



**WE HAVE A
NEW WEBSITE**

Tell us what you think for
your chance to WIN a
lunch with Geoff!

See page 19

In this issue

- 02 A message from the Board
- 03 Performance
- 04 Dividends
- 05 Market wrap
- 06 Investment Objectives & Process
- 07 What is a Listed Investment Company?
- 07 What Wilson Asset Management offer to shareholders
- 08 Stock-Markets: Thinking generally... and particularly about 2011
- 14 A closer look at two of our stocks
- 16 Portfolio Summary as at 31 December 2010
- 18 Director Profile – John Abernethy
- 19 New-look website

Dear shareholder

Welcome to our latest investor newsletter.

Recently I watched the movie 'Inside Job'. It was a sobering and accurate account of the Global Financial Crisis (GFC), what happened and why. It showed a financial system out of control and questioned whether anything had changed as a result of the lessons learnt from the GFC. As a fund manager, a quote I found interesting was "It's very easy to generate performance by taking on more risk. And so what you need to do is compensate for risk adjusted performance. And that's where all the bodies are buried". At WAM Research we are acutely aware of risk. We manage a highly diversified portfolio with a default position of holding cash when we can't find acceptable investments. We believe our portfolio is well structured to provide sound risk adjusted returns to shareholders. My final comment on the film is let's hope the regulators have learnt from the mistakes of the past. We have.

On a more sober note, we would like to pass on our deepest, heartfelt wishes to the people affected by the recent floods, bushfires and cyclones in Australia and the earthquakes in New Zealand.

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

Regards

**Geoff Wilson, Chairman
WAM Research Limited**

A message from the Board of WAM Research

Over the past year the Board has been engaged in a comprehensive review of the Fund to determine the best way to maximise value for shareholders. The outcome of this process is that the Manager will more actively manage the portfolio and the Board reaffirmed its commitment to providing a growing stream of fully franked dividends to shareholders.

“The Board is confident the refinement in strategy will deliver satisfactory risk adjusted returns to shareholders.”

Since floating on the ASX in August 2003, the investment philosophy has been to buy and hold shares for the medium to long term. The Board believes a more active strategy will maximise risk adjusted returns to shareholders.

The refined strategy will primarily utilise the Managers Research Driven approach, with a mandate to sell once an investee company does not rate. This refined strategy will only sparingly include the Investment Driven process which is a buy and hold strategy. The Research Driven process requires extensive research with each potential investment rated with respect to:

- a) Management;
- b) Projected earnings per share growth;
- c) Valuation – utilising a price for growth formula; and
- d) The industry and the investee’s position in that industry.

The above rating system works as a filter, identifying the most appropriate investments. Before undertaking a Research Driven investment, the Manager will identify a catalyst or event that it believes will lead to an increase in the market value of the investment. When the investee company does not rate, it is sold. This is a more active approach than previously adopted by the Manager.

Key features of this approach going forward are:

- Stocks will be sold if fundamentals change, valuation is reached or outlook for the equity market deteriorates;

- Fully franked dividends to shareholders remain a key focus;
- Higher turnover of stocks in the portfolio. No longer purely a buy and hold Fund;
- The investable universe will be stocks listed on the Australian Stock Exchange with the Fund predominately investing in small-mid cap industrials. No sector or market capitalisation restrictions; and
- No restrictions on cash holdings.

In the new financial year we have moved to restructure the portfolio to reflect the refined strategy.

The refined strategy will not change the Board’s dividend policy. 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. The ability to pay fully franked dividends every six months has recently been made more obtainable by the Federal Government’s decision to amend the Corporations Act regarding the payment of dividends. A company can now pay a dividend if the Directors believe the company is solvent according to the respective tests put in place.

The Board is confident the refined strategy will deliver satisfactory risk adjusted returns to shareholders.

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 and Julian Gosse.

Performance

The WAM Research portfolio experienced major changes during the six months to 31 December 2010.

For the period, \$73.5 million worth of shares were sold and \$64.9 million worth of shares were bought. This was a dramatic increase on previous periods and the direct result of a refinement in the investment strategy which provides the manager with greater flexibility to sell a company when it reaches a pre determined valuation or if the fundamentals change. At 31 December 2010, 79.2 per cent of the fund was invested in listed equities, 1.3 per cent was invested in hybrid equities and 19.5 per cent was held in fixed interest and cash. Of the listed equities component, 16.4 per cent is held in long term Investment Driven Stocks while the remainder are Research Driven investments that have the ability to be sold once the valuations are reached.

During the six months to 31 December 2010, the fund posted a return of 14.1 per cent before all expenses, fees and taxes, compared to an 8.4 per cent return by the S&P/ASX 300 Industrials Accumulation Index. The performance was pleasing given the turnover in the fund required to reposition the portfolio. The repositioning is largely complete.

The best performing stock for the six months was salary packaging and car leasing business, McMillan Shakespeare Limited (MMS). MMS has been a long

term holding for the fund, but was the victim of the Henry Tax Review which recommended the scrapping of Fringe Benefits Tax. If implemented this would have been a major blow to the company, however, the Federal Government ruled out implementing this recommendation, resulting in a re-rating of the stock. The company's acquisition of Interleasing Australia was received positively and drove share price performance. During the six month period in question, MMS's share price rose 80 per cent. We took the opportunity to sell approximately one third of our holding as the valuation changed and the company became too large a percentage of the overall portfolio.

Other stocks that made significant, positive contributions to the portfolio were debt collection business, Credit Corp Group Limited (CCP) and four wheel drive accessories manufacturer, ARB Corporation (ARP). Both of these companies have been long term holdings in the fund. The fund's performance was also boosted by the takeover of retirement village operator Aevum Group (AVE) by industry giant Stockland (SGP).

For the most part, the best contributions for the period came from small to medium industrial stocks.

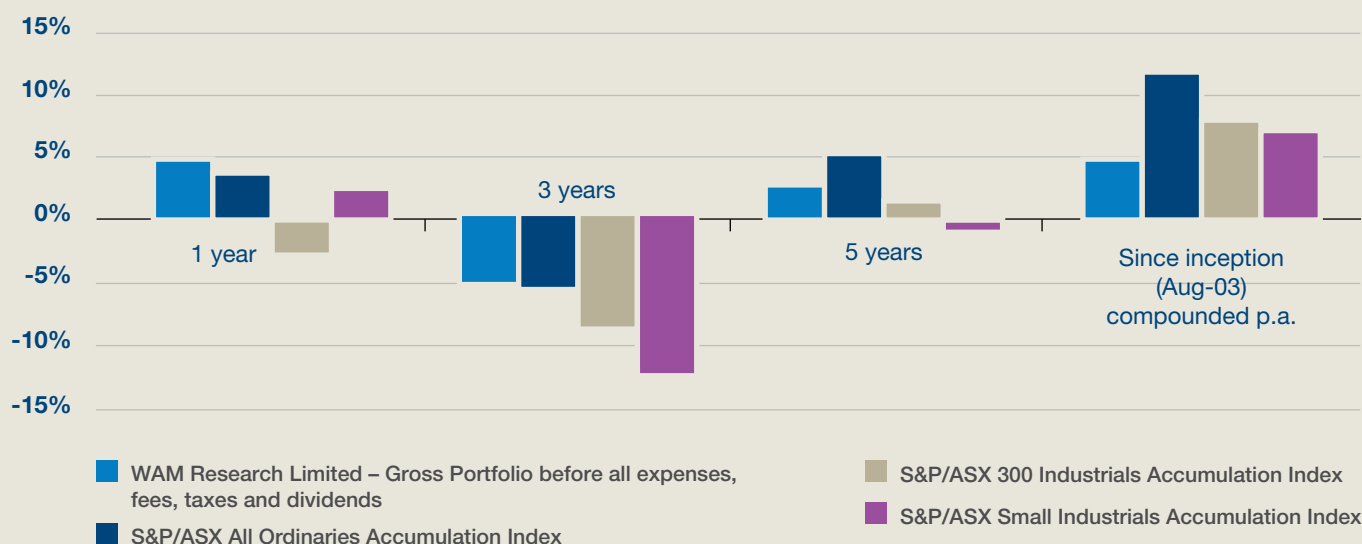
In addition to the above mentioned, this list of positive contributors included STW Communications Group Limited (SGN), Thorn Group Limited (TGA), SAI Group Limited (SAI) and Orotan Group Limited (ORL). We would expect that the portfolio will be dominated by these size stocks in the future as we search for small to medium industrial stocks that have good earnings prospects and are reasonably priced.

The worst performing stock in the fund for the six month period was marketing outfit Photon Group (PGA). Photon suffered from a major recapitalisation of its balance sheet following an acquisition spree that resulted in excessive debt. PGA's shares fell 91 per cent in the six month period due to the recapitalisation. We no longer hold Photon shares.

Other poor performers included Wilmott Forests Limited (WFL) which went into administration, and discount retailer, The Reject Shop Limited (TRS) which suffered from an earnings downgrade in December. We no longer hold these stocks.

In total, 61 investments contributed positively to the half yearly performance while 17 investments impacted negatively.

Annualised performance as at 31 December 2010



Dividends

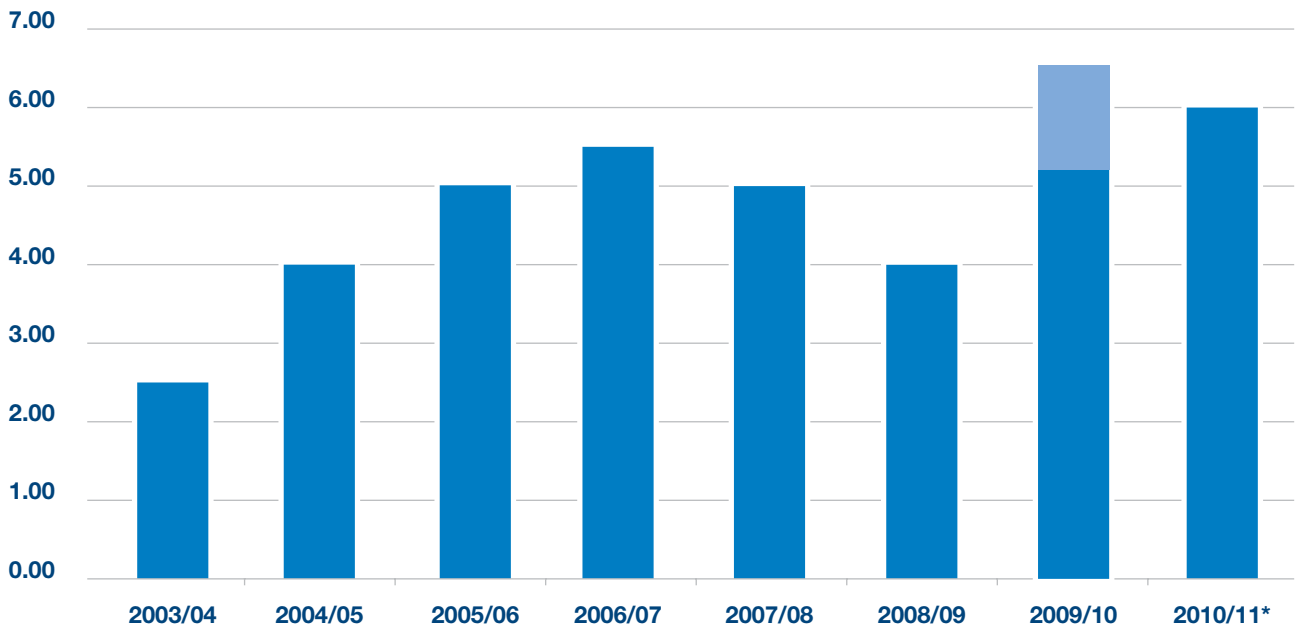
On 10 January 2011, the Board announced a 15% increase in the interim fully franked dividend to 3.0 cents per share to be paid on 28 March 2011.

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



Cents per share



■ Ordinary fully franked dividends
 ■ Special fully franked dividends

*annualised interim dividend

Market wrap

The consensus among Australia's top share market strategists is the S&P/ASX All Ordinaries Index will rise approximately 14 per cent in 2011.

This number is based upon a survey in the Australian Financial Review on January 4 of the top 10 strategists in the local market. If proven to be correct, this would mean we could expect a total return, including dividends, of close to 18 per cent which is well above the long term average of around 11 per cent. This bullish outlook is a significant improvement on 2010, which saw the S&P/ASX All Ordinaries Index track sideways before closing down for the year by 0.73 per cent. The market's performance in 2010 was characterised by a strong 10 per cent gain by the resources sector, and a 7 per cent decline by the top 200 industrial stocks. The hottest sector for the year was the small resources sector which leapt 30 per cent, mainly in the last four months of the calendar year.

The 2011 bulls argue the year ahead should see solid gains based on reasonable stock valuations, continued strong demand for resources from South East Asia, in particular China, and an acceleration of the economic recovery in the US. All of these arguments are a continuation of the themes that dominated Australian markets from early July in 2010.

We are however much more circumspect. We agree that industrial stocks are reasonably priced at around 13 times forecast 2011 earnings, however, the prospect of higher interest rates through the course of 2011 could put a cap on earnings growth. If this is indeed the case, we will see little upside in share prices for industrial stocks coming from price to earnings multiple expansion. In fact, it is quite possible that multiples may contract if the Reserve Bank of Australia is forced to aggressively raise interest rates due to a tight labour market and a massive expansion from the resources sector. While a sharp hike in rates is unlikely, it cannot be totally discounted. The best result for the industrial market would be for official interest rates to be on hold for the course of 2011.

Other recent events that will impact economic growth in 2011 are the wide spread flooding and cyclonic activity. While the full effect of these natural disasters are yet to be known, estimates predict a loss greater than 0.5 per cent of GDP.

We also believe that China, the engine for above average world growth during 2010, may not provide such a buoy for the local economy in 2011. In recent months, the Chinese Government has been forced to lift interest rates and restrict lending practices to try and cool the economy. These measures have failed to have an immediate impact and inflationary pressures have emerged. As a result, China will be forced to keep raising interest rates, which should eventually ease inflationary pressures and ratchet down economic growth from over 10 per cent to possibly as low as 7 per cent. In turn, the much loved Australian resources sector, may find it difficult to repeat it's stellar performance of last year. If this scenario plays out, the Australian dollar may also retrace some of its substantial gains of 2010. This is not to say the China economic miracle is over, but it may need to have a health check in 2011.

The prospect of the US economy continuing to recover in 2011 is more likely. Share market bulls are likely to be frustrated by the pace of the recovery given the moribund housing market. However, low interest rates should support economic growth of around 3 to 3.5 per cent for 2011. This may not lower unemployment dramatically, but it will be supportive of company earnings and equity prices. Leverage to this recovery can be found in Australian listed companies that have major operations in the US.

“ We believe the drivers of the market will change during the course of the year with the resources sector easing back, especially at the red hot small end of the market, while industrials, especially those with exposure to the US economy could perform strongly. ”

All of these factors should see equities struggle to move significantly higher in 2011. We believe the drivers of the market will change during the course of the year with the resources sector easing back, especially at the red hot small end of the market, while industrials, especially those with exposure to the US economy could perform strongly. We have moved to position our portfolio to take advantage of this view.

Investment Objectives & Process

The investment objectives are to provide a growing stream of fully franked dividends and to achieve a high real rate of return, comprising both income and capital growth within risk parameters acceptable to the Directors.

Our investment process focuses on:

a) Research Driven investing:

We undertake extensive research (over 700 company meetings each year), focusing on free cash flow then rating the company with respect to management, earnings growth potential, valuation and industry position. We only buy when we can identify a catalyst or an event that will change the valuation the market gives to the company.

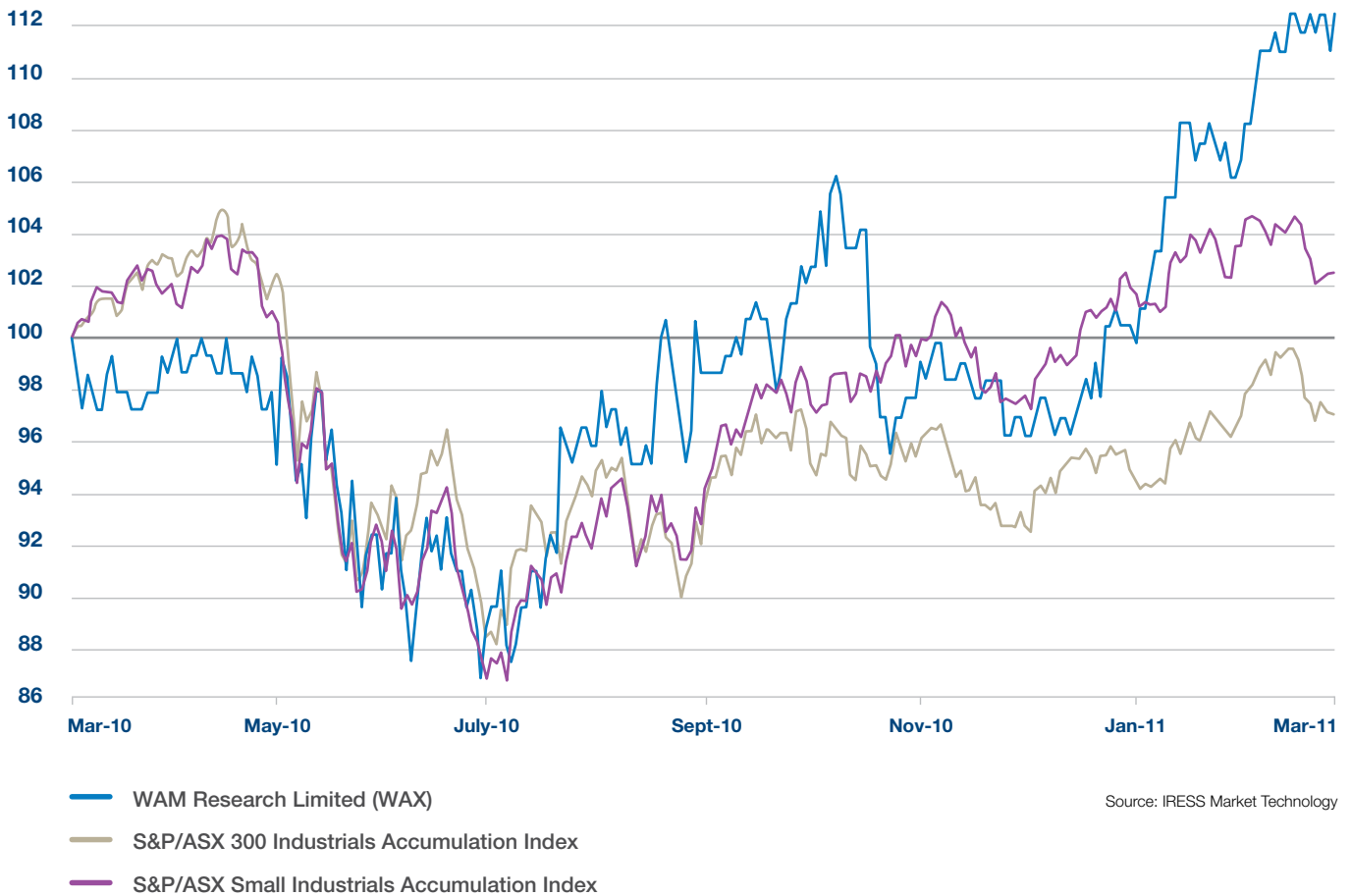
b) Investment Driven investing:

The investee company has a sustainable business model, a track record of profit making and dividends, generates positive free cashflow, acceptable financial strength and generates a sound return on equity.

This investment process is a buy and hold strategy.

In the portfolio, we do not favour investing in mining companies due to the high risk nature of mining businesses and the volatility of revenues.

WAM Research Share Price vs Index



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 research driven approach that involves staying very close to the market and an in depth analysis of investee companies
- An investment vehicle that delivers fully franked dividends.

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

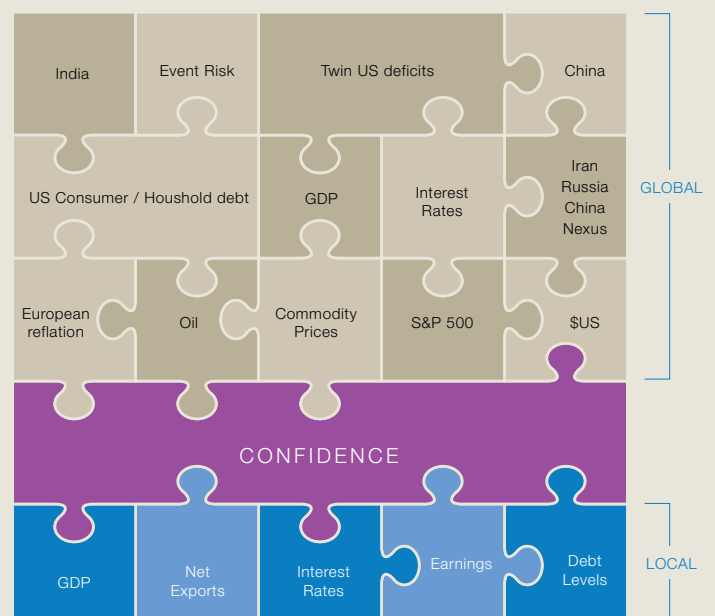
KEEPING IT AS SIMPLE AS IS SENSIBLY POSSIBLE (our version of 'kiss')

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.

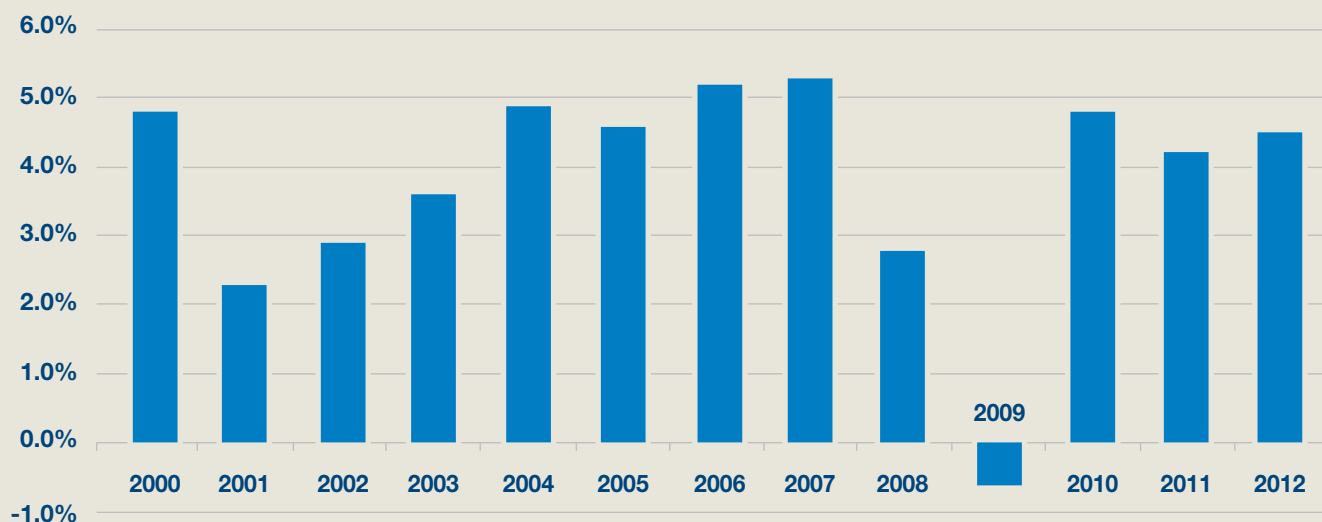
A WORD ON FORECASTS

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.

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A closer look at two of our stocks

Reckon

Reckon Limited (RKN) is involved in software sales and support predominately to small and medium enterprises in Australasia, UK, USA and Asia.



Reckon's business is split into three business units:

1) Business division: via its licensing partner from the USA Intuit, Reckon provides accounting, personal finance and wealth management software. Commonly known brands include Quicken or the Quickbooks accounting range of products, commonly found in retail stores such as Harvey Norman or Officeworks.

2) Professional division: this division is focused on practice management which amongst others provides tax, client accounting and cost management software to businesses. The divisions main business is Advanced Professional Solutions (APS). The divisions other business "Billback" provides cost recovery and practice management to legal firms. This business entered the group in 2009 via the acquisition from previously ASX listed Esperon.

3) NQueue Billback: is a joint venture between Billback USA (67%) (owned by Reckon) and NQueue (33%). Major customers include law firms on the cost recovery side. There is an emerging trend amongst competitors of selling to corporate with a range of new offerings such as education. The joint venture is now the number two player in the US market and is growing at a faster pace than the larger traditional Reckon group.

After a recent company visit to Intuit in the USA, it was evident that the trend of accountants moving online is gathering momentum. Intuit is capitalised at \$15bn and is a market leader in the American accounting space. Reckon's relationship with Intuit is a key advantage compared to its major competitor in Australia MYOB. Intuit incur all research and development costs on behalf of Reckon, approximately \$150m p.a. (half of Reckon's market capitalisation). In return, Reckon pays a revenue based royalty to Intuit, \$8m last year. MYOB has to pay for their own R&D which is a sizeable cost.

We rate company management highly, We visit them regularly to discuss and analyse the business. Clive Raby, CEO, is approaching 10 years with the company and has an intricate knowledge of the business and industry. He is a strong manager who has a successful track record of growth organically and via acquisition. The senior management team supporting Clive are of a very high calibre.

Key drivers for continuing to own the stock, are its strong industry position, experienced management team, strong organic growth and high barriers to entry. The recurring nature of their revenues is an attraction. It is currently running at just under 60% of group revenue. This revenue makes forecasting earnings more predictable.

A key driver for Reckon over the next 12 months will be the companies ability to increase prices in its business division which will lead to higher margins. This will be possible as Reckon's major competitor and market leader, MYOB has increased prices 10-20% over the last 18 months. Another catalyst is the ownership of MYOB (currently private equity).

Credit Corp

Credit Corp Group Limited (CCP) is a domestically focused debt collection business.



Small cap historical charts can sometimes look like rollercoaster rides, Credit Corp is one such example of this. The debt collector has been to the abyss and back with the share price. Peaking at \$12.55 in July 2007, then falling to \$0.39 in January 2009. In the bull market, the stock was a market darling. It was heavily owned by institutions until it had productivity issues hampering the companies performance. This led to profit downgrades late in 2008, resulting in the companies share price to fall off a cliff.

Credit Corp is a domestically focused debt collection business. They specialise in buying bad debts from parties such as the banks, and try to make a return on that investment. Key drivers of their business are unemployment rates (debtors ability to pay back debt) and the ability of management to purchase the right debt ledgers for the right price.

The stock has been a long term holding for the fund. Shares were purchased at an average price of \$3.40 during 2004-2005. This period saw the shares continue their upward momentum peaking in 2007 when issues suddenly arose. Collection efficiency rates declined, catching the investment community offguard.

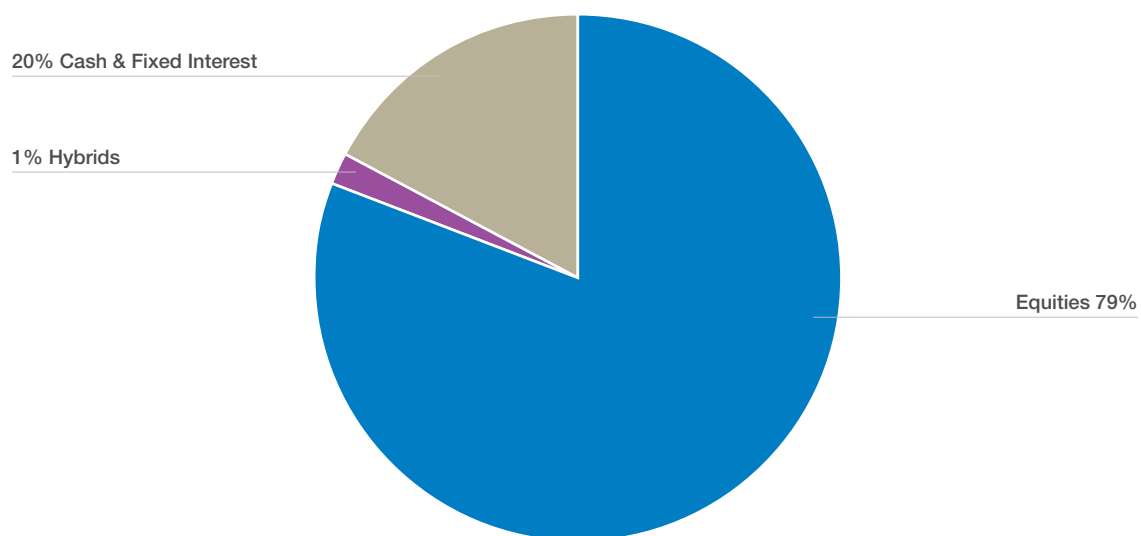
The previous managing director departed and a new managing director Thomas Beregi took charge. At its low point in 2009, Credit Corp had a market capitalisation of \$17m and a debt balance of \$100m. Things looked very dire and most institutions left the share register. It was clear that Credit Corps business model was not as solid as people had previously expected.

We met numerous times with the new management team led by managing director, Thomas Beregi and Chairman Don McLay to assess the company. We gained confidence in the new strategy and learned more about the teams plans and the quality of the companies debt ledgers. This was a very topical point as it had been assumed that the company had purchased poor debt ledgers and paid too much. We spent time analysing and understanding the debt ledgers and the new controls put in place. These more closely monitored collection rates and efficiency. The company was priced to go broke on a P/E ratio of 1.5x. Our view was to keep our position in Credit Corp as we believed the potential upside was far greater than the downside.

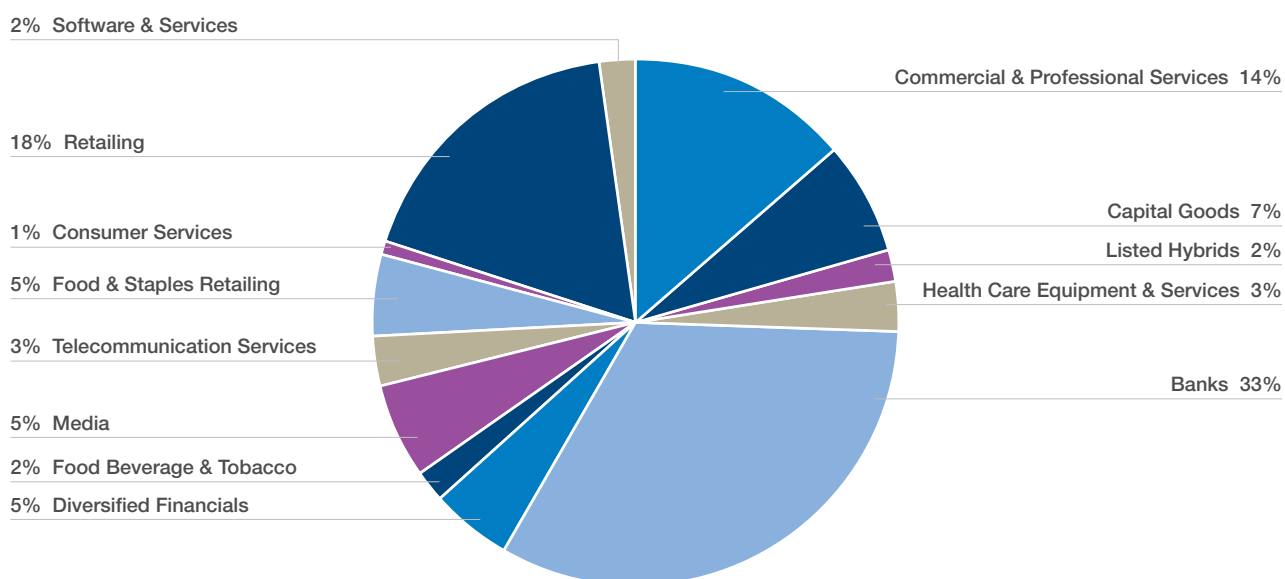
Having met with the management team 10 times in the last 2 years we have been pleasantly surprised with the results delivered. Not only has the company proven that the debt ledgers purchased pre GFC were not overpaid for, they have recovered far more out of them than we had expected. The great positive for us has been Credit Corp's ability to, not only collect on the existing ledgers, but continue to purchase new ledgers whilst generating a high level of free cash flow. This allowed the company to pay down their debt which is currently close to zero. As long as recovery rates stay strong and ledger quality remains, the future looks bright for Credit Corp. We currently value the stock at \$6.00 and see further upside potential to the earnings over the next 6-12 months as they continue to deliver above average returns on newly purchased debt ledgers. Share price catalysts include potential overseas expansion plans and continuing to report record profits.

Portfolio Summary as at 31 December 2010

Portfolio Asset Allocation



Long Portfolio Sector Allocation



Top 10 Stocks as at 31 December 2010

ASX Code	Company Name	Sector	Market Value \$m	% of Gross Portfolio
NAB	National Australia Bank Limited	Banks	5.5	5.2%
MMS	McMillan Shakespeare Ltd	Commercial & Professional Services	5.4	5.1%
WBC	Westpac Banking Corporation	Banks	4.7	4.5%
WBB	Wide Bay Australia Limited	Banks	4.5	4.2%
APE	AP Eagers Limited	Retailing	4.4	4.1%
MTS	Metcash Limited	Food & Staples Retailing	3.9	3.7%
CBA	Commonwealth Bank of Australia	Banks	3.9	3.7%
CCP	Credit Corp Group Limited	Diversified Financials	3.5	3.3%
SGN	STW Communications Group Limited	Media	3.5	3.3%
MYS	MyState Ltd	Banks	3.4	3.2%

Best Performing Stocks for the 6 months to 31 December 2010

ASX Code	Company Name	Sector	Unrealised/ Realised Gains
MMS	McMillan Shakespeare Limited	Commercial & Professional Services	\$3,115,086
CCP	Credit Corp Group Limited	Diversified Financials	\$1,290,778
ARP	ARB Corporation Limited	Retailing	\$1,006,461
AVE	Aveum Limited	Health Care Equipment & Services	\$864,739
BEN	Bendigo and Adelaide Bank Limited	Banks	\$664,916

Worst Performing Stocks for the 6 months to 31 December 2010

ASX Code	Company Name	Sector	Unrealised/ Realised Losses
PGA	Photon Group Limited	Media	(\$1,429,416)
WFL	Wilmott Forests Limited	Materials	(\$875,213)
TRS	The Reject Shop	Retailing	(\$244,702)
VMG	VDM Group Limited	Capital Goods	(\$139,063)
REH	Reece Australia Limited	Capital Goods	(\$72,223)

Director Profile – Introducing John Abernethy

John Abernethy has been a Director of WAM Research Limited since May 2002.



John spent ten years at NRMA Investments as Head of Equities, managing portfolios of approximately \$2 billion. In 1994, he joined Poynton Corporate Limited as an Executive Director before forming Clime Investment Management Limited (formerly known as Loftus Capital Partners) in 1996. John was also appointed Chairman of Clime Capital Limited in July 2009. He has a Bachelor of Law and Commerce from the University of NSW.

Under the microscope:

John's view on what is in store for 2011

The world will grow in 2011. It is likely that the developing world, which is dominated by China, Brazil and India, will grow at a rate of at least 6%. The developed world of the US, Europe and Japan will grow at a more subdued rate of just 2%. Australia is likely to grow at a rate that is faster than the major developed economies of the world.

These observations suggest to us that equity markets are more likely to rise moderately rather than fall in 2011. We do not expect a strong rise in markets because the economic problems confronting the developed world are immense. They range from excessively high levels of sovereign debt, to severely crippled European economies, to unstable banking systems and to a looming unfunded crisis created by an aging developed world population.

As the problems are immense, then so must be the response of governments. Indeed we suggest that there will be one very predictable response by governments around the world – new and higher taxes. Whatever growth there is and from wherever it comes, it will attract tax. The taxation response may not be until 2012, but markets will begin to price in the effects of new taxes at some point in the next 12 months. The effect of new and higher taxes will be to lower the expectation of the market of the potential for profit growth in future years.

Quite simply, the governments of the world will be forced to repair their highly indebted balance sheets in preparation for the forecast dramatic lift in pensions, social security and health payments that will arise throughout the next decade.

Whilst Australia's sovereign debt is low, we are also confronted like the rest of the developed world, with the looming problem of an aging population. The baby boomers, born between 1945 and 1960 are rapidly reaching retirement. Whilst they are the controllers of immense wealth, they will still burden society with increasing claims on healthcare, then retirement and aged care. They are moving from a consumption stage to a savings stage of their lives. The combination of increased taxes (whether in the form of direct tax charges or a lift in utility or services charges) and the dramatic change in consumption patterns, will surely slow economic growth. In Australia, we are also confronted by our excessive household debt. This burden falls most directly upon the generation of 30 to 45 year olds who have borrowed excessively to enter the residential market and they have, or will be required to, adjust their consumption patterns.

Despite the above, Australia is relatively well off compared to our peers for we benefit from our direct trade engagement with China. Further, our propensity to attract, house and to provide for immigrants also supports our population growth. The rest of the developed world is not so fortunate and the depressing impact of offshore economic sentiment will weigh negatively upon our equity market throughout 2011. Hence, our positive view on Australia's equity market is almost offset by our concerned outlook for the European and US economies.

Thus, 2011 could well be a rerun of 2010 and the investment lessons of the first decade on the twenty first century should not be lost on any of us. The last decade saw equities in Australia return to investors about 8% p.a. It is interesting to reflect that approximately 60% of this return has emanated from income or dividends. Thus, less than 40% of the total return is from capital gain. Further, whilst the first seven years of this century produced astronomical gains, they were subsequently decimated by the severe market contraction of 2008. The early economic and market gains were overstated by the burgeoning credit creation in the US, Europe and even Australia through to 2007. Then as debt and credit markets crunched the excess

gains were quickly taken away. The result was that the decade returned to the long term norm for Australia of about 8% annual return. Returns in the US were more sobering and barely matched inflation.

With this recent history so present in living memory, it would be extraordinary in the extreme to expect a resurgent recovery in equity markets, built upon excessive consumption, based upon the reopening of easy credit. It simply is not going to happen, and the demographic pressures plus excessive government debt, will simply cap any excessive market exuberance.

In the meantime, the growth in China and India should continue. Whilst there is much speculation about a slowdown in China, the commentators who so speculate somehow still predict strong equity market rallies in 2011. To our mind the very sober world economic outlook would be severely tested by a Chinese slowdown should it occur. We do not think that it will, and suggest that such an economic slowdown by China would derail the world economy and severely affect equity markets.

Given the above, we believe the outlook for world and in particular, Australian markets, in 2011 is as follows:

1. An Australian equity market return of about 5% to 8% with the return dominated by income;
2. Only minor upward adjustment in cash rates by the RBA as it becomes increasingly obvious that Australian households are in debt distress;
3. The continued strength of the \$A to levels well above parity with the \$US and towards 80 euro cents;
4. The continued weakening of long term bond markets as the market becomes concerned with the credit ratings of the major economies of the world; and
5. The continuance of market volatility as Europe aggressively ramps up its own form of quantitative easing in response to the contagion of economic calamity across its region.

Thus, yet again it will be a stock pickers market and those investors that rely on index type equity investment will be disappointed once again.

Further, a balanced portfolio which is over exposed to long term bonds, non-Australian dollar assets and low yielding property assets (for example retail) will also be in for another disappointing year.

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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