Queen Street Partners
Model Portfolio Report
June 2009

"Capturing Emerging Manager Alpha"

Market Conditions

Positive sentiment continued into June, with the ASX300 pushing up 4.0% to finish at just under the 4000 mark. The month began with RBA leaving rates on hold, with scope for further easing on deflationary concerns. Capital raisings continued into the month, with $10.2 billion raised in June, of which all but about 1% being secondary offerings. Indicators were positive, with a surprise +0.4% March Quarter GDP figure prompting claims Australia had avoided a technical recession. Both business and consumer confidence releases showed strong increases, tempered somewhat by a rise in the unemployment rate.

Globally markets were mixed in June with both the FTSE and the Dow Jones declining, whilst oil rose almost 8%. The Australian dollar continued its climb, up +1% against the USD and 2.2% on a trade weighted basis. The VIX finished lower by month-end at levels not seen since prior to the collapse of Lehmans in September last year.

Within the broader Australian equity market result, the small caps index underperformed larger cap indices in June, ending a period of relative outperformance that began in March. The S&P/ASX20 returned +4.4% for the month, outperforming the mid-caps (+4.1%) and the small ords (+3.1%). Within sectors, TelcoServices (+8.6%), Healthcare (+7.5%) and Financials Ex Prop (+7.1%) did well whereas Utilities (-4.0%) and Materials (-0.2%) detracted. In terms of style factors, value, high volatility and momentum reversion (past 12mth and 36mth loser) stocks did well for the month. Managers reported a consolidation phase in the second half of the month which was reflected in bond yields peaking early in the month then tapering off.

Emerging Manager Conditions

June was generally a quiet month for emerging manager fund flows, as many institutional investors focussed upon financial year end. The improving market conditions through June were judged positive for boutiques as early indications of a returning appetite for boutique allocation buoyed confidence for business managers. Treasury Group reported an uptick of inflows into their boutiques however fund inflows to the sector are still somewhat lagging pre GFC expectations. The focus for asset owners turned towards manager fee levels, on justifying the value of active management, and some interesting discussion regarding de-linking of fees to funds under management. The purchase of Aviva by NAB excluded the specialist manager Aviva Investors (formerly Portfolio Partners boutique) which will be closely watched by investors.

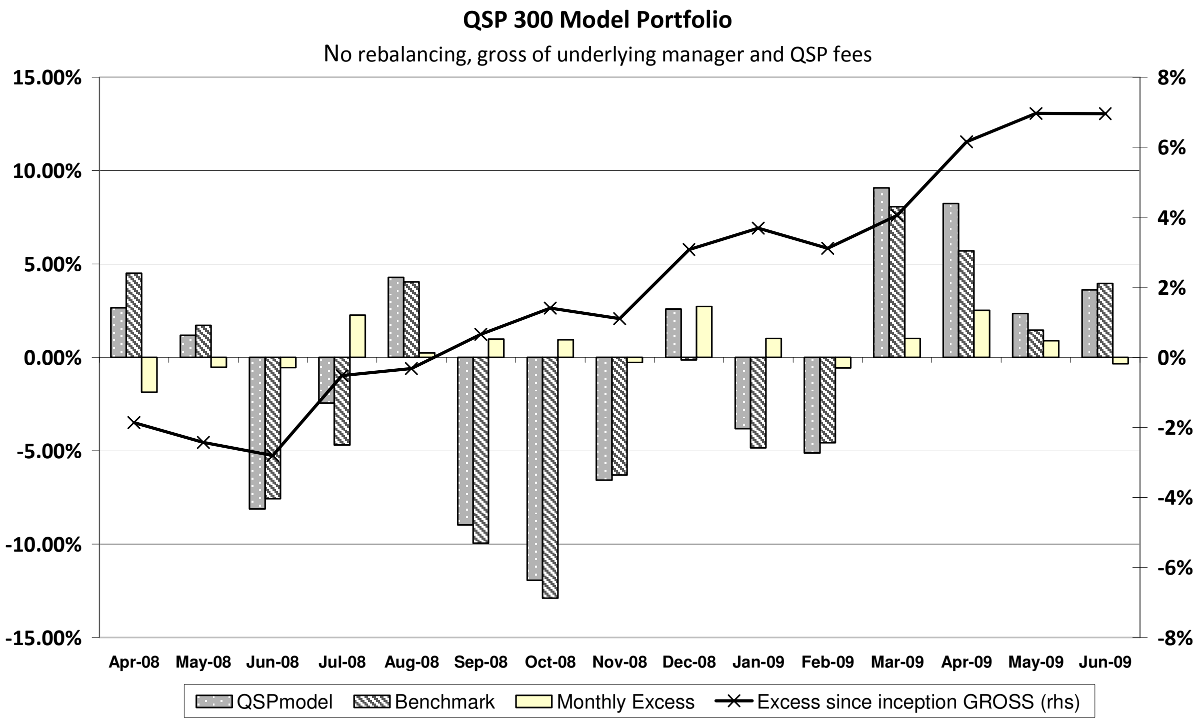
Corporate activity in the incubation space received attention over the month with larger platform backed institutions talking up their plans for the incubate/distribute deal making. Foreign sourced activity made its first appearance in the local market for some time with US based Asset Management Finance disclosing a deal with a Sydney based boutique with international aspirations. Small cap managers, who had suffered significant revenue losses in the past year's market correction, took comfort from the sector bounce back over recent months.

Travel budgets have been a useful reference point for considering how boutiques are allocating resources in the current environment, with less marketing travel in general being planned, and company visits being more targeted. We would not like to see company research being neglected for marketing by fund managers. Some large institutional backers of boutiques are still undergoing change and this is continuing to impact upon some firms, with ownership structures and some investment teams faced with continuing uncertainty.

Downward pressure on fees appears to be directed more towards funds with hedge-fund like fee structures and large performance fee elements than traditional fund fee structures. As well as fee discounts and reductions, we have discussed some innovative fee restructuring with some boutiques. The concern with some of the deferred fee structures we have encountered of late is that they may inadvertently lead to cash-flow and hence business instability in smaller FUM boutiques. Moving away from FUM-based models of remuneration for fund managers creates some interesting questions around the alignment of interests between investors and investment managers, and we expect more development in this space.

QSP 300 Model Performance

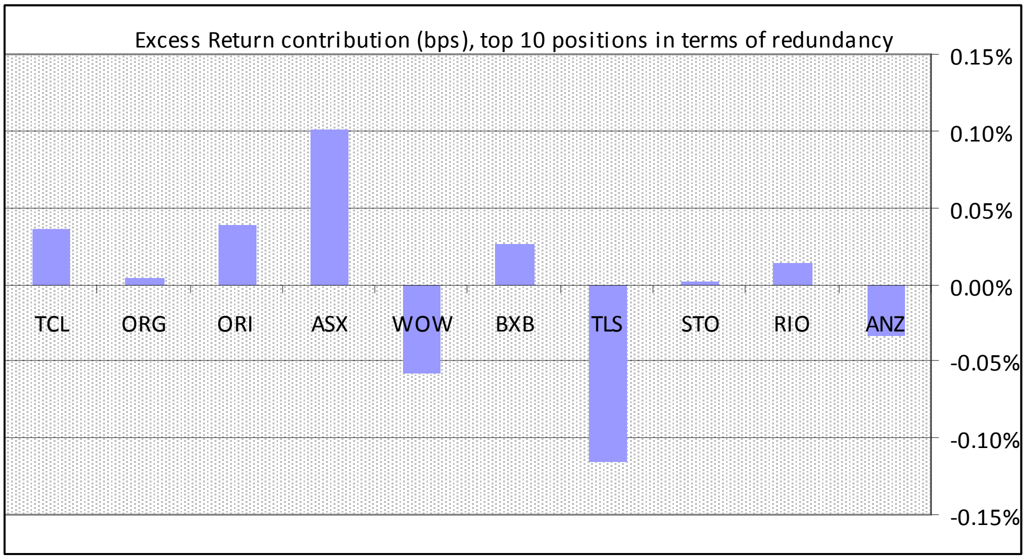
The model portfolio gross return was +3.6% for the month versus the S&P/ASX300 accumulation return of +4.0%. Over the last 12 months the model portfolio has returned -10.7% against -20.3% for the index, and cumulative -14.8% since inception (April 2008) vs. -21.7% for the index.



gross of all fees	1 mth	3 mth	6 mth	12 mth	Inception p/a	Inception
QSP 300 Model	3.62%	14.78%	14.23%	-10.71%	-12.00%	-14.77%
S&P/ASX 300 Accum	3.96%	11.49%	9.43%	-20.34%	-17.80%	-21.73%
Relative Performan	-0.34%	3.28%	4.80%	9.63%	5.79%	6.96%

The Portfolio's large underweight of -13.4% to financials was the main detractor from performance in June, leaving behind over 100 basis points of performance. Positive contributions from industrials, consumer discretionary and materials stocks combined with the total portfolio being underweight materials (-7.6% active) delivered +97bp towards performance, not quite enough to offset the financials underweight.

Redundancy in individual manager positions (in terms of individual differences to final portfolio weights) picked up slightly in June, potentially showing less conviction in the month across manager positions. Such an effect suggests some manager styles were (temporarily) reassessing the durability of the recent rally in selected stocks. This feature was particularly noticeable between the growth oriented and more defensive managers. Ideally, redundancy amongst manager positions will add value to the total portfolio over time, by reducing risk in the portfolio whilst not detracting significantly from overall performance after transaction costs. Queen Street regards redundancy as a key consideration in portfolio construction, where the degree and effect of redundant positions amongst individual managers are inputs to the process. Philosophically, we believe that differences of opinion amongst fund managers constitute information which can add value to the total portfolio where these differences are suitably combined. US research in the area suggests that for stocks where opinion differs, fund managers tend to deliver lower returns than those with greater agreement[1]. Accordingly, where differences of opinion lead to a reduction in portfolio exposure this can benefit the portfolio. Interestingly, this same research does not suggest that total agreement necessarily means better performance, as in their sample agreed sells subsequently *outperformed* agreed buys, reinforcing the need to select managers carefully. Encouragingly, the top 10 positions by redundancy in the QSP 300 Model Portfolio added value in aggregate for the month to the total portfolio. For more information on how Queen Street works with redundancy in multi-manager portfolios, please, contact us.

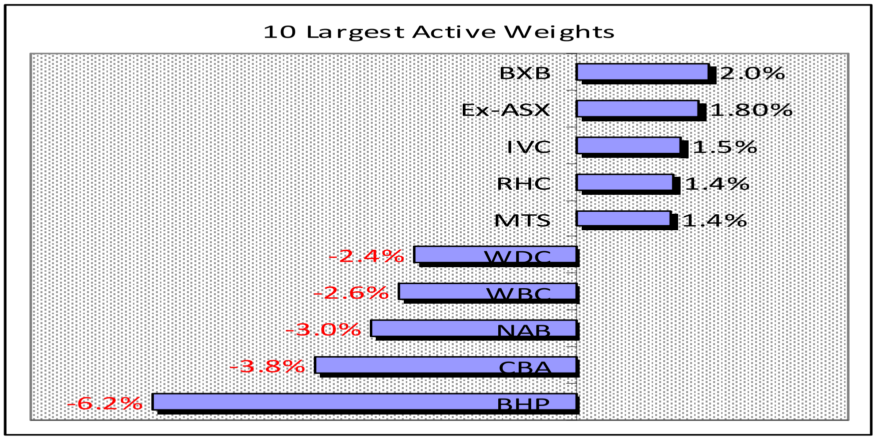


The portfolio continues to show style neutrality with regards value measures, with a slightly higher PE ratio contrasting with a lower price to book ratio than the market. Growth measures show a clear quality bias, with the portfolio at a large discount to market on interest cover measures coupled with a bias towards higher EPS growth on 09/10 numbers which becomes more conservative again on 2011 forecasts.

Our size bias away from the top 20 persisted into June, detracting from performance as the S&P/ASX 20 Leaders (XTL) outperformed the 300 index strongly for the month. The portfolio continued to outperform in the 51-200 market cap size band. Cash exposure also remains high, but reduced slightly to under 8.5% of the portfolio by month's end. Historic beta for the portfolio is currently just over 93%, with an ex-ante tracking error of 3.4%.

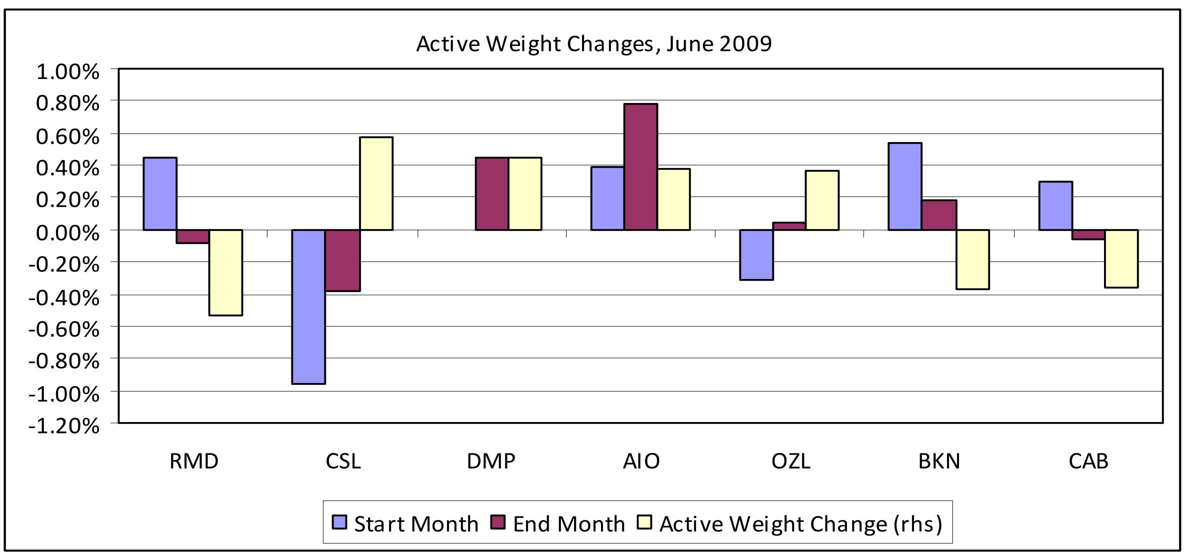
The month end portfolio remained underweight to BHP (-6.2%) and Westfield (-2.4%), along with the banks. Brambles (+2.0%) continues to be the largest positive active bet along with a single non-ASX stock (+1.8%), and smaller positions in Invocare (+1.5%), Ramsay Health Care (+1.4%) and Metcash (+1.4%).

[1] Hu, G and Meng, J. G. and Potter, M. (2008). "Opinion Divergence Among Professional Investment Managers," *Journal of Business Finance & Accounting*, 35 (5-6), pp. 679-703



The ten largest individual active positions in the portfolio at end June

Stock activity during the month saw the decision to close out of Resmed in what was a positive month for the stock price which had support from a share buy-back program by the company. CSL went from underweight to overweight in the portfolio as managers re-weighted on the back of the merger with US firm Talecris being called off. A new position in Domino's Pizza was opened, Asciano saw a doubling of its active weight on the back of placement activity while up weighting in Oz Minerals on a month of heightened corporate activity saw the active underweight largely removed. Both Bradken and Cabcharge were sold down during the month, Cabcharge becoming a slight underweight after a month in which the ACCC reportedly initiated court action against the company.



QSP300 Investment Outlook

Boutiques we spoke with in June were actively participating in capital raisings and were generally seeing top-ups from existing investors. Many managers remain sceptical of an uninterrupted continuation of the current rally, though talk of a major retracement has all but disappeared. The cash weighting in the portfolio reflects this view. There is some swing in sentiment towards so-called defensive stocks which have been overlooked over the last month or so. There is a diverse view on smaller stocks particularly mining services companies, and to a lesser extent property trusts.

Managers are generally positive towards the Australian economy but bearish about the US and the possibility of higher interest rates in the medium term. China sentiment remains generally strong with the commodities sector seen as a sound medium term support for the local market.

Manager Rotation Decisions

The QSP Model portfolio initial manager line-up has not changed since inception, nor as we explained in our last update has it been rebalanced. Queen Street's justification for active rotation of emerging boutiques is that we believe the return premium generated by boutique managers' declines over time. This belief is not unique, and also underlies the investment philosophy of offshore managers and fund of hedge funds such as Infiniti Capital. Academic research supports this view, with research suggesting newer fund managers do better[2], consistent with models of skilled managers attracting assets until excess returns disappear[3] [4]. In Australia work by Martin and Gallagher suggests the effect is not evident[5], however our own research shows a clear historical outperformance of screened emerging boutique managers over their institutional and larger FUM counterparts, reinforcing the importance of active selection and monitoring.

The question often comes up as to at what level of FUM would we consider a manager "emerged". As a general guide we consider 0.05% of ASX market capitalisation to be a reasonable point to review, but the threshold may be lower or higher depending upon the strategy. Even if a manager were to have achieved this FUM goal we may not rotate the manager out immediately, but they would be considered a candidate for rotation and replacement with alternate emerging boutiques, and closely monitored. Another major factor to consider is that of traction. Most manager closures we have been aware of amongst emerging boutiques have been due to a failure to gain sufficient FUM so as to remain viable, rather than poor performance. Indeed, managers may retire despite having consistent above median manager performance.

We regularly monitor our managers against these criteria, alongside general performance, business and organisational stability considerations. To date we have not made any manager rotations in the portfolio, but some rotation is possible over the next six to twelve months.

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[2] Aggarwal, Rajesh K. and Jorion, Philippe,The Performance of Emerging Hedge Fund Managers (January 23, 2008). AFA 2009 San Francisco Meetings Paper. Available at SSRN: http://ssrn.com/abstract=1103215

[3] Green, Richard C. and Berk, Jonathan B.,Mutual Fund Flows and Performance in Rational Markets (October 2002). NBER Working Paper No. W9275. Available at SSRN: http://ssrn.com/abstract=338881

[4] Wang, Y. "Mutual fund flows, performance persistence and manager skill" (Dec 2007). Thesis, Arizona State University. http://proquest.umi.com/pqdlink?did=1375526351&Fmt=7&clientI d=79356&RQT=309&VName=PQD

[5] Martin, K. and Gallagher, D. "Size and Investment Performance: a research note" (February 8, 2005). *Abacus*, 41 (1), pp. 55-65

Emerging Manager Ratings for All

Queen Street Partners are currently exploring the viability of providing a basic level of our manager research and ratings assessments online for wholesale investors to access free of charge, to both increase visibility of our research capability, and to assist large wholesale investors who would like an independent source of reference on Australian boutique and emerging managers within our universe. We would intend that providing such a channel would not only increase visibility of high-quality boutique fund managers for institutional investors, but would also increase competition and quality of research in the boutique manager research space. Please contact us for details.

Queen Street Partners

Queen Street Partners is an employee owned multi-boutique investment manager and advisor specialising in discovering, researching, constructing and monitoring Australian Equities portfolios of employee-owned emerging and boutique fund managers, which Queen Street believe capable of delivering superior performance over time. The Queen Street research and investment process incorporates qualitative and quantitative techniques, with significant focus on identifying Emerging Manager Alpha potential alongside long term business viability.

We believe in combining contrasting and complimentary manager skill sets where there is a very strong alignment of interests between the ultimate client outcome and the success of the manager.

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