LIBERTY ALL STAR EQUITY FUND
Form N-CSR
March 06, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

File No. 811-04809

Liberty All-Star Equity Fund

(exact name of registrant as specified in charter)

1290 Broadway, Suite 1100, Denver, Colorado 80203

(Address of principal executive offices) (Zip code)

Tane T. Tyler, General Counsel

ALPS Fund Services, Inc.

1290 Broadway, Suite 1100

Denver, Colorado 80203

(Name and address of agent for service)

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

Date of fiscal year end: December 31

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

Table of Contents

Item 1. Report of Shareholders.

Table of Contents

Table of Contents

A SINGLE INVESTMENT...

A DIVERSIFIED CORE PORTFOLIO

A single fund that offers:

- A diversified, multi-managed portfolio of growth and value stocks
- Exposure to many of the industries that make the U.S. economy one of the world s most dynamic
- Access to institutional quality investment managers
- Objective and ongoing manager evaluation
- Active portfolio rebalancing
- A quarterly fixed distribution policy
- Actively managed, exchange traded fund listed on the New York Stock Exchange (ticker symbol: USA)

LIBERTY ALL-STAR® EQUITY FUND

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

Contents

PRESIDENT S LETTER (UNAUDITED)

Fellow Shareholders: *February 2012*

The stock market was essentially unchanged over the span of 12 months in 2011, but that doesn t mean it was a smooth ride. Quite the contrary, the market fluctuated wildly during a year in which investors seemed to develop a split personality--optimistic one day, fearful the next. In an attempt to explain the volatility, the media even coined the term risk-on/risk-off, as if repeated changes in direction could be likened to the flip of a switch.

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

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

Behind the uneven performance of the stock market and its extreme volatility was a mix of factors. On the positive side, corporate earnings were strong, balance sheets continued to recover nicely and managements did a good job of managing costs. The offsets to good corporate performance were an anemic housing and job market. But it was macro concerns on both sides of the Atlantic that created the turmoil, as investors lost confidence in governments ability to deal with fiscal crises. In the U.S., concerns were driven by the size of the federal budget deficit and the political infighting that prevented Washington from coming up with any meaningful solution. The federal debt, just $1 trillion in 1981, skyrocketed 15-fold by 2011. It didn t help when rating agency, Standard & Poor s downgraded U.S. debt from AAA to AA+. It was the first-ever downgrade of

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

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

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

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

Table of Contents

PRESIDENT S LETTER (UNAUDITED)

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

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

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

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

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

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

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

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

Sincerely,

William R. Parmentier, Jr.

President and Chief Executive Officer

Liberty All-Star® Equity Fund

ANNUAL REPORT DECEMBER 31, 2011

Table of Contents

LIBERTY ALL-STAR® EQUITY FUND

3

PRESIDENT S LETTER (UNAUDITED)

FUND STATICTS AND SHORT-TERM PERFORMANCE

PERIODS ENDING DECEMBER 31, 2011

FUND STATISTICS:

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

	Quarter	2011
Distributions	$0.08	$0.34
Market Price Trading Range	$3.77 to $4.65	$3.77 to $5.43
Discount Range	11.3% to 16.8%	7.2% to 16.8%
PERFORMANCE:		
Shares Valued at NAV	10.70%	(6.73%)
Shares Valued at NAV with Dividends Reinvested	10.94%	(5.84%)
Shares Valued at Market Price with Dividends Reinvested	4.80%	(8.09%)
S&P 500® Index	11.82%	2.11%
Lipper Large-Cap Core Mutual Fund Average*	11.04%	(0.65%)
NAV Reinvested Percentile Rank (1 = best; 100 = worst)	62nd	91st
Number of Funds in Category	1108	1066

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

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

* Percentile ranks calculated using the Fund s NAV Reinvested results within the Lipper Large-Cap Core Mutual Fund Universe.
** Performance from the first full calendar year of operations since inception date of October 31, 1986.
Figures shown for the Fund and the Lipper Large-Cap Core Mutual Fund Average are total returns, which include dividends, after deducting Fund expenses. The Fund s performance is calculated assuming that a shareholder exercised all primary rights in the Fund s rights offerings. Figures shown for the unmanaged S&P 500® Index are total returns, including dividends. A description of the Lipper benchmark and the S&P 500® Index can be found on page 34.

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

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

Table of Contents

Multi-management for Individual Investors

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

Real-time Trading and Liquidity

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

Access to Institutional Managers

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

Monitoring and Rebalancing

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

Alignment and Objectivity

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

Distribution Policy

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

Table of Contents

MULTI-MANAGEMENT HAS PRODUCED MORE CONSISTENT RETURNS (UNAUDITED)

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

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

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

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

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

Table of Contents

INVESTMENT MANAGERS/PORTFOLIO CHARACTERISTICS (UNAUDITED)

THE FUND S ASSETS ARE APPROXIMAT ELY EQUALLY DISTRIBUTED AMONG THREE VALUE MANAGERS AND TWO GROWTH MANAGERS:

MANAGERS DIFFERING INVESTMENT STRATEGIES ARE REFLECTED IN PORTFOLIO CHARACTERISTICS

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

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

* Certain holdings are held by more than one manager.
** Excludes negative earnings.

Investment Manager Roundtable

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

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

CORNERSTONE CAPITAL MANAGEMENT, INC.

*Portfolio Manager/*Thomas G. Kamp, CFA

President and Chief Investment Officer

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

MATRIX ASSET ADVISORS, INC.

*Portfolio Manager/*David A. Katz, CFA

President and Chief Executive Officer

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

PZENA INVESTMENT MANAGEMENT, LLC

*Portfolio Manager/*Antonio DeSpirito, III

Principal and Portfolio Manager

Investment Style/Value Pzena uses 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 Manager/Craig C. Blum, CFA

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.

With all five managers contributing to the roundtable, it s a good opportunity for shareholders to compare the various approaches to portfolio management that each of you represent. Can you summarize your investment style, strategy and process, as well as any factors that are distinct to your firm? Tom Kamp and Craig Blum, let s hear from the growth managers to start.

Kamp (Cornerstone Growth): Our philosophy is to successfully identify a perception gap. A perception gap exists when consensus expectations fail to recognize the true earnings power of a given company. This perception gap is an underappreciated opportunity. The greater this gap between consensus expectations and the true earnings power of a given company, the greater the opportunity for investment gains as the consensus recognizes reality and the gap is closed. Furthermore, this creates an alpha advantage that is harvested during the period in which the perception gap closes through v-factor trading. This is the term that describes Cornerstone s active trading philosophy. Assuming there is no change in fundamentals, if a stock s price falls, we will concentrate the portfolio by increasing the average position size. As a stock s price rises we will do the opposite.

We re trying to find good companies when their share prices get very depressed relative to the ability of the underlying business to generate earnings and cash flow over the long term.

Tony DeSpirito (Pzena - Value)

Cornerstone s strategy seeks long-term growth of capital for its clients through the opportunistic selection of stocks expected to appreciate at a faster rate than the benchmark. These stocks are evaluated based on a variety of key factors where our research identifies the perception gap. Stock selection is further based on the fundamentals of revenue, earnings, cash flow, and management depth and credibility. Sector allocation is a by-product of individual stock selection. Stocks will generally be selected from those that are primarily traded on U.S. exchanges or markets. The objective of the strategy is to generate alpha over the long term by purchasing high growth companies where our research has identified one or more perception gaps.

Blum (TCW Growth): We are a quality-focused, concentrated, large-cap growth manager. In our view, four attributes set the strategy apart from many others. First, our definition of quality is unique in that we focus squarely on large and attractive end markets that face each company and then combine that with research around business model advantage. Second, we own a concentrated portfolio of approximately 25 to 35 stocks, allowing us to focus our efforts strictly on our best ideas. Third, we embrace a long-term orientation, which typically translates into a holding period of between three and five years. This enables the strategy to remain invested in the most attractive opportunities given our belief that the best businesses tend to repeat their successes for long time periods. Finally, we employ what we refer to as a light macro overlay that aligns our current portfolio construction with our current macro view. The team s investment process is a proprietary, fundamental, bottom-up approach designed to identify attractive opportunities and then move those names through an exhaustive, fundamental research process. Our focus is on evaluating and modeling industry dynamics, modeling company-specific fundamentals, conducting competitor analysis, identifying sustainable competitive advantages, meeting with and evaluating management, and performing all related valuation work.

Thank you both. Let s turn to the value managers and ask Tony DeSpirito to begin.

DeSpirito (Pzena Value): We are old-fashioned value investors. Some people would use the term deep value. We think of it in a fairly straightforward way: We re trying to find good companies when their share prices get depressed relative to the ability of the underlying business to generate earnings and cash flow over the long term. We approach these businesses with a fairly healthy dose of realism; that is, you don t get to buy the best businesses with the fastest growth rates and the wonderful management teams and all of the characteristics that everybody wants for the simple reason that they don t sell for a low price. Many times, however, there are good businesses that do get marked down, generally because something has gone wrong. Our whole philosophy is to try and identify those companies and then make the judgment as to which ones are really good businesses where the problems are only temporary.

There are a few things that we feel differentiate us from other firms. First, we have an unwavering commitment to our investment approach, which provides assurance that we are constructing deep value portfolios true to our investment philosophy. We also have a long-term orientation - three to five years - which reflects our buy the business perspective. This gives us the ability to make judgments about deeply undervalued businesses

where the market is obsessed with short-term problems and we see long-term potential. Lastly, we have a systematic approach to handling negative information, which enables us to differentiate between companies that we believe are facing temporary setbacks versus a permanent change in our investment thesis. This has proven to be a significant advantage over our history, and reflects our commitment to deep fundamental research.

Thank you. Let s hear from Matrix and Schneider to round out our first discussion point.

Katz (Matrix Value): Since its founding 25 years ago, Matrix has maintained a disciplined relative value investment style that focuses on investing in successful businesses that are trading at compelling valuations. We use the term relative value because our goal is not to identify the statistically cheapest companies, as a deep value investor might, but rather the optimal combination of business strength/success with attractive valuations based on an assessment of a company s key fundamentals. Simply stated, our goal is to invest in undervalued companies that have meaningful upside potential. We implement this goal through two sequential steps. The first employs rigorous quantitative screening models designed to provide an intrinsic business value for a company. This quantitative screening process reduces an initial universe of 1500 candidates to 75-100 statistically attractive candidates. We will then undertake detailed qualitative research on the remaining candidates, focusing on financial statements, as well as diverse factors such as management s assessments of the state of the business, assessments by competitors and analysts, trading activity by insiders, and the potential for a catalyst to create greater value. Typically, we own 35 to 40 stocks at any given time. We will sell a stock when its price rises to meet our intrinsic valuation for the company. Conversely, if the company s intrinsic valuation declines we will also sell a stock. On occasion we will sell a stock if we believe a comparable company offers a more compelling risk/reward profile.

Schneider (Schneider Capital Management - Value): We believe that disciplined value investing, built on a research-driven foundation, can deliver investment success over time. Promising opportunities can be found

Our research process is geared toward identifying securities with low investor expectations that are temporarily trading at a substantial discount to their underlying business value.

among securities that are most deeply undervalued relative to their future earnings potential. Our research process is geared toward identifying securities with low investor expectations that are temporarily trading at a substantial discount to

Arnie Schneider

(Schneider Capital

Management Value)

Table of Contents

their underlying business value. In practice, this has produced an investment discipline focused on timely investments in cyclical industries and discovering individual companies going through meaningful change. The strategy often targets companies under temporary duress where we have identified a path leading to recovery.

Please summarize what produced the best results for you in 2011 and what, in retrospect, didn t play out the way you thought. We ll stay with the value managers and ask Arnie Schneider to begin.

Schneider (Schneider Capital Management Value):

EQT Corporation, an integrated energy company engaged in finding and developing natural gas in Appalachia, was a strong performer. Given its peer-leading cost structure and substantial resource potential in Marcellus shale gas, the stock was cheap relative to its asset values as the market focused only on its modest current production. The market also ignored future opportunities in its less well-known acreage in West Virginia.

Coal stocks had a rough year. Prices for metallurgical coal, which is used in the production of steel, slipped a bit more than we expected due to the sharp global slowdown. In contrast, global thermal coal (used in power generation) dynamics continue to improve. Inventories are in decline and U.S. exports are up substantially. Our investment is intentionally oriented toward companies more exposed to thermal coal. The coal companies in the portfolio present a very favorable risk/reward profile.

Let s hear from Matrix and Pzena.

Katz (Matrix Value): Our best results in 2011 largely tracked the most successful areas of the overall market: more defensive sectors such as consumer staples, led by CVS, Coca-Cola and Procter & Gamble, and healthcare with companies like Bristol-Myers and Covidien. While these areas and stocks were positive contributors to the portfolio, their gains were not enough to offset the areas that didn t work. Our significant detractors were financial stocks, where macroeconomic and global concerns more than overshadowed significantly improved company fundamentals. These laggards included JP Morgan, MetLife and Wells Fargo. Other detractors were economically sensitive stocks such as Alcoa, Carnival, Monster Worldwide and Staples. Because of their ongoing business success, we believe that many of our laggards in 2011 will be among portfolio leaders in the upcoming year.

DeSpirito (Pzena Value): Two thousand eleven was a year dominated by macro events, with eurozone sovereign debt and banking issues, along with the U.S.

debt ceiling standoff, taking center stage. At mid-year, investor sentiment shifted from cautious optimism for a sustained recovery to fear and uncertainty about the future. In this environment, sectors that investors perceived to be safe (utilities, consumer staples and healthcare) did well, as investors fled cyclical sectors in search of stable earnings and dividends. We had little exposure to consumer staples and utilities, which were expensive, and this hurt our performance. Our healthcare holdings, however, did well, and we sold most of them during the year to fund purchases of deeply discounted, yet high quality, cyclical businesses. As a result, the portfolio is dominated by industry leaders with strong balance sheets and high cash flow generation that are trading at extraordinarily attractive valuations.

Growth style managers, how do you reflect on 2011?

Blum (TCW Growth): From a portfolio attribution perspective, our information technology holdings

contributed most to our results during the year. Solid fundamental developments continued to support names such as QUALCOMM and Apple, while Visa continued to execute well and post respectable growth following the poor sentiment that developed after the debit-interchange legislation of 2010. Intuitive Surgical, a leader in robotically-

The team s investment process is a proprietary, fundamental, bottom-up approach designed to identify attractive opportunities and then move those names through an exhaustive, fundamental research process.

assisted minimally invasive surgery, was our single best performing name, with performance driven by procedure growth, profitability and innovation that continued to exceed expectations.

One of our disappointments was mainly isolated to poor sentiment and industry dynamics that continue to pressure C.H. Robinson. Third-party logistics provider C.H. Robinson struggled throughout the year with anemic growth in freight volumes combined with a reduced ability to raise prices. While it was a disappointment for the year, we still believe the company to be meaningfully underpriced longer term and we are maintaining our current exposure.

Kamp (Cornerstone Growth): We began the year with a bullish outlook and generated strong returns in the cyclical stocks of the energy, industrial and technology sectors. Our stock selection in the technology, healthcare and industrial sectors was particularly strong. Part of our success early in the year came from one of our energy holdings, Petrohawk Energy Corp., which was acquired by BHP Billiton Ltd. for a 65 percent premium. We were long-term holders of Petrohawk and one of its largest institutional shareholders premised on the value of its assets in some of the most prolific natural gas locations in the country.

The market began to roll over in late July, accelerating to the downside until October 3, driven by the combined fears of the European sovereign debt crisis and a potential hard landing in China, post the rapid infrastructure spending boom and property speculation of the last three years. Unfortunately, we began to increase our aggressiveness too early in the third quarter, detracting from absolute and relative performance. By maintaining our investment discipline and exposures, however, we generated strong returns from October 4 onward, led by the energy and industrial sectors and to a lesser extent the consumer staples and materials sectors.

What is a stock in the portion of the All-Star Equity Fund portfolio that you manage that is a long-term holding that reflects your style and strategy as summarized in the first question? And what is a recent addition to your portion of the portfolio about which you are optimistic, and why?

Kamp (Cornerstone Growth): In the financial sector, we continue to own only one name, Goldman Sachs, but we have owned it since we started managing this portfolio. In a recent meeting with Goldman s senior management, we learned that the firm s investment banking pipeline is quite robust. Management teams, however, have slowed their deal activity pending some clarity on the depth of Europe s problems. The stock continues to trade at 70 percent of book value despite sitting on nearly $60 billion of excess capital as the company awaits clarity on Dodd-Frank and Basel III regulations. We initiated new positions in Exxon Mobil, Hess Corp. and Schlumberger Ltd. These moves de-risked the portfolio somewhat for what may be a bumpy ride ahead while maintaining exposure to oil commodity prices at a time of tight capacity and rising tensions in the Middle East.

Our philosophy is to successfully identify a perception gap... which exists when consensus expectations fail to recognize the true earnings power of a given company

Tom Kamp

(Cornerstone Growth)

Blum (TCW Growth): Precision Castparts Corp. (PCP) remains a relatively long-term holding for the portfolio. PCP manufactures specialized metal components and engineered composite products for the global aerospace, infrastructure and power markets. We believe a multi-year cycle has developed, defined by increasing demand for lighter, stronger, cleaner and more energy efficient materials to be used across a wide variety of industrial end markets. PCP is thus benefiting from rising demand for its high strength-to-weight ratio products that are forged and cast with proprietary materials and technology. In particular, we believe the commercial aerospace market represents a significant long-term opportunity for the company as high-margin composite products continue to increase as a share of total aircraft content. Additionally, the company is nicely leveraged to emerging market infrastructure growth and is a best-of-breed operator with industry leading margins and returns on capital.

A recent addition to the portfolio is VMware. VMware is the dominant provider of server virtualization software and virtualization-based cloud infrastructure solutions. We believe the financial and operational benefits of server virtualization will continue to drive penetration of workloads in the enterprise, with VMware being the primary beneficiary. Increased virtualization penetration is also driving an increased need for management and automation software, another significant opportunity that VMware is well positioned to exploit. The company has also amassed a portfolio of technologies, including desktop virtualization, cloud-based applications and cloud-related development platforms, that is expanding its addressable market. In our opinion, the current valuation does not adequately reflect these growth opportunities.

DeSpirito (Pzena Value): Hewlett-Packard, the world s largest information technology company, is a great example of a business that we have owned since mid-2010 and that offers long-term opportunity at a very attractive valuation. Despite market fears, our research indicates that H-P continues to maintain its number one or number two positions in virtually all their business segments, which are technology services, printing, PCs, servers and storage. Also, the company is solidly profitable and has a strong balance sheet. The company trades at only 6.3x current earnings and 5.3x our estimate of normal earnings. This is the second time we have owned H-P, and it is one of the largest holdings in our portfolio.

Staples, the world s largest office supplies company, is a new addition that became cheap during 2011 as investors worried about its outlook in light of an uncertain economy. Despite its sensitivity to white collar employment, Staples has significant scale and geographic advantages over its competitors, enabling it to post solid profits and capture market share while the competition retrenches. Staples is well positioned for an eventual normalization in employment and business formation, and trades at 10.1x current earnings estimates and 6.3x our estimate of normal earnings. Staples is also one of our larger holdings.

Table of Contents

Schneider (Schneider Capital Management Value):

Boeing is a long-term holding. We purchased Boeing in anticipation of an upturn in the commercial aerospace business after a period of extreme stress in the industry. The recovery has partially occurred, but Boeing also benefits from several new product cycles, the secular growth in international air travel and stumbles by their competition. Boeing is changing the face of commercial aircraft with the 787, and we expect a substantial increase in cash flow and profit margins as the company boosts production rates.

During the year we increased our exposure to the property/ casualty insurance segment through the purchase of ACE Limited. Given the pressure from low returns in the industry, pricing trends are clearly improving and should lead to growth in revenues, margins, earnings and return on equity. Stock valuations for the group are at the low end of the historical range, which we believe provides an attractive entry point.

Katz (Matrix Value): American Express (AXP) exemplifies our focus on strong fundamental business attributes, while sizing the implications of possible headline risk.AXP is a

superior business with strong management and solid balance sheet. While not subject to the same issues that beset banks during the financial crisis of 2008, AXP was nonetheless punished because of fears of credit defaults and a broad-brush negative appraisal of all financial institutions. As successful prior owners of AXP, we bought the

... our goal is not to identify the statistically cheapest companies, as a deep value investor might, but rather the optimal combination of business strength/success with attractive valuations based on an assessment of a company s key fundamentals.

David Katz (Matrix - Value)

stock during this period of uncertainty, confident that the company would manage its business well during this period. The company did, in fact, manage very adroitly through their credit exposures. As management produced very favorable results, the stock has moved to much higher valuations, providing us with a gain on our investment.

A recent addition to our portfolio has a similar profile, Charles Schwab, the leading discount brokerage firm. In some respects our process in identifying Schwab mirrored that of American Express: a great business in an out-of-favor sector was not necessarily subject to the same pressures and problems as its financial sector peers, yet valued as if it were. We have followed Schwab closely over the years. The business is well run and not beset

with huge structural or financial issues. Importantly, Schwab has a history of being a fast-recovery stock when the market believes that overall economic conditions are improving. We were able to buy Schwab at approximately 12x normalized earnings and believe that it could be a strong contributor to 2012 performance.

Great insights from experienced investment managers and we thank you all. It should be an interesting year ahead. We ll check in again next year.

Table of Contents

TABLE OF DISTRIBUTIONS AND RIGHTS OFFERINGS (UNAUDITED)

			RIGHTS OFFERINGS		
	PER SHARE	MONTH	SHARES NEEDED TO PURCHASE	SUBSCRIPTION	
YEAR	DISTRIBUTIONS	COMPLETED	ONE ADDITIONAL SHARE	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				
2007	0.90	December	10	6.51	
2008	0.65				

2009***	0.31
2010	0.31
2011	0.34
Total	$22.42

* The Fund s net investment income and net realized capital gains exceeded the amount to be distributed under the Fund s 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.
*** Effective with the second quarter distribution, the annual distribution rate was changed from 10 percent to 6 percent.

DISTRIBUTION POLICY

Liberty All-Star® Equity Fund s current policy is to pay distributions on its shares totaling approximately 6 percent of its net asset value per year, payable in four quarterly installments of 1.5 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 distribution 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 distribution 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.

Table of Contents

LIBERTY ALL-STAR® EQUITY FUND

TOP 20 HOLDINGS AND ECONOMIC SECTORS (UNAUDITED)

December 31, 2011

TOP 20 HOLDINGS*	PERCENT OF NET ASSETS
Apple, Inc.	2.99%
JPMorgan Chase & Co.	2.08
QUALCOMM, Inc.	2.05
Cisco Systems, Inc.	1.99
Google, Inc., Class A	1.86
Wells Fargo & Co.	1.83
ACE Ltd.	1.76
Dell, Inc.	1.46
Exxon Mobil Corp.	1.42
The Western Union Co.	1.34
The Allstate Corp.	1.32
Staples, Inc.	1.31
BP PLC	1.25
State Street Corp.	1.13
Visa, Inc., Class A	1.11
Microsoft Corp.	1.09
American Tower Corp., Class A	1.04
Hewlett-Packard Co.	1.01
SunTrust Banks, Inc.	1.01
Carnival Corp.	0.98

	30.03%

ECONOMIC SECTORS*	PERCENT OF NET ASSETS
Information Technology	25.01%
Financials	19.20
Energy	14.39
Consumer Discretionary	10.41
Health Care	8.66
Industrials	7.91
Consumer Staples	6.32
Materials	3.43
Utilities	1.82
Telecommunication Services	1.39
Other Net Assets	1.46
	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.

Table of Contents

MAJOR STOCK CHANGES IN THE QUARTER (UNAUDITED)

December 31, 2011

The following are the major ($3 million or more) stock changes - both purchases and sales - that were made in the Fund s portfolio during the fourth quarter of 2011.

SECURITY NAME	PURCHASES (SALES)	SHARES AS OF 12/31/11
PURCHASES		
Exxon Mobil Corp.	72,597	152,772
General Mills, Inc.	142,479	142,479
SALES		
Anadarko Petroleum Corp.	(41,836)	31,120
Baidu, Inc.	(32,688)	53,710
Beam, Inc.	(65,725)	0
Broadcom Corp., Class A	(172,645)	0
Colgate-Palmolive Co.	(34,534)	0
Edison International	(89,000)	0
J.C. Penney Co., Inc.	(92,880)	190,965
Rockwell Automation, Inc.	(55,986)	97,434

Table of Contents

LIBERTY ALL-STAR® EQUITY FUND

16

SCHEDULE OF INVESTMENTS

as of December 31, 2011

COMMON STOCKS (98.54%)	SHARES	MARKET VALUE
u CONSUMER DISCRETIONARY (10.41%)		
Auto Components (1.29%)		
Johnson Controls, Inc.	240,505	$ 7,518,186