Lodestar Australian Strategic Share Fund
Monthly Investment Report

February 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 gained 2.3% over the month of February, lagging the S&P500 whilst outperforming the Euro STOXX. In local currency terms the S&P500 rose 3.2% whilst the Euro STOXX rose 2%. The U.S. market continued to rally on the back of increasing evidence of a strong economic recovery, although the U.S. housing market continues to provide mixed signals.
- Over the period unrest in the Middle East overhung the market, with the fall of Egypt's President Hosni Mubarak, the uprising in Libya and unrest in Bahrain, Yemen and Iran all leading to uncertainty. Both oil and gold prices rose sharply on the back of this.
- Local economic news was positive with employment numbers improving, capex intentions strong and consumer confidence increasing. This was particularly significant when one considers the back drop of the natural disaster caused by flooding across the eastern states over the period.
- The local earnings season brought mixed news with earnings on average slightly below expectations. Whilst sectors such as media and retail were affected by sluggish conditions, Mining sector results reflected continuing buoyant commodity prices. BHP announced a A$5bn off-market share buy-back whilst insurers were hit by costs associated with flooding, Cyclone Yasi and the Christchurch earthquake.

Fund Performance

Period ending 28.02.11	1m %	3m %	1yr %	2yr % p.a.	3yr % p.a	Since Inception % p.a.
Total Return	0.98	1.83	-1.20	12.00	-1.80	0.22
90 Day Bank Bill*	0.38	1.22	4.82	4.16	5.14	5.58
S&P/ASX 200 Accum^	2.35	6.30	8.65	25.39	-0.26	-0.30

Standard Deviation#	
Fund	13.73%
S&P/ASX 200 Accum	17.72%

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 1.0% over the month, which was approximately in line with the average net exposure over the period. The Materials sector performed well and holdings in stocks such as BHP, Santos and Emeco assisted performance.

- The net exposure rose from 48% to 56% over the month. Lodestar upgraded their price target on a number of stocks following on from the fresh financials of the recent reporting season. As a result, there was an increase in exposure to these positions.

Positive Influences

Company	February Return %	Fund Position %
Emeco Holdings	10.9%	1.5%
BHP Billiton Limited	4.1%	3.6%
Santos Limited	7.0%	2.0%

- Emeco delivered a strong first half profit of $29.5 million in February which was ahead of guidance. Return on capital increased to 11.2%, up from 6.4% in the previous corresponding period. Demand for large mining equipment remains strong, with global fleet utilisation averaging 87.6%. The company announced a dividend of 2 cents plus a special dividend of 5 cents, both fully franked.
- BHP reported an 88% rise in profit to US$10.7 billion. Margin and returns were strong, with an underlying EBIT margin of 46% and an underlying return on capital of 41%. Half yearly production records were set in three commodities. As a result of the strong operating cash flow of US$12.2 billion and an ungeared balance sheet, the company was able to announce projected organic expenditure of US$80 billion over the next five years. In addition, an expanded capital management programme of US$10 billion was announced, with an off market buy-back to commence in Australia during March.
- Santos reported a 46% increase in underlying net profit to $376 million for the full year 2010, despite an 8% fall in production due to flooding in the Cooper Basin. Delivery of the company's growth strategy is progressing well. Construction of the PNG LNG project has commenced, with first LNG due in 2014, and the US$416 billion Gladstone LNG project remains on track for first production in 2015. The share price responded well to the result and to the higher oil price.

Negative Influences

Company	February Return %	Fund Position %
Gloucester Coal	-12.3%	1.7%
Wotif.com Holdings	20.6%	-0.8%
Navitas Limited	15.0%	-0.5%

- Gloucester Coal produced a profit of $23.2 million for the first half of FY 2011. This was 28% higher than the previous corresponding period and was driven by increasing coal volumes and prices. Work progressed on their two major growth projects: the Duralie Extension Project in NSW and the Middlemount Project in Queensland. The share price weakened during the month when it was announced that the CEO and deputy CEO were to be replaced by employees of the major shareholder, Noble Resources.
- Wotif.com bounced strongly on the back of a result that matched management's guidance which included contracting margins due to a difficult domestic leisure travel market. The stock was aggressively shorted prior to the result given the tough environment for consumer discretionary stocks and the inclement weather over the summer holiday period. The stock is now priced on a Price Earnings (P/E) multiple of 18 times for FY12 despite an unclear earnings outlook.
- Navitas priced on a PE multiple of over 20x 2012 earnings is priced for growth yet faces a myriad of headwinds. These include a high $A, a tight local student migration policy (albeit starting to ease) and concerns as to the extent and timing of their offshore expansion, particularly into the USA. Coupled with their recent questionable acquisition of SAE, a provider of courses in primarily audio engineering and seen by many as a plug to cover this year's lack of earnings momentum, this leads us to conclude the stock continues to be over priced.

Outlook

- The main focus domestically was the reporting of the December half financial results. The majority of results were in line, although there were slightly more negative surprises than positive ones. The resources and property trusts were generally in line and there was little change to forecasted earnings. The banks surprised with healthy margin expansion and this led to general upgrades to the remainder of this year's earnings forecasts and the next financial year's expectations. The Industrials tended to be a little disappointing and this sector of the market saw a continuation of the downgrades witnessed prior to the reporting season. Interestingly the downgrades did not extend into the next financial year. This puts some of the more bullish forecasts from this sector under a degree of pressure.
- The Fund does not have significant exposure to this part of the market. The stocks owned by the Fund in this sector tend to have a growth profile superior to the general market. Stocks such as Amcor and Super Cheap have growth driven by acquisitions and healthy organic growth.
- The Banks have shown the resilience of their core franchises with expanded margins achieved in an environment where credit growth is growing at near recessionary levels. The Fund has been looking for opportunities to add to this sector. There was minimal exposure to this sector last calendar year.
- The Fund has retained a strong allocation to the resources sector as commodity prices have remained strong. The improving trends of the G3 nations (U.S.A., Eurozone and Japan) are improving the global growth profile and this should offset the lower momentum that China may produce as a result of their attempts to get inflation under control. At the recent People's Congress the Premier announced the focus on controlling inflation was the paramount priority. Thus the recent loss of momentum in some leading indicators, such as the Purchasing Managers Index (PMI) may persist until the pressure of inflation abates.
- The sovereign debt issues in Eurozone persist. Moody's Ratings have recently downgraded Greek sovereign debt again this time by a significant three notches. The market is now pricing the Greek bonds for an effective default event. Portuguese Bonds remain under pressure as speculation of a Greek/Irish style bail out for this nation persists. The sharemarkets have treated the weakness in these Eurozone Bond markets as "ambient noise" and may only react if the existing rules around the bail outs change or the ability of the Eurozone to fund these events is brought into question.
- The unrest in the northern Africa/Middle East has unsettled markets. The fear of higher oil price derailing the recovery profile of the world was quickly priced in as soon as the unrest spread to Libya. This country produces 1.8% of the world's oil and has amongst the best quality crude on the planet. The fear of the unrest spreading to the more significant oil producing nations such as Saudi Arabia and Iran are also impacting on markets. There have been calls for days of protests in March in these nations. It remains to be seen if these come to anything.
- The market has begun to weaken on the back of a number of macro issues described above. All of these issues warrant respect. However, the actual growth profile of the world is still improving. In addition the growth in level and security of dividends in the Australian market gives a strong underpinning of absolute value in the market. Also the low yielding stocks such as the large cap resources companies are initiating capital management in the form of buy backs. Valuations are not stretched and a pull back would likely be taken as an opportunity to add to the exposure of those favoured stocks.

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