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NEW WEBSITE**

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your chance to WIN a
lunch with Geoff!

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Dear shareholder

Welcome to our latest investor newsletter.

Recently I watched the start of the movie Freakonomics. Unfortunately the plane landed and I didn't get time to watch the whole film. In the introduction they talked about human behaviour which as we know has a significant impact on the stock market. The quote that I liked was "Incentives matter and if you can figure out what people's incentives are, you have a good chance of guessing how they're going to behave". We as fund managers try to understand what management's incentives are. When we meet with company management one of our goals is to understand what it is that drives them. This helps us to understand how they will behave – are they motivated to enhance shareholder value or are they interested in other outcomes?

On a more sober note, we would like to pass on our best wishes to the people affected by the recent natural disasters in Australia, New Zealand and Japan.

We trust you enjoy this current edition and always welcome your feedback.

Regards

**Geoff Wilson, Chairman
WAM Active Limited**

A message from the Board of WAM Active

WAM Active Limited has enjoyed a strong start to its life as a Listed Investment Company and the Board is pleased with the funds solid performance.

“The Board’s determination to grow the market capitalisation from its current levels of around \$17 million towards \$100 million.”

The investment objectives are to deliver investors a growing stream of fully franked dividends and to preserve capital in both the short term and long term. These have been achieved since listing in January 2008. The company has been able to outperform the Australian share market at a time when volatility and uncertainty has been the order of the day. The Board and Management are hopeful that with the company’s flexible investment approach and ability to take advantage of many varying trading situations, investors will continue to see positive returns in all market environments.

In last year’s Investment Newsletter we outlined the Board’s determination to grow the market capitalisation from its current levels of around \$17 million towards \$100 million within a period of 5 years. We believe that with \$100 million of funds under management, the management team can continue to perform strongly, while the shareholders receive the benefit of a reduction in costs as a percentage of assets and an increase in liquidity of the shares.

The approach to growing the company has been carefully considered by the Board. Up until now we have stated that we would grow the company through a series of option issues. We currently have options outstanding that are exercisable at \$1.15 per option. These options (WAAO) expire on 30 April 2011.

With the changes in the Corporations Act in reference to dividends, the Board is exploring the most effective means of growing the company, without stemming a rising dividend stream. This approach has not been finalised, however, it could see a combination of underwriting the dividend reinvestment plan and/or initiating regular light rights issues. All of these approaches will be considered along with the merits of further option issues.

We look forward to discussing this with you at our May 2011 shareholder roadshows.

Thank you for your continued support.

Regards,

Geoff Wilson, Matthew Kidman,
John Abernethy, Chris Cuffe and
Ron Walker.

Performance

Since listing three years ago, WAM Active has delivered strong absolute returns with the investment portfolio delivering an annualised performance of 15.5% versus the S&P/ASX All Ordinaries Accumulation Index which has produced -4.9% annualised over the same 3 year period.

The gross portfolio increased 12.2% for the 6 months to 31 December 2010 as the S&P/ASX All Ordinaries Accumulation Index increased by 14.5%. This performance was achieved with an average equity weighting of 40.6% for the period. Over the same period after tax net tangible assets increased 9.3% (adjusted for dividends) to 116.39 cents per share.

The first half of the 2011 financial year proved to be a strong one for the Australian equity market with the resources sector outperforming the broader market. WAM Active participated in 93 capital raisings for the period, the majority being in the small resource sector which ran hot, increasing 47% in the 6 months. We expect a decline in the small resources sector during 2011.

Top contributors to the funds performance for the December half included RHG Ltd (RHG), Tower Australia Group Ltd (TAL) and Investorfirst Ltd (INQ). RHG has been a longer term holding for the fund trading at a significant discount to NTA. During

the December half RHG announced a proposed equal access buyback at 88 cents per share (1 cent capital and 87 cents dividend) plus a franking credit of 30 cents per share. This announcement saw the shares re rate to be up 56% for the half. TAL was the subject of a takeover bid from Dai-Chi Life at \$4.00 per share for the 71% of the company it did not own, while INQ performed strongly off the back of a \$12.5m capital raising which funded the acquisition of Hub24, a financial software product.

Key detractors for the half included Everest Financial Group Ltd (EFG), which announced it was subject to litigation, Macquarie Group Ltd (MQG) and David Jones Ltd (DJS). DJS was a short position which was closed out after sentiment surrounding the retail sector improved at the time of the investment.

Listed Investment Company (LIC) arbitrage, buying LIC's at a discount to NTA, proved the most successful for the period in terms of return on capital. This was due to the narrowing of LIC

discounts across the market during the half. The worst performing trade type during the half were short sales which provided a return on capital of 1.7% versus 13.0% for LIC arbitrage.

The half was characterised by an increased level of M&A activity across the market. We expect this will continue into the second half as company balance sheets are in good shape with excess capital. We invested in several takeover stocks including AWB Ltd (AWB), Adtrans Group Ltd (ADG), Healthscope Ltd (HSP) and Aevum Ltd (AVE). Our investment in these companies were after the bids were announced, enabling us to earn a higher return than cash together with franking credits. HSP and AVE were a few examples of stocks we bought after the initial bids were made, and a higher offer was received. A common theme was companies paying out franking credits as part of takeover offers. We see this increasing as companys pay excess franking credits to their rightful owners, their shareholders.

The fund moved into the second half with a 65% weighting in equities. By the end of February this figure was down to 54%. We are cautious on the equity market and believe the 2011 year will provide relatively flat returns with heightened volatility. As always we will scour the market for event driven opportunities which we expect will continue during the second half. We expect continued capital raisings particularly in the small resource sector. Capital management is becoming a growing theme which should provide opportunities. Special dividends across a select range of stocks are expected, providing a good source of franking credits for the fund.

Attribution Analysis

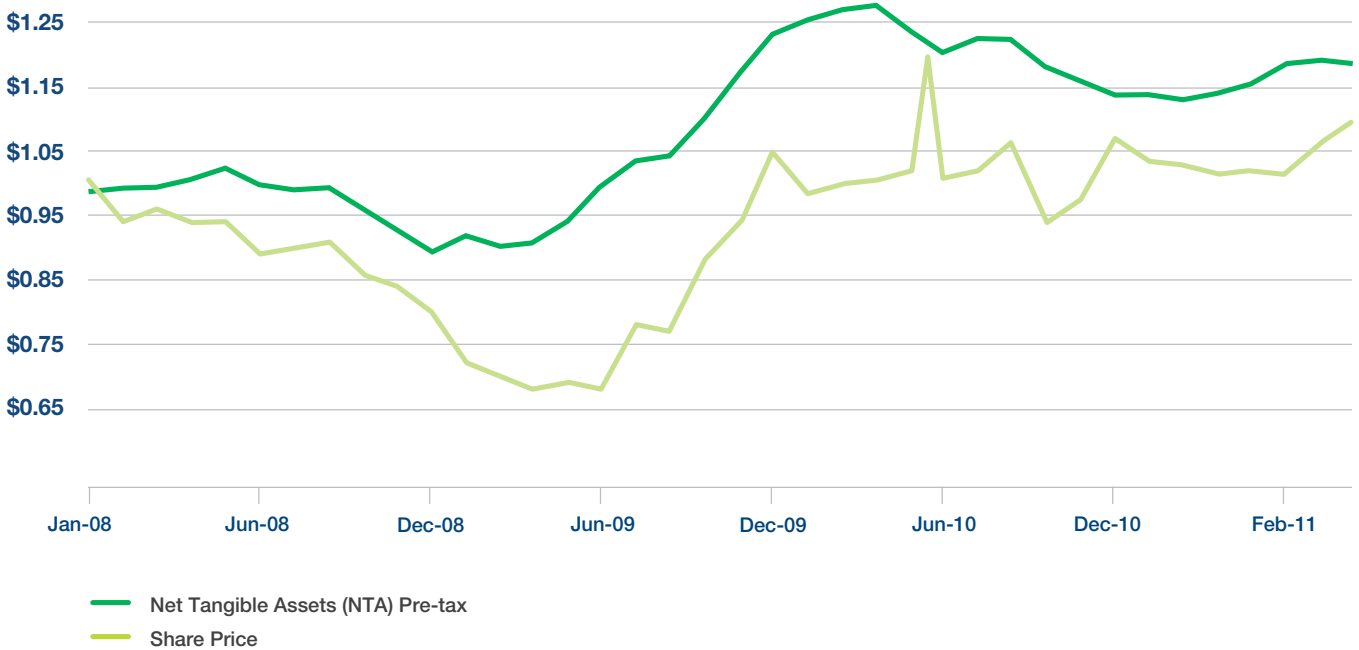
Trade Type	Return on Capital
1. Block trades at a discount	6.2%
2. IPO/Capital Raising	7.1%
3. Takeovers	3.9%
4. Oversold position/trading/asset allocation	3.4%
5. Short Selling	1.7%
6. LIC Arbitrage	13.0%
7. Valuation (low P/E, discount to NTA)	10.6%

The attribution above is based on the 6 months to 31 Dec 2010.

Annualised Performance as at 31 December 2010



NTA & Share Price History



Dividends

On 13 January 2011, the Board announced a 33% increase in interim fully franked dividend to 4.0 cents per share to be paid on 31 March 2011.

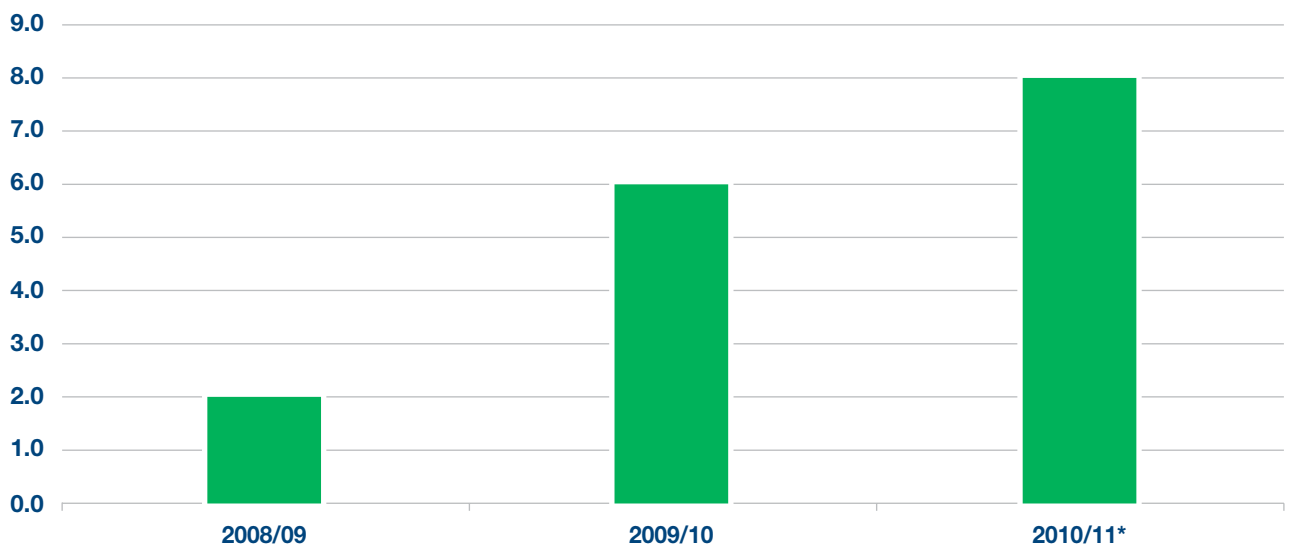
“Growing stream of fully franked dividends”

The Board is committed to paying an increasing stream of fully franked dividends to shareholders provided the company has sufficient franking credits, and it is within prudent business practices.

Dividends are paid on a six-monthly basis. Government legislation introduced in June 2010 now enables companies to pay dividends if the company is deemed solvent. Dividend payments will not be reliant on reported profit and retained earnings as it was previously. Rather it will be with consideration to cash flow, cash holdings and available franking credits. Essentially, WAM Active will always be in a position to pay dividends providing it is solvent.



Cents per share



■ Ordinary fully franked dividends

*annualised interim dividend

Market wrap

The December half has been marked by volatility for the Australian share market, with the S&P/ASX All Ordinaries Index trading in a 700 point range between 5023 and 4325.

“We believe these events have provided the catalyst for a more prolonged correction in equity markets.”

Calendar year 2010 proved to be another strong year for capital raisings in the Australian market. Over the year \$56 billion of equity was raised by Australian companies. This added to the \$109 billion raised in 2009, leading to a significant deleveraging of Australian companies balance sheets. The challenge for companies going forward will be the successful deployment of this capital. With subdued organic revenue growth, we believe companies will try and ‘buy growth’ resulting in an increase in mergers and acquisitions. WAM Active will benefit from these mergers and acquisitions as they provide opportunities for the fund to generate solid risk adjusted returns.

Over the 6 months to December 2010, the fund participated in 96 capital raisings (88 placements and 8 IPO’s). In this period the S&P/ASX Small Resources Index was up a colossal 46.7% which supported a plethora of capital raisings by junior mining companies as they took advantage of their strong share prices to raise money. We believe the volume of capital raisings will fall in the year ahead, as the air comes out of the small resource bubble.

In November 2010, we saw QR National the largest IPO since Telstra successfully listed on the ASX. On the back of this successful listing, we believe there will

be an increase in the number of large IPO’s this year. Analysts are predicting over \$8 billion of raisings from IPO’s.

Heading into the new calendar year we remain cautious despite the rally in equities since July 2010. We remain concerned about a bubble forming in the small cap mining sector. In recent months, the Chinese Government has been forced to lift interest rates and restrict lending practices to try and cool the economy. Any slowdown in China could materially effect commodity prices. More recently we have witnessed a high level of global uncertainty, with political unrest in the Middle East followed by the earthquake, tsunami and ensuing nuclear meltdown fears in Japan. We believe these events have provided the catalyst for a more prolonged correction in equity markets. We have used this opportunity to initiate some short positions in the small resources sector, which we believe is currently over-valued.

We expect the major trading opportunities in the next twelve months will be focussed on corporate activity, capital raisings and short selling.

Investment Objectives & Process

“To achieve these objectives, the company aims to take advantage of relative short term arbitrages and mispricings in the Australian equities market.”

The investment objectives of WAM Active are to:

- Deliver investors a regular income stream in the form of fully franked dividends; and
- Preserve capital in both the short term and long term.

To achieve these objectives, the company aims to take advantage of relative short term arbitrages and mispricings in the Australian equities market, rather than investing in any individual companies or portfolio of companies for a prolonged period of time. This is referred to as our “Market Driven” process.

The various strategies employed by the manager to fulfil its mandate include:

- Participating in initial public offerings, placements, rights issues and underwritings where the immediate valuation upside appears favourable;
- Participating in block trades which appear to be below market values;

- Participating in corporate transactions such as takeovers, mergers, schemes of arrangement and corporate spin-offs which appear favourably priced;
- Trading oversold positions;
- Short selling and option trading opportunities;
- Taking advantage of Listed Investment Company discounts; and
- Trading opportunities which will deliver acceptable risk adjusted return.

These strategies are undertaken from detailed monitoring of both primary and secondary market activity, in particular monitoring new capital raisings and corporate activity. In addition, the manager undertakes regular research, meetings and discussions with various companies listed on the Australian Securities Exchange to identify opportunities. In the last 12 months the manager had over 700 company meetings.

What is a Listed Investment Company?

A Listed Investment Company (LIC) is a listed pooled investment vehicle that offers investors access to a diversified portfolio of shares in other companies also listed on the stock market.

The underlying portfolio offers investors a range of different strategies. A LIC is a company structure listed on the ASX just like BHP or CBA.

A major benefit of the LIC structure is that it is a closed end pool of capital. By closed end we mean that if an investor wants to leave the fund, he or she sells shares to another investor. This is usually done through a broker. Effectively, no money leaves the fund and only the shareholders change. This differs from a managed fund/unit trust structure, where an investor leaves the fund by redeeming units and withdrawing the money from the fund.

We believe that a closed end fund is a superior structure to a managed fund/unit trust structures. With closed end funds or LIC's, the manager of the fund does not have to sell stocks in the portfolio to raise cash for a departing investor. That means investment decisions are based on the fundamentals of the companies the manager invests in, rather than money flow via redemptions.

Most other funds, like managed funds and mutual funds, are open ended. This means that when an investor wants to leave the fund the manager is forced to liquidate stocks to finance the redemption. This places pressure on the manager who has to put fundamental investing to the side while he or she manages the cash flows. Invariably, most investors depart a fund when stocks have fallen significantly, which historically has proven to be the best time to buy. This means the manager may have to sell companies which they believe represent good value.

At the other end of the scale, most money pours into the market and open ended funds, when stock prices are soaring in a bull market. The manager of the managed fund may then be forced to buy companies at inflated prices due to their strict mandates. This type of momentum investing can cause a serious destruction of capital when the bull market ends.

As a LIC is a closed end fund it does not have any of these problems which can be of significant advantage and benefit to the investor.

LIC's are unique investment vehicles because they can trade at a discount or premium to the assets that they own. When investors want to take their money out of LIC's, selling may result in the share price falling below the value of its net asset backing (or NTA). We refer to this as trading at a discount to NTA. This can provide a great buying opportunity for investors. On the other hand, when investors are buying shares in LIC's, the share price may trade higher than the value of the assets it owns. This is referred to as trading at a premium to NTA. This can provide a selling opportunity for investors.

What Wilson Asset Management Group offer to shareholders

Style

- A flat structure that delivers quick decision making
- A nimble investment process due to the relatively small funds under management
- A broad coverage of market sectors, especially at the small to medium end of the market
- An aversion to risk with above average cash positions
- Over 50 years of experience in the Australian share market with a high degree of street smarts
- Extensive company research with over 700 company meetings per year.

Structure

- Closed end funds avoiding the problem of being forced sellers and buyers at inappropriate times
- An active Market Driven approach that involves staying very close to the market.
- An investment vehicle that delivers fully franked dividends.

A closer look at two of our Market Driven trades

Maryborough Sugar Factory

Maryborough Sugar Factory Ltd (The) (MSF) is a company that we currently have a position in.



Maryborough Sugar is a Queensland based company that grows sugar cane and manufactures raw sugar and sugar cane by-products. We bought shares in the company through a discounted capital-raising in December 2010.

At the time the stock was trading at \$3.48 while the company was raising money at \$3.15, a discount of 9.5%. Maryborough Sugar was trading on an undemanding price to earnings ratio of 6x (assuming current spot sugar prices). The capital being raised was to exercise an option to acquire the assets of Bundaberg Sugar Limited, which we believed was a positive.

Prior to the capital raising, there has also been a strong M&A theme in the sugar

sector in recent times. In late October, Mitor Phol acquired a 19.9% stake in the Maryborough Sugar at \$4.00, a 46% premium to the price at the time (\$2.73).

Late last year there were a number of overseas acquisitions in Brazil which were transmitted at an Enterprise Value (EV)/Tonne of \$100. While we don't believe MSF will receive a takeover at that valuation, even an EV/Tonne valuation of \$50 per tonne values the company at \$4.20.

Panic selling in February 2011 due to Cyclone Yasi provided another buying opportunity.

Aristocrat Leisure

Occasionally we come across companies that have inherent problems within their business as well as structural problems in the industry in which they operate. These situations can provide short sale opportunities such as this.

Aristocrat Leisure Ltd (ALL) is a developer, manufacturer and distributor of gaming machines in Australia and overseas. We were alerted to Aristocrats precarious industry position by one of the stockbrokers we talk to regularly.

After conducting our own research we agreed that Aristocrat was facing serious structural industry headwinds.

The key issues Aristocrat were facing were:

- Boutique slot machine operators stealing market share with superior technology;

- Rate of casino expansion in the US decreasing;
- Existing casino's delaying the replacement cycle of older slot machines; and
- WMS the 2nd largest gaming machine producer globally expanding in Australia.

In addition to this, Aristocrat was trading at an expensive P/E multiple of 22x consensus earnings for FY2010, while the broader All Ordinaries Index was trading on a P/E of 14x.

Based on our research we decided to short sell the stock in late July at an average price of \$3.50. We held the position until late November 2010 when the company announced a reduction in its estimated earnings for financial year 2010. The downgrade represented a 20% reduction to consensus earnings. Following the downgrade, the stock dropped 18%. We closed out our position a few days after the downgrade.

STOCK-MARKETS: Thinking generally... and particularly about 2011

By George Sutton of Ecinya ("we")

ECINYA is an acronym for Exercise Caution In Your Affairs and is meant to remind both you, and us, that in order to get rich quickly you should endeavour to get rich slowly, as all endeavours require appropriate management of risk, and time.

“I remember particularly a lecture in 1933 when he tried to convey how new ideas were born. Never did they arrive, he said, with the hard edges that later critics came to attribute to them when trying to define their terms. Ideas were likely to be like fluffy balls of wool with no fixed outline and the relationship between concepts when first perceived was likely to be equally woolly. Keynes distrusted intellectual rigour of the Ricardian type as likely to get in the way of original thinking and saw that it was not uncommon to hit on a valid conclusion before finding a logical path to it.”

Sir Alex Cairncross talking about 'Ideas' and John Maynard Keynes, circa 1936.

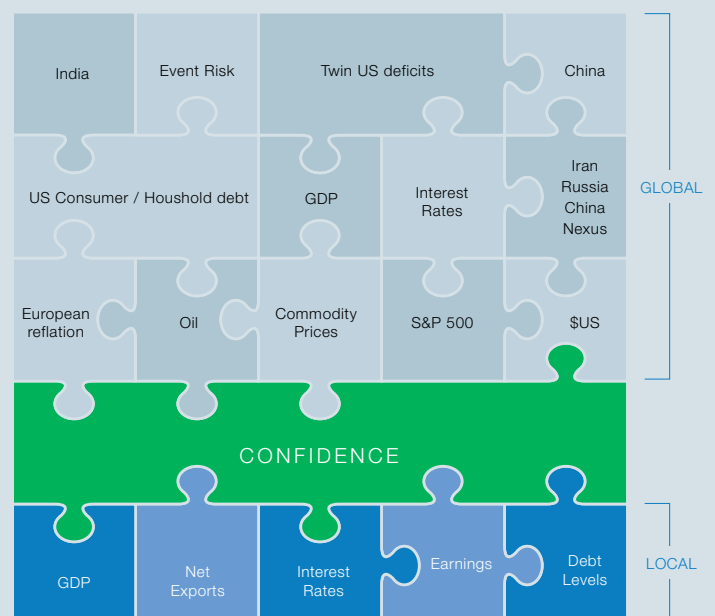
KEEPING IT AS SIMPLE AS IS SENSIBLY POSSIBLE (our version of 'kiss')

The stock-market from time to time appears to be an easy endeavour, but neither the economic cycle or market cycle is dead, and profits won on one adventure can disappear in the next. Folly can easily follow triumph. Those that tell you the market is easy, 'either do not know, or do not know that they do not know' (J K Galbraith).

There is so much noise in the markets that it is often difficult to know what to think, where to start, who to trust, how to allocate your resources etc. We have thus enshrined in our thinking the acronym 'ICE'. This translates into Interest rates, Confidence and Earnings.

Interest rates gives us a yield to work off as well as being relevant to interest costs being incurred by companies which will impact their earnings. Confidence levels give us a guide to price earnings multiple expansion as there is a level of belief in how sustainable the earnings will be. And most importantly of all, the absolute level of earnings gives us a number to apply our multiple to.

But confidence is the dynamic that the markets have the most trouble with. In a 2006 presentation we drew The Market as a dynamic jigsaw:



What is interesting to us as we reflect upon the jigsaw is how little has changed in the puzzle pieces over the past 5 years. A few observations:

- India and China are still vitally positioned
- Event risk has not gone away and still cannot be measured
- The twin US deficits are unimaginably worse
- Household debt has been joined or given way to sovereign debt issues
- Europe is deflating now but will reflate in due course
- Iran is still a stand-out problem within the broader, deeper, wider Middle East discourse.

SO LET’S THINK ABOUT 2011

Our real focus is stock selection against the background of micro company earnings forecasts and macro market and macro economic analysis. Technical and quantitative analysis provide confirmation or divergence from these deliberations. In index terms we focus on the All Ordinaries locally (XAO) and the SP500 as our global proxy (SPX on most systems).

In our opinion 2011 will be a year of shadow and light, not unlike 2010.

The SP500 finished 2010 at 1257. Our 2011 forecast expectations for the SP500 is that it encounters resistance around 1275 to 1290, then falls to around 1200. After that it rises about 15% to around 1380 and then falls about 15% to around 1180 before rising to finish the year at about 1320 for an overall gain of about 5%.

Our market in All Ordinaries terms is steady at around 4900 at the moment. We suggest that it will over the course of the year rise to about 5400 before retracing to around 4700 and finishing the year around 5100, up 5% year-on-year.

Our hypothesis therefore is that overall the year will be essentially flat, but with sufficient volatility to allow traders and active value investors to out-perform market indices.

There is always scope for over-and under-shoot but trend, bias and momentum are the phenomena needing to be observed for risk management and asset allocation decisions.

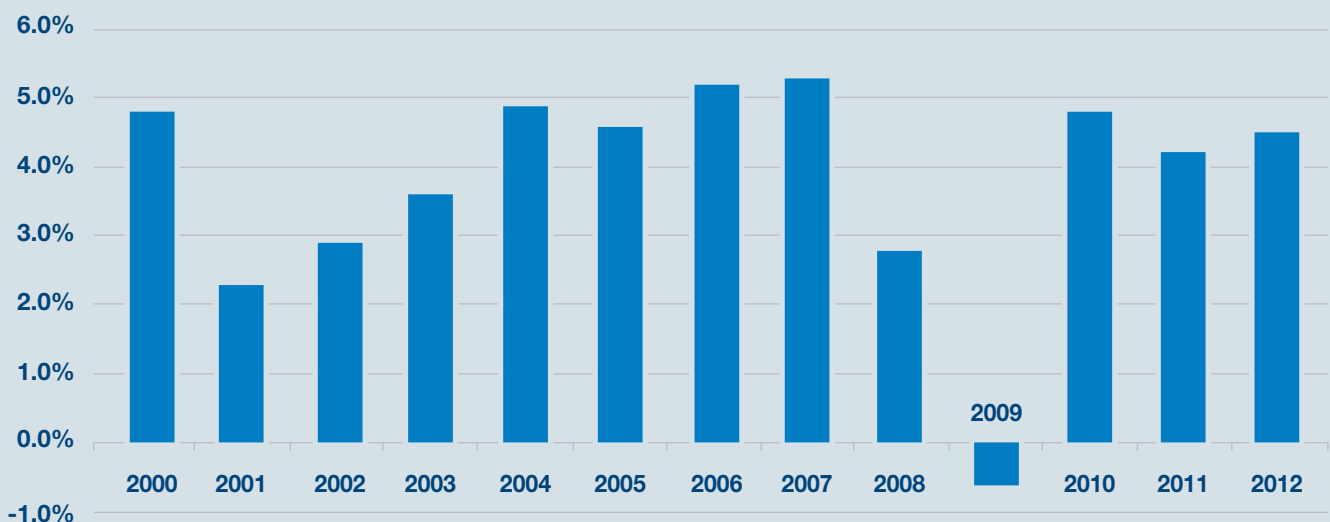
A WORD ON FORECASTS

A forecast is a prediction and calculation related to future events. The future is difficult to predict both in relation to time and dimension. Therefore, the underlying hypothesis has to be set out so that as events unfold and time passes, the forecasts can be measured to provide confidence, or provoke action.

An hypothesis is according to our Collins Dictionary “A suggested explanation for a group of facts or phenomena, either accepted as a basis for further verification or accepted as likely to be true”.

The world was in recession for 2009 with world growth running at negative 0.6% according to the IMF. In 2010 their estimate is that the world will grow at 4.8% and at about 4.2% for calendar 2011.

World GDP



Source: International Monetary Funds

STOCK-MARKETS: Thinking generally... and particularly about 2011

The market recovery from March 2009 was a renunciation and recognition that the world was NOT about to end. Too many of the world's bureaucrats failed to recognise that inappropriate fiscal and monetary policy was encouraging manipulation and exploitation of inadequate regulatory frameworks and this combination of factors would lead to an inevitable crash. Responsible persons and entities above the market were not moved to say "Stop, this has gone too far!" Current observations are that we have learned little from the last crash and previous episodes.

The 2010 year was driven by monetary and fiscal stimulus as "too big to fail" prevailed. "Too big" embraced both countries and corporations.

In 2011 we face the natural consequences of the actions that aided an economic and market recovery in 2010. The bullish hypothesis is that the emerging world (Asia and parts of South America) can take the developed world from survival to revival. Also that Ben Bernanke will succeed in stabilising the US economy to allow free enterprise to invest and borrow to create jobs. It is rather amusing that we hear the expression "jobless recovery"... how can you have a jobless recovery?

In Europe the approach has been that austerity is the path to prosperity. The PIIGS (Portugal, Italy, Ireland, Greece, Spain) have not gone away they are merely sleeping.

Australia went into the global financial crisis in good shape thanks to good government prior to 2007, China and commodity prices. However, over-reaction on the fiscal front to the GFC in early 2009 now leaves us more exposed, as so much of the fiscal policy resulted in waste, extravagance and fraud. Thoughtless politics got in the way of thoughtful economics.

On the American sub-prime fiasco It is interesting to reflect that home ownership which normally requires a job and the resulting income to repay a mortgage only required the existence of an aspiring home-owner and a glut of financial engineering. But then we pass this sub-prime event and the dot-com event off as 'bubbles' which both softens and trivialises the enormity of the travesty. It seems that too many of our global bureaucrats think that a university degree, briefcase and Armani suit plus a reading of Buffetology, business and economic history qualifies them to recognise and solve problems that impact on ordinary workers and taxpayers.

Though we got our 2010 market forecasts (XAO and SP500) near enough to 100% correct, our reasoning was marginally deficient in that the scale of the required stimulus was so large. It seems that the world is currently relying on fiat money to achieve survival and revival plus global excess capacity to mitigate inflation. Additionally, we find that our own forecasts whether accurate, or inaccurate, do not provide much in the way of a basis for constructive action over the course of a year in the stock-market.

We find the forecasts of others as quite useful as we know from experience that they will be either inaccurate, or extremely inaccurate, especially those of professional economists. People who forecast a year-end number for any economic or market indicator without a low forecast as well as an intermediate high, are adding little, or nothing, to your chances of matching or beating the market indices.

Recently, we re-visited the forecasts of 9 major players who on 4 January 2010 made forecasts for the top 200 (XJO). None were correct within a 3% margin of error. The best was wrong on the high side by 9% and the worst was 17% wrong on the high side. Updated forecasts for 2010 year-end were made by another group of 14 forecasters, inclusive of the original 9, on 2 July 2010. Only 3 were correct within a 3% error margin, which means that 11 were wrong. The largest error was 10%. And that was with half of the year gone and knowledge of their propensity for error given their six month earlier forecasts and the basis for them.

We see the 2011 year as having stronger elements of revival provided that government stimulus is constructively withdrawn. Using George Soros' word on reflexivity for a good part of the 2011 year the trend will be up and the bias will be supportive of the trend, but elements will emerge that give reason to focus on the possibility of a crash. Something more than a 10% retracement constitutes a 'crash' in our view.

BACKGROUND TO OUR HYPOTHESIS

“All countries which accumulate debt and habitually run big current account deficits are vulnerable. And for many centuries societies have been susceptible to irrational booms, South Sea Bubbles, tulip bulb booms, and dot com busts. But no central bank can offset the cascading effects of bad government policy.”

**Peter Walsh former Labor Party Finance Minister,
Financial Review 10/12/2003.**

“The principal contribution that monetary policy can make to economic well-being is to maintain low and stable inflation. I think it is true to say that if you wished to forecast the path of the Australian economy, and you were able to have fore-knowledge of only one economic variable, the one you would choose is the path of the world economy. That is not to say that we have no influence over our own destiny – we can make the situation better or worse than it would otherwise be – but we cannot escape the influence of the world business cycle and the other factors that feed off it.”

**Ian Macfarlane, former Governor of the Reserve Bank,
14/6/2005.**

The background to our 2011 hypothesis of our reference markets (XAO and SP500) rising to a peak of about 15% before falling over to be essentially flat, is twofold.

Firstly, is our belief that government in the developed world has now become too big having moved to around 30% of GDP and is significantly over-leveraged for the very worst of reasons – to encourage their re-election. This applies in greater measure to America, but also in significant measure to Australia. Australia's march of folly has begun from a better base than in the USA.

The second plank to our hypothesis is that the symbol economy of money and credit is wagging the real economy dog of production of goods and services. Monetary policy cannot offset the cascading effects of bad fiscal policy. Ben Bernanke is not Charles Atlas carrying the weight of the world economy upon his fiscal fiat money shoulders.

The March of Folly: Barbara Tuchman wrote “The March of Folly (from Troy to Vietnam)” in 1984. Across the pages of a big slice of history she describes various events that lead to her opening paragraph:

“A phenomenon noticeable throughout history regardless of place or period is the pursuit by governments of policies contrary to their own interests. Mankind it seems, makes a poorer performance of government than almost any other human activity”.

The final paragraph in her book is clinically neutral and says:

“We can only muddle on as we have done in those three or four thousand years through patches of brilliance and decline, great endeavour and shadow”.

An intermediate paragraph that always captures our attention concerned the United States of America: *“For two centuries, the American arrangement has always managed to right itself under pressure without discarding the system and trying another after every crisis, as have Italy, Germany, France and Spain. Under accelerating incompetence in America, this may change. Social systems can survive a good deal of folly when circumstances are historically favorable, or where bungling is cushioned by large resources or absorbed by sheer size as in the United States during its period of expansion. Today, when there are no more cushions, folly is less affordable.”*

From Ms Tuchman's text immediately above the striking and agreeable words to us are “accelerating incompetence” and “when there are no more cushions folly is less affordable.”

STOCK-MARKETS: Thinking generally... and particularly about 2011

'Folly' in the Austrian school of economics is reflected in their focus on misallocation of resources. Economics teaches us that relative to wants and needs, resources are always scarce. 'Cushions' to us means things like balanced free enterprise with governments playing a role that guarantees or strives for integrity and transparency. However, as governments have become more opaque and less honest in their dealings with voters and taxpayers, the private sector has followed suit (especially large businesses) and become less opaque and less transparent itself for reasons of short-term profit maximisation and for survival.

Real reform is off the agenda until truth becomes politically fashionable and effective again. In the meantime we can rely on market trends being up for most of the year and the bias tending towards optimism. The Ninth Zurich axiom of Max Gunther says "*Optimism means expecting the best, but confidence means knowing how you will handle the worst. Never make a move if you are merely optimistic*".

ACCORDINGLY ECINYA'S AIMS FOR 2011 ARE:

1. Preserve capital.
2. Lock in some of the gains from 2010 early in 2011.
3. Be more committed to fewer stocks over the course of the year knowing that stock selection is almost always vital. A few stocks that have the potential to surprise will be bought from time to time.
4. Be prepared to move quickly and aggressively into cash from time to time.
5. Pick some recovery stocks (eg. media, building materials are possibilities, banks, some retailers later in the year perhaps).
6. Pick some takeovers (Crane has been a good beginning, though we got the bidder wrong).
7. Double digit returns.
8. Out-perform the All Ordinaries by more than 400 basis points.
9. Have a good dividend flow.

WHAT DO YOU NEED TO DO TO ACHIEVE OUT-PERFORMANCE?

We have long believed that out-performance can best be achieved by an investor learning to trade a reasonable proportion of his stake over the course of the year. The 'buy and hold' strategy is risky. The 'buy and sell' strategy is less risky. Our preferred approach is the 'buy and trade-around-the edges' of an investment portfolio which can be rewarding and can be fun. Occasional speculation is OK but do not confuse speculation with investment. Junior mining stocks look like an obvious bubble.

UPSIDE / DOWNSIDE

The upside is always easily manageable, the downside less so. With upside you can go with the flow and try to not get too far outside beyond your view of what represents reasonable value. The downside requires much more effort and deliberation.

If good things happen then that is good news. If bad things do not happen then that is good news as well. Do not expect that progress will be linear.

EXECUTIVE SUMMARY OF THE CONCERNS SURROUNDING OUR 2011 HYPOTHESIS

Australian Concerns:

- The current Queensland floods.
- Fiscal policy out of control and will get worse before it gets better, and may not get better at all in the life of the Gillard-Rudd-Greens coalition.
- China might slow down just enough to give us a dose of economic castor oil.
- Interest rates may stay uncomfortably high.
- Tax reform is off the agenda, pretend reform is on the agenda.
- Economic growth may be uninspiring below 3% in real terms.
- Policy positions on water management, electricity, climate change, national broadband, refugees, and welfare generally seem hopelessly inept.
- Lack of attention to small business.
- Political donations need to be banned and instead go into an electoral bank to be distributed on a formula basis. Too many cronies in the political ranks.
- The federal parliamentary term should be extended to 4 years with a minimum term of 42 months to give time for policy to work and/or be fine-tuned.
- Liberal Party provoking Labor into bad policy eg. the recent bank bashing exercise lacked perspective and balance.

American concerns:

- Crony capitalism has not dissipated under Mr Obama. Goldman Sachs, Bank of America, Citibank, and JP Morgan appear to be part of government providing personnel, market and donor support.
- The Federal Reserve is outwardly non-independent promising to 'print money' as long as it takes. We hope that behind closed doors they are somewhat more independent.
- Trends in the US domestic deficit and current account deficit. America can afford its deficits but not an acceleration in the current trend.
- Lack of employment policies though this may be remedied by a successful implementation of the Dodd-Hagel Infrastructure Bank Act.
- Lack of effective savings plans eg. compulsory superannuation Aussie style.
- House prices still in decline.
- Smaller commercial banks still being closed down.
- Large state and local government budget gaps. California appears to be insolvent.
- Energy prices still a problem.
- Paranoia over China leading to poor dialogue and lack of constructive communication.
- QE2? Where does it end?
- Need for structural reforms in taxation, probably a national sales tax.
- Continuing debate and lack of consensus and viability in health-care.
- Wall Street appears to have learned nothing from sub-prime and dot-com fiascos.
- Congressional grid-lock giving the impression that America is ungovernable.

European concerns:

- Germany appears to be the only European country with an established work ethic.
- Portugal, Italy, Ireland, Greece and Spain struggling on high sovereign debt loads.
- European response to austerity seems to be riots, looting and burning... hellishly unproductive.
- The Euro seems to be a constraint when countries cannot devalue their way to recovery.
- Euro area growth projected by the IMF to move from negative 4.1% in 2009 to positive 1.5-1.7% in 2011, a muted recovery.

Asian concerns:

- China inflation and consequent policy tightening.
- China to decide how it wants to become a fully fledged member of the global community.
- Over-simplification to regard China as a country of economic geniuses. That mistake was made when Japan was growing exponentially.
- Japan still in the doldrums after several decades.
- India inflationary concerns.

Technical concerns/watch-list:

- SP500 seems over-bought.
- Baltic Dry index, a reasonable proxy for world trade, is weak possibly indicating that China trade is weakening.
- The Shanghai A index is wilting.
- Chinese industrial production slowing.

Geo-political concerns/watch-list:

- North Korea
- Afghanistan
- Pakistan
- The middle east – Iraq, Iran, Israel, Palestine, Yemen, Egypt.

George Sutton B.Ec (Syd), ACA, F Fin is an authorised representative of Ecinya Consultants Pty Limited and acts as editor of the Ecinya pages. George has been a former lecturer at The Securities Institute, a Corporate Finance Executive with two major investment banks, an analyst with BZW (formerly ABN Amro, now RBS) and then Managing Director of James Capel Australia. His major interests are the stock-market and golf – both mind games requiring technique, discipline, patience, and a sense of humour.

Ecinya Consultants Pty Ltd

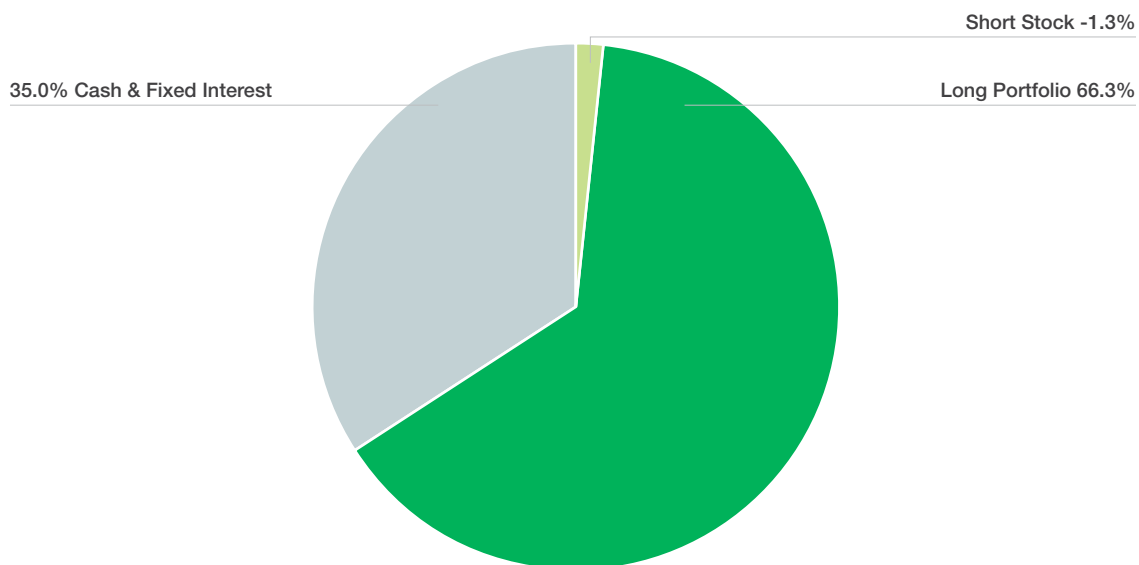
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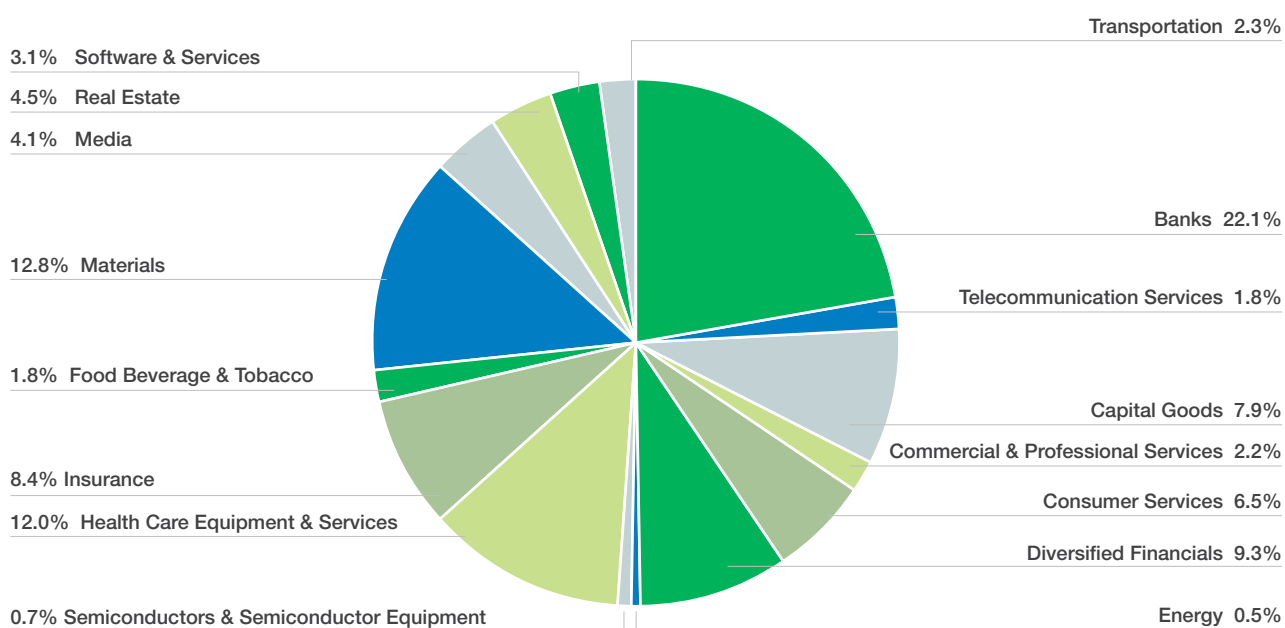
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Portfolio Summary as at 31 December 2010

Portfolio Asset Allocation



Long Portfolio Sector Allocation



Top 10 Holdings as at 31 December 2010

ASX Code	Company Name	Sector	Market Value \$m	% of Gross Assets
RHG	RHG Limited	Banks	1.2	6.3%
TAL	Tower Australia Group Limited	Insurance	1.0	5.5%
PRY	Primary Health Care Limited	Health Care Equipment & Services	0.8	4.3%
JHX	James Hardie Industries Se	Materials	0.7	3.8%
CSR	CSR Limited	Capital Goods	0.7	3.7%
FLT	Flight Centre Limited	Consumer Services	0.6	3.3%
CBA	Commonwealth Bank of Australia	Banks	0.3	2.0%
NAB	National Australia Bank Limited	Banks	0.3	2.0%
SYM	Symex Holdings Limited	Materials	0.3	2.0%
ANZ	Australia and New Zealand Banking Group Limited	Banks	0.3	2.0%

Best Performing Stocks for the 6 months to 31 December 2010

ASX Code	Company Name	Sector	Unrealised/ Realised Gains
RHG	RHG Limited	Banks	\$422,698
TAL	Tower Australia Group Limited	Insurance	\$376,947
INQ	InvestorFirst Limited	Diversified Financials	\$120,372
HSP	Healthscope Limited	Health Care and Equipment Services	\$106,715
ESS	Essa Australia Limited	Capital Goods	\$68,650
WFM	Webfirm Group Ltd	Software and Services	\$65,385
BTU	Bathurst Resources Limited	Materials	\$64,996
JHX	James Hardie Industries Se	Materials	\$60,390
IAU	Interpid Mines Limited	Materials	\$59,126
VTP	Van Eyk Three Pillars Limited	Diversified Financials	\$58,782

Worst Performing Stocks for the 6 months to 31 December 2010

ASX Code	Company Name	Sector	Unrealised/ Realised Losses
EFG	Everest Financial Group Limited	Diversified Financials	(\$56,576)
MQG	Macquarie Group Limited	Diversified Financials	(\$43,906)
DJS	David Jones Limited	Retail	(\$42,355)
RISX	Richfield International Limited	Transportation	(\$38,787)
CSR	CSR Limited	Capital Goods	(\$38,158)
PGA	Photon Group Limited	Media	(\$34,438)
LYC	Lynas Corporation Limited	Materials	(\$30,021)
DYE	Dyesol Limited	Semiconductors & Semiconductor Equipment	(\$29,039)
WEB	Webjet Limited	Consumer Services	(\$27,133)
BOL	Boom Logistics Limited	Capital Goods	(\$25,725)

Director Profile – Introducing Christopher Cuffe

Chris has been a Director of WAM Active Limited since November 2007.



Following a five year period with chartered accountants KPMG, Chris Cuffe entered the funds management industry in 1985. In 1988 he joined Colonial First State where he was CEO from 1990 until 2003. Chris took the company from a start up operation to Australia's largest investment manager. Chris joined Challenger Financial Services Group Limited in early 2003 as Chief Executive Officer and subsequently as Chief Executive of Challenger's Wealth Management business. In 2006, Chris joined non-profit organisation Social Ventures Australia (SVA) as an Executive Director, a position he held until May 2009 when he became Chairman of the SVA Future Trust. Chris is now involved in a portfolio of activities including a number of directorships, managing public and private investments and in various roles assisting the non-profit sector.

Chris holds a Bachelor of Commerce in Accounting, Finance and Systems with merit from the University of New South Wales as well as a Diploma from the Securities Institute of Australia (now the Financial Services Institute of Australasia). He is also a Fellow of the Institute of Chartered Accountants in Australia, a Fellow of the Financial Services Institute of Australasia and a Fellow of the Institute of Company Directors.

Other current directorships

Chris is also a Director of UniSuper Limited, Third Link Investment Managers Pty Limited, Centric Wealth Limited and Arkx Investment Management Limited.

Under the microscope:

Chris' view on Democracy

"Remember, democracy never lasts long.

It soon wastes, exhausts, and murders itself. There never was a democracy yet that did not commit suicide." John Adams (1735-1826) Second President of the USA.

In the last 12 months we have been through the experience of a change in Prime Minister, a Federal election, a hung parliament, a minority Government in power, and now a new Government.

It is not only the political landscape that has seen dramatic change, but the broader environment they govern. Many respected investment commentators believe that most of the developed world is at the end of 35 years of binge-borrowing, of over-consumption, and of under-saving. And during this period many pension funds around the world have over promised benefits and under-funded liabilities. In addition, across the US for example, many state governments are on the edge of fiscal calamity (and some of these are bigger than whole countries in Europe). To add salt to the wound we have an aging population in many countries causing a growing strain on the health and social security system. At the same time the people of most developed worlds want better medical care, better schools, attractive social security arrangements, wide highways, and adequately funded defenceand low taxes of course.

What a dilemma for today's politicians, particularly those political parties always on the knife-edge of popularity!

Quoting from David Brooks in The New York Times on May 13, 2010:

"If you're elected president or prime minister in pretty much any country in the developed world today, you're faced with the same set of challenges: to reduce national deficits without choking off a fragile recovery; to trim the welfare state and raise taxes while still funding the things that lead to long-term growth; to try to enact brutally painful measures at a time when voters don't trust their leaders; to do it at a time when politics are polarized and a hundred different interest groups have the ability to block change.

"The chances that the world's leaders are going to be able to do these things successfully are between slim and none. It's hard enough to figure out the right

mix of spending cuts and tax increases. It's nearly impossible to build a political majority willing to enact them. Sometime over the next decade or so, the world will probably suffer from another series of crushing fiscal crises with significant economic pain and maximum political turmoil."

The process of solving such problems will be unpleasant in the short term, while the benefits will only be seen in the long term – when today's politicians will have left the stage. Unfortunately voting for short-term pain in order to solve long-term problems is a rarity, particularly in these days of 24x7 'populist' media scrutiny.

How lucky we are in Australia that our economic outlook appears fairly positive. From an economic perspective, the developing world is powering ahead with high growth rates and high savings rates and a relentless desire for increased living standards – and Australia has been and continues to be a beneficiary of this growth.

But despite many respected commentators talking about the potential for this decoupling over the past year, the reality is that the US and Australian markets still tend to dance to the same tune. This helps explain why the Australian investment market has stalled over the last six months (and over the last year). It would appear there have been continued investor concerns regarding the prospects for sustained improvement in global economic and financial market conditions. Put another way, it seems investment markets (that are usually predictive in nature about future growth) came out of the blocks very quickly from the lows of March 2009 and have since stalled over the last year as people are still assessing whether the pace of recovery will be different this time. Recovery may indeed be at a different pace this time, but Australia's strong growth outlook and the relatively sound balance sheets of its companies should hold us in good stead.

New-look website

We are pleased to announce that we have launched our new and improved website.

Our goal was to provide our clients with an interactive, user-friendly experience. While we offer the same useful information, you will notice some new sections:

- Newsroom – this will include latest newspaper articles on all our funds and the industry, audiocasts by our investment team
- A biography on each of our team members
- Section for Financial Advisors – this will include latest independent research on our funds.

We will continually strive to add more information to update you with the latest news.



www.wamfunds.com.au

WIN A LUNCH with Geoff Wilson!

We would like to encourage all shareholders to visit our new website, and let us know what you think – good or bad!

Visit the home page on our website, and click on the 'Start Survey Now' link to complete the online form by 30 April 2011. The shareholders that provide the most constructive feedback (as voted by our investment team) will each receive a copy of one of these leading financial books. In addition, one of these lucky shareholders will also win the opportunity to have an enjoyable lunch with Geoff Wilson who will discuss his view of the market and some of the stocks held in the portfolio.



20 BOOKS TO GIVE AWAY!

Wilson Asset Management is an independently owned boutique investment manager established in 1997 by Geoff Wilson. Wilson Asset Management is based in Sydney, Australia.

The Wilson Asset Management Group (WAM Group) employs five investment professionals who have a total investment experience of over 50 years.

The WAM Group is the manager of three listed investment companies with funds under management of approximately \$314 million. The group also manages an unlisted fund on behalf of investors.

In August 1999 the first of the three listed companies, WAM Capital Limited (WAM), was established and has grown from \$21.5 million to approximately \$187 million today. WAM predominantly invests in small to medium sized companies listed on the ASX for the short to medium term.

In August 2003 the second listed investment company, WAM Research Limited (WAX) (previously known as Wilson Investment Fund Limited), was established with \$161 million raised and after buying back \$47.5 million, currently \$108 million. WAX predominantly invests in small to medium sized industrial companies listed on the ASX for the medium to long term.

WAM Active Limited (WAA) is the most recent addition to the group which was listed in January 2008 with approximately \$15 million raised and currently \$19 million. WAA is an active investor with high turnover and a focus on absolute returns.



WILSON
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