Lodestar Australian Strategic Share Fund
Monthly Investment Report

October 2011

Lodestar Capital Partners Pty Ltd is a dynamic specialist Australian equity manager, founded in 2005. Lodestar's focus is on delivering sustainable investment returns over the long term by applying its extensive experience and skills, within a nimble structure that enables it to seize opportunities.

Market Review

John Morgan, Chief Investment Officer, Lodestar Capital Partners

- The S&P/ASX 200 Accumulation Index rose 7.2% over the month, the ninth largest gain since the Index began in 1992, as investors grew more confident in Europe's ability to defuse the euro sovereign debt crisis. The market was also encouraged by better than expected US reporting season and economic data. However, with the currency rebounding 9% against the USD over the month, the Australian market was only a moderate performer in global terms. Within the Index Banks rallied 10.7%, reflecting easing credit spreads, whilst Resources were up 9.2% on improving sentiment towards world growth.
- European markets rallied strongly on the positive news regarding the local sovereign debt issues, with the Euro Stoxx up 9.4% and the FTSE100 rising 8.1%. In the US the S&P500 had its best month since December 1991, rising 10.8%, as firmer domestic economic indicators added to the optimism from events in Europe.
- Australian economic news supported expectations of an easing by the Reserve Bank with the 3Q CPI lower than expected and RBA commentary appearing to moderate concerns on inflationary pressures.
- Eurozone leaders unveiled a new initiative to tackle the sovereign debt issue. This involved a 50% "haircut" for private sector holders of Greek government bonds, a €106b recapitalisation of the regions banks and an intention to expand the firepower of the €444b fund created in July. Whilst the package was well received by the market, Italian bond yields still remain uncomfortably high and the market is now clearly focusing on Italy as the next domino should Greece fall.
- US macro data generally surprised on the upside with US GDP increasing at a 2.5% annual rate, the strongest performance in a year. Non-farm payrolls increased 103k in September versus expectations of 60k, the ISM Manufacturing Index rose to 51.6 compared to an expected 50.5, retail sales rebounded at their fastest pace in 7 months, whilst housing starts jumped to an annual rate of 658k versus expectations of 590k.
- In China 3Q GDP grew 9.1%, slightly below expectations, however continued growth in domestic demand compensated for weaker exports. The CPI eased further in September whilst the market manufacturing Purchasing Managers' Index was 51.2, the first reading above 50 since June this year.
- National Australia Bank kicked off the banking sectors earnings season with an in-line result. Super Retail Group announced the acquisition of Rebel Sports, whilst Transpacific announced a large issue to reduce its debt position whilst also lengthening and lowering the cost of the remainder. The buyback trend continued with Sims Metal and Transfield Services announcing programs. The Qantas dispute with unions reached a critical point late in the month with the airline grounding all aircraft globally.

Fund Performance

Period ending 31.10.11	1m %	3m %	1yr %	2yr % p.a.	3yr % p.a	Since Inception % p.a.
Total Return	7.30	-1.13	-4.41	-3.35	2.56	-1.06
90 Day Bank Bill*	0.40	1.24	5.03	4.73	4.51	5.50
S&P/ASX 200 Accum^	7.25	-1.25	-3.65	0.38	6.94	-2.11

Standard Deviation#	
Fund	10.50%
S&P/ASX 200 Accum	14.85%

Performance returns are calculated net of management and performance fees and are pre tax. Past performance is not a reliable indicator of future performance, the value of your investment can go up and down.

* 90 day Bank Bill rate resets quarterly and is used for the purposes of calculating the performance fee.

^ S&P/ASX 200 Australian Shares Accumulation Index is provided for comparison purposes due to the Australian Share investment focus of this Fund. It is not the Fund's benchmark.

Rolling 3 year annualised using monthly returns.

Inception date 1 March 2007.

- The Fund returned 7.3% for the month of October, outperforming the S&P/ASX 200 Accumulation Index which rose 7.2%.
- Over the month the net market exposure of the Fund was increased from 73% to 92%.
- The Funds exposure to Metals and Mining was increased from 17.9% to 21.7% over the period as metal prices rebounded.
- The Banking weighting was increased from 15.9% to 17.9% as valuations became more compelling. Legislation was passed over the month allowing domestic issuance of covered bonds giving banks access to a diversified and cheaper funding source.
- The Insurance weighting was increased from 2.4% to 4.4% with Suncorp being added to the portfolio. At Suncorp's AGM, the Chairman confirmed the company’s commitment to returning capital to shareholders once market conditions stabilise, whilst the CEO reiterated his targets for the company.
- The Fund’s exposure to Airlines, via Qantas, was decreased from 0.9% to 0.4% over the month as the industrial standoff worsened and the position was subsequently exited.

Positive Influences

Company	October Return %	Fund Position %
National Australia Bank	13.9	8.7
ANZ	10.5	7.6
PanAust Ltd	25.0	1.8

- National Australia Bank reported during the month, and was in line with consensus estimates. FY11 net interest margins were 2.25% and in line with the prior corresponding period, while loan growth of 10% exceeded expectations.
- ANZ outperformed in the lead up to its result in early November.
- PanAust rallied strongly on a stronger copper price following large falls in the commodity over the previous month.

Negative Influences

Company	October Return %	Fund Position %
Ramsey Health Care	-1.1	2.2
Seven Group Holdings	-3.2	0.6
Woolworths	-4.2	0.8

- Ramsay Health Care moved lower over the month on limited news flow.
- Seven Group Holdings failed to rebound over the month despite strong share price performance by its listed investments Seven West Media and Consolidated Media, as well as a strong quarterly result by Caterpillar. However the Caterpillar result was by tempered guidance that the Chinese operations were weaker than expected.
- The Woolworths position was exited over the month following the 1Q12 Group sales release which highlighted moderating comparable store sales growth of 1.9% versus 3.0% in the previous quarter.

Outlook

As highlighted over the last few months the Australian market has represented excellent value, with earnings multiples trading at two decade lows. The catalysts for October's rebound have been covered earlier in this report. The question moving forward is whether the rally in the S&P/ASX 200, where the average market Price Earnings Multiple has expanded from 9.8x at the end of September to 11.3x at October end, is now fully reflecting the outlook.

With Greece still struggling to remain in the Eurozone fold, we expect the Eurozone to remain the key issue with investors already focusing on other countries perceived to be at risk. Lodestar expects Italy to be the next battle ground and until it is resolved markets are likely to be unstable. Larger Eurozone nations are of increasing concern, with even the formerly impenetrable Germany seeing negative data including contracting production. This adds to the risks as a slowing economy will make Germany less inclined to increase support to the Eurozone's indebted economies moving forward.

The US economy is continuing on from last month's string of good economic news and appears to be continuing its slow recovery. The recent upgrades to the US employment data to October has now produced one of the strongest quarterly periods of growth since the GFC started.

Chinese indicators have continued to moderate with October indicators likely to show clear evidence that inflation is fading, exports faltering and the property market weakening, whilst the government continues to focus on encouraging domestic demand. This slowing was evidenced by the latest Purchasing Managers Index from the China Federation of Logistics and Purchasing released in November which fell from 51.2 to 50.4. The Chinese will be watching closely the improving fortunes of a critical export market, the United States.

Domestically, the economic outlook remains reasonable with concerns over recent momentum in key indicators such as employment and consumer and business confidence. Inflation appears benign and confidence is low. The market continues to receive downgrades, particularly by domestic cyclicals, indicating the outlook for the local economy remains tough. However the market was heartened by the RBA's monetary easing on Melbourne Cup day and a perception this will assist the economy. With valuations so low the market could well surprise with its resilience now the RBA has changed direction on Monetary Policy. Despite the rally in the market, the S&P/ASX 200 still appears to represent very good value.

In conclusion, we remain bullish on the cheapness of Australian equities. However, the resolution of the European debt crisis is a key hurdle to jump. There needs to be stability in that region, even if this is associated with a continued slowdown or mild recession, before equities can produce a sustained rally. Several other important hurdles, such as lower official interest rates in Australia, improving US economic statistics and the inflation outlook in China seem to be surmountable.

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