LIBERTY ALL STAR EQUITY FUND
Form N-CSR
March 04, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

Investment Company Act 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)

Alex Marks

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, 2014

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Item 1. Report of Shareholders.

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A SINGLE INVESTMENT…

A DIVERSIFIED CORE PORTFOLIO

A single fund that offers:

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

LIBERTY ALL-STAR® EQUITY FUND

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

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PRESIDENT S LETTER (UNAUDITED)

Fellow Shareholders:

February 2015

Although roiled by periodic sell-offs, U.S. equity markets rose once again in 2014, as the S&P 500® Index and the widely followed Dow Jones Industrial Average (DJIA) posted numerous record highs throughout the year. The S&P 500 returned 13.69 percent while the DJIA gained 10.04 percent. The technology-focused NASDAQ Composite Index returned 14.75 percent.

The S&P 500 Index recorded positive returns each quarter in 2014, with the first and third quarters in the range of 1 percent-plus while the second and fourth quarters were in the mid-single digits. The U.S. economy was the main source of strength for equities. An abnormally harsh winter caused gross domestic product (GDP) to decline 2.1 percent in the first quarter. Growth was strong in the second and third quarters, however, when GDP rose 4.6 percent and 5.0 percent, respectively. The employment picture in the U.S. also brightened. Except for January, which was distorted by the weather, every month in 2014 was marked by the creation of more than 200,000 non-farm jobs. The ongoing job growth meant that by May all of the 8.7 million jobs lost during the Great Recession had finally been recouped. Throughout the fiscal year, the Federal Reserve (Fed) kept short-term interest rates at record low levels, even as it continued to wind down its program of quantitative easing (QE), first launched in December 2008. In October, the Fed ended the program altogether. Another powerful theme running throughout the year was the industrial renaissance in the U.S., as auto, capital equipment and energy output gained strength. U.S. energy production stood out as a growth driver, as hydraulic fracturing methodologies unlocked previously inaccessible or economically impractical oil and gas deposits. The price of oil began a gradual descent at mid-year, a move that accelerated in the fourth quarter. From a peak of $106 per barrel in June, the price of West Texas Intermediate (WTI) crude fell to an average of $59 per barrel in December (and continued to slide in early 2015).

The steep, rapid decline in the price of oil was interpreted by many to be a sign of slowing economic growth

worldwide and investors responded by selling equities in one of the several sell-offs that made 2014 a positive, but choppy year. Fears of higher interest rates and geopolitical tensions, chiefly in Ukraine, fueled a retrenchment in the first quarter. A significant sell-off in biotechnology, information technology and social networking stocks hit the NASDAQ Composite in April. And falling oil prices led to a one-week decline of 3.1 percent in the S&P 500 in early October.

One characteristic of the 2014 investment environment that warrants comment was how challenging it was for active managers and actively managed funds. According to data provider Lipper, 2014 was the worst year for active managers relative to the market in three decades, while data from research firm Morningstar indicates that less than 20 percent of U.S. equity fund managers beat their benchmark. As Liberty All-Star® Equity Fund is actively managed, we asked the Fund s five investment managers to comment on this in our annual Manager Roundtable, which begins on page 9 of this report. We recommend their thoughts and insights to you.

After strongly outperforming the market in 2013, Liberty All-Star® Equity Fund returns lagged in 2014. The Fund returned 8.87 percent with shares valued at net asset value (NAV) with dividends reinvested and 6.98 percent with shares valued at market price with dividends reinvested. (Fund returns are net of fees.) The Lipper Large-Cap Core Mutual Fund Average returned 11.32 percent. The Fund posted positive returns for three quarters, but experienced a negative return of -1.38 percent in the third quarter, hurt in part by the sell-off in energy stocks. The discount at which Fund shares traded relative to their underlying NAV widened compared with 2013, ranging from a low of -10.5 percent to a high of -13.6 percent.

Looking longer term, the Fund s average annual returns are in-line with most indices, as they lag the S&P 500 by just 42 basis points for the trailing three-year period (with

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PRESIDENT S LETTER (UNAUDITED)

shares valued at market price with dividends reinvested) and are ahead of the Lipper average by 87 basis points for the same period. By the same measure, the Fund trails the S&P 500 for the past five years, but once again is ahead of the Lipper.

As previously discussed, it had been a challenging environment for active managers relative performance during 2014 and, actually, for most years subsequent to the 2008 financial crisis. The massive liquidity provided by the Federal Reserve in response to the crisis certainly pushed stock indices to record highs and interest rates to record lows. It has, however, been a challenging period for active managers, as the transmission mechanism for that liquidity into domestic stocks has been largely through index funds and index exchange-traded funds (ETFs) rather than actively managed products. Looking longer term, there are also periods when active managers, on balance, have outperformed stock indices, which points to the cyclical nature of those performance patterns. The last such period was from 2000-2007, a time frame beginning after the bursting of the technology bubble and, coincidentally, was approximately the same duration as the current post-crisis period. It is worth noting that for the past 15 years, from January 1, 2000, to December 31, 2014, the Fund s NAV reinvested return after fund expenses exceeds both the Lipper average and the S&P 500. No one can predict the timing of when or for how long active managers generally out- or underperform stock indices, but viewing active managers relative performance in the context of a combined cycle is relevant.

Fund distributions totaled $0.39 per share in 2014. 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. These distributions add up to $24.66 since 1987 (the Fund s first full calendar year of operations). We continue to emphasize that shareholders should include these distributions when determining the return on their investment in the Fund.

One of the key principles on which the Fund was founded is multi-management, or the practice of allocating the Fund s assets to carefully selected investment managers

representing both value and growth styles of investing. Thus, we are once again offering insights into the managers thinking through the previously mentioned roundtable discussion, and invite shareholders to read the managers comments.

In a difficult environment for active managers, the Fund lagged key benchmarks in 2014. After a strong 2013, however, the Fund s market price returns over the past two years average 19.52 percent. If the start of the year is any indicator, 2015 may be highly volatile. We are confident in the Fund s five investment managers ability to navigate whatever market conditions prevail in the year ahead. For our part, we will continue to manage the Fund with our sights set on rewarding long-term returns for shareholders.

Sincerely,

William R. Parmentier, Jr.

President and Chief Executive Officer

Liberty All-Star® Equity Fund

ANNUAL REPORT DECEMBER 31, 2014

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FUND STATISTICS AND SHORT-TERM PERFORMANCE

PERIODS ENDED DECEMBER 31, 2014

FUND STATISTICS:

Net Asset Value (NAV)	$6.84
Market Price	$5.98
Discount	-12.6%

	Quarter	2014
Distributions*	$0.09	$0.39
Market Price Trading Range	$5.22 to $6.09	$5.22 to $6.09
Premium/(Discount) Range	-11.8% to -13.6%	-10.5% to -13.6%

PERFORMANCE:

Shares Valued at NAV with Dividends Reinvested	4.30%	8.87%
Shares Valued at Market Price with Dividends Reinvested	4.16%	6.98%
Dow Jones Industrial Average	5.20%	10.04%
NASDAQ Composite Index	5.70%	14.75%
Lipper Large-Cap Core Mutual Fund Average	4.27%	11.32%
S&P 500® Index	4.93%	13.69%

G-TERM PERFORMANCE SUMMARY AND DISTRIBUTIONS PERIODS ENDED MBER 31, 2014	ANNUALIZED RATES OF RETU 3 YEARS	5 YEARS	10 YEARS	15 YEARS	25 Y
TY ALL-STAR® EQUITY FUND					
utions	$1.06	$1.71	$5.32	$10.49	S
Valued at NAV with Dividends Reinvested	18.67%	12.84%	5.95%	4.80%	
Valued at Market Price with Dividends Reinvested	19.99%	14.08%	4.25%	5.51%	
nes Industrial Average	16.29%	14.22%	7.91%	5.44%	1

Large-Cap Core Mutual Fund Average	19.12%	13.90%	7.05%	4.29%	
AQ Composite Index	23.60%	17.19%	9.17%	1.82%	1
0® Index	20.41%	15.45%	7.67%	4.24%	

* All 2014 distributions consist of ordinary dividends and long-term capital gains. A breakdown of each 2014 distribution for federal income tax purposes can be found in the table on page 39.

Returns for the Fund are total returns, which include dividends. Performance returns are net of management fees and other Fund expenses.

Figures shown for the Lipper Large-Cap Core Mutual Fund Average are based on open-end mutual funds total returns, which include dividends, and are net of Fund expenses. Figures shown for the unmanaged Dow Jones Industrial Average, NASDAQ Composite Index and the S&P 500® Index are total returns, including dividends. A description of the Lipper benchmark and the market indices can be found on page 39.

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.

Closed-end funds raise money in an initial public offering and shares are listed and traded on an exchange. Open-end mutual funds continuously issue and redeem shares at net asset value. 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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Unique Attributes of Liberty All-Star® Equity Fund

Several attributes help to make the Fund a core equity holding for investors seeking diversification, income and the potential for long-term appreciation.

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.

UNIQUE FUND ATTRIBUTES (UNAUDITED)

Access to Institutional Managers

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

Monitoring and Rebalancing

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

Alignment and Objectivity

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

Distribution Policy

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

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INVESTMENT MANAGERS/PORTFOLIO CHARACTERISTICS (UNAUDITED)

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

MANAGERS DIFFERING INVESTMENT STRATEGIES ARE REFLECTED IN PORTFOLIO CHARACTERISTICS

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

INVESTMENT STYLE SPECTRUM

PORTFOLIO CHARACTERISTICS AS OF DECEMBER 31, 2014 **VALUE** **GROWTH**

	Schneider	Pzena	Matrix	Cornerstone	TCW	Total Fund	S&P 500® Index
Number of Holdings	36	41	35	43	31	158*	502
Percent of Holdings in Top 10	55%	36%	36%	39%	44%	17%	18%
Weighted Average Market Capitalization (billions)	$44	$86	$106	$67	$64	$74	$131
Average Five-Year Earnings Per Share Growth	5%	13%	17%	25%	19%	18%	15%
Dividend Yield	1.5%	1.9%	2.1%	0.7%	0.6%	1.4%	2.0%
Price/Earnings Ratio**	15x	13x	17x	25x	33x	18x	19x

Price/Book Value Ratio	1.4x	2.0x	2.1x	4.0x	5.7x	2.6x	3.0x

* Certain holdings are held by more than one manager.

** Excludes negative earnings.

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GROWTH OF A HYPOTHETICAL $10,000 INVESTMENT

The graph below illustrates the growth of a hypothetical $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, 2014. For certain information, it also assumes that a shareholder exercised all primary rights in the Fund s rights offerings (see below). This graph covers the period since the Fund commenced its 10 percent distribution policy in 1988. Effective with the 2009 second quarter distribution, the annual distribution rate was changed from 10 percent to 6 percent.

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 $50,217 (including the December 31, 2014 value of the original investment of $9,967 plus distributions during the period of $39,133 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 $145,963.