

## Market Rallies as Global Recovery Commences

### Market Report

**The December quarter saw broad gains across the equity markets as investors laid the Global Financial Crisis to rest and looked forward to rebounding economies both in Australia and globally.**

The ASX 200 posted a rise of 2.7% in the December quarter, as it went through a period of consolidation and struggled to keep pace with the stellar 20% September quarter gains (the largest quarterly gain in some 22 years).

The Australian market has now rallied 55% off its March lows and a feeling of cautious optimism seems to have returned to most market participants. International markets continued their upward trend over the past three months with the key US S&P 500 and UK FTSE 100 indices moving up 5.5% and 5.4% respectively.

The key feature of the Australian equities market in the December quarter was the performance of the Materials sector and, in particular, resource companies. The Materials sector rallied 13.7% during the quarter, partly driven by strong performances by BHP and Rio Tinto. The recovery in the Chinese economy over the past six months has seen import volumes for bulk commodities, in particular iron-ore, back above the previous peak achieved in 2008. As such,

spot iron ore prices rallied strongly in the fourth quarter (+38.6%), while base metal prices were also firmer. Chinese economic data continue to confirm a robust recovery which remains positive for both the materials sector and the domestic economy.

Another driver of the market during the quarter was broad based Merger and Acquisition activity as well capitalised vehicles identified value amongst their listed peers leading to several proposed or completed corporate transactions. The higher profile of these included:

- AMP and AXA SA of France teaming up to make a \$13b bid for the locally listed AXA Asia Pacific. The bid has since lapsed and NAB is now the front runner for the AXA Asia Pacific business but either transaction could eventuate.
- Sumitomo of Japan proposing to take a 20% stake in ASX listed Nufarm at \$14 per share (a healthy 25% premium to the last traded price before the proposed transaction). This follows Nufarm rejecting advances from Sinochem of China after a protracted period of due diligence which resulted in the Chinese suitor lowering its proposed 100% takeover of Nufarm from \$13 per share to \$12.

OC Performance*	1 Mth	3 Mths	6 Mths	1 Yr	5 Yrs	7 Yrs	Since Incep	FUM
<b>OC Premium</b>	<b>5.5%</b>	<b>10.5%</b>	<b>41.8%</b>	<b>74.3%</b>	<b>0.0%</b>	<b>8.2%</b>	<b>10.2%</b>	<b>\$27.8m</b>
Small Inds Accum	4.3%	1.9%	28.3%	44.9%	1.6%	8.9%	5.1%	
<b>OC Dynamic</b>	<b>5.4%</b>	<b>12.8%</b>	<b>48.4%</b>	<b>82.9%</b>	<b>0.3%</b>	<b>10.3%</b>	<b>11.8%</b>	<b>\$47.7m</b>
Small Inds Accum	4.3%	1.9%	28.3%	44.9%	1.6%	8.9%	5.4%	
<b>OC Concentrated</b>	<b>5.0%</b>	<b>18.3%</b>	<b>64.5%</b>	<b>158.0%</b>	<b>11.5%</b>		<b>15.6%</b>	<b>\$12.7m</b>
Small Inds Accum	4.3%	1.9%	28.3%	44.9%	1.6%		6.2%	
<b>OC 200</b>	<b>3.8%</b>	<b>4.0%</b>	<b>27.0%</b>	<b>39.0%</b>			<b>12.7%</b>	<b>\$5.2m</b>
200 Accum	3.7%	3.4%	25.6%	37.0%			9.0%	

Performance figures are based on the soft close unit prices as at 31/12/2009

## Market Report cont.

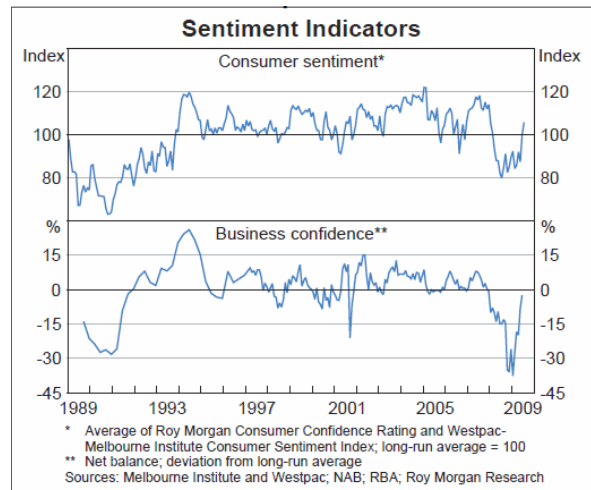
- Two large Canadian pension funds launching an unsolicited \$6.8b bid for the 74% of Transurban they don't already own. The bid was rejected by the Transurban board but with the Future Fund now also expressing an interest in taking the toll road operator into private hand we would expect further developments on this front early in the new-year.

Capital raisings continued unabated during the quarter but with most of ASX 200 index now recapitalised and very few of the remaining companies likely to require additional capital this process seems to have largely run its course. Raisings of note included oil majors Woodside Petroleum (\$2.5b) and Oil Search (\$895m), CSR (\$375m) and innumerable raisings by smaller cap stocks.

After a two year lull in the Initial Public Offer market, the high profile IPO's of Myer and Kathmandu hit the market. Whilst both are trading at a slight discount, the rebound in global markets is expected to herald a rush of IPOs in the new-year.

Helping to keep a lid on the market during the quarter was the unprecedented move by the Reserve Bank of Australia to raise rates for three consecutive months. Rates rose from the emergency settings of 3.00% in October toward a more neutral stance of 3.75% in early December. With the big four banks passing on more than the 75 basis points to their mortgage customers, the Australian consumer would appear to be bearing the brunt of this rather sharp mone-

etary policy tightening. We anticipate this may be borne out by some retailers announcing more subdued Christmas trading figures than many analysts are anticipating.



## OC200 Fund

The OC200 Fund outperformed the S&P/ASX200 Accumulation Index over the quarter and continues to track consistently ahead of the Index. The OC200 Fund increased 4.0% for the quarter, ahead of the S&P/ASX200 benchmark which added 3.4%. The OC200 Fund is now 39.0% higher than it was one year ago as stock markets recovered throughout the 2009 calendar year.

Within the Index, the best performing sectors during the December quarter were the Materials sector (+13.7%), in particular Resource companies, and the Consumer Staples sector (+4.6%). The rally in resource stocks aided outperformance for the OC200 Fund during the period, with index heavyweights **BHP** and **Rio Tinto** (RIO) among our top five portfolio holdings. Improving demand for bulk commodities, particularly from China, is driving expectations of higher commodity prices and future profits for Australia's aforementioned two largest miners. Overweight positions in **Wesfarmers** (WES) and **Coca-Cola Amatil** (CCL) in the Consumer Staples sector also assisted the performance of the Fund.

The worst performing sectors in the quarter were Financials (-2.6%) and Energy (-2.5%). Our overweight position in the Financials sector detracted from Fund performance over the quarter. However, the slight decline in the performance of the Financials sector follows a sector gain of 35.7% in the September quarter. The profitability of the major Australian banks remains robust and we believe further outperformance is likely in 2010.

During the period, we added to our existing holdings in **Newscorp** (NWS) and **Ten Network Holdings** (TEN), which should each benefit from an improvement in advertising revenues as the local and global economies recover. We sold down existing holdings in **Toll Holdings** (TOL) and **JB Hi-Fi** (JBH) due to their respective valuations achieving our targets levels during the period.

## OC Premium Fund

The Premium Fund enjoyed a very strong quarter with all of its core positions performing strongly. The Fund finished the December quarter up 10.5%, well ahead of the Small Industrials Accumulation Index which was up 1.9% and the All Ordinaries Accumulation Index which was up 3.7%.

**CSG Group** was a stand out performer rising 50% during the quarter. In December the company announced the acquisition of 90% of Konica Minolta Business Solutions New Zealand Limited for \$84m and the associated financing business for \$20m. The acquisition is a strong strategic fit with CSG's existing print management business and is immediately EPS accretive in FY10 and 15% accretive on a full year basis in FY11. Management also announced that it had entered into a negotiating phase with the Northern Territory Government and we believe that they are well placed to retain the existing contracts (valued at ~\$35m) as well as an additional \$15m of work being bid for.

Newly listed **Carsales.com** was a stellar performer, up 42.6% for the quarter. Given anecdotal feedback from car dealers that we have contacted, we believe there is a strong prospect of upside to the prospectus forecasts. Despite the share price appreciation, we remain attracted to

the business model and its very high operating leverage.

Fibre based telecommunications company **Amcom** upgraded its earnings forecast at its AGM in November guiding for FY10 NPAT growth of 30%. The main driver of growth has been the continued demand for Amcom's fibre network products. Fibre is now essential for most businesses and Amcom is well positioned having the right assets at the right time to leverage this demand.

The retailers in the portfolio continued to perform well during the quarter with **JB Hi-Fi**, **Fantastic Holdings**, **The Reject Shop** and **Pacific Brands** all posting gains. **Fantastic Holdings** upgraded its profit at its AGM and looks set for very strong growth in the coming year. Management of JB Hi-Fi and The Reject Shop also made positive comments about the outlook for retail and the consumer.

We sold positions in **Pacific Brands** and **SP Telemedia** after some significant share price appreciation. A number of new positions were added to the portfolio during the quarter including **Cash Converters**, **Thorn Group** (formerly Radio Rentals), **Kathmandu** and **Campbell Brothers**.

## OC Dynamic Fund

The Dynamic Fund had an excellent quarter performing ahead of the Premium Equity Fund and rising 12.8%. This Fund is more fully invested than the Premium Fund and also benefitted from some trading positions taken during the quarter.

In addition to the solid results from the core holdings mentioned in the Premium Fund wrap, the Dynamic Fund also benefitted from some profitable trading positions in Transurban, **AXA Asia Pacific** and **MacArthur Coal**.

The Fund benefitted from the position taken in **Halcygen** which recently purchased the Mayne Pharma International business from Hospira Inc. **RER Group**, which specialises in the design, construction, maintenance and rental of pumping, mine dewatering and mobile power generation equipment, also made a solid contribution.

## OC Concentrated Fund

The Concentrated Equity Fund capped off an outstanding calendar year 2009 in which the Fund increased in value by 158%. The December quarter performance was up 18.3%.

Pleasingly the key performance driver of the Concentrated Equity Fund was again the core holdings of the small to mid-cap funds. This comprises our seven or eight preferred picks from the Premium and Dynamic Funds held at a slightly higher weighting.

The incubation section of the Fund added significant value. The key performers were **Halcygen** and **RER Group** which

were also added to the Fund during the quarter after further due diligence and financial analysis. New incubation positions were added in **Oaks Hotels and Resorts** and **Global Construction Group**. Both of these companies have reported strong recent trading and look cheap on our forecast future earnings.

The quarter threw up numerous trading opportunities which were profitably exploited. These include placements in **Service Stream** and **Silver Chef** which were both traded out at a profit. Resource stocks **Indophil Resources** and **MacArthur Coal** (held in the trading component of the portfolio) both benefitted from corporate activity and have now been sold.

## Outlook

We see the market entering a period of consolidation on light trading volume and little company specific news flow through January before the February interim reporting season sets the scene for the coming months. We will be looking to the interim reported numbers for evidence of the ongoing recovery that we expect from the businesses we hold in our portfolio. Based on recent contact with company management and related industry sources, we expect the OC Funds' holdings to report solid interim numbers. As always, companies that disappoint in February are likely to be harshly dealt with by the market.

We believe Merger and Acquisition activity across the market spectrum will be an important driver of performance in the Australian equities space. As has been evidenced in recent months, well capitalised domestic and international vehicles have recognised value in the market have been wading in with bids for what they perceive to be "cheap" listed business. We expect this theme to continue to play out over the coming 6 to 12 months.

Interest rates, both domestically and in the US, will be a key theme to watch in the coming 12 months. With the RBA having moved three times in the past three months we would anticipate a "wait and see" approach at the next RBA meeting in February whilst the governors assess the impact these hikes have had before deciding on their next move. Notwithstanding that, we expect domestic interest rates to move materially higher over the balance of calendar year 2010 as a global economic recovery plays out. It is worth noting that rising cash rates have traditionally been associated with positive equity market performance.

Clearly the Funds have recovered strongly this past calendar year. Much of the good performance has been from long term holdings which were trading well below fair value despite performing strongly at an operational level during this period and we feel vindicated in sticking with our core holdings such as CSG Group, Hastie Group, Ardent Leisure and McMillan Shakespeare.

The equity market now appears to be "fair value" on traditional price to earnings (PE) metrics with the S&P 200 Index trading at a multiple of 13.5 x FY11 earnings. Nevertheless we expect the economic recovery to drive a cycle of earnings upgrades over the coming year which should continue to be supportive of strong equities performance.

All in all we remain confident in our portfolios' positioning and have firm conviction that we are well placed to capture solid portfolio performance in 2010.

## OC Team Update

**The Board of OC Funds Management (OC)** is pleased to announce an operational restructure with a view to driving continued strong investment returns.

Following a wide ranging review involving all OC staff and other respected industry participants, the board has formally appointed **Robert Frost to the position of Head of Small-Mid Cap Investments**. Robert is an Executive Director and shareholder and has over 10 years experience in the small-mid cap space. He will continue to be supported by the existing investment team. OC Funds Management **Chairman Mr. Charles Baillieu** said "Robert has been the key driver behind OC's performance improvement over Calendar Year 2009 and has been a leading Portfolio Manager over a long period of time".

As a result of the restructure, **Dean Fergie's** position as Executive Director has been made redundant. Dean was a founding shareholder of OC Funds Management and has made a valued contribution to the business.

**Chairman Charles Baillieu** added, "the Board would like to thank Dean for his service and wishes him all the best in his future endeavours. Dean will stay on as a director and shareholder of the company. OC Funds Management maintains a strong balance sheet and a commitment to driving excellent performance for our clients."



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Fund holdings only available to OC unitholders

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\* Past performance is not a reliable indicator of future performance. The Total Returns of the OC Funds over specified periods are shown in the above table. This table contains information regarding Total Returns to 31 December 2009. Total Returns are calculated after taking into account performance fees. Where OC Funds generates a return on the OC200 Fund over and above the performance hurdle (S&P/ASX200 Accumulation Index) in a quarter, a performance fee of 10.25% of all profits above this level is charged to the Fund directly. Where OC Funds generates a return on The Premium and Dynamic Funds over and above the performance hurdle of 15% in any financial year, a performance fee of 20.5% of all profits above this level is charged to the Funds directly. Where OC Funds generates a return on the Concentrated Fund over and above the performance hurdle of 0% in any financial year (subject to a high water mark), a performance fee of 10.25% of all profits above this level is charged to the Fund directly. Between 1 July 2004 and 30 June 2009 where OC Funds generated a return on the Concentrated Fund over and above the performance hurdle of 0% in any financial year (subject to a high water mark), a performance fee of 20.5% of all profits above this level was charged to the Fund directly. Before 1 July 2004, performance fees were not paid out of the Funds but billed by OC Funds directly to investors. In this table, the Total Returns for the period prior to 1 July 2004 have been adjusted to reflect the paid performance fees as if the fees were paid out by the Funds. The Total Return performance figures quoted are historical, calculated using end of month mid prices and do not allow the effects of income tax or inflation. Total Returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The Indices do not incur these costs. This information is provided for general comparative purposes. Positive returns, which the Funds are designed to provide, are different regarding risk and investment profile to index returns.

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