twist" failed to excite the market. Commodity prices fell sharply, particularly gold and base metals, on concerns a Euro recession would impact emerging markets, particularly China. Investors de-risked portfolios with the defensive Consumer Staples, Telecoms and Healthcare sectors outperforming, while the more cyclical Resources, Energy, and Industrial sectors lagged. Economic data releases in September continued to highlight emerging softness in the non-mining segments of the economy. House prices, credit data and retail sales remained soft, while building approvals and employment fell further. The RBA left rates on hold at 4.75%. The AUDUSD traded in a wide range, hitting a high of \$1.076 then declining to a low of \$0.962 before finishing the month at \$0.973 (-9.7¢).

Performance Review

Over the quarter, Northward's portfolio returned -11.16% versus the ASX 300 ex LPT return of -11.65%, resulting in an outperformance of 49bps versus the market.

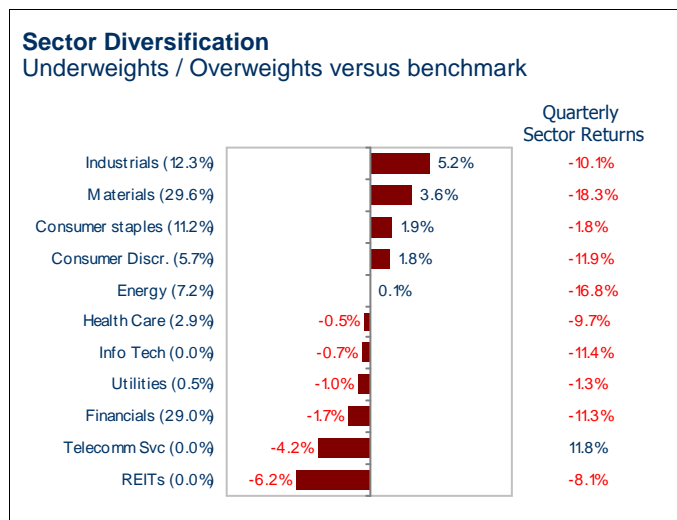
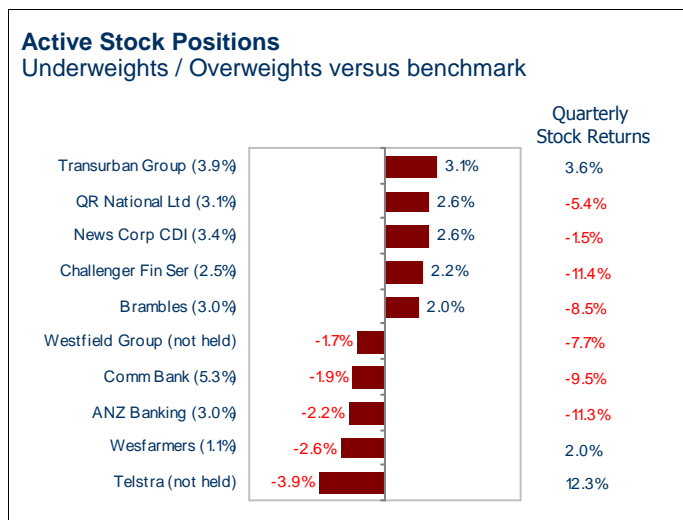
The ASX200 index shed 13.0% in 3Q11 posting its second consecutive quarterly loss; in the process it twice broke below the 4000 mark and only just held that level for the close, ending September at a level first breached in December 2004. Corporate news offered little inspiration for buyers with management comments in results season remaining guarded, though buy-backs were a positive feature. Corporate activity was generally subdued; Foster's Group was the subject of a bid from SABMiller which gained board recommendation at the second attempt and BHP Billiton announced a \$14bn acquisition of Petrohawk Energy.

Falling confidence in global growth prospects and signs that tight policy in China are having a dampening effect on property demand in China made it hard going for commodity stocks; the ASX 200 Resources index (-19.7%) underperformed the benchmark for a third straight quarter. Banks (-11.3%) beat the broad index but underperformed slightly against the non-Resources universe (-9.9%), as higher funding costs and weak credit growth weighed on the sector.

Contributors to performance included Transurban, Macarthur Coal, News Corp, Fortescue (not held) and Resmed.

Detractors to performance included Telstra (not held), Wesfarmers, Ivanhoe Australia and Henderson Group.

Fund Composition



Portfolio Strategy

As we said in our June quarter report, the prospects for the Australian market moving higher over the remainder of the year remain dependent on a number of macroeconomic events. These events continue to be the ongoing lack of resolution to the Euro sovereign debt issues, the extremely tepid US economic recovery and the Chinese authority's efforts to rein in inflation and the over-extended Chinese property market. If Europe is able to 'ring-fence' the Greek default problem and adequately recapitalise its banking system, then this would see risk assets globally rise sharply, with resources acting as a beta trade on this outcome. A relaxation of China tightening should also be bullish for the sector, all other things being equal. Euroland needs to come up with, sooner rather than later, a credible plan to establish a European Treasury with the power to raise taxes and issue bonds. And such an announcement should coincide, preferably, with a concrete bank capitalisation plan.

With regard to China there are growing legitimate concerns about the fallout from the intensifying credit squeeze in terms of the high interest rates being paid in China's shadow credit system, most particularly in the so-called underground lending market. There is also growing evidence of a severe funding squeeze in the property market. While there remains potential for further bearish sentiment on this credit crunch issue in China to affect resource share prices, investor sentiment is already very bearish on Euroland. In reality, authorities still have plenty of room to ease should they so chose. The current Chinese leadership is most likely to move from a tightening stance to a neutral one once they are confident they have inflation and credit growth under control. The issue is whether an intensification of the European crisis will force the Chinese leadership to undertake a more abrupt U-turn because of mounting fears about external growth.

Here in Australia a number of companies are beginning to benefit from a weaker Australian dollar. We also believe there is a good chance the RBA will do a complete u-turn and commence a new rate-cutting cycle as the economy appears much weaker than the RBA have been espousing to corporates and consumers alike. We are now witnessing a significant shift in market expectations from only three months ago, with consensus forecasts for the cash rate moving from 5.25% by June 2012 to 4.25%. These two factors will likely provide some fresh support to the equities market. We believe the market is good value by historical standards at a P/E of 12.5x FY12 compared to a long term average of 14x. The dividend yield premium over the 10 year bond yield is now also well over 150 bps.

Overall Reporting Season results were broadly in line with market expectations. The Resource sector provided the largest negative bias, while Industrials came in above weak expectations. At the sector level the positive surprise bias favoured Energy and Telecoms. Consumer Discretionary was mixed with News Corporation and Seven West Media being positive, but Retailers were weak. Materials and Info Technology had the largest negative surprise bias. The Cyclical Industrials also did slightly better than the Defensive Industrials on the positive surprises.

Consensus Industrials FY12 EPS growth expectations have been cut from +15% to +9% (which may still be too high), while earnings expectations across the Resource sector also declined slightly forecasts for FY11.

Bank FY12 EPSg forecasts now stand at +6%, a downgrade of 1% against pre-reporting season forecasts, while the REIT sector has continued to see downgrades to FY11 and FY12 EPSg forecasts. Key themes from reporting season were lack of company guidance, restructuring (with associated job losses), increasing emerging market exposure, capital management initiatives and M&A activity.

We have increased our positions in some companies we regard as having more certain and defensive earnings such as Woolworths and Fosters, while increasing positions in stocks with 'defensive growth' such as MAP, QR National and Amcor. We also took the opportunity to buy an underpriced cyclical stock in the form of Iluka for the first time as it was sold down 35% during August and represented value. We increased our ILU holding again in recent weeks, such that it is our 3rd largest Resources Overweight now. Our view on the pace and strength of the US economic recovery has waned somewhat and that has led to the sale of riskier stocks with more opaque earnings in the form of CPU and Sims Metal. Macarthur Coal and ESG were sold into takeover offers, whilst our holding in Foster Group is likely to be successfully completed by SAB Miller this quarter.

Portfolio Activity

Position Change	Holding	Start %	End %	Activity
Sold	Sims Group Ltd	2.3%	0.0%	SGM had been held in the fund as a proxy for an improving US economy. However, the anticipated recovery in the US economy looks more problematic and is being adversely impacted by US political and the European Debt issues. The funds were predominantly redeployed in ILU.
Sold	Westfield Group	0.5%	0.0%	We switched our WDC holding into WOW at the start of the quarter. WDC revenue is a mix of development income, which has historically been higher ROE, and passive rental income. Global macro economic conditions and an excess of retail space will continue to limit shopping centre development opportunities for some time. Lack of confidence in households is leading to higher savings rates and less consumption, leading to retail sales growth rates below contracted rental increases. Given the already high occupancy costs, particularly in Australia, this will put pressure on retailer profitability and therefore cap future rental growth. In contrast, we see WOW as having a robust balance sheet and a valuable franchise which earns return on equity far in excess of that of WDC.
Sold	Macarthur Coal Ltd	0.9%	0.0%	MCC was bid for during the quarter by Peabody / ArcelorMittal. As a result there was a significant gain made on the position and we exited our position.
Sold	Eastern Star Gas Ltd	0.4%	0.0%	We sold out of our position in ESG after it was bid for by Santos at a significant premium to the share price during the quarter. As the bid was a full Santos scrip bid and was fully supported by the ESG board, we considered the likelihood of an increased bid to be very low.
Purchased	Iluka Resources	0.0%	1.8%	A position in ILU was established in the fund during the quarter. With the extreme market volatility in the quarter, ILU's stock traded down to a price well below its fundamental valuation. Given the strong industry position and robust pricing environment we considered ILU a compelling buy.
Increased	Westpac Bank	6.6%	7.5%	Reasoning consistent across Australian Bank holdings - refer to NAB
Increased	Newcrest Mining	3.5%	4.3%	NCM's long term growth profile is world class. With the macro environment supportive of a strong gold price and the underperformance of gold stocks relative to that price, we consider that Newcrest represents good value.
Increased	News Corp CDI	1.1%	3.4%	NWS FY11 result was very solid – it sets up NWS for another year of nearly +20% EPS growth – the majority of this is driven by contractual growth from Fox Network retransmission fees, higher affiliate fees for Fox Cable Channels, expansion of Fox International channels, improving satellite platform earnings, and News' huge \$5bn on-market buyback. We increased our holding in NWS by switching out of NWSLVs.
Increased	NAB	2.2%	3.4%	A decision was made to up-weight the banking sector in mid August. Globally, banking share prices had been under pressure due to global macroeconomic concerns including the European sovereign debt crisis. Australian banks were not immune to this sell off and moved to a level where prospective after tax dividend yields would be very attractive to investors. We also took the view there was some possibility of a policy decision which would ease some of the concern around risk in financial investments in the short term. The Australian banks remain valuable franchises in an oligopolistic industry structure and have demonstrated the ability to modify pricing in order to generate attractive return on equity. In this context, the Australian banks can be seen as an attractive sector if general economic concerns lead to a switch out of resources.
Increased	ANZ Banking	2.3%	3.0%	Reasoning consistent across Australian Bank holdings - refer to NAB
Decreased	CSL Ltd	2.0%	1.2%	We decreased our holding to an underweight position to accommodate additional banks buying.
Decreased	Incitec Pivot	1.4%	1.2%	We decreased our holding to provide some further cash flexibility to take advantage of other stock moves that had been oversold.

Stock in Focus

Challenger Financial Group (CGF)

Stock Price - \$4.25 Target Price - \$5.65

Under a robust and quality management team led by CEO Dominic Stevens, Challenger has continued to refine its strategy over recent years to concentrate on 2 key areas. CGF is clearly focused on providing alternate retirement income solutions to Australian investors. Through its "Life" business it is currently the largest issuer of annuities (~40% market share). These annuities offer reasonable returns, often capital protection and are targeted at investors with lower risk and volatility appetites. Challenger then reinvests the annuity funding in a diversified portfolio of assets to generate an investment spread that forms the basis of its earnings. The 2nd area is funds management. The funds management division manages funds for Challenger Life (property, infrastructure, fixed interest) and third party investors. Challenger also has a portfolio of boutique fund managers that have been performing well and generating reasonable FUM inflow.

Challenger has delivered compound 20%pa growth in eps over the 5 years to FY2011. We are forecasting further double digit growth for the next 3 years. As noted above the primary driver of earnings growth has been the 'Life' business. In simple terms the life business derives its income by achieving a higher rate of return from the portfolio of underlying investments than the annuity obligations it pays out to policyholders.

The key drivers therefore are:

- Volume – size of annuity portfolio. This will be impacted by sales of new annuities, reinvestment rates and average tenor of the book. Annuity sales have grown strongly in recent years, particularly post GFC, as retail investors have sought less volatile income streams. In addition, Challenger has invested more aggressively in building out sales channels, developing product and raising brand awareness.

- Price of annuities – ultimately annuities are a form of funding for CGF so the cost of this funding is a key input. The primary drivers are the equivalent bank bill rate (ie in terms of duration), competing products (eg term deposits), distribution costs, investor demand. Currently, all inclusive cost of funding is approx 6.5%.

- Investment returns on asset pool. Given that Challenger needs to generate an investment spread the investment availability of appropriate yielding fixed interest, property, infrastructure assets is vital. As is the investment decision of how to access these markets. While an ongoing risk, CGF is targeting a spread of between 4% and 5% (representing 2% to 3% at the asset level). It has achieved a rate of 4% to 5.4% over the last 10 half year results (5.1% in FY11).

- Costs – Challenger operational costs have remained relatively steady notwithstanding investment in product development and cost to income was 43% in FY11.

- Capital – CGF's capital position remains robust with surplus capital around \$600m. The company has been sensibly deploying this excess capital in an ongoing share buyback program.

The other component of the business is the third party funds management business. Challenger had been developing a portfolio of partly owned boutique fund managers as well as running an in-house strategy (branded Challenger). However with the divestment of its planning business and underperformance of in-house strategies, Challenger has decided to focus solely on the boutique model with the in-house funds converted into boutique structures.

Challenger has 10 boutiques with \$14.8bn of FUM as at 30 June 2011. Performance has been solid across the managers and further inflows would be expected.

Challenger is currently trading on a FY12 pe of 7.8x while forecast to generate compound eps growth of 13%pa over the next 3 years. We value the stock at \$5.65 under current conditions.

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