

LIBERTY ALL STAR EQUITY FUND  
Form N-CSR  
March 12, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED  
MANAGEMENT INVESTMENT COMPANIES**

Investment Company Act file number

Liberty All-Star Equity Fund  
(Exact name of registrant as specified in charter)

1625 Broadway, Suite 2200, Denver, Colorado  
(Address of principal executive offices)

80202  
(Zip code)

Tane T. Tyler, Secretary  
Liberty All-Star Equity Fund  
1625 Broadway, Suite 2200  
Denver, Colorado 80202  
(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: December 31, 2006

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**Item 1. Report of Shareholders**

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**LIBERTY ALL-STAR® EQUITY FUND**

**2006 ANNUAL REPORT**

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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 the world's dynamic
- Access to institutional quality investment managers
- Objective and ongoing manager evaluation
- Active portfolio rebalancing
- A quarterly fixed distribution policy
- The power of more than \$1.3 billion in assets
- Actively managed, exchange traded fund listed on the New York Stock Exchange (ticker symbol: USA)

**LIBERTY ALL-STAR EQUITY FUND**

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The views expressed in the President's Letter, Editorial Feature 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 interest. References to specific company securities should not be construed as a recommendation or investment advice.

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**LIBERTY ALL-STAR® EQUITY FUND  
PRESIDENT'S LETTER**

Fellow Shareholders:

*February 2007*

By just about all accounts, 2006 was a rewarding year for equity investors. It might be more accurate, however, to say that it was an especially rewarding *second half* for equity investors. You may recall that one of the most widely recognized measures of the U.S. stock market, the S&P 500 Index, was ahead just 2.7 percent through June 30 of last year, and it looked as though it was on track for another mid-single-digit gain for the second consecutive year. After drifting lower through the first two weeks of July, the market found its footing and the S&P 500 Index rose sharply to finish the year up 15.8 percent.

There were several catalysts sparking the market's strong second half performance. Perhaps the leading one was the Federal Reserve's decision in September to leave short-term interest rates unchanged after 17 consecutive quarter-point increases. But other positive factors contributed as well. Energy prices, gasoline in particular, declined after a summer spike and crude oil prices ended the year just about where they started. Corporate earnings proved surprisingly resilient. Economic growth eased, but not too dramatically. Housing experienced a significant slowdown it couldn't stay white-hot forever but did not collapse. And inflation, while a little above the Federal Reserve's target range, flashed no ominous signals.

For shareholders of Liberty All-Star Equity Fund, the biggest news of 2006 was the change in the Fund's adviser from Banc of America Investment Advisors, Inc. to ALPS Advisers, Inc. I'll say more about this momentarily. First, let me address Fund investment performance.

For the full year, the Fund returned 9.7 percent with shares valued at net asset value (NAV) and 10.4 percent with shares valued at NAV with dividends reinvested. In terms of the market price of its shares, the Fund rose 11.7 percent. We were disappointed that the Fund's NAV returns trailed the Lipper Large-Cap Core Mutual Fund Average (+13.5 percent) and the S&P 500 last year after outperforming both those benchmarks for the past three consecutive years.

Looking at the underlying reasons why the Fund trailed its relevant benchmarks during 2006, we would note it was primarily due to the underperformance of the approximately 40 percent of Fund assets allocated to growth stocks in general, and the higher multiple stocks specifically. Conversely, the approximately 60 percent of Fund assets allocated to value stocks outperformed both the Lipper Large-Cap Value Mutual Fund Average and the S&P 500. As Fund shareholders may be aware, value style stocks have experienced a prolonged period of outperformance—seven consecutive calendar years in which the Russell 3000 Value Index has outperformed the Russell 3000 Growth Index. Normally, one would have expected a rotation between these two styles by now, but the timing and magnitude of those shifts in leadership has and still remains unpredictable.

The Fund's blending of both growth and value managers has served shareholders well as a core investment holding over long periods involving multiple style rotations. To that point, the Fund's NAV results have outperformed the average manager in the Lipper Large-Cap Core Mutual Fund universe for the past three-, five-, 10-, 15- and 20-year trailing periods ending December 31, 2006. We experienced a similar situation in the late 1990s when value stocks were downtrodden and investors were only interested in growth- and technology-oriented funds. We can't predict when we will experience another shift in leadership, but we do feel it would be as unwise now, as it would have been

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in the 1999-2000 timeframe, to change our disciplined investment strategy of blending both growth and value managers within the Fund. The following tables trace key metrics for the fourth quarter and full year of 2006, as well as longer-term periods:

### FUND STATISTICS AND SHORT-TERM PERFORMANCE PERIODS ENDING DECEMBER 31, 2006

|   | 4TH QUARTER      | 2006              |   |
|---|------------------|-------------------|---|
| <b>LIBERTY ALL-STAR EQUITY FUND</b>                     |                  |                   |   |
| <b>STATISTICS:</b>                                      |                  |                   |   |
| Year End Net Asset Value (NAV)                          |                  | \$8.76            |   |
| Year End Market Price                                   |                  | \$8.29            |   |
| Year End Discount                                       |                  | 5.4               | % |
| Distributions   | \$0.22           | \$0.88            |   |
| Market Price Trading Range                              | \$7.76 to \$8.31 | \$7.06 to \$8.77  |   |
| Premium/(Discount) Range                                | (5.4)% to (9.8)% | (3.4)% to (11.5)% |   |
| <b>PERFORMANCE:</b>                                     |                  |                   |   |
| Shares Valued at NAV                                    | 6.2              | % 9.7             | % |
| Shares Valued at NAV with Dividends Reinvested          | 6.2              | % 10.4            | % |
| Shares Valued at Market Price with Dividends Reinvested | 8.5              | % 11.7            | % |
| S&P 500 Index   | 6.7              | % 15.8            | % |
| Lipper Large-Cap Core Mutual Fund Average               | 6.3              | % 13.5            | % |
| NAV Reinvested Percentile Rank (1 = best; 100 = worst)  | 56th             | 81st              |   |
| Number of Funds in Category                             | 853              | 811               |   |

### LONG-TERM PERFORMANCE SUMMARY PERIODS ENDING DECEMBER 31, 2006

|   | ANNUALIZED RATES OF RETURN |         |          |          |          |   |      |   |      |   |
|---|----------------------------|---------|----------|----------|----------|---|------|---|------|---|
|   | 3 YEARS                    | 5 YEARS | 10 YEARS | 15 YEARS | 20 YEARS |   |      |   |      |   |
| <b>LIBERTY ALL-STAR EQUITY FUND</b>                       |                            |         |          |          |          |   |      |   |      |   |
| Shares Valued at NAV                                      | 9.3                        | %       | 6.6      | %        | 7.9      | % | 9.6  | % | 10.9 | % |
| Shares Valued at NAV with Dividends Reinvested            | 9.4                        | %       | 6.7      | %        | 8.2      | % | 9.8  | % | 11.4 | % |
| Shares Valued at Market Price with Dividends Reinvested   | 6.2                        | %       | 4.7      | %        | 8.2      | % | 9.7  | % | 10.8 | % |
| S&P 500 Index   | 10.5                       | %       | 6.2      | %        | 8.4      | % | 10.6 | % | 11.8 | % |
| Lipper Large-Cap Core Mutual Fund Average*                | 8.9                        | %       | 4.8      | %        | 6.9      | % | 9.4  | % | 10.4 | % |
| NAV Reinvested Percentile Ranking (1 = best; 100 = worst) | 43rd                       |         | 16th     |          | 27th     |   | 41st |   | 26th |   |
| Number of Funds in Category                               | 680                        |         | 581      |          | 251      |   | 92   |   | 57   |   |

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

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 reinvested returns assume that all of the Fund's rights offerings were fully subscribed under the terms of each offering. Figures shown for the unmanaged Lipper benchmark and the S&P 500 Index are total returns, including income. A description of the Lipper benchmark and the S&P 500 Index can be found on page 46.

**Past performance cannot predict future results.** Performance will fluctuate with changes in 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.





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Returning to the change in the Fund's Adviser, as shareholders know, Banc of America Investment Advisors, Inc., in December concluded an agreement with ALPS Holdings, Inc. and ALPS Advisers, Inc. (ALPS) to sell to ALPS its advisory business of managing the Liberty All-Star Equity Fund (and its companion Fund, the Liberty All-Star Growth Fund, Inc.). Shareholders will find more information about ALPS in the editorial section of this report, which immediately follows this letter.

The Fund's management team and staff members continue to manage the Fund, having completed the transition to ALPS. We believe that ALPS will afford the Fund and its shareholders some distinct benefits, specifically its marketing, shareholder servicing and wholesaling capabilities, which should help support the trading of the Fund in the marketplace.

In closing, I would like to draw your attention to our traditional manager roundtable in this report. It's another chance to hear directly from the Fund's five investment managers, who are well-recognized thought leaders in value and growth style investing. In addition to providing information on ALPS, this report's editorial section also features a recap of the Fund's key investment attributes.

Beyond the change in the Fund's Adviser, 2006 marked the Fund's 20th anniversary. In 1986, the Fund's multi-managed, closed-end structure made it a pioneering investment for individual investors. Now, we can look back and say the Fund has proved its value through multiple market cycles and widely varied investment environments. We are excited about prospects for the future, and pledge to remain committed to the best interests of Fund shareholders. We are grateful for your ongoing support of the Fund and will do all in our power to maintain your trust and confidence.

Sincerely,

William R. Parmentier, Jr.

President and Chief Executive Officer

Liberty All-Star Equity Fund

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**LIBERTY ALL-STAR® EQUITY FUND  
FOUNDATION FOR THE FUTURE**

**In October 2006, Liberty All-Star Equity Fund marked its 20th anniversary. Just weeks later, the Fund entered a new era with a new investment adviser, ALPS Advisers, Inc. In successfully completing the transition, the Fund has maintained its continuity and looks to a promising future.**

For shareholders of Liberty All-Star Equity Fund, the biggest news of 2006 didn't occur officially until December 18. On that date, ALPS Advisers, Inc. assumed the role of the Fund's Investment Adviser from Banc of America Investment Advisors, Inc. Shareholders paved the way by voting to approve related advisory agreements and other proposals on November 21.

As a subsidiary of one of the largest financial organizations in the world, Banc of America Investment Advisors was a familiar name to shareholders. But, what about ALPS Advisers?

Its parent, ALPS Holdings, Inc. (ALPS), was established in 1985, the year before Liberty All-Star Equity Fund commenced operations. ALPS partners with a broad range of fund clients to provide them with a wide array of customized services that, taken together, makes ALPS a valuable source of turnkey service and support capabilities. At its founding, ALPS provided fund administration and fund distribution services. Over time, it has expanded its range of offerings to include fund accounting, transfer agency services, shareholder services, active distribution, legal, tax and compliance services. Today, ALPS provides fund administration services to funds with assets in

excess of \$13 billion, and distribution services to funds with assets of more than \$120 billion.

ALPS has traditionally conducted its business through two wholly-owned subsidiaries: ALPS Fund Services, Inc., a service company and SEC-registered transfer agent, and ALPS Distributors, Inc., an NASD-registered broker-dealer. The advisory agreement with Liberty All-Star Equity Fund is conducted through a third subsidiary, ALPS Advisers, Inc., which is a registered investment adviser with the Securities and Exchange Commission.

ALPS philosophy aligns well with that of the Fund. Quality is the company's hallmark. As the Fund is oriented to the interests of its shareholders, ALPS is focused on its clients' needs. ALPS is a leading provider of fund services and support, and is continually enhancing its value to its clients.

Beyond the philosophical fit, however, the Fund stands to gain tangible benefits by being part of the ALPS family. The marketing, shareholder service and wholesaling capabilities of ALPS should support the trading of the Fund in the marketplace. ALPS offers in-depth fund administration, accounting, compliance and distribution experience. In addition, ALPS has made growth of its asset management operations a key component of its business plan, meaning that effective management of the Fund is a strategic priority.

Of significance to shareholders, the investment operations of the Fund remain intact. The fundamental structure of the Fund as a closed-end, multi-managed, core equity vehicle is unchanged, and the five investment managers representing value and growth investment styles remain in place as well (subject, as always, to ongoing review by the Fund's management team and Board of Trustees). Likewise, the Fund's senior management staff including its President and Senior Vice President have transitioned to ALPS Advisers and remain Boston-based.

Bottom line: Liberty All-Star Equity Fund is well positioned to move into its second 20 years on the continued strength of a solid foundation for the future.

**Amid change, fundamentals endure**

**Even as the Fund transitions to tomorrow, the underlying attributes that set it apart remain solidly in place.**

When it was established, the Liberty All-Star Equity Fund brought together four key innovations in a single investment vehicle:

- Multi-management
- Real-time trading
- Access to institutional quality managers
- Ongoing monitoring and periodic rebalancing

Over time, these attributes have been enhanced by the Fund's commitment to objectivity and alignment with shareholders' best interests, and by its consistent distribution policy. Together, these attributes help to make the Fund a core equity holding for investors seeking diversification, income and the potential for long-term appreciation.





**LIBERTY ALL-STAR® EQUITY FUND  
AMID CHANGE, FUNDAMENTALS ENDURE**

**Multi-management for individual investors**

Large institutional investors, such as endowment and pension plans, have traditionally employed multiple investment managers. When it was founded, Liberty All-Star Equity Fund became the first publicly traded, multi-managed, closed-end fund. Twenty years later, multi-management has gained broad acceptance not only among institutions, but also with individual investors.

**Real-time trading and liquidity**

Owing to its closed-end structure, the Fund has a fixed number of shares that trade on the New York Stock Exchange and other exchanges. Share price is determined by supply and demand, and pricing is continuous not just end-of-day, as it is with open-end mutual funds. Fund shares offer immediate liquidity, there are no annual sales fees and expense ratios are often lower than many comparable open-end mutual funds.

**Access to institutional managers**

The Fund's investment managers invest primarily for pension funds, endowments, foundations and other institutions. By itself, that does not make them inherently better. But, because they are closely monitored by their institutional clients, these managers tend to be more disciplined and consistent in their investment process.

**Monitoring and rebalancing**

ALPS Advisers continuously monitors these investment managers to ensure that they are performing as expected and adhering to their style and strategy. If warranted, ALPS will recommend that the Board replace a manager, an action that has occurred 14 times in the Fund's history. 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. A series of checks and balances and the selection of unaffiliated investment managers ensure the integrity of this key principle. In addition, the Fund is governed by a Board of Trustees that is elected by and responsible to the shareholders.

**Distribution policy**

Since 1988, the Fund has followed a policy of paying annual distributions on its shares at a rate of 10 percent of the Fund's net asset value (paid quarterly at 2.5 percent per quarter), providing a systematic mechanism for distributing funds to shareholders.

**LIBERTY ALL-STAR® EQUITY FUND  
MULTI-MANAGEMENT HAS PRODUCED MORE CONSISTENT RETURNS**

The narrative on the preceding four 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 *Amid Change, Fundamentals Endure* 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 since All-Star's first full calendar year of operation 20 years ago, the Fund has achieved better-than-average returns and better-than-average consistency compared with peer funds in the Lipper Large-Cap Core universe.

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Each dot represents the precise 20-year return and consistency record ending December 31, 2006, of each fund in the universe of 38 open-end Large-Cap Core equity mutual funds (as classified by Lipper, Inc.) that has a 20-year history.

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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**LIBERTY ALL-STAR® EQUITY FUND**  
**INVESTMENT MANAGERS/PORTFOLIO CHARACTERISTICS**

**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.

**PORTFOLIO CHARACTERISTICS**  
**AS OF DECEMBER 31, 2006**  
**(UNAUDITED)**

|                                      | INVESTMENT STYLE SPECTRUM |       |        |       |       | Total<br>Fund | S&P<br>500 Index |     |
|--------------------------------------|---------------------------|-------|--------|-------|-------|---------------|------------------|-----|
|                                      | Schneider                 | Pzena | Matrix | Chase | TCW   |               |                  |     |
| Number of Holdings                   | 50                        | 34    | 34     | 36    | 27    | 154           | *                | 500 |
| Percent of Holdings in Top 10        | 43                        | % 43  | % 38   | % 40  | % 60  | % 19          | % 20             | %   |
| Weighted Average Market              |                           |       |        |       |       |               |                  |     |
| Capitalization (billions)            | \$ 26                     | \$ 74 | \$ 106 | \$ 92 | \$ 52 | \$ 70         | \$ 101           |     |
| Average Five-Year Earnings Per Share |                           |       |        |       |       |               |                  |     |
| Growth                               | 6                         | % 12  | % 15   | % 27  | % 34  | % 18          | % 20             | %   |
| Dividend Yield                       | 1.1                       | % 2.2 | % 1.5  | % 1.1 | % 0.6 | % 1.3         | % 1.8            | %   |
| Price/Earnings Ratio                 | 10                        | x 15  | x 18   | x 20  | x 22  | x 16          | x 17             | x   |
| Price/Book Value Ratio               | 1.9                       | x 2.7 | x 3.1  | x 4.9 | x 5.3 | x 3.5         | x 3.6            | x   |

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



**LIBERTY ALL-STAR® EQUITY FUND  
MANAGER ROUNDTABLE**

**In the face of ongoing change, the managers consistently adhere to their style and strategy**

**Stable short-term interest rates, lower energy prices and strong corporate earnings drove the stock market higher in 2006. In 2007, the drivers may or may not change, and outcomes are open to speculation. Based on comments from the Fund's five investment managers, what remains firmly in place is consistent implementation of their style and strategy.**

The Fund's Investment Adviser, ALPS Advisers, recently had the opportunity to moderate the annual roundtable with the Fund's five investment managers. From their respective points of view, the managers look at 2007, but mostly focus on longer-term trends before concluding with comments on a stock they have added recently to the portion of the Liberty All-Star Equity Fund portfolio that they manage. The participating investment managers and their styles are:

**CHASE INVESTMENT COUNSEL CORPORATION**

*Portfolio Manager*/David Scott, CFA, CIC,

Senior Vice President and Chief Investment Officer

*Investment Style*/Growth Chase is a growth manager that has a valuation orientation to its investment process, seeking to invest in quality growth stocks that demonstrate consistent earnings growth but whose shares are reasonably priced.

**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 fundamental research and a disciplined process to identify good companies with a sustainable business advantage that the firm believes are undervalued on the basis of current price to an estimated normal level of earnings.

**SCHNEIDER CAPITAL MANAGEMENT CORPORATION**

*Portfolio Manager*/Arnold C. Schneider, III, CFA,

President and Chief Investment Officer

*Investment Style/Value* The firm practices a disciplined, fundamental approach to add value over time. Research focuses on uncovering new ideas and owning undervalued stocks before they experience a rebound in earnings and come to the attention of other investors.

**TCW INVESTMENT MANAGEMENT COMPANY**

*Portfolio Managers/Craig C. Blum, CFA, Managing Director,*

and Stephen A. Burlingame, Managing Director

*Investment Style/Growth* TCW invests in companies that have superior sales growth, leading and/or rising market shares, and high and/or rising profit margins. TCW's concentrated growth equity strategy seeks companies with distinct advantages in their business model.

**A number of market-moving factors affected 2006. These included the Federal Reserve standing pat on short-term interest rates, declining energy costs and continued strength in corporate earnings. Do you expect these to remain in place during 2007 or do you anticipate the emergence of a new set of drivers? Let's ask the growth managers to lead off.**

**BLUM (TCW GROWTH):** Fed policy and energy prices, the key drivers in 2006, are difficult to predict. The current Fed funds rate seems to be out of synch with the rest of the yield curve, indicating that the Fed may have overshot the normal spread over inflation. So, it seems reasonable that the Fed will leave rates unchanged or actually make a modest reduction. The decline in oil prices seems to have pushed the speculators out of the trading pits, resulting in more rational prices. Supply is being expanded and alternative technologies are being developed, but there can be long lead times between capital expenditures and results. Along the way, supply levels will probably remain vulnerable to geopolitical shocks. The dollar may be a bigger factor in 2007. If the economy slows and we are not able to improve our current account deficit the dollar may weaken further. This may slow consumer spending but create opportunities for exporters.

**The equity markets during this decade certainly reinforce the wisdom that most long-term investors should be well-diversified at all times**

**Arnie Schneider,**

*Schneider Capital Management (Value)*

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**SCOTT (CHASE INVESTMENT COUNSEL - GROWTH):** Many of the same factors that sparked 2006 should continue to influence the stock market in 2007. However, some new catalysts will impact the stock market. These include a weakening U.S. dollar, the timing and magnitude of the slowdown in U.S. economic activity, and rising speculation as evidenced by increased short-term trading and record merger and acquisition activity.

**The poor relative performance of growth stocks in this decade to date can be directly traced to the massive concentration in growth stock investments in 2000.**

**David Scott,**  
*Chase Investment Counsel (Growth)*

**What's on the value managers' radar for 2007?**

**SCHNEIDER (SCHNEIDER CAPITAL MANAGEMENT - VALUE):** We expect two countervailing forces this year, and it is unclear which one will garner the most attention. Stock prices might come under pressure from a measurable deceleration in corporate profit growth after five years of double-digit gains. On the positive side, a downshift in the economy and corporate profits might deliver the tame inflation data and softness in employment that afford the Fed room to start a modest easing of rates sometime in 2007.

**KATZ (MATRIX ASSET ADVISORS - VALUE):** We believe quite strongly that what we saw in 2006 is just the beginning of a multi-year trend in favor of larger stocks. Furthermore, while the catalyst for their resurgence might have been economic slowing, we do not believe that the continued success of these stocks is dependent on a slower economy. The fundamentals for large and mega-cap stocks are so compelling that all they really needed was the first push to get them back into market favor. Their fundamentals will sustain them from here.

**DESPIRITO (PZENA INVESTMENT MANAGEMENT - VALUE):** It is always difficult anticipating which factors will drive the market over the short term, and as long-term value investors we concentrate our efforts on understanding a company's long-term earnings potential. That said, we expect that the sustainability of earnings growth and the outlook for inflation will continue to be two key drivers of market performance. The S&P 500 has just completed 14 straight quarters of double-digit earnings growth, which is likely not sustainable. Slower growth, however, along with low inflation could provide a favorable environment for equities in 2007.

**A much-anticipated rotation that turned out not to occur in 2006 was the one from value to growth. For 2006, the Russell 3000 Value Index was ahead 22.3 percent for the year, while the Russell 3000 Growth Index was up 9.5 percent. This makes seven straight years of value outperformance. From the perspective of your own style (value or growth), what's your point of view on this extended performance differential? Let's ask the value managers for their perspective, followed by the growth managers.**

**SCHNEIDER (SCHNEIDER CAPITAL MANAGEMENT - VALUE):** After another year of huge outperformance by value stocks, we would not be surprised if performance leadership shifts to growth style investments. Broad swaths of the value universe appear unattractive to us from both a valuation and earnings perspective. Over the past seven years, the Russell 3000 Value Index has produced an annualized return of 8.4 percent, while the Russell 3000 Growth Index return is down an annualized 4.5 percent during the same period. If these indices were viewed as a company stock, a \$30 investment seven years ago in Russell 3000 Value Inc. would now be worth \$53, while the same investment in Russell 3000 Growth Inc. would have shriveled to \$21.50.

**The dollar may be a bigger factor in 2007. If the economy slows and we are not able to improve our current account deficit the dollar may weaken further.**



Stephen Burlingame,  
*TCW (Growth)*

**KATZ (MATRIX ASSET ADVISORS VALUE):** The longer the cycle works against mega-cap stocks, the more dramatic and sustained will be the swing back in the other direction. The same, we believe, is true for growth versus value. The resurgence of mega-caps last year could be the precursor for growth's revival this year. We would be pleased to see it, despite the fact that we are value oriented both by disposition and discipline. We believe that some growth stocks are undervalued today and will be the beneficiaries of the growth revival we expect in 2007.

**DESPIRITO (PZENA INVESTMENT MANAGEMENT VALUE):** Although value stocks have outperformed for seven straight years, the nature of that outperformance has shifted dramatically. The earlier stages were driven by outperformance

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of industrial cyclicals and other economically sensitive stocks. Over the last 18 months or so, however, leadership has been taken over by industries that are earning well in excess of their historical levels, such as energy and materials. Although these companies are predominantly represented in the value index, we don't consider them values at today's valuation levels, yet they have perpetuated the outperformance of the value indices. We have taken this opportunity to add former growth names that are now trading at attractive valuations.

**BLUM (TCW GROWTH):** After a prolonged period of very meager profit growth some classic value industries benefited from incremental demand for commodity and industrial products from developing countries. As the price of oil, copper, zinc and other industrial materials rose, businesses in these industries saw their fortunes improve dramatically. We are now at a point that valuations are discounting continued price and unit volume increases while economic growth seems to be slowing. To our thinking, these undifferentiated, economically sensitive cyclical stocks have had their day. In contrast, classic large capitalization growth stocks appear relatively cheap. These stocks have been out of favor since the tech bubble burst. Yet the growth companies have done a great job of generating profits.

**SCOTT (CHASE INVESTMENT COUNSEL GROWTH):** The poor relative performance of growth stocks in this decade to date can be directly traced to the massive concentration in growth stock investments in 2000. By some measures, over 90 percent of investments in style allocation funds were growth related. While this concentration has declined significantly and now points to under-investment in growth, a catalyst such as an overall slowing of cyclical earnings growth may be necessary to shift relative performance from value to growth.

**As 2007 heralds a move into the last few years of the decade, can you step back and give us your historical perspective on the 00s to date? Our question is driven by the thought that in a period of seven years investors have experienced a microcosm of stock market history: a bubble of historic proportions; a protracted bear market; a recovery to new highs for some indices; and, currently, a debate over the future direction of the market given a huge range of internal and exogenous events and data. Value managers, give us an historical perspective, please.**

**SCHNEIDER (SCHNEIDER CAPITAL MANAGEMENT VALUE):** The equity markets during this decade certainly reinforce the wisdom that most long-term investors should be well-diversified at all times and possess nerves of steel to stay the course during the inevitable downdrafts that occur.

**KATZ (MATRIX ASSET ADVISORS VALUE):** There is no doubt that the market has covered a lot of ground since the new millennium/century/decade began. We were somewhat puzzled by all the hoopla last year when the Dow Jones Industrial Average reached record territory and made new highs from its previous high water mark in 2000. To us, the real question was, why did it take so long to get back to where it was?

One important answer, of course, is multiple compression – the stock market is much less frothy and expensive than it was in 2000. Price/earnings ratios have dropped from the mid-20s to the mid-teens. That becomes very significant as we look at the future direction of the market. Another is that the past seven years have been rather unimpressive. Cumulatively over the period, the S&P 500 had been negative until the latter part of 2006.

**Since 2000 price/earnings ratios have dropped from the mid-20s to the mid-teens. That becomes very significant as we look at the future direction of the market.**

**David Katz,**  
*Matrix Asset Advisers (Value)*

**DESPIRITO (PZENA INVESTMENT MANAGEMENT VALUE):** First, remember that this investment cycle started at a

point where the discount for value stocks was the deepest that it had been in a generation, so we had a lot of room for value outperformance. Despite the last seven years, our data tell us that the odds are still in the value investor's favor to secure outperformance over a reasonable investment horizon. The other interesting phenomenon we are seeing is role reversal or growth investors buying what were traditionally considered value stocks e.g., energy, commodities and industrial cyclicals and value investors buying traditional growth names, such as pharmaceuticals and technology.

**Interesting thoughts. Where are the growth managers on this one?**

**BLUM (TCW GROWTH):** Add to your list the reality of terrorism on U.S. soil, numerous examples of high profile corporate malfeasance, artificially low interest rates that fueled real estate inflation, and historically high energy

and commodity prices and it has been a very challenging period for investors. Despite this, corporate profit growth has been outstanding and operating margins are at their highest level in history. Much of this has to do with the successful utilization of advances in technology, but also improved capital discipline.

**we expect that the sustainability of earnings growth and the outlook for inflation will continue to be two key drivers of market performance.**

**Antonio DeSpirito,**  
*Pzena Investment Management (Value)*

**SCOTT (CHASE INVESTMENT COUNSEL GROWTH):** Even though the U.S. stock market, as measured by the S&P 500 Index, has made little progress so far this decade, the period can be described as anything but uneventful. Beginning with perhaps the greatest stock market bubble of all time, the decade has seen a massive effort by the Federal Reserve to cushion the U.S. economy. Steep cuts in interest rates contributed to two additional bubbles in housing and debt, which have shaped the economy and today threaten its future. These factors combined with globalization, worldwide geopolitical instability and oil-led commodity inflation may lead to considerable uncertainty and volatility for stocks as the decade closes.

**To conclude, please tell us about a stock that you have added recently to the portion of the Liberty All-Star Equity Fund portfolio that you manage and your rationale for buying it. We will ask the growth managers to start.**

**SCOTT (CHASE INVESTMENT COUNSEL GROWTH):** American International Group is a recent addition. AIG is the world's largest insurer, selling life and property casualty insurance in 130 countries. This high quality large capitalization growth company is benefiting from strong pricing and a lack of major catastrophes in recent quarters. Since 30 percent of the company's business comes from the Far East, the stock is considered a legitimate investment in the growth of China. Most importantly, AIG scores very well in our fundamental and technical models and is very reasonably priced, as it trades at less than 1 times both its historical and sustainable earnings growth rates.

**BLUM (TCW GROWTH):** We have recently established a position in Autodesk, the leading provider of computer-aided design software. The rapid growth of infrastructure projects around the globe coupled with the need to not waste evermore expensive building materials creates a powerful incentive to utilize Autodesk's products. Moreover, we believe the company is in the process of transitioning its customer base to a new generation of three-dimensional modeling software products.

**KATZ (MATRIX ASSET ADVISORS VALUE):** We recently bought Teva Pharmaceutical Industries, the Israel-based generic pharmaceutical leader, whose American Depositary Receipts are listed on the NYSE. We had successfully owned Teva several years ago, and admire its 20 percent market share in generics, strong 20 percent annual earnings growth and the quality of its management. Teva is somewhat unusual among generic manufacturers for also having a couple of significant proprietary drugs. We became buyers after the stock sold off more than 30 percent, allowing us to buy it at 14 times earnings compared to Teva's historic 21 times multiple. Despite short-term earnings concerns, we expect mid-teens growth over the next three to five years.

**SCHNEIDER (SCHNEIDER CAPITAL MANAGEMENT VALUE):** AGCO Corporation is the world's third-largest manufacturer and distributor of agricultural equipment, with operations in Europe, North America and Brazil. There are positive trends both inside the company and in the industry that should lead to improved profitability. The company has the largest market share in the rapidly growing Brazilian market, which we believe should begin to recover from its recent slump. The company is also implementing a number of operational improvements inside its

European operations. Finally, the global agriculture cycle looks promising in 2008 and beyond.

**DESPIRITO (PZENA INVESTMENT MANAGEMENT VALUE):** We added Wal-Mart Stores, the world's largest retailer, to the portfolio. Despite significant earnings growth, Wal-Mart's stock price has gone nowhere for years and the company now trades at about 16 times this year's First Call earnings estimate. We believe Wal-Mart can grow its bottom line as it has several plans in place to improve profits. These include increasing direct sourcing, reducing inventory to free up cash and offset the cost of entering new markets, making selective expense cuts, and moving to a more local merchandising and pricing model. In terms of consumer spending worries, we note that over half of Wal-Mart's sales come from staples, such as food, pharmacy, tobacco, and health and beauty aids.

**Many thanks to all for a very interesting discussion. We look forward to a productive 2007.**

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**LIBERTY ALL-STAR® EQUITY FUND  
INVESTMENT GROWTH**

*December 31, 2006*

**GROWTH OF A \$10,000 INVESTMENT**

The graph below illustrates the growth of a \$10,000 investment assuming the purchase of shares of beneficial interest at the closing market price (NYSE: USA) of \$6.00 on December 31, 1987, and tracking its progress through December 31, 2006. For certain information, it also assumes full participation in rights offerings (see below). This graph covers the period since the Fund commenced its 10 percent distribution policy in 1988.

The growth of the investment assuming all distributions were received in cash and not reinvested back into the Fund. The value of the investment under this scenario grew to \$48,117 (includes the December 31, 2006 value of the original investment of \$13,817, plus distributions during the period of \$33,183 and tax credits on retained capital gains of \$1,117).

The additional value realized through reinvestment of all distributions and tax credits. The value of the investment under this scenario grew to \$105,374.

The additional value realized through full participation in all the rights offerings under the terms of each offering. The value of the investment under this scenario grew to \$135,848 excluding the cost to fully participate in all the rights offerings under the terms of each offering which was \$35,416.

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Past performance cannot predict future results. Performance will fluctuate with changes in 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.

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**LIBERTY ALL-STAR® EQUITY FUND**  
**TABLE OF DISTRIBUTIONS AND RIGHTS OFFERINGS**

| YEAR | PER SHARE DISTRIBUTIONS | RIGHTS OFFERINGS MONTH COMPLETED | SHARES NEEDED TO PURCHASE ONE ADDITIONAL SHARE | SUBSCRIPTION PRICE | TAX CREDITS* |
|------|-------------------------|----------------------------------|--|--------------------|--------------|
| 1988 | \$ 0.64                 |                                  |  |                    |              |
| 1989 | 0.95                    |                                  |  |                    |              |
| 1990 | 0.90                    |                                  |  |                    |              |
| 1991 | 1.02                    |                                  |  |                    |              |
| 1992 | 1.07                    | April                            | 10   | \$ 10.05           |              |
| 1993 | 1.07                    | October                          | 15   | 10.41              | \$ 0.18      |
| 1994 | 1.00                    | September                        | 15   | 9.14               |              |
| 1995 | 1.04                    |                                  |  |                    |              |
| 1996 | 1.18                    |                                  |  |                    | 0.13         |
| 1997 | 1.33                    |                                  |  |                    | 0.36         |
| 1998 | 1.40                    | April                            | 20   | 12.83              |              |
| 1999 | 1.39                    |                                  |  |                    |              |
| 2000 | 1.42                    |                                  |  |                    |              |
| 2001 | 1.20                    |                                  |  |                    |              |
| 2002 | 0.88                    | May                              | 10   | 8.99               |              |
| 2003 | 0.78                    |                                  |  |                    |              |
| 2004 | 0.89                    | July                             | 10**   | 8.34               |              |
| 2005 | 0.87                    |                                  |  |                    |              |
| 2006 | 0.88                    |                                  |  |                    |              |

\*The Fund's net investment income and net realized capital gains exceeded the amount to be distributed under the Fund's 10 percent distribution policy. In each case, the Fund elected to pay taxes on the undistributed income and passed through a proportionate tax credit to shareholders.

\*\*The number of shares offered was increased by an additional 25% to cover a portion of the over-subscription requests.

#### DISTRIBUTION POLICY

Liberty All-Star Equity Fund's current policy, in effect since 1988, is to pay distributions on its shares totaling approximately 10 percent of its net asset value per year, payable in four quarterly installments of 2.5 percent of the Fund's net asset value at the close of the New York Stock Exchange on the Friday prior to each quarterly declaration date. **The fixed distributions are not related to the amount of the Fund's net investment income or net realized capital gains or losses and may be taxed as ordinary income up to the amount of the Fund's current and accumulated earnings and profits.** If, for any calendar year, the total distributions made under the 10 percent pay-out policy exceed the Fund's net investment income and net realized capital gains, the excess will generally be treated as a non-taxable return of capital, reducing the shareholder's adjusted basis in his or her shares. If the Fund's net investment income and net realized capital gains for any year exceed the amount distributed under the 10 percent pay-out policy, the Fund may, in its discretion, retain and not distribute net realized capital gains and pay income tax thereon to the extent of such excess. The Fund retained such excess gains in 1993, 1996 and 1997.



**LIBERTY ALL-STAR® EQUITY FUND**  
**TOP 20 HOLDINGS AND ECONOMIC SECTORS**

December 31, 2006

| <b>TOP 20 HOLDINGS*</b>            | <b>PERCENT OF NET ASSETS</b> |   |
|------------------------------------|------------------------------|---|
| Microsoft Corp.                    | 2.30                         | % |
| Countrywide Financial Corp.        | 2.10                         |   |
| Fannie Mae                         | 2.07                         |   |
| JPMorgan Chase & Co.               | 2.07                         |   |
| Citigroup, Inc.                    | 1.78                         |   |
| Schlumberger Ltd.                  | 1.64                         |   |
| Pfizer, Inc.                       | 1.57                         |   |
| Wal-Mart Stores, Inc.              | 1.52                         |   |
| American International Group, Inc. | 1.50                         |   |
| Johnson & Johnson                  | 1.39                         |   |
| MetLife, Inc.                      | 1.39                         |   |
| Freddie Mac                        | 1.34                         |   |
| General Electric Co.               | 1.33                         |   |
| Tyco International Ltd.            | 1.33                         |   |
| Reliant Energy, Inc.               | 1.33                         |   |
| Morgan Stanley                     | 1.31                         |   |
| QUALCOMM, Inc.                     | 1.28                         |   |
| Google, Inc., Class A              | 1.28                         |   |
| Cisco Systems, Inc.                | 1.26                         |   |
| Network Appliance, Inc.            | 1.19                         |   |
|                                    | 30.98                        | % |

| <b>ECONOMIC SECTORS*</b>   | <b>PERCENT OF NET ASSETS</b> |   |
|----------------------------|------------------------------|---|
| Financials                 | 26.83                        | % |
| Information Technology     | 18.74                        |   |
| Consumer Discretionary     | 15.16                        |   |
| Health Care                | 12.50                        |   |
| Industrials                | 11.40                        |   |
| Energy                     | 4.91                         |   |
| Consumer Staples           | 3.49                         |   |
| Utilities                  | 2.24                         |   |
| Telecommunication Services | 0.92                         |   |
| Materials                  | 0.57                         |   |
| Other Net Assets           | 3.24                         |   |
|                            | 100.00                       | % |

\* Because the Fund is actively managed, there can be no guarantee that the Fund will continue to hold securities of the indicated issuers and sectors in the future.

**LIBERTY ALL-STAR® EQUITY FUND**  
**MAJOR STOCK CHANGES IN THE FOURTH QUARTER**

The following are the major (\$5.0 million or more) stock changes both purchases and sales that were made in the Fund's portfolio during the fourth quarter of 2006.

| SECURITY NAME                       | PURCHASES (SALES) | SHARES AS OF 12/31/06 |
|-------------------------------------|-------------------|-----------------------|
| <b>PURCHASES</b>                    |                   |                       |
| Affiliated Computer Services, Inc.  | 107,375           | 107,375               |
| America Movil SA de CV              | 173,900           | 173,900               |
| American Express Co.                | 132,000           | 132,000               |
| American International Group, Inc.  | 85,800            | 287,350               |
| Cisco Systems, Inc.                 | 211,700           | 633,500               |
| EMC Corp.                           | 390,600           | 390,600               |
| Fidelity National Financial, Inc.   | 262,500           | * 274,339             |
| First American Corp.                | 143,200           | 143,200               |
| Freddie Mac                         | 95,750            | 271,450               |
| Home Depot, Inc.                    | 156,325           | 156,325               |
| News Corp.                          | 249,400           | 249,400               |
| Schlumberger Ltd.                   | 148,995           | 355,465               |
| Teva Pharmaceutical Industries Ltd. | 293,000           | 293,000               |
| <b>SALES</b>                        |                   |                       |
| American Power Conversion Corp.     | (287,700)         | ) 371,150             |
| CVS Corp.                           | (233,800)         | )                     |
| HCA, Inc.                           | (159,825)         | )                     |
| Hilton Hotels Corp.                 | (462,575)         | )                     |
| Kellogg Co.                         | (107,500)         | )                     |
| PepsiCo, Inc.                       | (172,600)         | )                     |
| Tidewater, Inc.                     | (137,000)         | )                     |
| Wells Fargo & Co.                   | (306,400)         | )                     |
| Wyeth                               | (106,200)         | ) 178,000             |

\* Adjusted for spin-off.

**LIBERTY ALL-STAR® EQUITY FUND**  
**SCHEDULE OF INVESTMENTS**
*as of December 31, 2006*

| <b>COMMON STOCKS (96.60%)</b>                     | <b>SHARES</b> | <b>MARKET VALUE</b> |
|---|---------------|---------------------|
| <b>CONSUMER DISCRETIONARY (15.00%)</b>            |               |                     |
| <b>Auto Components (1.13%)</b>                    |               |                     |
| Magna International, Inc., Class A                | 136,700       | \$ 11,011,185       |
| Visteon Corp. (a)                                 | 530,675       | 4,500,124           |
|   |               | 15,511,309          |
| <b>Hotels, Restaurants &amp; Leisure (1.47%)</b>  |               |                     |
| Carnival Corp.                                    | 50,925        | 2,497,871           |
| Marriott International, Inc.                      | 175,600       | 8,379,632           |
| McDonald's Corp.                                  | 209,000       | 9,264,970           |
|   |               | 20,142,473          |
| <b>Household Durables (2.14%)</b>                 |               |                     |
| Centex Corp.                                      | 133,000       | 7,483,910           |
| Pulte Homes, Inc.                                 | 411,970       | 13,644,446          |
| Whirlpool Corp.                                   | 98,800        | 8,202,376           |
|   |               | 29,330,732          |
| <b>Internet &amp; Catalog Retail (0.87%)</b>      |               |                     |
| Amazon.com, Inc. (a)                              | 303,300       | 11,968,218          |
| <b>Media (4.54%)</b>                              |               |                     |
| Comcast Corp., Class A (a)                        | 259,000       | 10,846,920          |
| Liberty Global, Inc., Series A (a)                | 102,132       | 2,977,148           |
| Liberty Global, Inc., Series C (a)                | 126,755       | 3,549,140           |
| Liberty Media Holding Corp., Capital Series A (a) | 48,979        | 4,798,962           |
| News Corp.  | 249,400       | 5,357,112           |
| Omnicom Group, Inc.                               | 27,700        | 2,895,758           |
| Time Warner, Inc.                                 | 582,000       | 12,675,960          |
| The Walt Disney Co.                               | 269,600       | 9,239,192           |
| XM Satellite Radio Holdings, Inc., Class A (a)    | 510,850       | 7,381,782           |
| Yell Group PLC (a)                                | 225,750       | 2,513,536           |
|   |               | 62,235,510          |
| <b>Multi-line Retail (1.97%)</b>                  |               |                     |
| Dollar General Corp.                              | 620,000       | 9,957,200           |
| J.C. Penney Co., Inc.                             | 120,300       | 9,306,408           |
| Kohl's Corp. (a)                                  | 113,100       | 7,739,433           |
|   |               | 27,003,041          |
| <b>Specialty Retail (2.88%)</b>                   |               |                     |
| AutoZone, Inc. (a)                                | 49,000        | 5,662,440           |
| GameStop Corp., Class A(a)                        | 58,550        | 3,226,691           |
| The Gap, Inc.                                     | 475,000       | 9,262,500           |
| Home Depot, Inc.                                  | 156,325       | 6,278,012           |
| Ross Stores, Inc.                                 | 285,000       | 8,350,500           |
| TJX Companies, Inc.                               | 236,650       | 6,739,792           |
|   |               | 39,519,935          |

See Notes to Schedule of Investments and Financial Statements



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| <b>COMMON STOCKS (continued)</b>               | <b>SHARES</b> | <b>MARKET VALUE</b> |
|--|---------------|---------------------|
| <b>CONSUMER STAPLES (3.49%)</b>                |               |                     |
| <b>Food &amp; Staples Retailing (1.83%)</b>    |               |                     |
| Wal-Mart Stores, Inc.                          | 451,575       | \$ 20,853,734       |
| Walgreen Co.                                   | 92,900        | 4,263,181           |
|  |               | 25,116,915          |
| <b>Food Products (0.59%)</b>                   |               |                     |
| Sara Lee Corp.                                 | 350,050       | 5,961,351           |
| Tyson Foods, Inc., Class A                     | 129,150       | 2,124,518           |
|  |               | 8,085,869           |
| <b>Household Products (1.07%)</b>              |               |                     |
| Colgate-Palmolive Co.                          | 85,200        | 5,558,448           |
| The Procter & Gamble Co.                       | 141,800       | 9,113,486           |
|  |               | 14,671,934          |
| <b>ENERGY (4.91%)</b>                          |               |                     |
| <b>Energy Equipment &amp; Services (1.63%)</b> |               |                     |
| Schlumberger Ltd.                              | 355,465       | 22,451,169          |
| <b>Oil, Gas &amp; Consumable Fuels (3.28%)</b> |               |                     |
| BP PLC (b)                                     | 88,200        | 5,918,220           |
| Cameco Corp.                                   | 109,350       | 4,423,208           |
| ChevronTexaco Corp.                            | 136,500       | 10,036,845          |
| ConocoPhillips                                 | 61,000        | 4,388,950           |
| Exxon Mobil Corp.                              | 152,700       | 11,701,401          |
| Massey Energy Co.                              | 365,600       | 8,492,888           |
|  |               | 44,961,512          |
| <b>FINANCIALS (26.83%)</b>                     |               |                     |
| <b>Capital Markets (3.01%)</b>                 |               |                     |
| The Bank of New York Co., Inc.                 | 240,000       | 9,448,800           |
| Franklin Resources, Inc.                       | 24,100        | 2,655,097           |
| Merrill Lynch & Co., Inc.                      | 62,400        | 5,809,440           |
| Morgan Stanley                                 | 220,400       | 17,947,172          |
| UBS AG, Registered Shares                      | 89,900        | 5,423,667           |
|  |               | 41,284,176          |
| <b>Commercial Banks (1.10%)</b>                |               |                     |
| Comerica, Inc.                                 | 117,925       | 6,919,839           |
| Commerce Bancorp, Inc.                         | 232,140       | 8,187,578           |
|  |               | 15,107,417          |
| <b>Consumer Finance (2.01%)</b>                |               |                     |
| American Express Co.                           | 132,000       | 8,008,440           |
| Capital One Financial Corp.                    | 75,490        | 5,799,142           |
| SLM Corp.                                      | 281,600       | 13,733,632          |
|  |               | 27,541,214          |

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|   |         |            |  |
|---|---------|------------|--|
|   |         |            |  |
| <b>Diversified Financial Services (4.50%)</b> |         |            |  |
| Bank of America Corp.                         | 170,000 | 9,076,300  |  |
| Citigroup, Inc.                               | 437,425 | 24,364,572 |  |
| JPMorgan Chase & Co.                          | 586,550 | 28,330,365 |  |
|   |         | 61,771,237 |  |

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| <b>COMMON STOCKS (continued)</b>                    | <b>SHARES</b> | <b>MARKET VALUE</b> |
|---|---------------|---------------------|
| <b>Insurance (9.16%)</b>                            |               |                     |
| Allstate Corp.                                      | 194,700       | \$ 12,676,917       |
| American International Group, Inc.                  | 287,350       | 20,591,501          |
| Aon Corp.   | 140,650       | 4,970,571           |
| Fidelity National Financial, Inc.                   | 274,339       | 6,551,215           |
| First American Corp.                                | 143,200       | 5,825,376           |
| Genworth Financial, Inc., Class A                   | 208,800       | 7,143,048           |
| Lincoln National Corp.                              | 64,500        | 4,282,800           |
| MetLife, Inc.                                       | 324,050       | 19,122,191          |
| The Progressive Corp.                               | 646,620       | 15,661,136          |
| RenaissanceRe Holdings Ltd.                         | 59,200        | 3,552,000           |
| Torchmark Corp.                                     | 177,175       | 11,296,678          |
| UnumProvident Corp.                                 | 68,225        | 1,417,716           |
| XL Capital Ltd., Class A                            | 173,600       | 12,502,672          |
|   |               | 125,593,821         |
| <b>Real Estate Investment Trusts (0.61%)</b>        |               |                     |
| Annaly Capital Management, Inc.                     | 603,450       | 8,393,989           |
| <b>Thrifts &amp; Mortgage Finance (6.44%)</b>       |               |                     |
| Countrywide Financial Corp.                         | 678,400       | 28,798,080          |
| Fannie Mae  | 479,166       | 28,457,669          |
| Freddie Mac   | 271,450       | 18,431,455          |
| Hudson City Bancorp                                 | 97,500        | 1,353,300           |
| IndyMac Bancorp, Inc.                               | 60,025        | 2,710,729           |
| Washington Mutual, Inc.                             | 189,037       | 8,599,293           |
|   |               | 88,350,526          |
| <b>HEALTH CARE (12.50%)</b>                         |               |                     |
| <b>Biotechnology (2.98%)</b>                        |               |                     |
| Amgen, Inc. (a)                                     | 35,800        | 2,445,498           |
| Genentech, Inc. (a)                                 | 143,700       | 11,658,381          |
| Genzyme Corp. (a)                                   | 114,800       | 7,069,384           |
| Gilead Sciences, Inc.(a)                            | 138,800       | 9,012,284           |
| MedImmune, Inc. (a)                                 | 331,800       | 10,740,366          |
|   |               | 40,925,913          |
| <b>Health Care Equipment &amp; Supplies (2.09%)</b> |               |                     |
| Becton Dickinson & Co.                              | 56,600        | 3,970,490           |
| Boston Scientific Corp.(a)                          | 458,800       | 7,882,184           |
| Stryker Corp.                                       | 47,600        | 2,623,236           |
| Varian Medical Systems, Inc. (a)                    | 147,900       | 7,035,603           |
| Zimmer Holdings, Inc. (a)                           | 91,900        | 7,203,122           |
|   |               | 28,714,635          |
| <b>Health Care Providers &amp; Services (1.59%)</b> |               |                     |

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|                          |         |            |  |
|--------------------------|---------|------------|--|
| AmerisourceBergen Corp.  | 121,275 | 5,452,524  |  |
| Omnicare, Inc.           | 210,400 | 8,127,752  |  |
| Triad Hospitals, Inc.(a) | 54,175  | 2,266,140  |  |
| WellPoint, Inc.(a)       | 75,300  | 5,925,357  |  |
|                          |         | 21,771,773 |  |
|                          |         |            |  |

See Notes to Schedule of Investments and Financial Statements



| <b>COMMON STOCKS (continued)</b>             | <b>SHARES</b> | <b>MARKET VALUE</b> |
|--|---------------|---------------------|
| <b>Health Care Technology (0.29%)</b>        |               |                     |
| Cerner Corp. (a)                             | 87,400        | \$ 3,976,700        |
| <b>Pharmaceuticals (5.55%)</b>               |               |                     |
| AstraZeneca PLC (b)                          | 58,100        | 3,111,255           |
| Bristol-Myers Squibb Co.                     | 441,225       | 11,613,042          |
| Johnson & Johnson                            | 289,825       | 19,134,247          |
| Novartis AG (b)                              | 45,000        | 2,584,800           |
| Pfizer, Inc.                                 | 831,325       | 21,531,317          |
| Teva Pharmaceutical Industries Ltd. (b)      | 293,000       | 9,106,440           |
| Wyeth  | 178,000       | 9,063,760           |
|  |               | 76,144,861          |
| <b>INDUSTRIALS (11.40%)</b>                  |               |                     |
| <b>Aerospace &amp; Defense (3.57%)</b>       |               |                     |
| The Boeing Co.                               | 56,925        | 5,057,217           |
| Bombardier, Inc., Class B (a)                | 1,040,325     | 3,523,804           |
| General Dynamics Corp.                       | 137,400       | 10,215,690          |
| Goodrich Corp.                               | 67,950        | 3,095,122           |
| Lockheed Martin Corp.                        | 133,700       | 12,309,759          |
| Rockwell Collins, Inc.                       | 127,000       | 8,037,830           |
| United Technologies Corp.                    | 108,400       | 6,777,168           |
|  |               | 49,016,590          |
| <b>Air Freight &amp; Logistics (0.67%)</b>   |               |                     |
| CH Robinson Worldwide, Inc.                  | 87,800        | 3,590,142           |
| Expeditors International of Washington, Inc. | 137,090       | 5,552,145           |
|  |               | 9,142,287           |
| <b>Airlines (0.09%)</b>                      |               |                     |
| Southwest Airlines Co.                       | 77,925        | 1,193,811           |
| <b>Electrical Equipment (0.83%)</b>          |               |                     |
| American Power Conversion Corp.              | 371,150       | 11,353,479          |
| <b>Industrial Conglomerates (2.84%)</b>      |               |                     |
| 3M Co.                                       | 33,000        | 2,571,690           |
| General Electric Co.                         | 489,200       | 18,203,132          |
| Tyco International Ltd.                      | 598,450       | 18,192,880          |
|  |               | 38,967,702          |
| <b>Machinery (2.29%)</b>                     |               |                     |
| AGCO Corp. (a)                               | 273,525       | 8,462,864           |
| Danaher Corp.                                | 124,800       | 9,040,512           |
| Navistar International Corp. (a)             | 304,475       | 10,178,599          |
| Paccar, Inc.                                 | 57,000        | 3,699,300           |
|  |               | 31,381,275          |

See Notes to Schedule of Investments and Financial Statements



| <b>COMMON STOCKS (continued)</b>                            | <b>SHARES</b> | <b>MARKET VALUE</b> |
|---|---------------|---------------------|
| <b>Road &amp; Rail (1.11%)</b>                              |               |                     |
| CSX Corp.   | 275,000       | \$ 9,468,250        |
| Union Pacific Corp.   | 63,000        | 5,797,260           |
|   |               | 15,265,510          |
| <b>INFORMATION TECHNOLOGY (18.74%)</b>                      |               |                     |
| <b>Communications Equipment (3.34%)</b>                     |               |                     |
| Alcatel-Lucent  | 765,398       | 10,883,960          |
| Cisco Systems, Inc. (a)                                     | 633,500       | 17,313,555          |
| QUALCOMM, Inc.  | 465,605       | 17,595,213          |
|   |               | 45,792,728          |
| <b>Computers &amp; Peripherals (2.59%)</b>                  |               |                     |
| Dell, Inc.(a)   | 555,725       | 13,943,141          |
| EMC Corp. (a)   | 390,600       | 5,155,920           |
| Network Appliance, Inc.(a)                                  | 417,215       | 16,388,205          |
|   |               | 35,487,266          |
| <b>Electronic Equipment &amp; Instruments (2.04%)</b>       |               |                     |
| AU Optronics Corp.(a)                                       | 534,528       | 7,381,831           |
| Celestica, Inc.(a)  | 301,275       | 2,352,958           |
| Symbol Technologies, Inc.                                   | 684,000       | 10,218,960          |
| Vishay Intertechnology, Inc.(a)                             | 595,000       | 8,056,300           |
|   |               | 28,010,049          |
| <b>Internet Software &amp; Services (2.24%)</b>             |               |                     |
| eBay, Inc. (a)  | 324,800       | 9,766,736           |
| Google, Inc., Class A (a)                                   | 38,200        | 17,590,336          |
| Yahoo!, Inc. (a)  | 128,800       | 3,289,552           |
|   |               | 30,646,624          |
| <b>IT Services (1.95%)</b>                                  |               |                     |
| Affiliated Computer Services, Inc. (a)                      | 107,375       | 5,244,195           |
| BearingPoint, Inc. (a)                                      | 529,180       | 4,164,647           |
| Computer Sciences Corp. (a)                                 | 50,950        | 2,719,201           |
| First Data Corp.  | 393,200       | 10,034,464          |
| The Western Union Co.                                       | 206,700       | 4,634,214           |
|   |               | 26,796,721          |
| <b>Semiconductors &amp; Semiconductor Equipment (1.33%)</b> |               |                     |
| Analog Devices, Inc.  | 29,100        | 956,517             |
| Intel Corp.   | 372,000       | 7,533,000           |
| International Rectifier Corp. (a)                           | 103,278       | 3,979,301           |
| Novellus Systems, Inc. (a)                                  | 167,900       | 5,779,118           |
|   |               | 18,247,936          |

See Notes to Schedule of Investments and Financial Statements

| <b>COMMON STOCKS (continued)</b>                  | <b>SHARES</b> | <b>MARKET VALUE</b> |
|---|---------------|---------------------|
| <b>Software (5.25%)</b>                           |               |                     |
| Activision, Inc. (a)                              | 11,100        | \$ 191,364          |
| Adobe Systems, Inc. (a)                           | 126,400       | 5,197,568           |
| Autodesk, Inc. (a)                                | 91,660        | 3,708,564           |
| CA, Inc.  | 354,875       | 8,037,919           |
| Microsoft Corp.                                   | 1,054,775     | 31,495,581          |
| Oracle Corp. (a)                                  | 944,975       | 16,196,871          |
| Salesforce.com, Inc. (a)                          | 197,400       | 7,195,230           |
|   |               | 72,023,097          |
| <b>MATERIALS (0.57%)</b>                          |               |                     |
| <b>Chemicals (0.54%)</b>                          |               |                     |
| Cytec Industries, Inc.                            | 36,475        | 2,061,202           |
| Praxair, Inc.                                     | 91,200        | 5,410,896           |
|   |               | 7,472,098           |
| <b>Paper &amp; Forest Products (0.03%)</b>        |               |                     |
| Louisiana-Pacific Corp.                           | 16,700        | 359,551             |
| <b>TELECOMMUNICATION SERVICES (0.92%)</b>         |               |                     |
| Wireless Telecommunication Services (0.92%)       |               |                     |
| America Movil SA de CV (b)                        | 173,900       | 7,863,758           |
| Sprint Nextel Corp.                               | 254,200       | 4,801,838           |
|   |               | 12,665,596          |
| <b>UTILITIES (2.24%)</b>                          |               |                     |
| Electric Utilities (1.33%)                        |               |                     |
| Reliant Energy, Inc. (a)                          | 1,280,100     | 18,190,221          |
| <b>Multi-Utilities (0.91%)</b>                    |               |                     |
| Sempra Energy                                     | 130,300       | 7,292,891           |
| Wisconsin Energy Corp., Series C                  | 110,200       | 5,230,092           |
|   |               | 12,522,983          |
| <b>TOTAL COMMON STOCKS (Cost \$1,169,486,196)</b> |               | 1,325,110,403       |
| <b>PREFERRED STOCKS (0.16%)</b>                   |               |                     |
| <b>CONSUMER DISCRETIONARY (0.16%)</b>             |               |                     |
| <b>Automobiles (0.16%)</b>                        |               |                     |
| General Motors Corp., Series C (Cost \$1,707,639) | 97,150        | 2,207,248           |

See Notes to Schedule of Investments and Financial Statements

| SHORT TERM INVESTMENTS (3.87%)  | PAR VALUE     | MARKET VALUE     |
|---|---------------|------------------|
| <b>REPURCHASE AGREEMENT (3.87%)</b>   |               |                  |
| Repurchase agreement with State Street Bank & Trust Co., dated 12/29/2006, due 01/02/2007 at 4.65%, collateralized by several U.S. Treasury Bonds with various maturity dates, market value of \$54,146,416 (repurchase proceeds of \$53,109,426) (Cost \$53,067,000) | \$ 53,067,000 | \$ 53,067,000    |
| <b>TOTAL INVESTMENTS (100.63%) (COST \$1,224,260,835) (C)</b>   |               | 1,380,384,651    |
| <b>LIABILITIES IN EXCESS OF OTHER ASSETS ( 0.63%)</b>   |               | (8,618,604 )     |
| <b>NET ASSETS (100.00%)</b>   |               | \$ 1,371,766,047 |
| <b>NET ASSET VALUE PER SHARE (156,669,818 SHARES OUTSTANDING)</b>   |               | \$ 8.76          |

Notes to Schedule of Investments:

- (a) Non-income producing security
- (b) American Depositary Receipt
- (c) Cost of investments for federal income tax purposes is \$1,235,171,545.

Gross unrealized appreciation and depreciation based on cost of investments and foreign currency for federal income tax purposes at December 31, 2006 is as follows:

|   |                |
|---|----------------|
| Gross unrealized appreciation                     | \$ 189,984,027 |
| Gross unrealized depreciation                     | (44,770,921 )  |
| Gross unrealized depreciation on foreign currency | (469 )         |
| Net unrealized appreciation                       | \$ 145,212,637 |

See Notes to Financial Statements

**LIBERTY ALL-STAR® EQUITY FUND****STATEMENT OF ASSETS AND LIABILITIES**

December 31, 2006

**ASSETS:**

|   |                      |
|---|----------------------|
| Investments at market value (identified cost \$1,224,260,835) | \$ 1,380,384,651     |
| Cash  | 2,426                |
| Foreign currency, at value (Cost \$26,047)                    | 26,001               |
| Receivable for investments sold                               | 11,849,018           |
| Dividends and interest receivable                             | 1,175,344            |
| Foreign tax reclaim receivable                                | 895                  |
| <b>TOTAL ASSETS</b>   | <b>1,393,438,335</b> |

**LIABILITIES:**

|  |                   |
|--|-------------------|
| Payable for investments purchased                        | 3,010,461         |
| Distributions payable to shareholders                    | 17,293,846        |
| Investment advisory fees payable                         | 803,011           |
| Payable for administration, pricing and bookkeeping fees | 216,537           |
| Accrued expenses   | 348,433           |
| <b>TOTAL LIABILITIES</b>                                 | <b>21,672,288</b> |

|                   |                         |
|-------------------|-------------------------|
| <b>NET ASSETS</b> | <b>\$ 1,371,766,047</b> |
|-------------------|-------------------------|

**NET ASSETS REPRESENTED BY:**

Paid-in capital (unlimited number of shares of beneficial interest

|  |                  |
|--|------------------|
| without par value authorized; 156,669,818 shares outstanding)                  | \$ 1,226,553,410 |
| Accumulated net realized loss on investments and foreign currency transactions | (10,910,710)     |
| Net unrealized appreciation on investments and foreign currency translations   | 156,123,347      |

|  |                         |
|--|-------------------------|
| <b>TOTAL NET ASSETS APPLICABLE TO OUTSTANDING SHARES OF BENEFICIAL INTEREST (\$8.76 PER SHARE)</b> | <b>\$ 1,371,766,047</b> |
|--|-------------------------|

See Notes to Financial Statements

**LIBERTY ALL-STAR® EQUITY FUND**  
**STATEMENT OF OPERATIONS**

*Year Ended December 31, 2006*

|   |                   |
|---|-------------------|
| <b>INVESTMENT INCOME:</b>   |                   |
| Dividends   | \$ 17,106,591     |
| Dividends from affiliates   | 360,440           |
| Interest  | 1,826,544         |
| Miscellaneous income  | 5,840             |
| <b>TOTAL INVESTMENT INCOME (NET OF FOREIGN TAXES WITHHELD AT SOURCE WHICH AMOUNTED TO \$50,416)</b> | <b>19,299,415</b> |

**EXPENSES:**

|                                    |           |
|------------------------------------|-----------|
| Investment advisory fee            | 9,500,251 |
| Administrative fee                 | 2,368,052 |
| Pricing and bookkeeping fees       | 173,963   |
| Audit Fees                         | 48,338    |
| Custodian fee                      | 83,229    |
| Legal fees                         | 229,970   |
| NYSE fee                           | 154,242   |
| Transfer agent fees                | 114,526   |
| Shareholder communication expenses | 418,938   |
| Trustees fees and expense          | 150,156   |
| Miscellaneous expenses             | 309,802   |

|                       |                   |
|-----------------------|-------------------|
| <b>TOTAL EXPENSES</b> | <b>13,551,467</b> |
|-----------------------|-------------------|

|                                |                 |
|--------------------------------|-----------------|
| <b>CUSTODY EARNINGS CREDIT</b> | <b>(4,162 )</b> |
|--------------------------------|-----------------|

|                     |                   |
|---------------------|-------------------|
| <b>NET EXPENSES</b> | <b>13,547,305</b> |
|---------------------|-------------------|

|                              |                  |
|------------------------------|------------------|
| <b>NET INVESTMENT INCOME</b> | <b>5,752,110</b> |
|------------------------------|------------------|

**REALIZED AND UNREALIZED GAIN ON INVESTMENTS AND FOREIGN CURRENCY:**

|   |                       |
|---|-----------------------|
| Net realized gain on:   |                       |
| Investments   | 124,736,126           |
| Foreign currency transactions                                     | 7,321                 |
| Net realized gain on investment transactions and foreign currency | 124,743,447           |
| Net unrealized appreciation on investments and foreign currency:  |                       |
| Beginning of year   | 163,702,429           |
| End of year   | 156,123,347           |
| Net change in unrealized appreciation                             | (7,579,082 )          |
| <b>NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS</b>       | <b>\$ 122,916,475</b> |

See Notes to Financial Statements





**LIBERTY ALL-STAR® EQUITY FUND**  
**STATEMENTS OF CHANGES IN NET ASSETS**

|   | Year Ended December 31, |                  |
|---|-------------------------|------------------|
|   | 2006                    | 2005             |
| <b>OPERATIONS:</b>  |                         |                  |
| Net investment income   | \$ 5,752,110            | \$ 2,558,482     |
| Net realized gain on investment transactions and foreign currency                             | 124,743,447             | 83,342,615       |
| Net change in unrealized appreciation   | (7,579,082)             | (20,825,770)     |
| Net increase in net assets resulting from operations  | 122,916,475             | 65,075,327       |
| <b>DISTRIBUTIONS DECLARED FROM:</b>   |                         |                  |
| Net investment income   | (5,753,686)             | (2,557,705)      |
| Net realized gain on investments  | (124,889,788)           | (84,322,544)     |
| Paid-in capital   | (5,402,964)             | (43,732,531)     |
| Total distributions   | (136,046,438)           | (130,612,780)    |
| <b>CAPITAL TRANSACTIONS:</b>  |                         |                  |
| Dividend reinvestments  | 16,734,378              | 61,508,410       |
| Total increase (decrease) in net assets   | 3,604,415               | (4,029,043)      |
| <b>NET ASSETS:</b>  |                         |                  |
| Beginning of year   | 1,368,161,632           | 1,372,190,675    |
| End of year (including undistributed net investment income of \$0 and \$43,520, respectively) | \$ 1,371,766,047        | \$ 1,368,161,632 |

See Notes to Financial Statements

**LIBERTY ALL-STAR® EQUITY FUND**  
**FINANCIAL HIGHLIGHTS**

|   | <b>Year Ended December 31,</b> |             |             |             |             |
|---|--------------------------------|-------------|-------------|-------------|-------------|
|   | <b>2006</b>                    | <b>2005</b> | <b>2004</b> | <b>2003</b> | <b>2002</b> |
| <b>PER SHARE OPERATING PERFORMANCE:</b>                                     |                                |             |             |             |             |
| Net asset value at beginning of year  | \$ 8.85                        | \$ 9.30     | \$ 9.13     | \$ 7.14     | \$ 10.65    |
| <b>Income from Investment Operations:</b>                                   |                                |             |             |             |             |
| Net investment income   | 0.04                           | 0.02        | 0.02        | 0.01        | 0.01        |
| Net realized and unrealized gain (loss) on investments and foreign currency | 0.75                           | 0.40        | 1.09        | 2.76        | (2.56)      |
| Total from Investment Operations  | 0.79                           | 0.42        | 1.11        | 2.77        | (2.55)      |
| <b>Less Distributions from:</b>   |                                |             |             |             |             |
| Net investment income   | (0.04)                         | (0.02)      | (0.02)      | (0.01)      | (0.01)      |
| Realized capital gain   | (0.81)                         | (0.56)      | (0.66)      | (0.30)      | (0.02)      |
| Paid-in capital   | (0.03)                         | (0.29)      | (0.21)      | (0.47)      | (0.85)      |
| Total Distributions   | (0.88)                         | (0.87)      | (0.89)      | (0.78)      | (0.88)      |
| Change due to rights offering (a)   |                                |             | (0.05)      |             | (0.08)      |
| Total Distributions, Reinvestments and Rights Offering                      | (0.88)                         | (0.87)      | (0.94)      | (0.78)      | (0.96)      |
| Net asset value at end of year  | \$ 8.76                        | \$ 8.85     | \$ 9.30     | \$ 9.13     | \$ 7.14     |
| Market price at end of year   | \$ 8.29                        | \$ 8.28     | \$ 9.56     | \$ 9.46     | \$ 6.64     |
| <b>TOTAL INVESTMENT RETURN FOR SHAREHOLDERS: (b)</b>                        |                                |             |             |             |             |
| Based on net asset value  | 10.4%                          | 5.0%        | 13.0%       | 40.7%       | (25.0)%     |
| Based on market price   | 11.7%                          | (4.4)%      | 12.1%       | 56.7%       | (33.0)%     |
| <b>RATIOS AND SUPPLEMENTAL DATA:</b>  |                                |             |             |             |             |
| Net assets at end of year (millions)  | \$ 1,372                       | \$ 1,368    | \$ 1,372    | \$ 1,153    | \$ 869 %    |
| Ratio of expenses to average net assets (c)                                 | 1.01                           | % 0.99      | % 1.01      | % 1.04      | % 1.05      |
| Ratio of net investment income to average net assets (c)                    | 0.43                           | % 0.20      | % 0.20      | % 0.11      | % 0.11      |
| Portfolio turnover rate   | 72                             | % 46        | % 57        | % 64        | % 83        |

(a) Effect of Fund's rights offerings for shares at a price below net asset value.

(b) Calculated assuming all distributions reinvested at actual reinvestment price and all rights offerings were fully subscribed under the terms of each offering.

(c) The benefits derived from custody credits and directed brokerage arrangements, if applicable, had an impact of less than 0.01%.

See Notes to Financial Statements

**LIBERTY ALL-STAR® EQUITY FUND  
NOTES TO FINANCIAL STATEMENTS**

*December 31, 2006*

**NOTE 1. ORGANIZATION**

Liberty All-Star Equity Fund (the Fund) is a Massachusetts business trust registered under the Investment Company Act of 1940 (the Act), as amended, as a diversified, closed-end management investment company.

**Investment Goal**

The Fund seeks total investment return comprised of longterm capital appreciation and current income through investing primarily in a diversified portfolio of equity securities.

**Fund Shares**

The Fund may issue an unlimited number of shares of beneficial interest.

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES**

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements.

**Security Valuation**

Equity securities are valued at the last sale price at the close of the principal exchange on which they trade, except for securities listed on the NASDAQ, which are valued at the NASDAQ official closing price. Unlisted securities or listed securities for which there were no sales during the day are valued at the closing bid price on such exchanges or over-the-counter markets.

Debt securities generally are valued by pricing services approved by the Fund's Board of Trustees (the Board), based upon market transactions for normal, institutional-size trading units of similar securities. The services may use various pricing techniques which take into account appropriate factors such as yield, quality, coupon rate, maturity, type of issue, trading characteristics and other data, as well as broker quotes. Debt securities for which quotations are readily available are valued at an over-the-counter or exchange bid quotation.

Short-term debt obligations maturing in more than 60 days for which market quotations are readily available are valued at current market value. Short-term debt obligations maturing within 60 days are valued at amortized cost, which approximates market value.

Investments for which market quotations are not readily available are valued at fair value as determined in good faith under consistently applied procedures approved by and under the general supervision of the Board.

**Security Transactions**

Security transactions are accounted for on the trade date. Cost is determined and gains (losses) are based upon the specific identification method for both financial statement and federal income tax purposes.

**Repurchase Agreements**

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The Fund may engage in repurchase agreement transactions with institutions that the Fund's investment adviser has determined are creditworthy. The Fund, through its custodian, receives delivery of underlying securities collateralizing a repurchase agreement. Collateral is at least equal, at all times, to the value of the repurchase obligation including interest. A repurchase agreement transaction involves certain risks in the event of default or insolvency of the counterparty. These risks include possible delays or restrictions upon a Fund's ability to dispose of the underlying securities and a possible decline in the value of the underlying securities during the period while the Fund seeks to assert its rights.

### **Income Recognition**

Interest income is recorded on the accrual basis. Premium and discount are amortized and accreted, respectively, on all debt securities. Corporate actions and dividend income are recorded on the ex-date.

The Fund estimates components of distributions from real estate investment trusts (REITs). Distributions received in excess of income are recorded as a reduction of the cost of the related investments. If the Fund no longer owns the applicable securities, any distributions received in excess of income are recorded as realized gains.

### **Federal Income Tax Status**

Consistent with the Fund's policy to qualify as a regulated investment company and to distribute all of its taxable income to shareholders, no federal income tax has been accrued.

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### Distributions to Shareholders

The Fund currently has a policy of paying distributions on its shares of beneficial interest totaling approximately 10% of its net asset value per year. The distributions are payable in four quarterly distributions of 2.5% of the Fund's net asset value at the close of the New York Stock Exchange on the Friday prior to each quarterly declaration date. Distributions to shareholders are recorded on ex-date.

### Indemnification

In the normal course of business, the Fund enters into contracts that contain a variety of representations and warranties and which provide general indemnities. The Fund's maximum exposure under these arrangements is unknown, as this would involve future claims against the Fund. Also, under the Fund's organizational documents and by contract, the Trustees and Officers of the Fund are indemnified against certain liabilities that may arise out of their duties to the Fund. However, based on experience, the Fund expects the risk of loss due to these warranties and indemnities to be minimal.

### Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (the *Interpretation* ). This Interpretation is effective for fiscal years beginning after December 15, 2006 and is to be applied to open tax positions upon initial adoption. As such, any necessary adjustments pursuant to the Interpretation will be reflected on the Semi-Annual report for the period ending June 30, 2007. This Interpretation prescribes a minimum recognition threshold and measurement method for the financial statement recognition of tax positions taken or expected to be taken in a tax return and also requires certain expanded disclosures. Management has recently begun to evaluate the application of this Interpretation to the Fund and has not at this time quantified the impact, if any, resulting from the adoption of this Interpretation on the Fund's financial statements.

In September 2006, Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS 157 ), was issued. SFAS 157 is effective for fiscal years beginning after November 15, 2007. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Management has recently begun to evaluate the impact the application of SFAS 157 will have on the Fund's financial statement disclosures.

### NOTE 3. FEDERAL TAX INFORMATION

The timing and character of income and capital gain distributions are determined in accordance with income tax regulations, which may differ from GAAP. Reclassifications are made to the Fund's capital accounts for permanent tax differences to reflect income and gains available for distribution (or available capital loss carryforwards) under income tax regulations.

For the year ended December 31, 2006, permanent book and tax basis differences resulting primarily from differing treatments for net operating losses and excess distributions were identified and reclassified among the components of the Fund's net assets as follows:

|                                 |          |                               |        |                 |      |
|---------------------------------|----------|-------------------------------|--------|-----------------|------|
| Accumulated Net Investment Loss |          | Accumulated Net Realized Loss |        | Paid-In Capital |      |
| \$                              | (41,944) | \$                            | 41,945 | \$              | (1 ) |

Net investment income and net realized gains (losses), as disclosed on the Statement of Operations, and net assets were not affected by this reclassification.

The tax character of distributions paid during the years ended December 31, 2006 and December 31, 2005 was as follows:

|                          | 12/31/06       | 12/31/05       |
|--------------------------|----------------|----------------|
| Distributions paid from: |                |                |
| Ordinary income          | \$ 13,728,960  | \$ 14,149,452  |
| Long-term capital gain   | 116,914,514    | 72,730,797     |
|                          | 130,643,474    | 86,880,249     |
| Return of capital        | 3,477,453      | 43,744,165     |
|                          | \$ 134,120,927 | \$ 130,624,414 |

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As of December 31, 2006, the components of distributable earnings on a tax basis were as follows:

| <b>Undistributed<br/>Ordinary Income</b> |   | <b>Undistributed Long<br/>Term Capital Gains</b> |   | <b>Net Unrealized<br/>Appreciation*</b> |
|--|---|--|---|---|
| \$                                       | 0 | \$   | 0 | \$ 145,212,637                          |

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\* The differences between book-basis and tax-basis net unrealized appreciation are primarily due to deferral of losses from wash sales.

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**NOTE 4. FEES AND COMPENSATION PAID TO AFFILIATES****Investment Advisory Fee**

Effective December 18, 2006, ALPS Advisers, Inc. ( AAI ) serves as the investment adviser to the Fund. AAI receives a monthly investment advisory fee based on the Fund's average daily net assets at the following annual rates:

| Average Daily Net Assets | Annual Fee Rate |   |
|--------------------------|-----------------|---|
| First \$400 million      | 0.800           | % |
| Next \$400 million       | 0.720           | % |
| Next \$400 million       | 0.648           | % |
| Over \$1.2 billion       | 0.584           | % |

Under Portfolio Management Agreements, AAI pays each Portfolio Manager a portfolio management fee based on the assets of the investment portfolio that they managed. The portfolio management fee is paid from the investment advisory fees collected by AAI and is based on the Fund's average daily net assets at the following annual rates:

| Average Daily Net Assets | Annual Fee Rate |   |
|--------------------------|-----------------|---|
| First \$400 million      | 0.400           | % |
| Next \$400 million       | 0.360           | % |
| Next \$400 million       | 0.324           | % |
| Over \$1.2 billion       | 0.292           | % |

Prior to December 18, 2006, Banc of America Investment Advisors, Inc. ( BAIA ), an indirect, wholly owned subsidiary of Bank of America Corporation ( BOA ), served as the Fund's investment advisor. AAI became investment adviser when the Fund Management Agreement was approved by Fund shareholders at a Special Meeting of the Shareholders of the Fund on November 21, 2006.

The fee rates of BAIA's investment advisory agreement with the Fund and BAIA's agreements with the Portfolio Managers were the same as AAI's fee rates noted above, except that the investment advisory fee the Fund paid to BAIA and the portfolio management fee BAIA paid to the portfolio managers were calculated based on the Fund's average weekly net assets.

**Administration, Pricing and Bookkeeping Fees**

ALPS Fund Services, Inc. ( ALPS ) provides administrative and other services to the Fund for a monthly administration fee based on the Fund's average daily net assets at the following annual rates:

| Average Daily Net Assets | Annual Fee Rate |   |
|--------------------------|-----------------|---|
| First \$400 million      | 0.200           | % |
| Next \$400 million       | 0.180           | % |
| Next \$400 million       | 0.162           | % |
| Over \$1.2 billion       | 0.146           | % |

In addition, ALPS provides pricing and bookkeeping services to the Fund for an annual fee consisting of: (i) \$38,000 paid monthly plus an additional monthly fee based on the level of average daily net assets for the month; and (ii) a multi-manager fee based on the number of portfolio managers; provided that during any 12-month period, the aggregate amount of (i) shall not exceed \$140,000 (exclusive of out-of-pocket expenses and charges).

The Fund also reimburses ALPS for out-of-pocket expenses and charges, including fees payable to third parties for pricing the Fund's portfolio securities and direct internal costs incurred by ALPS in connection with providing fund accounting oversight and monitoring and certain other services.

Prior to December 18, 2006, BAIA provided administrative and other services to the Fund under the same terms as ALPS noted above, except that BAIA's fee was based on average weekly net assets.

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Further, prior to December 18, 2006, Columbia Management Advisors, LLC ( Columbia ), an indirect, wholly owned subsidiary of BOA and an affiliate of BAIA, was responsible for providing pricing and bookkeeping services to the Fund under a pricing and bookkeeping agreement. Under a separate agreement (the Outsourcing Agreement ), Columbia delegated those functions to State Street Corporation ( State Street ). As a result, Columbia paid State Street the total fees collected under the pricing and bookkeeping agreement.

The terms of Columbia s pricing and bookkeeping agreement were the same as the ALPS terms noted above.

### **Custody Credits**

The Fund has an agreement with its custodian bank under which custody fees may be reduced by balance credits. These credits are recorded as a reduction of total expenses on the Statement of Operations. The Fund could have invested a portion of the assets utilized in connection with the expense offset arrangement in an income-producing asset if it had not entered into such an agreement.

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**Fees Paid to Officers**

All officers of the Fund are employees of AAI or its affiliates, and receive no compensation from the Fund. The Board of Trustees has appointed a Chief Compliance Officer to the Fund in accordance with federal securities regulations. Prior to December 18, 2006, the Fund paid a pro-rata share of the expenses associated with the Chief Compliance Officer position up to a maximum of \$15,000 per year.

**NOTE 5. OTHER**

Prior to December 18, 2006, Columbia provided certain services to the Fund related to Sarbanes-Oxley compliance. For the year ended December 31, 2006, the Fund paid \$2,857 to Columbia for such services. This amount is included in Miscellaneous expenses on the Statement of Operations.

**NOTE 6. PORTFOLIO INFORMATION**

For the year ended December 31, 2006, the cost of purchases and proceeds from sales of securities, excluding short-term obligations, were \$941,951,094 and \$1,053,816,550, respectively.

**NOTE 7. OTHER RELATED PARTY TRANSACTIONS**

During the period ended December 18, 2006, the Fund earned dividend income of \$360,440 from Bank of America Corp., which was considered an affiliate of the Fund. During the period ended December 18, 2006, the Fund used Bank of America Securities LLC, a wholly owned subsidiary of BOA, as a broker. Total commissions paid to Bank of America Securities LLC during the period were \$18,963. After December 18, 2006, Bank of America Corp. and Bank of America Securities LLC were no longer considered affiliates of the Fund.

**NOTE 8. CAPITAL TRANSACTIONS**

During the years ended December 31, 2006 and December 31, 2005, distributions in the amount of \$16,734,378 and \$61,508,410, respectively, were paid in newly issued shares valued at market value or net asset value, but not less than 95% of market value. Such distributions resulted in the issuance of 2,071,594 and 7,032,882 shares, respectively.

**LIBERTY ALL-STAR® EQUITY FUND**  
**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**TO THE SHAREHOLDERS AND THE BOARD OF TRUSTEES OF LIBERTY ALL-STAR EQUITY FUND**

In our opinion, the accompanying statement of assets and liabilities, including the investment portfolio, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of Liberty All-Star Equity Fund (the Fund ) at December 31, 2006, and the results of its operations, the changes in its net assets and its financial highlights for the periods indicated in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as financial statements ) are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at December 31, 2006 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Boston, Massachusetts

February 20, 2007

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**LIBERTY ALL-STAR® EQUITY FUND**  
**AUTOMATIC DIVIDEND REINVESTMENT AND CASH PURCHASE PLAN (UNAUDITED)**

Under the Fund's Automatic Dividend Reinvestment and Cash Purchase Plan (the Plan), shareholders may elect to participate and have all their Fund dividends and distributions automatically reinvested by Computershare Trust Company, N.A., as agent for participants in the Plan (the Plan Agent), in additional shares of the Fund. For further information and enrollment forms, call Investor Assistance at 1-800-LIB-FUND (1-800-542-3863) weekdays between 9 a.m. and 5 p.m. Eastern Time.

Shareholders whose shares are held in the name of a brokerage firm, bank or other nominee can participate in the Plan only if their brokerage firm, bank or nominee is able to do so on their behalf. Shareholders participating in the Plan through a brokerage firm may not be able to transfer their shares to another brokerage firm and continue to participate in the Plan.

Under the Plan, distributions declared payable in shares or cash at the option of shareholders are paid to participants in the Plan entirely in newly issued full and fractional shares valued at the lower of market value or net asset value per share on the valuation date for the distribution (but not at a discount of more than 5 percent from market price). Distributions declared payable only in cash will be reinvested for the accounts of participants in the Plan in additional shares purchased by the Plan Agent on the open market at prevailing market prices. If, prior to the Plan Agent's completion of such open market purchases, the market price of a share equals or exceeds its net asset value, the remainder of the distribution will be paid in newly issued shares valued at net asset value (but not at a discount of more than 5% from market price). Dividends and distributions are subject to taxation, whether received in cash or in shares.

Participants in the Plan have the option of making additional cash payments in any amount on a monthly basis for investment in shares of the Fund purchased on the open market. These voluntary cash payments will be invested on or shortly after the 15th day of each calendar month, and voluntary payments should be sent so as to be received by the Plan Agent no later than five business days before the next investment date. Barring suspension of trading, voluntary cash payments will be invested within 45 days of receipt. A participant may withdraw a voluntary cash payment by written notice received by the Plan Agent at least 48 hours before such payment is to be invested.

The Plan Agent maintains all shareholder accounts in the Plan and furnishes written confirmations of all transactions in the account, including information needed by shareholders for tax records. Shares in the account of each Plan participant will be held by the Plan Agent in non-certificated form in the name of the participant, and each shareholder's proxy will include those shares purchased or received pursuant to the Plan.

There is no charge to participants for reinvesting distributions pursuant to the Plan. The Plan Agent's fees are paid by the Fund. There are no brokerage charges with respect to shares issued directly by the Fund as a result of dividends or distributions declared payable in shares or in cash. However, each participant bears a pro rata share of brokerage commissions incurred with respect to the Plan Agent's open market purchases in connection with the reinvestment of distributions declared payable in cash.

With respect to purchases from voluntary cash payments, the Plan Agent will charge \$1.25 for each such purchase for a participant, plus a pro rata share of the brokerage commissions. Brokerage charges for purchasing small amounts of shares for individual accounts through the Plan are expected to be less than the usual brokerage charges for such transactions, as the Plan Agent will be purchasing shares for all participants in blocks and prorating the lower commission thus attainable.

Shareholders may terminate their participation in the Plan by written notice to the Plan Agent, Computer-share Trust Company, N.A., P.O. Box 43078, Providence, RI 02940-3078. Such termination will be effective immediately if received not less than 10 days prior to the record date for a dividend or distribution; otherwise it will be effective on the first business day after the payment date of such dividend or distribution. On termination, participants may either have certificates for the Fund shares in their Plan accounts delivered to them or have the Plan Agent sell such shares in the open market and deliver the proceeds, less a \$2.50 fee plus brokerage commissions, to the participant.

Experience under the Plan may indicate that changes are desirable. Accordingly, the Fund reserves the right to amend or terminate the Plan.

**LIBERTY ALL-STAR® EQUITY FUND  
TAX INFORMATION (UNAUDITED)**

All 2006 distributions whether received in cash or shares of the Fund consist of the following:

- (1) ordinary dividends
- (2) long-term capital gains and
- (3) return of capital

The table below details the breakdown of each 2006 distribution for federal income tax purposes.

**TAX STATUS OF 2006 DISTRIBUTIONS**

| DATE PAID | AMOUNT PER SHARE | ORDINARY DIVIDENDS QUALIFIED | NON-QUALIFIED | LONG-TERM CAPITAL GAINS | RETURN OF CAPITAL |
|-----------|------------------|------------------------------|---------------|-------------------------|-------------------|
| 1/03/06*  | \$ 0.21          | 10.24                        | %             | 87.17                   | % 2.59            |
| 3/20/06   | \$ 0.23          | 10.24                        | %             | 87.17                   | % 2.59            |
| 6/19/06   | \$ 0.22          | 10.24                        | %             | 87.17                   | % 2.59            |
| 9/18/06   | \$ 0.21          | 10.24                        | %             | 87.17                   | % 2.59            |
| 1/02/07** | \$ 0.22          |                              |               |                         |                   |

\* Pursuant to Section 852 of the Internal Revenue Code, the taxability of this distribution will be reported in the Form 1099-DIV for 2006.

\*\* Pursuant to Section 852 of the Internal Revenue Code, the taxability of this distribution will be reported in the Form 1099-DIV for 2007.

**TAX DESIGNATIONS**

The Fund designates the following amounts for the fiscal year ended December 31, 2006:

|  |        |   |
|--|--------|---|
| Qualified Dividend Income              | 100.00 | % |
| Corporate Dividends Received Deduction | 42.16  | % |

**LIBERTY ALL-STAR® EQUITY FUND  
PROXY INFORMATION (UNAUDITED)**

A Special Meeting of Shareholders of the Liberty All-Star Equity Fund was held on November 21, 2006 for the purpose of voting on the matters listed below. The final tabulation results of this meeting are as follows:

The number of shares issued, outstanding and eligible to vote as of the record date of September 7, 2006 was 154,598,224.

1. To elect three new Trustees of the Fund.

|                        | <b>For</b> | <b>Withheld</b> |
|------------------------|------------|-----------------|
| (1) Richard C. Rantzow | 76,027,750 | 5,982,676       |
| (2) George R. Gaspari  | 76,081,311 | 5,929,115       |
| (3) Edmund J. Burke    | 76,032,535 | 5,977,890       |

2. To approve a new Fund Management between the Fund and ALPS Advisers, Inc. to become effective upon completion of the Transaction described in the Proxy Statement.

| <b>For</b> | <b>Against</b> | <b>Abstain</b> |
|------------|----------------|----------------|
| 74,401,367 | 3,844,571      | 3,764,489      |

3. To approve new Portfolio Management Agreements for the Fund with ALPS Advisers, Inc. and each of the current Portfolio Managers listed below to become effective upon completion of the Transaction described in the Proxy Statement.

|  | <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Non Votes</b> |
|--|------------|----------------|----------------|------------------|
| Chase Investment Counsel Corporation     | 73,644,797 | 4,533,415      | 3,831,441      | 1,174            |
| Matrix Asset Advisors, Inc.              | 74,129,241 | 3,989,343      | 3,891,842      | 0                |
| Pzena Investment Management, LLC         | 74,062,222 | 4,079,915      | 3,868,289      | 0                |
| Schneider Capital Management Corporation | 74,015,066 | 4,082,049      | 3,913,311      | 0                |
| TCW Investment Management Company        | 73,820,434 | 4,198,948      | 3,991,044      | 0                |

4. To approve a policy to permit the Fund and ALPS Advisers, Inc. to enter into Portfolio Management Agreements in advance of Shareholder approval.

| <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Non Votes</b> |
|------------|----------------|----------------|------------------|
| 72,324,643 | 5,755,492      | 3,930,289      | 0                |

**LIBERTY ALL-STAR® EQUITY FUND  
TRUSTEES AND OFFICERS**

The names of the Trustees and Officers of the Liberty All-Star Equity Fund, the date each was first elected or appointed to office, their term of office, their principal business occupations and other directorships they have held during at least the last five years, are shown below.

**DISINTERESTED TRUSTEES**

| NAME AND ADDRESS*             | POSITION WITH EQUITY FUND, TERM OF OFFICE AND LENGTH OF SERVICE | PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS  | NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY DIRECTOR | OTHER DIRECTORSHIPS HELD  |
|-------------------------------|---|---|---|---|
| John A. Benning<br>(Age 72)   | Trustee<br>Since 2002; Term expires 2009                        | Retired since December, 1999; Senior Vice President, General Counsel and Secretary, Liberty Financial Companies Inc. (July, 1985 to December, 1999); Vice President, Secretary and Director, Liberty Asset Management Company (August, 1985 to December, 1999). | 2   | Director, Liberty All-Star Growth Fund (since 2002).  |
| Thomas W. Brock<br>(Age 59)   | Trustee<br>Since 2005; Term expires 2008                        | CEO, StoneHarbor Investment Partners LP (since April 2006); Adjunct Professor, Columbia University Graduate School of Business (since September, 1998).   | 2   | Director, Liberty All-Star Growth Fund (since 2005); Director, Columbia Management Multi-Strategy Fund LLC (Hedge Fund); Manager, BACAP Alternative Multi-Strategy Fund, LLC. |
| George R. Gaspari<br>(Age 66) | Trustee<br>Since 2006,<br><br>Term Expires 2008                 | Financial Services Consultant<br><br>(since 1996)   | 2   | Trustee and Chairman, The Select Sector SPDR Trust (since 1998); Director, Liberty All-Star Growth Fund (since 2006).   |
| Richard W. Lowry<br>(Age 70)  | Trustee and Chairman<br>Since 1986; Term Expires 2007           | Private Investor since 1987   | 2   | Director and Chairman, Liberty All-Star Growth Fund (since 1994); Trustee, Columbia Fund Complex (81 portfolios).   |
| John J. Neuhauser<br>(Age 63) | Trustee<br>Since 1998; Term Expires 2007                        | University Professor since December 2005, Boston College (formerly Academic Vice President and Dean of Faculties, from August 1999 to December 2005, Boston College).   | 2   | Director, Liberty All-Star Growth Fund (since 1998); Trustee, Columbia Fund Complex (81 Portfolios).  |
| Richard C. Rantzow            | Trustee   | Chairman of the Board of First Funds (from 1992 to July 2006)   | 2   | Trustee, Clough Global Allocation Fund (since   |

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|          |                                      |   |
|----------|--------------------------------------|---|
| (Age 68) | Since 2006,<br><br>Term expires 2007 | 2004), Clough Global Equity Fund (since 2005) and Clough Global Opportunities Fund (since 2006); Director, Liberty All-Star Growth Fund (since 2006). |
|----------|--------------------------------------|---|

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\* The address for all Trustees and Officers is: c/o ALPS Advisers, Inc., 1625 Broadway, Suite 2200; Denver, CO 80202.

**INTERESTED TRUSTEES**

| <b>NAME AND ADDRESS*</b>      | <b>POSITION WITH EQUITY FUND, TERM OF OFFICE AND LENGTH OF SERVICE</b> | <b>PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS</b>   | <b>NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY DIRECTOR</b> | <b>OTHER DIRECTORSHIPS HELD</b>  |
|-------------------------------|--|---|--|--|
| Edmund J. Burke<br>(Age 45)** | Trustee<br>Since 2006,<br>Term expires 2009                            | President and a Director of ALPS (since 2005), President and a Director of ALPS Advisers (since 2001), President and a Director of ALPS Financial Services, Inc. (1991-2005). | 2  | President, Financial Investors Trust (since 2001); President, Reaves Utility Income Fund (since 2004); President, Financial Investors Variable Trust (since 2006); Trustee and President, Clough Global Allocation Fund (Trustee since 2006, President since 2004); Trustee and President, Clough Global Equity Fund (Trustee since 2006, President since 2005); Trustee and President Clough Global Opportunities Fund (since 2006); Director, Liberty All-Star Growth Fund (since 2006). |

**OFFICERS**

| <b>NAME AND ADDRESS*</b>            | <b>POSITION WITH LIBERTY ALL-STAR EQUITY FUND</b> | <b>YEAR FIRST ELECTED OR APPOINTED TO OFFICE</b> | <b>PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS</b>  |
|-------------------------------------|---|--|--|
| William R. Parmentier, Jr. (Age 54) | President and Chief Executive Officer             | 1999   | Chief Investment Officer, ALPS Advisers, Inc. (since 2006); President and Chief Executive Officer of the Liberty All-Star Funds (since April 1999); Senior Vice President (2005-2006), Banc of America Investment Advisors, Inc. |
| Mark T. Haley, CFA (Age 42)         | Senior Vice President                             | 1999   | Senior Vice President of the Liberty All-Star Funds (since January 1999). Vice President, ALPS Advisers, Inc. (since 2006); Vice President, Banc of America Investment Advisors (1999-2006).                                     |
| Edmund J. Burke (Age 45)            | Vice President                                    | 2006   | President and a Director of ALPS (since 2005), President and a Director of ALPS Advisers (since 2001), President and a Director of ALPS Financial Services, Inc. (1991-2005). See above for other Directorships held.            |

\* The address for all Trustees and Officers is: c/o ALPS Advisers, Inc., 1625 Broadway, Suite 2200; Denver, CO 80202.

\*\* Mr. Burke is an interested person of the Fund as defined in the Investment Company Act, because he is an officer of ALPS and ALPS Advisers.





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| NAME AND ADDRESS*              | POSITION WITH LIBERTY ALL-STAR EQUITY FUND | YEAR FIRST ELECTED OR APPOINTED TO OFFICE | PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS   |
|--------------------------------|--|---|--|
| Jeremy O. May<br>(Age 36)      | Treasurer                                  | 2006                                      | Mr. May is Managing Director of ALPS. Mr. May joined ALPS in 1995. Because of his position with ALPS, Mr. May is deemed an affiliate of the Fund as defined under the 1940 Act. Mr. May is currently the Treasurer of Reaves Utility Income Fund, Clough Global Equity Fund, Clough Global Allocation Fund, Clough Global Opportunities Fund, Financial Investors Trust, and Financial Investors Variable Insurance Trust. Mr. May is also on the Board of Directors, and is Chairman of the Audit Committee, of the University of Colorado Foundation.  |
| Kimberly R. Storms<br>(Age 34) | Assistant Treasurer                        | 2006                                      | Ms. Storms is Director of Fund Administration and Vice-President of ALPS. Ms. Storms joined ALPS in 1998 as Assistant Controller. Because of her position with ALPS, Ms. Storms is deemed an affiliate of the Fund as defined under the 1940 Act. Ms. Storms is also Assistant Treasurer of the Clough Global Equity Fund, Clough Global Allocation Fund, Clough Global Opportunities Fund, Reaves Utility Income Fund and Financial Investors Trust and Assistant Secretary of Ameristock Mutual Fund, Inc.   |
| Bradley J. Swenson<br>(Age 34) | Chief Compliance Officer                   | 2006                                      | Chief Compliance Officer ( CCO ), ALPS Fund Services, Inc. and ALPS Distributors, Inc., since 2004; CCO ALPS Advisers, Inc. since 2006; Mr. Swenson currently acts in the capacity of Fund CCO for Financial Investors Variable Insurance Trust, the SPDR Trust, MidCap SPDR Trust, DIAMONDS Trust, NASDAQ-100 Trust, BLDRS Index Funds Trust, WisdomTree Funds Trust, and Healthshares, Inc.; Senior Audit Manager, Janus Capital Group, Inc.; Senior Internal Auditor, Oppenheimer Funds, Inc.   |
| Tané T. Tyler<br>(Age 41)      | Secretary                                  | 2006                                      | Chief Legal Officer, Assistant Secretary, ALPS Funds Services, Inc. and ALPS Distributors, Inc. since September 2004; Chief Legal Officer, Secretary, ALPS Holdings, Inc. since August 2005; Chief Legal Officer, Assistant Secretary, ALPS Advisers, Inc., since August 2006; Secretary, Liberty All-Star Equity and Liberty All-Star Growth since December 2006; Secretary, Reaves Utility Income Fund since December 2004; Secretary, Westcore Funds since February 2005; Secretary, First Fund from November 2004 to January 2007; Secretary, Financial Investors Variable Insurance Trust from December 2004 – December 2006; Vice President and Associate Counsel, Oppenheimer Funds from January 2004 to August 2004; Vice President and Assistant General Counsel, INVESCO Funds from September 1991 to December 2003. |

\* The address for all Officers is: c/o ALPS Advisers, Inc., 1625 Broadway, Suite 2200; Denver, CO 80202.

## **LIBERTY ALL-STAR® EQUITY FUND**

### **BOARD EVALUATION OF NEW AGREEMENTS WITH ALPS ADVISERS**

#### **BOARD MEETINGS AND CONSIDERATIONS**

On September 7, 2006, Banc of America Investment Advisors, Inc. ( BAIA ) entered into an asset purchase agreement with ALPS Holdings, Inc. ( ALPS ) and ALPS Advisers, Inc. ( ALPS Advisers ) whereby ALPS Advisers agreed to purchase certain assets related to BAIA 's business of providing investment advisory and certain administrative services to Liberty All-Star Equity Fund (the The Fund ) and Liberty All-Star Growth Fund, Inc. (the The Growth Fund and, together with the Fund, the Funds ) (the Transaction ). Upon the closing of the transaction (the Closing ), ALPS Advisers became the investment adviser to the Fund. The Closing was subject to certain terms and conditions, including, among others: (1) each Fund obtaining shareholder approval to enter into a new Fund Management Agreement ( New Fund Management Agreement ) with ALPS Advisers and new Portfolio Management Agreements ( New Portfolio Management Agreements and, together with the New Fund Management Agreements, the New Agreements ) with each Fund 's Portfolio Managers, and (2) BAIA and ALPS Advisers obtaining any necessary regulatory approvals. Because the existing Fund Management Agreements and Portfolio Management Agreements were to terminate upon the Closing of the Transaction, shareholder approval of the New Agreements was required. Shareholders of the Fund approved the New Agreements at a special meeting of shareholders on November 21, 2006.

#### **BOARD CONSIDERATION OF THE NEW AGREEMENTS**

The Investment Company Act of 1940 (the Investment Company Act ) requires that the Board of Trustees of the Fund ( Board ) review the Fund 's advisory contracts and consider whether to approve them and recommend that the shareholders of the Fund approve them. At its meeting on September 7, 2006, the Board, all members of which were Disinterested Trustees, conducted such a review and approved the New Fund Management Agreement between the Fund and ALPS Advisers and the separate New Portfolio Management Agreements, each among the Fund, ALPS Advisers and a Portfolio Manager.

Prior to the Board 's approval of those agreements, the Disinterested Trustees met to consider management 's recommendations as to the approval of each New Agreement. As part of the process to consider those matters, legal counsel to the Disinterested Trustees requested certain information from ALPS Advisers and each Portfolio Manager. In response to these requests, the Disinterested Trustees received reports from ALPS Advisers and each Portfolio Manager that addressed specific factors to be considered by the Board. The Board 's counsel also provided the Dis-interested Trustees and the Board with a memorandum regarding their responsibilities pertaining to the approval of each New Agreement. Based on its evaluation, the Board unanimously concluded that the terms of each New Agreement were reasonable and fair and that the approval of each New Agreement was in the best interests of the Fund and its shareholders.

In voting to approve each New Agree-ment, the Board did not identify any single factor as all-important or controlling. The following summary does not identify all the matters considered by the Board, but provides a summary of the principal matters it considered. The Board considered whether each New Agreement would be in the best interests of the Fund and its shareholders, based on: (1) the nature, extent and quality of the services to be provided under the New Agreement; (2) the investment performance of the Fund; (3) the expenses borne by the Fund (including management fees and other expenses), the fees charged by ALPS and the Portfolio Managers to the Fund and to their other clients, as applicable, and projected profits to be realized by ALPS Advisers and its affiliates from their relationships with the Fund; (4) the fact that economies of scale may be realized as the Fund grows and whether fee levels will reflect economies of scale for the benefit of shareholders; (5) potential fall-out benefits to ALPS Advisers and each Portfolio Manager from their relationships with the Fund; and (6) other general information about ALPS Advisers and each Portfolio Manager. The following is a summary of the Board 's consideration and conclusions regarding these matters.



## **NATURE, EXTENT AND QUALITY OF THE SERVICES TO BE PROVIDED**

The Board considered the nature, extent and quality of the services to be provided by ALPS Advisers, including portfolio manager selection, evaluation and monitoring, and the portfolio management services to be provided by each Portfolio Manager, in light of the investment objective of the Fund. The Board considered that, following the Transaction, the same senior investment advisory personnel that currently provide advisory services to the Fund at the Fund Manager level were expected to continue to provide these services to the Fund as employees of ALPS Advisers. In that regard, the Board considered the long-term history of care and conscientiousness in the management of the Fund provided by that personnel, which would continue to be provided following the Transaction. The Board also considered each Portfolio Manager's demonstrated consistency in investment approach. The Board reviewed the background and experience of (1) the current BAIA personnel to be employed by ALPS Advisers and to be responsible for portfolio manager selection, evaluation and monitoring for the Fund and (2) the Portfolio Manager personnel responsible for managing the portfolio of the Fund. The Board also considered the compliance records of ALPS and each Portfolio Manager. Finally, the Board also considered its and the Fund's long association with the current BAIA personnel to be employed by ALPS Advisers, the relationships those BAIA personnel maintain with the Portfolio Managers, and the ability of those personnel to evaluate the services provided by the Portfolio Managers.

The Board concluded that the nature, extent and quality of the services to be provided by ALPS Advisers and the respective Portfolio Managers to the Fund was appropriate and consistent with the terms of the respective New Agreements and that the Fund was likely to benefit from services provided under the New Agreements. The Board also concluded that the quality of the services provided by the senior advisory personnel to be employed by ALPS Advisers and by the Portfolio Managers had been consistent with or superior to quality norms in the industry, and that ALPS Advisers and the respective Portfolio Managers would have sufficient personnel, with the appropriate education and experience, to serve the Fund effectively. The Board also concluded that the Portfolio Managers had demonstrated a continuing ability to attract and retain well-qualified personnel, and that the structure of ALPS Advisers' operations was sufficient to retain and properly motivate the Fund's current senior advisory personnel who were to be employed by ALPS Advisers. Finally, the Board concluded that the financial condition of ALPS Advisers and of each respective Portfolio Manager was sound.

## **INVESTMENT PERFORMANCE**

At the time of the annual renewal of the Fund's advisory contracts earlier in the year, the Board reviewed the long-term and short-term investment performance of the Fund as of year end 2005 and of other investment companies and other accounts managed by the Portfolio Managers. In that connection, the Board also considered the long-term and short-term investment performance of the existing senior investment advisory personnel of BAIA who will continue to manage the Fund as ALPS employees, in the absence of any investment performance data for ALPS Advisers. The performance information previously provided demonstrated to the Board a generally consistent pattern of favorable long-term performance of the Fund. Among other information addressed, the Fund's Board considered the fact that the Fund's NAV returns outperformed the S&P 500 and the Lipper Large-Cap Core Mutual Fund Average during the one-, three- and five- year periods.

## **COSTS OF THE SERVICES TO BE PROVIDED TO THE FUND AND THE PROJECTED PROFITS TO BE REALIZED BY ALPS ADVISERS FROM ITS RELATIONSHIP WITH THE FUNDS**

The Board reviewed the fees to be paid by the Fund to ALPS Advisers and the fees to be paid by ALPS Advisers to the Portfolio Managers, noting that the rates of fees to be paid under the New Agreements are the same fee rates the Fund currently pays. In that regard, the Board noted that it had reviewed comparative fee information at the time of the annual renewal of the Fund's advisory contracts earlier in the year, including information about



(1) the rates of compensation paid to investment advisers, and overall expense ratios, for funds comparable in size, character and investment strategy to the Fund and (2) the fees charged by the Portfolio Managers to their other client accounts, including institutional accounts. At that time, the Board considered the fact that the Fund's fees were generally comparable to the fees charged to similar closed-end funds. The Board noted that currently ALPS Advisers does not manage other accounts. The Board also considered that the Portfolio Managers would be paid by ALPS Advisers, not the Fund. Further, the Board also considered the differences in the level of services provided and the differences in responsibility of the Portfolio Managers to the Fund and to other accounts. The Board also noted that the Fund's fee schedule has breakpoints at which the advisory fee rate declines as the Fund's assets increase above the breakpoint, and further noted that those schedules would remain unchanged under the New Agreements. The Board concluded that the management fees payable by the Fund to ALPS Advisers and the fees payable by ALPS Advisers to the Portfolio Managers were reasonable in relation to the nature and quality of the services expected to be provided, taking into account the fees charged by other advisers for managing comparable funds with similar strategies and the fees the Portfolio Managers charge to other clients.

#### **PROJECTED PROFITABILITY AND COSTS OF SERVICES TO ALPS ADVISERS**

The Board reviewed reports of the financial position of each of the Portfolio Managers at the time of the annual renewal of the Fund's advisory contracts, and in that regard noted that the rates of fees payable to the Portfolio Managers under the New Agreements were unchanged from the current agreements. The Board considered the projected profitability of ALPS' overall relationship with the Fund, which included fees payable to ALPS Advisers for advisory services as well as fees payable to other ALPS affiliates for non-advisory services, and concluded that the projected profitability of ALPS was reasonable in relation to the services to be provided and to the costs of providing services to the Fund. The Board also considered the potential fall-out benefits (including the receipt of research products and services from unaffiliated brokers) that ALPS Advisers or the Portfolio Managers might receive in connection with their association with the Fund, and acknowledged each Portfolio Manager's well-established stand-alone management relationships independent of the Fund and the regulatory risks each assumed in connection with the management of the Fund.

#### **EXTENT OF ECONOMIES OF SCALE AS THE FUNDS GROW AND WHETHER FEE LEVELS REFLECT ECONOMIES OF SCALE**

The Board reviewed the Fund's management fee schedules and the breakpoints in the schedule and concluded that the fee schedules reflect certain economies of scale that may be realized by ALPS Advisers as the assets of the Fund increase.

Based on their evaluation, the Board unanimously concluded that the terms of the New Agreements are reasonable, fair and in the best interests of the Fund and its shareholders. The Board concluded that the New Agreements will enable the Fund to continue to enjoy the high-quality investment management and sub-advisory services it has received in the past from its Fund Manager and each Portfolio Manager, at fee rates identical to the present rates, which the Board deem appropriate, reasonable and in the best interests of the Fund and its shareholders. The Board determined to approve and to recommend to the shareholders of the Fund that they approve the New Agreements.

## **LIBERTY ALL-STAR® EQUITY FUND PRIVACY POLICY**

This Privacy Policy Notice discloses the privacy policies of the Liberty All-Star Funds, which are advised by ALPS Advisers, Inc. and serviced by ALPS Fund Services, Inc. (the Companies ). The Companies and the Funds are referred to herein collectively as we or us.

### **PROTECTING YOUR PRIVACY IS A TOP PRIORITY**

We realize that our ability to offer superior products and services depends on the personal and financial information we collect from you. We value your business and are committed to maintaining your trust. That is why we have made your privacy a top priority.

### **THE INFORMATION WE HAVE AND WHERE WE GET IT**

We collect information about you from a variety of sources, including:

- Information we receive from you on applications or other forms, such as your name, address and phone number; your social security number; and your assets, income and other household information;
- Information about your other transactions with us, our affiliates or others, such as your account balances and transactions history; and
- Information from visitors to our websites provided through online forms, site visitorship data and online information-collecting devices known as cookies.

We do not solicit personal or financial information from minors without written parental consent, nor do we knowingly market products and services to minors.

### **HOW WE USE THIS INFORMATION**

We may share all of the information we collect with the Companies as part of the ordinary course of providing financial products and services to you, for the purpose of offering you new products and services to address your financial needs, for product development purposes and as otherwise required or permitted by law.



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To assist in our business dealings with you, we may also share this information with companies (other than the Companies) that perform services, including marketing services, on our behalf (such as vendors that package and mail our investor statements and marketing research firms that enhance our ability to market our products and services). We do not share your information with mailing list or direct marketing companies. Thus, the information you provide to us will not result in unwanted solicitations from third-party marketers.

Finally, we may share this information with other entities outside of the Companies for the following purposes, including among others:

- To respond to a subpoena or court order, judicial process or regulatory inquiry;
- To report suspicious transactions to government agencies and law enforcement officials;
- To protect against fraud;
- To provide products and services with the consent or the direction of a customer; or
- In connection with the proposed or actual sale or merger of all or a portion of a business or operating unit.

*Except as described above, and except for information we provide to nonaffiliated third parties as otherwise required or permitted by law, we do not share information about you with nonaffiliated third parties.*

### **SECURITY OF PERSONAL FINANCIAL INFORMATION**

We restrict access to information about you to those employees we determine need to know that information to provide products and services to you. We maintain physical, electronic and procedural safeguards to protect this information.

If you provide information to us via our websites in order to view your account activity or conduct transactions, we use 128-bit SSL encryption security with passwords to ensure a safe transmission of data between you and us. Information you provide is stored and transmitted in a secure environment, accessible only by a select group of people who are given a secure passcode to access the information.

We continuously assess new technology for protecting information and upgrade our systems where appropriate.

**IF YOU HAVE ANY QUESTIONS OR CONCERNS ABOUT THIS PRIVACY POLICY NOTICE, PLEASE WRITE TO US AT:**

ALPS Advisers, Inc.

Attn: Compliance Department

1625 Broadway, Suite 2200

Denver, CO 80202

**FORMER CUSTOMERS**

If, for whatever reason, our customer relationship with you ends, we will preserve your information as necessary to comply with applicable laws. The measures we take to protect the privacy of customer information, as described in this Privacy Policy Notice, will continue to apply to you. We also will comply with more restrictive state laws to the extent they apply.

*We reserve the right to change this Privacy Policy Notice, and any of the policies described herein, at any time. The examples contained in this Privacy Policy Notice are illustrations; they are not intended to be exclusive.*

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**LIBERTY ALL-STAR® EQUITY FUND**  
**DESCRIPTION OF LIPPER BENCHMARK AND MARKET INDICES**

**Lipper Large-Cap Core Mutual Fund Average**

The average of funds that, by portfolio practice, invest at least 75% of their equity assets in companies with market capitalizations (on a three-year weighted basis) greater than 300% of the dollar-weighted median market capitalization of the middle 1,000 securities of the S&P SuperComposite 1500 Index. Large-Cap core funds have more latitude in the companies in which they invest. These funds typically have an average price-to-earnings ratio, price-to-book ratio, and three-year sales-per-share growth value, compared to the S&P 500 Index.

**Russell 3000 Growth Index**

Measures the performance of those Russell 3000 companies with higher price-to-book-ratios and higher forecasted growth values. The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

**Russell 3000 Value Index**

Measures the performance of those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values.

**S&P 500 Index**

A representative sample of 500 leading companies in leading industries of the U.S. economy. Focuses on the large-cap segment of the market with over 80% coverage of U.S. equities.

**LIBERTY ALL-STAR® EQUITY FUND  
NOTES**

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**LIBERTY ALL-STAR® EQUITY FUND  
NOTES**

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**INVESTMENT ADVISER**

ALPS Advisers, Inc.

1625 Broadway, Suite 2200

Denver, CO 80202

303-623-2577

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

**INDEPENDENT REGISTERED**

**Public Accounting Firm**

PricewaterhouseCoopers LLP

125 High Street

Boston, Massachusetts 02110

**custodian**

State Street Bank & Trust Company

225 Franklin Street

Boston, Massachusetts 02110

**Investor Assistance,**

**Transfer & Dividend**

**Disbursing Agent & Registrar**

Computershare Trust Company, N.A.

P.O. Box 43078

Providence, Rhode Island 02940-3078

1-800-LIB-FUND (1-800-542-3863)

www.computershare.com

**LEGAL COUNSEL**

Kirkpatrick & Lockhart Preston Gates Ellis LLP

1601 K Street, NW

Washington, DC 20006

**TRUSTEES**

John A. Benning\*

Thomas W. Brock\*

Edmund J. Burke

George R. Gaspari\*

Richard W. Lowry\*, Chairman

Dr. John J. Neuhauser\*

Richard C. Rantzow\*

**OFFICERS**

William R. Parmentier, Jr., President

Mark T. Haley, CFA, Senior Vice President

Edmund J. Burke, Vice President

Jeremy O. May, Treasurer

Kimberly R. Storms, Assistant Treasurer

Tané T. Tyler, Secretary

Bradley J. Swenson, Chief Compliance Officer

\* Member of the Audit Committee

Annual Certifications As required, on May 18, 2006, the Fund submitted to the New York Stock Exchange ( NYSE ) the annual certification of the Fund's Chief Executive Officer certifying that, as of such date, he was not aware of any violation of the NYSE's Corporate Governance listing standards. The Fund also has included the certifications of the Fund's Chief Executive Officer and Chief Financial Officer required by Section 302 of the Sarbanes- Oxley Act of 2002 as exhibits to reports filed with the Securities and Exchange Commission on a quarterly basis on Form N-CSR and Form N-Q.

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A description of the Fund's proxy voting policies and procedures is available (i) on the Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov), and (ii) without charge, upon request, by calling 1-800-542-3863. Information regarding how the Fund voted proxies relating to portfolio securities during the 12-month period ended June 30, 2006 is available from the SEC's website at [www.sec.gov](http://www.sec.gov). Information regarding how the Fund voted proxies relating to portfolio securities is also available at [www.all-starfunds.com](http://www.all-starfunds.com).

The Fund files a complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The Fund's Form N-Q's are available on the SEC's website at [www.sec.gov](http://www.sec.gov) and may be reviewed and copied at the SEC's Public Reference Room in Washington, DC. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

Notice is hereby given in accordance with Section 23(c) of the Investment Company Act of 1940 that the Fund may purchase at market prices from time to time shares of its own common stock in the open market.

This report is transmitted to shareholders of Liberty All-Star Equity Fund for their information. It is not a prospectus or other document intended for use in the purchase of Fund shares.

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ALPS Advisers, Inc.

Investment Adviser

1625 Broadway Suite 2200

Denver, CO 80202

303-623-2577

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

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**Item 2. Code of Ethics.**

- (a) The registrant has, as of the end of the period covered by this report, adopted a code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party.
- (b) The registrant's Board adopted, effective January 3, 2006, a revised code of ethics described in 2(a) above.
- (c) During the period covered by this report, there were not any waivers or implicit waivers to a provision of the code of ethics adopted in 2(a) above.

**Item 3. Audit Committee Financial Expert.**

The registrant's Audit Committee is composed of six of the registrant's independent directors who are not affiliated with the registrant's investment adviser. The Board has determined that each of the audit committee members is financially literate and that at least one member has accounting or related financial management expertise as used in the New York Stock Exchange definitions of the terms.

Under the Sarbanes-Oxley Act, if the Board has not determined that a financial expert, a term based on criteria contained in the Sarbanes-Oxley Act, is serving on the audit committee, it must disclose this fact and explain why the committee does not have such an expert. The Board has determined that none of the members of its audit committee meets the technical requirements of the definition. Moreover, it believes that for the following reasons it is not necessary for a registered investment company such as the registrant, with an audit committee that meets the New York Stock Exchange requirements of financial literacy, to have a financial expert as a member of the committee.

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1. The financial statements of and accounting principles applying to the registrant are relatively straightforward and transparent compared to those of operating companies. The significant accounting issues are valuation of securities and other assets (regulated under the Investment Company Act of 1940 (the 1940 Act ) and computed daily), accrual of expenses, allocation of joint expenses shared with other entities, such as insurance premiums, and disclosures of all related party transactions. Equally important is a knowledge of the tax laws applying to registered investment companies. None of the accounting issues involving corporate America that have received recent publicity, such as sophisticated derivative transactions and special purpose entities, are present in financial reporting for this registered investment company.

2. During the years that the registrant has been filing financial reports under the 1940 Act since its inception in 1986 there has never been a requirement for a financial report or statement to be restated.

3. The current members of the audit committee have many years of aggregate experience serving on this audit committee and/or in the Board's judgment, through this experience and experience with other public corporation's financial affairs, they have an understanding of the relevant generally accepted accounting principles governing the registrant's financial statements, tax laws applying to the registrant, the registrant's internal accounting controls and audit committee functions necessary to satisfy the objectives of the Sarbanes-Oxley Act with respect to the financial statements, auditing process and internal controls of the registrant.

4. The audit committee has the capability of employing a consultant who satisfies the technical definition of a financial expert and will do so from time to time if circumstances warrant.

#### **Item 4. Principal Accountant Fees and Services.**

(a) *Audit Fees.* Aggregate Audit Fees billed by the principal accountant for professional services rendered during the fiscal years ended December 31, 2006 and December 31, 2005 are \$38,400 and \$36,400 respectively.

Audit Fees include amounts related to the audit of the registrant's annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years.

(b) *Audit-Related Fees.* Aggregate Audit-Related Fees billed to the registrant by the principal accountant for professional services rendered during the fiscal years ended December 31, 2006 and December 31, 2005 are approximately \$4,400 and \$4,200 respectively.

Audit-Related Fees include amounts for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported in Audit Fees above. In both fiscal years 2006 and 2005, Audit-Related Fees include certain agreed-upon procedures performed for semi-annual shareholder reports.

(c) *Tax Fees.* Aggregate Tax Fees billed by the principal accountant to the registrant for professional services rendered during the fiscal years ended December 31, 2006 and December 31, 2005 are approximately \$5,200 and \$4,600 respectively.

Tax Fees in both fiscal years 2006 and 2005 consist primarily of fees associated with tax compliance, tax advice and tax planning, including services relating to the filing or amendment of federal, state or local income tax returns, regulated investment company qualification reviews, and reviews of calculations of required distributions to avoid excise tax.

(d) *All Other Fees.* Aggregate All Other Fees billed by the principal accountant to the registrant for professional services rendered during the fiscal years ended December 31, 2006 and December 31, 2005 are \$0 and \$0 respectively.

All Other Fees include amounts for products and services provided by the principal accountant, other than the services reported in paragraphs (a) through (c) above.

None of the amounts described in paragraphs (a) through (d) above were approved pursuant to the de minimis exception under paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X. During the fiscal years ended December 31, 2006 and December 31, 2005, there were no Audit-Related Fees, Tax Fees and All Other Fees that were approved for services related directly to the operations and financial reporting of the registrant to the investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser) and any entity controlling, controlled by, or under common control with such investment adviser that provides ongoing services to the registrant under paragraph (c)(7)(ii) of Rule 2-01 of Regulation S-X.

**(e)(1) Audit Committee Pre-Approval Policies and Procedures**

The registrant's Audit Committee is required to pre-approve the engagement of the registrant's independent accountants to provide audit and non-audit services to the registrant and non-audit services to its investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser) or any entity controlling, controlled by or under common control with such investment adviser that provides ongoing services to the registrant ( Adviser Affiliates ), if the engagement relates directly to the operations or financial reporting of the registrant, including the fees and other compensation to be paid to the independent accountants.

The Audit Committee has adopted a Policy for Engagement of Independent Accountants for Audit and Non-Audit Services ( Policy ). The Policy sets forth the understanding of the Audit Committees regarding the engagement of the registrant's independent accountants to provide (i) audit and permissible audit-related, tax and other services to the registrant; (ii) non-audit services to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser) and Adviser Affiliates, if the engagement relates directly to the operations or financial reporting of a Fund; and (iii) other audit and non-audit services to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser) and Adviser Affiliates. Unless a type of service receives general pre-approval under the Policy, it requires specific pre-approval by the Audit Committee if it is to be provided by the independent accountants. Pre-approval of non-audit services to the registrant, the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser) and Adviser Affiliates may be waived provided that the de minimis requirements set forth in the SEC's rules relating to pre-approval of non-audit services are met.

Under the Policy, the Audit Committee may delegate pre-approval authority to any pre-designated member or members who are Independent Trustees/Directors. The member(s) to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next regular meeting. The Audit Committee's responsibilities with respect to the pre-approval of services performed by the independent accountants may not be delegated to management.

The Policy requires the Fund Treasurer and/or Director of Board Administration to submit to the Audit Committee, on an annual basis, a schedule of the types of services that are subject to general pre-approval. The schedule(s) provide a description of each type of service that is subject to general pre-approval and, where possible, will provide estimated fee caps for each instance of providing each service. The Audit Committees will review and approve the types of services and review the projected fees for the next fiscal year and may add to, or subtract from, the list of general pre-approved services from time to time based on subsequent determinations. That approval acknowledges that each Audit Committee is in agreement with the specific types of services that the independent accountants will be permitted to perform.

(e)(2) The percentage of services described in paragraphs (b) through (d) of this Item approved pursuant to the de minimis exception under paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X during both fiscal years ended December 31, 2006 and December 31, 2005 was zero.

(f) Not applicable.

(g) The aggregate non-audit fees billed by the registrant's accountant for services rendered to the registrant, and rendered to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio

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management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the adviser that provides ongoing services to the registrant for the fiscal years ended December 31, 2006 and December 31, 2005 were \$0 and \$0, respectively.

(h) The registrant's Audit Committee has considered whether the provision of non-audit services that were rendered to the registrant's adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registrant that were not pre-approved pursuant to paragraph (c)(7)(ii) of Rule 2-01 of Regulation S-X, is compatible with maintaining the principal accountant's independence. The Audit Committee determined that the provision of such services is compatible with maintaining the principal accountant's independence.

### **Item 5. Audit Committee of Listed Registrants.**

The registrant has a separately-designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(58)(A)).

As of December 31, 2006, John A. Benning, Thomas W. Brock, George R. Gaspari, Richard W. Lowry, John J. Neuhauser and Richard C. Rantow are each independent trustees and collectively constitute the entire Audit Committee.

### **Item 6. Schedule of Investments**

The registrant's Schedule I Investments in securities of unaffiliated issuers (as set forth in 17 CFR 210.12-12) is included in Item 1 of this Form N-CSR.

### **Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.**

**The Fund has delegated to ALPS Advisers, Inc. (the Advisor) the responsibility to vote proxies relating to portfolio securities held by the Fund. In deciding to delegate this responsibility to the Advisor, the Fund's Board reviewed and approved the policies and procedures adopted by the Advisor. These included the procedures that the Advisor follows when a vote presents a conflict between the interests of the Fund and its shareholders and the Advisor, its affiliates, its other clients or other persons.**

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The Advisor's policy is to vote all proxies for Fund securities in a manner considered by the Advisor to be in the best interest of the Fund and its shareholders without regard to any benefit to the Advisor, its affiliates, its other clients or other persons. The Advisor or an affiliate examines each proposal and votes against the proposal, if, in its judgment, approval or adoption of the proposal would be expected to impact adversely the current or potential market value of the issuer's securities. The Advisor or an affiliate also examines each proposal and votes the proxies against the proposal, if, in its judgment, the proposal would be expected to affect adversely the best interest of the Fund. The Advisor or an affiliate determines the best interest of the Fund in light of the potential economic return on the Fund's investment.

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The Advisor addresses potential material conflicts of interest by having predetermined voting guidelines. For those proposals that require special consideration or in instances where special circumstances may require varying from the predetermined guideline, a Proxy Committee determines the vote in the best interest of the Fund, without consideration of any benefit to the Advisor, its affiliates, its other clients or other persons. The Proxy Committee is composed of representatives of equity investments, equity research, compliance, legal and fund administration functions. In addition to the responsibilities described above, the Proxy Committee has the responsibility to review, on a semi-annual basis, the Advisor's proxy voting policies to ensure consistency with internal and regulatory agency policies and to develop additional predetermined voting guidelines to assist in the review of proxy proposals.

The Proxy Committee may vary from a predetermined guideline if it determines that voting on the proposal according to the predetermined guideline would be expected to impact adversely the current or potential market value of the issuer's securities or to affect adversely the best interest of the client. References to the best interest of a client refer to the interest of the client in terms of the potential economic return on the client's investment. In determining the vote on any proposal, the Proxy Committee does not consider any benefit other than benefits to the owner of the securities to be voted. A member of the Proxy Committee is prohibited from voting on any proposal for

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The Advisor's policy is to vote all proxies for Fund securities in a manner considered by the Advisor to be in the best interest of the

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which he or she has a conflict of interest by reason of a direct relationship with the issuer or other party affected by a given proposal. Persons making recommendations to the Proxy Committee or its members are required to disclose to the Committee any relationship with a party making a proposal or other matter known to the person that would create a potential conflict of interest.

The Advisor has retained Institutional Shareholder Services ( ISS ), a third party vendor, to implement its proxy voting process. ISS provides proxy analysis, record keeping services and vote disclosure services.

### **Item 8. Portfolio Managers of Closed-End Management Investment Companies.**

#### **Chase Investment Counsel Corporation ( Chase )**

**MANAGEMENT.** The portion of the Fund allocated to Chase is managed by a team of investment professionals including David B. Scott, Chief Investment Officer, Derwood S. Chase, Jr., President, Brian J. Lazorishak, Vice President, Peter W. Tuz, Vice President, and Peter C. Wood, Vice President. All of our accounts are managed on a team basis with by this team.

#### **Derwood S. Chase, Jr., CIC**

##### ***President, Founder and Director***

Mr. Chase earned a BS with Distinction from the University of Virginia in 1952 and a MBA from Harvard University in 1954. His speeches, articles and comments on investing and economic policy have been quoted in Barron's, Business Week, The Wall Street Journal, Pensions & Investments, Kiplinger's Personal Finance, The New York Times, and Value Line Mutual Fund Survey. He has appeared on CNBC, The Nightly Business Report (PBS) and Bloomberg. Derwood is a Chartered Investment Counselor, a member of the Analysts Club (N.Y.C.), the New York and Richmond Societies of Financial Analysts, a former Governor of the Investment Counsel Association of America, a member of the Mont Pelerin Society, President of the Chase Foundation of Virginia, and a trustee of the Reason Foundation.

#### **David B. Scott, CFA, CIC**

##### ***Senior Vice President and Director***

##### ***Chief Investment Officer***

Mr. Scott earned his BA in 1977 and a MBA with Honors in 1980 from the College of William and Mary. Before joining us in 1994, he had 15 years of experience as an analyst and portfolio manager. He is a CFA charter holder and a member of The Richmond Society of Financial Analysts. He has been quoted in Barron's, Business Week, Kiplinger's Personal Finance, The New York Times, and Value Line Mutual Fund Survey. He has been a guest speaker on CNBC.

#### **Brian J. Lazorishak, CFA, CIC, CMT**

##### ***Vice President***

##### ***Portfolio Manager & Quantitative Analyst***

Mr. Lazorishak earned a BS in Psychology and Business Cum Laude from the University of Pittsburgh in 1994. Brian joined us in 1997. He serves as a portfolio manager and concentrates on quantitative and technical research. Brian is a CFA charter holder and a Chartered Market Technician. He is a member of the Richmond Society of Financial Analysts.

#### **Peter W. Tuz, CFA**

##### ***Vice President***

##### ***Senior Security Analyst & Portfolio Manager***

The Advisor's policy is to vote all proxies for Fund securities in a manner considered by the Advisor to be in the best



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Mr. Tuz earned his BA from Ripon College in 1976, a MA from the University of Missouri in 1979, and a MBA from Tulane University in 1984. Peter is a CFA charter holder. Before joining us in 1997 he had 10 years experience as a senior analyst and officer with two NYSE member firms. He is a member of the Richmond & Washington Societies of Financial Analysts.

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**Peter C. Wood, CFA**

*Vice President*

*Senior Security Analyst & Portfolio Manager*

Mr. Wood earned his BA from Duke University in 1979 and a MBA from Indiana University in 1985. Peter is a CFA charter holder. Before joining us in 1997 he had 10 years experience as a senior security analyst concentrating in technology. He is a member of the New York and Richmond Societies of Financial Analysts.

**OTHER ACCOUNTS.** The table below provides information regarding the other accounts managed by the team of investment professionals listed above as of December 31, 2006:

| Type of Account                  | Number of Accounts Managed | Total Assets Managed | Number of Accounts Managed for which Advisory Fee is Performance-Based | Assets Managed for which Advisory Fee is Performance-Based |
|----------------------------------|----------------------------|----------------------|--|--|
| Registered Investment Companies  | 2                          | \$618 million        | 0  | N/A  |
| Other pooled investment vehicles | 0                          | 0                    | 0  | N/A  |
| Other accounts                   | 226                        | \$5,854 million      | 0  | N/A  |

#### **COMPENSATION STRUCTURE.**

In addition to competitive salary (including 401K and profit-sharing), all investment professionals are equity shareholders of the firm and participate in the overall success of the firm through distributions from the corporation. Distributions are directly related to the individual's percentage ownership of the corporation. No portion of the fixed base salary of the portfolio managers is tied to the management or the performance of the Fund or to the performance of the Advisor's separately managed accounts. The portfolio managers as equity owners of the Advisor do not receive a salary bonus. As the firm is a subchapter S corporation, all net earnings are distributed to the portfolio managers and the firm's other equity owners. Mr. Chase also receives a portion of the consulting fees received by the firm for work he performs on alternative oil and gas investments.

**OWNERSHIP BY PORTFOLIO MANAGERS.** None of the individuals responsible for the day-to-day management of the Fund own any shares of the Fund.

**Matrix Asset Advisors, Inc. ( Matrix )**

**MANAGEMENT.** The portion of the Fund allocated to Matrix is managed by David A. Katz, Head of the Investment Policy Committee. Mr. Katz, CFA, graduated summa cum laude from Union College with a Bachelor of Arts degree in Economics. He received a Master of Business Administration degree, with a concentration in Finance, from New York University Graduate School of Business in 1987, graduating with distinction. His numerous works on Value Investing have earned him various awards and distinctions at the undergraduate and graduate levels. Mr. Katz is a Chartered Financial Analyst. After initially working at Management Asset Corporation (Westport, CT), Mr. Katz co-founded Value Matrix Management with John M. Gates in 1986. He served as the firm's Senior Vice President and Chief Investment Officer and was Head of the Investment Policy Committee. In 1990 he merged the Value Matrix Management organization into Matrix Asset Advisors. Mr. Katz is the firm's President and Chief Investment Officer, chairs the Investment Policy Committee and is a Portfolio Manager/Analyst.

**OTHER ACCOUNTS.** The table below provides information regarding the other accounts managed by Mr. Katz as of December 31, 2006:

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| Type of Account                  | Number of Accounts Managed | Total Assets Managed | Number of Accounts Managed for which Advisory Fee is Performance-Based | Assets Managed for which Advisory Fee is Performance-Based |
|----------------------------------|----------------------------|----------------------|--|--|
| <b>David A. Katz</b>             |                            |                      |  |  |
| Registered Investment Companies  | 4                          | \$586 million        | 0  | N/A  |
| Other pooled investment vehicles | 1                          | \$10 million         | 1  | \$10 million   |
| Other accounts                   | 445                        | \$812 million        | 4  | \$6 million  |

COMPENSATION STRUCTURE. Matrix Portfolio Managers, including Mr. Katz, are paid competitively with meaningful potential bonuses based on individual performance and firm success. Base salary is approximately 50-75% of total compensation, with bonus, equity and profit sharing participation. Discretionary bonus is based on overall performance of the firm, and not performance of any particular account. Portfolio Managers are incented through competitive compensation and benefits, as well as high degrees of responsibility, input and autonomy. The firm has created a stakeholder program and profit sharing plan, in which key personnel are granted participation in the profitability of the firm in a parallel fashion as the owners of the firm.

Such participation is contingent on continued employment. In addition, the firm has offered equity ownership to retain key investment professionals.

OWNERSHIP BY PORTFOLIO MANAGERS. Mr. Katz does not own any shares of the Fund.

**Pzena Investment Management, LLC ( Pzena )**

MANAGEMENT. The portion of the Fund allocated to Pzena is managed by a team of portfolio managers. Individual portfolio managers on the team do not have any latitude to make independent portfolio decisions. All decisions require unanimous consent of a three-person portfolio management team. For the Fund, Rich Pzena, John Goetz, and Tony DeSpirito have joint decision-making responsibility and veto authority over any decision.

Richard S. Pzena Mr. Pzena is the Founder, Managing Principal, Chief Executive Officer and Co-Chief Investment Officer of the firm. Prior to forming Pzena Investment Management in 1995, Mr. Pzena was the Director of U.S. Equity Investments and Chief Research Officer for Sanford C. Bernstein & Company. He joined Bernstein in 1986 as an oil industry analyst and was named to the Institutional Investor All America Research Team from 1988-1990. During 1990 and 1991, Mr. Pzena served as Chief Investment Officer, Small Cap Equities, and assumed his broader domestic equity role in 1991. Prior to joining Bernstein, Mr. Pzena worked for the Amoco Corporation in various financial and planning roles. He earned a B.S. summa cum laude and an M.B.A. from the Wharton School of the University of Pennsylvania in 1979 and 1980 respectively.

John P. Goetz Mr. Goetz is a Managing Principal and Co-Chief Investment Officer at the firm. Prior to joining Pzena Investment Management in 1996, Mr. Goetz held a range of key positions at Amoco Corporation for over 14 years, most recently as the Global Business Manager for Amoco's \$1 billion polypropylene business where he had bottom line responsibility for operations and development worldwide. Prior positions included strategic planning, joint venture investments and project financing in various oil and chemical businesses. Prior to joining Amoco, Mr. Goetz had been employed by The Northern Trust Company and Bank of America. He earned a B.A. summa cum laude in Mathematics and Economics from Wheaton College in 1979 and an M.B.A. from the Kellogg School at Northwestern University in 1982.

Antonio DeSpirito, III Mr. DeSpirito is a Principal and Portfolio Manager of Large Cap Value. Previously, Mr. Despirito was one of the Portfolio Managers of Pzena Investment Management's Small Cap Value service. Prior to joining Pzena Investment Management in 1996, Mr. DeSpirito was an Associate in the Corporate Department at the Boston based law firm of Ropes & Gray. At Ropes & Gray, he advised clients in the direct television, financial services, fitness, packaging films, retail, software, and wire and cable industries. Mr. DeSpirito earned a B.S. summa cum laude from the Wharton School of the University of Pennsylvania in 1990 and a J.D. magna cum laude from Harvard Law School in 1993.

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The Advisor's policy is to vote all proxies for Fund securities in a manner considered by the Advisor to be in the best

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OTHER ACCOUNTS. The table below provides information regarding the other accounts managed by Messrs. Pzena, Goetz and DeSpirito, as of December 31, 2006.

| Type of Account                  | Number of Accounts Managed | Total Assets Managed | Number of Accounts Managed for which Advisory Fee is Performance-Based | Assets Managed for which Advisory Fee is Performance-Based |
|----------------------------------|----------------------------|----------------------|--|--|
| <b>Richard S. Pzena</b>          |                            |                      |  |  |
| Registered Investment Companies  | 10                         | \$9,930.6 million    | 0  | N/A  |
| Other pooled investment vehicles | 110                        | \$3,298.5 million    | 0  | N/A  |
| Other accounts                   | 442                        | \$12,784 million     | 12   | \$1,962.3 million  |
| <b>John Goetz</b>                |                            |                      |  |  |
| Registered Investment Companies  | 12                         | \$9,985.7 million    | 0  | N/A  |
| Other pooled investment vehicles | 121                        | \$4,387.8million     | 0  | N/A  |
| Other accounts                   | 443                        | \$12,916.9 million   | 12   | \$1,962.3 million  |
| <b>Antonio DeSpirito, III</b>    |                            |                      |  |  |
| Registered Investment Companies  | 9                          | \$9,879.4 million    | 0  | N/A  |
| Other pooled investment vehicles | 45                         | \$2,592.9million     | 0  | N/A  |
| Other accounts                   | 136                        | \$5,614.3 million    | 8  | \$1,115.9 million  |

COMPENSATION STRUCTURE. Pzena portfolio managers, including Messrs Pzena, Goetz and DeSpirito, and other investment professionals at Pzena are compensated through a combination of a fixed base salary, performance bonus and equity ownership, if appropriate due to superior performance. Pzena avoids a compensation model that is driven by individual security performance, as this can lead to short-term thinking which is contrary to the firm's value investment philosophy. Pzena considers both quantitative and qualitative factors when determining performance bonuses; however, performance bonuses are not based directly on the performance of the Fund or other clients. For investment professionals, Pzena examines such things as effort, efficiency, ability to focus on the correct issues, stock modeling ability, and ability to successfully interact with company management. However, Pzena always looks at the person as a whole and the contributions that he/she has made and is likely to make in the future. The time frame Pzena examines for bonus compensation is annual. Ultimately, equity ownership is the primary tool used by Pzena for attracting and retaining the best people. Shares may be in the form of capital interests or profits only interests. All shares are voting shares (i.e., not phantom stock).

OWNERSHIP BY PORTFOLIO MANAGERS. None of the individuals at the firm responsible for the day-to-day management of the Fund owns any shares of the Fund.

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**Schneider Capital Management Corporation ( Schneider )**

MANAGEMENT: The portion of the Fund allocated to Schneider is managed by Arnold C. Schneider III, CFA. Mr. Schneider serves as President and Chief Investment Officer and manages the portion of All-Star allocated to Schneider. Prior to founding Schneider, Mr. Schneider was a Senior Vice President and Partner of the Wellington Management Company. He has earned the right to use the CFA Institute Chartered Financial Analyst designation. Mr. Schneider received a B.S. in Finance from the McIntire School of Commerce of the University of Virginia.

OTHER ACCOUNTS. The table below provides information about the other accounts managed by Mr. Schneider as of December 31, 2006:

| Type of Account                  | Number of Accounts Managed | Total Assets Managed | Number of Accounts Managed for which Advisory Fee is Performance-Based | Assets Managed for which Advisory Fee is Performance-Based |
|----------------------------------|----------------------------|----------------------|--|--|
| <b>Arnold C. Schneider III</b>   |                            |                      |  |  |
| Registered Investment Companies  | 7                          | \$1,222 million      | 0  | N/A  |
| Other pooled investment vehicles | 6                          | \$901 million        | 0  | N/A  |
| Other accounts                   | 40                         | \$3,320million       | 0  | N/A  |

COMPENSATION STRUCTURE. Mr. Schneider's compensation consists of a fixed base salary and a bonus. A portion of his bonus may be deferred. Generally, his salary is fixed at the beginning of each year; his bonus and any deferred compensation are discretionary and based on the overall profitability of the firm.

OWNERSHIP BY PORTFOLIO MANAGER. Mr. Schneider does not own any shares of the Fund.

**TCW Investment Management Company ( TCW )**

MANAGEMENT. The portion of the Fund allocated to TCW is managed by Craig C. Blum and Stephen A. Burlingame.

Craig C. Blum, CFA, Portfolio Manager, Managing Director and US Equities Mr. Blum is Co-Portfolio Manager of the Concentrated Core and Select Equities investment strategies. He joined TCW in 1999 as part of a program designed to fast-track high potential individuals, providing them with in-depth knowledge of the firm's various investment groups. After gaining experience in the High Yield and Mortgage-Backed Securities Groups, in 2000 Mr. Blum joined the US Equity Research Group as an Analyst covering data networking, communications equipment, and enterprise hardware and software companies. In 2002, Mr. Blum became a member of the Concentrated Core / Select Equities Group, and in 2004 he was promoted to Co-Portfolio Manager. Prior to joining TCW, Mr. Blum focused on commercial mortgage-backed securities cash flow modeling and deal structuring as a Senior Analyst with FMAC Capital Markets. Prior to that, he worked in institutional sales and mortgage-backed securities analysis at PaineWebber. Mr. Blum began his investment career in 1994 at Merrill Lynch where he developed a financial advisory business focused on high net worth and corporate clients. He has more than 10 years experience in the investment management industry. Mr. Blum received his Bachelor of Science in Applied Mathematics and Computer Science from the University of California at Los Angeles (UCLA) in 1993, and his MBA in Finance from the UCLA Anderson Graduate School of Management in 1999. Mr. Blum is a CFA charterholder.

Stephen A. Burlingame, Portfolio Manager, Managing Director, US Equities Mr. Burlingame is Co-Portfolio Manager of the Concentrated Core and Select Equities investment strategies at TCW. Previously, Mr. Burlingame was a member of the Concentrated Core/ Select Equities team, having joined TCW in 2000 as a health care analyst in the US Equity Research group. Prior to joining TCW, Mr. Burlingame was an analyst with

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Brandywine Asset Management from 1999 to 2000. Between 1996 and 1999, Mr. Burlingame completed internships at two different asset management firms. Mr. Burlingame graduated cum laude from Claremont McKenna College in 1999 with a Bachelor of Arts degree in Economics and a minor in Spanish.

OTHER ACCOUNTS. The table below provides information about the other accounts managed by Messrs. Blum and Burlingame as of December 31, 2006:

| Type of Account                     | Number of<br>Accounts<br>Managed | Total Assets<br>Managed | Number of<br>Accounts Managed<br>for which Advisory<br>Fee is<br>Performance-<br>Based | Assets Managed for<br>which Advisory Fee<br>is Performance-<br>Based |
|-------------------------------------|----------------------------------|-------------------------|--|--|
| <b><i>Craig C. Blum</i></b>         |                                  |                         |  |  |
| Registered Investment Companies     | 9                                | \$4,639.4 million       | 0  | N/A  |
| Other pooled investment vehicles    | 5                                | \$1,871.2 million       | 1  | \$601.4 million  |
| Other accounts                      | 137                              | \$10,399.6 million      | 6  | \$1,349.2 million  |
| <b><i>Stephen A. Burlingame</i></b> |                                  |                         |  |  |
| Registered Investment Companies     | 9                                | \$4,639.4 million       | 0  | N/A  |
| Other pooled investment vehicles    | 5                                | \$1,871.2 million       | 1  | \$601.4 million  |
| Other accounts                      | 137                              | \$10,399.6 million      | 6  | \$1,349.2 million  |

COMPENSATION STRUCTURE. The overall objective of the compensation program for portfolio managers is for TCW Investment Management Company (the Advisor) to attract what it considers competent and expert investment professionals and to retain them over the long-term. Compensation is comprised of several components which, in the aggregate, are designed to achieve these objectives and to reward the portfolio managers for their contribution to the success of their clients and the Advisor and its affiliates within The TCW Group (collectively,

TCW). Portfolio managers are compensated through a combination of base salary, profit sharing based compensation (profit sharing), bonus and equity incentive participation in the Advisor's immediate parent, The TCW Group, Inc. and/or ultimate parent, Société Générale (equity incentives). Profit sharing and equity incentives generally represent most of the portfolio managers' compensation. In some cases, portfolio managers are eligible for discretionary bonuses.

*Salary.* Salary is agreed to with managers at time of employment and is reviewed from time to time. It does not change significantly and often does not constitute a significant part of the portfolio manager's compensation.

*Profit Sharing.* Profit sharing is linked quantitatively to a fixed percentage of income relating to accounts in the investment strategy area for which the portfolio managers are responsible and is paid quarterly. Profit sharing may be determined on a gross basis, without the deduction of expenses; in most cases, revenues are allocated to a pool and profit sharing compensation is paid out after the deduction of group expenses. The profit sharing percentage used to compensate a portfolio manager for management of the Fund is generally the same as that used to compensate them for all other client accounts they manage in the same strategy for TCW, with limited exceptions involving grandfathered accounts (accounts that become clients of TCW before or after a specified date or former clients of a manager that joined TCW from another firm), firm capital of TCW or accounts sourced through a distinct distribution channel. Income included in a profit sharing pool will relate to the products managed by the portfolio manager. In some cases, the pool includes revenues related to more than one equity or fixed income product where the portfolio managers work together as a team, in which case each participant in the pool is entitled to profit sharing derived from all the included products. In certain cases, a portfolio manager may also participate in a profit sharing pool that includes revenues from products besides the strategies offered in the TCW Funds, including alternative investment products (as described below); the portfolio manager would be entitled to participate in such pool where he or she supervises, is involved in the management of, or is associated with a group, other members of which manage, such products. Profit sharing arrangements are generally the result of agreement between the portfolio manager and TCW, although in some cases they may be discretionary based on supervisor allocation.

The Advisor's policy is to vote all proxies for Fund securities in a manner considered by the Advisor to be in the best



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In some cases, the profit sharing percentage is subject to increase based on the relative pre-tax performance of the investment strategy composite returns, net of fees and expenses, to that of the benchmark. The measurement of performance relative to the benchmark can be based on single year or multiple year metrics, or a combination thereof. The benchmark used is the one associated with the Fund managed by the portfolio manager as disclosed in the prospectus, except in the case of the Growth Insights Fund where profit sharing of managers is tied to the full menu of TCW-managed equity products that outperform their associated benchmarks. Benchmarks vary from strategy to strategy but, within a given strategy, the same benchmark applies to all accounts, including the Funds. In the case of the Equities and Focused Equities Funds, which have two benchmarks, the Russell 1000 Value is used.

Certain accounts of TCW (but not the Funds) have a performance (or incentive) fee in addition to or in lieu of an asset-based fee. For these accounts, the profit sharing pool from which the portfolio managers' profit sharing compensation is paid will include the performance fees. For investment strategies investing in marketable securities such as those employed in the Funds, the performance fee normally consists of an increased asset-based fee, the increased percentage of which is tied to the performance of the account relative to a benchmark (usually the benchmark associated with the strategy). In these marketable securities strategies, the profit sharing percentage applied relative to performance fees is generally the same as it is for the asset-based fees chargeable to the Fund. In the case of alternative investment strategies and TCW's alpha strategies, performance fees are based on the account achieving net gains over a specified rate of return to the account or to a class of securities in the account. Profit sharing for alternative investment strategies may also include structuring or transaction fees. *Alpha strategies* are those in which the strategy seeks to provide incremental risk-adjusted return relative to a LIBOR rate of return through alpha and beta isolation techniques, that include the use of options, forwards and derivative instruments. *Alternative investment strategies* include (a) mezzanine or other forms of privately placed financing, distressed investing, private equity, project finance, real estate investments, leveraged strategies (including short sales) and other similar strategies not employed by the Funds or (b) strategies employed by the Funds that are offered in structured vehicles, such as collateralized loan obligations or collateralized debt obligations or in private funds (sometimes referred to as hedge funds). In the case of certain alternative investment products in which a portfolio manager may be entitled to profit sharing compensation, the profit sharing percentage for performance fees may be lower or higher than the percentage applicable to the asset-based fees.

*Discretionary Bonus/Guaranteed Minimums.* In general, portfolio managers do not receive discretionary bonuses. However, in some cases where portfolio managers do not receive profit sharing or where the company has determined the combination of salary and profit sharing does not adequately compensate the portfolio manager, discretionary bonuses may be paid by TCW. Also, pursuant to contractual arrangements, some portfolio managers may be entitled to a mandatory bonus if the sum of their salary and profit sharing does not meet certain minimum thresholds.

*Equity Incentives.* All portfolio managers participate in equity incentives based on overall firm performance of TCW and its affiliates, through stock ownership or participation in stock option or stock appreciation plans of TCW and/or Société Générale. The TCW 2001 and 2005 TCW Stock Option Plans provide eligible portfolio managers the opportunity to participate in an effective economic interest in TCW, the value of which is tied to TCW's annual financial performance as a whole. Participation is generally determined in the discretion of TCW, taking into account factors relevant to the portfolio manager's contribution to the success of TCW. Portfolio managers participating in the TCW 2001 or 2005 TCW Stock Option Plan will also generally participate in Société Générale's Stock Option Plan which grants options on its common stock, the value of which may be realized after certain vesting requirements are met. Some portfolio managers are direct stockholders of TCW and/or Société Générale, as well.

*Other Plans and Compensation Vehicles.* Portfolio managers may also participate in a deferred compensation plan that is generally available to a wide-range of officers of TCW, the purpose of which is to allow the participant to defer portions of income to a later date while accruing earnings on a tax-deferred basis based on performance of TCW-managed products selected by the participant. Portfolio managers may also elect to participate in TCW's 401(k) plan, to which they may contribute a portion of their pre- and post-tax compensation to the plan for investment on a tax-deferred basis.

Following the sale of TCW to Société Générale in 2001, a retention plan was put in place in which most portfolio managers then at TCW were entitled to participate. The retention plan provides for payout of fixed bonus compensation to participants at various milestones over the course of five years, the last of which will be paid in February 2007.

**OWNERSHIP BY PORTFOLIO MANAGERS.** None of the individuals at the firm responsible for the day-to-day management of the Fund owns any shares of the Fund.

The Advisor's policy is to vote all proxies for Fund securities in a manner considered by the Advisor to be in the best





### Potential conflicts of interest in managing multiple accounts

Like other investment professionals with multiple clients, a portfolio manager for a Fund may face certain potential conflicts of interest in connection with managing both the Fund and other accounts at the same time. The paragraphs below describe some of these potential conflicts, which may be faced by investment professionals at most major financial firms. ALPS Advisors, Inc. and the Fund have adopted compliance policies and procedures that attempt to address certain of these potential conflicts.

The management of accounts with different advisory fee rates and/or fee structures, including accounts that pay advisory fees based on account performance ( performance fee accounts ), may raise potential conflicts of interest by creating an incentive to favor higher-fee accounts. These potential conflicts may include, among others:

- The most attractive investments could be allocated to higher-fee accounts or performance fee accounts.
- The trading of higher-fee accounts could be favored as to timing and/or execution price. For example, higher-fee accounts could be permitted to sell securities earlier than other accounts when a prompt sale is desirable or to buy securities at an earlier and more opportune time.
- The trading of other accounts could be used to benefit higher-fee accounts (front- running).
- The investment management team could focus their time and efforts primarily on higher-fee accounts due to a personal stake in compensation.

Potential conflicts of interest may also arise when the portfolio managers have personal investments in other accounts that may create an incentive to favor those accounts.

A potential conflict of interest may arise when a Fund and other accounts purchase or sell the same securities. On occasions when a portfolio manager considers the purchase or sale of a security to be in the best interests of a Fund as well as other accounts, the adviser's trading desk may, to the extent permitted by applicable laws and regulations, aggregate the securities to be sold or purchased in order to obtain the best execution and lower brokerage commissions, if any. Aggregation of trades may create the potential for unfairness to a Fund or another account if one account is favored over another in allocating the securities purchased or sold—for example, by allocating a disproportionate amount of a security that is likely to increase in value to a favored account.

Cross trades, in which one account sells a particular security to another account (potentially saving transaction costs for both accounts), may also pose a potential conflict of interest. Cross trades may be seen to involve a potential conflict of interest if, for example, one account is permitted to sell a security to another account at a higher price than an independent third party would pay. The Fund has adopted compliance procedures that provide that any transactions between a Fund and another advised account are to be made at an independent current market price, as required by law.

Another potential conflict of interest may arise based on the different investment objectives and strategies of a Fund and other accounts. For example, another account may have a shorter-term investment horizon or different investment objectives, policies or restrictions than a Fund. Depending on another account's objectives or other factors, a portfolio manager may give advice and make decisions that may differ from advice given, or the timing or nature of decisions made, with respect to a Fund. In addition, investment decisions are the product of many factors in addition to basic suitability for the particular account involved. Thus, a particular security may be bought or sold for certain accounts even though it could have been bought or sold for other accounts at the same time. More rarely, a particular security may be bought for one or more accounts managed by a portfolio manager when one or more other accounts are selling the security (including short sales). There may be circumstances when purchases or sales of portfolio securities for one or more accounts may have an adverse effect on other accounts.

A Fund's portfolio manager who is responsible for managing multiple funds and/or accounts may devote unequal time and attention to the management of those funds and/or accounts. As a result, the portfolio manager may not be able to formulate as complete a strategy or identify equally attractive investment opportunities for each of those accounts as might be the case if he or she were to devote substantially more attention to the management of

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a single fund. The effects of this potential conflict may be more pronounced where funds and/or accounts overseen by a particular portfolio manager have different investment strategies.

A Fund's portfolio managers may be able to select or influence the selection of the brokers and dealers that are used to execute securities transactions for the Fund. In addition to executing trades, some brokers and dealers provide portfolio managers with brokerage and research services (as those terms are defined in Section 28(e) of the Securities Exchange Act of 1934), which may result in the payment of higher brokerage fees than might have otherwise be available. These services may be more beneficial to

certain funds or accounts than to others. Although the payment of brokerage commissions is subject to the requirement that the portfolio manager determine in good faith that the commissions are reasonable in relation to the value of the brokerage and research services provided to the fund, a portfolio manager's decision as to the selection of brokers and dealers could yield disproportionate costs and benefits among the funds and/or accounts that he or she manages.

The adviser or an affiliate may provide more services (such as distribution or recordkeeping) for some types of funds or accounts than for others. In such cases, a portfolio manager may benefit, either directly or indirectly, by devoting disproportionate attention to the management of fund and/or accounts that provide greater overall returns to the investment manager and its affiliates.

A Fund's portfolio manager(s) may also face other potential conflicts of interest in managing the Fund, and the description above is not a complete description of every conflict that could be deemed to exist in managing both a Fund and other accounts. In addition, a Fund's portfolio manager may also manage other accounts (including their personal assets or the assets of family members) in their personal capacity. The management of these accounts may also involve certain of the potential conflicts described above. Investment personnel at the advisers, including each Fund's portfolio manager, are subject to restrictions on engaging in personal securities transactions pursuant to Codes of Ethics adopted by the adviser.

Each of the Fund's sub-advisers has trade allocation and other policies and procedures that it believes are reasonably designed to address these and other potential conflicts of interest.

### **Item 9. Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers.**

During the six months ended December 31, 2006, there were no purchases made by or on behalf of the registrant or any affiliated purchaser, as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934 (Exchange Act), of shares or other units of any class of the registrant's equity securities that are registered by the registrant pursuant to Section 12 of the Exchange Act.

### **Item 10. Submission of Matters to a Vote of Security Holders.**

There have not been any material changes to the procedures by which shareholders may recommend nominees to the registrant's board of directors, since those procedures were last disclosed in response to the requirements of Item 7(d)(2)(ii)(G) of Schedule 14A or this Item.

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**Item 11. Controls and Procedures.**

(a) The registrant's principal executive officer and principal financial officers, based on their evaluation of the registrant's disclosure controls and procedures as of a date within 90 days of the filing of this report, have concluded that such controls and procedures are adequately designed to ensure that information required to be disclosed by the registrant in Form N-CSR is accumulated and communicated to the registrant's management, including the principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) There were no changes in the registrant's internal control over financial reporting that occurred during the registrant's second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

**Item 12. Exhibits.**

(a)(1) Code of ethics required to be disclosed under Item 2 of Form N-CSR attached hereto as Exhibit 99.CODE ETH.

(a)(2) Certifications pursuant to Rule 30a-2(a) under the Investment Company Act of 1940 (17 CFR 270.30a-2(a)) attached hereto as Exhibit 99.CERT.

(a)(3) Not applicable.

(b) Certification pursuant to Rule 30a-2(b) under the Investment Company Act of 1940 (17 CFR 270.30a-2(b)) attached hereto as Exhibit 99.906CERT.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**LIBERTY ALL-STAR EQUITY FUND**

By: /s/ William R. Parmentier, Jr.  
William R. Parmentier, Jr. (Principal Executive Officer)  
President

Date: March 9, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**LIBERTY ALL-STAR EQUITY FUND.**

By: /s/ William R. Parmentier, Jr.  
William R. Parmentier, Jr. (Principal Executive Officer)  
President

Date: March 9, 2007

By: /s/ Jeremy O. May  
Jeremy O. May (Principal Financial Officer)  
Treasurer

Date: March 9, 2007