Quarterly Investment Review

31 December 2011

Sentiment poor but valutions compelling

FUNDS MANAGEMENT

Market Report

The Australian equity market finished the quarter in the black with the S&P ASX 200 Accumulation Index finishing up 2.1%. This was well behind many of the major international bourses which bounced from oversold levels at the end of the September quarter despite a continuing challenging macro backdrop. The US S&P 500 bounced a healthy 11.2%, the UK FTSE was up 8.7%, the German DAX was up 7.2% and the French CAC finished the quarter up 6%. The Asian region had mixed results with the Hong Kong Hang Seng up 4.8% whilst the Japanese Nikkei was down 2.8%.

Company specific news offered little during the quarter to offset the difficult global macro-economic backdrop. AGM commentary was mixed and a number of companies lowered their profit expectations including **JB Hi-Fi**, **Billabong**, **Kathmandu** and **Newcrest Mining**. Corporate activity was subdued, although a number of companies announced share buy-backs including **Sims Metals Management** and **Transfield Services**.

Having remained on hold for a year, the Reserve Bank of Australia (RBA) cut its cash rate in November and December, taking it to 4.25%. The cuts were driven by sovereign debt stress in Europe and potential risks to the global and domestic economic outlook. The unemployment rate remained steady at 5.3% and 3rd Quarter GDP rose by 2.5% year-on-year, up from 1.9% in the prior quarter. The Australian dollar gained against the US dollar (+5.7%), but this was from a low starting point of late September and for most of the quarter the two currencies traded around parity.

OC Premium Fund

The extreme market volatility, driven largely by Euro-zone debt concerns, continued during the quarter and the OC Premium Equity Fund finished the quarter down 1.5% versus the Small Industrials Accumulation Index which was flat and the Small Ordinaries Accumulation Index which was down 0.6%.

Despite the difficult macro-economic backdrop, a number of our core holdings returned in excess of 15% for the quarter including **Maryborough Sugar** (+44%), **Spotless** (+33%), **Chandler Macleod** (+23%) and **Cash Converters** (+20%). These were unfortunately more than offset by three stocks which fell significantly, namely **Talent 2 International** (down 57%), **CSG Group** (-43%) and **SMS Management** (-32%).

As discussed in the November Update, both **Maryborough Sugar (MSF)** and **Spotless (SPT)** have been the beneficiaries of indicative takeover offers. **MSF** suitor, Mitr Pohl, has completed due diligence and has received Foreign Investment Review Board approval to proceed with the takeover. We will accept their offer in the absence of a higher bid. **SPT** indicative bidder, Pacific Equity Partners, is currently engaged in a game of cat and mouse with the Spotless board over access to due diligence information and the price that the board believes is fair and reasonable. We have lightened our position into the strength of the bid given some uncertainty about whether a full takeover will eventuate. Nevertheless, we still believe that the takeover will ultimately be successful given that most of the major shareholders seem supportive of the bid.

OC Performance*	1 Mth	3 Mths	6 Mths	1 Yr	3 Yrs	5 Yrs	Since Incep
OC Premium Fund^	-4.3%	-1.5%	-13.6%	-14.8%	19.6%	-8.5%	8.1%
S&P/ASX Small Inds Accum	-2.3%	0.0%	-10.5%	-12.8%	8.9%	-8.0%	3.1%
Added Value	-2.0%	-1.5%	-3.1%	-2.0%	10.7%	-0.5%	5.0%
OC Dynamic Fund	-4.5%	-1.1%	-15.4%	-17.2%	20.6%	-8.4%	9.1%
S&P/ASX Small Inds Accum	-2.3%	0.0%	-10.5%	-12.8%	8.9%	-8.0%	3.3%
Added Value	-2.2%	-1.1%	-4.9%	-4.4%	11.7%	-0.4%	5.8%
OC Concentrated Fund	-3.8%	1.2%	-14.2%	-20.5%	38.5%	4.2%	12.0%
S&P/ASX All Ords Accum	-1.6%	1.9%	-9.6%	-11.4%	8.5%	-2.1%	7.5%
Added Value	-2.2%	-0.7%	-4.6%	-9.1%	30.0%	6.3%	4.5%

*Performance figures are based on the hard close unit prices as at 31/12/2011. ^Cum distribution price.

In an environment where profit downgrades have been rife, it was pleasing to see core holding underground coal contractor **Mastermyne Group** advise the market that its first half profit would be well in excess of market expectations. The increase was due to organic growth on **Mastermyne's** existing projects and the revenue contribution from additional mining equipment purchased late in last financial year. The company has forecast a strong second half leading to consensus profit upgrades across the market which has driven a re-rating of the shares.

On a disappointing note, **Talent 2 International (TWO)** announced that its H1 FY12 profit would be below the previous year and significantly below consensus market forecasts. The company cited global uncertainty leading to material deferral of decision making in both its recruitment and managed services divisions. We were surprised by the severity of the downgrade as we held the management team, led by industry stalwart Andrew Banks, in high esteem. Typically, in these situations, we sell our holding immediately. In this case, the market reaction was swift and we do not believe it would be rational to sell our holding at current market levels. We have subsequently met with management and are comfortable that the business will resume growth once excess costs are stripped from the business. Interestingly, management have received approaches on several assets of the business and we believe that the break-up value of **TWO** is far in excess of the current market price of $0.52.

In an unexpected development, **CSG Group's (CSG)** suitor (who we believe was Japanese multi-national NEC) failed to cement a formal bid for the company. Whilst no official reason was cited, we do know that the company conducted several months of due diligence and informally told the **CSG** Board that it was walking away due to head office concerns about the global economic environment. The share price reaction has been severe (-40%) which is not surprising given that a number of event arbitrage funds had come onto the register in anticipation of a takeover and are now exiting. Whilst there has no doubt been costs incurred in the bid process, and some contract deferrals due to uncertainty surrounding the ownership of the business, the stock still looks very cheap (PE less than 5.5 x FY12 earnings). In a tough economic environment **CSG's** print services business and annuity type IT services contracts typically lend themselves to more resilient earnings than their IT services peers. This was aptly demonstrated during the GFC. We expect the stock price to recover once the H1 FY12 result is delivered and the event arbitrage funds have exited the register.

OC Dynamic Fund

The OC Dynamic Equity Fund finished the quarter down 1.1%, slightly ahead of the OC Premium Equity Fund. The Fund's trading position in **Virgin Blue** was the key difference in performance between the two Funds during the quarter. The stock re-rated on the back of emerging confidence in its corporate strategy and industrial action at its rival Qantas. We closed out the position in December at a handsome profit.

OC Concentrated Fund

The OC Concentrated Equity Fund finished the December quarter up 1.2%, slightly behind the All Ordinaries Accumulation Index which finished the quarter up 1.9%.

The Core Fundamental section of the Fund benefitted from corporate activity in both **Maryborough Sugar** and **Spotless Group** (mentioned above), although **Gerard Lighting** fell 13% for the quarter in a tough macro environment.

Most stocks in the Emerging Leaders section were relatively flat for the quarter, the notable exception being Mark Bouris' wealth management and financial services venture **Yellow Brick Road** which fell 24% on no news and very little volume. **Yellow Brick Road** received excellent exposure during the recent series of *The Celebrity Apprentice* screening on the network of major shareholder Nine Entertainment Group. Despite the share price fall, the business remains on track, although the lack of liquidity in the stock is a concern.

In the Alpha Plus (trading) section of the Fund **Iron Ore Holdings**, **Indophil** and **African Iron** all posted solid gains during the quarter. Whilst **Iron Ore Holdings** was closed out following the realisation of the catalysts for which it was held, we continue to hold **Indophil** and **African Iron** on the belief that both stocks have further upside to come. The Funds position in **Ironbark Zinc** was a laggard during the quarter, although we expect a further resource upgrade to drive shareholder value in the near term.

Outlook

The European sovereign debt crisis and slowing global growth continue to be major thematics dominating financial markets and the financial press as we enter the new calendar year. Equity market participants clearly remain extremely bearish and this is reflected in company valuations which are being priced for a very low growth environment. Indeed, the last time we saw market analysts and commentators this bearish was near the depths of the GFC when the equity market was approaching its low.

It is worth noting that equity markets, in the short-term, typically price in the prevailing consensus of market sentiment at that point in time. Many people are reacting to what we consider to be "scare mongering" in the broader press where headlines are almost universally bearish. This is no doubt impacting sentiment. In these times the question we ought to be asking is "whether the outlook is more gloomy than is currently being priced into the market".

We all know that Europe is a mess which is threatening the US recovery and contributing to a slowdown in the important Chinese growth engine (Europe is China's largest export market). This is all well publicised and a major reason why the equity markets have performed so poorly over calendar year 2011. Arguably this information has been priced into our market. The question the OC team is asking itself at present is whether this picture will further deteriorate in 2012 or whether some of these macro challenges will dissipate or move towards a resolution over the course of the new year. Should the latter transpire, we would expect to see a considerable rally in equity markets.

In our opinion, the key question near term revolves around the likelihood of a Euro-zone breakup or major (Italian or Spanish) sovereign default. Our view is that it is highly unlikely to happen and that there is no appetite whatsoever from the major Euro-zone nations for a breakup.

There are large amounts of sovereign debt to be rolled in the coming months, including upcoming Spanish and Greek bond actions. What we must remember is that this debt is already being held by counterparties and default is not an attractive option for any of these counterparties. An analyst we regard highly recently returned from Europe where he met with the European Central Bank, the Italian Central Bank, the Spanish Central Bank, the French Central Bank and the Deutsche Bundesbank, along with 15 or so major European banks. His comments were "*it is bad over there but not nearly as bad as what you would believe from reading the press*".

According to this analyst, there is a strong consensus amongst the key European Banks and monetary authorities that the upcoming bond auctions would be successful and all manner of incentives (such as tax breaks) would be offered to make sure that they happen in an orderly fashion. Supportive of that view is the fact yields on short term bonds have been falling in both Italy and Spain in recent weeks.

In our view, the equity market is pricing in a material chance of a major sovereign default in the coming months. Should such a scenario be avoided (and we believe that it will be avoided) then we ought to see a strong relief rally in equity markets.

OC Fund's Ratings

The OC Premium Equity Fund and the OC Dynamic Equity Fund recently received their annual ratings review from independant rating house Lonsec and both funds were rated "recommended".

For more information or a copy of the Lonsec report, please visit our website, www.ocfunds.com.au/ratings.

Fund Holdings^

* Largest Holdings	OC Premium	OC Dynamic	OC Concentrated
	Ausenco	Ausenco	African Iron
	Gerard Lighting	Automotive Holdings	Ausenco
	Maryborough Sugar	Maryborough Sugar	Maryborough Sugar
	McMillan Shakespeare	Slater & Gordon	Service Stream
	Super Retail Group	Super Retail Group	Swick

*Largest holdings in alphabetical order

Fund Stats

Contributions	OC Premium		OC Dynamic		OC Concentrated	
Positive	Maryborough Sugar	1.9%	Maryborough Sugar	1.9%	Maryborough Sugar	2.7%
	Spotless	1.1%	Spotless	1.2%	Indophil	1.2%
	Bradken	0.6%	Mineral Resources	0.5%	African Iron	1.0%
	JB Hi Fi	0.5%	Ausenco	0.4%	JB Hi-Fi	0.6%
	Mineral Resources	0.5%	Imdex	0.4%	Mineral Resources	0.5%
Negative	Talent 2 International	-1.6%	Talent 2 International	-1.6%	Ironbark	-1.2%
	CSG Limited	-1.1%	CSG Limited	-1.1%	CSG Limited	-1.0%
	Gerard Lighting	-0.6%	Gerard Lighting	-0.6%	Oakton	-0.9%
	Super Retail Group	-0.6%	Super Retail Group	-0.5%	Newcrest Mining	-0.8%

Company Contact

Adelaide Brighton Limited	African Iron Limited	Allied Gold Mining PLC	Allied Healthcare Group Ltd	Allmine Group Limited
Amcor Limited	Ansell Limited	APN News & Media Limited	Arafura Resources Limited	Aristocrat Leisure Limited
Aston Resources Limited	Atlas Iron Limited	Aurora Oil & Gas Limited	Ausdrill Limited	Ausenco Limited
Austal Limited	Australian Power and Gas Company Limited	Automotive Holdings Group Limited	Bannerman Resources Limited	Berkeley Resources Limited
BSA Limited	Campbell Brothers Limited	Carbon Conscious Limited	Cash Converters International	Challenger Limited
Chandler Macleod Group Limited	Clough Limited	Collins Foods Limited	Commonwealth Bank of Australia	CSG Limited
Decmil Group Limited	Doray Minerals Limited	Echo Entertainment Group	Elemental Minerals Limited	Emeco Holdings Limited
Engenco Limited	Fairfax Media Limited	Finbar Group Limited	Fleetwood Corporation Limited	Fletcher Building Limited
Forge Group Limited	G8 Education Limited	Gale Pacific Limited	Gindalbie Metals Ltd	Global Construction Services Limited
GR Engineering Services	Humanis Group Limited	Imdex Limited	IOOF Holdings Limited	Ironbark Zinc Ltd
JB Hi-Fi Limited	Kasbah Resources Limited	Lemur Resources Limited	M2 Telecommunications	MACA Limited
Macmahon Holdings Limited	Matrix Composites & Engineering Limited	Mermaid Marine Australia Limited	Mesoblast Limited	Mineral Resources Limited
Monadelphous Group	Navitas Limited	Nexus Energy Limited	Northern Star Resources Ltd	NRW Holdings Limited
Nufarm Limited	Pacific Energy Limited	Phosphagenics Limited	Pmi Gold Corporation	Programmed Maintenance Services Limited
Pro-Pac Packaging Limited	RCR Tomlinson Limited	Regis Resources Limited	ResMed Inc.	Resolute Mining Limited
Resource Equipment Ltd	ROC Oil Company Limited	RXP Services Limited	Samson Oil & Gas Limited	Seven Group Holdings
Sigma Pharmaceuticals Limited	Sirtex Medical Limited	Southern Cross Electrical Engineering Ltd	Strike Energy Limited	Swick Mining Services Ltd
Tanami Gold NL	Ten Network Holdings	Thorn Group Limited	Tiger Resources Limited	Tox Free Solutions Limited
Transfield Services Limited	TZ Limited	VDM Group Limited	Virgin Australia Holdings	Wasabi Energy Limited
Webjet Limited	Whitehaven Coal Limited	WHK Group Limited	Wide Bay Australia Ltd	Woolworths Limited
XRF Scientific Limited				

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OC FUNDS MANAGEMENT

* 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 31 December 2011. Total Returns are calculated after taking into account performance fees. 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.