

LIBERTY ALL STAR EQUITY FUND

Form N-CSR

March 06, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED**

**MANAGEMENT INVESTMENT COMPANIES**

File No. 811-04809

Liberty All-Star Equity Fund

(exact name of registrant as specified in charter)

1290 Broadway, Suite 1100, Denver, Colorado 80203

(Address of principal executive offices) (Zip code)

Tane T. Tyler, General Counsel

ALPS Fund Services, Inc.

1290 Broadway, Suite 1100

Denver, Colorado 80203

(Name and address of agent for service)

Registrant's telephone number, including area code: 303-623-2577

Date of fiscal year end: December 31

Date of reporting period: January 1 - December 31, 2011

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**Item 1. Report of Shareholders.**

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### **A SINGLE INVESTMENT...**

### **A DIVERSIFIED CORE PORTFOLIO**

A single fund that offers:

A diversified, multi-managed portfolio of growth and value stocks

Exposure to many of the industries that make the U.S. economy one of the world's most dynamic

Access to institutional quality investment managers

Objective and ongoing manager evaluation

Active portfolio rebalancing

A quarterly fixed distribution policy

Actively managed, exchange traded fund listed on the New York Stock Exchange (ticker symbol: USA)

### **LIBERTY ALL-STAR® EQUITY FUND**

The views expressed in the President's Letter, Unique Fund Attributes and Manager Roundtable reflect the current views of the respective parties. These views are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict, so actual outcomes and results may differ significantly from the views expressed. These views are subject to change at any time based upon economic, market or other conditions, and the respective parties disclaim any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions for the Fund are based on numerous factors, may not be relied on as an indication of trading intent. References to specific company securities should not be construed as a recommendation or investment advice.

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**PRESIDENT'S LETTER (UNAUDITED)**

Fellow Shareholders:

*February 2012*

The stock market was essentially unchanged over the span of 12 months in 2011, but that doesn't mean it was a smooth ride. Quite the contrary, the market fluctuated wildly during a year in which investors seemed to develop a split personality--optimistic one day, fearful the next. In an attempt to explain the volatility, the media even coined the term "risk-on/risk-off," as if repeated changes in direction could be likened to the flip of a switch.

The greatest volatility came during the second half of the year. The S&P 500® Index moved up or down by 1 percent or more on 22 percent of the trading days during the first half. That rate more than doubled in the second half, rising to 57 percent of trading days, approaching the 69 percent of trading days with similar moves in the first quarter of 2009. That period marked the capitulation phase of the market decline triggered by the most severe financial crisis since the Great Depression.

When the dust finally settled, the S&P 500® Index gained 2.11 percent for the year. The first and fourth quarters of the year were positive, as they returned 5.92 percent and 11.82 percent, respectively. However, the second quarter was flat (+0.10 percent) and the third quarter was very poor, as the index declined 13.87 percent.

Behind the uneven performance of the stock market and its extreme volatility was a mix of factors. On the positive side, corporate earnings were strong, balance sheets continued to recover nicely and managements did a good job of managing costs. The offsets to good corporate performance were an anemic housing and job market. But it was macro concerns on both sides of the Atlantic that created the turmoil, as investors lost confidence in governments' ability to deal with fiscal crises. In the U.S., concerns were driven by the size of the federal budget deficit and the political infighting that prevented Washington from coming up with any meaningful solution. The federal debt, just \$1 trillion in 1981, skyrocketed 15-fold by 2011. It didn't help when rating agency, Standard & Poor's downgraded U.S. debt from AAA to AA+. It was the first-ever downgrade of

U.S. debt. Sovereign debt woes plagued the European Union as well. Greece, a relatively small economy, was at the eye of the storm, but the real worry was that debt problems could result in defaults in Italy, Ireland, Spain or Portugal--and could even lead to the demise of the euro. Not even a core euro-zone economy like France was immune to the concerns. Like their counterparts in Washington, Europe's leaders have proved ineffectual in dealing with the problem.

For the year, Liberty All-Star Equity Fund declined 6.73 percent with shares valued at net asset value (NAV), 5.84 percent with shares valued at NAV with dividends reinvested and 8.09 percent with shares valued at market price (with dividends reinvested). It was a disappointing year, as all three measures of return considerably lagged the -0.65 percent return of the Lipper Large-Cap Core Mutual Fund Average, the Fund's primary benchmark, as well as the S&P 500® Index.

The Fund's underperformance can be attributed largely to the third quarter of 2011. Through the first half of the year, the Fund outperformed both the Lipper benchmark and the S&P 500® Index on a market price basis (with dividends reinvested). At June 30, 2011, the Fund had returned 8.66 percent on a market price basis versus 5.19 percent for the Lipper average and 6.02 percent for the S&P 500® Index. But, in the third quarter, the Fund declined 18.96 percent with shares valued at NAV; 18.80 percent with shares valued at NAV with dividends reinvested; and 19.29 percent with shares valued at market price (with dividends reinvested). Although Fund returns were more competitive in the fourth quarter, the worst of the damage had been done.

We are disappointed that a poor quarter had such a negative impact on relative long-term performance. As recently as June 30, the Fund's NAV reinvested return had outperformed the Lipper benchmark for the trailing one, three, five, 10 and 20 years, as well as since inception, which was 24 1/2 years as of that date. Even after the poor 2011, returns over the trailing three year period rank the Fund in the 26th percentile of its Lipper universe.



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**PRESIDENT'S LETTER (UNAUDITED)**

Looking beneath the numbers, most actively managed funds did poorly in the highly volatile environment that existed in 2011. This observation is borne out by the fact that 77 percent of the funds in the Lipper Large-Cap Core universe underperformed the S&P 500® Index last year. Further, our managers are going to remain true to their style and strategy, as we want them to. So, for example, while investors were rushing into defensive sectors (consumer staples, healthcare, utilities) in 2011, our managers did not abandon their principles for potential short-term refuge. And our value managers, representing 60 percent of the Fund, were hurt the most due to their focus on economically sensitive stocks, as investors shunned them over fears of fallout from the euro zone. On the subject of diversification, while it can help long term, it can hurt short term when investors panic and concentrate on the most defensive sectors of the market. It is also the Fund's policy to stay essentially fully invested and not attempt to "hide" in cash during market sell-offs, such as last year's third quarter.

Turning to specific sector allocations, the Fund was underweight in the three best performing S&P sectors, which were, in order of return, utilities, consumer staples and healthcare, and was overweight to the poorest performing S&P sector, financials. The Fund was also overweight in information technology and energy, but hurt more by poor stock selection than sector allocation.

For most of the year, the discount at which Fund shares traded relative to their underlying NAV narrowed, although it widened in the fourth quarter. For the year, the discount ranged from 7.2 percent to 16.8 percent compared with 10.4 percent to 17.6 percent in 2010.

Fund distributions totaled \$0.34 per share in 2011, up from \$0.31 in 2010. As shareholders may recall, the Fund's distribution policy has been in place since 1988 and is a major component of the Fund's total return. Since the Fund's first calendar year of operations in

1987, the Fund has paid distributions of \$23.60 per share. We would emphasize that shareholders need to include these distributions when determining the return on their investment in the Fund.

Once again, in this annual report we offer a question and answer session with the Fund's five investment managers. We believe you will find the comments of these leading investors to be both interesting and insightful. As we have also done in recent annual reports, we once again offer a brief summary of the Fund's attributes on pages 4 and 5. I urge you to revisit these attributes, as they help to make the Fund a unique and attractive investment vehicle.

In closing, while we are disappointed with the Fund's performance during the second half of 2011, in this highly volatile environment markets rise and fall in ever more compressed and unpredictable timeframes. As cited earlier, as of June 30, 2011 the Fund was ahead of its primary benchmark for all short- and long-term periods. That was due in part to the managers remaining focused on their respective styles and the opportunities that became available during the market declines. And although 2008, much like 2011, was a disappointing year in relative terms, the Fund was positioned to fully exploit those opportunities and it outperformed 90 percent of its peers in the Lipper Large-Cap Core universe during calendar years 2009 and 2010.

We thank you for your ongoing support of the Fund. Please remain assured that we at Liberty All-Star Equity Fund will continue to monitor markets and our managers closely, and will keep the best long-term interests of shareholders first and foremost in all that we do.

Sincerely,

William R. Parmentier, Jr.

President and Chief Executive Officer

Liberty All-Star® Equity Fund



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Net Asset Value (NAV)	\$4.99
Market Price	\$4.22
Discount	15.4%

	<b>Quarter</b>	<b>2011</b>
Distributions	\$0.08	\$0.34
Market Price Trading Range	\$3.77 to \$4.65	\$3.77 to \$5.43
Discount Range	11.3% to 16.8%	7.2% to 16.8%

**PERFORMANCE:**

Shares Valued at NAV	10.70%	(6.73%)
Shares Valued at NAV with Dividends Reinvested	10.94%	(5.84%)
Shares Valued at Market Price with Dividends Reinvested	4.80%	(8.09%)
S&P 500® Index	11.82%	2.11%
Lipper Large-Cap Core Mutual Fund Average*	11.04%	(0.65%)
NAV Reinvested Percentile Rank (1 = best; 100 = worst)	62nd	91st
Number of Funds in Category	1108	1066

**LONG-TERM PERFORMANCE SUMMARY AND DISTRIBUTIONS  
PERIODS ENDING DECEMBER 31, 2011****ANNUALIZED RATES OF RETURN  
3 YEARS 5 YEARS 10 YEARS 25 YEARS**

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Distributions	\$0.96	\$2.51	\$6.81	\$23.60
Shares Valued at NAV	12.90%	(2.79%)	1.80%	7.99%
Shares Valued at NAV with Dividends Reinvested	14.10%	(1.65%)	2.43%	8.67%
Shares Valued at Market Price with Dividends Reinvested	14.75%	(3.84%)	0.32%	7.70%
S&P 500® Index	14.11%	(0.25%)	2.92%	9.28%
Lipper Large-Cap Core Mutual Fund Average*	12.72%	(0.87%)	2.41%	8.68%
NAV Reinvested Percentile Ranking (1 = best; 100 = worst)	26th	69th	51st	58th
Number of Funds in Category	958	827	498	69

\* Percentile ranks calculated using the Fund's NAV Reinvested results within the Lipper Large-Cap Core Mutual Fund Universe.

\*\* Performance from the first full calendar year of operations since inception date of October 31, 1986.

Figures shown for the Fund and the Lipper Large-Cap Core Mutual Fund Average are total returns, which include dividends, after deducting Fund expenses. The Fund's performance is calculated assuming that a shareholder exercised all primary rights in the Fund's rights offerings. Figures shown for the unmanaged S&P 500® Index are total returns, including dividends. A description of the Lipper benchmark and the S&P 500® Index can be found on page 34.

**Past performance cannot predict future results.** Performance will fluctuate with market conditions. Current performance may be lower or higher than the performance data shown. Performance information does not reflect the deduction of taxes that shareholders would pay on Fund distributions or the sale of Fund shares. An investment in the Fund involves risk, including loss of principal.

Shares of closed-end funds frequently trade at a discount to net asset value. The price of the Fund's shares is determined by a number of factors, several of which are beyond the control of the Fund. Therefore, the Fund cannot predict whether its shares will trade at, below or above net asset value.

[www.all-starfunds.com](http://www.all-starfunds.com)

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**LIBERTY ALL-STAR® EQUITY FUND**

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**UNIQUE FUND ATTRIBUTES (UNAUDITED)**

## Multi-management for Individual Investors

Liberty All-Star® Equity Fund is multi-managed, an investment discipline that is followed by large institutional investors to diversify their portfolios. In 1986, Liberty All-Star® Equity Fund became the first closed-end fund to bring multi-management to individual investors.

## Real-time Trading and Liquidity

The Fund has a fixed number of shares that trade on the New York Stock Exchange and other exchanges. Share pricing is continuous not just end-of-day, as it is with open-end mutual funds. In addition, Fund shares offer immediate liquidity and there are no annual sales fees.

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## Access to Institutional Managers

The Fund's investment managers invest primarily for pension funds, endowments, foundations and other institutions. Because institutional managers are closely monitored by their clients, they tend to be more disciplined and consistent in their investment process.

## Monitoring and Rebalancing

ALPS Advisors continuously monitors these investment managers to ensure that they are performing as expected and adhering to their style and strategy, and will replace managers when warranted. Periodic rebalancing maintains the Fund's structural integrity and is a well-recognized investment discipline.

## Alignment and Objectivity

Alignment with shareholders' best interests and objective decision-making help to ensure that the Fund is managed openly and equitably. In addition, the Fund is governed by a Board of Trustees that is elected by and responsible to shareholders.

## Distribution Policy

Since 1988, the Fund has followed a policy of paying annual distributions on its shares at a rate that approximates historical equity market returns. The current annual distribution rate is 6 percent of the Fund's net asset value (paid quarterly at 1.5 percent per quarter), providing a systematic mechanism for distributing funds to shareholders.



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**MULTI-MANAGEMENT HAS PRODUCED MORE CONSISTENT RETURNS (UNAUDITED)**

The narrative on the preceding two pages is intended to focus on the unique attributes of the Fund. The chart below demonstrates the long-term outcome of these attributes, particularly the Fund's multi-management structure. Most mutual funds are run by a single portfolio manager or an internal team of managers pursuing a particular investment style, whether it's growth or value. But styles go in and out of favor. A style that outperforms on a relative basis one year may disappoint the next, leading to higher volatility.

As discussed in our Unique Fund Attributes feature, ALPS utilizes multi-management, that is, combining managers who practice different investment styles to reduce volatility while producing competitive returns.

All-Star's long-term track record provides clear testimony to the value of the multi-management strategy. The chart below demonstrates that for the trailing 25-year period ending December 31, 2011, the Fund has achieved better-than-average returns and better-than-average consistency compared with peer funds in the Lipper Large-Cap Core universe that have a 25-year performance history.

Each dot represents the precise 25-year return and consistency record ending December 31, 2011, of each fund in the universe of 56 open-end Large-Cap Core equity mutual funds (as classified by Lipper, Inc.) that has a 25-year history. The star represents the Fund's 25-year NAV reinvested return for the period ending December 31, 2011. The Fund is a closed-end fund and does not continuously offer shares. The Fund trades in the secondary market, investors wishing to buy or sell shares need to place orders through an intermediary or broker. The share price of a closed-end fund is based on the market's value.

Consistency is measured by the volatility of non-market monthly returns, calculated by subtracting the return of the S&P 500 index from each mutual fund's return. The lower the volatility, the higher the consistency of results compared with the stock market.

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**INVESTMENT MANAGERS/PORTFOLIO CHARACTERISTICS (UNAUDITED)**

**THE FUND'S ASSETS ARE APPROXIMATELY EQUALLY DISTRIBUTED AMONG THREE VALUE MANAGERS AND TWO GROWTH MANAGERS:**

**MANAGERS' DIFFERING INVESTMENT STRATEGIES ARE REFLECTED IN PORTFOLIO CHARACTERISTICS**

The portfolio characteristics table below is a regular feature of the Fund's shareholder reports. It serves as a useful tool for understanding the value of a multi-managed portfolio. The characteristics are different for each of the Fund's five investment managers. These differences are a reflection of the fact that each pursues a different investment style. The shaded column highlights the characteristics of the Fund as a whole, while the final column shows portfolio characteristics for the S&P 500® Index.

	Schneider	Pzena	Matrix	Cornerstone	TCW	Total Fund	S&P 500® Index
Number of Holdings	41	39	36	48	31	160*	500
Percent of Holdings in Top 10	48%	40%	38%	41%	46%	19%	20%
Weighted Average Market Capitalization (billions)	\$33	\$54	\$58	\$81	\$68	\$59	\$91
Average Five-Year Earnings Per Share Growth	(7)%	(2)%	0%	19%	21%	6%	7%
Dividend Yield	1.6%	2.5%	2.0%	1.2%	0.8%	1.6%	2.2%
Price/Earnings Ratio**	13x	11x	11x	16x	23x	14x	14x
Price/Book Value Ratio	1.6x	1.8x	2.2x	4.6x	4.9x	3.0x	3.4x

\* Certain holdings are held by more than one manager.

\*\* Excludes negative earnings.





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**MANAGER ROUNDTABLE (UNAUDITED)**

**Investment Manager Roundtable**

*The Fund's five investment managers summarize their strategy, look back at 2011 and identify stocks that exemplify their investment approach*

Liberty All-Star Equity Fund's five investment managers represent long experience, deep knowledge, a proven track record and, given that they represent both growth and value styles of investing, a broad point of view on the stock market and equity investing generally. Thus, once again, we are grateful to be able to call upon this resource to provide Fund shareholders with commentary and insight. The Fund's Investment Advisor, ALPS Advisors, Inc., serves as moderator of the roundtable. Participating investment management firms, the portfolio manager for each, and their respective styles and strategies are:

**CORNERSTONE CAPITAL MANAGEMENT, INC.**

*Portfolio Manager/Thomas G. Kamp, CFA*

President and Chief Investment Officer

*Investment Style/Growth* Cornerstone evaluates stocks that its research identifies as offering underappreciated opportunities for growth as defined by one or more of their metrics. Stock selection is further based on the fundamentals of revenue, earnings, cash flow, and management depth and credibility.

**MATRIX ASSET ADVISORS, INC.**

*Portfolio Manager/David A. Katz, CFA*

President and Chief Executive Officer

*Investment Style/Value* Matrix follows an opportunistic value-oriented investment philosophy. Matrix believes that value can be found in all sectors of the economy, and thus looks for investment opportunities beyond traditional value industries.

**PZENA INVESTMENT MANAGEMENT, LLC**

*Portfolio Manager/Antonio DeSpirito, III*

Principal and Portfolio Manager

*Investment Style/Value* Pzena uses fund