QUEST

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QUARTERLY REPORT
MARCH 2010

John Citizen Superannuation Fund

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Mr John Citizen

123 ABC Street
Sydney NSW 2000

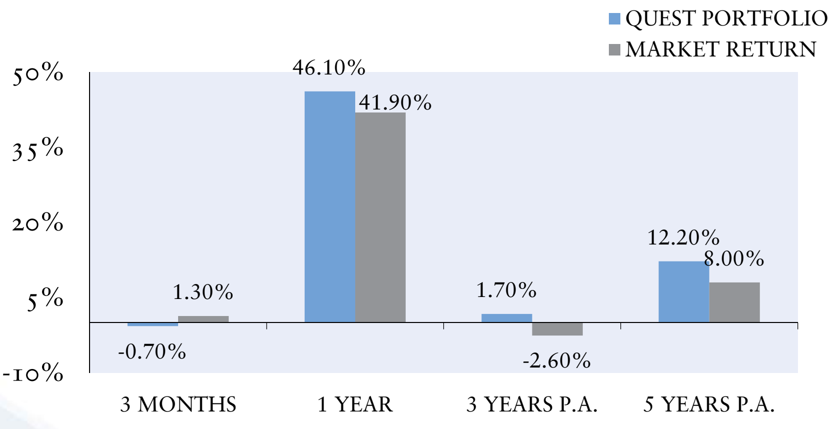
Account Name: John Citizen Superannuation Fund

PORTFOLIO MOVEMENT – 31 MARCH 2010	
PREVIOUS MARKET VALUE 31-DEC-09	
CONTRIBUTIONS DURING QUARTER	
PORTFOLIO MOVEMENT*	
MARKET VALUE 31-MAR-10	

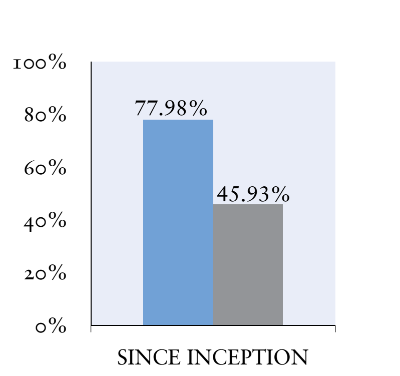
YOUR PORTFOLIO PERFORMANCE FOR THE QUARTER*	
MARKET RETURN (S&P / ASX 300 ACCUMULATION INDEX)	

*Includes fees for the quarter

PERFORMANCE TO 31 MARCH 2010



SINCE INCEPTION RETURN



** 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

A FLAT MARCH QUARTER FOLLOWED A RETURN OF 45% FROM THE QUEST PORTFOLIO LAST CALENDAR YEAR. WE EXPECT A TOUGHER GRIND THIS YEAR AFTER THE HECTIC PACE OF LAST YEAR. THIS SHOULD BE A STOCK PICKER'S MARKET HIGHLIGHTED BY ONGOING CORPORATE ACTIVITY.

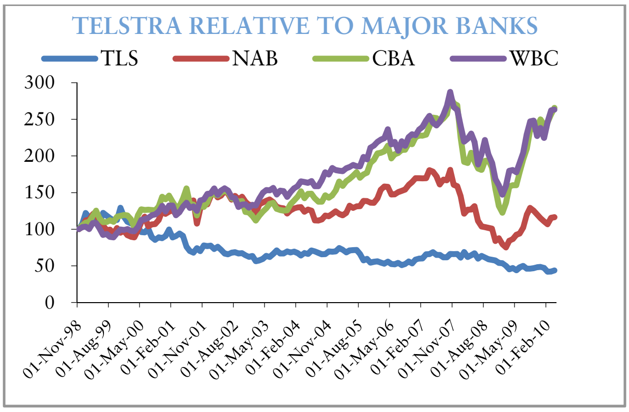
The March quarter finished flat after a new year rally, followed by a late January slump induced by concern over the financial health of Greece, Spain and Portugal as well as Barack Obama's threats of increased bank regulation in the USA. The market then rallied in March as the USA turned out some improved economic numbers and commodity prices improved.

The banks had a good quarter with Quest bank holdings charging ahead: ANZ rose 9%, CBA rose 4.5% and WBC rose 14%. NAB, not in our portfolio, plodded along after bidding for AXA Asia Pacific. The bid is in competition with AMP who also bid for AXA. Both bids are subject to regulatory approval.

In March, iron ore price negotiations resulted in a massive 90% increase in quarterly prices. The resulting surge in revenues will flow through to increased development expenditure, such as mine expansion, additional equipment, new ports, railways and roads, increased employment and increases in government tax collections. The coal producers have also enjoyed pricing gains with coking coal (used for steel making) up over 100% and thermal coals (used for electricity production) up over 30% relative to a year ago. Resource stocks performed well in the quarter with RIO up 11%, BHP up 6%. Some small miners made big gains while steel stocks BlueScope Steel and OneSteel rose as potential steel price rises were factored in following a surge in iron ore and coal prices.

Shell and Petro China bid for Arrow Energy, an emerging coal seam gas company based in Queensland. MacArthur Coal received a bid from US coal producer Peabody at a low price (they bid higher only days later in April). Newcrest has launched a cash and scrip bid for Lihir Gold which was rejected by Lihir Directors.

Telstra had another poor quarter falling from $3.43 to $2.99 as the stand off with the government drags on. The chart below contrasts the performance of Telstra against some major banks since listing.



Healthcare stocks had a better quarter after CSL, Resmed and Ramsay Healthcare posted good gains but Primary Healthcare delivered a poor result and fell heavily.

Retail stocks were flat post the cessation of government stimulus. Small caps underperformed the broader market. The Australian dollar ambled from $0.87 to $0.89.

PORTFOLIO ACTIVITY

OUR PORTFOLIO IS TILTED TOWARD BANKS AND RESOURCES IN ANTICIPATION OF CONTINUED GROWTH IN BANK EARNINGS AND THE RECENTLY ANNOUNCED BULK COMMODITY PRICE RISES. CORPORATE ACTIVITY IS DOMINATING NEWS FLOW PARTICULARLY IN THE RESOURCES SECTOR.

The Quest portfolio has taken on a “barbell” appearance with approximately 24% held in bank shares and 40% in resource and resource related stocks. This tilt was established in the latter part of 2009 and increased in 2010.

During the quarter we added ERA Resources (uranium), Henderson Group (UK-based fund manager), MacArthur Coal (Queensland coal producer), Toll Holdings (transport) and Worley Parsons (global resource engineering services) to the portfolio. All have performed well since acquisition, particularly MacArthur Coal which has surged since purchase.

We increased our holdings in Alumina, Aristocrat, BHP, CSL (prior to a good result in February), QBE, RIO and Silex. BHP continues to be a core holding in our portfolio; it is our only “A” grade resource stock.

We sold positions in Charter Hall, Hastie Group, Sedgman, SAI Global, Westfield and Woolworths. This is the third time we have invested in SAI Global in the last five years and again the stock has delivered a great return. Woolworths has been a long standing holding however our target price was attained. The ascendancy of Woolworths appears to have faltered as Wesfarmers are now providing more solid competition after their Coles acquisition in 2007.

Reduced positions included Citadel Resource Group, CSL (after rallying hard in February post result), Origin Energy and Westpac. Citadel was reduced as the company draws closer to mining approval in Saudi Arabia and a probable share issue to fund mine development.

While Westpac, ANZ, CSL, Seek and BHP performed well, our relative outcome was undermined by poor results from WDS Limited and Primary Healthcare.

WDS contracts engineering services to the emerging Queensland coal seam gas market. The company downgraded earnings twice last year before a third downgrade this year that was brought about by project delays and some poor internal management. The resignation of the CEO in February and subsequent business restructuring, followed by torrential March rains in Queensland causing further work delays, led to the sale of our holding at a loss.

Primary Healthcare owns medical centres, pathology laboratories and diagnostic imaging services nationally. Over the last two years our valuation has slipped under the weight of stock issuance, higher debt costs, increased imaging competition, changes to government funding and changes to the revenue model. Despite this, the Quest valuation continued to exceed the market price by a good margin. In February, the half yearly result was well below our expectations. This long standing position was sold at a loss.

The quarterly result was therefore disappointing and marginally below the benchmark. Cash approximated 6% at quarter end.

OUTLOOK

WE BELIEVE THE IMMEDIATE OUTLOOK IS FOR VOLATILITY WITHIN A NARROW RANGE. AUSTRALIA HAS RECOVERED WELL FROM THE GFC AND IS REVELLING IN THE GLOBAL DEMAND FOR RESOURCES. GLOBALLY, ONGOING DEBT ISSUES AND QUESTIONS OVER THE ECONOMIC INTEGRITY OF MANY DEVELOPED COUNTRIES CONTINUE.

The recovery of 2009 is now behind us and the market is grappling with the intriguing variables of earnings certainty, currency fluctuation and global economic health. The more bullish are encouraged by the strength of the local economy which is bolstered by stimulus packages and the resources boom. The bears are worried about global debt levels and the ability to break the debt spiral.

March 2010 saw the fifth Australian interest rate increase since October. Cash rates have increased from 3% to 4.25%. We expect further increases. The long term average cash interest rate in Australia since 1993 according to the Reserve Bank is 5.5%, so the recent cycle has provided a two year period of relatively cheap money. Rising interest rates will crimp share valuations. US rates are also likely to rise however the timing is not readily apparent. Due to the high levels of debt prevailing in the United States, the US Federal Reserve is regularly selling bonds to fund the deficit. Should the appetite for US bonds fall, and constant issuance should cause that to happen, it would follow that bond prices will fall as higher interest rates are required to attract buyers.

The emergence of China, now the world's third largest economy behind the USA and Japan and the presence of India as a developing economy, have changed the dynamics of resource markets. The frequency of Chinese investments in mining operations and the number of partnerships involving Chinese companies are symptomatic of the importance of resource custody; that is the ability to ensure supply for a lengthy period. China lacks quality iron ore and coal deposits and a natural supply of nickel, zinc, manganese and bauxite amongst others. The Chinese are now developing an impressive collection of mining joint ventures, particularly in Australia and Africa in order to secure supply. Non Chinese mining houses are looking to grow through acquisition. Indian demand is also developing rapidly fuelled by a population of 1.2 billion which is lacking in infrastructure. The value of resource assets are pushing ahead as a result. Recent corporate takeover activity has seen Newcrest bid for Lihir Gold and MacArthur Coal receiving multiple, conditional offers.

This does not mean that resource prices just go up forever. We regard resources as trading stocks that are best bought when the world is negative and risk averse and should be sold when the emotional appetite for greed reaches frenzied proportions. It is this view that saw our resource and resource related stock weight push up towards 40% early this year.

Our process dictates that we have target prices for each stock. It is likely that any material gains in our resource holdings will see a reduction in our position over the next few months as stocks adjust to higher commodity prices and earnings forecasts. We are also wary of the potential for cost inflation, particularly labour costs, to affect earnings. Seasonally, the northern hemisphere summer will bring a quieter period for resource markets.

The other big sector is banks. The banks continue to deliver encouragement at their regular "trading updates". Australian banks are well managed, have largely local businesses (less exposed to US and European economic woes) and have consensus earnings growth of a lofty 50% over the next two years. A lot of this growth is driven by the reversal of provisions that were charged during the financial crisis that began in 2007.

Most of the banks will report half yearly results in May and will be cum dividend at that time. While the banks appear to be in a sweet spot at this time, we question the assured deliverability of such strong earnings forecasts over the next two years. It is not uncommon for markets to factor in euphoric results ahead of delivery. Thus, if bank prices continue to climb, we are likely to reduce our exposure to the sector.

In the event that both resources and banks continue to run, we will see the ASX All Ordinaries easily breach 5000 this quarter. We expect then to rotate away from these sectors and therefore need some new stock opportunities.

The arrival of Henderson Group, Toll Holdings, MacArthur Coal and Worley Parsons in the portfolio addresses this issue. Henderson is a London based fund manager with UK, European and US portfolios managed on behalf of clients. Portfolios include equities, fixed interest and property and are subject to performance fees. Henderson was previously owned by AMP but the union was unsuccessful, leading to a listing of the business in 2008. The stock rates as a “B” under our qualitative valuation process and was conspicuously cheap on relative valuations. We think well of management. Short term we see the stock moving to $2.60 from our initial entry at $2.15. Our target price sits at a higher level and we see this as Australia’s cheapest listed fund manager.

Toll Holdings was purchased in February post a disappointing result that saw the stock belted 20% in a few days. This pulled the stock back to a buyable level in our view. Toll rates as a “B” under our Q Stocks ranking. Toll has logistics operations in Australia, New Zealand and Asia. The success of Toll depends on economic activity and service delivery. Activities include car and food transport, freight forwarding, shipping and mining support.

Worley Parsons returns to the portfolio after a two year absence. Worley provides engineering services globally to the energy, resource and infrastructure industries. The share price bears some correlation to the oil price as business opportunities increase as the oil price rises. Worley ranks as an “A” in our rankings.

The company is based in Sydney and has offices in 40 countries with 29,000 staff. Management are familiar to us as we have covered the stock since listing in 2004. Contracts are typically in hydrocarbons, power, renewable energy, resources and infrastructure. Recent activities include LNG developments, hydrocarbon expansions particularly in the Middle East and renewable energy projects. The company is susceptible to the economic cycle as investment confidence and development funding tend to wane in tougher times. It was the correction in late January that gave us an opportunity to invest at about $24.

MacArthur has provided some excitement since our purchase with three conditional takeover bids and the possibility of another. The company is a coal producer in the Bowen Basin producing coking, PCI and thermal coal. Annual production of five million tonnes with a solid growth profile and rapidly rising prices brought us into the stock at $11.53 per share. At the time of writing, takeover speculation has driven the stock to $16.50.

The strength of the Australian dollar continues. While we spend a lot of time watching the dollar, we have as much chance as the next person of guessing the next gyration. As a result we monitor our portfolio exposure to differing scenarios rather than attempt to guess direction. While 33% of the portfolio is domestically focussed, 26% is currently better suited to a weaker dollar. These are mainly industrial stocks with offshore earnings. Another 34%, mainly resource stocks, would be expected to benefit from a higher Australian dollar as this would suggest ongoing appetite for commodities. The balance is currently in cash.

There are only three small cap industrials left in our portfolio. The small market is now up 50% from lows in March 2009 thanks to the well documented recovery, the resources boom and the flow through from the Gorgon gas development in Western Australia. It is now hard to find value in this part of the market and note that recently floated Kathmandu and Miclyn Express debuted post IPO at a discount to float price.

The market is currently vulnerable to unexpected regulatory change. An example was the 2007

Victorian government's decision to end the Tattersalls' monopoly in lotteries. The threat of government regulation appeared again as the Federal Communications Minister took on Telstra in a well publicised stoush in 2009.

Telstra shareholders again lost considerable value. Government changes to pathology reimbursement regimes, mining royalties and employment regulations are ongoing. Government reviews such as the Cooper Review into superannuation and the Henry Review into taxation will shift the goal posts for many companies as well. While we are unable to predict exact outcomes, we are very cognisant of the potential for sudden change in our investee companies.

In terms of the balance of the year, we see this as a period where stock pickers should excel. Our system of appraisal, valuation and targeted purchase should be suited to current conditions. We also expect to be taking profits into strength given the instability of the broader global outlook.

FEES

No performance fee was earned during the March 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.

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