



Discovery Investment Services Core Income Fund

Delivering an attractive balance of risk and return, the Discovery Investment Services Core Income Fund is a blend of traditional mortgage trust returns, with the security of a well diversified portfolio of first mortgages.

Retail 1 year return

3.11%*

Wholesale 1 year return

3.72%*

Key benefits

- Attractive income returns
- Monthly income payments
- Stable unit price
- Specialist mortgage asset managers managing the Fund
- Diversification of geographic location, property sector, size, loan type and maturity profile
- Secured by registered first mortgages
- Flexibility to invest in fixed interest and property to diversify sector and income risk

What does the fund invest in?

The Fund will use investor contributions primarily to acquire units in a blended portfolio of various Underlying Funds focused predominantly on the mortgage sector, including:

- Australian Unity High Yield Mortgage Trust (HYMT)
- Australian Unity Mortgage Income Trust (MIT)

These Underlying Funds primarily invest in a portfolio of loans secured by registered first mortgages over quality retail, commercial, investment residential, industrial property and other income producing assets. The HYMT also invests in vacant land and specialised loans such as service stations, motels and cinemas.

There are currently 137 mortgagors within the HYMT representing 151 loan accounts. Nineteen loan accounts were in arrears as at 31 December representing 14.39% of net assets. The current average loan to valuation ratio is 70.2%.

There are currently 221 mortgagors within the MIT representing 271 loan accounts. Six loan accounts were in arrears as at 31 December representing 1.47% of net assets. The current average loan to valuation ratio is 61.8%.

Fund investments

	%
HYMT	72.97
MIT	23.97
Cash & short term securities	3.06
Total	100.00

Fund performance

Retail units	1 mth %	3 mths %	6 mths %	1 year %	2 year % p.a.	3 year % p.a.
Total return	0.24	0.71	1.42	3.11	5.05	5.70
Wholesale units	1 mth %	3 mths %	6 mths %	1 year %	2 year % p.a.	3 year % p.a.
Total return	0.30	0.87	1.72	3.72	5.68	6.32

Returns are calculated after fees and expenses and assume the reinvestment of distributions. Past performance is not a reliable indicator of future performance. # Inception date for performance calculations is 31 December 2006.

* One year return, assuming reinvestment of distributions.



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Sector allocation of the underlying fund

Asset class	Actual HYMT %	Actual MIT %
Registered first mortgages	80.07	81.48
Cash and short term securities	19.93	18.52
Total	100.00	100.00

Arrears

HYMT Days in arrears	Number of loans	% of fund size
31 - 60	3	2.07
61 - 90	0	0.00
> 90	16	12.32
Total	19	14.39

MIT Days in arrears	Number of loans	% of fund size
31 - 60	2	0.84
61 - 90	0	0.00
> 90	4	0.63
Total	6	1.47

Geographic allocation of the underlying fund

State	Actual HYMT %	Actual MIT %
NSW / ACT	59.17	38.41
VIC / TAS	19.99	24.99
QLD / NT	17.03	32.07
WA	3.81	2.69
SA	0.00	1.84
Total	100.00	100.00

Interest rate type of the underlying fund

Type	Actual HYMT %	Actual MIT %
Fixed Rate Loans	6.38	30.54
Variable Rate Loans	93.62	69.46
Total	100.00	100.00

Fund snapshot

	Retail units	Wholesale units
Inception date	11 December 2006	11 December 2006
Minimum initial investment	\$25,000	IDPS/ MasterFund minimums will apply
Entry fee	Nil	Nil
Exit fee	Nil	Nil
MER	1.70%	1.10%
Buy/sell spread	Nil	Nil
Income distributions	Monthly	Monthly
Adviser commission	0.495% pa	Nil

Mortgage selection criteria	AUI High Yield Mortgage Trust	AUI Mortgage Income Trust
Total assets in registered first mortgages	Up to 100%	Up to 90%
Maximum single loan exposure	No single loan amount to exceed the greater of \$10 million or 5% of net assets of the Fund.	No single loan amount to exceed 5% of net assets of the Fund.
Maximum Loan to Valuation Ratio (LVR)	85%	70%
Loans secured by income producing property	Yes, however, annual rents must be greater than 80% of annual interest payments.	
Loans secured by owner occupied property	Yes, however, borrowers must demonstrate strong repayment ability.	
Loans secured by vacant land	Yes, however, borrowers must pre-pay interest for the term of the loan.	No
Exposure to specialised securities	Yes, however, no single loan to valuation ratio for specialised securities to exceed 70%.	Yes, however, no single loan amount for specialised securities to exceed 1% of net assets.
Exposure to construction and development loans	Yes, however, borrowers must demonstrate an adequate level of pre-sales or lease commitments.	No



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Investment manager

Australian Unity Funds Management Limited undertakes the investment management of the Fund, and generally of the Underlying Funds. Their success in mortgage management can be attributed to their sound management of cash levels, excellent arrears record and well-defined risk parameters.

Investment process

Australian Unity Investments (AUI) maintain strong relationships with key commercial and residential originators Australia-wide. This ensures that AUI are able to convert cash into mortgages over a relatively short space of time, ensuring strong returns for investors.

AUI is one of the few funds management groups with the in-house expertise required to directly manage mortgages. AUI currently manage a portfolio of registered first mortgages over retail, commercial, investment residential and industrial property valued at over \$1 billion. Mortgages are an outstanding asset class for investors who wish to diversify their exposure across a range of income-producing assets with some certainty of consistent income. In particular, mortgages satisfy four key criteria required by a conservative investor:

- **Security** – AUI advance loans on property against the security of a registered first mortgage. Stringent credit analysis is performed, ensuring that borrowers can service interest commitments. Additionally, the property is generally income producing, which provides the added security of a rental income stream. Before a mortgage is approved, an independent valuation is obtained to assess the market value of the security property. A loan to valuation ratio is then applied, ensuring adequate borrower equity in the property. Risk management of the mortgage portfolio is also extremely strong. Mortgages are diversified by geographic location, sector, loan size, and interest rate and maturity profile according to a stringent set of benchmarks, ensuring that minimum levels of diversification are achieved. Exposure to individual borrowers is monitored and controlled by maximum exposure limits.
- **Steady income stream** – Mortgages provide a regular monthly income stream. The interest rate for a mortgage can be fixed or variable. This provides the flexibility to implement different fixed/variable weightings depending on the economic outlook.
- **Premium income yield** – Fixed and variable rate mortgages produce a yield that is superior to that received from cash-based investments. AUI set interest rates at a margin above the prevailing 90-Day Bank Bill Rate, adjusted quarterly, or fixed at a margin above the relevant loan period Swap Rate.

- **Capital stability** – Unlike alternative fixed interest investments, mortgages do not generally need to be marked to market. As a result, the volatility in financial returns is reduced.

Sector in review

Liquidity management remains the key focus of all mainstream mortgage trust managers and most (if not all) are not currently undertaking any new lending or renewing existing loan accounts upon maturity.

Most of the major research houses still maintain an 'on hold' status for most of the participants in the conventional mortgage trust sector.

The level of arrears is elevated for the high yield sector when compared to its conventional counterpart; we will continue our efforts to reduce the level of arrears during the first six months of 2010.

The Reserve Bank of Australia (RBA) moved from neutral to tightening bias increasing the official cash rate by 0.75% to 3.75%; during the quarter. The RBA believes that the emergency measures implemented during the past twelve months can now be relaxed.

Underlying Funds in review

High Yield Mortgage Trust

Some key milestones include:

- Investment performance during the quarter remained stable.
- The mortgage portfolio is comprised of approximately 94% variable rate mortgages.
- There were nineteen loan accounts more than thirty days in arrears representing 14.39% of funds under management. All loans in arrears are being supervised by the Australian Unity Asset Management Committee (AMC), which brings together lending, legal, finance and property management staff. Our approach is to evaluate the immediate sale of the security property or improve the security by leasing the security property. This evaluation process is critical to how the AMC deal with the security asset.
- At the time of writing this report we had one long-standing default property under contract for sale subject to finalisation of due diligence. This account represents approximately 1.70% of funds under management.
- Mortgage allocation was 80.07%.
- HYMT currently is not undertaking any new lending due to the changed redemption offer.
- Variable rate loans were repriced on 1 November. The next reprice is due on 1 February 2010.



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Mortgage Income Trust

Investment performance during the quarter is as follows:

- The mortgage portfolio is comprised of approximately 69% variable rate mortgages.
- There were six accounts more than thirty days in arrears representing 1.47% of funds under management. All loans in arrears are being supervised by the Australian Unity Asset Management Committee (AMC), which brings together lending, legal, finance and property management staff. Our approach is to evaluate the immediate sale of the security property or improve the security by leasing the security property. This evaluation process is critical to how the AMC deal with the security asset.
- Mortgage allocation was 81.48%.
- MIT is not undertaking new lending or offering renewal to maturing loan account holders, in order to maintain sufficient cash holdings to meet ongoing monthly redemption offers.
- Variable rate loans were repriced on 1 November. The next reprice is due on 1 February 2010.

Outlook

Our lending teams remain in place in Melbourne, Sydney and Brisbane ensuring sound management of our existing mortgage portfolio. The key focus is two-fold; management of the existing mortgage book and managing down the level of current arrears and defaulting loan accounts. Our intention is to sell some of these defaulting loan assets commencing second quarter 2010, thereby reducing the level of arrears.

The change to an interest rate tightening bias by the Reserve Bank will be accretive to investment performance of the fund during the next quarter. The next variable rate re-price is due on 1 February 2010.

Commentary courtesy of Australian Unity Investments. 'Australian Unity Investments' is a general description which covers entities within the Australian Unity Group undertaking investment activities, and includes Australian Unity Funds Management.

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For more information or full product details, please refer to the
Product Disclosure Statement.

Important information

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