

December 2009 Quarterly Retail Investment Report

Fairview Equity Partners – Emerging Companies Fund

Fairview Equity Partners is a smaller company Australian equities manager. The Fairview Equity Partners Emerging Companies Fund seeks to provide capital growth and some income by outperforming the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.

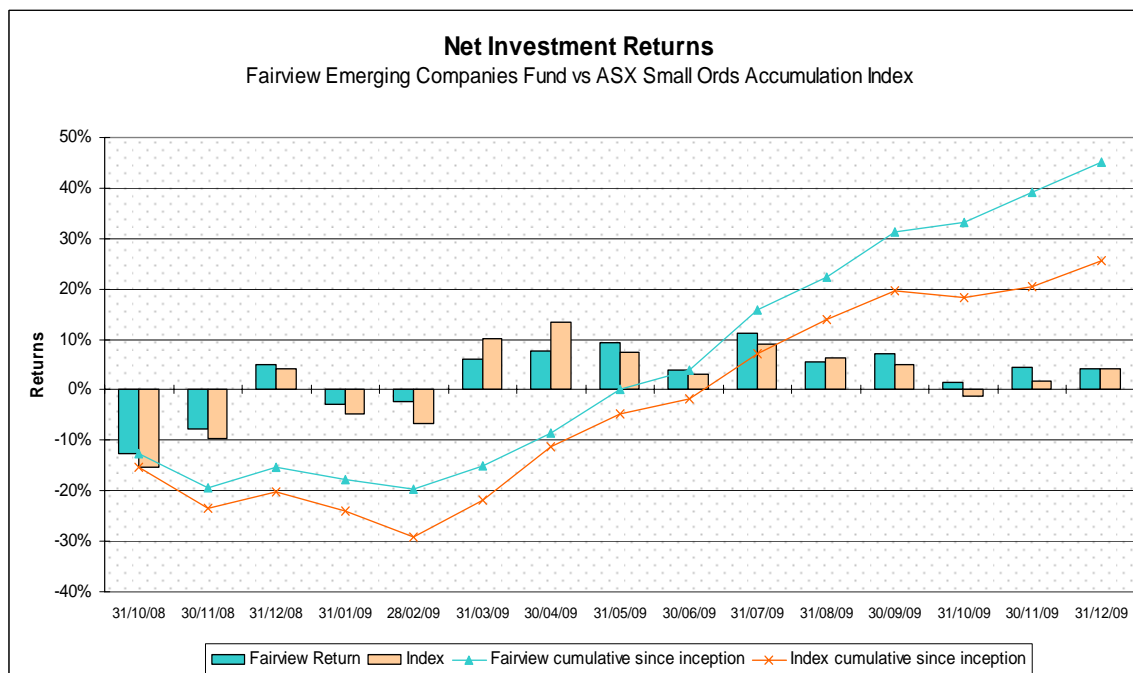
Performance Return

Period ending 31 December 2009	1 mth	3 mths	12 mths	Since inception #
Fairview Emerging Companies Fund *	4.28%	10.59%	71.38%	35.36%
S&P/ASX Small Ordinaries Accumulation Index	4.29%	4.88%	57.43%	20.28%
Net Excess Return	-0.01%	5.71%	13.95%	15.08%

* Returns shown are net of fees (including management and performance fees) but before tax

Annualised. Fund inception 8 October 2008

Following a significant recovery during calendar 2009 the S&P/ASX Small Ordinaries Accumulation Index closed the year on a solid note, rising by 4.3% during the month of December, with the December quarter increase +4.9%. The broader market continued to be supported by encouraging economic data, improving consumer and business confidence levels, as well as more positive AGM outlook comments and the commencement of positive earnings revisions. Within this environment the Fairview Emerging Companies Fund solidly outperformed, delivering strong absolute and relative gains to investors.



Market Outlook

Before crystal ball gazing for 2010 it is perhaps worth reflecting for a moment on the year that was. During calendar 2009 the S&P/ASX Small Ordinaries Accumulation Index rose by a significant 57.4%, although we note that this sees the Index back to September 2008 levels (just prior to the collapse of US investment bank Lehman Brothers, which brought with it fears of global financial system malaise) and still approximately 32% off its November 2007 highs. Within this benchmark return for calendar 2009 the Small Resources component rose 88.3% versus the Small Industrials +44.9%, highlighting that appropriate representation across the complete smaller companies universe was essential in order to produce strong relative returns for investors.

Price gains over the 2009 calendar year were primarily driven by P/E multiple re-rating, more than offsetting declines in earnings per share (EPS). However, these trends were somewhat divergent over the course of the year with most of the P/E multiple re-rating and EPS decline occurring during the first half. During the past 6 months the multiples largely stabilised whilst EPS estimates in several cases expanded more significantly. In our view this latter trend will be sustained through calendar 2010, as we enter a period of improving / positive earnings momentum.

We revisit below the key factors that typically drive equity markets. They do not provide for exact predictions or short term moves but in our view provide pointers of the general direction of markets. Pleasingly most of these are very supportive of continued strength in equity markets.

Valuation: Despite significantly appreciating from levels evident during the depths of market despair market P/E ratios have merely returned to more normalised levels. Indeed on fiscal 2011 earnings, which more closely approximate mid cycle levels, the market remains sizeably discounted versus historical averages. This is despite now more robust balance sheets and a significantly reduced earnings risk profile. Small caps remain at an above average discount to large caps despite being more leveraged to improving economic conditions.

Earnings revisions: The trend in earnings expectations are traditionally a key driver for equity markets. We view that we are at the early stages of an earnings upgrade cycle and are likely to see progressive upgrades to existing estimates, as previously cautious expectations are revised to reflect an improved environment and a greater appreciation of the likely full extent of margin improvement.

Economic: There has been a progressive and broad based improvement in lead economic indicators throughout the course of the year. We have seen a stabilisation of conditions within developed economies whilst emerging economies remain well placed for above average growth. Australia continues to prove itself as a stand out economy with solid fundamentals and continued exposure to likely solid growth out of Asia.

Capital Flows: A normalisation of economic conditions and improved financial market returns has seen investors commence a progressive reweighting back into equities from in many cases significant overweight cash positions.

In summary, whilst returns of a similar quantum to those of calendar 2009 are unlikely, there exists a strong case for a sustained further rise in the domestic equity market. Importantly, there are few of the more obvious triggers for a significant market fall.

Obviously, we are buying individual stocks rather than the market in aggregate and we continue to strongly view that as an experienced investment team with a robust and disciplined investment process and a rigorous program of company visitation, we are very well placed to continue to uncover mispricing opportunities within the smaller companies space.

Portfolio Strategy

The fund remains overweight many domestic cyclical sectors such as media, consumer, retail, financials and IT services. Additionally we retain several positions exposed to more global dynamics especially in energy related resource companies. These include some large coal positions and our preferred oil and gas companies. Almost half of the small cap index comprises resources and soft commodity exposures and we are currently similarly positioned in the fund.

We would still caution investors not to place undue reliance on broader thematic considerations. As always there is a wide disparity of business models and management capabilities that require careful appraisal to ensure a solid investment case. Further to this, activity is still slow in many areas exposed to new infrastructure and commercial property. Residential construction remains fairly anaemic although we are positive on this sector in the medium term.

Key underweights include property (no exposure), infrastructure and healthcare. Property has now separated into two distinct camps – those who re-capitalised and those who didn't (couldn't). The trusts that were unable to re-capitalise remain highly speculative propositions, while those who did destroyed most of their valuation appeal courtesy of the massive dilution caused by the new equity issuance. Although they are now more appropriately structured there is little appeal for equity investors given their limited growth prospects. Infrastructure is a similar story whilst healthcare contains both ongoing regulatory risks and an absence of suitably valued opportunities.

Finally we firmly believe that many stocks still offer outstanding value given their growth prospects and low multiples. Over half the stocks in the fund have a PER forward rating of below 11.5x which is indicative of the considerable investment opportunities we are seeing in the small cap space.

Performance Attribution

We highlight below the largest positive and negative relative performance contributors during the December quarter.

Positive contributors		Negative contributors	
Aquila Resources	Overweight	Karoon Gas	Nil Holding
Whitehaven Coal	Overweight	Mount Gibson Iron	Nil / Overweight
CSG	Overweight	Murchison Metals	Nil Holding
Carsales.com	Overweight	Virgin Blue	Nil Holding
Austin Engineering	Overweight	Customers	Overweight

Major Stock Additions

Discovery Metals (DML): Discovery Metals' key asset is the proposed Boseto copper project in Botswana. On current resources the stock screens very favourably. It is trading at a 40% discount to other copper explorers on a cash cost adjusted EV to resource basis. There is also significant scope for further expansion of current indicated resources. Such upgrades should extend the current 10 year mine life. The next key catalyst is the bankable feasibility study due for completion in March quarter 2010.

Mount Gibson Iron (MGX): We initiated a position in Mount Gibson Iron during the quarter. This stock offers significant leverage to near term iron ore prices due to its short mine life and higher cash costs of production (relative to the industry giants). The company is forecast to capture a vast majority of the mooted price increases due to the canny agreement it struck with two major Chinese shareholders during the depths of the financial crisis. The latest quarterly showed that production was recovering at the company's key assets of Koolan Island and the (depleting) Tallering Peak mine.

Mineral Resources (MIN): This is a company we have been cautious on previously due to its historic reliance on one particular project to generate the bulk of its earnings. However during the 2009 year the company had added a substantial array of new projects and it now has a far more diversified earnings stream. These projects should provide the company with a considerable earnings uplift over the next 2-3 years and most market expectations are not capturing this.

Silver Chef (SIV): We participated in the Silver Chef rights issue and placement during the December quarter. SIV is a provider of equipment rental finance, primarily to the hospitality sector. The stock trades at a significant discount to its smaller company peers and also to the multiple at which it traded before the onset of the global financial crisis. A recent profit upgrade demonstrates the strong leverage to economic recovery and SME formation in a credit rationed business environment. Funding was the key constraint to short term growth, which it removed by the raising.

Austin Engineering (ANG): The attraction of ANG is its leverage to commodities such as coal, iron ore and copper through its mining consumable products. The key products are dump truck bodies and excavator buckets and the company is well placed for both shorter and longer term cyclical growth from mining activity.

Major Stock Disposals

OZ Minerals (OZL): A combination of the Discovery Metals placement and associated recalibration of our copper sector cash cost adjusted valuations provided the impetus to sell Oz Minerals and place cheaper copper stocks such as DML into the portfolio. Recent investor communications from OZ Minerals demonstrated Prominent Hill is the pre eminent way to invest in a low cost domestic copper. However there is limited relative valuation appeal.

Crane Group (CRG): We exited our position in CRG due to a rapid decline in the results and prospects for its key Iplex pipes division. This business is reliant on large civil infrastructure projects coming on stream and there is insufficient visibility on these at present to warrant an attractive investment case. Consensus downgrades are likely to be a feature for this company over the next 2-3 years

OMH (OMH): We sold out of this company following its foray into a substantial new project in South Africa. This is not a project that we have sufficient transparency on, especially given its early stage nature and lack of supporting infrastructure. Accordingly the risk profile of this company has also changed and is no longer satisfactory in our opinion. We have switched into a more compelling vehicle as discussed above.

Pacific Brands (PBG): Our conviction levels in this investment deteriorated after a lacklustre full year result and seemingly modest progress on its turnaround objectives. We now view its targets as more aspirational than probable and given it reached our valuation targets despite our concerns we were happy to exit.

Sedgman (SDM): Despite our favourable view on general coal sector thematics the company has not been able to make sufficient progress in building up its project pipeline. Further it is increasingly reliant on 2 major projects to generate the bulk of its earnings over the next couple of years. This provides for a risky investment proposition especially given one of those projects is highly uncertain to proceed. The stock delivered us a return of almost 100% over our 3 month investment and we were happy to take our profits.

Number of stock holdings at 31 December:

49

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