

Lodestar Australian Strategic Share Fund

Monthly Investment Report

March 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 Index barely changed over the month of March, increasing only 0.1%. Whilst developed markets indices were generally flat or lower over March (for example the S&P 500 USD fell 0.1%), emerging markets clawed back some of their recent underperformance with the MSCI EM Asia USD rising 7.1% over the period.
- The month was characterised however by great volatility, with the local index down 6% at one stage as the market digested Japan's devastating earthquake and its potential effects.
- Further unrest in the Middle East and in North Africa (MENA) added to volatility and supported the oil price. Fighting between government forces and rebels in Libya worsened, whilst the situations in Bahrain and Yemen deteriorated markedly over the month with Syria being drawn into the fray towards the end of the period.
- Locally economic news was mixed with falls in consumer confidence, housing starts and mortgage approvals. Whilst employment fell for the first time since August 2009 full-time numbers remained strong.
- US data was patchy over the month with positive job and ISM readings but disappointing housing numbers. The Peoples Bank of China announced their sixth rise in bank reserve requirements in five months.
- The S&P/ASX 200 sector performance was lacklustre with the notable exception of the Energy sector up 3.3% which benefited from higher crude prices, anticipation of stronger demand for gas from Japan to replace nuclear capacity and M&A speculation. QBE announced a preliminary estimate of claims associated with the earthquake and uranium stocks were sold off in anticipation of lower demand.

Fund Performance

Period ending 31.03.11	1m %	3m %	1yr %	2yr % p.a.	3yr % p.a.	Since Inception % p.a.
Total Return	0.67	1.62	-2.65	10.39	-0.49	0.38
90 Day Bank Bill*	0.42	1.23	4.88	4.20	5.07	5.57
S&P/ASX 200 Accum [^]	0.67	3.23	3.44	21.07	1.09	-0.13

Standard Deviation[#]

Fund	13.61%
S&P/ASX 200 Accum	17.61%

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 0.67% over the month.
- Over the course of the month the net equity exposure was increased from 56.6% to 88.3%. This was primarily achieved by lifting the Funds exposure to the Banking sector whilst taking off the majority of the Fund's short positions. This was done on the back of compelling value appearing in the Banking sector and for the market in general based on the Lodestar aggregated price targets.

Positive Influences

Company	March Return %	Fund Position %
Santos (STO)	10.05	0.67
Carabella Resources (CLR)	21.95	1.92
Ramsay Healthcare (RHC)	4.20	2.12

- Santos performed strongly during the month on the back of rising oil prices due to production disruptions in Libya, and the advancement of their two LNG development projects at Gladstone and PNG. The market is now looking more favourably on LNG as an energy source after the nuclear incident in Japan.
- Carabella Resources is a Queensland coal exploration company. Their flagship project is the Mabbin Creek coking coal project in the northern Bowen Basin, where they have a JORC resource of 92 million tonnes of coking coal with significantly more exploration potential. Lodestar took a placement of stock at \$1.80 per share in mid March and the stock had risen to \$2.50 by the end of the month.
- Ramsay (+8.9%) traded up strongly after reaffirming guidance of 18-20% core eps growth for FY11. RHC hosted a UK investor tour highlighting that their strategy to push for National Health Service work had insulated it from a slowdown in the private hospital market. Potential reforms to the UK's National Health Service (NHS) will affect the way in which GP's refer work to private hospitals and hence fundamentally change the way that public and private hospitals operate.

Negative Influences

Company	March Return %	Fund Position %
Equinox (EQN)	-3.77	1.61
Ten Network Holdings (TEN)	-1.51	2.06
Fortescue (FMG)	-2.29	0.40

- Equinox fell almost 10% during March after they launched a C\$4.8billion cash and scrip takeover bid for Lundin Mining. The main concern for the market was the impact the bid would have on the companies' balance sheet.
- Fortescue Metals' share price fell almost 20% during the month on the back of falling spot iron prices, due to softening demand in China, and production disruptions due to heavy rainfall in the Pilbara.
- The Ten Network underperformed as the stock was sold down on weak earnings, poor ratings and subsequent management change. Despite the appointment of the high calibre Seven executive James Warburton as CEO the market shuddered as James Packer resigned from the Ten board over a perceived conflict with Kerry Stokes over this hiring. (Both Packer and Stokes are partners in the Consolidated Press vehicle holding a crucial Foxtel stake). Subsequently Seven launched legal proceedings to halt Warburton's commencement to late 2012.

Outlook

- Lodestar remains of the opinion that the key driver for markets in the medium term will be the continuing strengthening of the US economy as evidenced by improving US employment numbers, signs of early recovery in the US retail sector and some glimmers of improvement in the crucial housing market. The US quarterly reporting season looms and the market will be looking to this for further direction. Further merger and acquisition activity is returning to the market with value of M&A up 25% on a year ago. Meanwhile the steepness of the US yield curve indicates the end of the easing cycle and we believe it will be up to the private sector to drive further expansion. As a consequence we have been increasing our weighting to Australian stocks with US exposure with News Corporation and Amcor prime examples.
- Shorter term the market is coming to terms with a further deterioration in the Middle East and its potential affect on energy prices and the effects of the devastating Japanese tsunami, with markets using the 1995 Kobe earthquake as a benchmark as to the likely effects. Energy stocks have been affected with natural gas plays being viewed positively whilst uranium stocks have been sold off. The portfolio's energy exposure has been increased as a consequence.
- China's tightening cycle continues with rates raised for the 4th time in 5 months as the Government struggles to reduce bank lending, rein in inflation and slow economic growth to a more sustainable pace. The market meanwhile is closely watching emerging details of China's latest 5 year plan which envisages a shift from investment in heavy industry towards consumption whilst still targeting a 7.5% annual GDP growth rate. The Chinese plan to build 36 million units of affordable housing over the period.
- Whilst resource commodities are moving into a period of seasonal weakness and with China no longer stockpiling at the same rate we still remain positive on the medium term outlook. Likewise soft commodities remain strong on fears of shortage and we have increased our exposure to this area through Graincorp and Incitec.
- The European sovereign debt issue remains a key risk with concern over Portugal now seemingly heading towards a bail out from the EU similar to Ireland and Greece. However importantly the European powerhouse economies Germany and France are starting to see falling unemployment rates.
- Domestically we expect the RBA to continue to delay any further tightening for the time being but note full time employment is improving and retail sales no longer appear to be deteriorating. M&A activity has reappeared in the domestic market and capital management is also occurring with RIO, BHP and JB HiFi all announcing buy backs.
- In our opinion there is earnings risk for 2011/12 earnings numbers for the All Industrial stocks ex Banks based on outlook statements from the recent reporting season. The market only appears to have wound back current financial year expectations yet remains with high growth rates one year out. However Banks represent good value with high yields at these levels and we continue to add to our positions. On the resource side the risk to earnings revolve around possible cost blow outs.
- On our internal market valuations, the market is still in our buy zone despite the recent rally with aggregated price targets still supportive.
- Lodestar's intention is to buy further targeted equities on any weakness.

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