

8 October 2007

NOTIFICATION OF CHANGES TO MORNINGSTAR INCOME FUND CATEGORIES

The universe of income managed funds offered in Australia has changed dramatically in recent years, with an increase in the diversity and complexity of products available. In response to this, Morningstar has completed a review of our income fund categories, which we use to classify funds which invest in cash, mortgages, Australian and global bonds, and higher-yielding and hybrid debt securities.

We believe that the classification changes resulting from this review are necessary to keep pace with developments in the income fund sector. Our objective is to better serve the needs of investors, advisers, and fund managers alike, by grouping comparable funds together in more precisely-defined categories. This will also help users to undertake more meaningful performance and statistical comparisons of funds within peer groups with similar risk/return profiles. This new classification system applies to all publicly-available retail and wholesale income funds on our database.

Fund categories are by necessity attempts to create close peer groups of funds which although investing in similar areas, have different underlying approaches to investment. Because of this, these categories should be used as a starting point only, leading to more detailed analysis of the underlying investments, and the way they're managed.

What's Changing?

Morningstar grouped income funds previously into nine separate categories. We are now introducing two new categories, Mortgages – Aggressive, and Diversified Credit, thereby increasing the number of income categories to 11. While some categories are not changing, we are renaming others to better reflect the nature of the funds in these categories' underlying investments. The following table summarises the changes we are making.

Existing Category	New Category
Specialty Australian Bonds – Cash	Australian Cash
Specialty Australian Bonds - Enhanced Cash	Australian Cash Enhanced
Mortgages	Mortgages Mortgages - Aggressive
Australian Bonds – Diversified	Australian Bonds
Global Bonds – Diversified	Global Bonds
World/Australian Bonds	Global/Australian Bonds
Hybrid Income	Multi-Strategy Income Diversified Credit
Specialty Australian Bonds - High Yield	High Yield
Reserve-Backed	Reserve-Backed

Reasons for These Changes

Mortgage Category

We are separating mortgage funds into two categories – Mortgages, and Mortgages – Aggressive. This reflects the different risk/return characteristics on offer within the sector. A number of mortgage funds now offer higher returns than more traditional funds which typically invest in residential and commercial loans secured by a first mortgage over property. These more 'aggressive' funds have expanded their investment universe to include more risky investments such as mezzanine debt, development and construction loans, vacant land, and specialist loans. While these riskier loans offer investors higher rates of interest, the probability of the mortgagee defaulting is correspondingly greater. We therefore believe that these higher-risk mortgage funds should more appropriately be grouped in a separate category to the lower-risk, more traditional offerings.

Bond Categories

The composition of the fixed interest universe has also changed considerably, due largely to growth in credit securities. We are therefore allocating bond funds into three broad categories:

- ▶ Traditional fixed interest funds - these include Australian and global bonds, and funds which invest in a combination of the two. This means that there will now be three primary traditional fixed interest categories – Australian Bonds, Global Bonds, and Global/Australian Bonds.
- ▶ Credit enhanced funds – these invest in a broad range of Australian and global credit securities, to provide higher returns than government bonds. We are subdividing the credit enhanced category into two groups on the basis of credit quality:
 - ▶ Diversified Credit – funds which invest predominantly in investment-grade securities; and
 - ▶ High Yield Credit – funds which invest predominantly in higher-yielding sub-investment-grade securities such as emerging markets and junk bonds.
- ▶ Multi-Strategy Income – this replaces the existing Hybrid Income category. There has been an increase in the nature and range of securities being included in fixed interest and income-generating funds. In some cases, for example share options, this has introduced elements of equity risk. While the focus of these funds is on generating income, the category now includes funds also investing in listed property, infrastructure, private debt, hybrids, and shares and share options.

This reclassification coincides with the recent introduction of the Morningstar Fixed Income Style Box, a graphical representation showing a fund's sensitivity to interest rates as well as its underlying credit quality. We have used this template as the basis for our new category definitions for fixed interest funds. The following chart gives an indication of where the new categories and securities are positioned in terms of interest rate and credit risks.

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Global Bonds	Investment Grade Corporates A - BBB	Sub-investment Grade Corporates BBB- / Unrated
Australian Bonds	Rated Hybrids/ Corporate Bonds/ Asset-Backed Securities	Emerging Markets/High Yield/Collateralised Debt Obligations
Cash/ Mortgages	Enhanced Cash	Unrated Bank Loans / Aggressive Mortgages

CREDIT RISK



When These Changes Are Taking Place?

We will be implementing these changes on 7 November 2007, and they will then flow through into the calculation and publication of performance data and Morningstar Ratings to 31 October 2007 month-end. These new categories and fund reclassifications will then go live in Morningstar products including licensed datafeeds, Adviser Workstation, our retail website, and in our supply of data to third parties including financial planning software providers and media tables.

Questions/More Information

The Income Category Definitions document attached contains more detailed explanations and definitions of our new income fund categories.

Questions about these changes, and how they may affect your fund(s), should be directed to analyst.au@morningstar.com. You may also contact the following individuals with questions:

Regards

Morningstar

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