QUEST

QUARTERLY REPORT
DECEMBER 2011

John Citizen Family Super Fund

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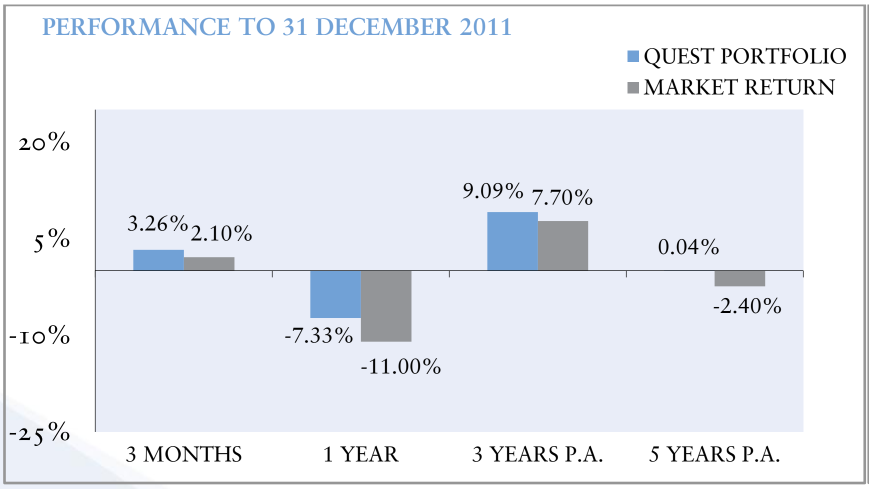
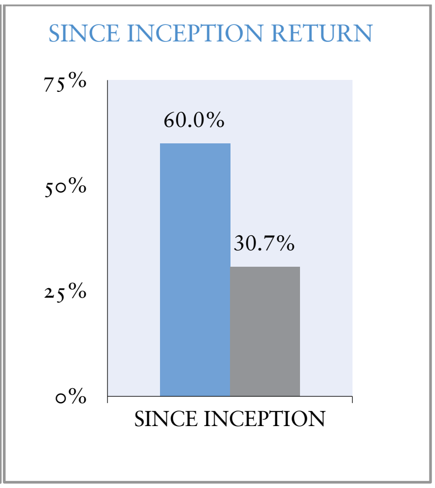
Mr John Citizen	123 ABC Street, Sydney NSW 2000
Account Name: John Citizen	

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

YOUR PORTFOLIO PERFORMANCE FOR THE QUARTER*	3.26%
MARKET RETURN (S&P / ASX 300 ACCUMULATION INDEX)	2.05%

*Includes fees for the quarter



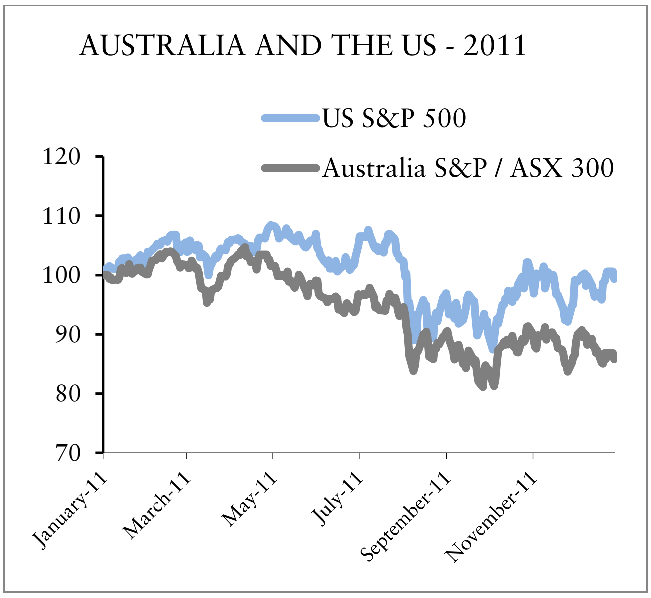


****The portfolio returns quoted above represent the return achieved if invested in the Quest portfolio since inception (February 2005). Individual returns will differ for investors that made an initial investment after this inception date or where additional investments or redemptions have been made.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

MARKET SUMMARY

THE MARKET RALLIED IN THE DECEMBER QUARTER RECOVERING SOME OF THE GROUND LOST DURING THE MIDDLE OF THE YEAR. AUSTRALIA CONTINUED TO LAG WELL BEHIND THE US, PERFORMING MORE IN LINE WITH ASIAN MARKETS. THE QUEST PORTFOLIO OUTPERFORMED THE MARKET DURING THE QUARTER.

It was a disappointing year for equity investors in Australia in 2011. While returns were positive in the first and last quarters, significant weakness in the middle quarters left the market down 11% for the year, including dividends. This compares to the Dow Jones which was up 5.5%.



Source: Iress

The Quest portfolio performed very well relative to the market, beating the index by 3.6% (after fees) over the last twelve months. However given the size of the market fall we still recorded a net loss for the 2011 calendar year.

Over the longer term, investors in Quest remain a long way ahead of the market. If you invested with Quest from inception (Feb 2005) you would have earned an average compound return (after fees) of 7.2% p.a., compared with the market return of 4.0% over the same period.

The following key statistics and chart summarise the 2011 calendar year.

S&P/ ASX 300 accumulation	-11 %
Dow Jones	6 %
S&P 500	0 %
Japan Nikkei	-17 %
China Shanghai	-22 %
ASX Industrials	-9 %
ASX Resources	-26 %
ASX Financials	-11 %
ASX Small Companies	-24 %
BHP	-24 %
CBA	-3 %
AUD rise against USD	0 %

Source: Iress

The table above shows how poorly the Australian and Asian markets have performed over the year compared to the US. This is due to:

1. A perception that the US economy is in recovery mode whereas the local and Asian markets are cooling down after a prolonged period of growth;
2. large resource weightings in the local market index dragging down performance. Our largest stock, BHP, has fallen 24% over the year.
3. the impact of the strong Australian dollar on local stocks.

This disparity in returns is now so pronounced that some realignment is likely over the next few months. There is no doubt that on many measures the US is improving; unemployment has fallen below 9% and housing starts are rising. There are however still 25 million people unemployed and 47 million on food stamps.

The big problem is the enormous US deficit. Another politically charged negotiation of the US debt ceiling is imminent in the New Year. The escalating debt is caught in a web of politics that seems more directed at shoring up the electoral prospects of each party at the next election than in achieving a sensible outcome.

Calls for action are now heard from a range of commentators including the Chinese. It is estimated that Chinese holdings of US debt exceed $1 trillion of the total debt of $15 trillion. The Chinese are on the record as saying that international financing should not be “taken for granted”.

The Australian dollar should ease in the coming months. The November rate cut is expected to be followed by at least one 25bp cut in early 2012 which will take the pressure off the currency. That would lower the official rate to 4%. Further slowing of Chinese growth will take the pressure off resource prices and allow the dollar to fall permitting local businesses to regain some competitiveness. This occurrence would be beneficial for our US dollar earning stocks such as Resmed, CSL and Computershare.

In terms of corporate activity, a number of fund raisings occurred in the quarter. Bendigo Bank raised $150m to buy Bank of Cyprus Australia. Super Retail Group raised $284m in a surprise bid for sporting goods chain Rebel.

A number of resource stocks raised funds ahead of the holiday period, a move that highlights the risk of geared resource players that face softer prices in 2012. Independence Group raised $118 to fund mining development after the disappointing performance of recently acquired Jabiru Metals. Evolution Mining raised $152m to fund mine acquisitions and Northern Iron raised $20m for ongoing operations.

Blue Scope Steel raised $600m in a massive four for five rights issue to rebuild the balance sheet. The surprise raising came only five days after the AGM. Three weeks later, in a move reminiscent of our struggling car industry, Blue Scope applied for $100m in government assistance under the government steel transformation plan as it battles a strong currency, soft demand, the carbon tax and restructuring headwinds.

Hybrid debt issues proved popular and were chased by retail investors; AFIC raised $200m, Origin $900m and Woolworths $700m. Retail investors are being driven by yield rather than capital gain in the current environment. Brokers are reporting that it continues to be difficult to persuade retail investors to invest in equities rather than bank deposits.

The Trade Me business was spun out from Fairfax and listed in December 2011 at a premium to its IPO price. Trade Me is an online New Zealand classifieds business with nearly 3 million members.

Gloucester Coal and Chinese company Yancoal have entered discussions to merge via a scheme of arrangement which will see Yancoal acquire all Gloucester shares. Yancoal took over Felix Resources a few years ago and undertook to the Foreign Investment Review Board to relist at least 30% of the company on the Australian market in 2012. Yancoal assets include the Moolarben, Ashton and Austar mines in the Hunter Valley and the Yarrabee and Minerva mines in the Bowen Basin. The deal is complicated and will undoubtedly include synergies in blending, port usage and overheads. The combined entity will have a high level of debt at around $3.5 billion and a significant capital expenditure program ahead of it.

An interesting feature of the year is the ongoing dreadful performance of the worst stocks of 2010. The tale below shows a list under achievers in both 2010 and 2011. The moral of the story is that troubled businesses can be very difficult to turn around!

S&P/ ASX 300 accumulation	-11 %
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AUD rise against USD	0 %

Source Iress

PORTFOLIO ACTIVITY

CASH WAS BUILT UP DURING THE QUARTER AS THE QUEST PORTFOLIO ADOPTED A MORE CONSERVATIVE STANCE. GOLD, YIELD AND OFFSHORE EARNINGS ARE FEATURES OF THE PORTFOLIO. WHITEHAVEN COAL AND DOLOMATRIX ANNOUNCE CORPORATE ACTIONS, BOTH SUBJECT TO SHAREHOLDER APPROVAL.

During the quarter the portfolio was moved in a more defensive direction. In our view, yield will be increasingly sought after in 2012 and capital gains will be harder to find. The portfolio is focussed on maintaining wealth and generating income during this time.

Bank positions sold in November included ANZ and National Bank. We now own only two banks; Commonwealth and Westpac which make up 18% of the portfolio. Bank valuations are reasonable in a flat economy and the franked yield is appealing. We will probably move our bank holdings around to optimise dividend flow in the months ahead. The problem for banks is the lack of growth as the consumer has a diminished appetite for bank debt.

The resources market will be volatile in 2012. Upside is likely from smaller and mid size stocks via takeover and merger activity. While China will continue to consume resources, the rate of economic growth will slip back to around 8%; still a healthy clip but lower than the last few years. Resource prices have already eased in anticipation. As a result we own iron ore miners Atlas Iron and Gindalbie Metals rather than the majors; about 6% of the portfolio.

Property stocks purchased in the quarter included Commonwealth Property Office Fund and an increase in our GPT Group and Stockland positions. The trusts yield around 7% per annum and continue to trade below asset backing. Trusts will be more resilient than others if the market weakens. Property trusts currently comprise 8% of the portfolio.

At this point it is worth looking at the composition of the Australian market which is 30% banks and 30% resources. Thus 60% rests on the fortunes of two sectors. The banks are trading in a range that is supported by yield at the lower end and by optimism at the high end. While banks may offer some trading opportunities, a major upward move by banks is, in our opinion, less likely. We also believe resources will have a tough year with most opportunity to be had from trading the volatility and takeover activity. The conclusion we have reached is that 60% of the market is less likely to drive upward in the coming months and we maintain a more conservative stance for the present.

Given our concerns about the financial state of many of the world's developed economies, we still favour gold investments. We own Alacer Gold, Doray Minerals and Newcrest Mining.

Alacer has gold production in Turkey and Australia. It is Australia's second largest gold producer. We visited the Copler mine in Eastern Turkey this year and will visit the West Australian assets again in February. Copler is an impressive site, not just for the mining conditions and ore grade but also for the skilful and enthusiastic local team that run the operation. There are only a handful of westerners on site. We can see gold production doubling to 800,000 ounces of gold for the group from the current 400,000 ounces over three years. We continued to accumulate during the quarter.

Doray Minerals is a small Western Australian gold explorer looking to move into production in 2013. The resource is 45 kms north of Meekatharra in Western Australia and is high grade and near surface. It sits aside a major highway and is easily supplied with power and water. Rival gold producer Ramelius Resources has recently taken a 7.7% stake in Doray as well as raising money in a placement for “asset level acquisitions”. The attraction for Ramelius is the proximity of a high grade undeveloped resource. As Ramelius has diminishing grades and Doray is a fresh resource we anticipate that Ramelius may increase its holding in Doray.

Newcrest is Australia’s largest gold producer. It is also our most disappointing stock in recent months having a series of production downgrades which have dropped the share price back to below our entry price of 2010.

Computershare was added to the portfolio after recent price declines. Computershare is the largest global share registry supplying services to companies, investors and exchanges in 20 countries. We like this business over the longer term and it provides exposure to US earnings in the event of a weaker Australian dollar. We will continue to accumulate on weakness.

Atlas Iron was added in the December quarter. Atlas is Perth based and ships around 6 million tonnes of iron ore from Port Headland to Chinese buyers each year. The company is set to double production in coming years, has port capacity and a conspicuously open share register. It is well managed and has a number of growth options. Market weakness this year has given us a chance to buy in below $3.00. Atlas was trading above $4 only months ago.

Our holding in Henderson has increased once again as the price falls. Henderson is a London based fund manager. While the price appears cheap on metrics, the back drop of the Euro economy has been a drag on the stock for most of the year. Henderson does provide enormous leverage to an improved European situation should that develop.

We continued to buy Lend Lease over the quarter. The stock is cheap on our Q-Value analysis with a lot riding on the development of Barangaroo in Sydney and a good first year from the newly acquired Valemus construction business. We expect Lend Lease to announce the first commitments to Barangaroo in the March quarter.

Macarthur Coal was sold into the takeover by Peabody USA. Macarthur was a terrific investment, surging from $10.50 in July to $16.20 as we sold out in October.

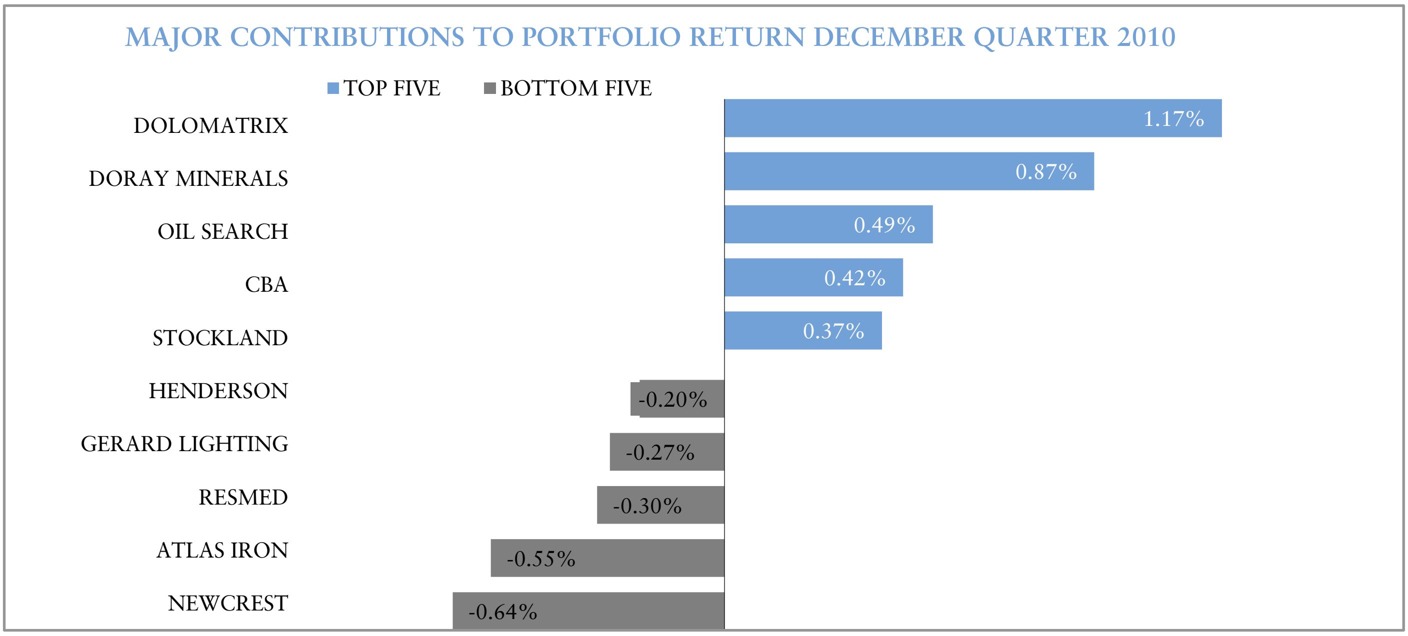
Our major exposure to coal is now Whitehaven Coal. Whitehaven is a NSW coal producer with a number of mines near Narrabri and Gunnedah. Whitehaven has recently announced a merger with Aston Resources which owns an adjoining coal resource as well as exploration properties in Queensland. The merged entity will take annual production from this company to 25m tonnes per annum. The merger will however take some months, a process that may retard the stock until the end of the March quarter.

Quest has been a long-standing shareholder in the small waste management company, Dolomatrix. Dolomatrix has been a chronic underperformer trading consistently below our valuation. For most of 2011, Dolomatrix traded between 20- 25 cents and paid a dividend of 2 cents per share in October. In mid December, the company announced it had entered into an agreement to sell 100% of business assets to another larger waste company, Tox Free Solutions. This would allow the company to return 39 cents of capital plus 1 cent franked dividend to shareholders if / when the sale is completed. The agreement is subject to shareholder approval. Dolomatrix has traded at 38 cents since the announcement and was a major contributor to the Quest portfolio return during the December quarter.

Cash at year end was 13%, higher than usual.

Contribution to Portfolio Returns December Quarter 2011

The largest contributors to Quest's return for the December 2011 quarter are shown in the chart below.



PREDICTIONS FROM 2011

LAST YEAR WE MADE EIGHT PREDICTIONS ON 2011. WE THOUGHT IT WOULD BE INTERESTING TO REVIEW HOW THESE PREDICTIONS FARED.

Last year we made eight predictions on 2011. We thought it would be interesting to review how these predictions fared.

1. *BHP will launch an off market buy back in the first quarter.*

   Result: BHP launched a buy back on 22nd February 2011.

2. *Labour shortages will become a real issue, not only in WA but also in Queensland.*

   Result: This was not a hard call. While companies in the front line continue to call for some action, the government is silent on initiatives.

3. *The race for resource security will continue with more off take contracts, strategic shareholdings and takeover activity likely.*

   Result: Two of our four suggested companies, Equinox and Extract, received take over bids while Whitehaven has recently announced a merger with Aston Resources.

4. *Politically, the tenuous hold on power by the current federal government will make it obvious that the Gillard government will not run full term.*

   Result: Incorrect - a full term looks more likely (for now anyway!)

5. *The Greens will hold the balance of supply from July, leaving the government in protracted and multifaceted negotiations on multiple issues.*

   Result: Better than expected. The government has passed a lot of legislation and taken a tougher stance with the Greens.

6. *After two years of serious lay offs, the US employment market actually starts recovering and the market rallies 15% in double quick time.*

   Result: Yes and no. The US unemployment level has fallen from 9.2% to 8.6% but the market only ran 10.6% in April and again in July before declining. The Dow Jones finished up 5.5% over the calendar year.

7. *While there are always opportunities, the Australian market will struggle to attract offshore investor dollars while the local currency stays above $US1.00.*

   Result: The performance difference between the Dow Jones (up 5.5%) and the S&P/ASX 300 (down 11%, including dividends) suggests the strong Australian dollar has impacted Australia as an investment destination.

8. *Economic and geopolitical tensions continue to support the gold price.*

   Result: Gold was up another 14% during the year.

THINGS TO WATCH IN 2012

THERE IS A LOT GOING ON IN THE WORLD, POLITICALLY, FINANCIALLY AND SOCIALLY. THE POTENTIAL FOR SURPRISES DURING 2012 WILL BE HIGH – BOTH GOOD AND BAD. WE EXPECT INVESTORS WILL SEEK YIELD RATHER THAN CAPITAL GAIN AND WEALTH PRESERVATION WILL BE FRONT OF MIND. GOOD STOCK PICKING WILL BE REWARDED IN 2012.

There is plenty of scope for further political and civil unrest in 2012. A push for power by Vladimir Putin in Russia and ongoing political issues in Egypt, Syria and Iran could put pressure on Middle Eastern stability and therefore the oil price. Remember that the world's largest oil producers (in order) are Russia, Saudi, USA and Iran.

Some resource stocks will come under pressure in 2012 as China's ongoing demand for resources is further questioned. With both internal demand and export demand from Europe slowing, commodity prices will struggle in the absence of further stimulus out of China. Against this backdrop and lower domestic interest rates, the Aussie dollar should fall back below parity, perhaps even to 90 cents.

The most exposed resource stocks will be those with higher costs that will see margins compress as commodity prices fall. The situation will worse for those with higher debt levels. A number of stocks raised money late in 2011 as a result of this squeeze.

US elections this year may see the exit of Obama after only one term in office. The signs are encouraging that the US will deliver slow improvement in employment and housing. Whilst not spectacular, this muddle through continues to be rewarded by the market.

The European challenges will wax and wane and result in some spectacular market moves. We think you can expect both fear and jubilation in 2012 with high probability of a huge market bounce sometime during the year. One or more major European banks are likely to fail requiring re-capitalisation and /or nationalisation. The path may also be set for at least one country to leave the Euro, though the actual exit may take years. As the year wears on, the spectre of stagflation in Europe may loom, dampening enthusiasm for any recovery.

Domestically, the political tensions will rise. Given all the wrangling over the Minerals Resource Rent Tax (MRRT) and State government royalties, we wouldn't be surprised to see the WA Government dramatically up the ante later in the year. With a Federal election due in 2013, is there a chance that WA threatens succession to get the Federal Government's attention?!

The Australian stock broking industry will contract significantly in 2012. The industry is over populated with some sources claiming there are as many as 700 analysts employed as well as tiers of execution and dealing staff.

In an uncertain world, investors will have lower return aspirations and will seek yield rather than capital gain in 2012. Wealth preservation will be a major priority and tax effective income will be seen as a bonus. This will be a year for the stock picker and you can expect good performances from quality, high yielding industrials. Resources stocks will provide trading opportunities with significant price volatility. Merger and acquisition action may well increase during the year delivering some good wins, just like 2011.

In our view you will do better to own fewer higher quality stocks than a clutch of more average stocks. We would like to find another early stage mining company in which to build a stake as we did in Citadel and Doray, taking a longer-term view.

In the sporting world we reckon there is a better than even chance that; Australian Tom Slingsby wins gold in the Laser sailing class at the London Olympics; Cadel Evans can't manage back to back Tour wins going down valiantly to younger and stronger riders; and Geelong and Collingwood once again battle it out for the flag.

FEES

No performance fee was earned during the December quarter.

Clients should note that a high water mark has been established with respect to any performance fee. This means that no performance fee will be earned until the portfolio value exceeds the high water mark and the performance hurdle is met.

CONTACT QUEST

Quest Asset Partners Pty Limited

ACN 109 448 802

AFS Licence No. 279207

Suite 807, 6A Glen Street
Milsons Point NSW 2061

Telephone: (02) 9409 2333

Email: askus@questap.com.au

Web: www.questap.com.au

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