



## QUARTERLY INVESTMENT UPDATE (DEC 2011)

### MARKET REVIEW

Global markets were generally stronger in the December quarter, even though volatility continued as investors remained focussed on European fiscal issues. The S&P500 finished up 11.2%, after US data pointed towards a more positive outlook. The FTSE100 also finished strongly, up 8.7%. The Nikkei225 and Shanghai Composite fell 2.8% and 6.8%, respectively. The S&P/ASX 100 Accumulation Index (the Index) was up 2.3% for the quarter.

Having left cash rates on hold for over a year, the Reserve Bank of Australia cut its cash rate target in November and December, taking it to 4.25% - citing risks posed by the eurozone crisis. The unemployment rate remained steady at 5.3% over the quarter and consumer sentiment was also flat. Corporate news was generally muted. Notably, a number of retailers downgraded earnings expectations late in the quarter. The Australian dollar (AUD) weathered the rate cuts and finished up 5 cents at 102 US cents.

### STOCK NEWS

Japanese-based market operator Chi-X launched stock trading operations on the last day of October, ending a two-decade monopoly held by the ASX Group (ASX). Chi-X began trading eight blue chip securities in its first week, with plans to expand to all shares in the S&P/ASX 200 Index in its second week. Chi-X has announced trading fees up to 40% lower than the ASX and Australia's financial regulator has made it mandatory for brokers to connect to both platforms under a "best execution policy". ASX Limited (ASX) gained 0.8% for the quarter.

Qantas Airways Limited (QAN) took the unprecedented step of shutting down all domestic and international flights. Grounding of the fleet reportedly cost QAN \$20 million a day, in addition to \$68 million in lost earnings from the month-long labour dispute. The decision by management marked the high point of a wave of strikes that have struck the global airliner throughout the year. The grounding lasted two days until Fair Work Australia terminated the industrial action after the Gillard government took the matter before the tribunal. Despite the turbulent quarter, QAN ended the quarter up 3.6%.

Australian retail giant Woolworths Limited (WOW) announced to the market a subordinated debt issue called the Woolworths Notes II (Notes). WOW was initially aiming to raise \$500 million through the offer, but the issue was increased to \$700 million following the institutional bookbuild process which reportedly closed ten times oversubscribed. Many institutional investors received 10% or less of their desired allocation. Of the \$700 million issue, \$675 million of Notes has been allocated to institutional investors, with the remaining \$25 million allocated to investors who applied through the Shareholder Offer. Woolworth Notes II were priced at 325 basis points over the 90-day bank bill swap rate. WOW ended the quarter 1.0% up.

Telstra (TLS) shareholders overwhelmingly approved a \$11 billion deal with the government and NBNCo Limited (NBN Co) to hand over its fixed-line monopoly to NBN Co. Telstra will progressively decommission its copper-based network and allow NBN Co to access its pits, manholes and exchanges, and sell some infrastructure. In return, Telstra will receive \$11 billion from the federal government, with the financial benefits to come over a period of 30 years. TLS ended the quarter up 7.4%.

Embattled steel company BlueScope Steel Limited (BSL) announced a \$600 million highly dilutive capital raising. The key reason for the deal, conducted via an entitlement offer, is to strengthen BSL's balance sheet with the full proceeds being applied to the repayment of its existing \$1.6 billion in net debt. BSL's earnings continue to be affected by the ongoing environment of a high Australian dollar, low steel prices, high raw material costs and softer demand conditions in Australia. The capital raising will allow BSL to move to a more appropriate capital structure. BSL shares fell 44.5% for the quarter.

Foster's Group Limited (FGL) shareholders overwhelmingly approved the \$10.48 billion takeover by Anglo-South African brewer SABMiller, with 99.1% of shareholder votes cast in favour of the brewer being handed over to foreign ownership. The Supreme Court of Victoria approved the scheme and FGL was officially removed from trading on 2 December 2011.

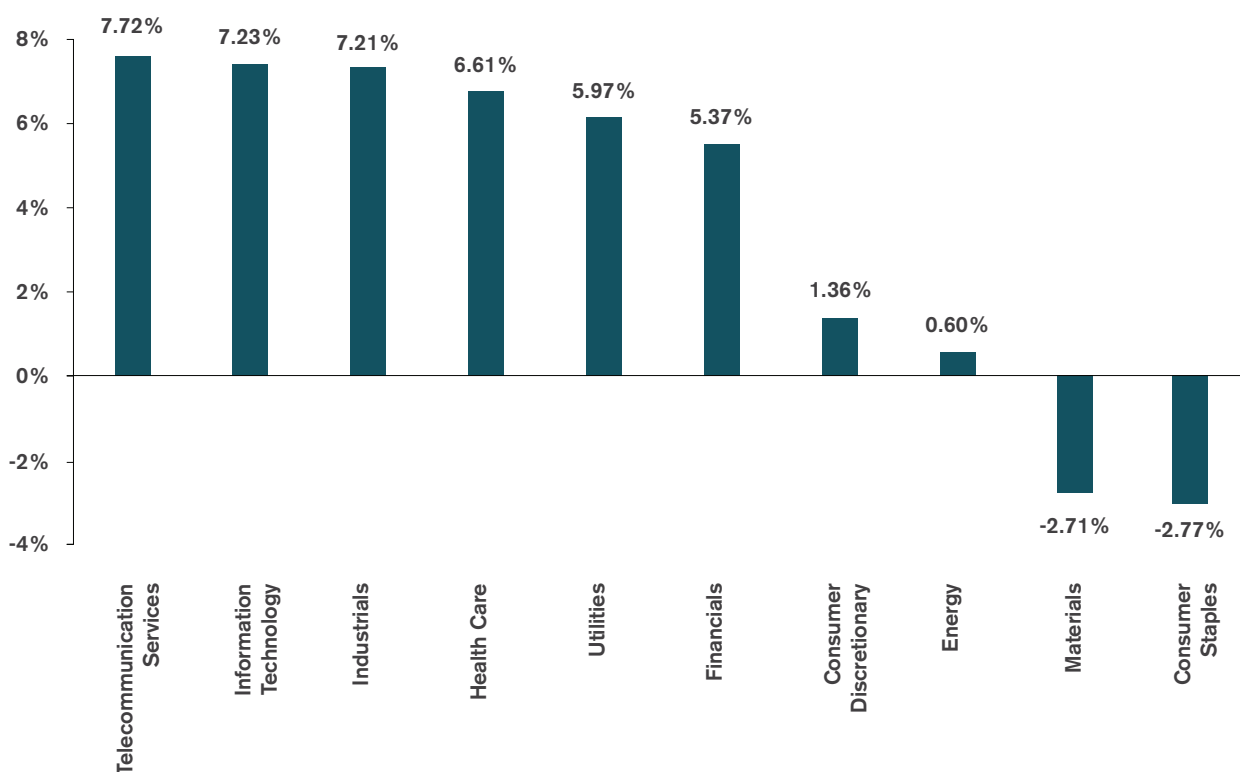
Shares in Billabong International Limited (BBG) warned first-half profit could fall by as much as 26%. BBG said sales growth had deteriorated significantly in the past two months as fears of global recession undermined consumer confidence. A late start to winter in the northern hemisphere and limited snowfalls had reduced sales of snowboarding apparel to European retailers, while a cold start to summer in Australia was affecting sales of beachwear. BBG has forecast earnings before interest, tax, depreciation and amortisation (EBITDA) of between \$70m and \$75m for the first half of the financial year, down from \$94.6m in the first half of the 2011 financial year. Billabong finished the quarter up by 15.7%.

Bendigo and Adelaide Bank Limited (BEN) announced it would pay \$130 million for the Australian unit of Bank of Cyprus Group and

would raise \$120 million from a share issue to pay for the transaction. The Australian regional lender issued new shares to institutional investors at \$8.45 each. Bank of Cyprus Australia has 14 branches with interest-bearing assets of \$1.4 billion. BEN closed down 5.4% for the quarter.

The best five performing stocks in the S&P ASX 100 during the quarter were Cochlear (33.7%), Panaust (26.0%), Iluka Resources (23.9%), Seven West Media (23.2%) and Campbell Brothers (19.7%). The worst five performers were Bluescope Steel (-44.5%), OneSteel (-43.6%), JB Hi-Fi (-25.7%), Alumina (-24.7%) and Aquarius Platinum (-21.2%).

### PERFORMANCE OF THE SECTORS WITHIN THE S&P ASX 100 INDEX OVER THE DECEMBER QUARTER



\*The S&P ASX 100 sector returns are estimates

### AUSTRALIAN GOVERNANCE MASTERS INDEX FUND (ASX: AQF) OVERVIEW

AQF Listing Date	February 2010
Total Assets (\$m)	\$57,776,936
NTA per Share (31 December 2011)	\$1.438
Number of securities held	75

## AQF PERFORMANCE

For the December quarter of 2011 (30 September 2011 to 31 December 2011), the unaudited pre-tax NTA of the Australian Governance Masters Index Fund increased by 2.1%. This represents an underperformance relative to the S&P ASX 100 Accumulation Index of 0.2%.

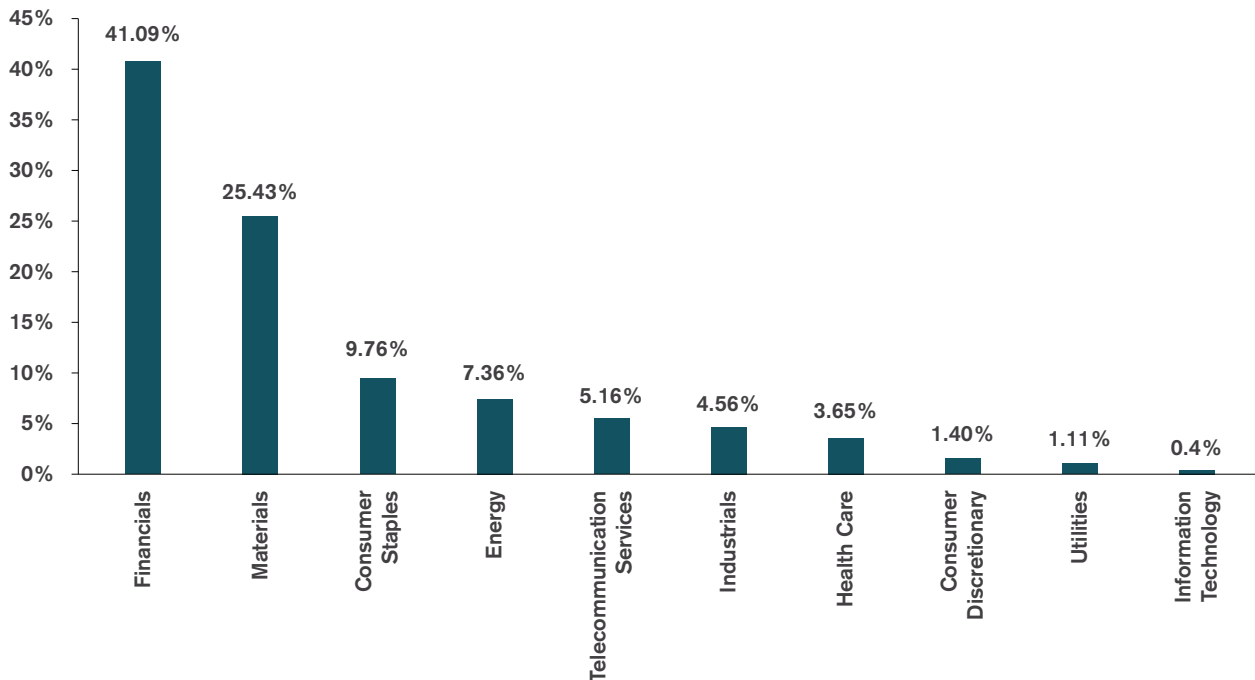
The biggest positive contributors to performance relative to the benchmark were the exclusions of Sydney Airport, Fortescue and JB Hi-Fi and overweight positions in Commonwealth Bank and Telstra. The biggest detractors to performance were the exclusion of News Corp, Campbell Brothers and overweights to BHP, Newcrest Mining and Wesfarmers.

### PERFORMANCE

	Quarter	Since Inception
<b>AQF</b>	+2.1%	-4.2%
<b>S&amp;P ASX 100 Accumulation Index<sup>1</sup></b>	+2.3%	-2.4%
<b>Out (Under) performance</b>	-0.2%	-1.8%

1. The S&P ASX 100 Accumulation Index assumes dividends from underlying companies are fully re-invested in the shares of the company.

## SECTOR ALLOCATION



## PORTFOLIO HOLDINGS

Asset Name	Market Value	Weight
BHP BILLITON LIMITED	7,092,413	12.99%
COMMONWEALTH BANK OF AUSTRALIA.	4,929,580	9.03%
WESTPAC BANKING CORPORATION	3,890,640	7.13%
ANZ BANKING GROUP LIMITED	3,460,311	6.34%
NATIONAL AUSTRALIA BANK LIMITED	3,301,165	6.05%
TELSTRA CORPORATION LIMITED.	2,662,825	4.88%
WESFARMERS LIMITED	2,196,216	4.02%
WOOLWORTHS LIMITED	1,963,573	3.60%
RIO TINTO LIMITED	1,687,375	3.09%
NEWCREST MINING LIMITED	1,452,916	2.66%
WOODSIDE PETROLEUM LIMITED	1,180,370	2.16%
CSL LIMITED	1,094,944	2.01%
ORIGIN ENERGY LIMITED	967,830	1.77%
QBE INSURANCE GROUP LIMITED	907,795	1.66%
AMP LIMITED	738,168	1.35%
SUNCORP-METWAY LIMITED.	692,657	1.27%
SANTOS LIMITED	686,688	1.26%
BRAMBLES LIMITED	681,023	1.25%
AMCOR LIMITED	566,547	1.04%
ORICA LIMITED	565,398	1.04%
MACQUARIE GROUP LIMITED	526,711	0.96%
TRANSURBAN GROUP	503,923	0.92%
STOCKLAND TRUST GROUP	488,909	0.90%
OIL SEARCH LIMITED	432,506	0.79%
AGL ENERGY LIMITED	421,976	0.77%
ILUKA RESOURCES LIMITED	404,721	0.74%
IAG LIMITED	400,369	0.73%
COCA-COLA AMATIL LIMITED	391,064	0.72%
ASX LIMITED	344,117	0.63%
WORLEYPARSONS LIMITED	340,230	0.62%
GPT GROUP	332,711	0.61%

Asset Name	Market Value	Weight
INCITEC PIVOT LIMITED	325,651	0.60%
ASCIANO GROUP	282,995	0.52%
SONIC HEALTHCARE LIMITED	281,763	0.52%
DEXUS PROPERTY GROUP	256,884	0.47%
MIRVAC GROUP	249,950	0.46%
COMPUTERSHARE LIMITED.	249,536	0.46%
LEND LEASE GROUP	239,416	0.44%
COCHLEAR LIMITED	224,502	0.41%
QANTAS AIRWAYS LIMITED	212,742	0.39%
OZ MINERALS LIMITED	207,878	0.38%
TATTS GROUP LIMITED	206,109	0.38%
METCASH LIMITED	199,447	0.37%
JAMES HARDIE INDUSTRIES SE	190,346	0.35%
BENDIGO AND ADELAIDE BANK LIMITED	179,591	0.33%
TOLL HOLDINGS LIMITED	178,810	0.33%
ALUMINA LIMITED	176,998	0.32%
RAMSAY HEALTH CARE LIMITED	158,578	0.29%
ECHO ENTERTAINMENT GROUP	158,409	0.29%
APA GROUP	152,570	0.28%
BORAL LIMITED.	152,093	0.28%
TREASURY WINE ESTATES	138,309	0.25%
CHALLENGER GROUP LIMITED	137,314	0.25%
SIMS METAL MANAGEMENT LIMITED	134,976	0.25%
ANSELL LIMITED	127,879	0.23%
UGL LIMITED	125,236	0.23%
TABCORP HOLDINGS LIMITED	121,654	0.22%
SEEK LIMITED	119,064	0.22%
MONADELPHOUS GROUP LIMITED	110,660	0.20%
GRAINCORP LIMITED	98,125	0.18%
FAIRFAX MEDIA LIMITED	96,383	0.18%
CALTEX AUSTRALIA LIMITED	93,183	0.17%
BANK OF QUEENSLAND LIMITED.	88,955	0.16%

Asset Name	Market Value	Weight
PANAUST	85,238	0.16%
BOART LONGYEAR LIMITED	76,692	0.14%
DAVID JONES LIMITED	73,160	0.13%
CSR LIMITED	65,548	0.12%
PALADIN ENERGY LTD	62,653	0.11%
PERPETUAL TRUSTEES AUSTRALIA LIMITED	55,345	0.10%
GOODMAN FIELDER LIMITED	52,218	0.10%
ONESTEEL LIMITED	52,124	0.10%
ARISTOCRAT LEISURE LIMITED	48,558	0.09%
BLUESCOPE STEEL LIMITED	41,195	0.08%
AWE LIMITED	35,354	0.06%
BILLABONG INTERNATIONAL LIMITED	18,810	0.03%
CASH	2,953,943	5.41%
<b>TOTAL</b>	<b>54,602,516</b>	<b>100.00%</b>

## AQF VOTING AND CORPORATE ACTIONS

As highlighted in the AQF prospectus, the Company intends to be an active participant in voting at general meetings and taking part in corporate actions. During the December quarter the Company voted in 45 AGMs on a total of 273 resolutions.

Australian Governance Masters Index Fund Limited invests only in the best governed Australian companies within the S&P/ASX 100 Index, as ranked by the Company's corporate governance analysis and third party research. The Company pursues an index style of investing with an active corporate governance bias and expects to hold securities of approximately 75 to 85 Australian entities within the S&P/ASX 100 at any time.

The Company believes boards and management that show relatively high levels of corporate governance tend to outperform relatively poorly governed companies over the long term. The Company also seeks to promote adherence to corporate governance best practice recommendations in its investments by voting its proxies and participating in shareholder meetings.

The Company aims to achieve long-term capital appreciation, while reducing risk, preserving the capital of the Company and by investing in a diversified portfolio of investments.