Overseas Asset Management

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OAM European Value Fund

29th January, 2016

Dear Fellow Shareholder,

Last year was another tough year for European equities. The MSCI Europe (US$) index fell 5.7% last year while the Fund's NAV per share declined 2.4% to end the year at $36.09. The euro fell by 10% against the US Dollar last year so the decline in the Fund's NAV and in European equities was entirely due to currency losses. During the 13 years since inception, the Fund's NAV compounded at 10.4% per annum, while the MSCI Europe (US$) index rose by 4.2% per annum. The benchmark figures used for comparison do not include dividends. We estimate that if dividends, net of withholding taxes, are included in the benchmark returns, the benchmark returns would increase by nearly 3 percentage points

The Fund's NAV peaked at $36.01 in June 2007 prior to the Global Financial Crisis (GFC) so we have made virtually no money for our shareholders in 8 ½ years. The only consolation that we can offer is that the MSCI Europe (US$) index is 35% lower than at its pre-GFC peak and the euro is down about 25% during that period. Meanwhile, cash has earned nothing since 2007 and recently we have seen banks and custodians starting to charge customers to hold euro cash through negative interest rates, so arguably we have done better than holding cash. Nevertheless, after such a long period of lacklustre absolute returns, we thank our shareholders for their patience and for the confidence that they have placed in us.

Currency

Last year, and in several recent years, currency losses have been the main detractor from returns. The Fund has the ability to hedge currency risk, and we have done so for part of the Fund's euro exposure a few times successfully in the past. Our policy on hedging currency risk is simple: we hedge currency risk if the currency to which the Fund is exposed looks significantly overvalued on a fundamental basis. The best approximation that we have of fair value for currencies is purchasing power parity (PPP) which I have explained in the past. PPP for the euro is estimated at 1.25 which explains why we did not hedge the Fund's euro currency exposure last year.

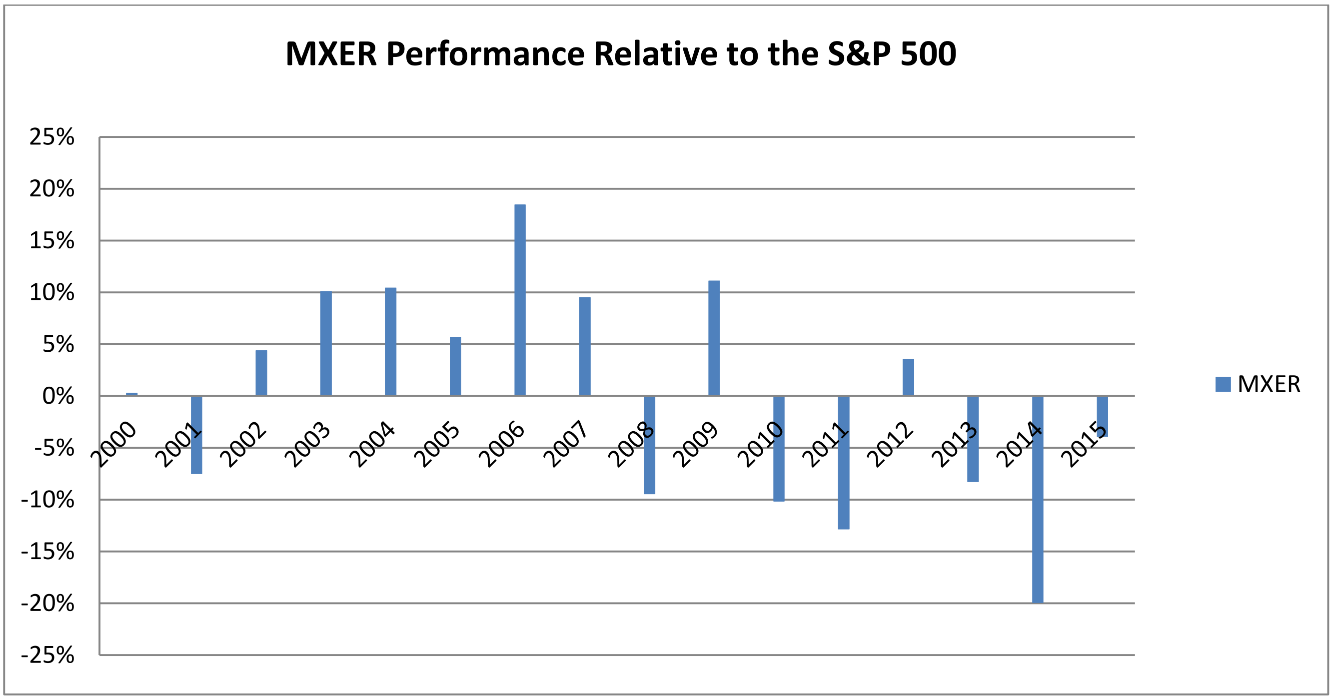
Our long-term view is that the US Dollar is likely to decline. The US Federal Reserve (Fed) appears far more willing to print money than the European Central Bank (ECB). Since 2008, the Fed's balance sheet has grown 5-fold while the ECB's balance sheet has doubled. Ultimately, we fail to see how massive expansion of a central bank's balance sheet will not result in currency debasement, even though this has not happened yet because of the collapse in the velocity at which money has circulated since the GFC.

The chart below shows the long-term trend of the euro (with the European Currency Unit shown prior to the introduction of the euro) versus the US Dollar. It shows a general gentle downtrend for the dollar versus the euro and it suggests that the euro is close to a low point historically versus the US Dollar.

About 10% of the Fund's net assets are in Sterling on a functional currency basis, i.e. the currency in which a closed-end fund's assets or an operating company's earnings are denominated. There has been much talk of late about the risk of an exit by Britain from the European Union, dubbed in the press as the Brexit risk. This looks likely to be a close call with the balance of probability currently not favouring an exit. Estimates of PPP for Sterling are around 1.55 so the Fund's exposure to Sterling remains unhedged.

Average portfolio valuations

European equities underperformed US equities by a wide margin during the past 8 years.



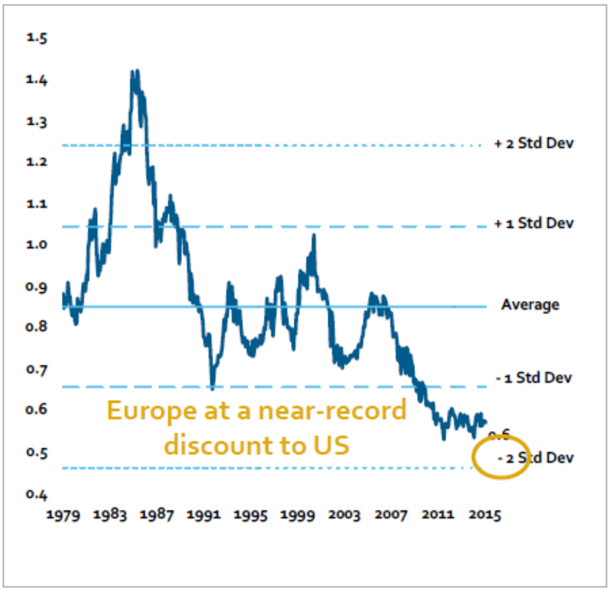
As a result, they offer far more attractive valuations for investors, and I would argue are likely to provide significantly higher returns than US equities. In last year's Chairman's statement, I wrote about the predictive value of the cyclically-adjusted P/E (CAPE) in forecasting equity returns over the next 10 years. According to Research Affiliates, these are the current CAPE valuations of the US, certain European countries, and Russia where the Fund has some investments.

Country	US	Germany	Italy	UK	Russia
Current	26	17	11	11	5
Median	16	18	21	15	7
Max	44	57	54	26	24
Min	5	8	6	6	5
Inception	1871	1969	1984	1969	1996

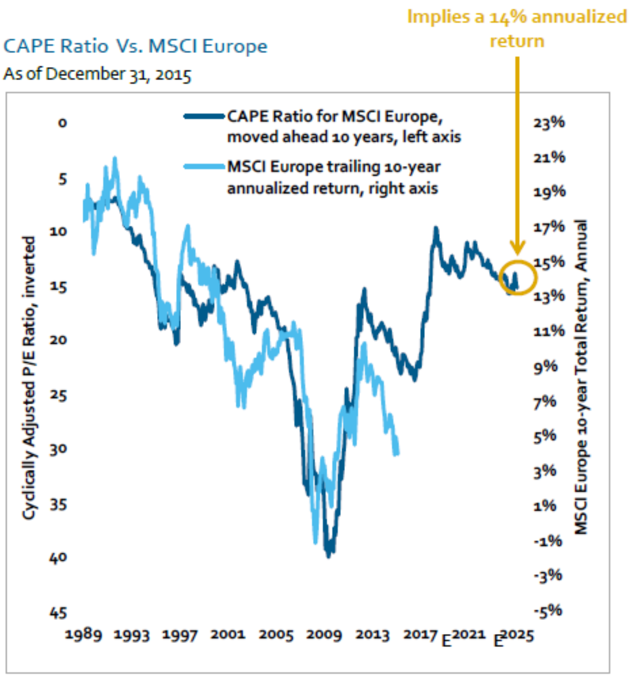
As the table shows, US equities at year end were valued at 60% above the median CAPE, while UK and German equities look undervalued compared to their median CAPE, and Italian and Russian equities look very cheap. Our portfolio is as undervalued relative to our estimates of intrinsic value for our holdings as it has been in quite some time. The average P/E of the Fund's operating businesses at year end was just over 11 and most of these businesses have very strong balance sheets and good long-term earnings growth prospects. The average discount to NAV of the closed-end funds held by the Fund was 34% and a number of these funds have catalysts to realise NAV over time. The average discount to NAV of our family-controlled investment holding companies was a staggering 46% at year end.

These two charts were recently sent to us in a presentation by Morgan Stanley Wealth Management. The first one shows the huge discount in the CAPE valuation of European equities to US equities in a historic context. The second chart shows the predictive power of CAPE in forecasting future returns by plotting the CAPE ratio for the MSCI Europe index with the trailing 10-year annualized return of the MSCI Europe index lagged by 10 years. Their chart suggests a return expectation for European equities over the next 10 years of 14% per annum. We are optimistic, but not that optimistic!

CAPE Ratio[1]: MSCI Europe Relative to S&P 500
As of December 31, 2015



CAPE Ratio Vs. MSCI Europe
As of December 31, 2015

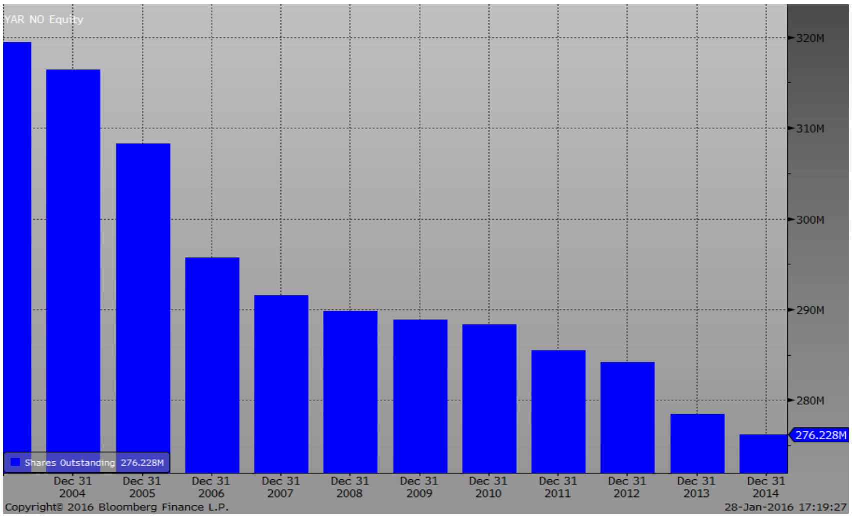


Rather than extol more about average portfolio averages or overall market valuations, I wish to devote the remainder of this letter to discussing the Fund's dozen largest investments, plus a few others that comprise over half the Fund's net assets.

Yara, a perpetual favorite

Last year, I wrote that Yara "still does not get the respect it deserves. It seems that most analysts over-estimate the cyclicality of its earnings whilst ignoring the large increase in the proportion of its sales of value-added products. Yara's shares trade at 12 times estimated earnings, which we think is cheap, particularly since commodity nitrogen fertiliser prices are quite depressed. Furthermore, we think that current consensus earnings estimates fail to fully take into account the sharp decline in natural gas feedstock costs and the benefit of other overhead costs being denominated in euros and Norwegian krone which have fallen significantly versus the US Dollar."

Last year, 2015 consensus earnings estimates for Yara rose by 32% in US Dollars. Yet, Yara's share price in Dollars fell marginally last year. As a result, Yara International trades at a P/E of only 9.5. It is debt-free and its return on equity has averaged nearly 20% over the past 5 years. It is a highly free cash flow generative business that is well-managed. During the past 10 years, it has invested to build new fertiliser capacity as well as making clever acquisitions, while paying off debt and paying a generous dividend that currently equates to a nearly 4% yield. Furthermore, it has been steadily buying back shares as the chart below of the number of shares outstanding illustrates. Although it was the largest holding in the Fund's portfolio at year end, we took advantage of market weakness in January to add to our holding and it now accounts for 5.5% of the Fund's NAV. The biggest risk that we see to Yara is a large devaluation of the Chinese RMB as China is the marginal producer of urea in the world and therefore the price-setter for urea in a supply-driven market. This devaluation risk is difficult to assess, and it is the main factor that tempers our very positive view of Yara's prospects.



A quartet of Italian family-controlled companies

Over many years, we have found Italian family-controlled holding companies to be a rich source of profitable investment ideas, as long as you back the right families! There are a few reasons for this being the case, the most important of which is that it is an area that is neglected or consciously avoided by most investors. Neglect or avoidance often leads to bargains. It also helps that Camilla is fluent in Italian which is a great help when speaking to these companies. As mentioned earlier in this letter, Italian equities are currently trading at around half their average cyclically-adjusted earnings multiple during the past 30 years. It is therefore hardly surprising that we are finding such compelling bargains in Italy, with these four Italian family-controlled companies accounting for about 12% of the Fund's NAV.

The largest of our Italian investments is savings shares in Italmobiliare which was the Fund's second largest holding at year end. I spoke at length about Italmobiliare at the October 2013 Santangel's conference in New York and have discussed it extensively in client newsletters. At the Santangel's presentation just over two years ago, I pointed out that Italmobiliare had a market capitalisation of €630 million and net assets of €1,286 million, of which cash was €127 million and it owned shares in listed equities, consisting mainly of its shareholding in Italcementi, worth €950 million. Therefore, the share price discount to NAV was 51%, and on an ex-cash basis was 57%. Furthermore, I noted in my presentation that Italcementi's share price valued the company at less than $90 per tonne of capacity which was less than half replacement cost and represented the lowest valuation on this metric by a wide margin amongst leading cement companies; half the implied valuation of recent industry transactions; and half the valuation of its key competitors. Therefore, in addition to Italmobiliare selling at half price, its largest investment was selling at half price. There was also a third level of discount as Italmobiliare's savings shares which we own was selling at about a 35% discount to its ordinary shares. Italcementi's profit margins were very depressed because of the state of the world economy post-GFC but I argued that they should normalize in the next five years, leading to a re-rating of Italcementi.

In my presentation, I argued that a few other things needed to happen at Italmobiliare and Italcementi in order to shrink the massive discount. These were all matters that I have discussed with the Pesenti family in letters and with Italmobiliare's senior management meetings in Milan. Firstly, I suggested that they should buy out the minority shareholders in Cements Francais to simplify the structure. In March 2014, Italcementi announced the acquisition of the 17% of Ciments Francais that it did not already own. Secondly, I argued that Italmobiliare needed to reduce its holding company costs which were around €15 million per annum and high as a percentage of NAV compared to other family-controlled investment holding companies. The company has reduced these expenses somewhat, but not enough yet. Thirdly, I argued that they should sell their other investments when the right price and opportunity arises and focus on the global cement business which is their area of expertise. Since then, the company has sold some of its small investments at attractive prices, but they made a much bigger move in July last year which was a pleasant surprise. Italmobiliare agreed to sell its 45% stake in Italcementi to Heidelberger Cement. The deal is expected to close in the first half of this year, subect to the receipt of US, EU and Kazach anti-trust approvals. Italcementi's share price more than doubled last year, more or less valuing the company at what I estimated its intrinsic value to be two years ago. Heidelberger Cement, following its acquisition of Italcementi, will be the global market leader in aggregates, #2 cement producer globally, and #3 ready-mix concrete player globally.

Following completion of the transaction, Italmobiliare will have a shareholding in the German-listed Heidelberger Cement worth about €600 million at the current market price, other listed investments worth about €150 million, unlisted investments worth about €400 million, and about €900 million in cash. The market capitalisation of Italmobiliare is about €1.1 billion compared to over €2 billion in net assets, so the shares still trade at a 45% discount to NAV, and a more than 80% discount to NAV on an ex-cash basis, in spite of some excellent capital allocation decisions by the Pesenti family during the past two years. Moreover, the savings shares still trade at around a 25% discount to NAV and we think it is only a matter of time before Italmobiliare uses some of its cash to buy back its savings shares and ultimately eliminate them, which was the last of our suggestions to the company.

ASTM is another Italian family holding company that was the Fund's fourth largest investment at year end. It is controlled by the Gavio family. ASTM's principal asset is SIAS, which operates a toll road network in north-west Italy. SIAS makes up 75% of ASTM's net asset value. Under the terms of the toll road concession agreements, SIAS is entitled to an annual tariff increase in line with inflation and other parameters, such as investment and road quality. SIAS is guaranteed a certain rate of return on the toll roads; if this return is not met SIAS will be paid the requisite amount at the end of the concession. Two of the three concessions that expire within the next five years stand to receive large payments at the end of the concession. This puts SIAS at a competitive advantage to win the next concession term. SIAS shares are currently valued at a 10% free cash flow yield. ASTM trades at a 46% discount to net asset value, so through ASTM we are essentially buying SIAS at half price. Despite some uncertainty surrounding SIAS's concession renewals, SIAS's valuation is a massive discount to the valuation of similar assets in other developed markets, and ASTM is valuing this asset at a further large discount. This double discount seems unwarranted given the guaranteed tariff increases and total return of the concessions.

Danieli is an operating company that is a global market leader in plant manufacturing for the steel industry. It is the market leader in niches such as mini-mills and recycled steel. Plant manufacturing contributed 72% of Danieli's EBITDA, with the other 28% from the production of specialty steel. The steel industry is in the doldrums. China makes up half of the world's steel consumption. Domestic consumption of steel in China has fallen and Chinese exports of steel have increased, and as a result steel prices have plummeted. Danieli's expertise lies in more efficient manufacturing plants that allow for flexible production, increasing the impetus for steel producers to invest in such plants during low points in the cycle. The CEO, Gianpietro Benedetti, and his family (his wife's family founded the company) control Danieli with a 67% shareholding. Danieli has net cash (after deducting pension liabilities, provisions, and cash received in advance for orders not yet in production) equal to 55% of its market capitalisation. Danieli is a high quality company serving niche markets with an excellent track record. Yet, Danieli's shares are valued on an ex-cash basis at 4 times earnings.

We own the savings shares which trade at a 25% discount to the ordinary shares. The savings shares, under Italian Law, pay a higher dividend than the ordinary shares, but have no voting rights, which we argue are meaningless in the case of family-controlled companies. Savings shares are an expensive form of financing for Italian companies, and one by one, Italian companies have been eliminating them. We believe that eventually Danieli will eliminate this historic anachronism.

COFIDE is the family holding company of the De Benedetti family. Cofide controls CIR through a 46% shareholding, and Cofide in turn is controlled by the De Benedetti family through a 52% shareholding. Cash and investments in private equity funds and hedge funds make up 40% of CIR's net asset value, or 60% of its market value. CIR's other significant assets are shares in L'Espresso, the Italian listed publishing group; Sogefi, which manufactures automobile parts; and KOS, the leader in private nursing homes, rehabilitation and hospital management in Italy. KOS which is owned by CIR and Ardian, a private equity group, accounts for more than 15% of CIR's NAV. KOS has been growing rapidly with high EBITDA margins. Ardian is expecting to exit KOS in mid-2016 at a significant uplift to its investment cost in 2010. If this happens, it would have a positive effect on the value of CIR's investment in KOS. CIR has been using some of its cash to buy back shares, which is accretive to NAV at such a wide discount. CIR is trading at a 42% discount to NAV and COFIDE trades at a 50% discount to its look-through NAV. We added to this holding on recent stock market weakness.

A trio of Russian investments with good corporate governance

The Fund has nearly 6% of its net assets invested in Russia. As the CAPE analysis showed, Russian equities are very cheap. The difficulty is in finding Russian companies with track records of strong corporate governance that are listed outside Russia, which we believe gives us an extra layer of assurance. In addition to having a cheap equity market, the currency, according to the Big Mac index, is more than 65% undervalued on a PPP basis versus the US Dollar. Russia was hit with a double whammy. First, economic sanctions were imposed after their takeover of Crimea from Ukraine. Then, oil prices collapsed by 70%. There are signs that the Ukraine sanctions may be reversed this year. Senior European and US officials have indicated that they are running out of patience with Ukraine's inability to live up to its obligations of a peace deal. More importantly, problems caused by the civil war in Syria are having an impact on the EU as throngs of migrants flood into Europe. Putin is seen as a key power broker in helping to resolve or at least address the civil war in Syria caused by the Bashir Assad-led regime.

Sberbank is our biggest investment in Russia. The shares returned 46% last year. Sberbank is the dominant bank in Russia with nearly half Russian retail deposits which is 7 times the deposits of its largest competitor. It has 17,000 branches over 11 time zones which is 18 times as many branches as its largest competitor. During the current financial crisis in Russia, Sberbank has continued to increase its domination of the Russian banking market which is hardly surprising in a place like Russia where people's trust in banks is very low. It is estimated that last year and this year, the financial crisis caused by the collapse in oil and gas prices will result in about 20% of Russian banks being closed. Last year, Sberbank announced revised targets for 2018 including a return on equity (ROE) of 18%, a capital adequacy ratio above 10%, net interest margins of at least 5%, and a cost to income ratio below 40%. These are ambitious targets, but not unrealistic given that Sberbank compounded its book value per share by 24% per annum during the past 10 years. If Sberbank meets these targets, the shares are trading at around 3 times estimated 2018 earnings. In spite of the rebound in Sberbank's share price last year, the shares still look significantly undervalued on a price/book valuation of 0.9. During the past 10 years, Sberbank traded at an average valuation of 1.65 times book value.

Raven Russia is the Fund's second largest Russian investment. It is a London-listed owner of modern logistics warehouses located principally on the ring roads around Moscow and St. Petersburg. The company has a cash buffer of over $200 million and its warehouses are 89% let, generating annual net income of about $60 million. Raven's rents are generally US Dollar denominated, but the rouble has more than halved from 35 to 80 to the Dollar over the past 18 months. To a local company therefore, rents have more than doubled. For a small local logistics player, warehouse rent is a very high proportion of overhead, perhaps as high as 70%, which has resulted in some forced vacancy of small amounts of space in the portfolio. For the largest tenants who include the Finnish Post Office's logistics subsidiary, DHL and leading retailers such as Dixy and X5 Group, they either invoice in Dollars, or warehouse rents are a small proportion of tenants' turnover, so there is no life-threatening impact from the rouble devaluation. It is only the small local logistics players where genuine distress is obvious. Raven has been extending and renegotiating leases with these weaker local players and leases maturing in the near term, recognising the changed market environment. There has been some modest redenomination of rentals from Dollars to roubles under short-term lease contracts, to offer some relief to selected tenants. This represents less than 10% of the portfolio.

We own both the Raven Russia ordinary and preference shares. The ordinary shares currently trade at a 50% discount to NAV and the NAV is calculated using a 12.5% capitalisation rate to value its Moscow warehouses and 13.5% rate for its St. Petersburg warehouses. Raven pays a decent dividend which is free of withholding tax, and the preference shares pay a 10% effective yield based on the price that we paid for a block of shares that we bought at year end, again free of withholding tax. We owned the preference shares in the past, having bought them at par in mid-2010 with a tax free yield of 12% and sold them less than three years later at 150% of par when the effective yield fell to 8%. They are less liquid than the ordinary shares but we regard them as a low risk investment with an attractive yield that we expect to ultimately sell at a profit when fears about Russia recede.

Gazprom Neft is a Russian oil exploration, refining and distribution company with nearly 2,000 service stations. It has a high domestic market share in premium markets such as aviation fuel, ship bunkering, lubricants and bituminous materials. It has proven reserves of 9,165 million BOE as of December 2014 and a 10 year average reserve replacement ratio of 232% which compares to the industry average for integrated oil companies of around 125%. The sharp drop in oil prices since 2014 negatively affected Gazprom Neft's results, but this was largely offset by the devaluation of the Russian rouble in which most of the company's expenses are denominated. While Gazprom Neft has suffered from the weak oil price, it made good operational progress. Hydrocarbon production increased by 22% Y-o-Y while refining volumes and premium sales remained stable. The company earned an average ROE over the last 10 years of 25% while its median price to book ratio was 1.1 and its median valuation was $4.60 per barrel of proven reserves during that period. The company is expected to generate a ROE of 14% in 2015 while its price to book ratio is 0.4, putting the shares on a P/E of 2.8 based on currently depressed earnings. Gazprom Neft currently trades at an enterprise value to proven reserve ratio of $2 per barrel. This compares to $12 for Royal Dutch Shell, $14 for Exxon, $7 for BP, $9 for Petrobras and $13 for PetroChina.

<u>Three European financials that stand out</u>

We like the free cash flow generative nature of financial businesses. The difficulty is that they are sometimes difficult to understand and analyse, and in many cases, regulatory burdens and more stringent capital adequacy requirements render them far less profitable than they used to be. We own shares in two London-listed banks that operate predominantly in emerging markets, one of which is Sberbank which we already discussed, the other being a new addition to the Fund that we have not publicly disclosed yet. In addition, we have 8% invested in three UK- and European-listed financial firms that operate predominantly in the UK and Europe.

The largest of these investments is NN Group which used to be called Nationale Nederlanden, a former investment that we owned in clients' segregated accounts 20 years ago. NN was spun off and listed by ING Group in mid-2014. We are attracted to spin-offs for reasons that we have discussed in the past and there is empirical research that shows that spin-offs have historically generated significantly better returns for investors than market indices. NN is an insurance and investment management group with leading positions in life and non-life insurance in the Netherlands. It also has a strong life and pensions business in other European markets and in Japan. As a condition for receiving aid from the European Commission, ING was forced to divest NN in an orderly manner by 2016. ING sold about 30% of its stake in an Initial Public Offering (IPO) in July 2014 and since then has sold subsequent tranches of shares. NN repurchased a significant proportion of these shares. Since the IPO, NN has performed very well and is delivering on the targets it set at the IPO. It reduced annual administrative expenses by €200 million in the Netherlands insurance and corporate holding divisions. Last year, earnings estimates for the year were increased by 60% as NN steadily exceeded analysts' expectations. This enabled NN to increase the return on equity (ROE) of the ongoing businesses from 7.1% in 2013 to 8.6% in 2014 and to an annualised return of 12% for the first 9 months of 2015. NN is also delivering on its target to generate more or less all its net operating income as free cash flow. NN's ability to generate substantial free cash flows has enabled it to achieve one of the highest solvency ratios in the industry and to return substantial cash to shareholders through share buybacks and dividends. In spite of generating a strong return for shareholders last year, we still believe the shares are undervalued at 0.8 times book value, 10 times earnings and a 4.5% dividend yield.

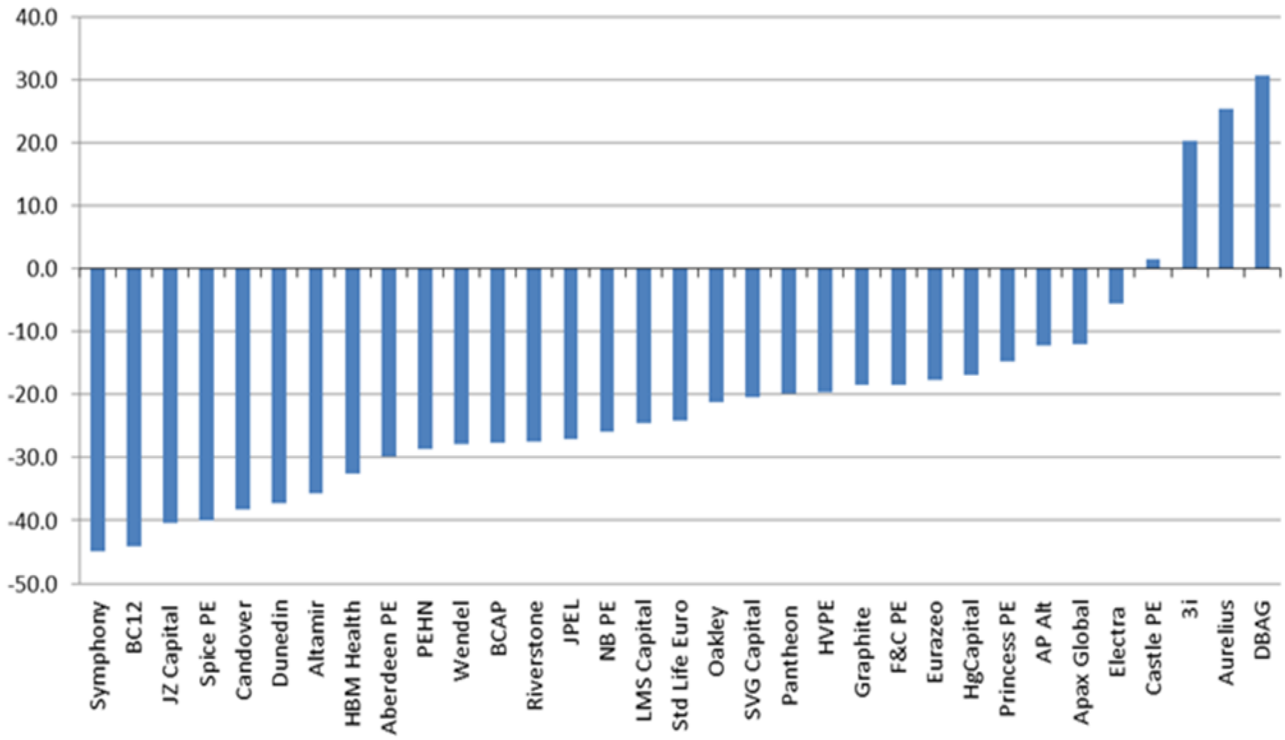
Close Brothers and Hiscox have been longstanding holdings in the Fund and have been discussed in previous Chairman's statements so I will not discuss these businesses in any detail. What I will say is that they are two of the best managed financial firms that we have ever encountered. For the most part, they both operate within clearly defined niches which they dominate. Whilst most banks in the developed world will be hard pressed to generate a sustainable return on equity (ROE) in double digits under Basel III capital adequacy rules and in the current stifling regulatory environment, we feel confident that both Close Brothers and Hiscox can generate ROEs in the mid-teens over a full business cycle. Both businesses are generating a ROE of more than 15% and have averaged that level of profitability during the past 10 years. Close Brothers trades at 10 times earnings and a 4.5% dividend yield which we think is far too cheap so we added to the Fund's holding during recent stock market weakness. Hiscox trades at 14 times earnings and a 3% dividend yield, and though not as cheap, it still represents a more than fair price for a wonderful business. Both companies have been compounding machines, generating compound annual returns for shareholders during the past 20 years of 12% and 14%, compared to 3% per annum for the FTSE All-Share index during the same period.

<u>Listed private equity funds stand out as the most undervalued closed-end funds</u>

The closed-end fund world is not filled with bargains as it used to be years ago. My own observation is that the sector is "over-broked" with too many specialist sales people, research analysts and traders covering the sector. However, within the closed-end fund world, listed private equity funds stand out as a rare area of bargains. The reason seems to be that many people investing in the sector as well as some closed-end fund research analysts do not understand private equity. The other reason is that some listed private equity funds found themselves in the unenviable position of having made over-commitments during the GFC and became forced sellers of some of their assets to resolve the over-commitment. We have invested in private equity secondaries for many years through our association with Greenpark Capital in London and I sat on the limited partner advisor boards for their first two private equity secondaries partnerships and learned a great deal about private equity during that time. During the past 10 years, I made a point of gaining a deep understanding of the listed private equity universe which has been a profitable area of investment for the Fund.

Today, closed-end funds that invest in listed equities trade at an average discount to NAV of only 5%. Meanwhile, in their quest for income, investors have bid up the prices of fixed income funds to parity with NAV on average, while closed-end funds that invest in infrastructure, renewables and property are trading on average at 5-10% premiums to NAV. In this context, closed-end funds that invest in private equity stand out as bargains as they currently trade at an average 20% discount to NAV.

Within the listed private equity universe, there is a wide dispersion in terms of both quality and discount to NAV. In June, I was invited as a speaker at the annual Listed Private Equity (LPEQ) conference in London and met with the managers of four of our six listed private equity investments to get an update. We believe that we have an exceptional portfolio of investments in listed private equity that combine high quality and excellent value. At the start of this year, Numis Securities produced the following chart which shows the wide dispersion of discounts to NAV within the sector. The listed private equity funds in the table do not represent the entire universe, but covers most of them.



In total, we have 16% of the Fund's net assets invested in six listed private equity investments: Ashmore Global Opportunities, Altamir, Spice Private Equity, NB Private Equity, Pantheon International, and Better Capital 2009. Each of these investments has its own attractions which I will briefly discuss, but first, I wish to set out in a table the size of our investment, the percentage of each fund that we own, and the current discount to NAV at which the shares trade.

Fund	Current value of investment	% of fund owned	Share price	NAV per share	Discount to NAV
Ashmore Global	$9.0 million	14.7%	365	508	-28%
Spice PE	$6.7 million	5.2%	24	42.21	-43%
Altamir	$5.4 million	1.4%	9.9	17.11	-42%
NBPE	$5.2 million	1.1%	10	14.37	-30%
Pantheon	$3.2 million	0.6%	1230	1620	-24%
Better Capital 2009	$2.5 million	0.9%	93	128	-27%

Ashmore Global Opportunities is a closed-end fund that invests in private equity deals done by Ashmore in emerging markets. Ashmore is a large, well-respected emerging markets investment manager, but this fund was launched at the worst possible time and activist shareholders (for which we stand guilty) persuaded the Board to wind up the fund. It is now in the relatively late stages of liquidation and we have made a decent return on our investment by purchasing shares at a judiciously wide discount to NAV and having capital returned to us at NAV. The manager thinks that they can return the current NAV to shareholders during the next two years. Since we expect about a third of the current market capitalisation to be returned in the next few months, with the remainder being returned to shareholders around the end of this year and next year, we think that the Fund will generate an internal rate of return (IRR) of more than 25% per annum on this investment during its remaining holding period.

At the start of last year, Spice announced that it had divested its entire legacy portfolio of private equity funds for US$192 million to the private equity secondaries division of Blackstone. The transaction also included the transfer of APEN's loan obligations resulting in a full deleveraging of APEN. The portfolio sale was done at a 14% discount to fair market value (FMV). This major transaction simplified Spice's balance sheet and transformed it into an emerging markets private equity fund of funds with a focus on private equity secondaries and co-investments. GP Advisors, which is part of Brazil's leading private equity investor, GP Investments (a major shareholder in Spice), has ambitious return targets for the new emerging markets strategy. I concur that there are good opportunities to buy interests in well-managed emerging market private equity funds at steep discounts to FMV. Last year, Spice also changed its reporting currency and the currency in which it reports to US Dollars. They also joined LPEQ, increasing their exposure to listed private equity fund investors.

However, there is more work to be done to tackle the very wide discount to NAV at which the shares trade. My suggestions to the manager and Board include listing the shares in London rather than Zurich, making the fees fairer to investors, and negotiating a deal with Fortress to buy its 13% shareholding at a price that is accretive to NAV. Listing the shares in London makes sense as the primary audience for listed private equity funds is London, not Zurich. Last year, they changed the high water mark for calculating performance fees in such a way that by simply buying secondaries at a steep discount and eliminating the complicated derivative liability on its balance sheet, the manager could earn a performance fee. That is unfair to shareholders and I have made my views known. If they charged management fees based on market capitalisation, it would certainly garner attention, and almost certainly result in the discount to NAV shrinking. Instead, they charge (until mid-2018) an annual management fee of CHF 5 million (equivalent to 2.2% of net assets currently) following which it will be changed to 1.5% of net assets. Fortress, through its Drawbridge Special Opportunities Fund, has an option to put to Spice its 13% shareholding in Spice. This option expires on 12th June 2018 and has an exercise price of CHF 21.80 per share. Fortress will need to exit its investment in the next 2-3 years and Spice is the obvious buyer. Once Fortress sells its shares, it would further simplifying Spice's balance sheet as it would get rid of the complicated derivative liability.

Altamir is a French-listed private equity fund. It is managed by Apax France which has a strong track record and invests in Apax France funds and co-investment opportunities offered by the manager. There is no rational reason for the large discount to NAV other than that Altamir is off most investors' radar screens because it is listed in France. Maurice Tchenio was one of the founders of Apax and owns 26% of Altamir, after increasing his shareholding again last year. There is therefore strong alignment of interest with shareholders, except in one respect. I have argued this point with Maurice several times to no effect so far. In response to the large discount to NAV at which Altamir's shares traded, they hiked the dividend significantly in 2013. The dividend yield based on the current share price is 5%. French shareholders like Maurice pay no withholding tax on dividends, but foreign investors like us suffer 30% withholding tax so as I explained to Maurice, we are seeing 1.5% of the value of our investment destroyed every year. We are certainly not unique in that respect, and would far rather see Altamir spend that money every year buying back shares which would be accretive to its NAV per share.

NB Private Equity is managed by Neuberger Berman which has 28 years private equity investing experience and has over $34 billion of commitments. NBPE invests in private equity funds as well as making direct and co-investments in both equity and subordinated debt. The roughly 35% of its net assets that are invested in subordinated debt fund a semi-annual dividend which equates to about 3.5% of net assets or a 5% yield based on the current share price. Unlike in the case of Altamir, since NBPE is Guernsey-incorporated, there is no withholding tax leakage so this is an efficient way of returning money to shareholders. NBPE is also buying back shares which we view as a positive development. NBPE reports and trades in US Dollars and nearly 90% of their underlying investments are in the US which is a further attraction to us. The subordinated debt area makes us nervous, and early last year, we reduced the investment in NBPE. However, after meeting with the manager at the LPEQ conference, our confidence in this part of the portfolio improved and we increased our holding when the discount to NAV widened later in the year.

Pantheon International is in our view the highest quality listed fund of private equity funds in the universe. Over the past 20 years, it has delivered a compound annual return to investors of 12%. There is no reason why its shares should trade at a nearly 25% discount to NAV. We think parity or close to parity is a more appropriate price. Pantheon has a track record of being very opportunistic in buying back shares at a discount to NAV which is accretive to its NAV per share. It is also an active buyer in the private equity secondaries market where we think some attractive opportunities lie.

Better Capital 2009 (BCAP) was set up by Jon Moulton who ran one of the best turnaround private equity houses, Alchemy, before falling out with his partners and creating this listed vehicle. Unlike other listed private equity funds, this is not an evergreen vehicle; it returns capital to shareholders as its investments are sold. Hence, there is a clear catalyst for the discount to disappear. The fund will be making a distribution of 17p per share at the end of this month so adjusted for this distribution, the shares are trading at a 31% discount to NAV which we think is unwarranted. More than 80% of BCAP's NAV is accounted for by one investment, Gardner Aerospace, which is a supplier to Airbus. Whilst Gardner is performing well, from a risk perspective, we wish to limit our exposure to any one underlying private equity investment which explains why this is not a larger position.

Shipping is often a value-destructive sector but some market leaders are worth owning

Nearly 6% of the Fund's net assets are invested in the shipping sector. We had two bad prior experiences investing in shipping companies and as I said to a group of executives, owners, and lawyers at a shipping conference where I was invited as a panellist, most shipping companies have no right being listed. I went on to say that freight rates and second-hand values are highly cyclical and ship owners have a history of abusing minority shareholders by privatising their listed shipping companies at or near the bottom of each shipping cycle. I was never invited back to speak at this annual conference, but I also had no serious rebuttal from the owners or their managers. Nevertheless, there are some parts of the shipping industry which are less cyclical and some families who have good track records in treating minority shareholders fairly.

Maersk is a Danish family-controlled conglomerate with diversified holdings ranging from container shipping, tankers and supply vessels, port terminal operation, to oil exploration and production. In recent years Maersk simplified its structure and increased its transparency. It focused on optimising its businesses with the highest potential returns, and divested non-core businesses such as its stake in Dansk Supermarked and Danske Bank. It made a significant return of capital to shareholders with the proceeds from these divestments. However, its core businesses are caught in a perfect storm. Container shipping rates have plummeted, port terminals growth and profitability have declined on lower global trade, and the oil price has plunged. Typically, the two main businesses, shipping and oil, served as a natural hedge, but that is currently not the case. In past years Maersk Oil under-invested in production, resulting in its production declining. This was, to some extent, fortuitous given the sudden fall in the price of oil, but production is now increasing and the division will perform poorly if oil prices remain low. Maersk Line is the market leader in container shipping with a 15% global market share and cost leadership. Its EBIT margin is over five percentage points above the estimated peer average. Maersk Line remains disciplined during the downturn, increasing capacity less than the industry and focusing on margins over market share. This increased the return on invested capital significantly. Although it is currently under pressure, the long-term fundamentals for APM Terminals are strong. APM Terminals business has strong barriers to entry and it aims to become the leading port developer and operator worldwide. The Moller-Maersk family control 53% of the share capital and 70% of the votes. Maersk currently trades at 7.5x 2015 estimated earnings and a price to book ratio of 0.62 compared to a ten-year average of 1.14, and slightly higher than its ten-year low of 0.52. Management agree that its shares are an attractive investment and have been buying back shares in the market. We recently added to our investment in Maersk at what we also view as a very attractive valuation.

Wilhelmsen is a Norwegian family-controlled shipping company with a long history. At the end of 2015 and during January, we bought shares in Wilh. Wilhelmsen Holding SA (WWH). WWH is a global provider of maritime related services, transportation and logistics solutions. Over half of WWH's net asset value is attributable to its controlling stake in a separately listed company called Wilh. Wilhelmsen ASA (WWASA) which is the world's largest operator of car carrier ships. WWASA has built barriers to entry arounds its car carrier business which has historically and should continue to enable it generate higher returns than those generated by the more commoditised sectors of the shipping industry. It is more difficult for shipping companies to develop relationships with car manufactures than it is to win contracts for shipping commodities. WWASA has established relationships with major car manufacturers, most importantly with Hyundai Kia, but also with luxury brand manufacturers such as BMW, Mercedes and Porsche.

WWASA's median price to book since it was listed 7 years ago is 1.1 while its current price to book is 0.5. We believe WWASA is undervalued because the market has exaggerated the current cyclical downturn plaguing the car carrier industry. WWASA also holds a large stake in Hyundai Glovis, a Korean-listed logistics business, which has generated an exceptional return on equity of 22% over the last 10 years. This stake is currently worth $780 million compared to WWASA's market capitalisation of $840 million. WWH has generated an average return on equity of 14% and 15% over the last 10 and 20 years respectively while the median price to book was 0.8 and 1.0 over those respective periods. The current price to book is 0.4 which we think is less than half intrinsic value.

Stable assets and a portfolio that bodes well for future returns

The Fund ended the year with net assets of $213 million. The size of the Fund and the stability of our client and asset base are important in allowing us to take a long-term view in buying shares in businesses that are temporarily out of favour with investors, but which we think are selling in the market at a deep discount to their intrinsic value. During the past year, the wide gap between price and intrinsic value did not close for most of our holdings, while the decline in the euro, Sterling and Norwegian krone hurt returns in Dollars.

We had a few instances where the gap between price and intrinsic value did close during the year and these helped offset most of the currency losses. Last year Dragon Oil was privatized by its largest shareholder, Emirates Oil. We refused their first two offers before finally accepting an improved offer of ₤8 per share for the Fund's 1.1 million shares. As a result, this investment which was worth $9 million at the start of the year, and to which we added about $200,000 in March, was sold for $13.6 million in September. Our other big success was Alent which was taken over by Platform Specialty Products. Our investment was worth $3.8 million at the start of the year and we invested another $1.8 million in February. In September, we sold our Alent shares for $8.4 million before the takeover was finalized because of concern over the deal possibly collapsing. These two takeovers brought the Fund profits of over $7 million last year. Apart from these two homeruns, we sold three of the Fund's investments - Deutsche Office, Altin and Telecom Italia savings shares - for a combined uplift from both cost and since the start of the year of $3 million.

There were a few disappointments during the year, the most important of which was Volkswagen which I have discussed extensively in the past. We sold our Volkswagen ordinary shares at a loss of less than $1 million, but the cost to the Fund during the year was $3.6 million. The media has covered what went wrong there so I have nothing further to add. Equally costly was our investment in Casino Guichard, the French supermarket chain with market leading positions in Brazil, Colombia, Thailand and Vietnam. Casino was hit hard by the slowdown and currency devaluations in South America in particular. With leverage being higher than what we usually find comfortable, this amplified the downturn. The company then made matters worse by reorganizing the shareholdings in some of its listed subsidiaries. In early January, we finally threw in the towel, probably too late given some of the warning signs, and sold our shares at a loss of $3.7 million, with most of this loss taking place last year. We finally gave up on two of the Fund's holdings, Eckert & Zeigler and BHF Kleinwort Benson (formerly RHJ International), realizing a combined loss of $1.7 million, with these losses having taken place in prior years. The sale of Eckert & Zeigler turned out to be a good decision, but frustratingly, BHF Kleinwort Benson was acquired at a premium shortly after we sold our shares.

Last year, the Fund had $8 million in subscriptions and $15 million in redemptions. We like to see each figure representing less than 10% of the Fund's net assets during a calendar year. This has historically been the case nearly every year, and it is something that we do not often see on a recurring basis in other open-ended funds. The Fund ended the year with net cash of $45 million and this has since been reduced to $39 million by adding to some of the Fund's existing holdings at what we felt were very attractive prices during January's market weakness.

As I said in last year's letter, I have been gradually handing the reins for the management of this Fund over to Camilla and Rob with Kia and Natalie supporting them as trainee analysts. However, this is a gradual process and I remain primarily responsible for most of the Fund's investments. The way this Fund is managed is that if any of us think that we should reduce the size or sell an investment, we discuss the investment and reach a consensual decision. We each try to generate new investment ideas and after I have done some very preliminary research on a potential new investment to see if it meets our requirements for being apparently mispriced and not being obviously value-destructive, Camilla, Rob, Kia and Natalie who work on this Fund will spend a few weeks researching the company before we discuss it and either reach a decision, or more likely, compose a list of questions for management. They will then take responsibility for the new holding and monitor the company. This process of analysing new investments for the Fund is currently very slow but this is to be expected during the learning process. Succession plans in this business take years to formulate!

Three new holdings were added to the portfolio during the year, and a fourth holding is currently being added. The Fund has 44 holdings. We regard fewer than 50 holdings as optimal. We feel positive about the prospects for the Fund's returns, but have no idea when the gap between the current market price and our estimate of intrinsic value for each of our holdings will close. While we wait, our expectation is that our investments will not diminish intrinsic value, but in most cases, increase it gradually while we wait for the aforementioned gap to close. In some cases, we will suffer disappointments when management does silly things or when cyclical downturns temporarily depress earnings, but sometimes, we will also be pleasantly surprised. As in recent years, currency has provided a strong headwind to returns in US Dollars, but in other years, it will provide us with a strong tailwind. The most important thing is to stick with our disciplined approach which has yielded good long-term returns for our shareholders in the expectation that, over a reasonable time period, we can achieve similar results in the future.

Desmond Kinch, CFA
Chairman