

Equity Market Sell Off Creates Opportunity For Patient Investors

Market Report

Global macro-economic factors weighted heavily on equity markets in the month of June driving equities sharply lower. Ongoing sovereign debt concerns in the Eurozone, a cooling Chinese economy and fears that the US economic recovery is under pressure conspired to drive global stock indices into negative territory.

The primary offshore markets all finished the month down, the US S&P 500 was off 5.4%, the UK FTSE 100 was down 5.2% and the Japanese Nikkei fell 4.0%. Domestically, the All Ordinaries Accumulation Index continued the downward trend that commenced in mid March finishing June 2.6% lower.

Weakening lead economic indicators in the US have raised fears that the US economy may fall back into recession. Whilst history suggests that double dip recessions are extremely rare, investors remain jittery and risk averse with the wounds of the GFC still fresh in the minds of many.

Sentiment in the Australian equity market was poor driven by the weak offshore lead and the better performing sectors were defensives such as Utilities (+0.7%) and Consumer Staples (+0.5%). Stocks exposed to equity markets and the economic cycle were particularly weak and the worst performing sectors were Industrials (-7.3%), Consumer Discretionary (-5.3%) and

Financials (-4.7%).

The Resource sector outperformed the Index (-1.2%) amidst hopes that Julia Gillard's appointment as Prime Minister might pave the way to a compromise on the Resource Super Profits Tax. China's decision to shift its currency policy from a US dollar peg to a basket of currencies was also seen as being a short-term positive for commodities.

The Telecoms sector (+9.5%) was a standout performer after Telstra signed an agreement with the company formed by the Federal Government to develop the National Broadband Network. Under the terms of the non-binding deal, Telstra will be compensated for the use of its infrastructure.

Domestic economic news was mixed in the month of June. On the positive front, the unemployment rate (-5.2%) continued to decline. However business and consumer confidence surveys recorded falls. The Reserve Bank of Australia (RBA) paused the cash rate at 4.5% following a sharp tightening cycle which saw rates hiked at six of the previous seven meetings. The RBA is now expected to hold rates steady until at least late 2010 as it monitors a possible global economic slowdown and assesses the impact of recent tightening measures.

OC Performance*	1 Mth	3 Mths	6 Mths	1 Yr	3 Yrs	5 Yrs	Since Incep
OC Premium Equity Fund	-1.9%	-10.3%	-6.7%	32.4%	-17.8%	-1.4%	8.9%
Small Inds Accum	-5.0%	-12.8%	-14.0%	10.3%	-18.1%	-1.8%	3.2%
OC Dynamic Equity Fund	-2.5%	-11.1%	-7.6%	37.2%	-17.9%	-1.0%	10.2%
Small Inds Accum	-5.0%	-12.8%	-14.0%	10.3%	-18.1%	-1.8%	3.5%
OC Concentrated Equity Fund	-0.7%	-9.1%	-4.3%	56.5%	-0.7%	11.0%	13.5%
All Ords Accum	-2.6%	-11.0%	-9.7%	13.8%	-8.0%	4.7%	9.1%
OC 200 Equity Fund	-3.6%	-13.1%	-11.7%	12.2%	-5.5%		8.8%
200 Accum	-2.6%	-11.1%	-9.9%	13.1%	-7.9%		5.9%

Performance figures are based on the soft close unit prices as at 30/06/2010. 30 June distribution is yet to be finalised for all

Year In Review

OC Fund's significantly bolstered the size and strength of its investment team over the past 12 months with strong returns generated for investors across the Funds. Robert Frost was appointed Head Small / Mid Cap Investments and Robert Calnon was promoted to Portfolio Manager. Following the acquisition of Patriot Managed Accounts, Stephen Sedgman and Stephen Evans joined the investment team, both of whom have an outstanding track record in large and small cap investment. The OC team now has five members with combined investment experience in excess of 70 years.

During the year we made a number of enhancements to our stock screening and stock selection process which we believe has improved the quality of the OC Fund's portfolios. Additionally, we introduced a Risk Management Committee, chaired by Stephen Sedgman, which adds a top-down macro-economic overlay to our bottom-up stock picking process. Stephen Sedgman has 40+ years funds management experience and an outstanding track record as a fund manager through many different business cycles. This has been a significant enhancement to our investment process, especially in the volatile economic environment that have we have experienced in recent times.

OC200 Fund

The OC 200 Fund had a solid year performing roughly in-line with the ASX 200 Accumulation Index, up 12.2% for financial year 2010.

Within the ASX 200 Accumulation Index, the best performing sectors for the year were the Info Tech sector (+22.8%), the REIT (property trust) sector (+20.4%) and the Financials sector (+17.8%). These sectors were amongst the poorer performers during the GFC and bounced strongly off their lows, despite some weakness over the past quarter. The relative underperformers included the Energy sector (-2.1%), the Telecoms sector (+1.9%) and the Healthcare sector (+2.4%).

During the year, the Fund benefited from overweight positions

in the financials (in particular the big four banks) as the market came to appreciate their strong market position, healthy balance sheets and increasing confidence that the bad debts cycle was improving. An underweight position in property trusts early in the financial year hurt the Fund from a relative point of view as we remained concerned about their high gearing levels.

In the past quarter, the OC 200 Fund has reduced its exposure to the Banks (sold **Bank of Queensland** and reduced **Westpac**) and sold Toll Holdings ahead of a profit downgrade by the company. We have added **Amcor** following a sensible well priced acquisition and taken a position in **Healthscope** which is currently the subject of indicative non-binding bids from two separate private equity consortiums.

OC Premium Fund

The OC Premium Equity Fund finished financial year 2010 up 32.4%, well ahead of the Small Industrials Accumulation Index and the All Ordinaries Accumulation Index which were up 10.3% and 13.8% respectively.

The Fund's strong performance was driven by two significant factors. Firstly, a solid performance from our core holdings led by **CSG Group**, **Mineral Resources**, **Automotive Holdings** and **IOOF**. Our core holdings have performed very well from an operational point of view despite the challenging economic environment and are all set to report solid earnings growth in the up-coming reporting season. Just as importantly, we managed to avoid most of the stock specific downgrades which have plagued the market over the past year through careful stock selection and risk management.

The shares prices of many of our core positions have softened slightly in the past quarter as the market has sold off on global macro-economic concerns. We remain confident of their long term prospects and have been in contact with management in the lead up to the August reporting season to confirm the financial year finished off strongly and that the earnings outlook remains robust.

On a positive note, **Campbell Brother's** (March year end) provided very strong first half earnings guidance in late June and the shares have re-rated as a result. It is a timely reminder that many companies continue to trade strongly at an operational level despite the investor uncertainty.

OC Dynamic Fund

The OC Dynamic Equity Fund finished financial year 2010, up 37.2%. It is typical for the Dynamic Equity Fund to outperform the Premium Equity Fund in a rising equity market. Whilst both funds have the same core holdings, the Dynamic Fund can hold a small number of positions (up to 15% of capital) in short-term or catalyst driven opportunities within the small to mid cap investment universe. These positions, on a whole, have performed very well over the past 12 months adding significant value to the Dynamic Equity Fund.

One such example was **Virgin Blue**. The stock was added to the portfolio when the company recapitalised its balance sheet towards the end of the GFC. The airline industry was in the early stages of a recovery and **Virgin Blue** was highly leveraged to a turnaround in industry conditions. In the March 2010 quarterly we explained that the stock was "highly leveraged to economic conditions and the fuel price and is not considered suitable for the more conservative Premium Fund". After a strong increase in share price driven by a profit upgrade, industry conditions turned sharply in April 2010. The onset of aggressive fare discounting was a trigger for us to exit

our holding at a handsome profit.

In the past quarter, the Dynamic Fund's out performance has been slightly less than that of the Premium Fund. This is not uncommon in a falling equity market. The key reasons were the falling share prices of two trading positions, namely services provider **Transfield** and litigation funder **IMF**. **Transfield** was sold off by investors after reportedly rebuffing a takeover approach from listed competitor **United Group** and as the services sector, in general, de-rated. **Transfield** has recently reiterated its earnings guidance and we retain the position believing it has been over-sold. **IMF** was sold out of the portfolio in early June after we became concerned that it may fail to make its earnings guidance following some delays to key cases. Fortunately the position was exited before an earnings downgrade was announced in early July.

OC Concentrated Fund

The Concentrated Equity Fund finished the financial year up 56.5%, well ahead of the All Ordinaries Accumulation Index which rose 13.8%. Like the Premium and Dynamic Equity Funds, the Concentrated Equity Fund was one of the top performing equity funds in Australia in FY2010.

The three components of the Concentrated Equity Fund all added significant value to investors during the financial year:

1. The Fund's core positions, as discussed above in the Premium Equity Fund commentary, made a strong contribution.
2. The incubation holdings of the Fund performed very well including **Wattyl**, **Talent Two** and **Cash Converters** all of which re-rated significantly during the year. These incubation holdings are often under researched by the market and 'off the radar' of other equity funds. We remain confident of being able to uncover more 'hidden gems' into financial year 2011.

3. The volatility in the market and a raft of secondary market raisings saw the trading component of the Fund extremely active during the year. Most trades were closed out profitably as the premise of the trading component is to take shorter-term catalyst driven positions which were executed well during the financial year.

In the past quarter the Concentrated Equity Fund has held up relatively well in a falling market. Whilst our core positions and incubation positions have softened, the Fund has benefited from a number of short positions which has enabled the Fund to profit from falling share prices (the Concentrated Fund is the only OC product that permits short selling). In particular, we short sold both **Fairfax** and **Ausenco** on the expectation that consensus earnings forecasts for those stocks were too high and would require analyst downgrades. We have closed out both short positions after recent share price falls. The current market volatility is continuing to throw up a raft of trading opportunities which will continue to seek to profitably exploit.

Outlook

The opaque global macro-economic picture has instilled a sense of panic in many equity market investors still haunted by the scars of the global financial crisis. The bombardment of negative economic news has been unrelenting during the quarter: Eurozone debt issues, concerns on China slowing, US lead economic indicators softening, an oil spill that won't stop, uncertainty over the Resource Super Profits Tax (RSPT) and question marks over who will lead the country following the upcoming Federal Election. These factors have all conspired to create a bearish market sentiment that has seen equities grind significantly lower.

Our job as equity investors is to take the available information and assess where the opportunities lie. It is interesting to note that despite an almost universal bearish short-term global economic view, a recent survey conducted by the *Australian Financial Review* found that ten leading equity strategists are, on average, forecasting the ASX 200 Index to finish financial year 2011 at 5032, up some 19% from present levels.

Notwithstanding the global headwinds, it is our view that a lot of bad news has been priced into the Australian equities market. The ASX 200 Index is currently trading on a 12 month forward price to earnings ratio of 11.2x, a 29% discount its ten year average. We are cognisant that consensus analyst earnings forecasts for FY11 are too high and need to be revised downwards. Undoubtedly this explains some of the above discount. But our point is that investors are factoring in a lot of bad news and some severe earnings revisions into financial year 2011 based on where the market is currently trading.

One of our favourite investment philosophies comes from investment guru Warren Buffett that states: *"Be fearful when others are greedy and greedy when others are fearful"*. Rather than simply cashing up, we have been vigilant in past few weeks buying quality stocks which have been sold down to attractive entry prices. By way of example, we recently purchased **Monadelphous**, a tier-one engineering services company who is a preferred supplier to **BHP Billiton** and **Rio Tinto**. We have long respected the company's management and their impressive track-record of earnings growth but we have balked at the company's share price. The uncertainty surrounding the impact of the RSPT and poor equity market conditions have recently thrown up an attractive entry price and we purchased a stake in the company.

The current market volatility has presented us with an opportunity to build a portfolio of quality stocks at attractive prices that ought to reward patient investors over the long-term. In this respect, we see volatility as a friend. Volatility provides us with the opportunity to buy quality stocks for a price well below their inherent long term value.

We appreciate the support of all of our investors throughout financial year 2010 and will be working diligently to generate strong returns in the new financial year.

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* Past performance is not a reliable indicator of future performance. The Total Returns of the OC Funds over specified periods are shown in the above table. This table contains information regarding Total Returns to 30 June 2010. Total Returns are calculated after taking into account performance fees. Where OC Funds generates a return on the OC200 Fund over and above the performance hurdle (S&P/ASX200 Accumulation Index) in a quarter, a performance fee of 10.25% of all profits above this level is charged to the Fund directly. Where OC Funds generates a return on The Premium and Dynamic Funds over and above the performance hurdle of 15% in any financial year, a performance fee of 20.5% of all profits above this level is charged to the Funds directly. Where OC Funds generates a return on the Concentrated Fund over and above the performance hurdle of 0% in any financial year (subject to a high water mark), a performance fee of 10.25% of all profits above this level is charged to the Fund directly. Between 1 July 2004 and 30 June 2009 where OC Funds generated a return on the Concentrated Fund over and above the performance hurdle of 0% in any financial year (subject to a high water mark), a performance fee of 20.5% of all profits above this level was charged to the Fund directly. Before 1 July 2004, performance fees were not paid out of the Funds but billed by OC Funds directly to investors. In this table, the Total Returns for the period prior to 1 July 2004 have been adjusted to reflect the paid performance fees as if the fees were paid out by the Funds. The Total Return performance figures quoted are historical, calculated using end of month mid prices and do not allow the effects of income tax or inflation. Total Returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The Indices do not incur these costs. This information is provided for general comparative purposes. Positive returns, which the Funds are designed to provide, are different regarding risk and investment profile to index returns.

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