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QUARTERLY INVESTMENT REVIEW

by Paul Saliba

Interest Rates	Rate at 31 Dec 10	Rate at 30 Sept 10
RBA Cash Rate	4.75%	4.50%
Aust 10 Year Bond	5.58%	4.96%
Aust 90 Day Bills	5.02%	4.90%
US 10 Year Bond	3.37%	2.52%
Commodities	**Dec 2010 US$**	**Quarter change**
CRB Index	629.53	17.4%
WTI Oil	89.84	12.3%
NYMEX Gold	1,421.10	8.7%
LME Copper	9,580.00	19.0%
LME Lead	2,559.00	13.1%
LME Aluminium	2,450.00	5.9%
LME Nickel	24,120.00	3.1%
Zinc	2,423.00	11.4%

Market moves ahead on positive macro data

The markets rallied in the December quarter on an improved economic outlook. Irish sovereign debt caused alarm in Europe and the quarter also saw an escalation of tension on the Korean peninsula but despite these events markets regained some lost ground.

In Australia, the S&P/ASX 200 index gained 3.5% over the quarter while global markets underperformed the local market in Australian dollar terms due to the continuing rise of the Australian dollar.

The Australian market had mixed results in the quarter with strength in small companies and materials outshining the much weaker large cap and financial stocks in the market.

The Australian yield curve has steepened with the RBA's 25 basis point rise through the quarter and mixed economic data resulting in the long end of the curve rising. The instigation of quantitative easing (QE2) in the US, combined with further data suggesting economic growth, saw the US yield curve steepen with long-term yields beginning to rise.

Australian Government bonds fell as did global bonds, with a -0.6% total return for Australian bonds and a -0.5% total return for global bonds (hedged). Australian corporate bonds fared better returning 1.1% for the quarter as compared to a -0.3% (hedged) return for global corporate bonds.

Confidence in the global recovery that emerged in the prior quarter prevailed despite the challenges of Ireland's government debt and the North Korean shelling. Key data points in Europe, North America and Asia continue to indicate that the global economy is recovering as we highlighted through much of 2010. It seems markets may now be starting to believe it.

Over the year markets were challenged regularly with concerns regarding European sovereign debt. Global equities struggled with this and the overhanging concern of a double dip recession in Europe and the United States. The appreciation of the Australian dollar meant that any unhedged exposure was significantly impacted.

Economic outlook

The economic outlook for the global economy remains mixed with advanced economies continuing to see slow growth and emerging markets growing strongly. The advanced nations, with the exception of Australia, face the difficulty of weak economic growth with huge government debt and therefore the need to constrain growth in government spending.

Grass root indicators such as industrial production, purchasing manager indices, wholesale inventories and manufacturing among others all indicate advanced nations will continue to recover in 2011.

KEY BENCHMARK INDICES - ONGOING REVIEW

Benchmarks are an essential part of managing your portfolio to compare between the various forms of investments and with peer groups to see if your assets are keeping pace with expectations. We summarise key benchmark indices for your information and review of your portfolio to 31st December 2010. We have highlighted returns for 1, 3, and 5 years ended 31st December 2010 for the medium to long term to benchmark your asset class returns.

Source : FactSet	ACTUAL TOTAL RETURNS		
As at 31st December 2010	**1 yr % pa**	**3 yrs % pa**	**5 yrs % pa**
S&P/ASX All Ords Accumulation - Australian Sharemarket	3.31	-4.92	4.85
S&P/ASX 200 Property Trusts Accumulation	-0.41	-20.92	-9.50
UBS Composite Bond Index 0+YR - Australian Fixed Interest	6.04	7.43	5.76
MSCI World ex Aust (Net Div) (AUD) - International Equities - unhedged	-1.52	-9.29	-3.93
MSCI World Index (AUD) hedged	11.01	-4.79	0.97
Barclays Capital Global Aggregate - International Bond Market - hedged	11.76	8.96	n/a
Australian CPI (Actual) - Inflation	**2.65**	**2.81**	**2.93**

continued on page 3

QUARTERLY INVESTMENT REVIEW

Increased savings in many western countries has resulted from a public wary of the global economy following the global financial crisis. This is hampering property markets as well as retail spending in many advanced nations, including the US and Australia.

The flow on effect for many countries is that there has been little improvement in unemployment which is restricting the recovery in Europe, the UK and the US. In Australia the effects of the last few years has resulted in a very cautious consumer, despite very low unemployment.

Australia remains well positioned due to its strong level of employment. However there is weakness in most sectors outside mining and mining services. This weakness may be overcome through 2011 to some degree once there is more comfort in the stability of the global economy, and wage inflation and confidence allows spending to increase. Many in the market suggest the Australian dollar has limited upside with the recent floods in Queensland likely to have a negative impact. The downside risk is now increasing.

Investment strategy

The slow but growing global economy combined with low unemployment in Australia and therefore a robust Australian economy is supportive of growth asset appreciation for the year ahead.

Australian Equities – remain preferential to international equities, in our view. The potential for economic recovery remains a potential driver of corporate earnings growth and a catalyst for share price appreciation.

Australian small cap shares have had a very good year with a total return (including income) on the S&P/ASX Small Ordinaries of 13.1% for 2010. Most of this return was generated in the last quarter with a total return of 11.2%, much of this coming from mining.

Australian listed companies remain relatively good value with the forward PE around 12.1 times the next twelve months' earnings estimates. The market remains well below the long term trend and with earnings growth to continue we consider an overweight position as appropriate.

Global Equities – are attractively priced with a forward PE at 12.7 times. It is important to understand that the woe of government debt does not mean poor operating performance from companies within the given economy. Poor economic growth may reduce corporate growth prospects, however economic recovery is driving improved earnings and looks set to continue.

We continue to favour an overweight position to emerging market equities. The economic growth of these economies looks set to continue while China endeavours to keep growth under control to limit inflation. The PE's of many emerging market economies do appear to indicate good value at an average of around 12.6 times next twelve months' earnings. We are cautious of economies where there is significant government control such as China and Russia, and therefore favour the entire emerging market over specific countries.

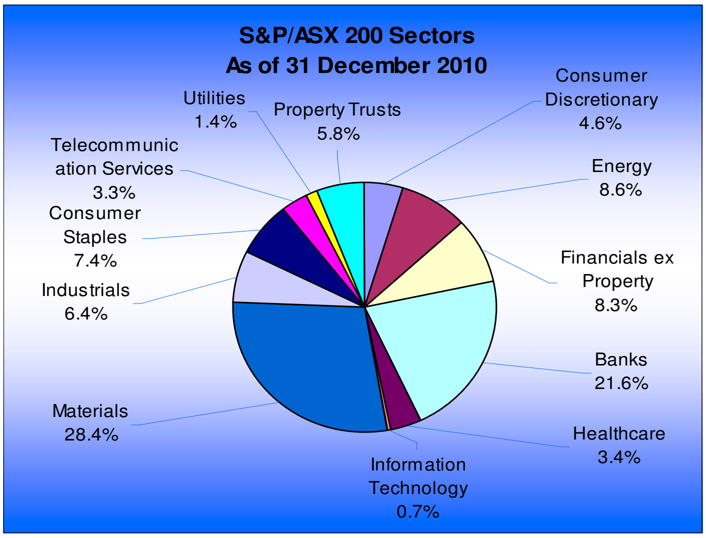
Property – listed property which is recovering slowly, has continued to underperform broader Australian equities through the quarter. We would expect this trend to continue and recommend a combination of listed and unlisted property for its diversification benefits and income generating characteristics. Direct commercial property prices continue to show signs of improvement particularly at the higher quality end, there are also now promising signs for B grade and lower quality assets. We continue to recommend an allocation to better quality assets in line with your long term strategic allocation.

Alternative Assets – have had a good year with our preferred strategies of managed futures and global macro indices up 1.1% and 8.8% respectively. These type of investments continue to provide diversification benefits and we continue to recommend an allocation in line with long term strategic allocations.

The Winton Global Alpha Fund combined with the BlackRock Asset Allocation Alpha Fund provide diversification benefit while enabling good growth opportunity. For the quarter our preferred alternative asset managers had mixed performance with the BlackRock Asset Allocation Alpha Fund down 2.0% and the Winton Global Alpha Fund up 4.2%, just ahead of Australian equities. For the year BlackRock was down 5.5% while the Winton fund returned 16.0% for 2010.

Fixed Interest – corporate credit spreads have continued to contract but remain elevated by historical standards. Weak but positive economic growth is a sweet spot for corporate bonds. With elevated spreads and weak economic growth corporate bonds and hybrid securities remain preferential to government bonds. However we remain tactically underweight to fixed interest generally. For investors with lower risk appetite fixed interest term deposits will secure capital while giving reasonable returns as well as surety of income. Term deposits continue to offer relatively good rates as banks continue to require diversified sources of capital.

The Reserve Bank of Australia (RBA) increased rates to 4.75% during the quarter which was somewhat surprising given the data that was coming through at the time. A variety of economic data points including retail sales, building approvals, and PMI indices are all indicating weakness outside the resources sector and so the market is expecting rates to be on hold for much of the first half of 2011. The RBA did indicate concerns for inflation with low unemployment levels and wage inflation expected to impact spending going forward. The events in Queensland are expected to impact economic growth by up to 1.0% – it is clear that the clean up and reconstruction will take time and an impact on fiscal and monetary policy is likely.



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