QUEST

QUEST

QUARTERLY REPORT
MARCH 2011

John Citizen Family Superfund

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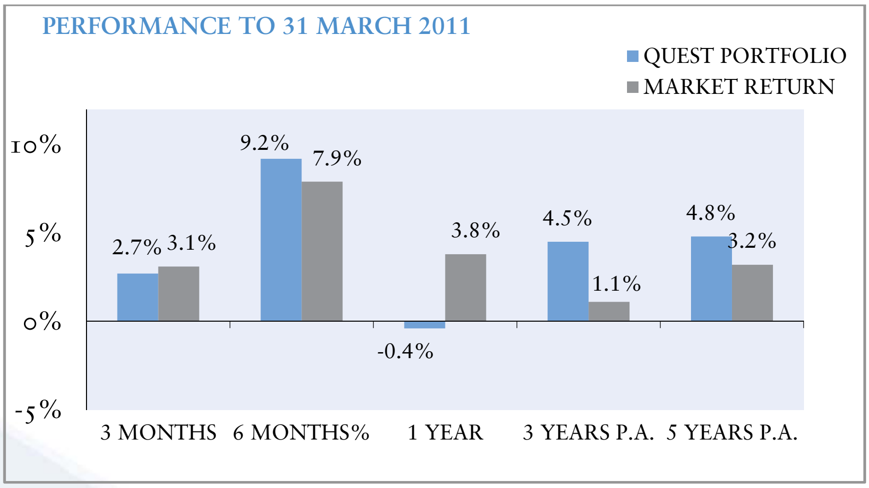
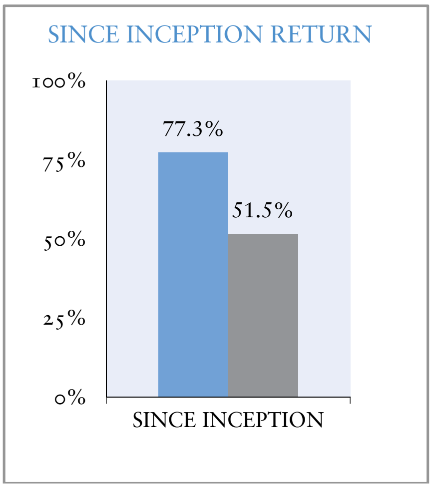
Mr John Citizen	123 ABC Street Sydney NSW 2000
Account Name: John Citizen Family Superfund	

PORTFOLIO MOVEMENT – 31-MAR-11	
PREVIOUS MARKET VALUE 31-DEC-10	
CONTRIBUTIONS DURING QUARTER	
PORTFOLIO MOVEMENT*	
MARKET VALUE 31-MAR-11	

YOUR PORTFOLIO PERFORMANCE FOR THE QUARTER*	
MARKET RETURN (S&P / ASX 300 ACCUMULATION INDEX)	3.12%

*Includes fees for the quarter





** The portfolio returns quoted above represent the return achieved if invested in the Quest portfolio since inception (February 2005). Individual returns will differ for investors that made an initial investment after this inception date or where additional investments or redemptions have been made. Quest returns are net of fees. Past performance is not a reliable indicator of future performance.

MARKET SUMMARY

MARKETS CONTINUE TO GRIND HIGHER. GLOBAL DISASTERS FAIL TO BREAK THE MOMENTUM. HOW MUCH BAD NEWS CAN A MARKET ABSORB? GLOBAL DEBT ISSUES CONTINUE UNRESOLVED.

Investors that believe in building wealth slowly should be happy with the Australian equity performance over the last two years. The Australian Accumulation Index (it includes dividends) was up 3.1% in the March quarter. This is the seventh quarterly rise over the last eight quarters. The Quest portfolio performed slightly below the benchmark for the quarter.

In terms of the fiscal year to date, returns from various markets and indices for the nine months to the end of March appear below:

ASX 300	13%
Dow Jones	26%
S&P 500	28%
Japan Nikkei	4%
ASX Industrials	18%
ASX Materials	24%
ASX Financials	8.4%
ASX Small Companies	26%
AUD rise against USD	**23%**

Source: Iress

The astonishing figure is the massive 23% increase in the Australian dollar to $1.03 relative to the United States dollar. At the time of writing, the cross rate is up again to $1.05. Apart from being a great time to buy a plane ticket to America, the strength of the dollar has become a drag on domestic competitiveness. Australian exporters will be struggling to sell relatively expensive product to a global market. The dollar strength will also lead to a further round of earnings downgrades from companies earning US dollars such as News Corporation, QBE, CSL, Computershare and Brambles.

The industrial sector performed better in the quarter with good gains made by News Corporation (better earnings outlook), Worley Parsons (moved up with the oil price), Coca Cola (solid earnings), Incitec Pivot (stronger soft commodities), Aristocrat (turning around!) and GPT (the clean up is almost complete). Commonwealth Bank went ex dividend in February while the other banks are cum dividend now until May. The banks were weaker until mid quarter then rallied as defensive stocks found favour post the Japanese earthquake.

The retail sector continues to struggle as consumers adopt a more conservative approach to consumption. There seems to be a transition from consumption in Australia to preservation. The move to shopping via the internet is well documented and we have seen estimates for the percentage of web retail purchased from overseas being as high as 60%! Government retail stimulus ceased in 2010 and the sector has struggled to build momentum since.

Natural disasters were numerous in the quarter. The December rains in Queensland led to a major flood in Brisbane. Soon after cyclone Yasi devastated areas of north Queensland. Next were Victorian floods and bushfires north of Perth. The Christchurch earthquake in February was followed by the Japanese earthquakes and tsunami. In March, the United Nations imposed a no fly zone in Libya to protect civilians.

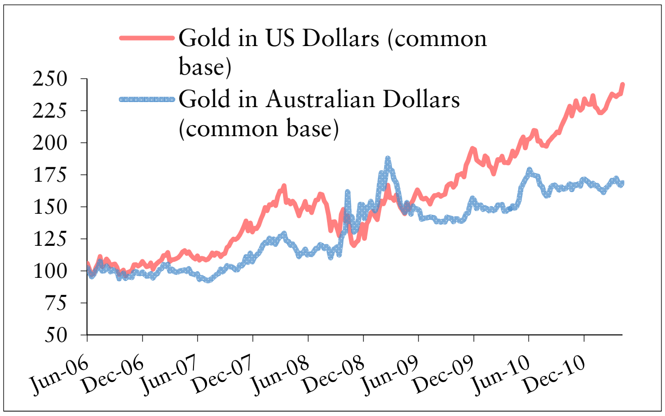
These events create disruption and uncertainty within economies, divert construction away from the normal cycle toward the recovery cycle, create the need for additional funding, disrupt normal spending patterns, push up insurance premiums, increase the price of oil and building materials and lower taxation collections. Overall, these events put huge pressure on the national purse.

The hand of Government continues to influence the listed market with around 75% of the market by capitalisation affected by some form of government tax, regulatory or procedural review. The Telstra saga drags on as more questions are raised over the viability and real cost / benefit of the National Broadband Network. The Australian Stock Exchange takeover by the Singapore Stock Exchange has been disallowed and a carbon tax has been proposed. On a positive note, the revised pathology funding review looks like a return to the more certain days of a capped reimbursement formula.

Corporate activity was below the usual levels this quarter. Origin announced a 1 for 5 issue at $13, a 17% discount to last trade. The issue was very successful with the stock now at $17. West Australian Newspapers agreed to acquire Seven Media Group. Nine Entertainment sold a 49% stake in Carsales.com in March into the general market. BHP announced an off market buy back which completed in April with 147 million shares being bought back totalling $6 billion.

Gold was up marginally over the quarter and finished at $US1,432 per ounce. Oil surged from $91 to over $106 per barrel by quarter end associated with political turmoil in the Middle East. Both commodities have continued to surge into early April.

We have previously commented on the strength of gold and other commodity prices. The following chart shows the gold price in both US dollar and Australian dollar. The recent rally is as much about global funds flowing to hard and soft commodities to protect themselves from a falling US dollar as it is about the growth of emerging economies.



Source: Iress

PORTFOLIO ACTIVITY

PROFITS WERE TAKEN AND CASH BUILT UP TO 12% AS THE MARKET RALLIED INTO FEBRUARY. THE JAPANESE EARTHQUAKE DROPPED THE MARKET 6%. QUEST BOUGHT INTO THE DIP. EXTENSIVE COMPANY VISITATION PROGRAM UNDERTAKEN.

Post the flurry of new stocks added to the portfolio during the previous quarter, this period was marked more by portfolio concentration. During the quarter we exited Campbell Brothers, New Corp non-voting shares, Westfield Retail and reduced Fletcher Building, all profitably. ERA was sold at a loss.

News Corp was sold at a small profit, with the strengthening $A limiting the benefit of this investment. Campbell Brothers was only added during the December quarter at around $35. Campbell Brothers is currently one of the largest companies in the Small Cap's Index and has been a major beneficiary of the mining boom. We were expecting the stock to move to the $40 plus within 12 months however strong operating performance resulted in a rapid price appreciation. With the stock well above our price target we exited the position.

The portfolio raised cash during late February and early March as the ASX 300 rallied towards 5000. In addition to the above mentioned exits, holdings in BHP and CBA were trimmed. This cash was redeployed following the Japanese earthquake given the market had plunged more than 6%. During this period we bought ANZ and RIO and increased our investments in Westpac, Orica, Newcrest and Oil Search. The cash weight at the end of March was 4.1%, a little above the 2.7% at the end of the previous quarter.

While Quest is not expecting strong revenue growth from the major banks, the lack of growth limits their need to raise expensive offshore wholesale funding. As a result, opportunistic trading in the banks has been yielding positive returns together with fully franked dividends.

Equinox emerged in the portfolio post their successful script and cash bid for Citadel. Our holding in Equinox is lower than our previous position in Citadel given the cash portion of the bid and the selling we did in Citadel late in the previous quarter.

Post the end of reporting season, Quest has been extremely busy reviewing current holdings and assessing potential investments. Here's a list of recent company contacts:

ERM Power, Seek competitors: 51 Jobs and JobStreet, Santos, Commonwealth Bank, Equinox (twice), MAp, Nufarm, Incitec Pivot, Fosters, Treasury Wine Estates, ANZ, JB Hi Fi, Next DC, Dart Energy, Hillgrove Resources, News Corp, Miclyn Express, GPT, New Hope Coal, IAG, Southern Cross media, BHP, Asciano, Transurban (twice), Infratil, Downer EDI, Macarthur Coal, BC Iron, Minmetals (bidding for Equinox), Westpac, Worley Parsons, Flint (Worley competitor), NIB, Ausdrill, Myer, Kathmandu, Hastie, Ausenco, Navitas, Ludowici, GUD, SMS, Credit Corp, Monadelphous, Gindalbie Metals, Doray Minerals, Atlas Iron, Sandfire Resources, Southern Cross Electrical, Empire Gas and Oil, Folkestone and Independence Group.

OUTLOOK

THE MARKET STAGED A RAPID RECOVERY FROM THE SHARP CORRECTION IN MARCH BUT DOES NOT LOOK EXPENSIVE COMPARED TO HISTORY. THE STRONG AUSTRALIAN DOLLAR AND THE POTENTIAL THREAT FROM HIGHER OIL PRICES, INTEREST RATES AND INFLATION WILL CONTINUE TO CHALLENGE CORPORATE EARNINGS. ACTIONS BY THE US GOVERNMENT TO CEMENT ECONOMIC GROWTH MAY FUEL FURTHER MARKET GAINS.

With the ASX / S&P 300 having staged a rapid recovery it is now nudging 5000, a level not seen since 2008. The obvious question is whether it can go higher in the short term.

Valuations in the Australian market don't look particularly demanding with market P/Es being at, or a little below, historical averages. Earnings however are likely to come under further pressure given the ongoing strength of the Australian dollar, increasing imbalances in the Australian economy and the risk of a wage blow out spilling into inflation fears.

The US continues to post positive data but it appears as if the trajectory of growth is slowing. The big factor is how the US government / US Treasury respond to any threat to ongoing growth. The second round of money printing (Quantitative Easing II or QE II) is ending soon and some are calling for a further round of QE III. We fear the US has become addicted to QE and ongoing Government stimulus. It's not hard to form the view that some of the current growth has been artificial and the economy may not stand too well on its own without further support. The US housing market continues to look dreadful with a huge inventory of unsold houses remaining and house prices still falling, lending support to this theory.

The extent of the impact from QE is widely debated however we think it has been a significant factor in the rise of the US market, the fall in the US dollar and higher commodity prices. In this environment, US companies with large offshore earnings are doing very well with the likes of Apple, McDonald's, Chevron, Amazon, Caterpillar and 3M trading around their all time highs. Encouraging the US$ lower also provides welcome pressure on China to raise its currency by the mechanism of higher domestic inflation.

There seems a good argument that the US will do whatever it takes to keep growth and the stockmarket ticking along. In our mind there is a reasonable likelihood that QE III or other stimulatory measures will be enacted, lending support to a continuation of the current trend in world markets. This of course would increase the risks down the track, with a growing and unsustainable fiscal deficit and a vulnerable underlying economy a continuing fact of life in the US.

We don't underestimate the impact of the high Australian dollar on local businesses. The pain here is likely to become acute if the currency remains at or above current levels. Australian companies with significant offshore earnings are surely cum another downgrade as analyst estimates remain behind the pace.

Interest rates are going up around the world, most notably in China and Europe. The impact of this on growth is yet to be seen with estimates for world GDP still above historical averages. These averages however may not mean much as the developing world has now taken over responsibility for generating the majority of world growth. China continues to grow at a good clip despite significant recent tightenings. It remains a case of so far, so good. We continue to monitor this closely.

Whilst there is plenty to worry about, markets have shown an impressive ability to rise despite the combined challenges of the Japanese earthquake, Middle East unrest and ongoing jitters in Europe. With falling unemployment, a huge capex pipeline and the RBA being ahead of the rest of the world on interest rates, the Australian economy has a number of buffers as it negotiates the future.

Overall, the Australian market is looking reasonable at present and many companies can be expected to deliver satisfactory returns from a combination of franked dividends and a small capital gain - banks being one such example.

We continue to search for opportunities to make better than market returns and have been very active in seeking company contact in recent weeks, as detailed above. We also have a number of site visits arranged for the June Quarter.

FEES

Many clients are now close to the high water mark previously established for their account. The highwater mark must be exceeded before any performance fee is payable.

A number of clients may pay a small performance fee for the quarter (payable in the next quarter), depending on the timing of their initial investment and any additional cashflows.

INTERVIEW WITH TROY CAIRNS

Here is a short Q&A with Quest member Troy Cairns. Troy has been with Quest for nearly three and half years and has recently become a shareholder in Quest.

You initially trained as a veterinarian. How did you end up at Quest? What previous work experience gave you the opportunity to join Quest?

I guess it's like a lot of things in life, something that appears to be a big change is actually the result of a lot of little steps in the same direction.

The short version is that I worked as a vet in Australia and the UK in the early 90s but knew early on I wouldn't ever become an old vet. I took some time to decide to return to study, embarking on an MBA. I relished all things financial in that course and took a job in Investment Banking with Rothschild.

I barely had time to scratch myself through the remainder of the 90s and early 2000s working in equity capital markets, raising money for companies as part of the ABN AMRO Rothschild JV and UBS. I worked on some terrific landmark deals like the float of NSW TAB and Contact Energy in NZ and I learnt a lot.

I took that experience and moved into advising CEOs in how they interact and communicate with the stockmarket. This was with Channel Financial Communication and I was a part owner of that business.

To this point in my financial career, I had been on the sell side of the stockmarket being "inside the tent". I sat with to the CEO and management and understood the real issues within a business. This is quite a different perspective to that of a fund manager on the buy side. I felt that this experience could be useful in making investment decisions rather than marketing them. I sought out a small and successful funds management team and subsequently joined Quest.

What did you know about Quest before you joined?

Not a lot, initially. Quest is not a major retail brand and flies under the radar to some degree. This discretion means that Quest is not that well known outside of those that deal with it directly. I certainly did my due diligence on Quest before joining using my market contacts. I got a very consistent message back from the market – they are smart guys, experienced, successful, genuine.

I was also interested to hear that those who knew Quest (but didn't know a lot about Quest), were surprised to learn that Quest managed over $1.5 billion of client money. A number of much "noisier" fund managers were much smaller than Quest when you scratched the surface.

What is your average day at Quest?

It's all about investing and generating and discussing ideas. There are four of us in the investment team and that's what we do. Get ideas and run them to ground by meeting with company management, using industry contacts and coming to grips with the markets for each company. I spend a fair bit of time wrestling with the numbers. We all use the Quest process for evaluating and valuing stocks and it's a great tool for discussing competing investment ideas. Each of us covers a diverse range of sectors - I can be looking at retail, healthcare, mining services, oil and gas, property or a small industrial on any given day. Not being boxed into a tight range of market sectors gives us a good feel for the overall market.

Being a small business, I also get involved in the day to day things at Quest like ensuring daily compliance with procedures, writing the quarterly report and marketing. Looking after voting for our holdings also sits with me and I have been increasingly active in assessing the impact of Environmental, Social and Governance (ESG) factors in our investment decisions.

Is working at Quest what you expected?

Yes. It's definitely been a case of "what you see is what you get." This was one of my main criterion - that I was joining a team that was true to label. In my mind, it's important to believe in what you are doing and to have a good fit with your workmates, particularly in a small business. The Quest investment process fits my style of thinking and I have slotted in well with it - so that works. We also all have young families at Quest so the culture is a good match.

What fills your life outside work?

Three young boys pretty much fill up my life outside work. We are now coming out of the fog of infancy with the youngest coming up to two and I try to keep fit swimming in a local squad and cycling regularly with friends. Hoping to do more cycling once things free up a bit and would like to get back to France to do more riding up some of those *%!$^#& Tour de France mountains!

Part of me would like to keep a (small) hand in the vet side of things but I never seem to manage it. Having said that I am taking my nine year old off to a vet friend's farm this weekend and I think we won't be able to help ourselves, testing out those old skills…

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