Investment Manager's Commentary

July 2007

The recent upheavals in sub-prime debt markets and the impact on institutions and funds specialising in collateralised debt obligations have inevitably spilled over into the broader financial markets. There is a high degree of nervousness at present, and certain hedge fund managers trading debt obligations have recorded double digit losses in July, in addition to which several high profile fund closures have been reported.

While our managers do not deal in sub-prime paper or over the counter illiquid instruments, those trend followers that trade in interest rate and equity markets were not immune to sharp price moves and as a result had an uncomfortable month. Performance was buffered to some extent by our fixed income trader who had anticipated the bond market movement and profited accordingly.

The open question is whether this correction was just a short, sharp interruption of an ongoing bull market or whether it is the start of a more serious downturn. Our view is that the flight from debt paper has been disturbing and this worry might prevail in the near term. However, the underlying fundamentals of strong corporate growth mean that equities should be underpinned. It is also clear that, although the panic relating to holding sub prime paper has spilled over into other debt markets, the bulk of the latter (meaning corporate, bank and sovereign debt) remains high quality and it can be argued that it has been unreasonably marked down. The implication is that buyers will soon emerge to take advantage of good quality paper at undervalued prices.

In the meantime, our trend followers have gone into capital preservation mode, which should limit further downside risk, until the outlook becomes clearer. Buying opportunities are always present when uncertainty appears to be at its highest. However investors must accept that there will be an increase in volatility in the interim.

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