



QUARTERLY INVESTMENT UPDATE (DEC 2012)

MARKET REVIEW

To equity investors' delight, the Australian share market rallied strongly in the final quarter of 2012 with the S&P/ASX 100 Accumulation Index (the Index) gaining an impressive 7.5%. The Index finished 2012 just off its high, which was reached the previous trading day, and at levels that hadn't been seen since June 2011.

October set the tone for the quarter with a 25 basis point rate cut from the RBA helping to push the market higher. Positive economic data out of the US boosted investor confidence that the world's largest economy might be on the path to recovery, while the Chinese economy met gross domestic product expectations and beat retail sales estimates, also helping to boost Australian shares.

Some volatility entered the market during November as international equities were sold off and domestic housing data was slightly softer than expected. Confidence returned briefly after US President Barack Obama was elected for a second term; however this was short lived as focus turned to the impending US fiscal cliff, whereby over US\$600 billion of tax increases and spending cuts were set to take effect on 1 January 2013.

December, on the other hand, was a great month for equities with the Index returning 3.3% to finish 2012 on a positive note. Australian unemployment beat expectations by 0.3% in December coming in at 5.2%, while spot iron ore prices continued to rise supporting major Australian resource stocks. China maintained its positive data flow and the country's new leader, Xi Jinping, promised to keep macroeconomic policies stable while expanding domestic demand and promoting urbanisation.

STOCK NEWS

Woolworths (WOW) beat analyst expectations, reporting a 3.4% gain in supermarket sales for the third quarter of 2012, while overall group sales increased 4.3%. Woolworth's CEO Grant O'Brien stated that the results quite possibly indicated that the worst was over for the retail sector. During the quarter, WOW also announced and completed the transfer of its 69 shopping centres to Shopping Centres Australasia Property Group (SCP), a newly established real estate investment trust. Woolworth's shareholders received one stapled unit in SCP for every five WOW shares held on the record date (30 November 2012). Analysts see the spinoff as positive for WOW because it will reduce debt and increase balance sheet strength.

Agriculture giant Graincorp Limited (GNC) received a takeover offer in October. The offer came from US food processing and commodities trading corporation Archer Daniels Midland Company (ADM), which purchased a 14.9% stake in GNC before market open on 19 October and later in the day submitted a conditional proposal to acquire the outstanding shares in GNC at \$11.75 per share. On 9 December, ADM announced an increase of its bid to \$12.20 per share and revealed it had acquired a further 5% of Graincorp, increasing its stake to 19.9%. The Board of GNC has not recommended the offer to shareholders, stating in a news release on 13 December that the offer materially undervalued the company. GNC shares closed the quarter up 37.8% at \$12.35, indicating market expectations of a higher offer in the future.

Two of the 'Big Four Banks,' Australia and New Zealand Banking Group Limited (ANZ) and National Australia Bank Limited (NAB) delivered their 2012 full-year results in October. NAB reported a slightly weaker than expected result, with cash earnings down 1.5% from the previous year. NAB's Business Banking maintained a leading market share of 24.8%, showing that strength in the bank's core operations was overshadowed by its struggling UK businesses. NAB announced a final dividend of \$0.90 per share, bringing the total dividend for 2012 to \$1.80, up \$0.08 from 2011. NAB shares closed the quarter down 1.9%. ANZ posted results that were broadly in line with expectations, reporting a record A\$5.7 billion profit. ANZ also announced a final dividend of \$0.79 per share, up 4% year on year. ANZ shares closed up 1.2% for the quarter.

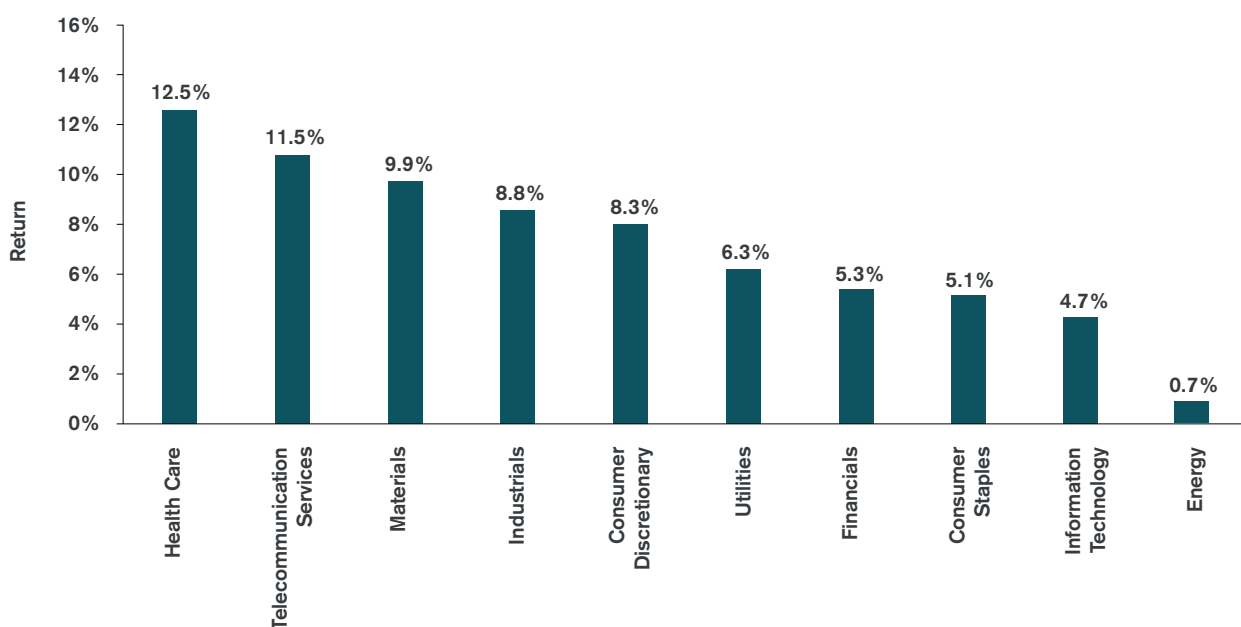
Blood products and vaccine supplier CSL Limited (CSL) had an impressive quarter, with its share price rising above the \$50 mark for the first time as the company increased its profit guidance for the 2013 financial year on 27 November. CSL announced the company expected net profit after tax to grow by 20%. The stronger profit forecast is based on higher sales revenues due to a better sales mix and improved efficiencies across the supply chain and higher-than-anticipated royalties from GARDASIL sales. The revised guidance is up from previous guidance provided by CSL in August that stated the company expected profit to rise by 12%. CSL shares increased 17.2% during the quarter.

Rio Tinto Limited (RIO) had a solid quarter, following the announcement that the company planned to cut operating costs and reduce spending to increase efficiency, along with continued strength in the spot iron ore price. The global resource giant announced plans to cut exploration and evaluation projects by US\$1 billion up until the end of 2013. Following a difficult year, RIO's action will help reduce

the unsustainable cost increases of the past several years, while increasing productivity. In 2013, RIO is relying on the expansion of iron ore production at its Pilbara operations, new commercial production at its copper-gold mine in Mongolia and a ramp up in production at its Yarwun 2 alumina refinery in Queensland for growth. The group was successful in selling its 57.7% stake in Palabora Mining Company Limited for US\$373 million. RIO shares closed the quarter up 23.7%.

Telecommunications provider Telstra Corporation Limited (TLS) posted strong gains during the December quarter as investors continued their hunt for yield in light of falling cash rates. On 8 November, TLS announced a successful A\$750 million bond issue at a coupon rate of 4.00% and a 5-year maturity. TLS closed up 11.5% for the quarter.

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



*The S&P ASX 100 sector returns are estimates

AUSTRALIAN GOVERNANCE MASTERS INDEX FUND (ASX: AQF) OVERVIEW*

AQF listing date	February 2010
Total assets	\$58,105,055
NTA per share (31 December 2012)	\$1.62
Number of securities held	76

*Note figures are pre-tax estimates



AQF PERFORMANCE

For the December quarter of 2012 (30 September to 31 December 2012), the accumulated unaudited pre-tax NTA of the Australian Governance Masters Index Fund increased by 7.85%. This represents an outperformance relative to the S&P ASX 100 Accumulation Index of 0.33%.

At the stock level, the biggest positive contributors to relative performance for the quarter were the overweight positions in BHP Billiton and Commonwealth Bank. The exclusion of Westfield Group and Treasury Wine Estates also contributed positively to the relative quarterly return.

The most significant detractor from performance was the exclusion of Fortescue Metals. Overweight positions in Newcrest, National Australia Bank, and QBE Insurance also led to underperformance.

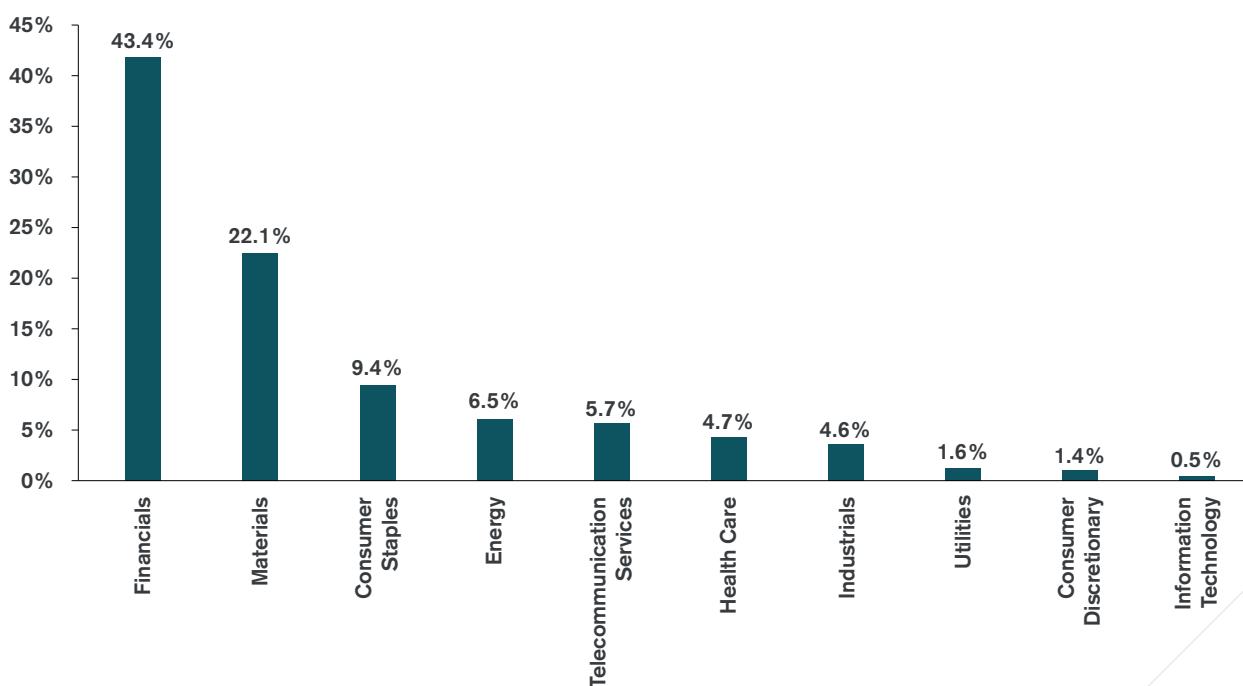
PERFORMANCE

	AQF ¹	Index ²	Relative
December quarter	7.85%	7.52%	0.33%
2012	22.34%	23.01%	-0.67%
2011	-10.52%	-8.44%	-2.08%
2010	7.07%	9.73%	-2.66%
Since inception	18.76%	23.58%	-4.82%

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

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

SECTOR ALLOCATION



PORTFOLIO HOLDINGS

Company	Market Value (\$)	Weight (%)
BHP BILLITON LIMITED	7,142,381	12.38
COMMONWEALTH BANK	6,002,360	10.41
WESTPAC BANKING CORP	4,809,562	8.34
ANZ BANKING GROUP LIMITED	4,077,789	7.07
NATIONAL AUSTRALIA BANK	3,405,650	5.90
TELSTRA CORPORATION	3,261,440	5.65
WESFARMERS LIMITED	2,560,117	4.44
WOOLWORTHS LIMITED	2,173,705	3.77
RIO TINTO LIMITED	1,725,567	2.99
CSL LIMITED	1,634,787	2.83
WOODSIDE PETROLEUM	1,268,162	2.20
NEWCREST MINING	1,015,689	1.76
AMP LIMITED	846,574	1.47
SUNCORP GROUP LIMITED	786,212	1.36
QBE INSURANCE GROUP	779,350	1.35
ORIGIN ENERGY	756,346	1.31
MACQUARIE GROUP LIMITED	725,771	1.26
BRAMBLES LIMITED	699,444	1.21
SANTOS LIMITED	634,454	1.10
AMCOR LIMITED	584,179	1.01
INSURANCE AUSTRALIA GROUP	582,793	1.01
ORICA LIMITED	546,275	0.95
TRANSURBAN GROUP	532,778	0.92
AGL ENERGY LIMITED	503,680	0.87
STOCKLAND	470,090	0.82
OIL SEARCH LIMITED	458,573	0.80
COCA-COLA AMATIL	426,217	0.74
GPT GROUP	359,694	0.62
ASX LIMITED	329,796	0.57
INCITEC PIVOT	314,734	0.55

Company	Market Value (\$)	Weight (%)
SONIC HEALTHCARE	312,495	0.54
MIRVAC GROUP	304,251	0.53
DEXUS PROPERTY GROUP	295,341	0.51
WORLEYPARSONS LIMITED	290,388	0.50
LEND LEASE GROUP	289,536	0.50
COMPUTERSHARE LIMITED	273,035	0.47
ASCIANO LIMITED	272,666	0.47
APA GROUP	270,953	0.47
COCHLEAR LIMITED	268,307	0.47
TATTS GROUP LIMITED	243,774	0.42
JAMES HARDIE INDUSTRIES	236,874	0.41
ILUKA RESOURCES	226,447	0.39
ALS LIMITED	216,918	0.38
RAMSAY HEALTH CARE	211,011	0.37
QANTAS AIRWAYS	202,467	0.35
BENDIGO AND ADELAIDE BANK	202,258	0.35
BORAL LIMITED	195,234	0.34
CENTRO RETAIL AUSTRALIA	194,323	0.34
TOLL HOLDINGS LIMITED	185,524	0.32
GRAINCORP LIMITED	169,109	0.29
CALTEX AUSTRALIA	157,176	0.27
ECHO ENTERTAINMENT	140,779	0.24
SEEK LIMITED	137,130	0.24
BANK OF QUEENSLAND	136,938	0.24
ALUMINA LIMITED	133,666	0.23
TABCORP HOLDINGS LIMITED	133,532	0.23
OZ MINERALS	126,456	0.22
MONADELPHOUS GROUP	124,957	0.22
ANSELL LIMITED	124,587	0.22
SPARK INFRASTRUCTURE	118,578	0.21

Company	Market Value (\$)	Weight (%)
CHALLENGER LIMITED	117,333	0.20
PRIMARY HEALTH CARE	112,844	0.20
BEACH ENERGY LIMITED	107,939	0.19
UGL LIMITED	106,863	0.19
BLUESCOPE STEEL LIMITED	106,740	0.19
DOWNER EDI LIMITED	101,027	0.18
PANAUST LIMITED	94,121	0.16
SIMS METAL MANAGEMENT LIMITED	92,269	0.16
ARISTOCRAT LEISURE	91,895	0.16
MYER HOLDINGS LIMITED	76,462	0.13
DAVID JONES LIMITED	74,677	0.13
ARRIUM LIMITED	68,710	0.12
FAIRFAX MEDIA LIMITED	63,999	0.11
BOART LONGYEAR	51,872	0.09
PALADIN ENERGY LIMITED	47,868	0.08
SCA PROPERTY GROUP	21,921	0.04
CASH	728,611	1.26
TOTAL	57,674,032	100

AQF VOTING AND CORPORATE ACTIONS

As highlighted in the AQF prospectus, the Company intends to be an active participant in voting at general meetings and taking part in corporate actions. During the December quarter, the Company voted in 49 AGM/EGMs on a total of 259 resolutions. The Company voted against Board recommendations on seven occasions.

Australian Governance Masters Index Fund Limited invests only in 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 75-85 Australian entities within the S&P/ASX 100 at any given time.

The Company believes boards and management that show relatively high levels of corporate governance tend to outperform relatively poorly governed companies over the long term. The Company also seeks to promote adherence to corporate governance best practice recommendations in its investments by voting its proxies and participating 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.