HALF YEARLY INVESTMENT REPORT

27 June 2007

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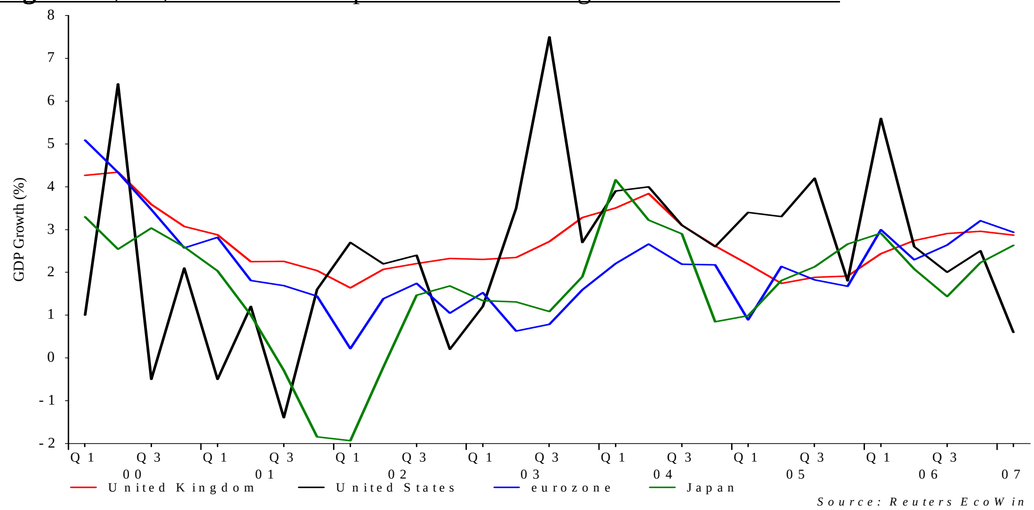
1. Overview

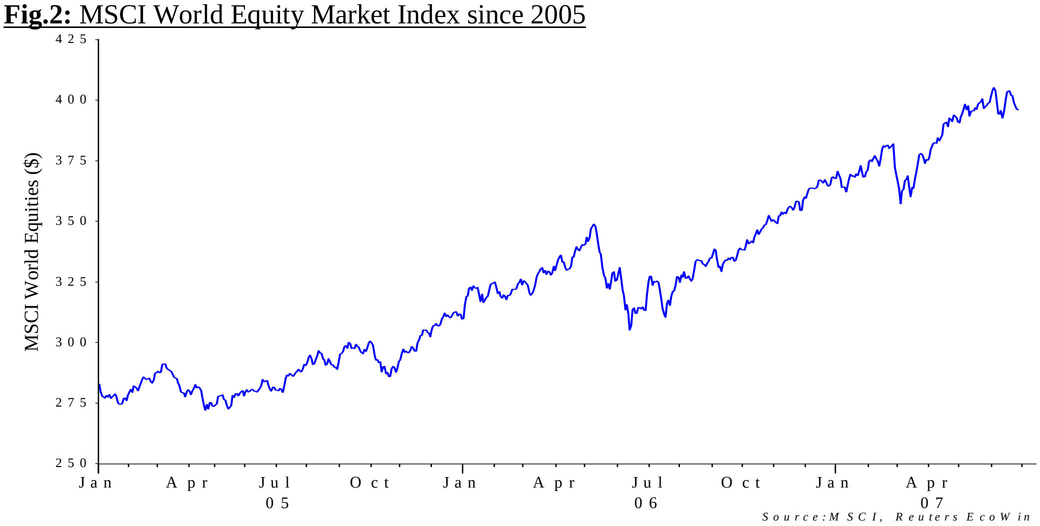
The global economy is proving remarkably robust. In the past year it has weathered a variety of challenges including several to the health of the world's largest single economy, the US. Rising inflation in the US and then fears of recession briefly damaged confidence last year, while earlier this year the US economy withstood a crisis in its sub-prime mortgage sector. The latter threatened to undermine the housing market and with it the US consumer, so long the bulwark of the world economy. Higher US interest rates, which triggered the problems for the sub-prime mortgage market, have succeeded in slowing the rate of growth of the US economy, which was necessary to ease the build up of inflationary pressures (see Fig.1). Slower US growth has been balanced by better than expected growth in both the UK and Continental Europe and sustained, rapid growth in the developing Asian economies.

Fig.1: UK, US, eurozone and Japanese annual GDP growth rates since 2000



Steady economic growth with relatively low inflation is excellent for corporate profits growth and therefore equities. Equity prices have continued on their upward path which began in 2003. However, when concerns have arisen, such as those mentioned above, equity prices have tended to fall back quite abruptly (see Fig.2).

Fig.2: MSCI World Equity Market Index since 2005



2. Summary

The World Economy

- The global economy continues to grow strongly and a US recession now seems highly unlikely.

- Accelerating growth in Europe is compensating for a slower US economy. Growth in other regions, including the Far East, remains very strong.

- Inflation remains the key concern and interest rates have been moving up more rapidly than expected. Central banks are actively raising interest rates in the UK, Continental Europe and the Far East while in Japan and, and quite possibly the US, central banks may need to resume interest rate increases later this year.

- After a weak start to the year, the oil price has moved higher once more. Coupled with continued buoyant economic growth, this has reignited inflation concerns.

Financial Markets

- Among the major currencies, the euro and sterling have strengthened against the dollar and the yen as better economic growth in the UK and Continental Europe has accelerated interest rate rises.

- Government bond yields have risen quite sharply in response to improving economic growth and the threat of inflation.

- Investment and non-investment grade bond yield spreads remain at historically low levels, indicating that risk appetite is still quite high.

- Equities have continued to make gains in most markets, aided both by continued corporate earnings growth and merger and acquisition activity driven by an abundance of cheap debt finance.

Investment Recommendations

- Sterling cash deposits earning approximately 5.5% are attractive.

- Despite rising sharply, government bond yields may not have peaked as stronger growth and inflation concerns are driving interest rates higher. We regard the yield premiums available on corporate and high yield bonds as wholly inadequate.

- UK commercial property continues to look expensive. We recommend reduced allocations to this asset class within portfolios.

- Equity valuations remain reasonable, although we are conscious of the valuation gap that has developed between large and mid/small cap. stocks and also the role that debt-funded private equity deals are playing in driving up equity prices.

3. Economic Review and Outlook

According to figures from the International Monetary Fund ("IMF") the **global economy** grew by 5.4% in 2006. This was the fastest pace recorded this century and crowns a five year period in which economic growth has exceeded 4.0% in each year, a feat unparalleled in modern times. Rising interest rates and supply constraints in commodities have meant that growth has slowed somewhat in 2007 but, as recently as April, the IMF confirmed its forecast for global growth of 4.9% both for this year and next. Better still, growth has rebalanced over the last two years with improved performances from Europe and the Far East compensating for a slower US economy. This reweighting of growth has given investors conviction that the imbalances present in the world economy, specifically the large US trade deficit and the over-reliance of the world economy on the US consumer, can correct without a recession or disruptive realignment of currencies.

In looking for explanations for this unbroken period of strong economic growth, two inter-related factors predominate. Firstly, the now well established credibility of central banks in controlling inflation has allowed interest rates to remain low and relatively stable compared with any period since the 1960s. The second factor has been the expansion of the workforce available to the global economy thanks to the development of previously closed economies such as those of Eastern Europe and China into more open market economies. This has facilitated the expansion of global productive capacity without the accelerating inflation that has typically been the result of previous periods of strong economic growth.

Sustaining rapid, non-inflationary economic expansion has generated various challenges which, on occasions, have looked likely to bring the era of strong growth to an abrupt end. Primary among these challenges has been the large adjustment to commodity prices that has occurred as a result of increased demand from both developed and emerging countries. Oil prices have doubled since the end of 2003 while those of some other key industrial inputs, copper, steel and aluminium, are up by 213%, 82% and 66% respectively. That this has not provoked general inflation is a testament to central banks' anti-inflation credibility and the greater flexibility of the economies themselves in dealing with relative price changes.

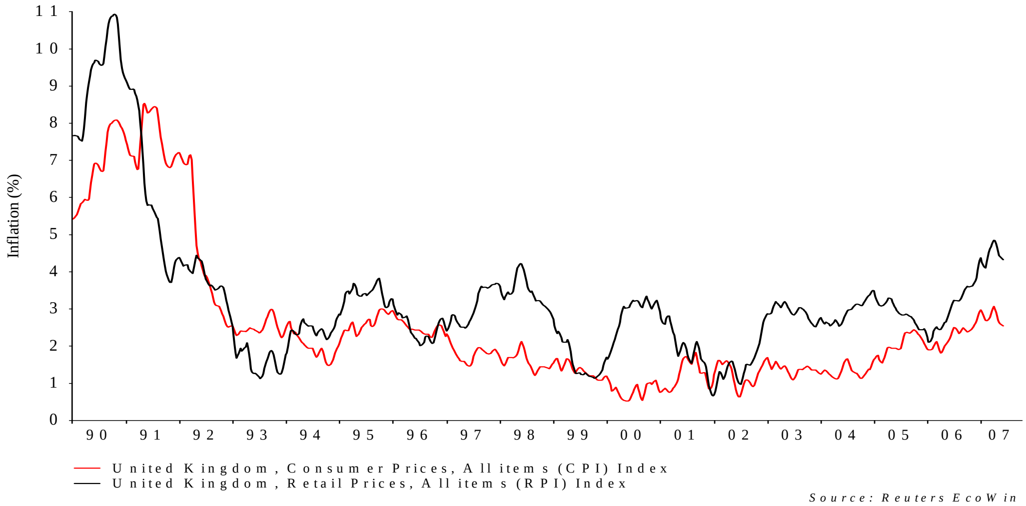
Another challenge, which would appear to have been successfully overcome, has been the slowing of the US economy. This culminated in growth in the first quarter of 2007 of just 0.6%. Concerns about whether the US would suffer a recession, and the extent to which this would impact the rest of the world, were increased by a crisis in the sub-prime mortgage market which exacerbated the problem of an already weakening housing market earlier in the year. However, the impact appears to have been contained and recent economic data is indicating that US economic growth is gathering pace once more.

Turning to the question of whether this era of strong global growth can be extended further, we believe that, with a US recession now appearing unlikely, the prognosis is very good. In our view, the central risk to continued growth is stubborn inflation which could increasingly become an issue and force central banks to raise rates more aggressively in order to regain credibility. This risk requires close monitoring.

More peripheral risks include a slowdown in China, which has been growing very quickly and could stall at some point as the economy begins to hit supply constraints, and the deteriorating political relations between the US and both Russia and some of the Middle Eastern countries. A further deterioration in these relationships, or another major act of terrorism, could result in further increases in oil prices with unhelpful consequences for inflation and growth.

In terms of economic growth, the **UK** is set to outpace its main Continental European rivals in 2007. Having grown by 2.7% in 2006, comfortably ahead of France and Italy and on a par with a recovering Germany, the UK economy looks set for growth of about 2.9% in 2007. In response to this stronger than expected growth, and to head off the related threat to price stability, the Bank of England has increased base rates twice thus far in 2007. The rise in January broke, for the first time since 2004, the Bank's unwritten rule of only raising rates in months in which it produces its quarterly Inflation Report[1]. This gives some insight into the degree of concern among members of the Bank's Monetary Policy Committee ("MPC") about both the current level of inflation and the outlook. Before easing slightly in May, levels of inflation as measured by the Consumer Price Index ("CPI"), the measure targeted by the Bank of England, and the Retail Price Index ("RPI"), the measure to which inflation-linked gilts are indexed, reached their highest levels since 1992 (see Fig.3). In April, the CPI breached the targeted range of 1-3% per annum for the first time since the Bank of England was granted independence in 1997.

Fig.3: UK Inflation since 1990 as measured by CPI and RPI



The UK's recent inflation experience results from a combination of relatively high service sector inflation balanced by price deflation in goods thanks largely to cheap imports from Asia. The steady upward trend in CPI from 2002 onwards corresponds to a gradual ending of this deflationary impact from imported goods. At present, goods price inflation is running at over 2% per annum; a ten year high.

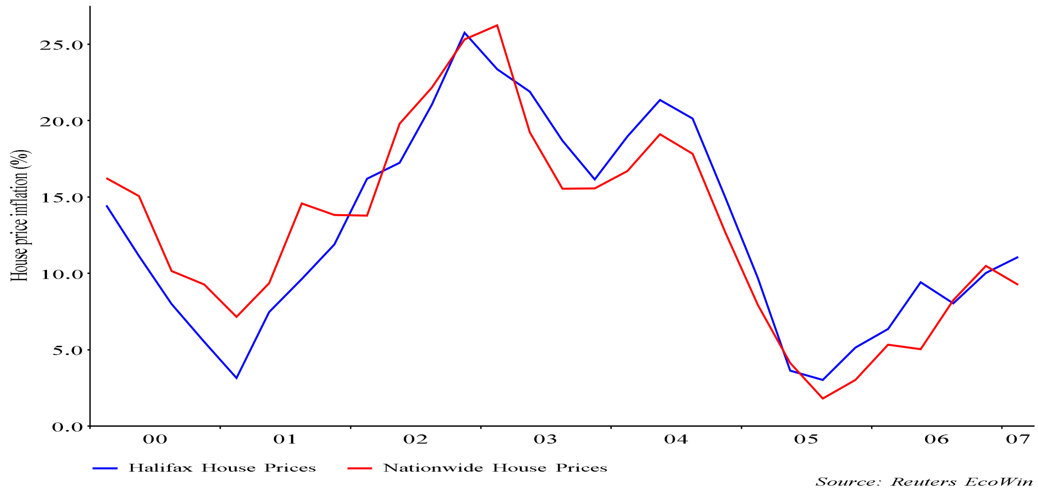
Overlaid on this picture is the impact of higher energy prices. The price of oil, as measured by the Brent Crude benchmark, has doubled over the last three years and tripled over the last five. Pressure from this source was relieved by a $20 fall in prices in late 2006 from a peak of almost $80 per barrel. The relief, however, appears to have been short lived with oil prices having moved up again this year. Brent Crude currently stands at over $70 per barrel.

In its most recent Inflation Report, the Bank of England cited two other causes for concern over inflation. Firstly, businesses appear more confident in increasing prices and secondly, growth in the money supply is now running at close to 14% per annum, a figure which the Bank of England admits is incompatible with price stability in the longer term.

[1] The Bank of England releases quarterly Inflation Reports each year in February, May, August and November.

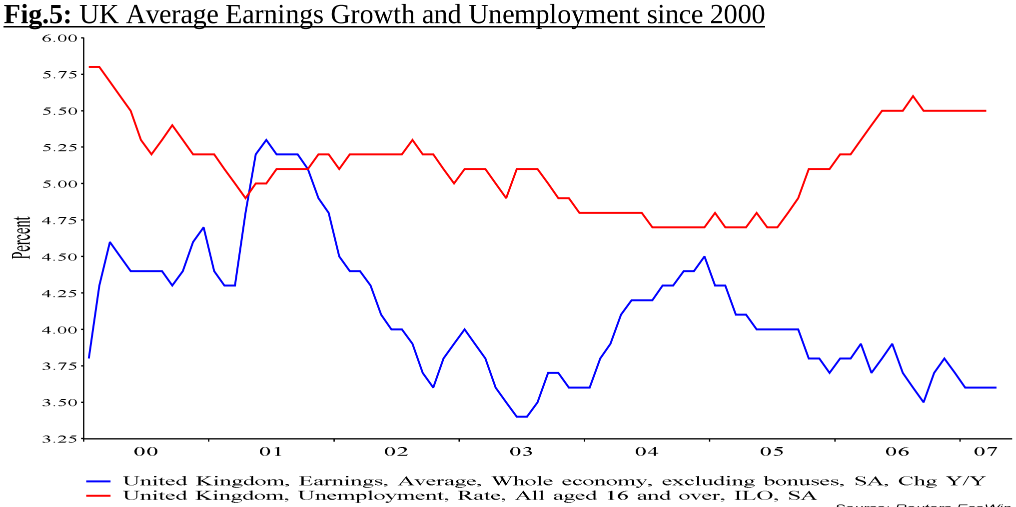
Another development which seems to have surprised the MPC is the resilience of house price inflation (see Fig.4). This appeared to have stalled in 2005, having reached very high levels in 2002 and 2003, but has since risen again. According to Nationwide, house prices rose by 10.3% in year to the end of May 2007.

Fig.4: Average UK House Price Inflation since 2000



Despite other signs of accelerating inflation, employee earnings growth has been remarkably benign. This may be the result of the availability of migrant workers or of unemployment, which has been moving higher over the last two years (see Fig.5).

Fig.5: UK Average Earnings Growth and Unemployment since 2000



In summary, the UK is enjoying a period of strong economic growth helped by the accelerating growth of its Continental European trading partners and continued strong growth in the Far East. With interest rates increasing we would expect growth to begin to moderate over the remainder of the year.

Turning to the risks that might derail this growth story, we believe that inflation poses by far the greatest threat. We expect the Bank of England to take the required action on interest rates to bring inflation back towards the target. If interest rates need to rise further than expected, the result could be a more rapid economic slowdown.

4. Investment Outlook

As outlined above, the outlook for the global economy remains very good. This does not, however, make life for an investor as simple as might be hoped. Asset prices have risen markedly since 2003 and, in assessing the outlook for further gains from these levels, investors need to consider whether the impact of three interrelated factors will remain benign. These three factors are: inflation, globalisation and liquidity.

As discussed in the previous section, central banks' inflation fighting credentials have allowed economies to expand rapidly without endangering price stability. Economists and investors alike may now start to question whether this credibility remains intact or whether, by perhaps being too slow to increase rates during the current expansionary phase and too slow to recognise the impact of innovation in financial markets, central banks have let their anti-inflationary credentials slip. If this were the case, interest rates may have to rise much further with a correspondingly negative impact on the value of non-deposit financial assets.

Globalisation has been a very positive development for the world economy. It has allowed low wage economies, such as India and China, to achieve rapid growth and development by selling goods to western economies. This, in turn, has fostered improving living standards and low inflation in the developed economies by making manufactured goods available at low prices. We may now, however, be witnessing the end of these positive effects of globalisation and seeing some of the negatives, such as the redeployment of developing countries' savings surpluses away from financial assets, with unhelpful consequences for interest rates and inflation.

Liquidity is much discussed but little understood. By liquidity we mean the abundance of low cost financing for consumers, businesses and governments. Explanations for the current high levels of liquidity include financial innovation, increasing appetite for risk and the low interest rate environment. Financial innovation, such as the introduction of new products and instruments, has increased liquidity by allowing market participants to focus their investment capital where they believe they will achieve the greatest returns and hedge out other risks. While these developments should be positive for financial markets, if such innovation encourages greater and greater risk taking in search of greater and greater rewards, or beguiles investors into believing that they are less exposed to risk than is actually the case, then the financial system might be storing up problems for the future.

Turning to asset allocation, the above discussion leads us to a slightly more cautious view without changing our preference for cash and equities over bonds and commercial property. Cash deposits offer security and the flexibility to take advantage of opportunities in other asset classes as and when they arise. With interest rates at current levels they offer investors attractive compensation for patience. Equities, despite being higher risk assets, remain reasonably attractively valued thanks to strong earnings growth and selling from pension schemes, which has provided a ready source of stock for buyers.

Considering our least favoured asset classes, we retain our view that bonds should be held in limited quantities for diversification and risk control purposes and that such allocations should be focused on medium-dated government conventional and index-linked stock. Finally, UK commercial property returns are showing the first signs of weakening after a prolonged period of very strong performance. Having recommended clients take profits from commercial property last year we remain negative on this asset class.

The following section covers our views on asset classes in more detail.

4.1 Cash Deposits

Sterling cash deposits offer a yield of approximately 5.50% per annum. This is similar to the current yield on ten year UK government bonds, and, with the likelihood of at least one further base rate increase in the coming months, we view the flexibility of cash as attractive.

4.2 Fixed Interest

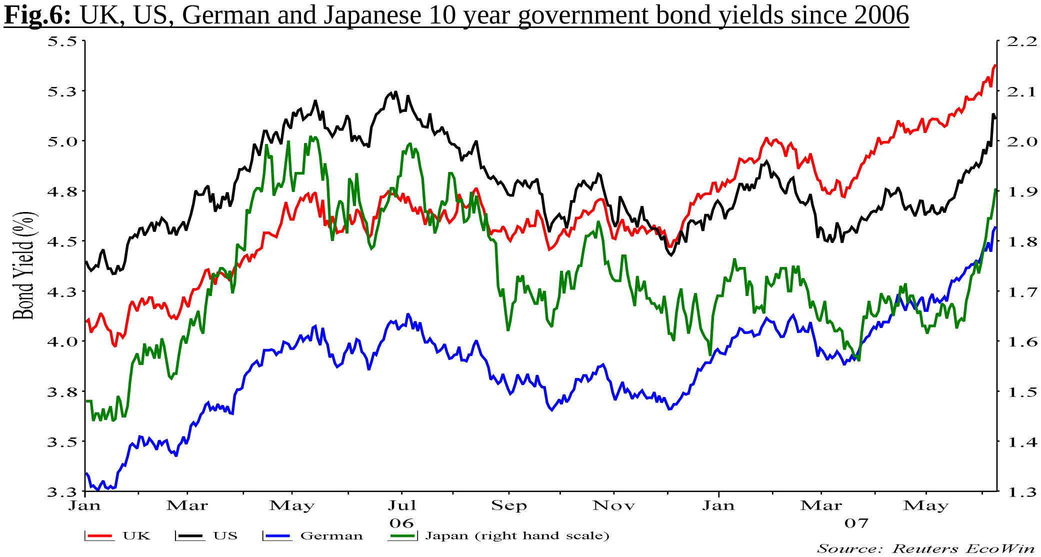
The diversification benefits of holding bonds can be observed clearly from movements in US Treasury bond yields over the last 12 months. When equity markets fell abruptly in May 2006, bond yields dropped (prices rose) as investors moved funds to the relatively safe haven of government bonds (see Fig.6). Also, from mid-2006 onwards, as concern increased that the US economy might suffer a recession, bond prices again increased and yields receded. More recently, during the latest bout of equity market weakness, this time caused by fears for the US sub-prime mortgage sector, government bond yields fell, cushioning to some degree the impact of equity market weakness on portfolios. That bond yields are significantly higher now, despite the frequent dips described above, indicates that the path of economic growth has been relatively benign and that riskier assets have therefore been favoured.

Until recently, government bond yields in the eurozone and in the UK had risen more markedly than those of the US as economic growth surprised on the upside to a greater extent in these two markets. In recent weeks, as it has become clear that interest rate cuts will not be required to rekindle growth, US bond yields have also started rising.

The yield on Japanese government bonds also gives us an insight into the improving health of that economy. Ten year government bond yields have recovered to stand at 1.89%, up from a low of less than 0.50% in 2003. Bond yields at this level indicate that Japanese interest rates are expected to rise from their current level of 0.5%.

Among fixed interest securities we maintain our preference for medium-dated UK sovereign debt. This has the positive characteristics of low volatility, low default risk and low correlation with equities. Government bonds will also provide some protection within portfolios in the event of unexpected negative developments – such as a major act of terrorism.

Fig.6: UK, US, German and Japanese 10 year government bond yields since 2006



- UK Government Bonds

Treasury 8¾% 2017, the ten year benchmark stock, currently yields 5.49% having moved up from 4.75% at the start of the year. Bond yields have been driven higher by strong economic growth which has convinced investors that base rates are likely to continue to rise in response to the threat of higher inflation.

All gilt issues with seven or less years to maturity are currently yielding more than the base rate, highlighting that fixed interest investors believe that the base rate is likely to rise. We are recommending combinations of cash deposits and medium-dated conventional and index-linked gilts in portfolios to utilise the diversifying characteristics of all three.

Prices of conventional UK government bonds tend to rise in response to events such as recessions, natural disasters and terrorist attacks. Such events would be expected to cause falls in the value of other assets. Government bonds are also low risk as capital repayment at par is guaranteed by the government if investments are held to maturity. We generally recommend that clients buy government bonds directly rather than through funds, thereby avoiding ongoing management charges which reduce the yield.

- UK Index-Linked Government Bonds

The yield on 2½% Index-Linked 2016 gilts has increased from 1.73% at the beginning of the year to 2.31% at 31 May. This yield, combined with the value of the inflation proofing element of index-linked stocks, is very valuable in portfolio construction. Our preference for medium-dated index-linked gilt stock is based upon the better yield available in these maturities and the reduced exposure to shifts in real interest rates. We view longer dated index-linked stock as expensive due at least in part to persistent buying by defined benefit pension schemes which has driven down yields at the longer end of the maturity spectrum. For example, a tranche of the 1¼% Index-Linked 2055 was auctioned at the end of January with a yield of just 0.83%.

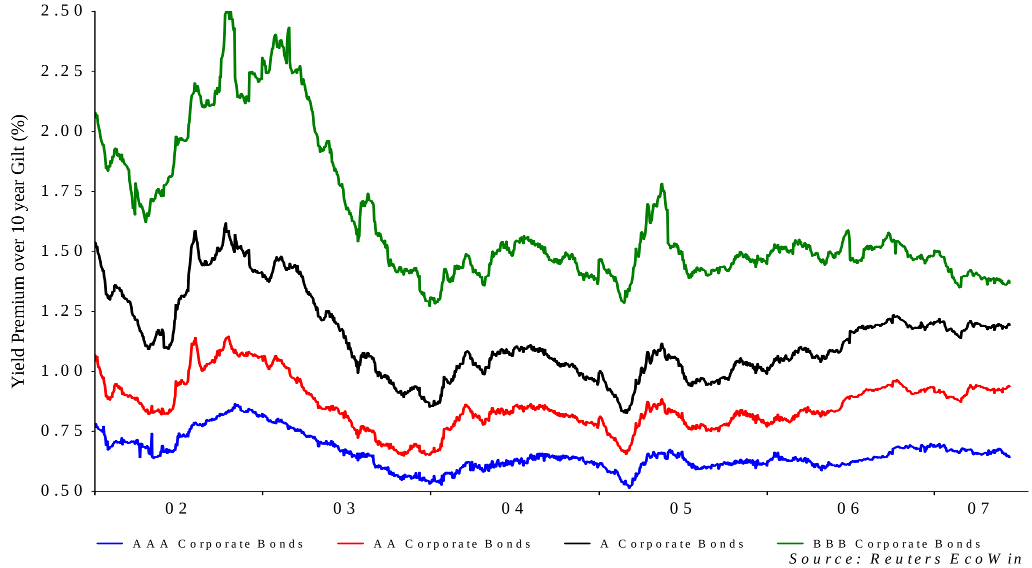
We continue to recommend medium-dated index-linked stocks such as 2½% 2013 and 2½% 2016 to give portfolios an element of inflation protection.

- Investment Grade Corporate Bonds

Corporate issuers of fixed interest securities offer investors a higher yield than government bonds of a similar maturity. This is known as a yield premium and is required by investors in compensation for the higher default risk associated with lending to a company rather than a government. A company with a strong financial position, as measured by rating agencies such as Standard and Poor's ("S&P"), will only have to offer a low risk premium to investors while a more financially stretched borrower will have to offer a larger premium.

Yield premiums tend to vary widely over the business cycle as the perceived risk of default ebbs and flows. The recent period of low interest rates, good economic growth and strong corporate earnings growth has driven yield premiums on corporate debt down to very low levels (see Fig.7). We believe that there is a significant risk that yield premiums on corporate bonds over government bonds will widen from these levels, resulting in weaker capital returns from the asset class. We therefore continue to advise that fixed interest exposure should be gained through government bonds.

Fig.7: Yield premiums on 10 year UK Corporate Bonds over the 10 year UK Gilt since 2002

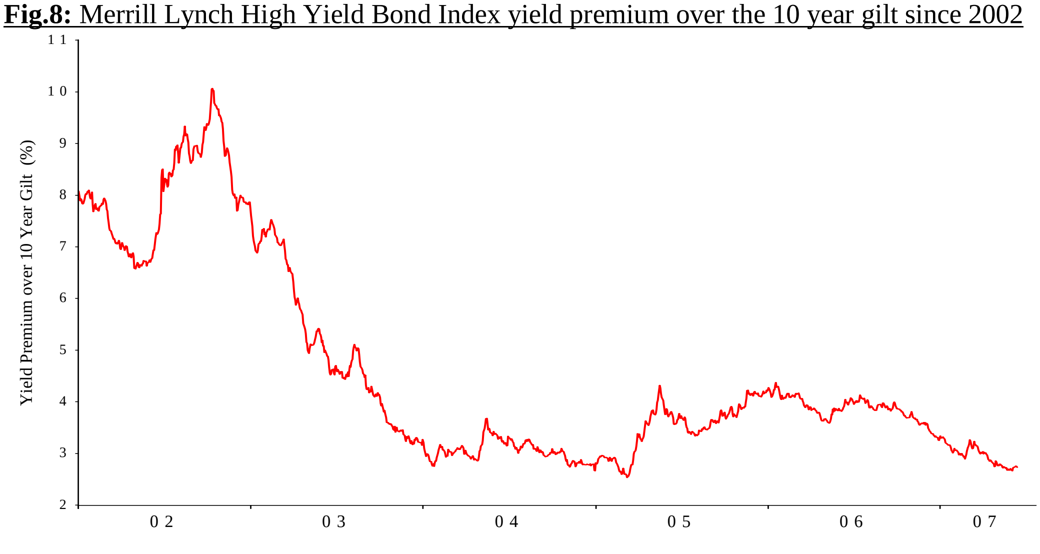


- Non-Investment Grade Corporate Bonds

Non-investment grade corporate bonds are those rated below BBB by S&P. They are also known as ‘high yield’ or ‘junk’ bonds. As the names suggest, these bonds offer a much higher yield than either government or investment grade bonds to compensate for the significantly higher risk of default.

Non-investment grade bonds provided very strong returns in the period 2002 to 2004 as yields fell from double digit levels, driven by the improving economic environment. As the Merrill Lynch High Yield Bond Index shows, yields on non-investment grade bonds have traded in a much tighter range since 2004, and returns have been correspondingly lower (see Fig.8). Yield premiums are now very low, even relative to their recent history, and we continue to believe that investors are not being sufficiently compensated for risk.

Fig.8: Merrill Lynch High Yield Bond Index yield premium over the 10 year gilt since 2002



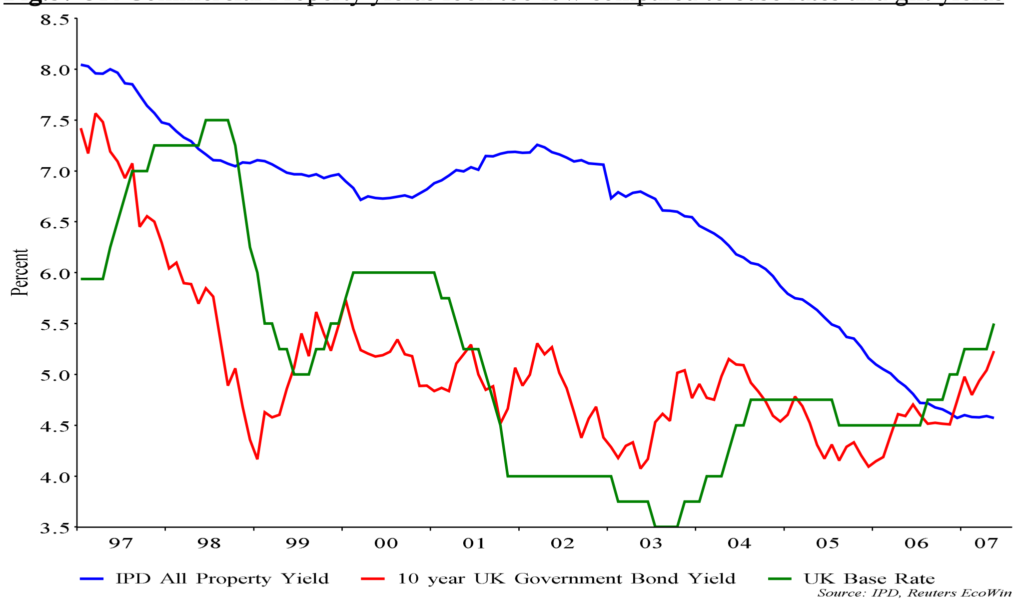
4.3 UK Commercial Property

Investors in UK Commercial property enjoyed another year of strong returns in 2006. As measured by Investment Property Databank ("IPD"), a property performance monitoring service, commercial property returned 18.10% in 2006. However, returns have slowed markedly in 2007 with the same IPD index providing a return of only 3.00% over the first five months of the year.

Looking back, the introduction into the UK of Real Estate Investment Trusts ("REITs") at the beginning of this year may have marked the peak in popularity for commercial property investment. Prior to this, the yield on commercial property had, correctly in our view, been falling for much of the last 10 years as falling interest rates and bond yields made the high yield on commercial property, together with the potential for rental growth, highly attractive (see Fig.9). By 2006, with interest rates and bond yields rising once more, this effect ought to have run its course. The introduction to the UK of REITs may have served to extend the period of strong returns but, with property yields currently below both the ten year gilt yield and the base rate, this now looks unjustified.

We issued a briefing note to clients in October 2006 recommending a reduction in allocations to UK commercial property. With bond yields and interest rates continuing to rise we do not foresee commercial property regaining favour with investors in the near future. We therefore continue to view this asset class with caution.

Fig.9: UK Commercial Property yields look too low compared to base rates and gilt yields

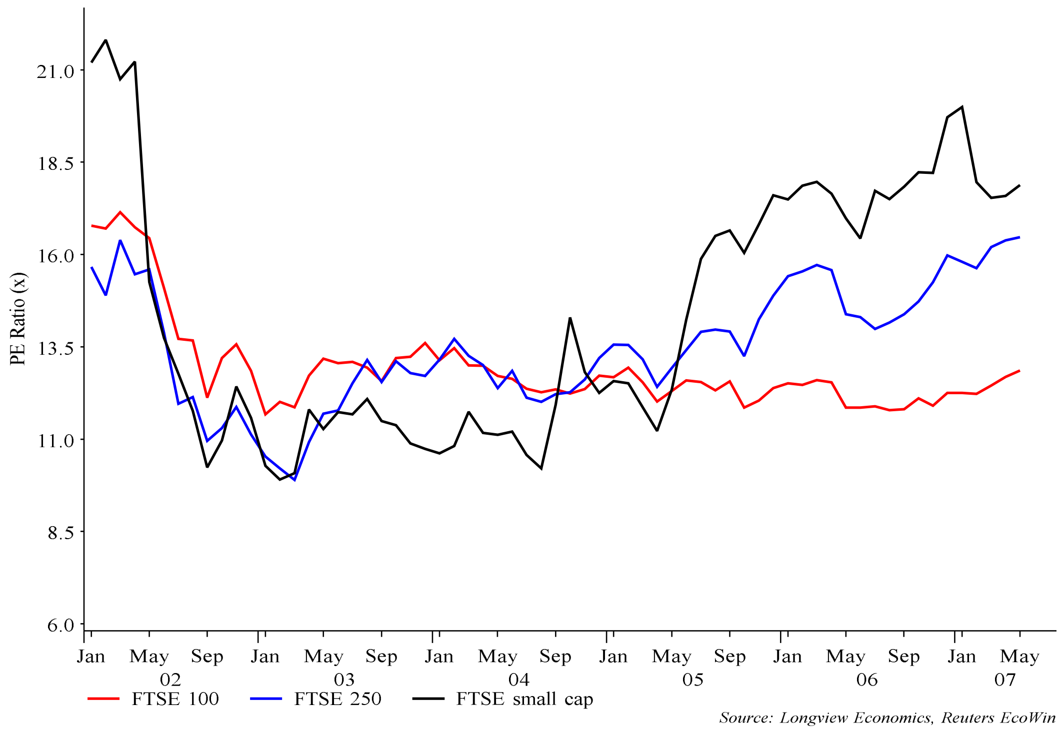


4.4 Equity Markets

- UK Equities

The UK equity market, as measured by the FTSE All-Share Index, is offering a yield of 3.2% and is trading on a price/earnings ("p/e") ratio of 13.2x for 2007[2]. These figures assume aggregate earnings and dividend growth of 4.4% and 5.6% respectively for the current year. This p/e ratio is not high by historical standards but it does conceal sharp differences within the FTSE All-Share's sub-indices (see Fig.10). Small and, most notably, mid cap. stocks are trading on quite high p/e ratios with the average figure, as quoted above, reduced by the low p/e ratios on the largest companies which account for a large proportion of the index by market capitalisation. Small and mid cap. companies have often traded at p/e premiums to large companies in the past in recognition of their ability to grow earnings and dividends faster. However, we believe this premium has now become too stretched. One explanation for this extended p/e differential might be the activity of private equity buy-out funds which have, so far, concentrated their interest on these areas of the market.

Fig.10: Small and mid cap. equities look expensive relative to large-cap. stocks



Our recognition of the better value offered by the large cap. area of the market has led us to recommend clients reweight the UK equity portion of their portfolios towards large cap. stocks. Aside from their more attractive valuations, large caps. should benefit from their more international business mix which will prove more resilient if UK interest rates continue to rise and act to slow the growth of the domestic economy.

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[2] Source: UBS.

- European Equities

Despite excellent returns over the past year, we continue to favour European equities for both macro and microeconomic reasons. The Continental European economy is enjoying accelerating growth thanks to the stimulus of strong export demand, particularly from the Far East, but also from gradually improving domestic demand. In addition to these factors are developments specific to Europe. The expansion eastward of the European Union, the trend among governments to more business friendly policies and the ongoing restructuring at the corporate level are all long term drivers which, in our view, have further to run.

Set against the positive factors mentioned above is the rising interest rate environment in Europe. The European Central Bank has taken on the mantle of its predecessor, the Bundesbank, in exhibiting extreme caution in relation to controlling inflation. Interest rates have now doubled to 4% in a little over 18 months. We believe, however, that in the current climate of strong global growth and rising commodity prices this may well prove to be the correct approach for the longer term health of the eurozone economy.

On balance, we remain of the view that European equities are attractive.

- North American Equities

Having taken a negative stance on US equities for the past two years we revised our view at the end of 2006 and recommended that clients make a small allocation to this market. This change of heart was based on the prolonged underperformance of US equities relative to other major equity markets, which left them looking more attractively valued. Moreover, after a year of acute weakness in 2006 the US dollar appeared to us to be oversold.

Since the beginning of the year, returns from US equities have improved, though they are still lagging those from the emerging markets and Continental Europe. We recommend small allocations to US equities are maintained.

- Japanese Equities

That the Japanese economy grew at a faster pace than either the US or the eurozone economies in the first quarter of this year has provided little consolation to investors in Japan's equity market. Returns from Japanese equities have lagged behind those from other major markets this year and returns to foreign investors are worse still due to the persistent weakness of the yen.

The poor performances of both the Japanese equity market and currency are related via the so-called yen 'carry trade', where investors borrow yen at low interest rates and switch into higher yielding assets overseas. The effects of the carry trade have been exacerbated by Japanese savers who, in search of higher yields, have sold yen to invest overseas. These transactions have generated excellent returns thanks to both the large spread between Japanese interest rates and those of destination countries (such as New Zealand where interest rates are now 8%) and because the yen has continued to depreciate.

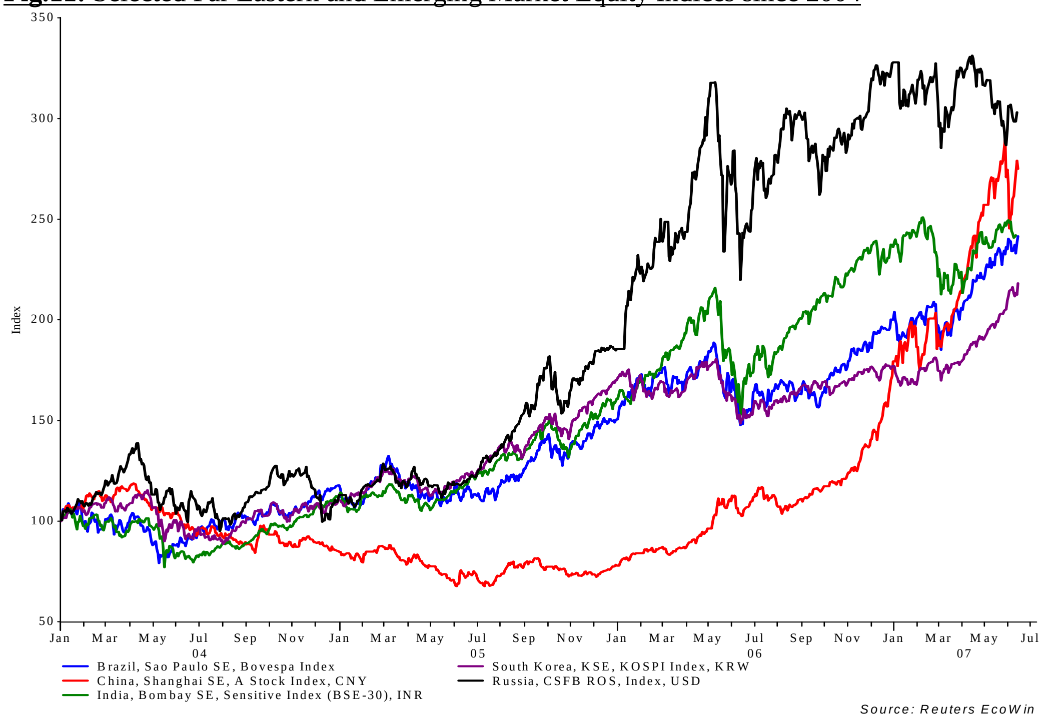
Our view remains that the Japanese economic recovery remains intact and that the yen will recover along with returns from Japanese equities. We therefore believe that allocations to Japanese equities should be maintained.

- Far East and Emerging Markets

Far East and emerging markets equities have continued to provide strong returns for investors (see Fig.11). Economic growth in the most populous developing nations, China and India, is continuing at rates at or close to 10% per annum while even relative laggards such as Russia and Brazil are growing at rates comfortably in excess of the developed economies. Moreover, the financial positions of many emerging economies are far more stable than in the past due to their strong foreign currency reserves and healthy current account surpluses. These factors, together with growing domestic consumption and developing regional trade, make the periodic crises that have halted emerging markets' economic development in the past less likely to be repeated.

Appetite for Far East and emerging markets equities from investors remains very strong and we continue to recommend that allocations to the region are maintained. However, we are monitoring market levels carefully and are aware that equities in many of these markets are, once again, starting to look fully valued.

Fig.11: Selected Far Eastern and Emerging Market Equity Indices since 2004



5. Fund Performance Commentary

Table 1 below contains performance figures for the major fund sectors. On pages 22 and 23 there are tables with performance figures for some of our selected funds and indices.

Table 1: Average Fund Performance

UK Sectors	**6 Months %**	**1 Year %**	**3 Years %**	**5 Years %**
Money	2.13	4.12	12.60	19.91
Fixed Interest Sterling	-1.59	1.40	17.02	30.45
Index-Linked	-3.84	0.80	51.05	29.54
Property	3.94	13.81	56.40	86.46
UK Equities – All Companies	11.75	22.18	70.96	64.22
UK Equities – Smaller Companies	18.80	27.62	94.85	113.70
International Sectors				
Global Fixed Interest	-0.84	0.21	9.15	15.28
Balanced Managed	8.41	15.89	54.17	48.36
Stockmarket Managed	11.03	18.90	62.73	43.26
Global Equities	11.07	18.91	62.80	48.17
Europe (excl UK)	15.86	26.37	93.36	80.81
North America	8.89	14.09	31.32	8.81
Japan	-0.03	-9.24	23.90	14.38
Far East (excl Japan)	17.28	30.48	103.61	95.12
Emerging Markets	17.09	30.66	146.73	157.00

(Source: Reuters Hindsight ABI UK Pension Fund Series on a bid to bid pricing basis in sterling terms to 31 May 2007).

The performance figures quoted below are in sterling terms and cover the six months to 31 May 2007. Performance figures for individual funds show total return on a bid to bid basis. Sector performance figures are shown mid to mid.

We favour the Morley Deposit and Merrill Lynch Institutional Sterling funds for **Cash** held in SIPPs. These funds carry low charges and have consistently outperformed their peers. For cash not held in pension funds, investors can achieve attractive returns from structured 'cash-plus' products such as those offered by AIG.

Investment grade sterling **Fixed Interest** securities returned an average of -2.77% over the period under review as falling capital values outweighed the income generated. Our recommended funds were among the stronger performers within the sector. Morley Corporate Bond returned -2.34%, Legal & General Fixed Interest -1.95% and Invesco Perpetual Corporate Bond -1.16%. Turning to non-investment grade securities, the average high yield bond fund returned 1.32% over the period. Our recommended funds in this sector performed well; the F&C Strategic Bond fund returned 2.17% while the Legal and General High Income Trust generated a return of 4.73%. We continue to believe that the additional yield available on corporate and high yield bonds is inadequate at present and that fixed interest allocations should be achieved through holdings in lower risk medium-dated gilts.

After several strong years, **Property** returns have slowed markedly since the end of 2006. Rising commercial property prices, without commensurate increases in rent, have left property yields looking too low compared to other asset classes. Recognition that commercial property is looking fully valued has also served to widen the discounts at which property investment trusts trade relative to Net Asset Value ("NAV"). The discount at which TR Property Investment Trust shares trade widened from c6% at its narrowest in December to c12% at the end of May, reducing share price returns to 2.14% over the period under review. The discount on Isis Property Trust 2 Ltd widened even more, from c2% at its narrowest in January to c12% at the end of May, reducing share price performance to just 1.06%. The Morley Pooled Pension Property fund meanwhile generated returns of 4.32%.

Of our recommended property funds, those investing indirectly through shares in global property companies and REITs performed the best. These funds have the advantages over UK "bricks and mortar" funds of broader diversification and lower costs. The Fidelity Global Property fund returned 7.20% in the period under review while the Schroder Global Property Securities fund returned 12.72%.

Despite short, sharp setbacks in late February and early March, **UK equities** continued to advance over the period as a whole due to the robust economic background, strong corporate earnings growth and the continuation of merger and acquisition activity. The FTSE All-Share Index, including income, returned 12.01% over the six month period to 31 May.

Over the past six months, the IMA UK All Companies sector provided an average return of 11.89%. Within this sector, the Standard Life UK Opportunities fund marginally underperformed, returning 10.52%. Mark Niznik, the fund's manager since its launch in 2002, left in April and was replaced by Harry Nimmo, the manager of the successful Standard Life UK Smaller Companies fund. The UK Opportunities fund has since suffered significant outflows of capital, causing Standard Life to switch from quoting NAV on a mid-price basis to quoting it on a bid-price basis. This offered some protection to remaining unit holders against the dilution of assets, but reduced returns in the short run. On a more fundamental level, the fund struggled in April and May as large cap. stocks outpaced the smaller cap. stocks to which the portfolio is heavily weighted.

The Rathbone Special Situations and GAM UK Diversified funds both performed exceptionally well, returning 15.10% and 15.02% respectively. GAM closed their fund to new money on 29 December in order to prevent its size becoming a hindrance to performance (though we are still able to access the fund by matching new inflows to redemptions). We applaud their decision as it signals that the fund manager is focusing on performance, not assets under management. Elsewhere AXA Framlington UK Select Opportunities returned 12.73% and Schroder Recovery 10.45%.

The IMA UK Equity Income sector produced an average return of 10.39% in the six months to 31 May. Of our recommended funds in this sector, Invesco Perpetual's Income and High Income funds, both managed by Neil Woodford, once again performed excellently, providing returns of 13.31% and 13.62% respectively. The funds benefited from increased exposure to oil and gas producers prior to the oil price rally in the latter part of the period under review, and to large caps. which outperformed small and medium caps. in April and May. Elsewhere, the Jupiter Income Trust lagged slightly, returning 9.41% as the manager, Tony Nutt, maintained a high weighting towards financials throughout the period despite concerns regarding the US sub-prime mortgage market early in 2007.

During the last six months, small cap. stocks once again outperformed the IMA All Companies sector with the IMA Smaller Companies sector generating an average return of 18.36%. The small and mid cap. indices were the primary beneficiaries of merger and acquisition activity as several companies were bought out at significant premiums to their market prices. Despite the continuation of this activity, the outperformance of small cap. stocks was reversed in the final two months of our review period as investors increasingly focused on the value to be found in the large cap. area of the index, particularly the largest, or 'mega cap.' stocks. We believe that, after a four year period of exceptional performance, small cap. stocks are now looking fully valued both in terms of absolute p/e ratios and relative to large cap. stocks. We have therefore been recommending that clients rebalance their portfolios away from small cap. equities.

The impressive performance of the Artemis UK Smaller Companies fund over the six months under review was largely driven by a factor unrelated to buy-out activity. The manager, John Dodd, has held a large weighting to oil and mining stocks for several years as he believes that increasing demand from the emerging economies provides a solid support for these sectors. While this hurt performance in the second half of 2006, it was beneficial in the period under review as the oil price rose strongly. The fund returned an impressive 21.93%.

Elsewhere, the Old Mutual Select Smaller Companies fund produced returns of 20.51%, the Merrill Lynch UK Smaller Companies fund 18.02% and the Aberforth Small Companies fund 16.43%.

Funds in the **Balanced Managed** sector generally performed in line with expectations, given the performance of the underlying markets in which they invest. The IMA Balanced Managed sector returned 8.67% while the Schroder Managed Balanced and AXA Framlington Managed Balanced funds performed well, producing returns of 10.95% and 9.37% respectively.

With an average of c60% invested in equities, funds in the IMA **Cautious Managed** sector understandably generated lower returns. The Morley Sentinel Managed fund returned 6.36%, outperforming the average return in the sector of 4.51%, while the Investec Cautious Managed fund underperformed, returning just 2.83% over the period under review. The Investec fund's underperformance can largely be attributed to the its overweight position in financials at the time of the late February, early March market weakness. Financial stocks suffered amid concerns over the US sub-prime mortgage market.

Whereas in our last review period **Stockmarket Managed** and **Managed Equity** funds performed well as a result of a narrowing of their share prices' discounts to NAV, this period has seen slight premiums revert to small but significant discounts. While in share price terms RIT Capital Partners returned 8.06%, British Empire Securities and General Trust 10.05% and Caledonia Investments 3.58%, each was impacted by 6-7% over the period as a result of the widening discounts. This may be explained by investors reacting to disappointing returns from these funds in the calendar year 2006. Caledonia was further hampered by the performance of its largest holding, Close Brothers. Shares in the merchant bank, which accounted for almost 15% of the Caledonia portfolio in December, fell by over 12% from their peak in February to the end of May, having performed strongly in the previous six month period. Close Brothers has been undergoing significant restructuring, and the management of Caledonia believe that the potential operational and cost benefits of this are yet to be fully reflected in the market value.

Returns from **North American equities** were again affected by changes in the sterling-dollar exchange rate, but not nearly to the same degree as in our last reporting period. In dollar terms, the S&P 500 rose by 10.29% in the period under review which translates into a healthy return of 9.67% for sterling based investors. The IMA North American sector average return over this period was 9.31% against which the Martin Currie North American and Old Mutual North American Equity funds significantly outperformed, generating 14.20% and 14.28% respectively. Elsewhere, the UBS US Equity and GAM North American Growth funds performed less well, returning of 9.01% and 6.36% respectively.

Continental European equities performed exceptionally strongly, with the average fund in the IMA Europe excluding UK sector returning 16.62%. Of our recommended funds, Odey Continental European and Artemis European Growth performed best, producing returns of 17.64% and 17.61% respectively. The Old Mutual European Equity and Jupiter European Special Situations funds also performed well, generating returns of 17.23% and 16.81% over the period respectively. The best performing of our funds from the calendar year 2006, the Schroder European Alpha Plus fund, struggled to maintain its impressive momentum, but nonetheless performed broadly in line with the sector average, returning 16.43%. The European Assets Trust, which invests in smaller European companies, returned 22.46%.

The lacklustre performance of **Japanese equity** markets in 2006 has been carried into the first half of 2007 and, though returns have improved somewhat, Japan has continued to lag the other major world equity markets. The Nikkei 225 Index returned 9.84% in yen terms which, due to yen weakness over the period, translates to just 3.70% for sterling based investors. Though we believe that the economic recovery is continuing, recent data releases have been weaker than anticipated and have undermined investor confidence. Equity markets have been weakened further by Japanese investors' reluctance to invest domestically, preferring instead to hold higher yielding overseas deposit accounts. Moreover, active fund managers finding value among medium-sized companies have underperformed as interest in Japanese equities has been concentrated in the large, international companies. The average fund in the IMA Japan sector has therefore lagged the index, returning 0.63% over the six months.

The JP Morgan Japan and Fidelity Japan Special Situations funds both continued to underperform, producing returns of -3.25% and -6.87% respectively. Both are biased towards smaller companies which have been hard hit by the withdrawal of capital by Japanese investors. In addition, small companies tend to operate in the domestic market and consequently have not benefited from the weakness of the yen as the larger, export-orientated companies have. The Schroder Tokyo fund, with a more cautious approach than the JP Morgan and Fidelity funds, returned a creditable 3.40% over the period under review.

The **Asia Pacific excluding Japan** sector has produced impressive returns. Strong economic performance continues to attract investors with high risk appetites. Our recommended funds underperformed. First State Asia Pacific Leaders returned 17.21% while Aberdeen Asia Pacific returned 13.47% against the IMA sector average of 18.51%. The Aberdeen fund's weak performance was due to its high allocation to Hong Kong, which performed less well than other markets in the region.

Returns from the **Asia Pacific including Japan** sector were dragged lower by the weak performance of Japan. The average fund in the IMA sector returned 10.55%. The Martin Currie Pacific Trust significantly outperformed, returning 16.64% as the manager, John Millar, employed gearing effectively and invested in China which is not a constituent of the benchmark index and which, despite two not insignificant corrections, returned over 30% as measured by the FTSE China Index during the six months under review. Large holdings in South Korea and Australia were also beneficial to the fund's performance.

Emerging Markets equities continued to thrive in the first half of 2007 as it has become increasingly clear that the world's developing economies are more resilient to a slowdown in the US economy than many economists and analysts had previously believed. As with the Far East excluding Japan region, emerging markets have been favoured by risk seeking investors. The IMA Global Emerging Markets sector returned 15.84% over the six month period under review. The Templeton Emerging Markets Investment Trust performed very well, returning 23.42% over the same period.

Private Equity funds have been receiving plenty of headlines as the frequency and magnitude of their activities have increased. Electra Private Equity generated returns of 24.06% in the period under review while Candover returned 24.02%, Graphite Enterprise Trust 20.93% and HG Capital Trust a very respectable 27.83%. Pantheon International Participations has been less successful, but still generated a respectable 14.14% in the six month period. The management of Pantheon believes that the economic backdrop remains supportive for private equity and is consequently giving shareholders the opportunity to purchase new shares in the company. However, in our opinion, this is the wrong time for private equity to be raising new money. Deals are taking place at increasingly high multiples of potentially peak earnings and private equity firms are assuming more and more debt at higher rates of interest in order to finance them.

The advantages of investing in **Venture Capital Trusts** ("VCTs") were again reduced by the chancellor in April this year. In particular, the size of companies in which VCTs may invest was significantly decreased. Most companies listed on the Alternative Investment Market ("AIM") now fall outside the scope of VCTs. We expect that VCTs launched this year will be few in number and focused on capital preservation rather than high returns. Nonetheless, we maintain that, given the tax incentives, appropriate VCTs still represent a good opportunity for some investors. We regard selecting the right VCT as key and will continue to focus our research efforts on trusts with generalist mandates and strong management track records.

Hedge Funds continue to generate a great deal of investor interest and press comment on their diverse investment styles, their performance records and their charging structures. Recent performance has been disappointing with the CSFB/Tremont Blue Chip Investable Index returning 5.20% over the twelve months to the end of May when measured in euros. We remain concerned that hedge funds have generated unimpressive total returns despite making increasingly risky investments. If hedge funds are resorting to equity-like investments to generate higher returns they may offer little protection in the event of a market downturn, which would undermine the rationale for allocating a portion of portfolios to them.

We acknowledge that funds demonstrating consistent absolute returns are attractive but remain sceptical about how many hedge funds can deliver this. We are also very concerned that the high charges made by hedge funds (typically an annual charge of 2% with a performance fee of 20%) create asymmetrical pay-offs for hedge fund managers. Funds of hedge funds offer some advantages over individual hedge funds, such as diversifying away specific risks but they carry the disadvantage of levying fees at several levels, obscuring exactly how much the investor is paying. Our research is targeted towards identifying hedge funds which have transparency of process, a demonstrable track record over at least ten years and low correlation with other asset classes.

Christopher Sexton
Investment Director
June 2007

Main Client Funds Performance Summary to 31 May 2007

Table 2: Cash and Fixed Interest

	Performance Over Six Months (%)	Gross Redemption Yield (%)	Average Duration (Years)
Cash			
Merrill Lynch Institutional £	2.59	5.37	0.11
Investment Grade			
Morley Gilt	-2.97	4.98	8.58
Legal & General Fixed Interest	-1.95	5.01	N/A
Morley Corporate Bond	-2.34	5.72	7.82
Non-Investment Grade			
Legal & General High Income	4.73	5.98	N/A
F&C Strategic Bond	2.17	5.73	3.96

Table 3: Property

	Six Months %	One Year %	Five Years %
Pension Funds			
Morley	4.32	14.00	104.71
Norwich Union (4)	5.64	12.16	82.98
Scottish Widows	4.23	11.70	92.55
Standard Life	5.09	14.75	89.41
Other Property Funds			
Isis Property Trust 2	1.06	2.24	N/A
TR Property Investment Trust	2.14	30.37	281.75

Table 4: UK Equities

	Six Months %	One Year %	Five Years %
UK All Companies			
GAM UK Diversified	15.02	25.59	97.62
Invesco Perpetual Income	13.31	31.33	103.80
Jupiter Income Trust	9.41	22.41	90.76
Liontrust First Income	10.49	21.79	76.62
Merrill Lynch UK Special Situations	15.44	25.48	92.50
Schroder Recovery	10.45	24.00	100.71
Standard Life UK Opportunities	10.52	31.13	N/A
UK Smaller Companies			
Aberforth Smaller Companies	16.43	32.47	148.30

(Sources: Individual companies' actual portfolio yields and duration, Reuters Hindsight ABI UK Pension Fund, IMA, AITC Investment Trust Series on a bid to bid pricing basis to 31 May 2007).

Table 5: International Equities

	Six Months %	One Year %	Five Years %
Managed Equity			
British Empire Securities & General	10.05	7.97	157.65
RIT Capital Partners	8.06	7.84	145.64
European Equity			
European Assets	22.46	44.22	245.55
Fidelity European	17.29	25.76	123.01
Schroder European Alpha Plus	16.43	29.99	N/A
North American Equity			
Martin Currie North America	14.20	22.03	30.46
UBS US Equity	9.01	16.99	N/A
Japanese Equity			
Schroder Tokyo	3.40	-2.34	21.26
Far Eastern Equity			
Martin Currie Pacific	16.40	23.20	107.85
Emerging Markets Equity			
Templeton Emerging Markets	23.42	39.05	204.92

(Source: Reuters Hindsight ABI UK Pension Fund, IMA, AITC Investment Trust Series on a bid to bid pricing basis to 31 May 2007).

Table 6: Selected Market Indices

	Six Months %	One Year %	Five Years %
FTSE British Govt All Stocks TR (Total Return)	-3.06	-0.02	26.19
FTSE Index-Linked British Govt All TR	-3.63	1.92	33.67
IPD All Property	4.51	13.12	103.61
FTSE 100 TR	11.37	19.60	54.46
FTSE 250 TR	14.80	33.39	130.26
FTSE Small Cap. TR	15.63	24.67	81.72
FTSE All-Share TR	12.01	21.67	63.77
S&P 500 TR	9.67	16.16	16.19
FTSE Eurofirst 300 ex UK TR	15.89	26.11	70.07
Nikkei 225 (Japan) CR (Capital Return)	3.70	0.62	14.51
FTSE Asia Pacific ex Japan TR	16.46	28.16	96.45
FTSE All World Emerging TR	18.81	33.24	150.48
Brent Crude Oil	8.78	-10.19	105.45
Gold Troy Ounce	1.35	-4.52	49.12

(Source: Reuters Hindsight on a mid pricing basis, in sterling terms, to 31 May 2007).