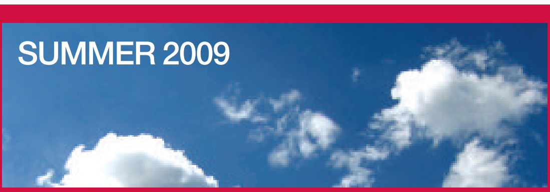
investment update



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B E R R Y

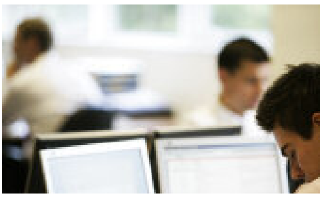
OVERVIEW

The second quarter of 2009 has certainly been calmer than several of the ones that have preceded it, with some welcome gains being made across a number of asset classes. Without sticking our neck out too far, it does now appear that a major meltdown has been averted: fears of systemic risk in the financial system do seem to be subsiding and banking sector stress has certainly diminished, particularly following government intervention. This is reflected quite clearly in the recovery in corporate bond funds over the past three months or so. As the perceived risk of default, particularly within the financial sector, has abated, so the yield spread between corporate and government bonds has also reduced, resulting in a strong and welcome rally in prices. This recovery still has some way to go before losses are reversed, but the outlook does appear to be brighter than it was a few months ago.

As far as stockmarkets are concerned, for much of the quarter there has been what is best described as a 'dash for trash' – a move away from the relative security of defensive companies with stronger balance sheets and durable franchises and into more cyclically orientated companies which are more sensitive to economic revival, including a strong rebound in some of the sectors that had previously been punished severely, including financials. With virtually no economic growth present in the entire world economy, this was a brave call for those who managed to reposition themselves for the brief rally between March and May. Some of the more nimble managers with whom we have invested managed a brief flirtation with this theme, but most have so far played things safer with only a modest repositioning into 'recovery' stocks. If anything, a healthier level of scepticism about the strength of economic recovery has developed as the quarter has progressed, allowing stockmarkets to take a breather and consider in which direction and in which areas they head next. In some ways, marking time for a while is probably what we need most, helping to rebuild confidence - overall it is good to see stockmarkets seemingly find a new, higher base level from which they can move forward at some point.

July 2009

HEDGE FUNDS - AN IMPROVED MOOD

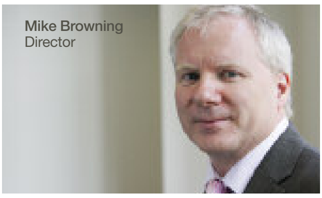


...invitations to shareholders allowing exit points at or closer to asset value.

Hedge Funds have also enjoyed a better time in recent months, generally posting more respectable net asset values and returns more in line with their stated aims.

Several closed-ended funds have now announced restructuring plans and invitations to shareholders allowing exit points at or closer to asset value. The closed-ended fund of hedge fund sector will undoubtedly shrink in size over the coming year as a result of corporate activity, with only the largest and fittest likely to survive. In an effort to maximise value, we are continuing to participate in tender offers and wind ups, and generally intend to recycle capital into 'absolute return' funds. These funds have greater flexibility and liquidity, but also returns which are not so aligned with market behaviour, unlike many hedge funds which proved to be more correlated than expected at the height of the financial crisis.

NOT A TIME FOR COMPLACENCY



Despite the recent recovery in various areas, however, we should not be complacent.

There are plenty of issues still to overcome, most notably the exit strategy from the massive monetary and fiscal response that has been necessary to avert a major collapse in the financial system. This exit strategy is probably the single most important thing for authorities to get right over the next year or so – leaving the current measures in place for too long runs the risk of a big inflation problem further down the line, whilst reversing action too quickly could tip many economies into a deflationary spiral from which extrication is extremely difficult. Investment markets are now at an impasse, divided between the inflationary and deflationary camps, and this accounts for the short term swings in market sentiment between cyclical and defensive sectors that we have seen in the past few weeks.

On balance, we are in the inflationary camp, believing that the authorities will leave interest rates at low levels for longer than they probably should for fear of killing off any nascent signs of economic recovery. Once the growth pendulum has started to swing, however, it will be very difficult to stop, by which time inflationary pressures will have started to build quite strongly. Stockmarkets, and other real asset classes, generally like some inflation, as it allows corporate pricing power to return. But too much inflation opens up a whole new chapter of challenges, most notably for fixed interest markets, with returns coming under pressure from associated rising interest rates. The most sensitive part of fixed interest markets to rising inflation is government bonds – conventional government bonds, particularly medium and longer dated issues, typically come under most pressure, whilst index-linked bonds are insulated from rising inflation. Judging the optimal time to move from conventional government bonds to index-linked is very difficult, but generally it pays to move before the inflation roller-coaster has really begun to gather momentum.

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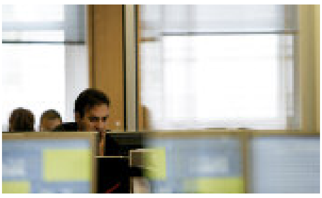
A SHIFT TOWARDS INDEX-LINKED



We may be a little early with this call, but we want to be correctly positioned...

We are therefore intending to reposition clients' government bond exposure into both indexed-linked and shorter-dated securities, typically via exchange-traded funds (ETFs) and short-dated bond funds.

We may be a little early with this call, but we want to be correctly positioned for the time when inflation expectations begin to turn, which we believe could be relatively soon. We are less concerned about corporate bonds in a modest inflationary phase as they should generally be more sensitive to economic revival. This points to a further narrowing of yield spreads as default risk reduces.

AN INCREASINGLY GLOBAL FLAVOUR TO PORTFOLIOS

The economies with the biggest debt burdens and structural disadvantages are likely to be the ones that take the longest to recover.

This would include most European economies, including the UK, where the huge budget deficit will take years to unwind and is likely to undermine productivity for some time to come. Meanwhile, those economies and markets that should come through more strongly are those which were less exposed to the financial crisis and are becoming increasingly less dependent on external demand. China scores well on this front, as do a number of other Asian and emerging markets, where we expect to increase exposure. In our view the US economy and stockmarket sits somewhere in the middle – it led us into this downturn but is also expected to play a major part in leading us out. The sheer scale and can-do attitude of the US worker and consumer gives rise to a vast pool of investment opportunity, which in turn we feel is capable of being translated into gains by active managers, even if the general economic recovery is quite slow. Our allocation to US markets is therefore also likely to increase.

We need to be mindful of the increased currency risk of making more investments outside the domestic economy. However, what is becoming clearer to us is that the financial damage done in the past few years to the established economies of the West is now enabling emerging economies in the East, in particular, to gain the upper hand. It is therefore becoming increasingly important that we reflect this more in our asset allocation. Time will tell, but when we look back in ten or twenty years' time from now, we may pinpoint the events of the past few years as defining the moment when the power shift from West to East really began.

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Berry Asset Management PLC
101 The Chambers, Chelsea Harbour
London SW10 0XF

Telephone: +44 (0)20 7376 3476
Within UK: 0845 456 0586
Facsimile: +44 (0)20 7823 3348
E-mail: Enquiries@berry.co.uk
www.berry.co.uk

Authorised and regulated by the Financial Services Authority
25 The North Colonnade, Canary Wharf, London E14 5HS