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OAM European Value Fund

Dear fellow shareholder,

Last year, OAM European Value Fund's NAV per share fell by 48.7%. By comparison, the Fund's principal benchmark, the MSCI Europe (US$) index, fell by 49.3%. A year or two ago I warned clients that a lot of stupid and aggressive lending had taken place, and that the US stock market and corporate bond markets in particular were priced for perfection. However, this dire result is significantly worse than anything that I felt was likely to occur. We thought that the portfolio of European businesses, closed-end funds and investment holding companies in which we invested were priced to offer us a margin of safety. We also felt that our focus on balance sheet strength would save us from the ravages of the next downturn. However, our lowly leveraged companies have seen their share prices fall by as much, or more, than stock market indices. In the first half of 2008, the Fund's NAV per share fell by 7% which was half the decline in the MSCI Europe (US$) index. Up to that point, we did a reasonable job of minimising losses for clients. The ravaging took place almost entirely during the months of September and October when global stock markets collapsed and liquidity evaporated. During this period hedge funds and mutual funds sold to meet large redemption requests and investment banks sold to rapidly reduce leverage, lest they follow Lehman's fate. This forced and indiscriminate selling led to sharp share price falls which caused many investors to panic, further adding to the selling pressure. Forced liquidation and the resulting irrational pricing meant that we were unable to distinguish ourselves from the overall market. In September and October, the Fund's NAV fell by 40%. The NAV fell a further 7% in November, before recovering by 7% in December.

There are three reasons why we are particularly surprised and disappointed that the Fund's NAV did not hold up better during the year. Firstly, at the beginning of the year, we viewed Sterling and the Euro as overvalued and we therefore hedged a significant portion of the Fund's exposure to these currencies against the US Dollar. Secondly, we recognised the excessive debt that many companies had taken on during the boom years, and believing this was unwise, we invested largely in companies with net cash or little debt on their balance sheets. Thirdly, our value approach to investing means that, we buy shares in companies that are selling at a significant discount to our appraisal of fair value. Our value approach saved our clients from huge losses in the 2000-02 bear market but this time around, it seems that (ex currency hedging), our stocks fared worse than the market.

The principal reason for the disappointing result during this savage bear market is that forced selling, particularly by hedge funds and proprietary trading desks at investment banks, resulted in value stocks

falling by far more than the stock market. In the first nine months of this past year, the average return of value stocks, as defined by the 50 lowest P/E stocks in the MSCI EAFE [Europe, Australia, Far East] Index and the 50 highest dividend yield stocks, fell by 41.6% and 42.8% respectively, versus 29.3% for the index. (So far, we have been unable to get updated figures encompassing the whole of 2008.) In the past 34 years, value stocks (using the same definition) beat the index by nearly six percentage points per annum (which is why more sophisticated investors like hedge funds and proprietary trading desks at investment banks had disproportionally high exposure to such stocks). However, there have been two roughly one-year periods during the past 34 years when value stocks did significantly worse than the market. The first was in 1998/9 (the height of the internet boom) and the second was in 2007/8 (forced selling by hedge funds, investment banks, and other sophisticated investors). After the battering for value stocks in 1998/9 (on a relative basis), they rebounded strongly, beating the index by roughly ten percentage points per annum over the next 8 years.

The secondary reason for our poor showing last year is that the majority of the Fund's assets were invested in non-index constituents. Smaller companies' share prices underperformed larger companies in the flight to liquidity. Over the longer term, just as with value stocks, smaller companies have historically outperformed the large company share price indices.

Whilst we feel that this past year's losses are likely to prove temporary, investors should be aware that they can lose capital permanently. There are four principal ways by which this can happen. The first is to invest in companies that are too highly leveraged which go bankrupt, either in a recession or when they experience a downturn in sales. We have generally avoided investing in such highly leveraged companies.

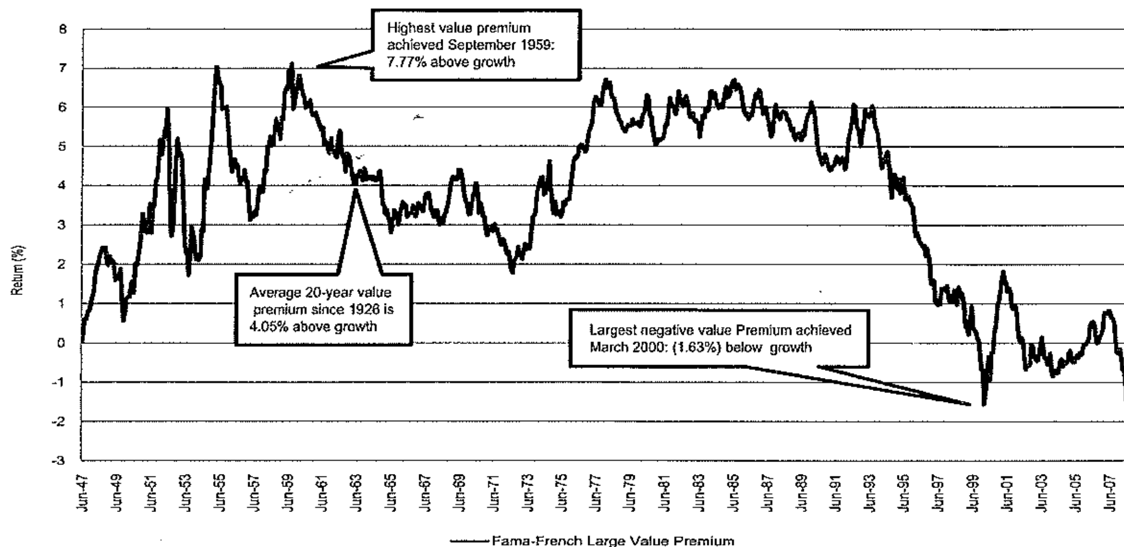
The second way to lose capital permanently is to invest in companies with unsustainable business models. Examples include the US car manufacturers whose costs are too high to compete with the Japanese, Koreans, and soon the Chinese, and whose design and engineering capabilities are too low to compete with the likes of the Germans or Italians. Other examples include large Western banks that are engaged in what are essentially commodity businesses, which for many years earned 20-25% returns on equity – a feat that should be impossible to achieve in such a highly competitive, undifferentiated business. We now know how they achieved such returns. They used off-balance sheet vehicles like SIVs (what some people recently referred to as the shadow banking system) to amplify already high leverage by borrowing short-term to invest in higher risk collateralised debt and mortgage obligations (CDO's and CMO's), and other hybrid securities. They then used the additional profits to pay dividends to the parent company, thereby increasing profits as long as the charade continued. We have only had exposure to one large European bank in the Fund during the past 5 years (Credit Agricole) which is largely a retail bank which addressed its problems at an early stage and seems likely to survive more or less intact without effective nationalisation as has befallen several of its peers. We also paid an average price of 1.35 times its 30th September 2008 NAV per share which does not seem excessive, even in hindsight (in comparison to valuations of 2.5-3 times "pre-write-off NAVs" at which many Western banks traded), though that provides little relief given that the shares trade at one third this price today.

The third way is to invest in a company which becomes worthless through government confiscation, fraud, or a massive lawsuit. Confiscation seems unlikely in the UK and Western Europe, but fraud and lawsuits are difficult risks to predict and avoid.

The fourth way to lose capital permanently is to pay way more for an asset than it is intrinsically worth. Examples would include Japanese shares and real estate in the late 1980's, and internet and most technology stocks in the late 1990's. In those instances where investors bought shares at 100 times earnings or real estate at a 1% rental yield, it is unlikely that most of those investors will ever see a return *of* their capital, far less a return *on* their capital, during their lifetime. As value investors, we have never been vulnerable to that trap.

According to the chart below of the difference in 20 year rolling returns for large US value stocks versus large US growth stocks, value stocks have never been cheaper. Over the past 80 years, large US value stocks outperformed large US growth stocks by an average of four percentage points per annum. The lesson is that it pays to buy value stocks. However, the margin by which value stocks beat growth stocks is cyclical. There have only been two brief periods during the past 80 years when value stocks did worse than growth stocks over the preceding 20 years – in 1999 at the height of the dot-com boom and this year. This chart is updated to 31st July 2008 and we suspect that value stocks are even cheaper today than they were in July. We could not find equivalent data for European equities, but intuitively we think the chart for European value stocks versus growth stock would look similar.

Large Value Premium Rolling 20-Year Periods



Source: Eugene Fama and Ken French, Morningstar EnCorr Analyzer
Past performance is not an assurance of future results. Please see important disclosure information at the end of this presentation.
As of July 31, 2008.
Note: Premium calculated as the spread between Fama-French Large Value and Fama-French Large Growth.

Fortunately, the Fund's longer term track record, even following the worst global financial crisis in 75 years and after value stocks have taken a battering, remains respectable. Over the six years since the Fund's launch, its NAV per share increased by 70.4% (9.3% per annum) versus 26.4% (4.0% per annum) for the MSCI Europe (US$) index. Our objective is to recover our losses from the peak within 5 years. This is an ambitious target which, if achieved, would result in a compound annual return of more than 16% per annum over the next 5 years. Nevertheless, we think that from the current starting point for valuations, we can earn these kinds of returns.

Why do we feel such high returns are possible? According to Bloomberg data, the P/Es and dividend yields of the European stock markets to which we are most exposed are as follows:

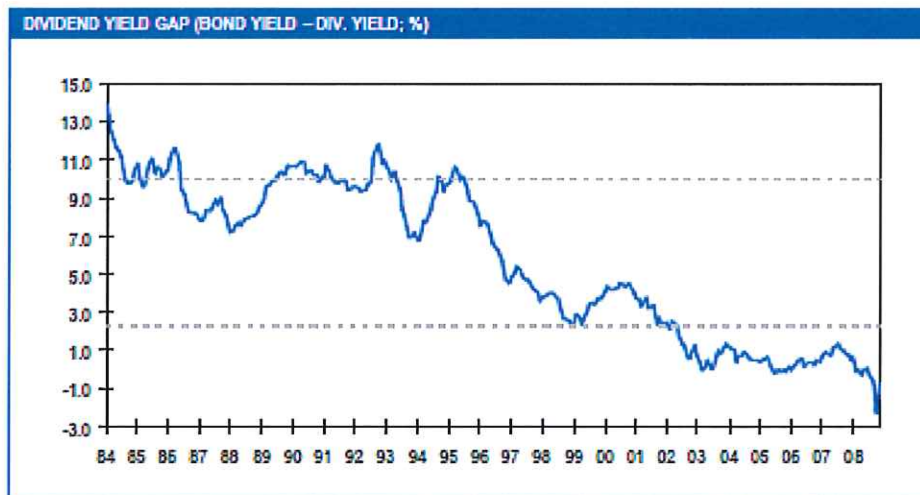
	P/E	Dividend yield
DJ Euro Stoxx 600	9.2	5.6%
FTSE 100 (UK)	8.1	5.8%
S&P/MIB (Italy)	6.4	7.0%
CAC 40 (France)	8.6	5.6%
AEX (Netherlands)	5.4	6.9%
BEL 20 (Belgium)	8.5	7.8%
OBX (Norway)	6.9	7.4%

The P/Es (average of about 7) and dividend yields (average of around 7%) of the Fund's holdings are similar to those shown above. To put this perspective, according to Bloomberg, the P/E of the S&P 500 is currently 20 and the dividend yield is 3.1%. To put this in a historical context, the following table shows the year end P/E and dividend yield of the S&P 500 going back to 1960.

Year	P/E	Yield	Year	P/E	Yield	Year	P/E	Yield	Year	P/E	Yield	Year	P/E	Yield
1960	18.7	3.4%	1970	16.7	3.5%	1980	9.1	4.7%	1990	15.2	3.7%	2000	25.4	1.2%
1961	21.2	2.9%	1971	18.3	3.1%	1981	8.1	5.6%	1991	21.8	3.1%	2001	26.0	1.4%
1962	17.2	3.4%	1972	19.1	2.7%	1982	10.2	4.9%	1992	24.0	2.9%	2002	18.6	1.8%
1963	18.1	3.1%	1973	12.3	3.7%	1983	12.4	4.3%	1993	23.5	2.7%	2003	20.5	1.6%
1964	17.8	3.1%	1974	7.3	5.4%	1984	9.9	4.7%	1994	17.0	2.9%	2004	18.1	1.6%
1965	17.5	3.1%	1975	11.7	4.1%	1985	13.5	3.9%	1995	17.4	2.3%	2005	18.3	1.8%
1966	14.8	3.6%	1976	11.0	3.9%	1986	16.8	3.4%	1996	20.7	2.0%	2006	17.3	1.8%
1967	17.7	3.1%	1977	8.7	5.1%	1987	15.4	3.7%	1997	24.5	1.6%	2007	16.8	1.9%
1968	18.1	2.9%	1978	8.3	5.4%	1988	12.2	3.7%	1998	32.2	1.3%	2008	20.3	3.1%
1969	15.1	3.5%	1979	7.4	5.5%	1989	14.7	3.3%	1999	32.6	1.1%			

This illustrates how cheap valuations of European stock markets are today, both in relation to the US and in a historical context. The only times that P/Es and dividend yields of equities were this compelling during the past 50 years were at the market troughs in 1974, 1979 and 1982. All proved to be excellent times to invest in shares. Although corporate earnings are quite volatile through an entire economic cycle and dividends are cut or eliminated by some individual companies during downturns, for the overall market, dividends tend to remain quite firm. Indeed, over the past 50 years, the dividends paid by S&P 500 constituents fell only twice for two consecutive years and only twice in single years. The largest peak to trough decline in dividends during the period was 6%.

Today, dividend yields on European equities are nearly double those of 10-year government bonds issued by their respective countries (as well as double those of US equities). In 1974, 1979 and 1982, the reverse was true, (10-year government bond yields were higher than dividend yields) so in this respect, valuations of European equities are even more attractive this time around. The chart below shows the dividend yield gap (bond yield minus dividend yield) in Italy. We have 12% of the Fund's assets invested in Italy and this is a good example of the extreme value that is on offer today in the equity market relative to government bond yields.



The other reason why we believe that we can generate abnormally high returns over the next 5 years is because indiscriminate, forced selling has resulted in the shares that we own selling at the biggest discount to our appraisal of fair value that we have ever seen. A pure measure of this is the 59% average discount to NAV at which the European holding companies in the Fund's portfolio now stand. This discount is not subject to flimsy earnings estimates, but is based on the mark-to-market prices of their holdings in listed companies which comprise the majority of their assets. The only subjectivity that enters the equation is an estimation of the value of any unlisted assets which in aggregate represent about 25% of NAV. Another measure is the 58% average discount to NAV at which the closed-end funds and investment trusts in the Fund's portfolio currently stand. Again the majority of the assets held by our closed-end funds are cash or listed assets. I have never seen discounts this wide except in isolated instances in my 25 years in the investment business. As liquidity returns, these pricing discrepancies should narrow, contributing we believe to the Fund's future outperformance of its benchmark index. Currently, investment holding companies account for 26% of the Fund's NAV and closed-end funds account for 16% of NAV.

We believe that many companies will not survive this economic downturn. This will make it difficult for market indices to post the returns that we are targeting. There are five companies in the Fund's portfolio with some canine features which we think could be tested in a deep, protracted downturn. We have not sold their shares because we like their business models, the quality of management, and their long-term track records. In aggregate, these risky holdings account for less than 3% of NAV. We think the risk/return of these holdings is very favorable: in a sense, they are priced like out-of-the-money warrants with long expiry dates.

The Fund has 15% of its net assets currently in cash, most of which we plan to invest in the near term. Most of this cash arises from the realised gains on hedging $20 million of the Fund's Euro exposure and $20 million of Sterling exposure. These forward currency swaps were settled with Royal Bank of Canada, the Fund's custodian just prior to year end. Since the Euro and Sterling are now selling at levels much closer to purchasing power parity and are no longer obviously overvalued against the Dollar, we will not be hedging the currency exposure, at least not at current levels. Furthermore, we have long-term concerns about the US Dollar and we believe that the strength of the Dollar last year is a short-term phenomenon related to the net flow of portfolio capital from Europe (and the rest of the world) to the US. We think this is likely to reverse this year.

The immediate economic outlook is frightening. However, we must remember that stock markets peak and trough ahead of the economic cycle. Based on our experience following the Asian financial crisis, which was the only other crisis of similar magnitude that I have experienced in 25 years working in this business, I am optimistic that I will be reporting favorable results to you this time next year.

Desmond Kinch, CFA
Chairman

Important note regarding year end NAV:

Owing to delays in receiving definitive valuations of one of the Fund's major investments (Greenpark International III, which represents approximately 8% of NAV), the NAV calculated as at 31st December 2008 should be regarded as "provisional". A definitive figure will be applied when Greenpark International III supplies its fair market value (FMV) figure as at 31st December 2008 which we do not expect to receive until the last week of February. Accordingly, the redemption prices of shares redeemed as at 31st December 2008 and 31st January 2009 are subject to adjustment and, likewise, the number of shares provisionally allotted as at 31st December 2008 and 31st January 2009 in respect of subscriptions are subject to adjustment.