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Dear Shareholder,

In what has been a challenging six months for equity markets, I am pleased all three of our Listed Investment Companies (WAM, WAX and WAA) were able to increase their fully franked dividend by around 10%. As a Board and Investment Manager, we continue to focus on delivering a growing stream of fully franked dividends to our shareholders.

A topic being talked about in the market at the moment is the long awaited float of Facebook. The valuation is expected to be between \$US80 billion and \$US100 billion. I am fascinated that the human desire to belong and be connected could deliver such paper wealth in such a short period of time. In my view, the floating of Facebook signals close to a top for its valuation.

In this newsletter we discuss a topic that we are frequently asked about by our shareholders – The Australian Banks. We have outlined the current dynamics in the Australian Banking Industry and try to answer the question: 'Are they a sound investment?'

I hope you enjoy reading this issue of our newsletter and I look forward to seeing you at the upcoming Investor Roadshows in May.

Thank you for supporting us.

Geoff Wilson, Chairman
WAM Active Limited

Australian Banks – Are they a sound investment?

Australian bank shares currently offer a historic dividend yield of approximately 7% per annum which is fully franked. This is a very attractive dividend yield, if it is sustainable and if bank earnings can at least be maintained throughout the next cycle.

Investors are questioning the sustainability of bank dividends in this post-Global Financial Crisis (GFC) world and are now asking if the banks will ever return to their former glory days as powerful earnings growth engines. The distress in Europe has only heightened investor concerns further and led to more risk aversion.

In this feature article we examine the status and prospects of the Australian banks.

Australian banks are indeed facing a number of headwinds

Australian banks today face a variety of difficult headwinds that haven't generally confronted the sector in the past 20 years. Credit growth in Australia has been slowing and is now trending at very low levels. Home lending grew by only 5% in 2011 which is a record low level of growth and business credit in Australia is even softer and is not growing much, if at all.

At the same time, banks around the world are also facing higher regulatory imposts around capital and liquidity under the new Basel III requirements. APRA is implementing tougher requirements in Australia to reflect these Basel III requirements, and APRA's standards will no doubt be at least as tough as any regulatory regime overseas.

Investors are becoming increasingly concerned about the risks facing banks in Australia

Share market investors have become very concerned that the Australian banks rely heavily on wholesale funding offshore. Concerns have been heightened since the onset of the European debt crisis last year and there is a real concern that the Australian banks' funding could be threatened by a collapse of European debt markets.

There is an increased realisation that the current levels of offshore wholesale debt by the banks represents a significant risk to bank balance sheets in any future crisis period.

Investors are also concerned that a downswing in global economic conditions could bring a second wave of bad debts for domestic banks in Australia. The largest asset class exposure is residential mortgages, and there is a concern that home affordability is problematic in Australia, with a very high ratio of house prices to median income. Investors highlight the risk of residential mortgage distress with particular overseas perceptions of an Australian housing bubble.

Any major collapse in residential house prices would threaten the asset quality of the Australian banks. However, Australian house prices have been resilient for the last 30 years despite a number of difficult economic environments. Theoretically, such a failure would only occur in the event of high levels of unemployment combined with rising interest rates, so this scenario would appear to be quite unlikely in the current environment, but can't be ruled out in the long term.

On the positive side of the bank outlook, we note that:

- (a) credit quality has never been stronger;
- (b) provisioning for impaired loans is very prudent; and
- (c) capital adequacy levels are very strong.

Old model of Australian banks transformed to a new paradigm

Following the deregulation of the banks in the 1980's, the banking system in Australia enjoyed rapid credit growth and the Australian banks generated exceptional profitability with very high return on equity of 20% or more consistently for over a decade. The banks were keen to facilitate strong credit growth and they achieved exceptionally high credit growth at double digit levels, close to 14% per annum.

But this rapid credit growth couldn't be internally financed by customer bank deposits and the banks therefore sought additional external funding from wholesale sources, particularly from overseas lenders.

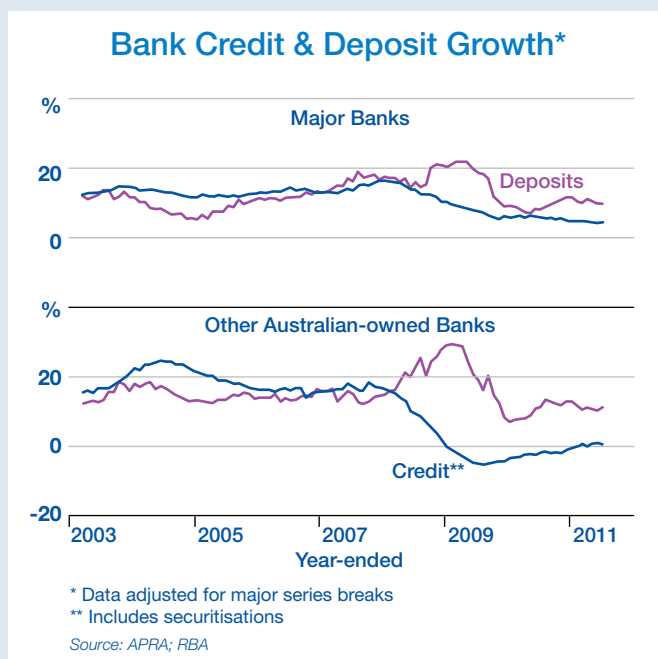
After the onset of the GFC, the availability of overseas debt dried up and customer lending growth slowed dramatically, and so the banks have found themselves facing a challenging new era of customer deleveraging. Both business and retail customers have sought to improve their own balance sheets and have been reluctant to borrow and have tended to repay existing loans.

There has been a step change in wholesale funding costs and the banks have been forced to suddenly reduce their reliance on wholesale funding, which has become more expensive and more challenging to place. The banks have offset the higher wholesale funding costs

with higher lending spreads on loans, and both retail and business loans have been significantly repriced upwards.

As mentioned, the Australian banks now face much tougher scrutiny and increased regulatory requirements in regard to capital, funding and liquidity.

Credit growth for the major banks has continued to slow since the GFC, with no evidence of any pipeline of lending growth re-emerging on either residential mortgages or business. However, deposit growth has



stepped up and has been exceeding credit growth, which significantly helps to alleviate the banks' funding requirements.

Banks are still overly reliant on wholesale funding

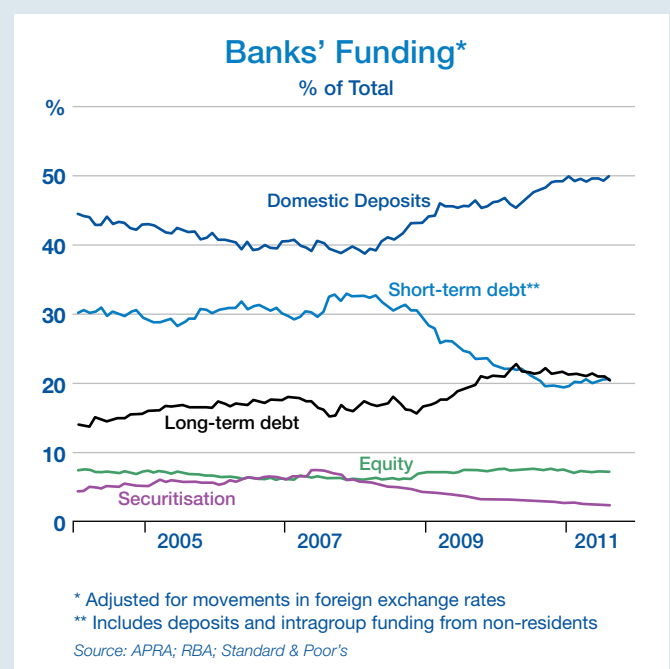
The Australian major banks have a structural weakness in their heavy reliance on overseas debt markets. This could leave the Australian banks exposed to a funding, and potentially a liquidity problem if wholesale debt markets became closed for a prolonged period, as during the depths of the GFC.

We highlight in the following chart that the major Australian banks have indeed improved their funding mix since the GFC with domestic deposits increasing from around 40% to about 50% of funding. Moreover the

banks have all lengthened the term profile of the funding maturities so they face fewer maturities in any given period. Nonetheless the banks still rely on wholesale debt markets for around 40% of funds that they lend to customers.

The majority of their wholesale funding is sourced overseas and a significant amount has traditionally been sourced from European investors and banks. The sovereign debt crisis in Europe has increased concerns about the stability of the funding of the Australia banks.

As the global uncertainty increased last year, the Australian banks found an increased tendency for business and consumer savings, which has significantly boosted the deposit base of the Australian banks and has alleviated the overall funding task facing the banks.



In total the four major banks will need to refinance about \$100 billion of wholesale debt maturities during 2012, although this will ultimately depend on the level of deposits and savings and the level of credit growth.

Covered bonds facilitate bank funding in 2012

The covered bond market was recently enacted in Australia in October 2011, with the first covered bond issued in November 2011. This development will assist the banks in meeting their funding task. Covered bonds

Australian Banks – Are they a sound investment?

(continued)

represent an additional credit enhancement to traditional bank debt, whereby lenders receive a pledge over a pool of high quality assets that are ring-fenced.

Investors in the covered bonds have a preferential claim on these earmarked assets and thus effectively rank higher than other creditors in the event of default. But covered bondholders also have an unsecured claim on the issuing bank to meet any shortfall. Covered bonds will enable a lower cost form of borrowing for the banks and also offer investors more security than previously available to wholesale borrowers. Covered bonds will therefore alleviate the funding pressures currently facing the banks.

Note that a Federal Government Guarantee applies to retail bank deposits

In November 2008, during the depths of the GFC, the Australian Federal Government introduced an explicit and free guarantee on retail deposits issued by any authorised deposit-taking institution (ADI) in Australia.

On 1 February 2012, the maximum limit on this guarantee was reduced from \$1 million to \$250,000 and is not scheduled to expire.

Improved market structure leads to a more dominant position for the major banks

The market structure has become highly oligopolistic with the four major banks now increasingly dominating lending and deposit markets in Australia over the last few years, as a result of the following factors.

- a) In October 2008, CBA acquired BankWest and in December 2008 Westpac acquired St George Bank. BankWest and St George were the strongest regional bank competitors to the major banks.
- b) Prior to the GFC, banks in Australia faced strong competition from non-bank lenders. Due to the GFC securitisation markets closed and have yet to re-open. This has crimped the ability of non-bank lenders to source adequate funding at economic levels and has led to the demise of non-bank lenders.
- c) Regional banks are lower rated than the major banks and as a result the regional banks face a more difficult funding task. As a result, this advantages the major banks in Australia.

Conclusion

What remains to be seen is, firstly, whether the banks can maintain their historic dividend yields, and secondly, whether the banks can grow earnings and dividends over the medium term.

Will the banks ever return to become strong profit growth engines or will they simply become high yield plays that are ex growth and effectively boring utilities?

In our opinion the Australian banks offer the following compelling benefits:

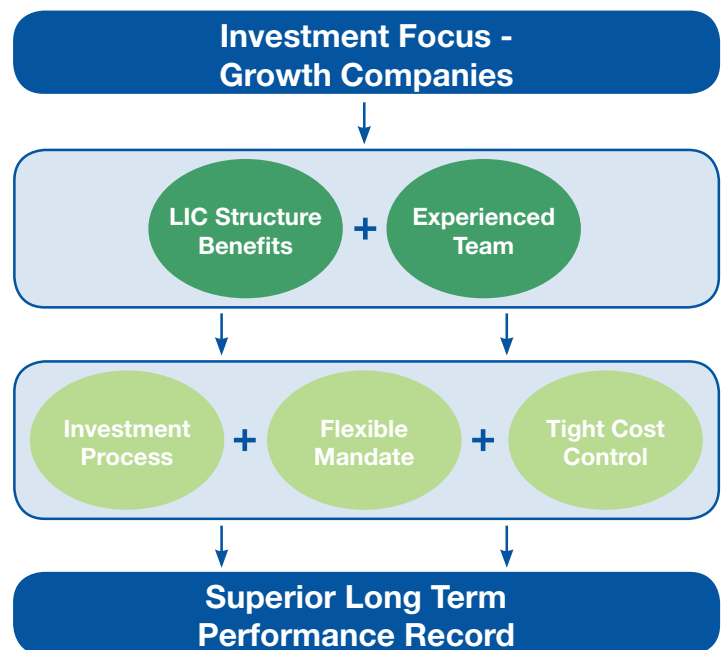
- 1. Improving Operational Efficiency.** Even in the face of low credit growth, well-managed banks will be able to maintain profits through the next cycle if asset quality is sound and if provisioning is prudent. Banks may well confront some margin pressure and face low asset growth but bank profits can be maintained if operating expenses and asset quality are tightly controlled. Bank profits, and hence dividends, will be maintainable if the bank is well managed.
- 2. Dominant Position.** The strength of their market position enables the banks to monetise their high franchise value, despite competition and ongoing political pressure.
- 3. Sustainable Yield.** Australian bank shares typically offer an attractive dividend yield of approximately 7% per annum which is fully franked. We believe this dividend yield is sustainable. Payout ratios are conservative. Banks are well positioned to maintain dividends and the current dividend yield, together with franking, represents approximately a very satisfactory 10% pre tax return to investors.
- 4. Capital Generation.** Although the banks may suffer from benign credit conditions, the low credit growth environment in the context of high return on equity means that the banks will tend to start generating significant free capital. Although APRA is now looking for all the banks to increase their regulatory capital ratios and reduce gearing, this capital generation will eventually become available for either new business investment or otherwise for potential return to shareholders by way of higher dividends or capital returns.

What Wilson Asset Management Group offers to shareholders

Funds & Investment Process



Business Model



Style

- Quick decision making resulting from a flat structure;
- Increased flexibility due to the relatively small funds under management;
- A broad coverage of various industries, especially at the small to medium end of the market;
- A focus on risk adjusted returns with above average cash positions; and
- Over 50 years of experience in the Australian share market with a high degree of street smarts.

Structure

- Closed-end funds avoiding the problem of being forced sellers and buyers at inappropriate times;
- An investment vehicle that delivers fully franked dividends; and
- An active Research Driven and Market Driven approach that involves staying very close to the market and an in depth analysis of investee companies (over 750 meetings with companies per year).

Listed Investment Company Structure Benefits

Listed Investment Companies (LICs) are structurally superior investment vehicles. Benefits include:

- They provide a diversified portfolio of assets with a range of different strategies and styles (e.g. Australian shares, international shares)
- Studies show LICs outperform managed funds*
- Closed-end pool of capital
 - Never forced seller of investments/underlying assets in difficult times
 - Never forced buyer of investments/underlying assets in bullish times
- Not beholden to short-term performance: As underlying assets cannot be withdrawn, the manager is more incentivised to deliver long term sustainable performance
- Provide consistent flow of fully franked dividends
- Lower MERs (management expense ratios) compared to managed funds
- Provide additional opportunities – LICs can trade at a premium/discount to underlying assets
- Publicly trades on an exchange (e.g. ASX) which provides intra-day liquidity for buyers and sellers
- Public companies provide more stringent corporate governance and accountability of Directors

* UK Study Source: Collins Stewart Pty Ltd

WAM Active Limited vs ASX Listed Investment Company Index



Indicies rebased for comparison. Source: IRESS.

WAM Active Investment Objectives & Process

The investment objectives of WAM Active are as follows:

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

To achieve these objectives, the Manager 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 include:

- Participating in initial public offerings, placements, rights issues and underwritings, where the immediate valuation upside appears favourable;
- Participating in block trades which are below market values;
- Participating in 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 discount arbitrages;
- Trading market trends and themes; 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 addition, the Manager undertakes regular research, meetings and discussions with various companies listed on the Australian Securities Exchange to identify opportunities. In the last year, the Manager conducted over 750 company visits.

WAM Active Limited Equity Exposure

% invested



Performance

The first four years of the Fund's performance has been pleasing. The Funds portfolio has outperformed the S&P/ASX All Ordinaries Accumulation Index by 17.9% p.a since inception.

In evaluating the Funds Performance, we look at three key measures. The first performance measure is used to show how the Investment Manager has performed and is compared to the relevant Index. These measures are both before all costs and taxes. WAM Active's gross portfolio increased 0.3% for the half year 31 December 2011, while the S&P/ASX All Ordinaries Accumulation Index fell by 9.6 %.

The second measure of performance is the movement in underlying assets (NTA) after taxes, management fees and all other costs. This performance shows the change in the value of the assets which belong to the shareholders over the period. Corporate tax, being 30%, is the most significant item of difference between the gross and the net performance. The franking credits attached to this tax paid are available to be distributed to shareholders through fully franked dividends. WAM Active's after tax NTA, adjusted for dividends, decreased 0.3% for the 6 months to 31 December 2011. This was after the payment of 0.15 cents a share in corporate tax.

The third measure of performance is the share price return. The share price adjusted for dividends rose 2.5% for the six months to 31 December 2011. This outperformed the broader

market driven by the closure of the discount to NTA of the share price.

The above mentioned performance figures are pleasing given the Fund's focus on risk adjusted returns to investors. These returns were achieved by holding an average of 54% cash for the period.

For the last six months there was a plethora of merger arbitrage opportunities. The Funds performance was assisted by positions in Coal & Allied Industries (CNA), Hunnu Coal (HUN), Isofit Group (ISF) and Souls Private Equity (SOE). All four of these positions were purchased after the initial takeover was announced. The annualised return on these positions were higher than what the Fund receives on its cash in term deposits, which is currently just below 6%.

The best performing stock for the period was listed investment company, Signature Capital (SGI), which benefited from an off market buyback at 98% of NTA. The position in Contango Capital Partners (CCQ) also added to performance with Contango Microcap (CTN) announcing an on market takeover bid at \$0.90 for the balance of the stock they did not own.

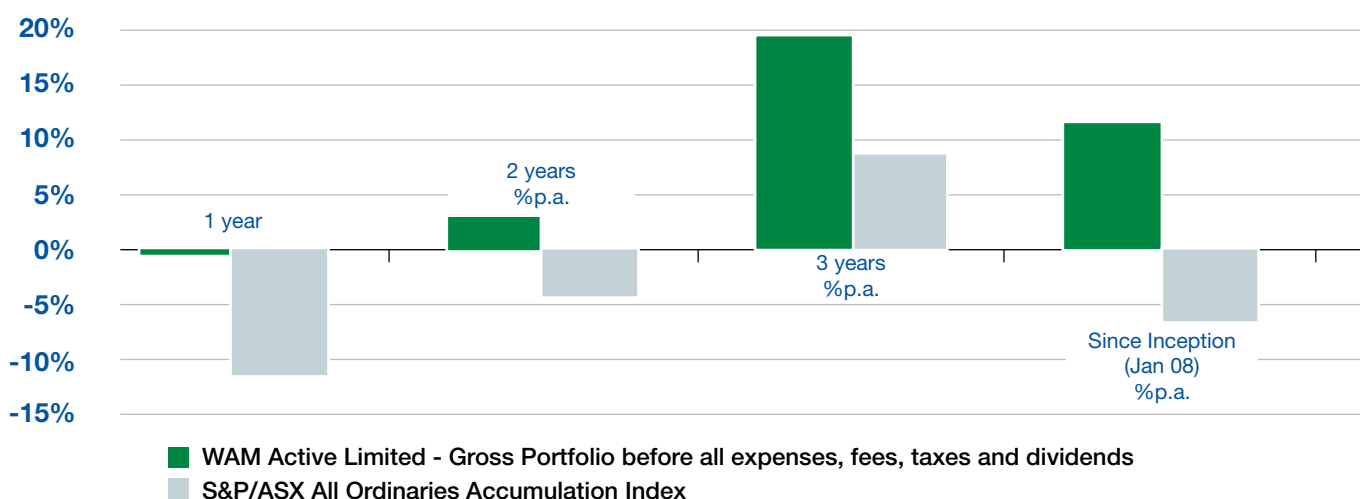
The largest detractor was Symex Limited (SYM), which announced a

profit downgrade late in the half with the outlook deteriorating significantly for its suite of consumer related products.

The Fund has also benefited positively from short selling opportunities, namely Billabong (BBG) which downgraded earnings and saw its share price fall 44%. Short selling positions in APN Media (APN), Monadelphous (MND) and Matrix Composites (MCE) also added to performance.

Looking ahead into the new calendar year 2012, we are cautiously optimistic that this will be a better year for equity markets than last. We are seeing significant value appearing similar to 2008/09 with stocks trading below cash backing and Net Tangible Assets (NTA). Examples the Fund currently owns that fit into this category are Sunland Group (SDG) (60% discount to NTA), Noni B (NBL) and Clarius Group (CND). We expect WAM Active will continue to benefit from a heightened level of corporate activity with Australian corporate balance sheets in sound positions. This Merger & Acquisition activity was a key driver of the Fund's performance for the six months and we expect this to continue. We remain well positioned to take advantage of opportunities as they arise in 2012.

Annualised Performance as at 31 December 2011



Interim Dividend

A fully franked interim dividend of 4.5 cents per share has been declared by the Board and will be paid on 24 April 2012. The shares will trade ex dividend on 11 April 2012. This is a 12.5% increase on the prior year's interim dividend.

“12.5% increase in the interim fully franked dividend to 4.5 cents per share represents an annualised fully franked dividend yield of 8.7% based on the 16 February closing price.”

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. It must also comply with Government legislation and the ATO's interpretation of a company's ability to pay franked dividends. Dividends are paid on a six-monthly basis.

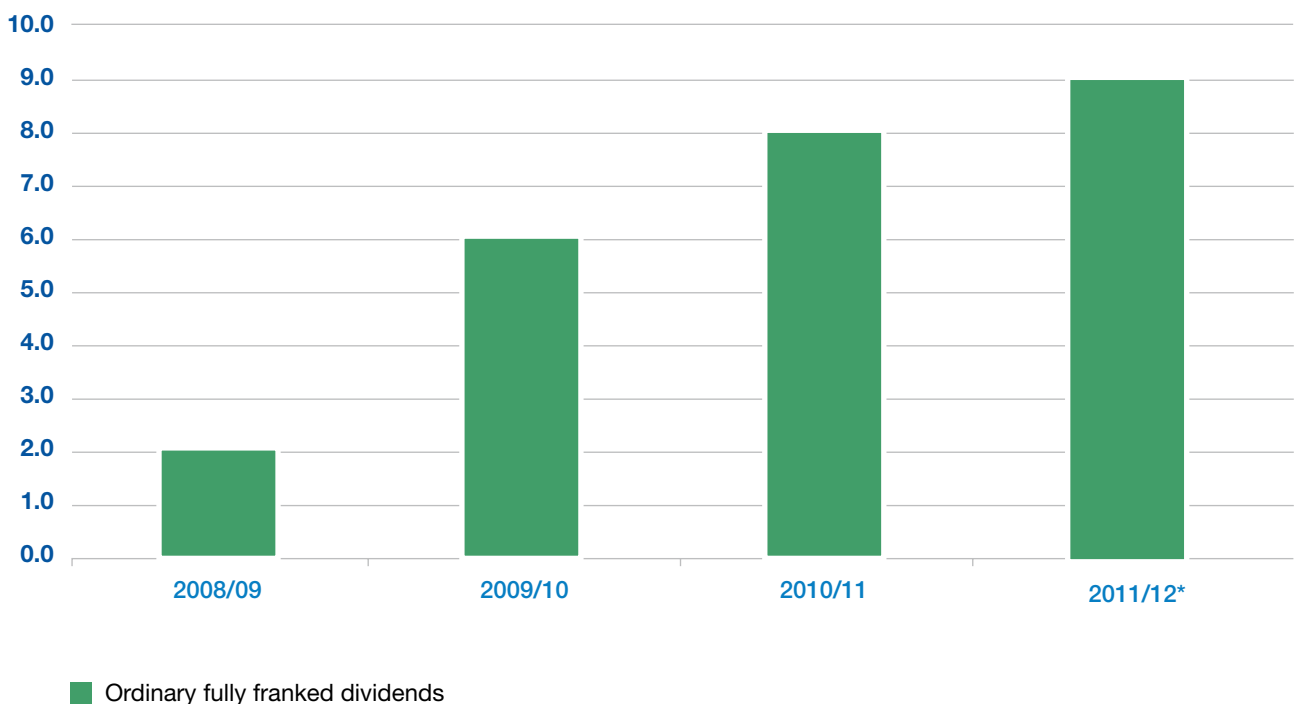
Government legislation introduced in June 2010 now enables companies to pay dividends if the company is deemed solvent. Dividend payments will be made with consideration to cash flow, cash holdings, available franking credits and ability to pay franked dividends. Essentially, WAM

Active will always be in a position to pay dividends providing it is solvent.

The dividend reinvestment plan will operate for the interim dividend at a 2.5% discount.



Cents per share



* Annualised interim dividend

A closer look at our holdings

Coal and Allied Industries Limited (ASX code: CNA) (Market Driven)



During the half, for a brief period, Coal and Allied became the largest position within the Fund and at the end of November, 11.5% of the Fund was invested in the Company.

The trade in Coal and Allied is an example of a takeover arbitrage, a strategy that has been utilised extensively during the last period.

Coal and Allied is a mining company involved in coal mining, and the preparation, marketing and supply of coal to domestic and export markets. Coal and Allied mines are located within the Hunter Valley region of New South Wales.

In early August, the company announced that it had received an indicative, non-binding and incomplete proposal from its two largest shareholders: Rio Tinto - which held 75.7% of the shares on issue and Mitsubishi Development - who held 10.2%. The proposal valued Coal and Allied at \$10.6 billion, or \$122 per share. After this announcement, the Fund purchased a small amount of shares investing 0.5% of the Fund in the company. Initially, only a small amount was invested because there was still the risk that the proposal would not lead to a formal offer.

In late August, after negotiations between the company and the bidding consortium, a formal scheme implementation agreement



was announced. This document contained all the details and conditions for the transaction. There was also an increase in the price to \$125 per share, which included an \$8 fully franked dividend component. After assessing the conditions of the scheme of arrangement, we concluded there was low probability of the takeover not going ahead. We commenced buying stock at an annualised return of 7% and increased our position by 1%.

Over the next few weeks, we spent a lot of time re-reading all the conditions, talking to brokers, company advisers and mergers and acquisition lawyers to de-risk

the deal as much as we could. Eventually, we took the view that it was extremely unlikely that the transaction would not proceed and so we invested our position further. The rationale was the stock was providing an annualised return, higher than what is earned on cash in the bank and we were receiving an \$8 fully franked dividend.

In late November, shareholders voted overwhelmingly in favour of the transaction and shareholders were paid the proceeds in mid-December.

Noni B Limited (ASX code: NBL) (Market Driven)

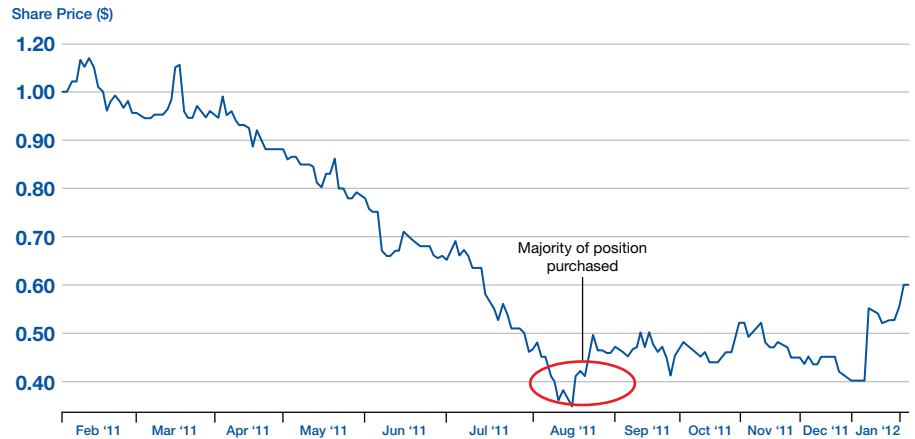
N O N I B

Noni B Limited is a women's fashion retailer of apparel and accessories. The company has 217 stores across Australia and has two labels: Noni B and Liz Jordan.

The brands offer stylish, contemporary clothes and are targeted at the mid to lower end of the market.

Over the past 12 months, the company has been caught up in the soft conditions which have plagued the Australian retail industry. The general malaise in the retail environment has seen investors shun retail stocks. Downgrades by JB Hi-Fi, Billabong and Kathmandu, in the latter half of the year, have shown just how tough the current market is.

In early August, one of our brokers advised that there was a large line of NBL stock for sale, which was the catalyst for further research. The stock price had fallen from \$5.20 in February 2007 to a low of 30.5 cents in early August 2011. The large fall in price saw the company trade below its Net Tangible Asset backing (NTA) of 42 cents. The company's market capitalisation was \$10 million dollars and it had \$5 million net cash on the balance sheet. The strong balance sheet and discount to NTA meant that effectively one was getting any upside in the business for free. After a few days of research, we decided to purchase the large line of shares for sale at 34 cents. This cleared the large seller and the stock quickly rallied back to over 40 cents.



In the ensuing months, we met with the company on two occasions. The company confirmed our belief that retail conditions were challenging, however, with \$5.1 million net cash on the balance sheet, the company was well positioned.

On 12 January 2012 the company provided a market update which stated after tax profits for the first half of the year would be \$2.1-\$2.4 million, compared to \$1.5 million in the first half of FY2011. This was significantly higher than our estimates and the market's expectations. Post the market update, NBL re-rated strongly, rallying 37.5% on the day of the announcement. Historically the company's first half result exceeded the second half, but even taking this

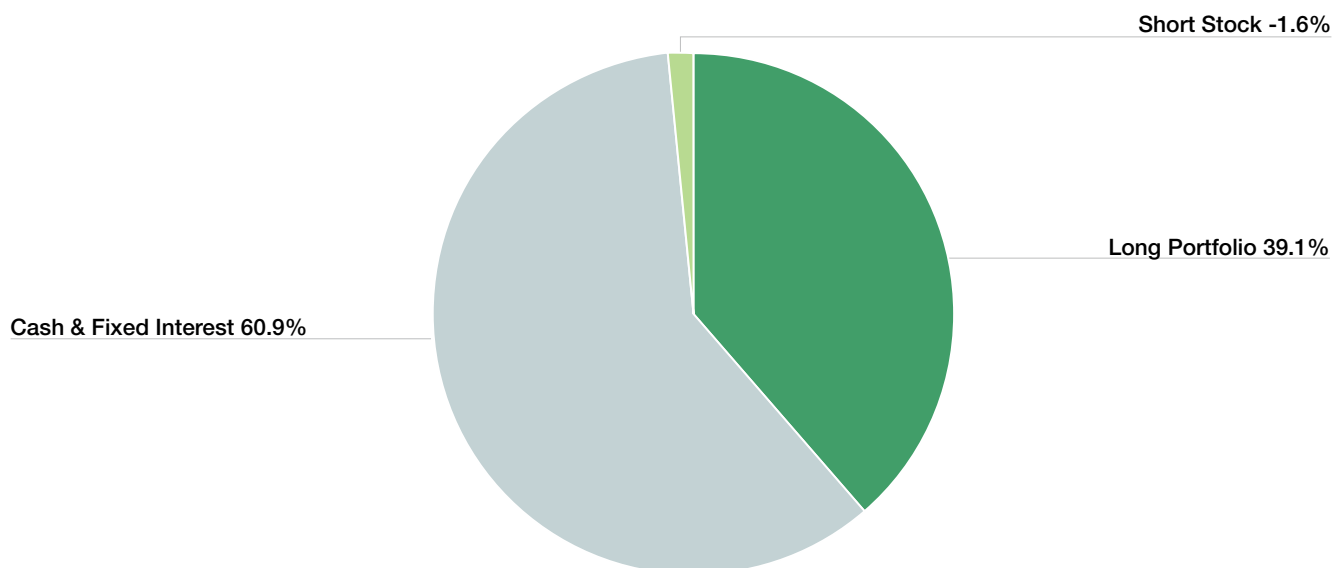
into account, the stock was trading on an attractive valuation of 10.3x P/E in FY2012 and 4.8x in FY2013.

Looking ahead, further RBA interest rate cuts should support earnings growth in the calendar year 2012. The company has large operating leverage, meaning that further incremental revenue increases will lead to substantial profit growth.

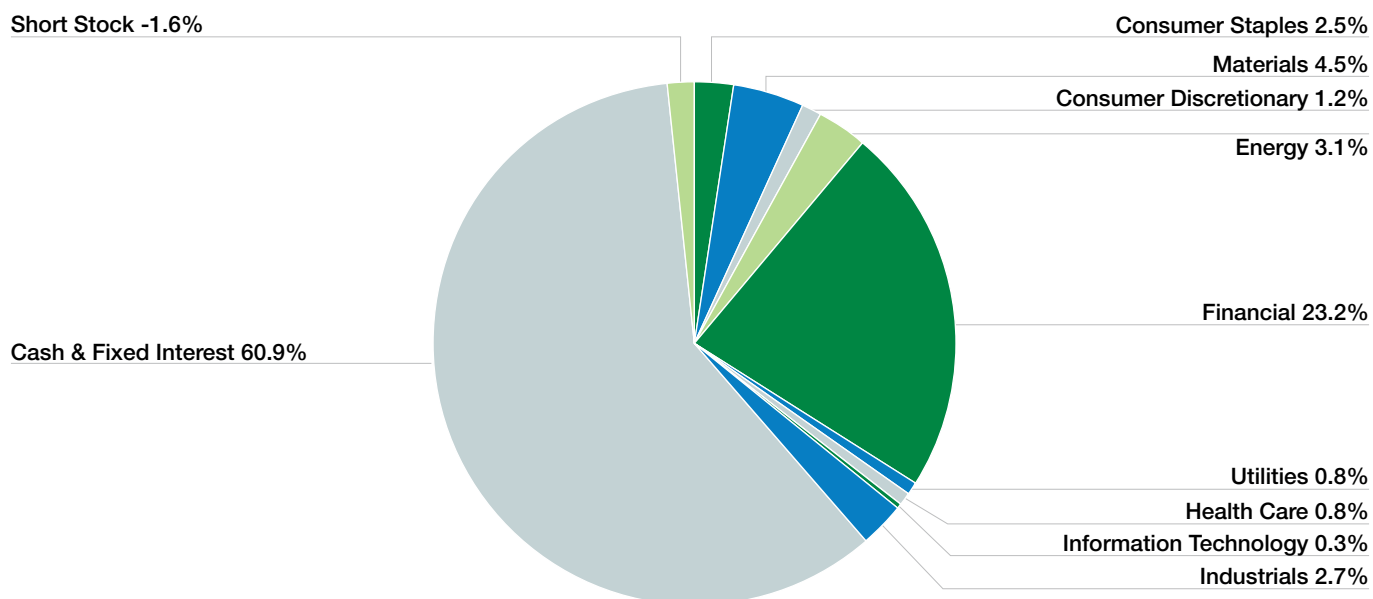
We continue to hold the position, and look forward to meeting management after the release of the first half result in February.

Portfolio Summary as at 31 December 2011

Asset Allocation



Sector Allocation



Stocks by Market Capitalisation

Category	Weighting
WAM Active Limited	
ASX (Top 50)	5.0%
Mid Cap (ASX 50-100)	0.0%
Small Cap (ASX 100-300)	3.9%
Ex-Index (Micro Cap)	30.2%
Total ASX Listed Equity	39.1%
Cash & Fixed Interest	60.9%
Total Gross Assets	100.0%

Top 20 Holdings as at 31 December 2011

ASX Code	Company Name	Sector	Market Value \$m	% of Gross Asset
SGI	Signature Capital Investments Limited*	Financials	1.4	8.3%
CCQ	Contango Capital Partners Limited	Financials	0.5	3.0%
MSF	MSF Sugar Limited (The)	Consumer Staples	0.4	2.5%
BSL	Bluescope Steel Limited	Materials	0.4	2.2%
WBC	Westpac Banking Corporation	Financials	0.3	2.0%
NAB	National Australia Bank Limited	Financials	0.3	2.0%
SDG	Sunland Group Limited	Financials	0.3	1.9%
NHC	New Hope Corporation Limited	Energy	0.3	1.9%
RHG	RHG Limited	Financials	0.3	1.7%
CYG	Coventry Group Limited	Industrials	0.2	1.2%
MIO	Miclyn Express Offshore Limited	Energy	0.2	1.1%
BHP	BHP Billiton Limited	Materials	0.2	1.0%
HHY	Hastings High Yield Fund	Financials	0.2	1.0%
FMS	Flinders Mines Limited	Materials	0.2	1.0%
IMFG	IMF (Australia) Ltd 10.25% Sec Red Conv Note	Financials	0.1	0.9%
EPX	Ethane Pipeline Income Fund	Utilities	0.1	0.8%
FRI	Finbar Group Limited	Financials	0.1	0.8%
CLO	Clough Limited	Industrials	0.1	0.7%
TGP	Trafalgar Corporate Group	Financials	0.1	0.7%
PGA	Photon Group Limited	Consumer Discretionary	0.1	0.6%

*We participated in the SGI buy-back with the proceeds received on 31 January 2012.

Best Performing Stocks Half Year to 31 December 2011

ASX Code	Company Name	Sector	Unrealised / Realised Gains
SGI	Signature Capital Investments Limited	Financials	\$357,523
CCQ	Contango Capital Partners Limited	Financials	\$100,049
MSF	MSF Sugar Limited (The)	Consumer Staples	\$58,146
ISF	Isoft Group Limited	Health Care	\$53,634
CNA	Coal & Allied Industries Limited	Energy	\$49,108

Worst Performing Stocks Half Year to 31 December 2011

ASX Code	Company Name	Sector	Unrealised / Realised Losses
SYM	Symex Holdings Limited	Materials	(\$161,107)
AUN	Austar United Communications Limited	Consumer Discretionary	(\$144,313)
TEN	Ten Network Holdings Limited	Consumer Discretionary	(\$68,644)
SDG	Sunland Group Limited	Financials	(\$66,293)
RVA	Reva Medical Inc	Health Care	(\$55,926)

Current Issues

We regularly get asked questions from shareholders relating to a number of macro economic factors. Here we aim to cover the most topical.

“*The Australian economy has slowed in the last six months which, in our view, will see more interest rate cuts.*”

Interest rates: At the time of writing, the cash rate remains at 4.25%. The Reserve Bank of Australia (RBA) commenced its loosening cycle in November with a reduction of 0.25% and followed this up in December with another 0.25% cut. The bond market is anticipating a 1% further reduction in interest rates in 2012. We view this as optimistic. The Australian economy has slowed in the last six months which, in our view, will see more interest rate cuts, however not at the pace the bond market is predicting. However, if we see further downside in Europe, this could trigger the RBA into further rate cuts than anticipated. The question will be: will these be passed on in full by the major banks? Given the recent rise in funding costs, we expect that any further rate cuts will not be passed on to mortgage holders in full as banks look to try and retain margins. This has been seen recently with all four Australian major banks lifting the standard variable mortgage rate higher independent of the RBA.

House prices: Recent data has seen continued weakness in Australian house prices, down 1% for the December quarter. The softer macroeconomic environment and the deleveraging of consumers have put downward pressure on prices. We anticipate house prices will remain relatively flat over the coming 12 months. Lower interest rates may encourage first home buyers to re-enter the market, which could provide a stimulant to the affordable end of the market. Affordability remains the key. Wages growth is anaemic, the savings rate continues to rise and unemployment is increasing. These factors in our view could see house prices remain flat in 2012. We don't see Australian house prices 'crashing', as some overseas experts predict. The shortage of new housing stock and net migration will see prices rise longer term.

Corporate activity: Australian corporates remain well-capitalised. Gearing levels are low and many companies have excess cash to deploy in assets, enhancing returns on their equity. We expect, given most industrial companies' earnings growth is currently sluggish, that some will seek acquisitions to drive earnings growth. One example is Super Retail Group's recent acquisition of Rebel Sport. The higher Australian dollar may encourage Australian companies to venture overseas for value accretive opportunities.

Australian economy: Productivity remains extremely weak and continues to decline, which is a concern for the economy longer term. The two-speed nature of the Australian economy continues, with the east coast of Australia experiencing recession-like conditions while the mining boom, particularly in Western Australia, gathers momentum. Inflation has declined to 2.5%p.a which remains in line with the Reserve Bank's target of 2-3%. Unemployment has increased recently to 5.2%. Large job losses have commenced, especially in the banking sector, which will see this figure rise in the coming months. We expect further interest rate cuts will stimulate the industrial sector in the coming months, while Chinese growth, albeit at a slower rate, will continue to support higher than average commodity prices.

Market Outlook

In the first 6 months of this financial year, the Australian share market posted a decline of 9.6% as measured by the S&P/ASX All Ordinaries Accumulation Index. Equity markets worldwide were dragged down, primarily by the European sovereign debt crisis and the inability of European governments and the ECB to coordinate a credible and robust response.

The European sovereign debt crisis appears, on the face of it at least, to be slowly reaching some form of conclusion. The ECB's near 500bn Euro lending programme to commercial banks just before Christmas seems to be having the desired effect, with yields falling considerably in the January 2012 debt auctions. Continued real progress on the debt crisis and further falls in yields, will remove a strong headwind which has been buffeting equity investors for the last few months. Any resolution in Europe could be a positive for equity markets in the coming months. However, at this stage this is far from certain.

In the US, there has been a steady increase in positive economic data points. We have seen unemployment drop from 9.0% to 8.3% whilst housing, GDP and manufacturing data have also all shown modest improvements. This suggests a nascent recovery may be underway in the world's largest economy. A US recovery will have positive effects into the broader world economy, offsetting the drag from the Euro zone. US companies balance sheets are in good shape, with high levels of cash, which has the potential to be put to use through corporate activity and expansion of products and hiring. The US economy is certainly one to watch carefully in the coming months, especially for

Australian companies exposed to the US market, such as James Hardie, Breville and Billabong.

With regards to Australia, the RBA has responded to the slowing down in the domestic economy by cutting interest rates by 0.50% in the period. Looking ahead, we expect further rate cuts in 2012 from the RBA. This will reduce funding costs for companies and could provide a springboard for increased levels of corporate activity in the coming year. It will also reduce the term deposit rates offered by banks, and this may turn investors' attention to higher yielding assets, such as shares and provide a boost to equity markets generally.

Equity analysts and market strategists have moved to a more conservative stance in recent months with regard to earnings and the outlook for the Australian economy. The consensus earnings estimates for Australian industrial companies for FY2012 are now 6%

compared to 14% a few months ago. This indicates that analysts have adjusted their earnings expectations downwards. In the current interim reporting period, we expect to see more earnings surprises to the downside rather than the upside. These results, we believe, will see analysts adjust downwards FY2013 earnings expectations for industrial companies.

There is still a reasonable amount of uncertainty about how Australian consumers will respond to the rate cuts and whether this nascent recovery in US economic activity can be sustained and improved upon. China, for now, appears to be ticking along at a more moderate pace, but strong enough to keep the mining boom intact in the medium term. Europe though, continues to remain a key issue. With this backdrop, we are cautiously optimistic that 2012 will be a better year for equity markets.





WILSON
ASSET MANAGEMENT

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 and one unlisted fund, with funds under management of approximately \$320 million.

In August 1999, the first of the three listed investment companies WAM Capital Limited (WAM), was established and has grown from \$22 million to approximately \$168 million today. WAM predominantly invests in growth companies with a focus on small to medium sized companies listed on the ASX.

The second listed investment company, WAM Research Limited (WAX), was established in August 2003. Funds under management are currently \$97 million. Previously known as Wilson Investment Fund, WAX predominantly invests in growth companies with a focus on small to medium sized industrial companies listed on the ASX.

WAM Active Limited (WAA) is the most recent addition to the Group which was listed in January 2008. Funds under management are currently \$17 million. WAA is an opportunistic investor with high turnover and a focus on absolute returns.

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