Lodestar Australian Strategic Share Fund
Monthly Investment Report

September 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/ASX200 Accumulation Index fell 6.1% in September, a sixth consecutive monthly decline. Within the Index Resources (-12.9%) significantly underperformed Industrials (-3.1%) on concerns as to the global growth outlook.
- Although the European debt issue was pivotal for global investors, over the month Australian equities fared worse than most European markets with the Euro Stoxx 50 falling 5.3% and the FTSE100 down only 4.9%. The US market continued to decline, with the S&P500 falling 7.2%. Asian markets also declined on pessimism over the global growth outlook and on increasing concerns over aspects of the Chinese economy. The MSCI Asia APEX 50 fell 11.8%.
- Australia's performance was even worse in common currency as the AUD weakened under the weight of softer metal prices and risk reduction in general. As a result the S&P/ASX200 Resources Accumulation Index fell 12.8%, its biggest loss since October 2008, whilst the biggest winners were defensive sectors such as Telco's which were up 2.2%. Banks also outperformed the market falling only 4.1%.
- The market's focus was firmly on Europe with Greek long yields hitting new highs, even as Eurozone parliaments were going through the ratification of the assistance package agreed in July. Fears grew as Italian yields also jumped despite ECB buying, though Spanish bonds rallied. Fears of a Eurozone recession drove commodity prices, particularly gold, downwards.
- Meanwhile in the USA the Federal Reserve announced an intention to lengthen the duration of its bond portfolio through "Operation Twist" (QEIII) but this failed to provide any catalyst for stabilisation.
- Globally, growth forecasts continued to fall in the face of declining confidence measures and slowing macro indicators as governments struggled to provide any creditable solutions for resolving current fiscal issues.
- Australian economic news remained soft, particularly in the non-mining segments of the economy. House prices, credit data and retail sales remained weak whilst building approvals fell further. Of most concern was the August labour report which showed a fall in employment for the second consecutive month, pushing the unemployment rate to its highest level since last October.
- Company news flow was subdued following on from the reporting season. However there was corporate activity, with the board of Fosters recommending an improved bid from SABMiller, Wesfarmer's selling part of its coal business to a Chinese buyer and two parties showing interest in NAB's UK business. Paladin Energy and Goodman Fielder also raised equity to strengthen their balance sheets over the period.

Fund Performance

Period ending 30.09.11	1m %	3m %	1yr %	2yr % p.a.	3yr % p.a	Since Inception % p.a.
Total Return	-7.24	-10.12	-10.49	-7.06	-4.43	-2.59
90 Day Bank Bill*	0.41	1.26	5.04	4.67	4.57	5.51
S&P/ASX 200 Accum^	-6.13	-11.58	-8.56	-4.09	-0.11	-3.63

Standard Deviation#	
Fund	12.24%
S&P/ASX 200 Accum	16.16%

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.

- For the month of September the Fund produced a return of -7.2%, underperforming the S&P/ASX200 Accumulation Index which fell 6.1%.
- Over the month the net market exposure of the Fund was reduced from 87.0% to 73.1%
- The Fund's Bank exposure was reduced from 24.4% to 15.9% on concerns that the problems being experienced by overseas banks could affect the valuations of their Australian peers. The Fund's Media exposure was also decreased, down from 4.2% to 3.5%, whilst the Fund's Gold exposure was exited.
- The Metals and Mining exposure was increased by 1%, the exposure to the Insurance sector was increased from 0.7% to 2.4%, and the Fund's weighting to the Chemical sector was increased from 3.4% to 4.7%.

Positive Influences

Company	September Return %	Fund Position %
Ramsay Health Care	3.7	2.5
Austar	3.5	1.3
Primary Health Care	2.9	1.9

- Ramsay Health Care continued to rally following the reporting season after positive guidance that earnings growth should increase by circa 10% - 12% p.a. as it increases its footprint via not only the Greenfield expansion but also the addition of beds to existing facilities.
- Austar shares rose as the ACCC indicated its decision date on Foxtel's proposed acquisition of Austar has been deferred from 8 September, with the ACCC to announce a new proposed decision date upon receipt of further information from the merger parties. The market drew positive parallels with the recent victory by Metcash over the ACCC regarding the purchase of Franklins.
- The Primary Healthcare share price rallied over the month on the latest Medicare data which showed strong volume growth for pathology and GP markets; the fact that Healthscope, third in the Australian pathology segment, continues to haemorrhage market share to Primary and expectations that the company will complete a favourable refinancing of its debt facility in the near term.

Negative Influences

Company	September Return %	Fund Position %
Fortescue	-39.0	2.4
Incitec Pivot	-22.7	2.3
PanAust	-41.0	1.9

- Fortescue Metals underperformed over the month on the expectation that Chinese iron ore imports would reduce in the next quarter due to rising inventories and slowing world steel demand.
- Incitec fell over the month on weak soft commodity prices and a disappointing result from Mosaic, a US peer. We remain of the view that the market will start focusing on the 2012 opening of its Moranbah plant, the DAP price continuing to be stronger than expected and the stock currently being undervalued.
- The PanAust share price fell over the month on the back of both a strengthening US dollar and weaker copper price as global growth expectations deteriorated.

Outlook

On historical measures the Australian market remains excellent value based on fundamentals, with the S&P/ASX200 trading on a forecast 2012 PE of only 9.8x at September end. With the exception of the GFC period, where the market traded on a PE around 9.4x, the current market is trading at two decade lows. This indicates that the Australian equity market is very inexpensive, with the caveat that we are continuing to see downgrades of forecast earnings.

However overshadowing this is a potential global economic storm, with the market increasingly making comparisons between the current economic outlook and 2008 as Europe, the USA and China all face large challenges.

The question is what will be the circuit breaker to this pessimism?

We are of the view that a strengthening of European banks capital adequacy would be positive for markets and there is currently a strong resolve by EU nations to rectify this problem. Despite the fact that some of the biggest French, German and Belgium banks hold tens of billions of Euros from struggling peripheral Eurozone countries, reinforcing the European banking system with additional capital and providing additional safety margins will reduce the uncertainty buffeting markets currently and help restore confidence. This has been highlighted again this week with Dexia, the Franco-Belgium lender and a holder of Euro 3.5 billion in debt, struggling to raise enough cash to run its day to day operations.

With this in place Lodestar believe the market would be better positioned should Greece write down their bond portfolio.

The US, despite worrying unemployment levels and a gridlocked government, appears to be seeing early signs of growth. Whilst data generally continues to move sideways, growth in US capital goods indicates an increase in business investment. Fears of a mild recession continue to grow on the back of the European economic situation, the growing Chinese trade conflict, the US political framework and the lack of levers, either fiscal or monetary, available to the US authorities. Bernanke has warned that the FOMC now expect a somewhat slower pace of economic growth over the current quarter.

The Chinese growth rate, whilst falling from above 9% p.a., is still expected to be a very respectable 8% p.a. over the next five years according to Chinese officials from the Development Research Centre of the State Council. While growth is slowing, one must factor in that this is consistent with macro-control policies which help inflation management, economic restructuring, energy saving and emission reductions.

In Australia business confidence continues to fall whilst unemployment increased to 5.3% in August vs. 5.1% in July. Employment remains strongest in Mining, Transport and Utilities whilst the Manufacturing sector remains the weakest.

Locally interest rates remain on hold, although the Reserve Bank will now clearly be lowering rates moving forward based on a its more dovish commentary. The market is now expecting interest rate cuts of 75pts likely in 3 stages.

A third cut could see a flat yield curve and at this point one could well see a bottoming of the market. However the local market must first face expected downgrades from companies at their looming AGM's, with any increasing profit outlooks likely to be rolled out by analysts pushed into future periods. Macquarie Bank's revision ratio analysis where any number over 1 is an upgrade is currently at 0.6 with an expectation this will fall to 0.3 (i.e. 3 downgrades for every increase). Historically at 0.3 the market is a buy.

At this point the market could be in a rare buy territory where one could reduce risk aversion, increase cyclicals, remain wary of cyclicals with structural issues and increase the Resources to Industrials bias.

In conclusion, we remain cautious. A perception that the European debt crisis is close to resolution is needed in our opinion before markets will react in a positive fashion.

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