

# Lodestar Australian Strategic Share Fund Monthly Investment Report

December 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 fell 1.4% over the month of December, its eighth fall for 2011. Since the Index's inception in 1992 there has only been one year (2008) that saw more negative months. Interestingly the Australian market was a laggard versus global peers over the month, with the S&P 500 up 0.8% and the Euro Stoxx 50 down only 0.6% despite persistent concerns over sovereign debt. The local market was affected by concern about the momentum of China's growth. Commodity related sectors lagged, with Resources down 4.5% and the Energy sector falling 5.0%. For the year, the S&P/ASX 200 Accumulation Index fell 10.5% with Telecoms and Utilities fared best and generated positive returns.
- Domestically, earnings news was negative with a number of companies revising down their guidance. Whilst a further rate cut by the RBA from 4.50% to 4.25% was not enough to offset these negatives, the third quarter GDP number exceeded expectations and the NAB Business Confidence Index remained stable.
- The European debt crisis continued to dominate market sentiment. An EU summit agreed on new measures to control government borrowing and to provide further funding support via the IMF. As a result the yields of most peripheral bond markets fell over the month. The European Central Bank lowered its key rate by 25bps for the second time in two months and extended its support to the banking system.
- US economic data mostly indicated a firming of momentum with the ISM's PMI increasing to 53.9 from November's reading of 52.7. Congress agreed a budget package to fund federal government spending to September and avert a shutdown.
- In China the economy continues to slow. The Ministry of Housing and Urban-Rural Development set an affordable housing target of 7 million for 2012, down from the 10 million target set earlier in 2011 and below consensus expectations of 8 million homes. Meanwhile, the HSBC Flash China Manufacturing PMI increased slightly to 49.0 in December from 47.7 in November.
- December brought negative news from the consumer sector with Billabong, Kathmandu and JB Hi-Fi all lowering their guidance. Commentary from the retail sector highlighted the difficult trading conditions with pre-Christmas sales confirming excessive stock levels. Both Insurance Australia Group and the Bendigo & Adelaide Bank announced acquisitions over the month. In the mining sector, Aston Resources and Whitehaven Coal announced their intention to merge whilst Yanzhou Coal Mining of China made an offer for Gloucester Coal.

## Fund Performance

Period ending 31.12.11	1m %	3m %	1yr %	2yr % p.a.	3yr % p.a.	Since Inception % p.a.
Total Return	-1.36	2.33	-9.24	-6.98	3.16	-1.99
90 Day Bank Bill*	0.40	1.20	5.00	4.85	4.38	5.48
S&P/ASX 200 Accum <sup>^</sup>	-1.35	2.12	-10.54	-4.68	7.58	-3.02

Standard Deviation <sup>#</sup>	
Fund	10.27%
S&P/ASX 200 Accum	14.55%

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.

<sup>^</sup> 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.

<sup>#</sup> Rolling 3 year annualised using monthly returns.

Inception date 1 March 2007.

- The Fund returned -1.4% for the month of December and was flat relative to the S&P/ASX200 Accumulation Index.
- Over the month the net market exposure of the Fund was increased from 73.5% to 73.8%.
- Exposure to Metals and Mining was reduced from 14.9% to 13.6% and the exposure to Chemicals was reduced from 4.4% to 3.3%.
- The weighting to Insurance was increased from 3.6% to 4.1%.

## Positive Influences

Company	December Return %	Fund Position %
Telstra	5.4	7.5
GrainCorp	10.1	2.7
ANZ Bank	3.2	8.4

- Telstra outperformed over the month, finishing up 5.4% as the company submitted its revised Structural Separation Undertaking (SSU) with the ACCC.
- GrainCorp closed up 10% after the group's recent harvest updates revealed the group had received 10.2mt of grain in its country storage facilities, well ahead of the 5.1mt at the same time last year. Despite the smaller Eastern States winter crop, the fact that GrainCorp's year-to-date country receipts are running well ahead of FY11 demonstrates the impact of last year's wet weather on delaying the harvest and reducing GrainCorp's storage income.
- ANZ Bank outperformed over the month despite limited news flow from the AGM. S&P downgraded all the big four banks by one notch as the agency changed its criteria for assessing banks.

## Negative Influences

Company	December Return %	Fund Position %
Flight Centre	-14.6	1.2
Cochlear	11.7	-1.3
NRW Holdings	-9.8	1.7

- Flight Centre fell 14.6% over the month despite releasing a first half profit result ahead of both company guidance and the markets expectations. The stock was sold off with other consumer exposed stocks such as retailers. However unlike traditional retailers, which have suffered due to the high Australian dollar as shoppers seek value offshore, Flight Centre's business model is a beneficiary of a strong \$A as offshore travel becomes more affordable.
- Cochlear rallied after identifying the problem in their recalled implant, the M5. The Fund's short position had been reduced before this announcement.
- NRW Holdings fell in line with the market on thin holiday trade. The company already has all FY12 revenues secured, with 50% of FY13 revenues also being secured.

## Outlook

Share markets globally are trading at extremely cheap valuations, particularly if inflation levels are taken into consideration. Earnings downgrades continue, though these tend to be concentrated in sectors that are impacted by the new austerity of consumers, the high Australian dollar or falling commodity prices.

There is also a high level of anxiety associated with the European Sovereign debts issue. The authorities' gradualist approach has tested the financial markets patience. The absence of a "silver bullet", in the form of a more aggressive stance with the Euro bond markets (particularly Spain and Italy) by the European Central Bank, has caused considerable angst in world capital markets. However there has been progress made by authorities and each new initiative brings the crisis one step closer to the point where the capital markets will function more normally and share markets can begin to quantify the damage done to European economic growth and global earnings.

At some point the markets will restore faith in forecasted earnings and begin to expand earnings multiples on stocks. There has been significant contraction of multiples on all share markets. Australia, despite its better economic credentials, is no exception.

Official interest rates have been lowered in the key economies of Europe, China and Australia in recent weeks. The settings for shares have gradually improved throughout the year. The key catalyst ties to the European capital markets. When they begin to function at a level that the rest of the world can move onto other issues, share markets are likely to rally strongly. The full resolution to the crisis is likely to take several years, however financial markets will begin to look through this issue. The timing of this is difficult to predict. However the cheap valuations are there now. Those stocks that have secure earnings and dividends are likely to perform well despite the volatility in markets.

Lodestar's exposure at the moment is slightly above our long term average of 70%. The movement above or below this current setting will largely depend on how the crisis in Europe unfolds.

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