CADENCE CAPITAL

Zenith Investment Partners — Recommended

INVESTMENT UPDATE March 2012

Summary Update

For the eight years and five months to 31st March 2012, Cadence Capital Fund has generated a gross performance of 17.65% per annum, outperforming the All Ordinaries Accumulation Index by 9.61% per annum.

During the month of March 2012, Cadence Capital Fund returned a gross performance of +2.58% compared to an increase in the All Ordinaries Accumulation Index of +1.15% and an increase in the Small Ordinaries Accumulation Index of 0.19%. For the first nine months of the financial year, to the 31st March 2012, the fund outperformed the All Ordinaries Accumulation Index by 14.04% and the Small Ordinaries Accumulation Index by 11.73%.

The fund finished the month 70.66% net long compared to 77.21% net long in February 2012.

Fund NTA

Cadence Capital unit price estimates as at 31st March 2012:

NTA (Post Fees) $1.81432

Cadence Highlights

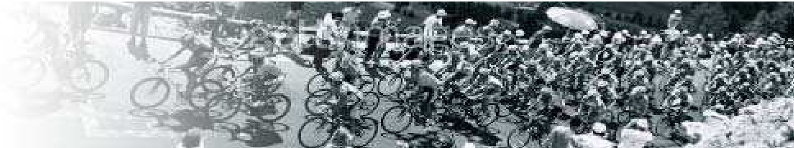
Cadence has a **RECOMMENDED Rating by ZENITH** Investment Partners

Cadence Capital Limited has been **ranked by ASX* as the Number 1 Australian Equities Listed Investment Company** over 1, 3 and 5 years in the LMI Quarterly Update as at 31 December 2011.

Cadence Capital Limited has also been **ranked by Patersons as the No. 1 Listed Investment Company** over both 1 and 2 years in their LIC Quarterly Update dated 24 August 2011.

All of these reports are available on our home page at www.cadencecapital.com.au

** Source: ASX website – Market Update on Management Funds section, LMI Quarterly Update as at 31 December 2011*



Fund Performance

Performance* to 31st March 2012	CCF**	All Ords	Outperformance
1 Month	2.58%	1.15%	+1.43%
1 Year	32.84%	-6.20%	+39.04
2 Years	78.53%	-1.70%	+80.23
3 Years	182.95%	41.57%	+141.38
4 Years	75.75%	-2.74%	+78.49
5 Years	42.40%	-8.59%	+50.99
6 Years	86.82%	11.83%	+74.99
Inception to date accumulated return (101 months)	292.81%	91.78%	+201.03
Annualised return since inception (101 months)	17.65%	8.04%	+9.61

* Gross Performance before Management and Performance Fees
** Adjusted to include material franking credit of 26.7 cents received from RHG dividend during May 2011

Top Portfolio Positions

ASX Code	Position	Direction	Holding
RHG	RHG Ltd	Long	24.4%
MMS	McMillan Shakespeare Ltd	Long	6.3%
RKN	Reckon Ltd	Long	5.3%
COF	Coffey International Limited	Long	4.4%
BVA	Bravura Solutions Ltd	Long	4.4%
DCG	Decmil Group Limited	Long	3.8%
FXL	Flexigroup Ltd	Long	3.7%
ANZ	Australia & New Zealand Banking Group	Long	3.4%
NAB	National Australia Bank Ltd	Long	3.1%
MQG	Macquarie Group Limited	Long	3.0%
VMG	VDM Group Limited	Long	3.0%
RFG	Retail Food Group	Long	1.2%
Portfolio Holdings > 1%			**65.94%**

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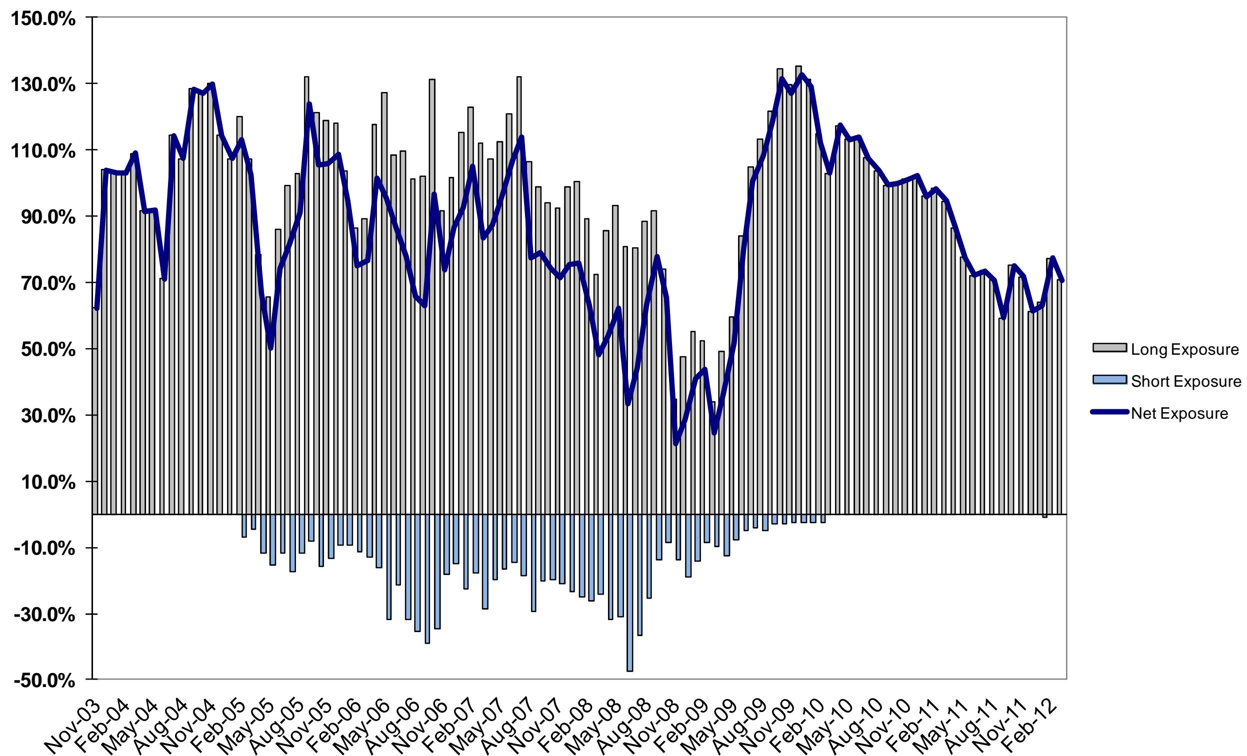
Portfolio Sector Analysis

Sector	Long	Short	Net
Banks	31.30%		31.30%
Commercial & Professional Services	10.68%		10.68%
Software & Services	10.18%		10.18%
Diversified Financials	8.04%		8.04%
Capital Goods	7.12%		7.12%
Consumer Services	1.20%		1.20%
Materials	0.89%		0.89%
Telecommunication Services	0.80%		0.80%
Energy	0.44%		0.44%
Exposure	**70.66%**	**0.00%**	**70.66%**
Cash on Hand			**29.34%**

Portfolio Exposure



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Cadence News

Rotating out of Equities into Fixed Income….is now the right time?

The first calendar quarter of 2012 has been marked by a proliferation of articles in the financial press advising that Australian investors and in particular Australian Superannuation investors are 'overweight' equities relative to other asset classes, and more specifically, fixed interest. As much merit as this barrage of articles have, it is worth bearing in mind that the best time to invest in an asset class is **before** it experiences a strong rally and not **after** a strong rally. Similarly the best time to divest from a particular class is **after** a strong rally and not after a significant fall. I am sure most investors in Australia would be aware of the strong rally fixed interest has experienced over the last twenty years, as well as the sharp fall the equity market has experienced in the last five years. As always timing is an important component when switching from one asset class to another……just as it is when switching from one stock to another stock. We have attached a transcript copy of a recent article appearing in the Sydney Morning Herald written by Matthew Kidman that echoes our sentiment and discusses the rotating out of equities and into fixed interest at the moment.

March 2012 Quarterly Webcast

The March 2012 quarterly webcast will be available later this month on our website at www.cadencecapital.com.au. A link to the March 2012 webcast will also be sent to all people who have registered to receive our monthly newsletter. Should you wish to receive our monthly newsletter and quarterly webcasts please register at www.cadencecapital.com.au on the Home Page by clicking 'Register for our Monthly Newsletter'.

Transcript of the Article by Matthey Kidman titled ***Henry is spot on and at odds with historical analysis, SMH March 26, 2012***

History holds some sanguine lessons for investors about the returns on asset classes, writes Matthew Kidman. Dr Ken Henry's view that Australian investors, especially retirees, are too exposed to the volatility of equity markets is 100 per cent correct. Shares, by their very nature, are a higher-risk, higher-return proposition than virtually any other asset class. A retiree with 60 per cent or more of life savings in the local and offshore sharemarkets is taking a large dose of risk that has made many of them feel bilious since 2008.

By comparison, bonds are relatively sanguine investments that are in a multi-year bull market, a trend unlikely to change in the short term as the local economy slows. In other words, local bond yields have the ability to fall further and bond prices to keep marching higher. The problem with Henry's view is his timing. It could hardly be worse. Beyond the short term, history and facts suggest investors should be looking over the next 12 to 24 months to increase their exposure to the sharemarket, rather than opt out for the safe haven of cash and government bonds. In historical terms, Australian equities are close to 30 per cent cheaper when compared with government bonds. This valuation gap is unlikely to change in the short term as the economy loses momentum. However, markets have a penchant to revert and align valuations to historical norms.

The desire to avoid risk and still earn regular income is not entirely new and is a natural reaction to the events that have unfolded since 2008. In fact, it is surprising it has taken this long for commentators to put the kybosh on shares given their shocking returns of late. It never ceases to amaze how people are attracted to assets that have been rising in value for an extended period, while washing their hands of the asset classes that have underperformed. The hypnotic nature of rising prices is what eventually creates bubbles. One only has to look at the magnetism of the tech boom of the 1990s or the gold rush in recent years. Eventually, all these booms come to an end and there is usually a trail of destruction and heartbreak.

A longer look at the history of Australian shares and bonds shows our shares are the best performing asset class in the world over the past 112 years. According to research by the London School of Economics and Credit Suisse, Australian shares have delivered a nominal return of 11.3 per cent per annum over that period, which means $1000 invested in 1900 was worth $2.47 million at the end of last year. When you take into account inflation, the real return is 7.2 per cent a year. In comparison, long-term government bonds delivered a 5.5 per cent nominal return and 1.6 per cent real return. You may say that is well and good but since 2008 the world has changed forever. A look back in history suggests what has unfolded over the past 4½ years is typical rather than exceptional.

In the two previous Australian secular bear markets of the 1970s and the period following the 1987 crash, a distinctly similar pattern emerged. The Australian sharemarket peaked in 1969 and fell nearly 60 per cent into late 1974. At that point it effectively rallied for the next 13 years, posting a 1250 per cent gain from bottom to top. After the market crash in 1987, the market fell 49 per cent in four months. It wasn't until late 1992, five years after the crash, the market started to head upwards again, a directional change that lasted for 15 years and delivered a gain of close to 400 per cent and almost 800 per cent if dividends are included.

Fast forward to now. It has been four years and four months since the benchmark All Ordinaries index hit an all-time high. Using previous bear markets as a guideline, the present secular bear market will conclude in the next

12 to 18 months. History may not prove to be a deadly accurate indicator, however. If we believe the Australian economy will grow and will be based on a capitalist model, then the next 12 months is possibly the best buying opportunity for equities for this generation. Ideally, this opportunity will arrive on the back of a struggling local economy that finally cleanses itself of the excesses of the past decade or so.

In contrast, bonds have been a stellar performer for the best part of 30 years. History tells us bonds don't outperform equities in the long term, because it is not a direct beneficiary of economic growth and human endeavour. The time to ratchet up the exposure to the bond market is not now but when the equity market has recovered and looks historically expensive. The sceptic in me, though, believes this is when commentators say investors should be overweight with shares in a new golden era.

Former fund manager Matthew Kidman is a director of WAM Capital and the author of Bulls, Bears and a Croupier.

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