QUEST

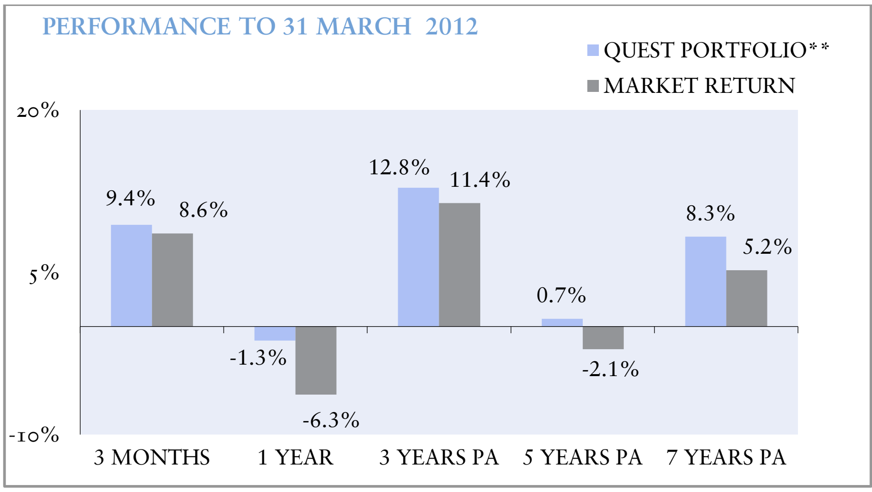
QUEST

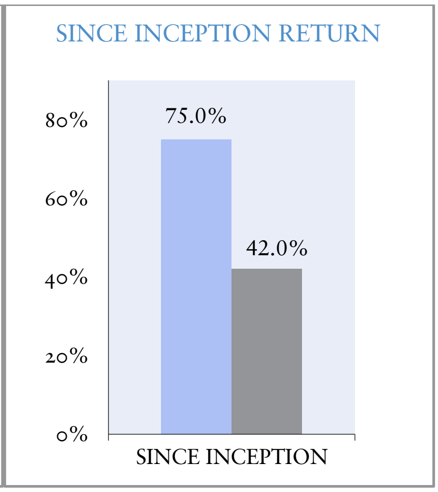
QUARTERLY REPORT
MAR-12

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

PORTFOLIO MOVEMENT – 31-MAR-12	
PREVIOUS MARKET VALUE 31-DEC-11	$0.00
CONTRIBUTIONS DURING QUARTER	$0.00
PORTFOLIO MOVEMENT*	$0.00
MARKET VALUE 31-MAR-12	$0.00
YOUR PORTFOLIO PERFORMANCE FOR THE QUARTER*	9.38%
MARKET RETURN (S&P / ASX 300 ACCUMULATION INDEX)	8.58%

*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 MARCH QUARTER DELIVERED STRONG RETURNS TO INVESTORS WITH MARKET SENTIMENT MUCH IMPROVED OVER LAST YEAR. THE QUEST PORTFOLIO CONTINUES TO OUTPERFORM, CONSISTENTLY DELIVERING RETURNS WELL AHEAD OF THE MARKET.

The March quarter saw a great start to the year. The S&P/ASX 300 Index rose by 5.1% in January, 2.0% in February and another 1.2% in March. The benchmark is now up 8.6% for the quarter. The Quest portfolio returned 9.4% (after fees) for the period.

Strong returns were posted in most international equity markets during the quarter: the US S&P500 was up 12%, the UK's FTSE rose 3.5%, Japan's Nikkei shot up 19% while the Venezuelan market delivered a startling 70% return.

It is good to see some momentum return to the markets after a prolonged period of depressing economic news and global conflict. It is unfortunately too early to break out the cigars; we expect more volatility this year which has already delivered some opportunities for our portfolio.

Gold was up 7% over the quarter but seems to have lost the impetus to go further. European economic fears have subsided for now and the gold price has been in a dawdling retreat since late February. Oil was up only 4% and finished at $103 after a 24% rise in the previous December quarter.

Australian interest rates have been on hold since November when the Reserve Bank cut rates by 25 basis points in both October and November. The next move is likely to be down but the timing is uncertain. The minutes of the November RBA meeting made it clear that the last cut was a pre-emptive strike against a deteriorating European situation. Since then Europe seems to have stabilised; the RBA won't use that excuse again for a while. The RBA will however react to the inflationary outlook and given that inflation is within the target range, we expect another 25bp cut or two in the next few months.

In the meantime our higher rates continue to hold the Australian dollar at crippling levels for manufacturers and exporters. The high dollar also inhibits stock market enthusiasm with global investors preferring the high interest rates of the Australian debt market to investing in the equity market. The Australian dollar is now seen as a global safe haven currency.

Australia is now one of only 12 countries that are AAA rated with the three ratings agencies after USA and France were downgraded in 2011. The AAA rated countries are: Australia, Canada, Denmark, Finland, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland and United Kingdom. Given the pressure on European economies at present, it is not surprising that Australia has seen considerable foreign investment flows that maintain the strength of the Australian dollar.

While markets were firmer, there were some startling performances over the quarter. OneSteel bounced 84% after being one of the worst stocks in 2011. Billabong reversed a steep downward track after takeover rumours fuelled a 60% rise but the stock has still more than halved over the year. The best performances in the Top 50 stocks were Toll Holdings up 42%, Fortescue Metals up 40% and Goodman Group up 22%. Iluka and Macquarie Group were up more than 20% while Qantas finally lifted off with an 18% gain.

The major corporate deal of the quarter was a $600 million placement from QBE Insurance in February. The raising was at a discounted price of $10.70.

At the end of March QBE was trading at $14 suggesting the maligned insurer has finally found a base level after a tough couple of years.

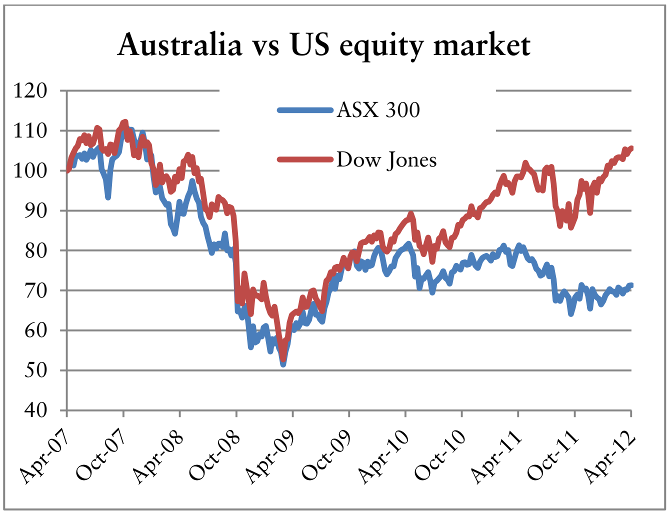
Other corporate deals included a $170 million placement in Kingsgate Consolidated, Bank of Queensland raising $450 million and a $260 million placement by Beach Petroleum. The sale of GUD's 19.3% stake in Breville into the market at $3.35 was popular. Breville shares reacted very positively to the sell down and now trade at $4.20 which suggests the market for toasters, kettles and sandwich makers is alive and well.

There were further hybrid issues during the quarter by ANZ, Insurance Australia Group and Tabcorp. These issues have been well sought by investors for their yield (which is often fully franked) at a 3% to 4% premium to the 180 day swap rate. There have been a lot of issues in this space and we expect the market will struggle to absorb many more deals in the coming months.

Quest did not participate in any of the above deals.

Amongst Quest holdings, Silex Systems rose 53%, Fortescue 36%, Henderson 30% and ERM Power 25% during the quarter. Our worst was Alacer Gold down 19% over the period.

Australia continues however to lag offshore markets. At the end of March the Dow Jones was 6% from the record highs of October 2007 while the Australian market is still a massive 35% shy of that peak. The chart indicates this trend has been running for three years now.



Source: Iress

The reason for this extraordinary divergence lies mainly with the performance of the US industrial stocks, specifically Apple, Bank of America, JP Morgan, Starbucks, McDonalds, Kraft and Baxter. These big names have become heroes of the US market. Sadly we do not have too many heroes at home at the moment. One local hero is undoubtedly Campbell Brothers. This is not a soup company. Campbell Brothers are a Queensland based supplier of analytical testing services for miners, amongst other things. The resources boom has been a company maker in this case. The stock is up 50% two years in a row!

A number of markets are at, or close, to all-time highs. The list includes Indonesia, Malaysia, Venezuela and the Philippines.

PORTFOLIO ACTIVITY

PROFITS WERE TAKEN IN SOME STOCKS AS THE MARKET ROSE AND OUR PRICE TARGETS WERE MET. THE QUEST PORTFOLIO HAS A STRONG BIAS TO COMPANIES WITH GOOD CASHFLOWS AND STRONG DIVIDEND YIELDS.

A number of new portfolio positions were established during the quarter including National Australia Bank, Rio Tinto, Telstra and Woolworths, whilst Commonwealth Bank, Dolomatrix, Sims Metal and Stockland were sold as price targets were reached.

Banks are a large component of our portfolio at the moment. Our present view on the banks is that they are range bound and lack growth - banks are in the business of selling debt which is not currently in demand. They are, however, the source of maintainable franked dividends. The volatility in the market has allowed us to pick up bank shares in weaker periods and to harvest the dividends. We look to sell in stronger times when our target prices are reached, while being mindful of satisfying the 45 day dividend rule. This strategy sees us in ANZ and National Australia Bank at present with the Commonwealth Bank recently sold. We intend to continue moving our bank holdings around in this environment whilst paying heed to our valuation ranges and the availability of franked yield.

We added Rio Tinto following our trip to China in March. We arrived in China after winter at the conclusion of the National People's Conference. Activity was on the rise in most sectors which was contrary to the consensus view from Australia. We found steel makers to be building inventory and experiencing stronger orders which explained the recent uptick in iron ore pricing. Our valuation suggests there is a lot of downside already priced into Rio Tinto shares at our entry level. The demand generated by an emerging economy with 1.4 billion people is, in our view, under estimated and we expect iron ore prices to trade in the range of $130 and $160 per tonne this year.

If demand eases, Chinese iron ore mines will be closed well before offshore mines given that Chinese costs are so much higher. This cost advantage protects Australian iron ore producers from slowing demand, to some extent. We also think that analyst's long term consensus iron ore prices are conservative. Our conclusion is that Rio Tinto provides good long term value at current levels and is preferred to BHP due to the dominance of iron ore within the business.

Telstra is not a stock that gets us excited but it has a yield of greater than 8% (fully franked) which is attractive. Telstra does display defensive characteristics and holds up well in torrid markets. Our valuation, however, suggests limited upside from this level and we continue to hold the stock for yield.

Woolworths has been the subject of a lot of research by our team over the years. The stock was a market darling for a long time but we sold it back in 2008 as it hit our target. The journey has been a bit tougher since then and we recently bought back at around $25 where we see reasonable value. Again the yield is good and the pricing seems to us to be more rational than the value ascribed to Wesfarmers, owner of the revamped Coles competitor.

While we had a good quarter, the decision to buy JB Hi Fi was not well timed with the stock now lower than our entry price. JB Hi Fi is a very well managed retailer with excellent cash flows and is trading significantly below our valuation. It pays a defensible dividend equating to a 7% yield and we remain patient.

Dolomatrix, a processor of waste and a chemical recycler, was sold following the sale of all its assets to a rival in January. The price rose around 50% during December and we sold in January.

While more recent Quest investors would have done well, our longer standing investors likely took a loss on this holding.

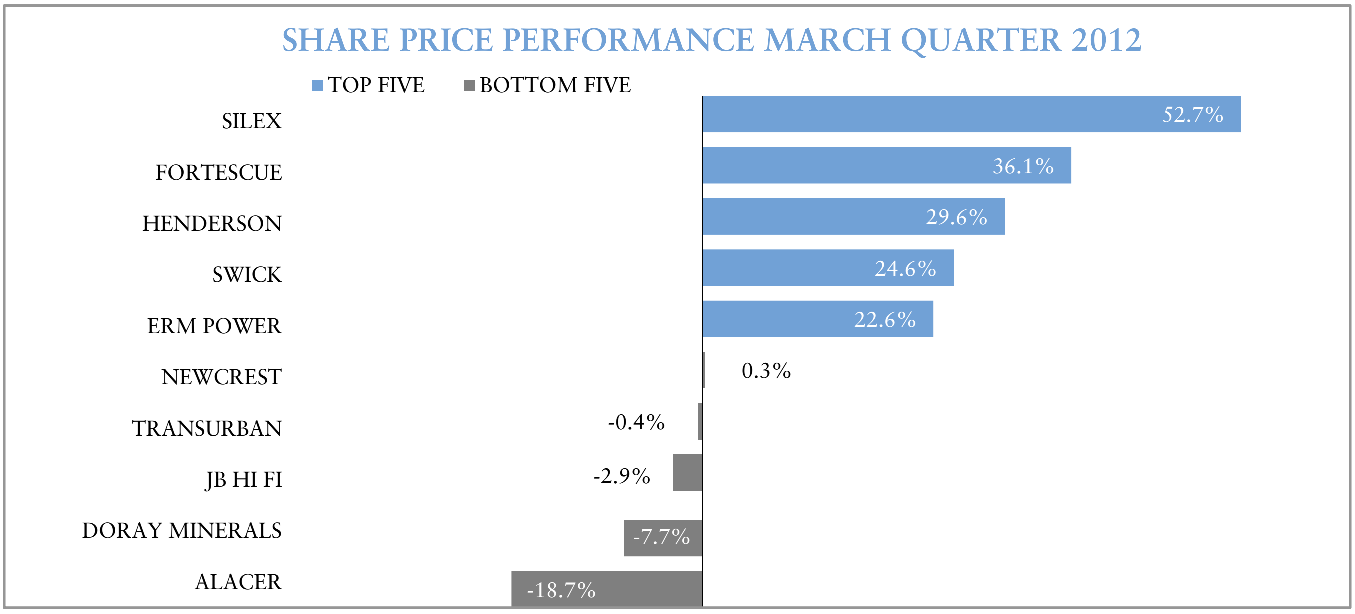
Stockland has exited the portfolio after achieving our target price. The stock was bought last August when property trusts were very depressed. The stock was well below net tangible asset backing and carrying a solid yield. The market, as it so often does, subsequently reassessed the value of Stockland and it rallied up to our target price in the new year. The overall return from holding Stockland was around 20%, excluding the distribution received on the way through.

We traded a few stocks in the period including Sims Metal, Fortescue Metals and Leighton. All were sold at a profit within weeks of purchase thanks to a strong market rally that commenced in January.

A number of our holdings were increased over the quarter including Australian Stock Exchange, GPT Group and Swick Mining. These stocks continue to trade below our target prices.

Our portfolio is currently focussed on providing exposure to industrials with good cash flow and reasonable growth potential with a solid yield. The resource component is more focussed on growth and the potential for a significant market rerating.

The Quest rationale for acquiring a stock is based on our Stage 1 screen that includes 18 subjective tests. The Stage 2 valuation gives us a price target based on long term valuation assumptions. Both Stages require a program of company visits by our team that runs throughout the year and is supplemented by company presentations and results during the year. A full description of the Quest process is on our website.



Source: Iress

REASONS TO BE OPTIMISTIC

IF YOU ARE LOOKING FOR REASONS TO BE OPTIMISTIC THEN READ ON. WHILE SENTIMENT IS GENERALLY NEGATIVE ON THE PROSPECTS FOR THE MARKET, WE LOOK AT SOME POSITIVE ASPECTS FOR AUSTRALIAN EQUITIES.

1. Our recent visit to China highlighted a distinct lift in activity post winter and The National People's Conference. While the consensus view on China is that the growth phase is slowing, it is possible that commentators under estimate the momentum that is created by a massive population of 1,338,299,512 people (according to the World Bank in 2010). Consider that GDP growth this year will be equal to the entire GDP back in the mid 90's!

   During March, housing sales, cement volumes and credit availability all improved. Late March, the Chinese PMI surprised the market with a better figure than expected. Over the last few weeks the iron ore price has crept up steadily to just under US$150 per tonne and steel production look stronger. While the Central Government is keen to burst the housing bubble, there will come a time when credit availability is increased and deposit rates are lowered. We are not China bears; rather we see a necessary slowing in a huge emerging economy.

2. The Reserve Bank is likely to ease interest rates in the coming months. The rhetoric from the bank has changed and their expectations of the economy have been too optimistic. A rate cut will take pressure off the Australian dollar allowing exporters to gain some competitiveness. Lower rates are good for banks, small businesses, housing and consumers.

3. Lower rates may promote a shift in cash balances out of deposits into equities as equity yields become relatively higher and discount rates fall. Private investors with cash have been building deposits at higher rates for years now. The franked yield is the focus of any savvy investor and now sits at the highest gap above deposit rates in the last ten years. A prolonged period of stability in equity markets would eventually entice retail investors to put some of their available cash back to work.

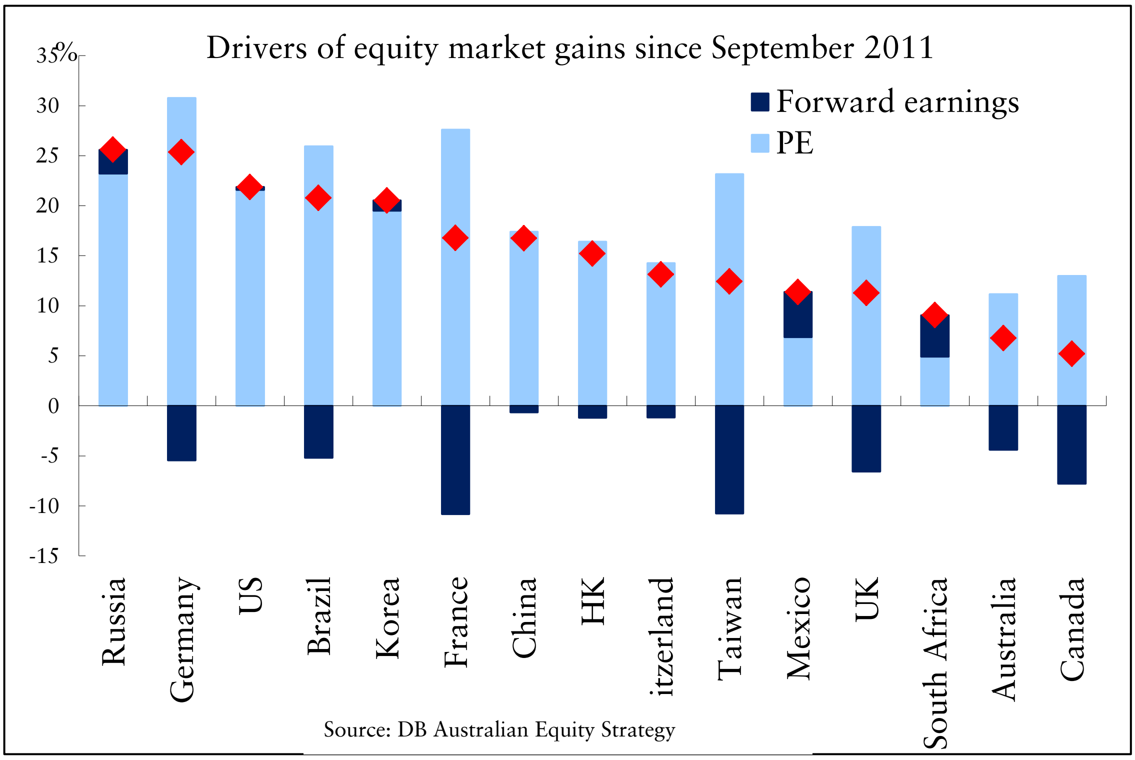
4. Business confidence is currently at very low levels in Australia. The next Federal election is only 18 months away and given that the markets price events well in advance we can expect this to soon become a factor. Polls indicate the change will be dramatic. A more constructive approach to wealth accumulation and the role of business in Australia seems likely with a new government.

5. Whilst the impact is often overstated, Australia is now seeing a massive investment in resource infrastructure which will run for another three years at least. Our estimates see Canada having the biggest spend upcoming followed by Australia, Chile and Peru.

   These projects have downstream implications for labour and fabrication as well as technical services, food and transport, health services, community planning, newsagents, barber shops and pizza shops. It all leads to activity, employment and consumption.

6. The US market is improving slowly from a low base and the US equity market has rallied accordingly, led by banks and leading industrials. As noted earlier, the Australian market has lagged the US market by a big margin. If the Dow continues to climb it is hard to see this gap widening further. This is especially the case if domestic interest rates are lowered and the Australian dollar continues to sag. In this scenario you could expect the Australian market to put in a good relative performance closing this gap.

The chart below highlights the opportunity. The major driver of recent market strength has been a global PE re-rate, meaning investors are prepared to pay more for a given level of earnings. Australia has so far missed much of this re-rate. Only two countries have fared worse than Australia (South Africa and Mexico) despite the fact that six countries have had a worse earnings performance (Brazil, Canada, France, Germany, Taiwan and the UK).



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.

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