

December 2011

'...February reporting season will provide an important marker for the Emerging Leaders Index but in the interim, corporate activity may continue to provide valuation metrics...'

Market Review

Portfolio performance for the month of December was -2.61% versus the benchmark return of -2.88%.

The Australian equity market as measured by the Emerging Leaders composite benchmark closed the month 2.9% lower. Equity markets fell in December for the eighth time in 2011 as investors avoided risk assets due to ongoing concerns over the sovereign debt crisis in the European Union and its potential impact on global growth. Stocks were also negative due to concerns regarding the near term Chinese growth slowdown. However on a positive note, markets were surprised by stronger than expected US economic data released during the month.

Portfolio Review

At a sectoral level, the Portfolio benefited from the overweight positions in the Industrials and Telecommunications sectors and the underweight positions in the Materials and Information Technology sectors. Conversely the nil holdings in the Utilities and the underweight in Consumer Staples sectors detracted from performance. The overweight in Consumer Discretionary and Energy Sectors also detracted from relative performance.

At a stock level, the overweight positions in Gloucester Coal, Bionomics and Transpacific Industries were the largest positive contributors to performance. Not holding JB Hi-Fi and Lynas also assisted relative performance. Detractors to the Portfolio included the overweight positions in Kathmandu and Mineral Resources, while the nil holdings in Cochlear and Tatts Group also detracted from performance.

Outlook

Europe's ability to deliver a credible and co-ordinated plan to counter the sovereign debt issues of several of its constituents remains a key focus for investors. Attempts thus far have fallen short of the mark and the impact felt via a general de-rating of risk assets globally. While events in Europe will continue to drag on market sentiment, confirmation of a recovery in the US recovery or a clear indication of robust Chinese growth (at a minimum, as per the 12th 5 year plan projections) would see Europe's relative importance reduced in the eyes of investors. On China, the move by the PBOC to ease the Reserve Requirement Ratio for the first time since early 2010 should backstop expectations that growth is being appropriately managed.

Having witnessed ongoing downgrading of growth expectations through 2011, the market still appears to be pricing further weakness for 2012, with domestic equities (as measured by the S&P/ASX Midcap 50 Index) trading on an FY12 multiple of 11.4 times. FY13 presents an even more pessimistic view at 9.8 times. The S&P/ASX Small Ords is trading on a relatively more aggressive 12.7 times FY12 whilst yields appear supportive for both measures at 5.3% and 4.0% respectively for FY12. Earnings growth assumptions of 7.6% and 39.7% respectively are likely to be cum downgrade – more so the further one ventures down the market cap chain - but valuations appear to be largely discounting this risk already. The February reporting season will provide an important marker for the Emerging Leaders Index but in the interim, corporate activity may continue to provide valuation metrics, albeit at a slower pace given current funding scarcity and market uncertainty.

Portfolio Characteristics

Returns as at 31st December 2011

	Portfolio%^	Index*	Value Add%
One Month	-2.61	-2.88	0.28
Three Months	4.71	1.36	3.35
One Year p.a	-14.50	-17.81	3.31
Three Year p.a	11.49	7.67	3.82
Five Years p.a	-0.53	-5.36	4.83
Since Inception p.a Date: March 2005	6.89	2.26	4.63

Top 10 Stocks

	Portfolio%	Index*	Tilt%
Challenger Financial	5.84	1.70	4.14
Gloucester Coal	5.68	0.22	5.46
Oz Minerals	5.60	2.42	3.18
Mineral Resources	4.69	0.45	4.24
Ansell	3.55	1.47	2.08
Echo Entertainment Group	3.50	1.83	1.66
James Hardie Industries	3.20	2.20	1.00
REA Group	3.19	0.23	2.96
Dexus Property Group	3.16	2.99	0.17
Bradken	2.98	0.40	2.58

Portfolio Sector Tilts

	Portfolio%	Index*	Tilt%
Energy	9.87	6.45	3.41
Materials	21.46	25.19	-3.72
Industrials	20.03	15.36	4.68
Consumer Discretionary	17.01	15.19	1.82
Consumer Staples	5.00	6.05	-1.05
Healthcare	9.12	9.37	-0.25
Financials (x LPT)	7.73	6.75	0.98
LPTs	6.23	8.18	-1.95
IT	0.00	0.88	-0.88
Telecommunication	1.60	1.03	0.58
Utilities	0.00	5.57	-5.57
Cash	1.95	0.00	1.95
Total	100.00	100.00	-

*70% S&P/ASX Midcap 50 Acc Index and 30% S&P/ASX Small Ord Acc Index
^ Gross of Fees