

Dealing with the impact of the credit crisis on financial markets and how GVI is positioned

In light of the current liquidity crisis and further write-downs announced by global investment banks, we thought it appropriate to share our thoughts and to provide an update as to the portfolio positioning of the GVI Global Industrial Share Fund.

The impact of the credit crisis continues to be felt world-wide. In Australia, we have seen liquidity conditions worsen as the 90-day bank bill rate increased by 25bps to 7.51% last week in extremely tight liquidity conditions. In addition, Centro Properties Group's share price has collapsed by 90% from its highs, after the group disclosed that it was having problems rolling over its short-term debt.

Globally, loose lending standards are the primary reason for the current crisis in global credit markets. The area with the weakest lending standards has been in US mortgages - lending to people with limited credit worthiness at deceptively low interest rates (the so-called 'sub-prime' mortgage market). This has been the chief reason for large global banks such as UBS and Citigroup writing off tens of billions of dollars.

The collapse in the sub-prime mortgage market has also acted as a catalyst for serious questions being raised about existing lending standards across all industries but particularly for those businesses that have relied on having ready access to wholesale funding markets.

Portfolio Positioning

While there are many banks globally that at first glance look inexpensive on both a price-to-earnings and price-to-book ratio basis, in our view many of these banks are not attractive once their weak capital positions are taken into consideration. Our strong preference therefore has been to owning banks and financial stocks that look attractive on a capital-adjusted basis – banking stocks that have strong balance sheets, capital strength and little need to re-finance substantial amounts of debt. Our stringent investment criteria have resulted in us holding only banking and financial stocks that are well-positioned in the current market, where wholesale funding is difficult to obtain.

Currently, the Fund's total exposure to financials is less than 10% and this is spread amongst six banks and one diversified financial, the ING group. As the Fund has been designed to be a bottom-up (non-index) driven portfolio, our financials exposure is in mainly European "retail" type banks. We do not hold any US banks in our Fund because of the view that we have held for some time that lending practices in the US have been poor and would ultimately lead to large bad debt write offs, which is what is happening now.

We remain comfortable with our portfolio holdings in the financial sector as none of the companies held are overly reliant on wholesale funding to carry on their businesses. The stocks we hold in this sector are all well-capitalised and have strong retail/deposit franchises, thereby predominantly supporting their own liquidity and funding costs. In

addition, the companies we hold also have a presence in attractive growth markets that have favourable structural growth characteristics.

While every financial institution globally is exposed to some degree to the sub-prime market, the extent varies greatly from case to case. The financial stocks we hold in our Fund have no direct sub-prime exposure. Our research has also sought to identify any indirect exposure through the financials held and reveals that, at worst, our exposure is minimal. For example, we have a holding in Deutsche Postbank in Germany. This particular bank, like other postal banks in most countries, has a large customer deposit base. Deutsche Postbank has invested a small proportion of these deposits in bonds that have some sub-prime exposure. The losses related to this exposure have been disclosed and they are minimal with respect to the total size of the bank.

Conclusion

We continue to monitor the portfolio diligently, particularly under these conditions of heightened volatility and we remain comfortable with the capital structure of all our holdings in terms of balance sheet strength and their ability to generate strong earnings which should, over time, assist in riding out these turbulent times.

We continue to adopt a cautious view and look for opportunities where good quality financial stocks are sold down indiscriminately, thereby creating a good opportunity for us to buy in. This was the case recently with our two Scandinavian retail banks, Danske Bank and DnB Nor that were both sold down quite heavily, despite no exposure to the sub prime market and which gave us the opportunity to purchase for the Fund in recent weeks.

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