QUEST

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QUARTERLY REPORT
DECEMBER 2009

John Citizen Superannuation Fund

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Mr John Citizen

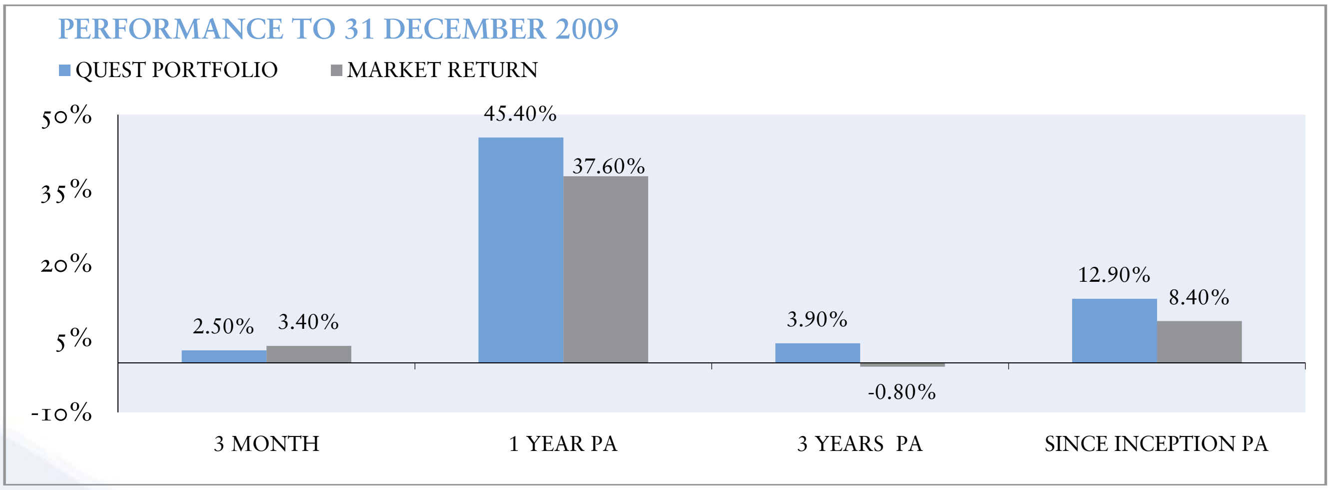
123 ABC Street
Sydney NSW 2000

Account Name: John Citizen Superannuation Fund

PORTFOLIO MOVEMENT – 31-DEC-09	
PREVIOUS MARKET VALUE 1-OCT-09	
CONTRIBUTIONS DURING QUARTER	
PORTFOLIO MOVEMENT*	
MARKET VALUE 31-DEC-09	

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

*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.

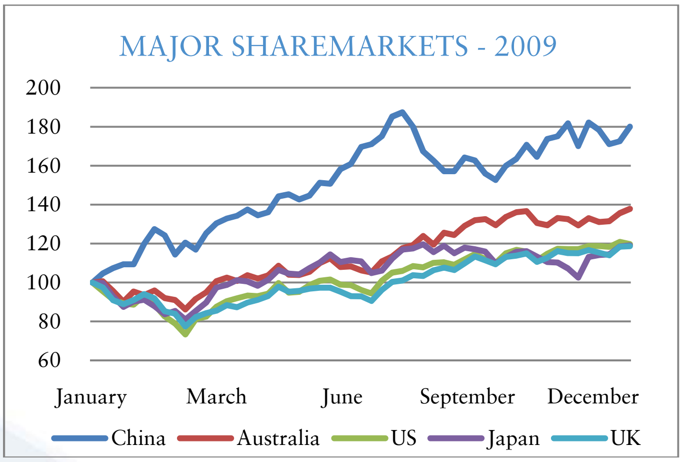
MARKET SUMMARY

THE DECEMBER QUARTER SAW THE MARKET GRIND OUT A COMPARATIVELY MODEST GAIN OF 3.4% TO CONCLUDE A LIVELY YEAR. THE AUSTRALIAN EQUITY MARKET WAS UP 38% OVER THE CALENDAR YEAR, COMPARED TO THE US MARKET AT 23% AND THE UK AT 22%. THE BEST PERFORMING MARKET WAS SRI LANKA WHICH ROSE 195%! THE QUEST MODEL PORTFOLIO RETURNED 45% OVER THE YEAR, AFTER FEES. THE AUSTRALIAN MARKET REMAINS 21% BELOW THE RECORD HIGH OF NOVEMBER 2007.

It's been a big year.

Extreme pessimism at the start of 2009 gave us the alarming lows of March. Unprecedented government action and the realisation that the world was not about to end saw the market roar back to life, posting some of the strongest returns ever during the June (+11.5%) and September (+21.6%) quarters. Taking a relative breather, the market dipped in October before recovering to post a 3.4% return for the December quarter.

China and India led the world posting massive 80% gains during the calendar year. Given our ties to Asia it is not surprising that Australia outperformed most of the developed world, posting higher returns than each of the US, UK and Japan.



Source: IRESS

The December quarter told quite a different story with Australia (+3.4%) underperforming most of the world, with returns well below China (+17.9%), the US (+7.4%), the UK (+5.4%) & Japan (+4.1%).

During the quarter resource stocks did quite a lot better than industrial stocks and small caps outperformed large caps. Banks as a group were flat with all the majors, other than CBA (+6%), posting negative returns. Healthcare continued to be the laggard sector.

The Australian market is now repriced for a strong earnings recovery in 2011. The level of optimism in the market is reasonable given the relatively undemanding forecast PEs and the steady flow of improving economic data which shows the Australian economy to be doing better than other more indebted developed economies. However, the debt-laden US economy remains a significant concern and Australian interest rates are now on the rise.

There were a number of interesting corporate transactions in the quarter: Transurban (owners of Sydney and Melbourne tollroads) received a takeover proposal, Macquarie Infrastructure Group (toll roads) and Macquarie Media (radio and television) both restructured, AXA Australia received takeover bids from both AMP and NAB while Woodside raised $2.5 billion to accelerate the development of its offshore gas assets.

The RBA raised the overnight cash rate three times in three months to 3.75%. More hikes are likely. With higher financing costs, banks are also requiring greater margins, pushing rates further. All banks are now chasing domestic deposits – with Westpac (and others) offering 8% on 5yr deposits (5yr bonds are 5.2%). This is great news for those with cash but not good news for market valuations.

PORTFOLIO ACTIVITY

OUR PORTFOLIO EXPOSURE TO RESOURCES INCREASED DURING THE QUARTER AND OUR SMALL CAP HOLDINGS REDUCED AS A NUMBER OF STOCKS HIT PRICE TARGETS AND WERE SOLD. CAPITAL RAISINGS CONTINUED AND TAKEOVER ACTIVITY TOOK OFF, PROVIDING SOME FURTHER OPPORTUNITIES. THE PORTFOLIO REMAINED FULLY INVESTED WITH CASH HOLDINGS KEPT LOW – THOUGH THIS CAN BE EXPECTED TO CHANGE IN COMING MONTHS.

The massive Government stimulus and liquidity injection in China, coupled with the nascent recovery in the US and elsewhere fuelled higher demand and pricing for commodities during the quarter. This, combined with a weaker US dollar, drove increasing interest in Australian dollar investments.

Recognising this, we added significantly to our resource holdings and topped up our bank positions early in the December quarter.

We added to our positions in the big miners, increasing BHP and re-established an investment in RIO.

The portfolio now holds 5% in Newcrest Mining, a major gold and copper producer in Australia, PNG and Indonesia. This position has given the portfolio exposure to the strongly appreciating gold price and provides some offset to any potential fallout from the massive increase in global money supply, courtesy of government action in response to the GFC.

We also have exposure to the precious metal platinum through our holding in Aquarius Platinum, a large South African miner. Platinum's primary use is in cars for emission control and in jewellery. Aquarius performed very strongly during the quarter, gaining more than 42%.

Oil Search announced a surprise $895 million equity raising at $5.90 per share in October. This was done to give funding certainty for Oil Search's share of the landmark PNG LNG project. An unexpected delay in finalising the partial selldown of an interest in the project to the International Petroleum Investment Company was the main cause of the need to raise equity. At the time of the raising, the final decision to proceed with the project was due within in weeks and we judged this a good opportunity to substantially increase our investment in Oil Search. The decision to proceed was subsequently taken in early December.

We also significantly reduced our Origin holding, given our preference for Oil Search. Oil Search is now in a better position to deliver a cheaper and quicker expansion of its planned LNG facilities to generate incremental returns.

Citadel Resources is also expected to raise capital to fund the ongoing development of their copper / gold resources in Saudi Arabia. As a substantial shareholder, we took the opportunity to sell some of our holding at good prices ahead of what is expected to be a sizeable raising.

The Citadel selldown contributed to a reduction in our holdings in small cap stocks during the quarter. We also exited small cap positions in Virgin Blue and Neptune Marine as price targets were met. In the case of Virgin, we realised a healthy profit on our 20 cents per share entry price courtesy of the capital raising in August. Neptune also had a strong run on the back of the euphoria surrounding the development of the Gorgon gas field in WA.

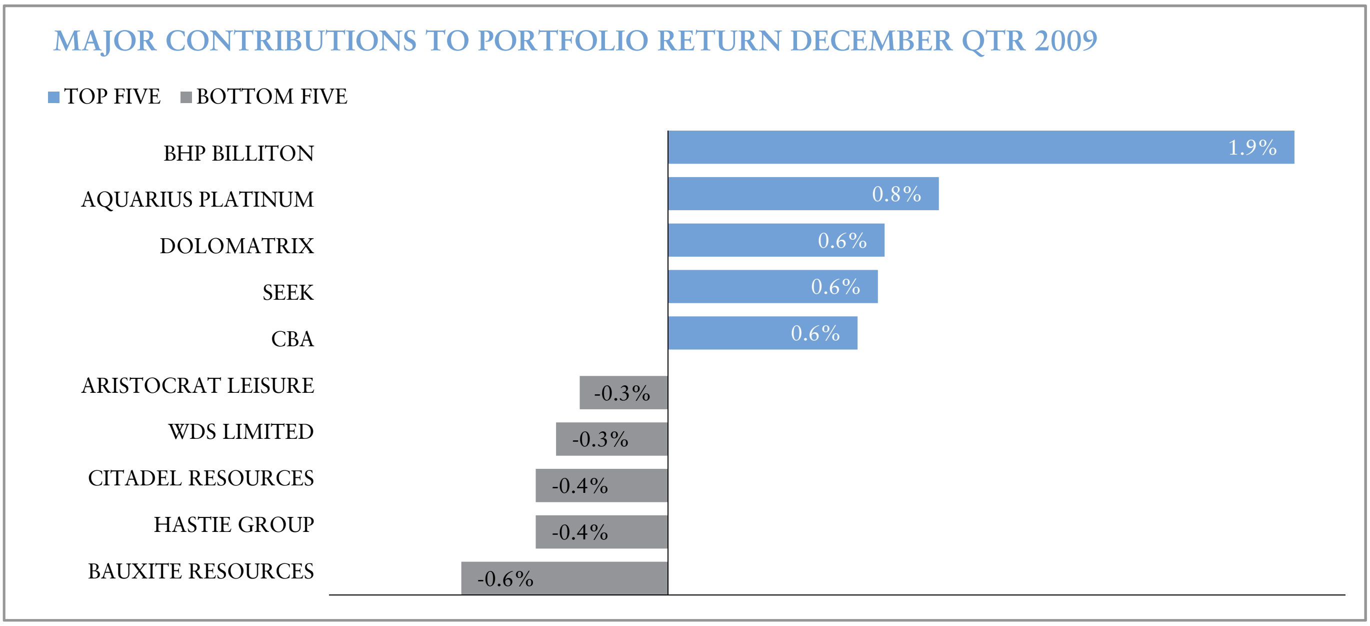
The portfolio also benefited from the strong performance from other small caps Seek, Dolomatrix, SAI Global and Charter Hall, which were among the best performers in the market.

This was offset by negative returns from other small cap holdings that gave back some of their previous strong gains, notably Bauxite Resources, Hastie Group, WDS and Elders. We remain positive on these companies with our valuations indicating substantial potential upside for the patient investor. Pleasingly, the New Year has seen share prices rally in each of these laggards.

CBA was the only bank to post a positive gain in the December quarter and we added to our bank holdings buying ANZ, the cheapest amongst the majors. We also bought Westfield Group, which rates as an "A" grade in our ranking system. Westfield has experienced management, very high quality assets and is trading below our valuation.

A small position was established in AXA Australia at $6.50 per share. AXA has now received three bids; the first two bids were from AMP in cash and scrip (AMP revised higher an earlier bid) and a third bid from NAB which can be taken in either cash at $6.43 per share or a combination of cash and scrip. This takeover will take some months to resolve. At this stage, it is not clear that either bid will be sufficient to take control of AXA. The AXA Australia business is strategically important, being the last available large wealth management business of scale in Australia outside of AMP.

Cash remains at a similar level to the start of the quarter - around 2% of the portfolio. With the strong recent market run, we expect to increase our cash holdings somewhat in future months.



OUTLOOK

THE PATH OF INTEREST RATES, BOTH IN AUSTRALIA AND OFFSHORE, WILL HAVE A LARGE IMPACT ON THE OUTLOOK FOR EQUITY MARKET VALUATIONS IN 2010 AND INTO 2011. A KEY QUESTION IS WHETHER THE UNITED STATES CAN EFFECTIVELY MANAGE ITS BURGEONING GOVERNMENT DEBT WITHOUT DERAILING A GLOBAL ECONOMIC RECOVERY. STOCK PICKING WILL BECOME MORE CRITICAL WITH VALUE GETTING HARDER TO FIND IN THE AUSTRALIAN EQUITY MARKET.

With the strong run of 2009 now behind us, the market is now wrestling with the future trajectory of corporate earnings, interest rates and currencies.

There are a lot of issues to consider here, so we have provided in this outlook a bit of detail on our current thinking as we assess the factors that will shape the future performance of your portfolio.

Having moved through the "hope" phase where stock prices go up in the anticipation of a better future and price earnings ratios expand as a result, we now confront the "growth" phase. This is where reality catches up with expectations and stronger earnings need to be actually delivered to justify current stock prices. It is in this phase that stock picking becomes more critical, in contrast to the recent past where macro factors dominated market pricing.

Quite a few companies will still report rather ordinary first half earnings in February, as a result of the lingering effects of last year's turmoil and the recent strength of the Australian dollar. Commentary from company management will be closely scrutinised. Analysts will be looking for confidence that earnings will be substantially higher from this point on. This will be critical for the market to remain positive.

The domestic economic data though does remain strong and is clearly supportive of a rebound in GDP. Australia is proving to be an early leader in the recovery in the developed world. This is certainly consistent with the market's optimism which is looking for 29% growth in 2011 earnings.

Given the degree to which some businesses reduced costs during the last 18 months, we may in fact see some decent upside earnings surprises in the next 12 months. This operating leverage could be stronger than most analysts appreciate if we see continued improvement in the economy. Analysts typically underestimate both the downside and the upside when forecasting earnings.

Offshore, the economic news continues to be positive. Key surveys on new orders and manufacturing remain strong in China and have been improving in the US, UK and elsewhere. Copper prices continue to rise and iron ore and coal spot prices are very strong.

The key question is whether such good growth news will ultimately lead to tighter fiscal policy and higher interest rates sooner rather than later. This concern applies to both the US and China as the latter is now arguably dealing with an asset bubble, particularly in property, courtesy of abundant cheap money. This was evident in a recent visit to China where we saw first hand the speculative excesses. There are clearly signs of overbuild with large numbers of expensive apartments being built. A good proportion of these will remain untenanted given the housing need is actually at the lower end. Despite this, people are still queuing up to buy new apartments. There are also early signs of inflation picking up in China.

At present it is still a case of "so far, so good" as markets show little sign of major concern. Although the yield curve is quite steep, US bond rates remain relatively benign and equity markets around the world continue their rally into the new year. Comfort is being taken from the fact that the US has enormous spare capacity which is keeping inflation at bay and that the 10% unemployment rate is likely to persist for some time allowing Fed funds rates to stay at record lows for an extended period. There is also ongoing talk of further government stimulus packages, perhaps just around the corner.

The maintenance of this goldilocks outlook for interest rates is the key risk facing the market in the short-term. Most commentators see the current mix of economic factors as strongly supportive of continuing growth. The most immediate cloud on the horizon is the potential withdrawal of the massive fiscal and monetary stimuli in the US, China and elsewhere. Most expect this will become an issue later in 2010 or into 2011.

Markets though have a habit of surprising and it is quite possible that the forces at play impact the market sooner rather than later.

Longer-term of course, is that lingering elephant in the room – the enormous debt being racked up by the US government. The size of the debt is truly staggering prompting questions of how, or indeed if, this debt will ever be repaid.

A browse through the May update to the US Federal Budget, ironically titled "The Era of Responsibility", brings the size of the challenge into focus. Government debt will soon exceed 100% of GDP and the US is relying on very optimistic (almost boom level) growth projections coupled with a very large increase in tax receipts to keep debt at a serviceable level over the next decade.

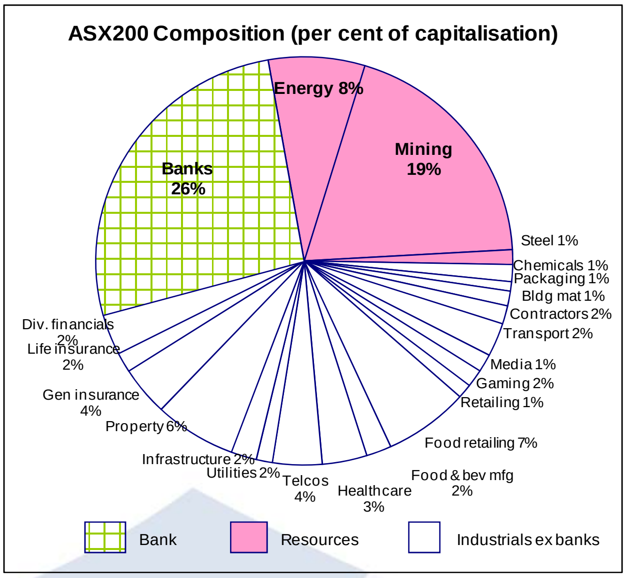
It is not clear whether the US, or other heavily indebted developed economies (eg UK, Japan), can still manage to grow with such high levels of debt. If bond yields were to rise significantly, simply servicing these large debts could become problematic. The US, UK and Japanese governments have been utilising "quantitative easing", which is akin to printing money, in order to manage the problem. This has, so far, kept bond yields at manageable levels which have continued to encourage investment and allow governments to comfortably meet interest payments.

In this environment, we want to maintain a significant exposure to gold.

The US dollar is also likely to remain under pressure over the medium-term. The weakness in the dollar may, however, spur resurgence in US manufacturing, which some argue is already underway. Merrill Lynch estimates that the US actually produces around 20% of the world's total manufacturing output and that approximately 40% of the earnings of the companies in the S&P500 index is sourced from outside of the US. Given this, it is possible that the US stockmarket continues to perform against a backdrop of a weaker US dollar and ongoing concerns about the underlying strength of the US balance sheet.

In Australia, the signs remain favourable. Falling unemployment, rising confidence, good retail sales, recovering building approvals and other positive lead indicators all bode well. The headwinds will of course be interest rates, which should continue to rise given the data and signals from the RBA, as well as the strong Australian dollar and rising input costs. We expect increasing labour costs to again be a feature of the Australian market along with the impact of higher commodity prices.

With the current momentum we can see the market pushing through 5,000 and rallying further. The Australian market is dominated by banks and resource stocks (see chart below) both of which have a reasonable short-term outlook. We expect CBA to report well in February, being the best provisioned for loan losses of the major banks. With economic conditions gradually improving, the release of loss provisions could be significant for the banks. With regard to resources, spot commodity prices continue to rise and earnings upgrades are inevitable. Share prices anticipate this to some degree; however the backdrop is likely to remain supportive for resources in the short-term.



Source: Deutsche Bank

Overall, however, value is getting harder to identify with many stocks now nearing our price targets. Some themes such as retailing and the building sector are now quite long in the tooth and could soon run out of steam. As the year progresses we expect our cash levels to increase as fully valued stocks are sold, particularly those with less robust and highly cyclical business models.

Pockets of value still exist, however, particularly in small caps. Stock picking focused on buying high quality companies at prices below our valuation remains our aim.

As an interesting aside, some in the market have noted that if the US market is positive in the first week of the new year it has gone on to rally for the full year, 85% of the time in the last 36 years.

We see that that the S&P50 was up 2.7% after the first five days this year!

FEES

Given our recent strong performance, most investors in the Quest high net worth portfolio will now be above the high water mark previously established.

Investors may therefore pay a performance fee for the quarter (payable in the next quarter), depending on when the initial investment was made and the nature of any subsequent additional cashflows.

CONTACT QUEST

Quest Asset Partners Pty Limited

ACN 109 448 802
AFS Licence No. 279207

Suite 706, 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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