



AUSTRALIAN GOVERNANCE MASTERS INDEX FUND LIMITED (AQF) **QUARTERLY INVESTMENT UPDATE (DECEMBER 2015)**

MARKET REVIEW

The **S&P/ASX 100 Index Accumulation Index** (Index) had a strong finish to the year, closing 4Q 2015 up 6.1%. A very positive October (+4.2%) was followed by a small decline in November (-0.8%) and then a solid - but volatile - December performance (+2.6%). From the beginning of December until the eve of the FOMC meeting, the Index fell 5.1%, within a whisker of its 2015 low, before rallying 8.1% into month end. This was a large gain in the context of the Index's total 2015 performance of +2.1% and the performance of other developed markets.

In the **Financials sector (+10.4%)**, the smaller banks including Bank of Queensland (+20.1%) and Bendigo and Adelaide Bank (+20.6%) outperformed CBA (+17.6%), WBC (+13.6%), ANZ (+3.1%) and NAB (+0.7%) after confirming they will take advantage of the "big four" banks' mortgage repricing. The recent increase in reserve capital requirements for the "big four" banks does not apply to smaller banks (which must already hold higher levels of capital), leaving them well placed to benefit from an increase in mortgage pricing. On the other hand, insurers such as QBE (-2.3%) and Suncorp (-0.4%) posted negative share price returns.

The **Materials sector (-8.0%)** again stumbled. Many commodity prices continued a steep decline with iron ore and Brent crude oil prices both dropping over 20% during the quarter. BHP Billiton (-19.6%) was the key laggard in the sector and faced legal claims following the dam collapse at its Samarco joint venture in Brazil.

In the **Energy sector (-0.4%)**, Brent crude oil price fell over 20% during the quarter and oil refiners are expected to capture higher refining margins. Caltex (+20.5%) announced it is poised for record full-year earnings, driven by higher returns on both refining and marketing. Santos (-6.2%) rejected a takeover bid from the private equity firm Sceptre Group and announced an approximately \$2.5 billion fully underwritten entitlement offer.

Over the quarter, the Index outperformed the **MSCI World Index excluding Australia** (+1.0% in Australian Dollar (AUD) terms). While US equities (**S&P 500** +2.4% in AUD terms) ended higher, both European (**Euro Stoxx 50** -1.5% in AUD terms) and emerging equities (**MSCI Emerging Index** -3.5%) performed poorly.

The **Reserve Bank of Australia (RBA)** left the cash rate unchanged at 2.00% during the quarter. The AUD rallied to 72.9c (as at 30 September 2015 it was 70.2c) against the US Dollar (USD) during the December quarter, partly as the Australian economy proved more resilient than expected. The October out-of-cycle rises in mortgage rates by the "big four" banks combined with the unexpectedly strong Labour Force Survey data in November (and to a lesser extent again in December), resulted in diminished expectations of interest rate cuts by the RBA, an increase in short-term yields and a firmer AUD against the USD. The RBA noted the lower AUD, following its depreciation over recent years, has to date been slow to stimulate the economy.

In the US, the Fed raised interest rates for the first time in almost a decade. The target rate is now 0.25%-0.50%, a 25 bps increase. The FOMC have guided towards four rate hikes in 2016.

In Europe, The ECB moved rates but in the opposite direction, cutting the deposit rate to -0.3% and announcing a six month extension to its QE program.

STOCK NEWS

ASCIANO (AIO): +4.1%

AIO's chairman Malcolm Broomhead, expects a speedy resolution to the takeover tussle between Canada's Brookfield Asset Management and a Qube-led consortium after the ACCC delivers its decisions on both bid proposals - expected in February 2016. The AIO board previously recommended shareholders accept the Brookfield deal, however this may change should the Qube consortium make a counter-offer.

AURIZON HOLDINGS (AZJ): -12.6%

AZJ downgraded its profit guidance as a result of an expected reduction in rail coal haulage volumes. The company also signalled asset impairments. The Fund does not hold AZJ.

BHP BILLITON (BHP): -19.6%

It was a torrid quarter for BHP as a result of the Brazilian iron ore mine disaster and commodity price declines. The accident was labelled "the biggest environmental catastrophe" in the country's history. Brazilian Federal and State governments plan to sue the joint owners of Samarco Mineracao, BHP and Vale. There have also been separate legal actions filed. Later in the quarter, there were heightened expectations of a change in BHP's dividend policy, which put further pressure on the stock price.

CSL LTD (CSL): +18.1%

The creation of a \$250m fund by the Australian government to help translate basic biomedical research into commercial products was positive for the biotech giant CSL. The company's substantial USD exposed operations also continue to benefit from the weaker AUD.

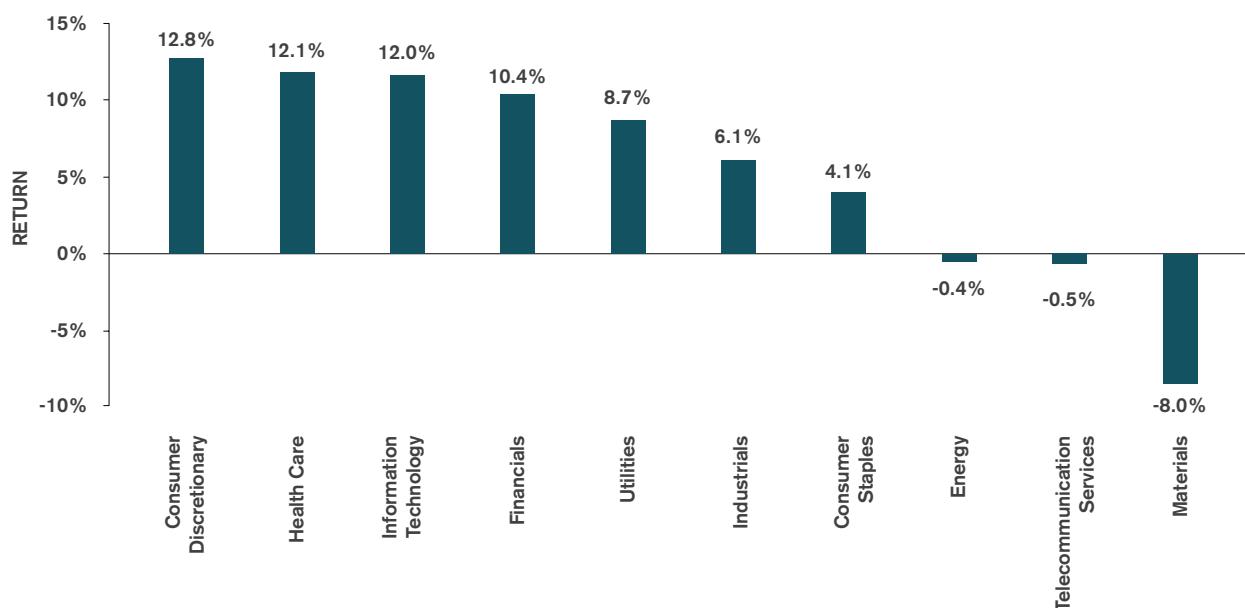
COMMONWEALTH BANK OF AUSTRALIA (CBA): +17.6%

Share prices of the "big four" banks" recorded a positive quarter led by CBA. The company's share price rebounded from its slump in August after announcing a \$5bn rights issue to boost capital in response to more rigorous capital requirements.

PRIMARY HEALTHCARE (PRY): -38.3%

PRY's updated guidance in November, following disappointing operating conditions and an extended timeframe to implement its strategic review, resulted in a significant share price fall. A further share price drop followed in December due to escalated concerns surrounding reimbursement risk, with the Government proposing to remove more than \$1.8bn in sector funding, with pathology and diagnostic imaging to be two areas targeted. The Fund does not hold PRY.

PERFORMANCE OF THE SECTORS WITHIN THE S&P/ASX 100 INDEX OVER THE DECEMBER QUARTER*



Source: Bloomberg, Walsh & Company Asset Management

* The S&P/ASX 100 sector returns are estimates and are based on average weightings during the quarter.

AUSTRALIAN GOVERNANCE MASTERS INDEX FUND (ASX: AQF) OVERVIEW¹

AQF listing date	February 2010
Total assets²	\$56,011,966
NTA per share²	\$1.84
Number of securities held	76

1. Figures are pre-tax estimates

2. As at 31 December 2015

AQF PERFORMANCE

For the 2015 December quarter (30 September 2015 to 31 December 2015), the accumulated unaudited pre-tax NTA of the Australian Governance Masters Index Fund (**Company**), increased by 6.7%. This compares to the Index, which increased by 6.4% for the quarter (assuming gross dividends were reinvested and including franking credits).

During the quarter, the Index and the Fund rebalanced. The Fund added Sirtex Medical Ltd, a new entrant into the S&P/ASX 100 this quarter, and sold Myer Holdings. The most significant contributors to relative performance for the quarter were the exclusions of Aurizon Holdings (-12.6%) and Westfield Corp (-4.6%) as well as the overweight positions in Commonwealth Bank of Australia (+17.6%), CSL (+18.1%) and Westpac Banking Corp (+13.6%). Meanwhile, the largest detractions came from the overweight BHP Billiton (-19.6%) position and the exclusions of Scentre Group (+7.4%), Treasury Wine Estates (+28.8%), Crown Resorts (+26.3%) and Challenger (+22.1%).

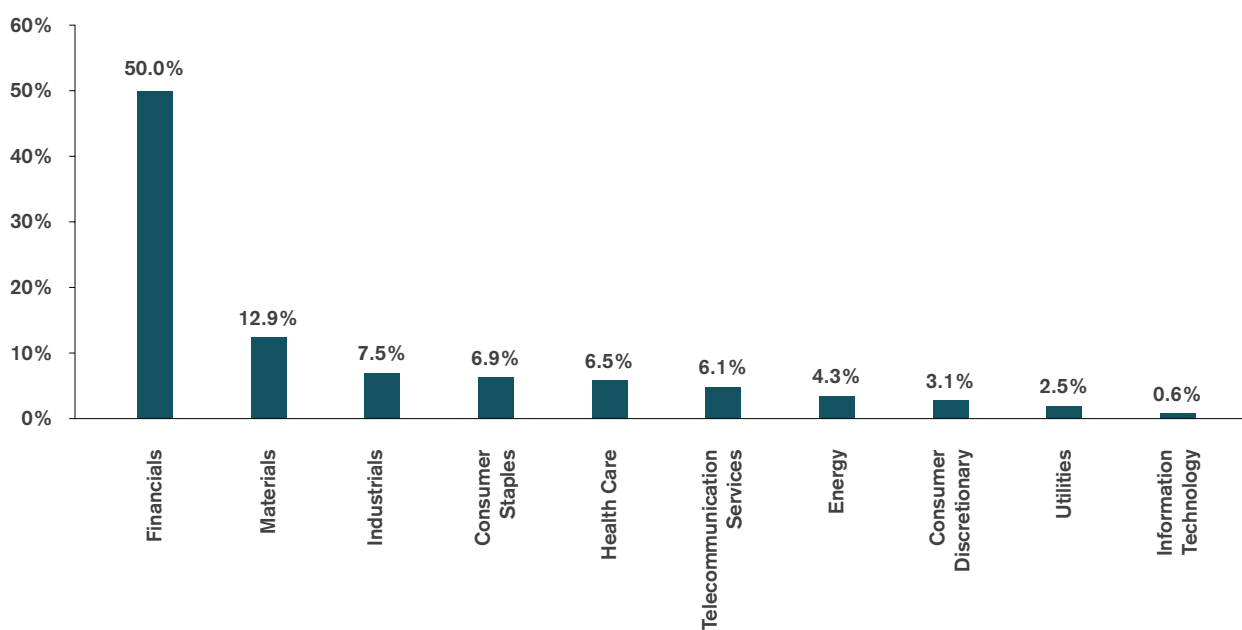
PERFORMANCE

	AQF ¹	Index ²	Relative
December Quarter	6.7%	6.4%	0.3%
2015	2.0%	3.8%	-1.8%
2014	7.1%	7.7%	-0.6%
2013	22.9%	23.4%	-0.5%
2012	22.3%	23.0%	-0.7%
2011	-10.0%	-8.4%	-1.6%
Since Inception p.a.	8.2%	9.5%	-1.3%

1. Assumes reinvestment of gross dividends (including franking credits).

2. The S&P/ASX 100 Accumulation Index returns assume reinvestment of dividends (including franking credits).

AQF SECTOR ALLOCATION AT 31 DECEMBER 2015



Source: Bloomberg, Walsh & Company Asset Management

PORTFOLIO HOLDINGS AT 31 DECEMBER 2015

Company	Market Value (\$)	Weight (%)
COMMONWEALTH BANK OF AUSTRALIA	7,081,200	12.64%
WESTPAC BANKING CORPORATION	5,407,355	9.65%
AUST AND NZ BANKING GROUP	3,894,978	6.95%
NATIONAL AUSTRALIA BANK LTD	3,845,487	6.87%
TELSTRA CORPORATION LTD	3,325,793	5.94%
BHP BILLITON LTD	2,780,820	4.96%
CSL LTD	2,373,477	4.24%
WESFARMERS LTD	2,268,286	4.05%
WOOLWORTHS LTD	1,505,011	2.69%
MACQUARIE GROUP LTD	1,338,556	2.39%
TRANSURBAN GROUP	1,056,517	1.89%
WOODSIDE PETROLEUM LTD	986,992	1.76%
RIO TINTO LTD	919,908	1.64%
BRAMBLES LTD	877,249	1.57%
AMP LTD	836,179	1.49%
QBE INSURANCE GROUP LTD	833,408	1.49%
AMCOR LIMITED	768,741	1.37%
SUNCORP GROUP LTD	757,475	1.35%
SYDNEY AIRPORT	682,352	1.22%
INSURANCE AUSTRALIA GROUP LTD	655,480	1.17%
AGL ENERGY LTD	590,167	1.05%
CALTEX AUSTRALIA LTD	493,606	0.88%
APA GROUP	469,041	0.84%
STOCKLAND	467,039	0.83%
RAMSAY HEALTH CARE LTD	424,693	0.76%
ASCIANO LTD	413,341	0.74%
GPT GROUP	409,053	0.73%
ASX LTD	398,572	0.71%
ORIGIN ENERGY LTD	397,550	0.71%
JAMES HARDIE INDUSTRIES	375,605	0.67%

Company	Market Value (\$)	Weight (%)
LEND LEASE GROUP	366,724	0.65%
MIRVAC GROUP	350,729	0.63%
SONIC HEALTHCARE LTD	347,554	0.62%
INCITEC PIVOT LTD	321,726	0.57%
TATTS GROUP LTD	310,974	0.56%
ARISTOCRAT LEISURE LTD	289,688	0.52%
MEDIBANK PRIVATE LTD	287,145	0.51%
COMPUTERSHARE LTD	286,816	0.51%
ORICA LTD	279,853	0.50%
SOUTH32 LTD	274,838	0.49%
SANTOS LTD	268,508	0.48%
BENDIGO AND ADELAIDE BANK	262,553	0.47%
COCHLEAR LTD	261,985	0.47%
SEEK LTD	259,599	0.46%
BANK OF QUEENSLAND LTD	250,948	0.45%
COCA-COLA AMATIL LTD	240,944	0.43%
DUET GROUP	225,686	0.40%
HENDERSON GROUP	225,441	0.40%
HEALTHSCOPE LTD	223,621	0.40%
BORAL LTD	221,595	0.40%
THE STAR ENTERTAINMENT GROUP LTD	194,564	0.35%
TABCORP HOLDINGS LTD	190,991	0.34%
DOMINO'S PIZZA ENTERPRISES LTD	177,119	0.32%
MAGELLAN FINANCIAL GROUP LTD	166,818	0.30%
ANSELL LTD	159,632	0.28%
TPG TELECOM LTD	159,061	0.28%
ORORA LTD	131,780	0.24%
REA GROUP LTD	128,194	0.23%
ILUKA RESOURCES LTD	124,525	0.22%
DULUXGROUP LTD	122,859	0.22%
BLUESCOPE STEEL LTD	121,586	0.22%

Company	Market Value (\$)	Weight (%)
CARSALES.COM LTD	120,760	0.22%
FLIGHT CENTRE TRAVEL GROUP LTD	112,370	0.20%
PERPETUAL LTD	109,954	0.20%
RECALL HOLDINGS LTD	107,760	0.19%
SIRTEX MEDICAL LTD	106,893	0.19%
ADELAIDE BRIGHTON LTD	105,217	0.19%
JB HI-FI LTD	94,750	0.17%
GRAINCORP LTD	78,688	0.14%
DOWNER EDI LTD	78,149	0.14%
OZ MINERALS LTD	75,439	0.13%
CSR LTD	74,478	0.13%
NAVITAS LTD	71,292	0.13%
SIMS METAL MANAGEMENT LTD	60,106	0.11%
SPOTLESS GROUP HOLDINGS LTD	58,129	0.10%
WORLEYPARSONS LTD	50,615	0.09%
SUBTOTAL	\$55,172,589	98.50%
CASH	\$839,376	1.50%
TOTAL	\$56,011,966	100.00%

Source: Walsh & Company Asset Management Pty Limited. Note some figures may not reconcile due to rounding. The historical performance of the Manager is not a guarantee of the future performance of the Portfolio or the Company.

AQF BOARD OF DIRECTORS



JEFFREY ROBERT WHALAN
AO, BA

Non-Executive Chairman



MAXIMILIAN SEAN WALSH
AM, BEC

Non-Executive Director



JOSEPHINE TAN
BCOM, BSC

Non-Executive Director

The Company invests only in what it considers to be the best governed Australian companies within the S&P/ASX 100 Index, as ranked by the Company's corporate governance analysis and third party research. The Company pursues an index style of investing with an active corporate governance bias and expects to hold securities of approximately 75 to 85 Australian entities within the S&P/ASX 100 at any time.

The Company believes that boards and management that show relatively high levels of corporate governance tend to outperform companies with relatively lower levels of corporate governance over the long term. The Company also seeks to promote adherence to corporate governance best practice recommendations in its investments by voting in shareholder meetings. The Company aims to achieve long-term capital appreciation, while reducing risk, preserving the capital of the Company and investing in a diversified portfolio of investments.

DISCLAIMER

This Quarterly Update (**Update**) has been prepared by Walsh & Company Asset Management as Investment Manager of Australian Governance Masters Index Fund (**Company**).

An investment in the Company is subject to various risks, many of which are beyond the control of the Investment Manager and the Company. The past performance of the Company is not a guarantee of the future performance of the Company.

This Update contains statements, opinions, projections, forecasts and other material (forward looking statements), based on various assumptions. Those assumptions may or may not prove to be correct. None of the Investment Manager and the Company, their officers, employees, agents, analysts nor any other person named in this Update makes any representation as to the accuracy or likelihood of fulfilment of the forward looking statements or any of the assumptions upon which they are based.

This Update may contain general advice. Any general advice provided has been prepared without taking into account your objectives, financial situation or needs. Before acting on the advice, you should consider the appropriateness of the advice with regard to your objectives, financial situation and needs, and consider obtaining advice from a financial advisor. You should obtain a copy of the relevant Prospectus or offer document before making any decisions to purchase the product.