



MONTHLY REPORT

JUNE 2010

MARKET SUMMARY

Investors can be forgiven for thinking it feels a little like 2008 again. Volatility is back - though thankfully nowhere near the levels we saw during the credit crunch. And, just like in 2008, market-driven, aggressive policy responses are also back in the spotlight. What initially started out as market nervousness over Greek debt quickly grew into a broader, self-fuelling panic in financial markets. Fear levels spiked up sharply, while electronic trading exacerbated the extent of market falls. Despite the fact that the global economic and corporate environment remains robust, investors demanded concerted action from the authorities to avoid Greek debt contagion spreading to other economies.

A long and growing list of concerns pushed markets lower again this week. Top of that list are: heavy-handed regulation, euro disharmony, the sustainability of economic recovery, uncertainty in China and an unsettling geopolitical mood around the world. Combined, they make a potent cocktail and have pushed shares in every major market across the world several percentage points lower.

Leading the charge was Wall Street, which just recently reacted to tough new banking regulation and worrying unemployment figures. Also of concern to investors is the continuing decline in China, which in the last week of May pushed shares in Shanghai close to technical bear market territory – a fall of 20% from its recent peak.

In the last week of May the euro rescue has barely papered over the cracks that are now appearing across the continent. Germany's financial regulator surprised the markets with a ban on a type of trading it claims is used by speculators and causes instability. The trade, known as a naked short, is a sell deal placed by someone that neither owns nor has borrowed the stock they are selling. It is a risky bet that an asset price will fall. The regulator produced a list of Germany's largest stocks, bonds and other tradable instruments that now cannot be traded in this way.

The surprise announcement echoes similar action taken during the worst of the financial crisis and raised suspicion that the authorities know something that the market does not. That the German authorities announced the ban without consulting or informing its fellow EU members does little to reassure investors that European leaders can face the continent's fiscal and economic problems with a united front.

At PFS, we believe the recent market weakness is a temporary "overreaction" to global events and it represents an attractive entry point for medium-term investors. Fears about contagion from the European sovereign debt crisis, anticipation of a Chinese property crash, and escalating political tensions in North and South Korea have all played their part in spooking the market. With the 2008 financial crisis still fresh in the memory, investors are acutely aware that markets can fall rapidly and quickly turn fearful.

FUND HOT PICK

In our view recent market weakness is an over down that will prove to be temporary. A (still) robust outlook for corporate profits, attractive valuations and evidence of extremely negative sentiment are reasons to maintain a positive view of prospective equity returns.

World equities are trading on a PE multiple of 12x forward earnings – the lowest multiple of the past 20 years, with the exception of the height of the 2008/09 financial crisis. Given our economic views, we continue to anticipate robust corporate profits growth over the coming quarters.

Although, we believe the current correction is short term, we do believe we will continue to see both positive and negative surges in world equity markets. We (PFS) have been analysing a large amount of alternative investment structures that have the ability to take advantage of both upward/downward and flat market conditions. The fund under review (and now accepted by the board) is a low volatile, low correlated

Long/Short Equity fund. The Fund's long / short equity strategy is designed to minimize exposure to the market and generate positive returns in all market conditions. More information on this fund is to follow.

YEAR TO DATE

The following table provides us with a summary of Year to Date performance on some of the larger markets around the world.

Region/Country	%Year-to-Date
Europe ex-U.K.	-16.98%
France	-19.86%
Germany	-14.14%
Italy	-25.90%
Spain	-31.58%
United Kingdom	-12.83%
Japan	-0.60%
AC Far East ex-Japan	-6.38%
Hong Kong	-6.34%
China	-20.25%
Korea	-5.05%
Thailand	3.84%
EM Latin America	-9.53%
Brazil	-13.90%
Argentina	-5.71%
Emerging Markets	-6.34%
India	-2.05%
Russia	-6.67%

US EQUITIES

This market has played a pivotal role in our global equity allocation with an overweight often at the expense of European equities. We are strengthening this choice amid widening growth prospects on the

two sides. As the US recovery broadens thanks to the enhanced contribution of consumer spending (supporting key industry groups such as Consumer Discretionary), the same does not apply to the European market. The latter will probably be supported by sectors with a strong export order book, notably from fast developing countries and regions. Overall, the first-quarter data on US earnings revealed more upside surprises. In both the US and Europe, Financials account for a large stake of broad indices (respectively 16.5% and 15% at current market prices). However, the risk of further asset writedowns has declined substantially among US banks, while the losses related to the latest turmoil in euro government bond markets may affect valuations at major European banks. These are also sensitive to domestic economic growth, which may be fragile against the backdrop of forced budget tightening

EUROPE EQUITIES

How ECB policy is affected by Greek risk? The policy adopted by the European Central Bank (ECB) over the last two years has been no exception to the global trend, led by the US Federal Reserve. Overcoming the recession was top of the agenda in 2008 but even now that the macroeconomic figures point to an overall recovery there seems to be no hurry to shelve the loosest policies.

While refraining from bringing key policy rates down to zero, the ECB has been lending lots of cash to struggling banks and accepted all euro government bonds as collateral. Banks have invested most of this additional cash into government bonds instead of lending to companies or households and thereby overcoming the credit crunch. With the debt of Greece and other deficit-prone countries downgraded by major rating agencies there was speculation that the ECB would make it unsuitable for collateral but that looks unlikely in the current turmoil.

EMERGING EQUITIES

The case for emerging equity markets is maintained by the area's overall strong growth potential, although regional differences should not be neglected. Our most positive call is on Asia where domestic demand is a key driver of GDP growth. The downside risks for most of these markets, with China in the first tier, are provided by undesired inflation pressures that central banks could counter by tightening monetary policy aggressively and curbing growth.

We still believe that Chinese officials are acting pre-emptively to cool down excess growth, particularly in bank lending. However, we have to watch for evidence of steep rises in property and other asset prices. Expected earnings at companies with a strong exposure to emerging markets have been repeatedly revised upwards over the last 12 months and are likely to be cut if those economies slowed down abruptly as a result of tighter policies. The role of these markets will take centre stage in this environment, although most of the attention will turn to Asia. Putting all countries tagged as 'emerging' by the main benchmarks together can be misleading, with so-called emerging Europe most suitably belonging to Western Europe on converging growth patterns. The proximity of Eastern Europe to a slow-growth area explains why we are less comfortable with it

CURRENCIES

A weaker euro as an additional stimulus to growth. Currency markets have duly priced in the Greek financial crisis, putting strains on the euro. Europe's single currency may even break through the 1.30 threshold against the US dollar if concerns over Greece and other peripheral countries do not abate soon. The silver lining of the euro's weakness is that it enhances export competitiveness and provides an additional stimulus to growth by partly

offsetting domestic demand. Unlike for higher bond yields, politicians are not blaming speculators for a depreciating euro.

The euro's trade-weighted value has declined about 7% since early December last year when the Greek problem virtually became a full-blown crisis. However, it is still on the 'strong' side of its trading range since EMU was born in 1999 (near 10% above the average of the entire period to date). Other countries are unlikely to complain loudly about unfair competition through a devalued currency. Therefore, there is still some downside for the euro both against the US dollar (on worse growth prospects) and in Europe against a safe haven, such as the Swiss Franc, amid a loss of credibility over Greece's bailout. We believe that there is also some downside for the euro against the British pound, which has largely priced in the political uncertainty related to the elections and the prospect of a hung parliament.

COMMODITIES

While the next year could be difficult for natural resource firms, we believe the long-term outlook for natural resource investing remains favorable, even if a protracted global recession delays the resumption of demand growth for commodities and natural resources.

At current valuations, we feel the resources sector is poised for a rebound once the global economy recovers and emerging market demand stabilizes.

We believe energy industries will lead a cyclical upturn in the natural resources sector. We also believe demand for oil will show some signs of improvement in the second half of the year, particularly in the U.S. gasoline market and in China. In our opinion, this could benefit producers whose earnings and outlook are particularly leveraged to oil prices, as well as oil and gas equipment and services companies.

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