



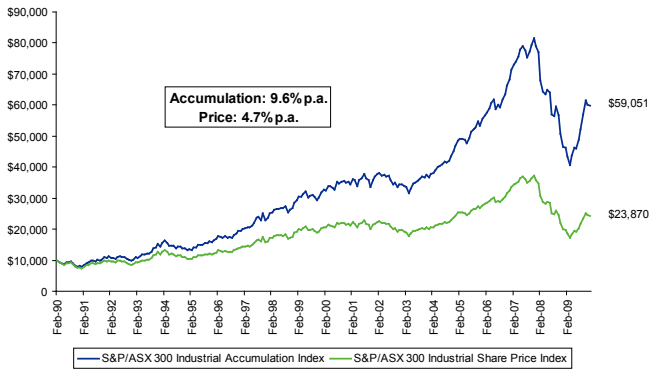
Building the case for dividends

One year ago, in our March 2009 Quarterly Investment Update, we examined the importance of dividends to investment returns. In that article we looked at long-term studies of the US equity market to illustrate the power of compounded dividends and the huge difference they can make to an investor's portfolio returns over time.

This quarter we look to build on those theories and apply a focus to dividends in the context of the Australian sharemarket.

The power of compounding

The power of compounded dividends in the Australian market is perhaps best illustrated in the following chart, which splits up the returns from the market index into accumulation versus price only.



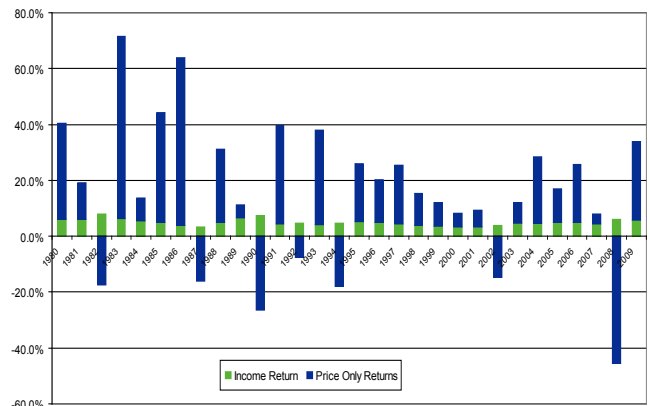
Australian shares - income vs growth

Source: Aviva Investors

As can be seen, the compounding effect increases over time and has helped equities deliver terrific long-term capital growth for investors.

An often overlooked aspect of the importance of dividends is the consistency of income returns, which are a big driver of the compounded returns highlighted in the previous graph. The following chart highlights the reliability of a dividend income stream, which has remained solid even during periods of high equity market volatility.

S&P/ASX 200 Industrials Accumulation Index

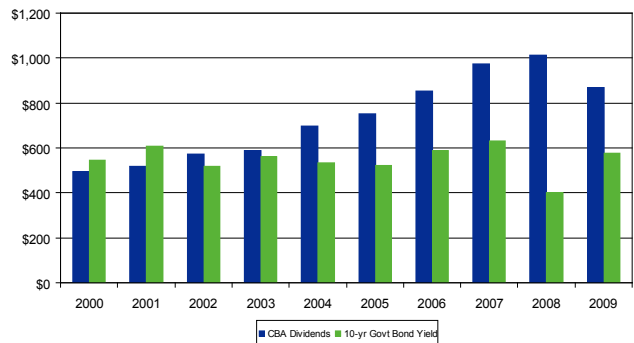


Source: Aviva Investors

Blue Chips

Clearly equities can be a powerful source of income for long-term investors. But how do Australian shares compare to other asset classes such as bonds? To explore this topic we have conducted a simple study based on comparing the dividend returns over the last ten years from investing \$10,000 in both the blue chip Australian company, Commonwealth Bank (CBA), and Australian Government 10-year bonds.

CBA dividends vs bond income



Source: Aviva Investors

As can be seen, the bond income is greater than the dividend income over the first two years, but the dividend income catches up and then grows to produce an income stream that far outweighs the bond income. This was even the case in 2009 where there was a cut to CBA's dividend payment.

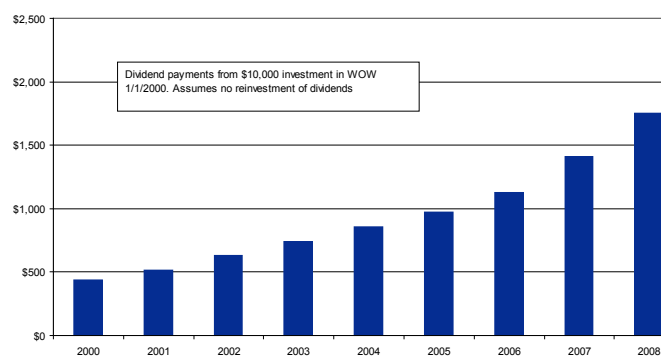
What makes the argument for equities as an income source even more compelling is the effect of franking credits and capital gains, which are not shown above. The CBA dividend stream also delivered valuable franking credits to the investor as a result of Australia's dividend imputation system, and therefore the after-tax returns of equities versus bonds look even better. In addition, CBA shares also produced some very healthy capital gains which were well above those produced by bonds.

One of the reasons for selecting CBA as the highlighted example is that it reinforces our belief that it is the quality of the company behind the dividend stream that results in equities being able to produce such a great after-tax income solution for investors.

This philosophy goes to the heart of our approach to managing income-focused equity funds at Aviva Investors. **Our belief is that the best way to build an income-focused share portfolio is to take a bottom-up approach to stock picking as opposed to simply selecting the highest yielding stocks.**

A further example of this concept can be seen by looking at the income returns delivered by Woolworths over the last ten years.

Woolworths growing dividends



Source: Aviva Investors

Woolworths has not typically been thought of as a high yielding stock in the Australian market, yet this chart shows that investors would have received a terrific income stream from an initial investment in Woolworths back in 2000. This highlights the previous point that focusing on a quality income stream that can grow strongly over the long-term is beneficial, and is our preferred approach to building income-focused Australian share portfolios like Dividend Builder and the Listed Property Fund.

A thought for the long-term

As a final point, I would like to repeat what we wrote in our article one year ago given its continued relevance to investors considering their current investment strategies:

“One such possibility is the re-emergence of high inflation. In this instance, seemingly safe fixed yielding investments such as bonds can quickly lose value, whereas equities with strong balance sheets and pricing power can be well placed to preserve the value of your investment and income stream.”

Conclusion

The research presented in both this article and the March 2009 article makes a logical case for equities as a good source of income within an investors' balanced portfolio. This story is even more compelling in the Australian sharemarket given the value of franking credits often attached to dividend payments.

We believe that the key to managing an income-focused share portfolio is to use an active, bottom-up stock selection approach as opposed to just investing in the highest yielding stocks without any regard for future income and capital growth.

Feature products

The Aviva Investors Dividend Builder and Listed Property Fund are two examples of funds available to investors specifically aiming to deliver high levels of dividend income while still providing the opportunity for capital appreciation.

Below are short commentaries on each Aviva Investors fund, outlining their gross performance and the main contributors to performance.[#]

Australian Equities Fund - The fund returned 1.6% for the March quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index return of 1.4% by 0.2%. The main contributors to performance for the portfolio over the quarter were overweight positions in CSL and Brambles. Being underweight ANZ Banking Group and overweight in CSR detracted from performance.

Australian Resources Fund - The fund delivered a return of 1.3% for the quarter, outperforming the benchmark S&P/ASX 300 Resources Accumulation Index of 1.1% by 0.2%. Positively contributing to performance during the quarter were overweight positions in Macarthur Coal and Riversdale Mining. Main detractors from performance was not owning Arrow Energy and being overweight in Kagara.

Dividend Builder - The fund delivered a return of 1.4% for the quarter, in line with the benchmark S&P/ASX 200 Industrials Accumulation Index. Not owning QBE Insurance Group and having an overweight position in Westpac Banking Corporation positively contributed to performance. Being overweight in Goodman Fielder and CSR detracted from performance.

Elite Opportunities Fund - The fund returned 1.7% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index return of 1.4% by 0.3%. The main contributors to performance for the portfolio were overweight positions in CSL and Brambles. Main detractors from performance over the quarter was an overweight positions in QBE Insurance Group and being underweight Commonwealth Bank.

High Growth Shares Fund - The fund returned 0.1% for the quarter, underperforming the benchmark S&P/ASX 200 Accumulation Index of 1.4% by 1.3%. Contributing to performance during the March quarter was an overweight position in CSL and an underweight position in James Hardie Industries. Main detractors from performance were overweight positions in QBE Insurance Group and Downer EDI.

Long/Short Equity Fund - The fund delivered a return of 0.3% for the quarter, underperforming the combined benchmark S&P/ASX 200 Accumulation Index (75%) and UBS Bank Bill Index (25%) of 1.3% by 1.0%. Positively contributing to performance during the quarter was an overweight position in CSL and an underweight position in James Hardie Industries. Detracting from performance were overweight positions in QBE Insurance Group and Downer EDI.

Small Companies Fund - The fund delivered a return of -1.5% for the quarter, outperforming the benchmark S&P/ASX Small Ordinaries Accumulation Index of -1.6% by 0.1%. The main contributors to performance for the portfolio was an overweight position in Mesoblast and not owning Sigma Pharmaceuticals. Detracting from performance were zero holdings in Macarthur Coal and Ramsay Health Care.

Sustainable Investment Fund - The fund returned 2.3% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index of 1.4% by 0.9%. The main contributors to performance for the portfolio during the March quarter, was a zero holding in Telstra Corporation and an overweight position in CSL. Stocks detracting from performance were overweight positions in Toll Holdings and an underweight position in ANZ Banking Group.

Australian Shares Fund* - The fund delivered a return of 1.6% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index of 1.4% by 0.2%. The main contributors to performance for the portfolio over the quarter were overweight positions in CSL and Brambles. Being underweight ANZ Banking Group and overweight in CSR detracted from performance.

Listed Property Fund - The fund delivered a return of -0.8% for the quarter, outperforming the benchmark S&P/ASX 200 A-REIT Accumulation Index of -1.5% by 0.7%. Positively contributing to performance during the quarter were overweight positions in Challenger Diversified Property Group and Peet. Stocks detracting from performance were underweight positions in Goodman Group and having an overweight position in Transurban Group.

Premier Fixed Income Fund - The fund returned 2.0% for the quarter to outperform the benchmark¹ return of 1.6% by 0.4%. Credit spreads globally continued to contract or improve and credit related securities performed strongly as a result. The fund's allocation to global high yield provided the major contribution to outperformance over the period.

High Yield Fund* - The fund outperformed its benchmark return for the fourth quarter in a row, delivering a positive return of 1.5% versus the benchmark² return of 1.1%. Credit spreads continued to contract or improve and credit related securities performed strongly as a result. The fund also continued to benefit from its investments in floating rate securities that outperform when the Reserve Bank of Australia is in a tightening phase of monetary policy, i.e. increasing the official cash rate.

[#] All returns are gross of fees. Please refer to page 4 of the Quarterly Review for a summary of returns which are net of fees.

* Closed to new investments

¹ Benchmark is 75% UBS Australia Composite Bond Index and 25% Barclays Capital Global Aggregate Bond Index (hedged into A\$)

² Benchmark is UBS Australia Composite 0-5 Year Index

Aviva Investors Investment Returns

Performance to 31 March 2010

		3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Since Inception % p.a.
Australian Equities						
Australian Equities Fund Inception date: 03/07/1995	Gross Return	1.6	43.0	0.3	9.9	11.8
	Benchmark Return	1.4	41.7	-2.4	8.1	10.5
	Excess Return	0.2	1.3	2.7	1.8	1.3
	Net Return	1.4	41.8	-0.6	9.0	10.8
Australian Resources Fund Inception date: 03/03/2008	Gross Return	1.3	41.0	-	-	0.8
	Benchmark Return	1.1	37.4	-	-	-2.4
	Excess Return	0.2	3.6	-	-	3.2
	Net Return	1.1	39.0	-	-	-0.5
Dividend Builder Inception date: 06/09/2005	Gross Return	1.4	42.5	-3.7	-	4.9
	Benchmark Return	1.4	43.8	-5.6	-	4.0
	Excess Return	0.0	-1.3	1.9	-	0.9
	Net Return	1.3	41.7	-4.3	-	4.3
Elite Opportunities Fund Inception date: 18/11/2002	Gross Return	1.7	47.9	3.0	11.5	15.9
	Benchmark Return	1.4	41.7	-2.4	8.1	11.5
	Excess Return	0.3	6.2	5.4	3.4	4.4
	Net Return	1.6	46.6	2.2	10.7	14.9
High Growth Shares Fund Inception date: 07/12/1999	Gross Return	0.1	43.1	4.9	11.5	15.3
	Benchmark Return	1.4	41.7	-2.4	8.1	8.8
	Excess Return	-1.3	1.4	7.3	3.4	6.5
	Net Return	-0.2	41.7	3.5	10.2	13.4
Long/Short Equity Fund Inception date:	Gross Return	0.3	33.7	7.2	13.3	16.0
	Benchmark Return	1.3	31.3	-0.2	9.5	11.9
	Excess Return	-1.0	2.4	7.4	3.8	4.1
	Net Return	0.1	32.4	5.6	12.0	14.8
Small Companies Fund Inception date: 19/11/1999	Gross Return	-1.5	65.4	2.6	12.7	13.5
	Benchmark Return	-1.6	58.1	-7.5	5.8	6.2
	Excess Return	0.1	7.3	10.1	6.9	7.3
	Net Return	-1.7	63.7	1.6	11.6	12.4
Sustainable Investment Fund Inception date: 16/02/2006	Gross Return	2.3	43.8	3.1	-	6.8
	Benchmark Return	1.4	41.7	-2.6	-	4.8
	Excess Return	0.9	2.1	5.7	-	2.0
	Net Return	2.1	42.6	2.2	-	5.9
Australian Shares Fund* Inception date: 25/01/2000	Gross Return	1.6	44.2	1.0	10.1	10.4
	Benchmark Return	1.4	41.7	-2.4	8.1	9.0
	Excess Return	0.2	2.5	3.4	2.0	1.4
	Net Return	1.4	43.0	0.1	9.2	9.5
Listed Property						
Listed Property Fund Inception date: 28/02/1994	Gross Return	-0.8	34.2	-17.3	-2.6	7.3
	Benchmark Return	-1.5	40.6	-22.8	-6.9	5.6
	Excess Return	0.7	-6.4	5.5	4.3	1.7
	Net Return	-1.0	33.3	-17.9	-3.3	6.6
Fixed Income						
Premier Fixed Income Fund Inception date: 31/05/2000	Gross Return	2.0	6.0	6.8	6.4	6.9
	Benchmark Return	1.6	4.6	7.2	6.4	6.7
	Excess Return	0.4	1.4	-0.4	0.0	0.2
	Net Return	1.9	5.5	6.4	6.0	6.5
High Yield Fund* Inception date: 21/01/2004	Gross Return	1.5	19.3	1.8	3.8	4.6
	Benchmark Return	1.1	3.8	6.8	6.2	6.0
	Excess Return	0.4	15.5	-5.0	-2.4	-1.4
	Net Return	1.4	18.5	1.2	3.1	3.9

* Closed to new investments

Disclaimer: All net returns are based on exit to exit unit prices for Professional Selection units, are net of fees and assume the reinvestment of income. Past performance is not a guide to or indication of future performance. At Aviva Investors' discretion, the management and/or performance fee may be partly rebated to professional, sophisticated or wholesale investors. The above information is of a general nature and has been prepared without taking account of your individual investment objectives, financial situation or particular investment needs. It is not intended as financial advice to retail clients. Before making an investment decision, you should consider the appropriateness of the information, having regard to your objectives, financial situation and needs. We recommend you consult with your financial adviser, who can help you determine how best to achieve your financial goals and whether investing in a fund is appropriate for you. Investment in the Aviva Investors Investment Funds will only be made upon receipt of a completed application form from the current PDS, a copy of which can be obtained from Aviva Investors. Aviva Investors Australia Limited ABN 85 066 081 114. AFS Licence No 234483. Level 28 Freshwater Place, 2 Southbank Boulevard, Southbank VIC 3006 GPO Box 2007s, Melbourne 3001 Telephone: (03) 9220 0300 Facsimile: (03) 9220 0333 Email: investorservices.au@avivainvestors.com Website: www.avivainvestors.com.au Part of the international Aviva plc group.