May 2007
Issue 3

The Quest Report

An occasional newsletter from Quest Asset Partners

Special points of interest:

- Quest business update
- Chinese visit and conclusions
- Market review
- Super opportunity; don't delay!

Superannuation:

don't leave planning for your future till the last week of June

Performance of the Quest portfolio

The Quest Sophisticated Investor* portfolio has returned 24% so far this fiscal year pre fees.

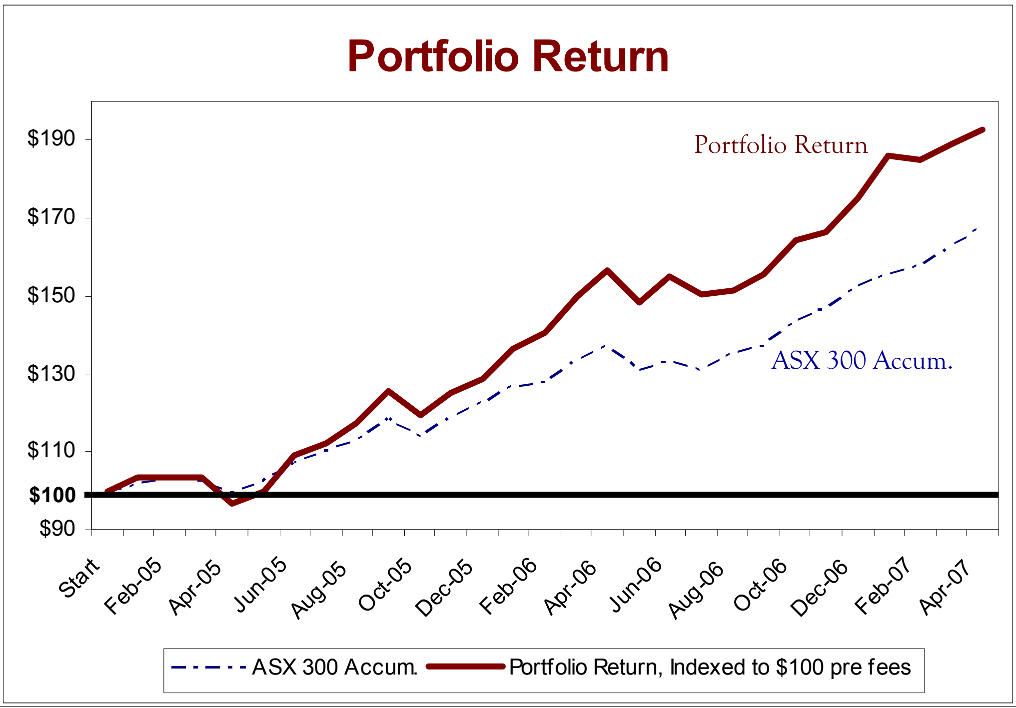
The chart below shows that before fees, the portfolio has significantly outperformed the benchmark ASX 300 since inception. The compound Quest return is now 32% per annum since inception before fees. This is to the end of April 2007. The portfolio is also well ahead of the ASX 300 post fees.

Although the portfolio is concentrated in approximately 25 stocks, returns have been driven by a diversity of investments rather than a few single contributors. Amongst the largest contributors have been investments in Worley Parsons, BHP, Cochlear, CSL and Bravura Solutions.

The Quest portfolio is administered on our behalf by Goldman Sachs JBWere who included Quest on their Select panel of Australian equity investment managers in 2005.

The Quest business plan from the outset was to limit our over all size to maximize flexibility. We now manage money for eight large institutional superannuation accounts while also building a Sophisticated Investor capability. Our large superannuation clients include Westpac Staff Super, NSW Treasury Corp and Unisuper. Funds in this category total $1.5 billion. Quest is now closed to large funds but still open to Sophisticated Investors. More than $50m is managed for over 100 clients to date.

*Quest holds a wholesale licence from ASIC. Sophisticated Investor clients must start with a minimum initial contribution of $500,000. Future performance may differ from past performance.



Chris visits China

Chris recently visited China. What was the purpose of the visit?

The growth of the Chinese economy has been a significant contributor to performance of a number of sectors of the Australian economy and market for some time. Monitoring the development of the Chinese economy and particularly it's impact on Australian materials demand is vital. The slow down in NSW, which has the lowest residential construction levels in 60 years, has been offset by the booming WA and Queensland economies.

Chinese materials demand growth only started to be a material influence on commodity demand growth in the 1990's. This materiality is growing. For instance, in the period 2000 to 2010, China will be more than 50% of demand growth for copper. The influence in the ten years from 2010 is forecast to be even greater.

> *"China built the equivalent of the UK power generation system in 2006."*

What did you do there?

I visited customers of Australia's major resource exporting companies such as Chinese steel companies, as well as energy companies, economists, the Australian Embassy, RIO, government officials, a journalist, a commodities trader and The British Chamber of Commerce. On the last day I went for a very long walk just to take it all in.

What were you major conclusions?

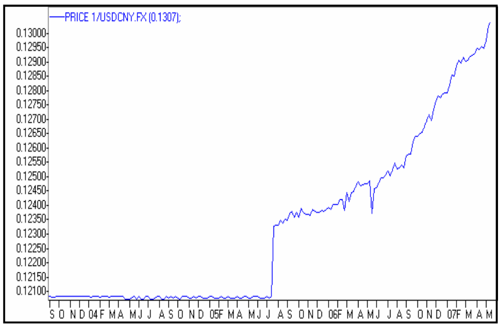
China is experiencing the world's largest peace time migration of people from west to east. There are 15 million new urban residents each year. The average city dweller earns less than $3,000 per annum. The development of communication networks, rail and road systems will lead to increased consumption of phones, refrigeration, cars and air conditioners. Nearly 50% of Chinese copper consumption is in power generation and transmission. There are a few kilos of copper in the average air conditioner. It is estimated that up to 500 million Chinese still have no power.

The scale of change is immense. China built the equivalent of the UK power generation system in 2006. Coal provides 85% of power. Twelve new nuclear power stations are under construction and a new coal fired power plant is completed at a rate of more than one per month.

Chinese vehicle production is expected to exceed USA car production by 2010 and is already producing over 7 million vehicles per annum and one in three of the world's buses. There is growing awareness of environmental issues but funding and commitment to reduce pollution is lagging.

In contrast to local views of politicians and the political process, the Chinese generally have greater respect for their central government.

China has been growing at close to 10% pa for more than two decades. The Central Authorities are well aware of the measures required to stem occasional over exuberance. Localised policy action has been used to control overly zealous growth, such as the dampening of property speculation in Shanghai by the imposition of a localised capital gains tax.



It is expected that currency escalation will continue given the historic trend and the

Chris visits China

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strong terms of trade. The chart shows the relative performance of the Chinese renminbi [lit. '*public money*'] against the $US.

The Chinese trade surplus is huge and growing. It is expected to top $US300bn in 2007, up from $US180bn in 2006. The Chinese invest 60% of reserves in US assets, primarily bonds, which keeps US interest rates lower. The Chinese stock market is an accident waiting to happen with 200,000 punters opening share broking accounts every day. Most are uninformed. Corruption is still rife and good information is an asset of the privileged.

Whilst there will be volatility, the demographic shifts in China will be felt the world over for decades to come.

How did the portfolio change?

Our response has been to increase our exposure to large commodity producers BHP and RIO while investing in Woodside to provide large scale exposure to the increasing demand for gas. We have also built a position in One Steel. This has been funded by reducing our domestic industrial exposure.

I also came home thinking my kids would be better off in the next decades by learning Chinese rather than French!

Market Review

Local and international markets have been driven by strong earnings growth, the emergence of China, cheap finance, legislated superannuation inflows in Australia, merger and acquisition activity and takeover rumours, usually from private equity.

In our most recent client quarterly report we highlighted that Australian Industrial P/E's are the highest for many years while resource and global P/E's are well within historic levels. Consider that 16 major Australian stocks have traded much higher in the last year as a result of take over rumour. As yet there are still no corporate actions in these stocks which tells us that this anticipation must unwind eventually. While private equity take over is prolific in the USA, it remains an over stated force in Australia.

Despite the private equity hype, there has been only one concluded take over in Australia's top100 being DCA Group, a radiology and aged care group based in Sydney.

While Rural Press has merged with Fairfax, Rinker is still working through a bid from Cemex. Flight Centre and Qantas bids have failed and Alinta is still being contested. At the small end, Colorado and Rebel have been consumed by private equity.

Elsewhere, Alumina, Amcor, Ansell, Austar, Boral, Corporate Express, Fosters, Harvey Norman, Leighton, PBL, RIO, Santos, Seven, West Australian News and Wesfarmers have all been the subject of take over rumours. As yet no bids have emerged.

It is difficult to see the medium term upside in most of the industrial stocks. Warning signs include corporate profitability at relatively unsustainable levels, interest rates appearing to have broken the long term down trend and an escalation in energy costs. The federal election may present an additional dampener.

Over the next twelve months, we see the key themes for our portfolio as being: i. bulk commodity demand, ii. energy shortage and iii. the strength of the funds management industry.

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Super Super

The attractiveness of superannuation has been front page news since the bonanza announced by Treasurer Costello in the 2006 budget.

Amazingly however, only 40% of Australians are aware of the benefits and the average super account continues to be well short of required levels.

Superannuation provides a remarkably tax efficient wealth accumulation vehicle. In addition, the Government have provided a one-time incentive for eligible players adding up to $1m into super accounts prior to June 30 2007. The threshold has also been raised for later years, but at a lower level.

The one time incentive requires immediate response. The window may never be opened this wide again. Quest is only licensed to provide general advice, but planners and tax advisers are well versed in the opportunity.

We would encourage our clients to act now if they wish to address this opportunity. Don't leave planning for your future till the last week of June!

Chinese copies — spot the original

Remarkable coincidence? One of the above cars is a Daimler Smart Car, the other is a City Smart by Chinese CMEC. Source Automotoportal