

Analysts: Simon Scott; Kaveh Jahromi

Product Facts

Investment manager:	Barclays Capital Fund Solutions	Peer Group:	Alternative Assets	Fund type:	Retail
Responsible entity:	Aurora Funds Management Ltd.	Specialisation:	Commodities	Min. Investment (A\$):	A\$10,000
APIR code:	AFM0004AU	Strategy type:	Index	Inception date:	July 2008
Fund Status:	Open			Domicile:	Australia

Standard & Poor's View

S&P has awarded this fund a four-star ratings based on its conviction that risk-adjusted returns can consistently exceed relevant investment objectives and returns of peer funds.

This is a new fund that offers exposure to an index that was launched in February 2008. Investors should view it as a quantitative, rules-based investment, rather than as an active commodity fund. The index contains 12 of the most liquid commodities and the product differentiates itself in that the model can go short or long in each individual commodity each month, with allocations of positive 20%-negative 10%. The index will always be fully invested, and does not use cash as a tactical allocation. By using this methodology, the fund aims to reduce volatility, take advantage of the low correlations between individual commodities, and offer a strong return stream over the medium term.

The fund only has a short live track record. Much of the product's rationalisation originates from an examination of back-tested data. Although back-tests should always be regarded with caution, the model's factor inputs were openly available over the time period, and its chosen commodities have had a good history of being very liquid. The data shows that the long/short model does provide excess returns over long-only equivalent allocations, and that the shorting component independently adds value. The diversification of commodities has meant that no one commodity has provided too much positive or negative attribution.

The investment-management team at Barclays Capital Fund Solutions is well-skilled in developing models of this type, and has created similar models across a number of asset classes and products. As the product is an index, a swap provides its exposure. This is like many other alternative product offerings, and the terms and conditions are similar, but do involve the opportunity in some cases for early termination events.

Key Risks

- No track record--the fund is new and has no track record. The underlying CORALS (USD) index began live trading in February 2008.
- Early swap termination--the exposure to the CORALS (USD) index is by a swap which may be terminated early in certain circumstances.
- Diversification risk--the CORALS (USD) index contains 12 commodities so is less concentrated than the popular indices.
- Volatility--Commodities as an asset class has relatively high levels of volatility.
- Swap exposure/tracking error--the swap is linked to the net performance of the CORALS portfolio and may be different to the performance of the underlying CORALS (USD) index.
- Methodology change--the fund has no control over any change to the composition or methodology of the CORALS (USD) index.

- Short Positions--the fund can take short positions. Although there is formal risk management against large losses, there is also the potential for losses between monthly rebalances on both long and short positions.

Product Features

The stand-alone management fee and expenses are competitive: in total the investor pays a combined 0.615% p.a. from the net asset value of the fund. A further 1.2% p.a. of the fund's U.S. dollar investment in the index is taken from the swap. At the index level there is a 0.3% p.a. fee, which is taken directly from the return of the CORALS (USD) index. Overall investors are paying 2.115% p.a. for this exposure. Daily liquidity is a positive, and any distributions will be paid semi-annually.

Fund Objectives

Target return (% p.a.)	To provide exposure to the return of the CORALS (USD) index over the medium-to-long-term.
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Fund Fees

Indirect Cost Ratio (ICR)	2.115%
Management fee (% p.a., incl. GST)	0.46125
Reclaimable expenses (% p.a.)	0.15375
Other fees (note, swap, fx etc.)	1.50
Performance fee (% p.a.)	None
High water mark (Y/N)	N/A
Hurdle rate	N/A

Adviser Fees

Upfront establishment fee	Up to 2.2%
Trail fees	Up to 0.22% p.a.

Fund Characteristics

Current/Max leverage at fund level (x)	None
Redemption period	Daily
Notice Period for redemptions	1 business day
Redemption payments received	5-7 business days
Limit on Redemptions (gate)	None
Distribution Frequency	Semi-annual

Investment Style

The CORALS fund provides exposure to a cash deposit and the CORALS (USD) index which is comprised of the 12 most-liquid commodities across four commodity sectors. This makes the fund more concentrated than other indices or managed peers. The fund offers diversified sources of return within a risk-managed optimisation framework. The CORALS (USD) index aims to avoid some of the failings of other commodities products by seeking to take advantage of both rising and falling markets.

The strategy seeks to reduce volatility and take advantage of the low correlations between individual commodities. Barclays optimises the strategy monthly and aims to offer a diversified exposure over the medium-to-long-term.

Investment Team

The 22-person team at Barclays Capital Fund Solutions (BCFS) is the investment management team at Barclays Capital. The six-person portfolio engineering team developed the multi-asset class Barclays Alpha-Variance model that underpins the CORALS index. This team and the wider BCFS unit provide structured solutions across multiple asset classes. In the design of the model, input was taken from the 12-strong commodities research team. This team provided relevant factors for each commodity. The model incorporates around 150 fundamental and 40 technical factors that are likely to affect the value of each commodity. There are no subjective views around these factors, the model determines on a monthly basis which factors are important and based on regression analysis assigns a relative weight to each factor. This process is run monthly for both technical and fundamental factors and generates fundamental forecasts and technical signals for each commodity. The fundamental forecasts are combined with the technical signals which strengthen or weaken those forecasts. This blended forecast for each commodity is input into the optimiser that also incorporates historical covariance and volatility for each commodity over the prior six-month period.

On a periodic basis BCFS will meet with the commodities research team to ensure that the factors remain relevant. New factors may be included or there may be a shift in an individual factors relationship with a commodity.

The technical and fundamental factors are not subjective. They represent known historical data in the market such as GDP, employment numbers and inflation. Therefore the backtests done by the model are seen as more representative of the views that would have been taken at the time.

As the model is predictive for the month ahead, the allocations are advised by the fund manager, BCFS, to the index products group and commodities trading desk at Barclays Capital. The trading team executes the orders to provide the returns of the CORALS (USD) index via a swap. This is executed at published closing index levels.

Investment Process

The investment process has three stages. Although the index is model-based, it takes into account both fundamental and technical factors. Barclays Capital selected these 12 commodities as they are the most liquid within each sector, yet they also provide sufficient depth and offer a diversified exposure due to their low historical correlation to each other.

Stage One--Formalisation of Investment Views.

In stage one investment-strategy views are formalised based on how different return drivers are likely to affect both the spot and commodity futures prices in the coming one-month period.

July. 11, 2008

Spot Price

In determining the forecast for the spot price, both fundamental and technical drivers are taken into consideration. In the fundamental analysis, six major factor components are built into the view. These are discussed below with some examples of what falls into each component.

- Macro: inflation, GDP data, growth, and employment.
- Market data: exchange rates, roll yield.
- Survey data: consumer confidence, sentiment surveys.
- Leading factor: yield and earnings forecasts.
- Position: total position, the exchange, and by hedge funds.
- Fundamental: credit spreads, inventories.

Technical drivers are the specific indicators that technical analysts use to determine trends and rates of change in different financial securities. Again, for illustrative purposes these are spread into four key components.

- Trend: relative strength and moving average.
- Demand-supply: open interest and trading volumes.
- Risk aversion: implied and 10-day volatility.
- Mean reversion: oscillators.

Futures Price

Commodity prices trade with a term structure, meaning the price for each commodity is dependent on the physical delivery date of the forward or futures contract. To remain invested in the current price of any commodity, known as the spot price, the investor is required to roll contracts. This in turn generates gains or losses often referred to as roll yield. Where the future or forward price is higher than the spot price and the futures curve slopes upwards then the roll yield for long positions is typically negative. Where the futures price is below the spot price then roll yield is typically positive for long positions.

The CORALS model looks at whether roll yield is a factor with reference to the term structure of each commodity curve and influencing factors impacting the shape of that curve. Where roll yield is determined to be a key factor it will become an input into the return forecast for that commodity.

Stage 2--Validation of the Forecasts

The fundamental forecasts are expressed as a percentage, and this generates a long or short signal. For instance, a negative 4% expected return forecast for corn would result in a short signal. The technical signals are then applied to this output to give the overall expected return for a commodity. Taking the example above, the technical signal will either be neutral, short, or long. A neutral signal would scale back the forecast, so in this case it may suggest a negative 2% expected return for corn. If the signal were short then the full negative 4% would be the expected return number.

Should the technical and signal forecasts differ, i.e. one is long and one is short, the fundamental forecast would be scaled back considerably to produce a minimal expected return. The following table summarises the validations. These expected returns then become the inputs for the asset-allocation optimisation tool.

Stage 3--Portfolio Optimisation

The portfolio-optimisation tool is a model that uses a mean-variance optimisation framework that incorporates a number of factors to come up with the final asset-allocation weighting.

In this stage the expected returns for each commodity is optimised using a variance-covariance matrix based on historical data to provide the asset-allocation weighting. This procedure will be carried at the end of each month to determine the allocation for the following month.

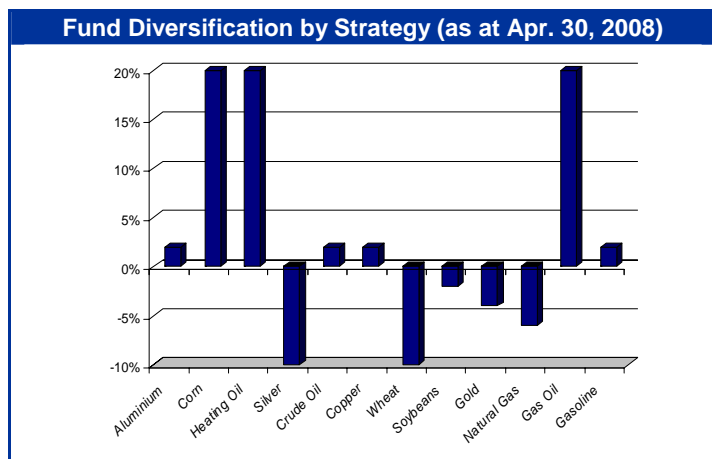
The strategy is always invested in all 12 commodities, either in a long or short position, subject to the individual commodity and sector constraints. Even though each commodity can implement a 20% long position, the maximum sector position is 50%, so that the fund avoids a large skew to any one sector. Market exposure cannot exceed 100%, so the manager does not apply borrowing or gearing to the fund.

The CORALS index references the underlying commodities via the S&P/GSCI single-commodity indices to ensure transparency.

Current Portfolio Holdings

As of April 30, 2008, there were five short positions, two of which were at the maximum negative 10% level (wheat and silver). On the long side, three commodities had maximum 20% allocations, and the remainder were between +2% and -6% allocations.

This is only a snapshot at a point in time, and the CORALS (USD) index allows for positions between +20% and -10% for each commodity. There are also sector constraints to ensure diversification. For instance, between April and May this year, silver moved from a positive 2% position to a negative 10% position; gold went from positive 4% to negative 4%; and copper changed from negative 6% to positive 2%.



Performance

The fund will start trading in July 2008, and so has no local track record on which to comment. The underlying index started live trading in February 2008. Back-tested performance is available from Barclays Capital or Aurora Funds Management that dates back to December 1999 but reflects a different fee structure than the locally-offered product. All of the attribution and commentary to follow refers to this dataset.

The correlations shown in the table opposite indicate that the strategy has very low correlations to traditional asset classes and resource stocks, and that it is not driven by exposure to the energy sector.

Attribution

The ability to change allocations in a short timeframe is a major benefit and differentiates the fund to the majority of long-only products in the local market. Attribution from the backtest shows that substantial excess returns can be added by adopting this approach. Although there will be times when the model does respond too early or late to each commodity, the data shows that excess returns are delivered on both a monthly and cumulative basis to a long-only exposure to the same commodities. Indeed the index would have produced a gross excess return of 68.15%

Commodity Contract Limits			
Commodity	Sector	Max Short	Max Long
Aluminium	Industrial metals	-10%	20%
Copper	Industrial metals	-10%	20%
Total Industrial Metals		-20%	40%
Silver	Precious metals	-10%	20%
Gold	Precious metals	-10%	20%
Total Precious Metals		-20%	40%
Heating Oil	Energy	-10%	20%
Crude Oil	Energy	-10%	20%
Natural Gas	Energy	-10%	20%
Gas Oil	Energy	-10%	20%
Gasoline	Energy	-10%	20%
Total Energy		-50%	50%
Wheat	Agriculture	-10%	20%
Soybean	Agriculture	-10%	20%
Corn	Agriculture	-10%	20%
Total Agriculture		-30%	50%

over an equally weighted basket of the S&P/GSCI sub-indices (the indices used to implement the positions) since December 1999.

It is hard to make general statements on whether signals work better in some sectors or commodities than in others. Attribution is best examined cumulatively over the index rather than by individual commodities or sectors in isolated time periods. As an example of this there have been 56 instances where the commodities in the agriculture sector have had a maximum short allocation of -10%. In some instances the sub-index returns have been positive and in others negative. However, overall each commodity has produced an overall negative return as measured by the sub-index. For industrial metals, the opposite is the case; there have been 31 instances of the maximum short allocations occurring and both sub-indices have increased quite substantially overall.

As an overall portfolio the diversification argument seems to hold true and that in the event that a few commodities have negative months, the remaining commodities offset this.

Correlation to the CORALS TR index	
BHP	0.19
Rio Tinto	0.13
S&P/ASX200	0.00
Citigroup World Bond Index	0.08
Natural Gas	0.38
Crude Oil	0.61
Dow Jones AIG TR	0.60
S&P/GSCI TR	0.63

Source: Barclays Capital. Data for the CORALS (USD) index are the results of a back-test from December 1999 to January 2008. The Australian product has a higher cost structure than the costs assumptions made in the stand-alone index and there may be some tracking error.

Back tested Returns of Corals TR index	
Annualised monthly return (% p.a.)	23.53
Annualised monthly volatility (% p.a.)	12.29
Largest annual loss (% p.a.)	(0.14)
Maximum monthly loss (%)	(7.08)
Months to recover loss	5

Source: Barclays Capital. Data for the CORALS (USD) index are the results of a back-test from December 1999 to January 2008. The Australian product has a higher cost structure than the costs assumptions made in the stand-alone index and there may be some tracking error.

Risk Management

The index has allocation constraints on the individual commodities to preserve portfolio diversification. In limited circumstances the manager also applies formal risk-management techniques. As the positions can be short and long and the index is concentrated into 12 commodities, there is the potential to suffer larger losses as the fund could be positioned on the wrong side of each commodity.

Examining the back-tested data of the CORALS total return index, the largest monthly loss was 7.08%. This took five months to recover, but that is for the index as a whole, and not an individual commodity. For individual commodities gasoline had the maximum weighted contribution loss of -7.03% so not dissimilar to the maximum overall loss that the index has experienced. This shows that the risk sizing and adjustments help keep both risk and volatility under control. In general terms, the maximum loss is at roughly the same level as for the Dow Jones AIG index, but with a quicker response to the draw down. The much more volatile S&P/GSCI index has almost double the maximum drawdown and time to recover the loss.

Management Group Profile

Investment Adviser

Barclays Bank plc is a UK-listed financial-services group that had over US\$2.4 trillion in funds under management in December 2007. It has an investment-grade credit rating. Barclays Capital is the investment bank of Barclays Bank plc. Within Barclays Capital, Barclays Capital Fund Solutions (BCFS) is the investment management team and has been appointed as the investment adviser to the responsible entity. BCFS will advise as to the swap transaction that provides exposure to the underlying CORALS (USD) index.

Barclays Bank plc has offices in over 60 countries and employs over 134,000 people. It is regulated by the Financial Services Authority (FSA) in the U.K.

Assets under Management

This is a new fund at the time of writing.

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Release authorised by: Mark Hoven.

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