Core Portfolio
Sterling Quarterly Report 31 December 2008

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Objective: To achieve a real return in excess of risk free sterling cash interest rates over a three to five year period. Performance is targeted through the strategic asset allocation of a diversified multi asset class investment. This means important changes will regularly be made to reflect changing market conditions. Asset allocation may be made across all of the major asset classes being cash, bonds, commercial property, equities and alternative investments. Our philosophy is to invest into passive investments (investment performance vehicles that mirror the respective market) through our core portfolio wherever possible.

Cash: A turbulent final quarter of 2008 saw the UK base rate fall to 2.00% (a 3.00% reduction since September 2008). It is hoped this aggressive move by the Monetary Policy Committee (MPC) will stimulate spending, as opposed to saving, and kick-start the economy once more. Although the intentions from the UK government are clear, economists are still unsure how long it will take to turn the corner. There are expectations of further cuts during the first quarter of 2009 and the UK base rate as low as 0.50% by June.

Actual Return in 2008	**4.64%**
Standard Deviation^	**0.29%**
Current Weighting	**33.30%**

Bonds: For the bond markets, the final quarter of 2008 was characterised by a continued flight to quality, as investors sought the relative safe haven of government debt amidst the on-going financial turmoil. As a consequence of this, 2-year gilts closed the year yielding 1.01%, with 10-year gilts at 3.01%. In contrast, the credit markets continued to underperform, driving yield spreads between government issues and investment grade bonds to historical wides, as investors demanded greater compensation for the increased default, volatility and liquidity risk.
An analysis of past default and recovery rates dating back to the Great Depression of the 1930s determined that given current valuations, high-grade corporate debt represented an extremely attractive investment opportunity. With this in mind, in November, we opted to increase our bond holding from 14% to a fully weighted 20%.
As a result of the continued market turbulence and the risk-return characteristics exhibited by the index tracker fund held within the core portfolio, a strategic decision was made to switch into actively managed bond funds. It was felt this change would facilitate enhanced risk management, offer increased flexibility and provide improved access to a more diverse universe of fixed interest investments. Two relatively conservative funds were selected, both managed by leading fixed income houses. These investments have already begun making a significant positive contribution to portfolio returns and are expected to continue to do so throughout 2009.

Actual Return in 2008	**-10.77%**
Standard Deviation^	**9.22%**
Current Weighting	**20.85%**

Equities: During the final quarter, equity markets tumbled as plunging business and consumer confidence indicators suggested that the major economies would experience a severe recession. Despite a small gain in December, the MSCI World Index fell by a further 22.18% during the quarter rounding off a dismal annual performance with a fall of 42.08% in dollar terms. In sterling terms, the MSCI World Index fell by 3.52% during the quarter and by 19.81% annually, reflecting the sharp and rapid decline in the value of sterling. Governments and central banks have continued in their attempts to revive the global economy with the US Federal Reserve in particular reducing dollar interest rates to zero, extended bail out plans, and the new president-elect Obama hinting at significant fiscal stimulus packages. In spite of these efforts, to date economic and corporate news continues to disappoint with rising unemployment, deflationary pressures and rising volumes of profit warnings confirming a continued slowdown.
With the recent addition of major financial scandals and the return of geo-political tensions, market conditions are expected to remain challenging and volatile in the short term and could fall further on fears about the global outlook. Stock markets are of course forward-looking as investors attempt to anticipate future prices, and the key question now is whether equities price in the scale of the economic downturn. (continued on next page)

Actual Return in 2008	**-38.74%**
Standard Deviation^	**21.82%**
Current Weighting	**16.27%**

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Clearly, investors will be looking for evidence of a more certain outlook and, in particular, for signs of positive growth in the US economy, which some commentators anticipate could occur at some point in the second half of this year. Accordingly, any increase in allocation would require an increase in confidence for a rebound in late 2009 and we intend to maintain our underweight position in the short term.

Property: UK property, both residential and commercial, had a very difficult time throughout 2008. The investment property databank which monitors the value of UK commercial and residential property has fallen 8.3% in the final quarter, giving a total fall of 16.86% for 2008. In anticipation of a difficult time for property in 2008, we have not been invested in this asset class for most of the year.

Looking forward, the outlook for residential property remains difficult for 2009. There is an inevitable conflict between the steps taken by the Bank of England and the Chancellor of the Exchequer to invigorate the economy and the caution felt by clients brought about by the recession. Most property commentators expect a negative year in 2009 but with a recovery forecast to start towards the end of the year.

Commercial property is expected to have an equally difficult time through 2009 with its recovery linked directly to the performance of the wider UK economy. We do not intend making any immediate investments into property and will continue to monitor the markets to determine if and when the time will be right for re-entry through 2009. We do not currently consider property will outperform cash over a 12-month period, even with cash rates expected to remain very low.

Actual Return in 2008	**-0.24%**
Standard Deviation^	**0.19%**
Current Weighting*	**0.00%**

* Asset class exited on 19 February 2008

Alternative Investments: **Hedge Funds:** The final quarter of 2008 capped a miserable year for the hedge fund sector. In addition to posting poor returns - the HFRX Global Index fell 13.99% in sterling terms and finished 22.82% down for the year - the sector witnessed the biggest corporate fraud totalling an estimated US$50bn. The allegations against Bernard Madoff have raised fundamental questions about the future of hedge funds in their current guise, especially from a regulatory perspective. A report by Barclays Capital estimates that these negative events will contribute to a contraction of 70% to 80% in the aggregate value of funds managed through 2009 and this will undoubtedly have serious implications for the industry. However, an irony may be that those surviving managers will find opportunities for active trading and arbitrage easier to come by in a less crowded market and it is likely that the best will survive. Nevertheless, other issues remain, including a reduced appetite for the provision of leverage to hedge fund managers and therefore the short-term outlook remains uncertain at best. Against this backdrop, we reduced our exposure to funds of hedge funds by 10% during the quarter.

Actual Return in 2008	**-24.44%**
Standard Deviation^	**11.98%**
Current Weighting	**29.58%**

Commodities: Concerns over global growth intensified through the quarter leading to downward pressure on many consumable commodities. Notably, crude oil finished the year at a level most commentators assumed would never be seen again and the prediction for US$200 oil now seems a long way off. Collapsing demand has led to production cuts by the OPEC oil cartel and calls for these to continue are intensifying. The negative political impact of lower oil prices are being felt in many countries, most notably in Russia where the energy boom to bust has registered markedly with a collapse in its currency and an increase in unemployment. A marginal rise in the price of gold (+1.3% in US dollar terms) seemed at odds with the heightened asset volatility and consequent risk aversion observed through the fourth quarter. However, this is misleading for sterling investors as the currency weakened some 18% against the US dollar making the effective gain more significant.

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Manager's Comment: The final quarter of 2008 was a traumatic one for capital markets as the world's banking sector teetered on the edge of failure. A series of globally coordinated measures were introduced by governments and central banks in an attempt to stabilise the position and prevent a complete collapse in the financial system. This tumultuous period has left all investors scarred and delivered the worst returns from equity markets since the Depression of the 1930s. Rising market inefficiencies and abnormal liquidity issues have severely impacted hedge fund managers, and collapsing earnings coupled with worsening credit conditions have maintained the strong headwinds against commercial property. Only cash and government debt provided investors shelter during 2008, as capital migrated to short-dated issues given their safe haven status. Inevitably, the core portfolio has not escaped these unprecedented and challenging conditions although we have sheltered investors from the very worse.

The global economy has entered 2009 in recession with the key questions being how severe will it be and how long will it last. We expect to see further corporate failures and rising unemployment in the months ahead and we also expect further intervention from policymakers as every effort is made to stimulate economic activity. Against this backdrop, we intend to maintain a very cautious approach to asset allocation with overweight positions in cash and exposure to the high quality corporate bond sector building steadily. Heightened volatility will continue to be a theme through the year and we will remain determined to manage this risk on behalf of our investors.

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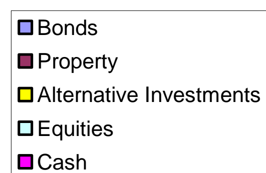
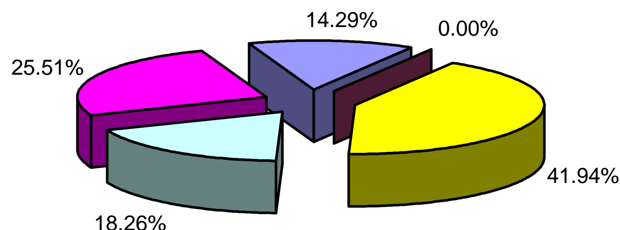
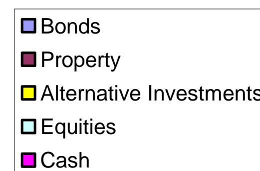
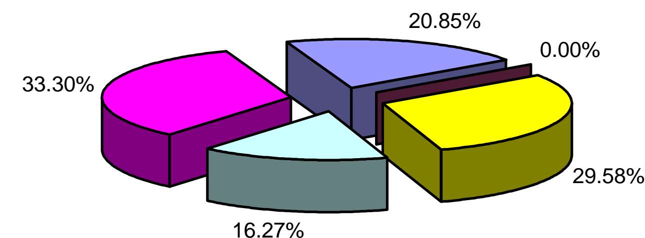
Quarter 3 - Asset Allocation





Quarter 4 - Asset Allocation





Performance Versus Benchmark:

	2005	2006	2007	2008	Rolling 12 Months Return	Since Inception**
Total Model Portfolio Performance	10.21%	8.58%	2.01%	-18.96%	-18.96%	0.74%
Cash Rate* (benchmark)	4.49%	4.48%	5.39%	4.64%	4.64%	20.85%
Standard Deviation^	4.15%	3.56%	5.46%	9.12%	9.12%	6.61%

Performance figures are for the sterling core portfolio model (based on income reinvested and gross of fees).

* Cash rate is based on 3 month LIBID
** Launch Date - 1 December 2004
^ Standard Deviation is a measure of how widely "spread out" the returns of an investment are. The more spread out the returns are, the bigger and more frequent the losses on that investment. An investment's return over a year will be within one standard deviation of its expected return roughly two-thirds of the time, and within two standard deviations roughly 95% of the time. So, for example, if an investment has an expected return of 10%, with a standard deviation of 2%, then its return should be between 8% and 12% two-thirds of the time; and between 6% and 14%, 95% of the time. From November 2006 this is the annualised standard deviation of the returns for the core portfolio model.

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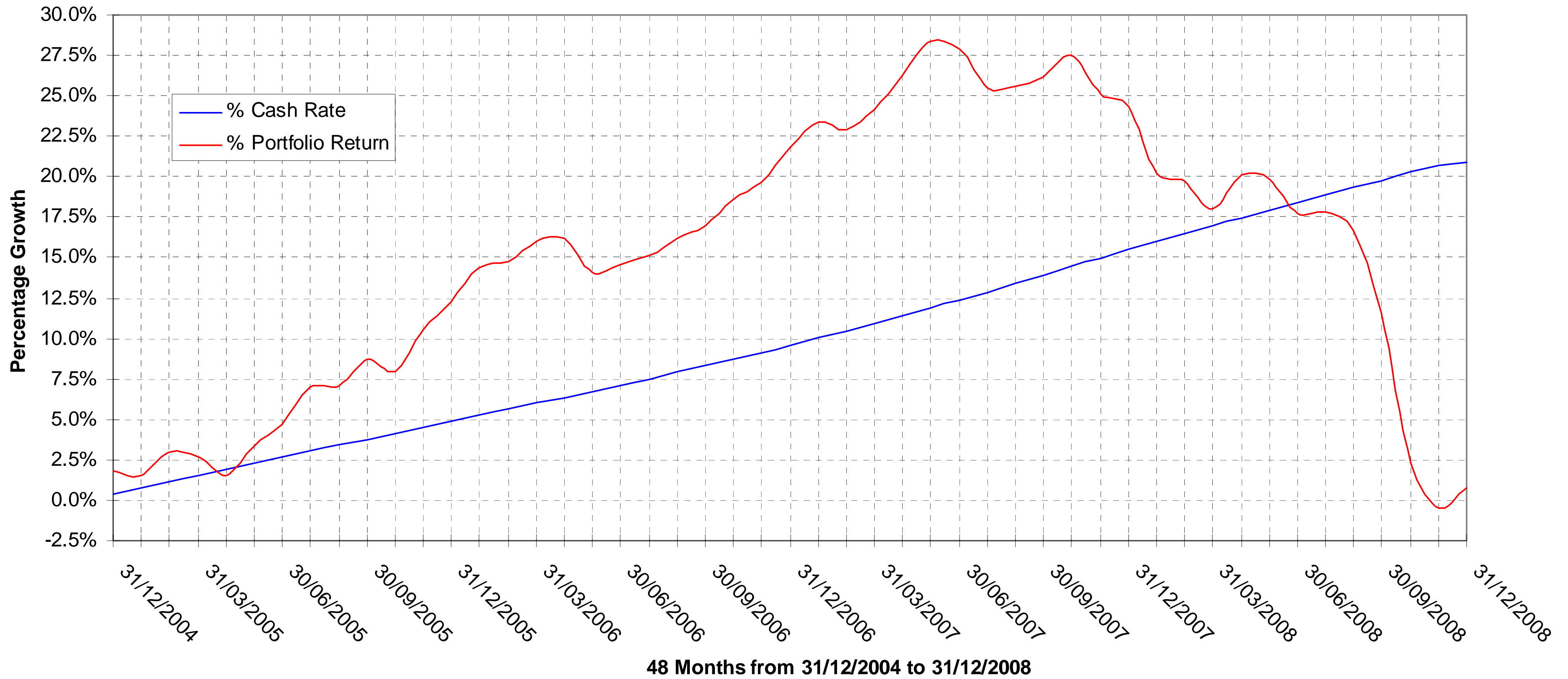

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Source: All data has been provided by Fairbairn Private Bank and Lipper Hindsight.