Overseas Asset Management

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OAM European Value Fund

Dear fellow shareholder,

Last year was an *Annus Mirabilis*. OAM European Value Fund's NAV per share increased by 59.3%. By comparison, the Fund's principal benchmark, the MSCI Europe (US$) index, increased by 32.9%. I concluded last Chairman's statement following 2008's *Annus Horribilis* by saying:

> "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 favourable results to you this time next year."

While I expected 2009 to be a year of positive returns, in the same way that 2008 turned out to be far worse than I anticipated, I am pleasantly surprised at the extent of the returns during the past year. Nevertheless, a recovery of this magnitude following a financial crisis is not unusual. For instance, in 1999, immediately following the Asian financial crisis, the NAV per share of OAM Asian Recovery Fund increased by 69%. In another sense, we should not be terribly surprised that 2009 turned out to be a very good year for the Fund. Valuations were at extreme lows at the start of last year. As I stated in last year's Chairman's statement:

> "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. ….. 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."

I am pleased to say that very few of the Fund's shareholders redeemed shares during late 2008 and early 2009 at the depth of the financial crisis. Last year, the Fund had net subscriptions of about US$5 million, which although lower than 2008's net subscriptions, they were weighted towards early in the year when European equities were cheapest.

The indiscriminate selling of last year has given way to more orderly markets that are now valued much closer to what we believe is fair value. European equity valuations are no longer very compelling; nor are they expensive. Shareholders should not expect stunning returns again this year. However, valuations are sufficiently compelling that we think the probability of making money for shareholders this year is quite favourable. To put this in perspective, here follow a few metrics that compare current valuations with last year and average figures during the Fund's seven-year life. Last year, I wrote that:

> "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."

Today, the average discount to NAV of the European holding companies in the Fund's portfolio is 49%. By comparison, the seven-year average discount to NAV for the Fund's investment holding companies is around 35%. We are particularly excited about the prospects for this part of the Fund's portfolio which accounts for 27% of the Fund's NAV.

In last year's Chairman's statement, I added that:

> "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."

Today, the average discount to NAV of the closed-end funds in the Fund's portfolio is 38%. By comparison, the seven-year average discount to NAV for the Fund's closed-end funds is around 20%. We think there are some catalysts already in place and others that we are working towards putting in place that should narrow this average discount to NAV significantly during the next 2-3 years.

In my final reference to last year's Chairman's statement, I mentioned "five companies in the Fund's portfolio with some canine features which we think could be tested in a deep, protracted downturn [that] account for less than 3% of NAV." All five holdings were sold last year due to our concerns about their level of debt. BW Gas was sold at the price at which it was later taken private by the Sohmen family. Cattles plc was sold before it was de-listed and ultimately went bankrupt in what seems to have been an accounting fraud. Camfin was sold just before it conducted a rights issue. Clinton Cards and Partnertech were sold earlier in the year at prices well below their current prices. We would like to think that the proceeds from these two sales were reinvested in equities that performed even better, although this is unlikely to have been the case with the Clinton Cards sale. As they say, you can't get every decision right! We feel that all the Fund's current holdings have balance sheets that will allow them to survive and prosper going forward.

There are a few risks that we think are not fully appreciated by investors. Firstly, we think that the risk of further banking problems are quite high, particularly amongst European banks. European banks still have too much leverage and do not seem to have owned up to many of their problem assets. Instead, they seem to be pursuing a strategy of growing their balance sheets so that they are deemed too big to fail. We sold both Credit Agricole and Axa at prices not far away from current levels. Although both companies look superficially cheap, they both have some "black box" characteristics that make their accounts difficult to understand. We felt more comfortable investing the proceeds elsewhere.

Another risk that we think is underappreciated is sovereign risk. Many commentators use the acronym PIGS to refer to the weak sovereign debtors of Europe: Portugal, Italy, Greece, and Spain. We think that Italy, Spain and Portugal will be fine. Accordingly, the Fund has an investment in the March family investment holding company (one of the wealthiest families in Spain), the Espirito Santo family investment holding company (one of the wealthiest families in Portugal), and investments in the holding companies of the Agnelli, Pesanti, de Benedetti, and Caltagirone families (amongst Italy's wealthiest families). We are more worried about Ireland, and particularly Greece, and accordingly have no exposure to either market. We also have no exposure to Eastern European including the Baltic and Balkan states, most of which we think are facing similar problems.

The other risk that we think is underappreciated is that the Euro and Sterling could weaken against the US Dollar. Sentiment against the US Dollar seems to be universally negative which is often a classic sign of a trough. Most measures of purchasing power parity also suggest that the Euro and Sterling are overvalued against the Dollar. We have no strong view on future currency movements, but if forced to bet would lean towards a recovery of the Dollar this year. Therefore, we are considering hedging part of the Fund's Euro and Sterling exposure. We are likely to do this through forward sales of Euros and Sterling. The Fund will be required by the bank through whom we do forward sales to provide collateral to cover mark-to-market losses plus a margin. After what happened to many investors who had collateral held by Lehman as a counterparty, we will almost certainly keep sufficient cash in the Fund as collateral rather than using the securities held by the Fund as collateral for a foreign exchange hedging facility. The Fund had US$6 million (5% of NAV) in cash at year end. In addition, the Fund has more than $2 million invested in shares of Permasteelisa SpA which is the subject of a privatisation transaction by its major shareholders so this will be a source of additional cash over the next couple of months. One of the Fund's holdings, Dragon Oil plc, was also the subject of a privatisation transaction by its major shareholder, but this attempt was defeated a few weeks ago by the company's minority shareholders. We are happy to retain our shareholding in Dragon Oil because we think the proposed privatisation offer price undervalued the company.

We deliberately run a concentrated portfolio. Fewer than 20 investments account for more than 60% of the Fund's net assets. Most of these holdings which each account for about 3-6% of the Fund's NAV fall into one of three distinct categories.

The first, and largest, category is family-controlled holding companies. Just over 4% of the Fund's NAV is invested (in aggregate) in the Boel family holding companies, Sofina and Henex. These are highly diversified, very well managed holding companies that have respectively provided shareholders with compound annual returns of 14% and 16% per annum during the past 15 years in USD terms, compared to 4% per annum for the MSCI World index over the same period. Henex which has done slightly better, is at the top of the chain of control, and currently trades at a higher discount to NAV, probably because its shares are less liquid. The Fund has a larger investment in Henex than Sofina. Both companies' balance sheets have net cash.

Our next largest holding company investments, each accounting for about 3% of NAV are the holding companies of the Bollore family in France, the Siem family from Norway, and the Agnelli family in Italy. The Bollore and Siem family holding companies have respectively generated compound annual returns of 15% and 22% per annum during the past 15 years in USD terms, but the Agnelli family holding company has lost money for its shareholders during the past 15 years. The Siem family holding company has net cash, the Bollore holding company has about EUR 600 million of debt supported by about EUR 3.5 billion of assets, while the Agnelli holding company is essentially debt-free. In the cases of the Siem and Bollore families, they own more than 80% of their listed holding companies so the free float is small, trading in the shares is fairly thin, and we are completely reliant on the controlling shareholder being fair to minority shareholders and not forcing them out at an opportunistic price. So far, their records are good. In the case of the Agnelli family holding company, there are three classes of shares. We own the preferred shares which trade at about half the price of the ordinary shares. Meanwhile the market capitalisation of the company is about half the net asset value. Furthermore, the largest investment of the holding company is Fiat, which itself is a holding company that sells at a discount to NAV. The three levels of discount make our shares very undervalued. There have been suggestions of a spin-off of the Fiat Auto business and there has been some fighting among the Agnelli heirs which leads us to believe that there are catalysts for the discounts at the various levels to narrow significantly. In the mid- to late-90's, the Agnelli family holding companies traded at premiums to NAV compared to today's large discount – one reason why the return to shareholders has been so disappointing.

We also have nearly 3% of NAV invested in each of the holding companies of the Pesanti family in Italy, the March family in Spain, and the de Benedetti family in Italy. The first two holding companies have good long-term track records of making money for shareholders with compound annual returns of 12% and 15% per annum during the past 15 years in USD terms. All three companies are essentially debt-free, with the Pesanti family holding company having the most net cash. The de Benedetti holding company has a less stellar track record, more or less matching the return of the MSCI World Index return during the past 15 years. However, we think it is an interesting investment, partly because the family holding company one level below the one in which the Fund owns shares was recently awarded EUR 750 million by an Italian Court that ruled against Italy's Prime Minister, Silvio Berlusconi, for allegedly bribing a judge. Without factoring in anything for this award (which is being appealed), the de Benedetti holding company's shares that the Fund owns are currently selling at less than half their NAV.

The second category of investments is private equity funds. With the exception of our commitment to Greenpark International Investors III, L.P. and investment in Partners Group Global Opportunities Ltd., these are listed private equity funds. The investment in Greenpark III which accounts for 4.5% of NAV is valued monthly at the most recent fair market value (FMV) provided to us by Greenpark's administrator. The administrator gets the FMVs for the underlying funds from quarterly reports provided by those funds' administrators. Shareholders should be aware that the Fund's other unlisted investment, Partners Group Global Opportunities (1.5% of NAV), was de-listed last month and will be valued monthly by applying to the most recent NAV the average discount to NAV of listed private equity funds-of-funds in Winterflood Securities' universe. The Fund will fully exit these investments by receiving distributions in the case of Greenpark III and redeeming shares at NAV in the case of Partners Group Global Opportunities during the next 5-7 years.

In total, the Fund has 15% of net assets invested in private equity funds. The Fund's investments in Heliad Equity Partners and RHJ International each account for just over 3% of net assets. Both investments were purchased for less than net cash on each of the companies' balance sheets. This year, both private equity firms have invested some of their large cash balances. In the case of RHJ International, they acquired Kleinwort Benson at 1.1 times tangible book value in what looks like a very good deal. Tim Collins, the Chairman of RHJ and founder of Ripplewood did one of Japan's most successful private equity deals ever when Ripplewood bought Long-Term Credit Bank, turned it around, and IPOed it a few years later as Shinsei Bank. Leonard Fischer, the CEO of RHJ, turned around Winterthur before Credit Suisse sold it to Axa for a very good price. RHJ has a lot of expertise in turning around financial companies which bodes well for its shareholders.

Heliad's largest shareholder is the Quandt family, directly and indirectly through a listed German company. They are also the controlling family of BMW. We are the third largest shareholder in Heliad with a 9.5% stake. Recently, Heliad's Supervisory Board proposed to acquire Themis, another listed private equity fund of which the Quandt family is the largest shareholder, on terms which are dilutive to Heliad's NAV per share. We opposed the terms of the transaction and have been in discussions with Heliad's managing partners and Supervisory Board. Based on the outcome of these discussions, we will try to better determine the prospects for NAV appreciation and narrowing of the huge discount to NAV at which the shares trade, and then decide on our course of action.

The third category of investments is agricultural companies. We believe that a combination of rising living standards will lead to higher protein consumption which in turn will lead to higher grain consumption (due to the amount of grain required to raise a pound of protein). This, along with the increasing shortage of water, the limited supply of arable land, the competition for food from biofuels, and the very low supply of global grain inventories, are likely to lead to much higher agricultural commodity prices. The Fund's largest investment is Yara International (6% of NAV), the world's largest and lowest cost producer of nitrogen fertilisers. Yara's shares do not look cheap based on 2009 estimated earnings or even on consensus estimates of 2010 earnings. The shares may have got a bit ahead of grain prices in the short-term. Accordingly, we sold about 15% of the Fund's Yara holding last month. However, we think the shares are trading at about 10 times average earnings throughout the cycle and at about half the replacement cost of its assets. Furthermore, we think that grain prices are likely to be very strong during the next few years and given fairly tight fertiliser capacity, prices of fertiliser should skyrocket again under such circumstances. Yara noted in its third quarter report that "the USDA forecasts a strong global grain harvest. However, even the second-largest crop on record is estimated to be only sufficient to match consumption. Normalised weather patterns should require increased fertiliser application to keep up with growing grain demand for food, feed and fuel." If we are right in our forecast for grain prices, earnings estimates for Yara will need to be upgraded.

We also have 4.5% of the Fund's net assets invested in three companies (which we treat as one investment) controlled by the Fabri family in Switzerland. The three companies are all listed in Luxembourg. Between the Fabri and Bollore families, they control well over half the shares in these three companies - two are operating companies and the other is a holding company which sells at a discount to the sum of its cash and investment in the two operating companies. All three companies have large amounts of net cash on their balance sheets. No analyst follows any of these companies which explain why their shares are ultra-cheap. Yet, they are amongst the most efficient growers and refiners of palm oil in the world with extensive plantations and refineries in Indonesia and West Africa. Excluding the variation in the valuation of biological assets (a non-cash item on the income statements of plantation companies), the two operating companies are selling at P/Es of about 6 times 2008 earnings and based on the dividends they paid this year, yielding 7% and 9% net of withholding tax. Palm oil prices peaked at $1,400 per tonne in the first quarter of 2008 before falling rapidly to a trough of $450 per tonne in the fourth quarter of 2008. Since then, prices have rebounded steadily to over $800 per tonne. The average palm oil price was about $940 per tonne in 2008 which marked peak earnings. Current palm oil prices are not far away from 2008's average. Palm oil is the cooking oil of choice in Asia so demand is rising.

There are five other investments held by the Fund that each account for 3-4% of the Fund's NAV but which fall into no particular category. The largest is Vopak, the world's largest owner of tank farms at strategically important harbours around the world. They store oil, chemicals and increasingly biofuels. This is a wonderful business with very strong barriers to entry, good pricing power, and long-term contracts that leads to good visibility of earnings. Even though Vopak's share price is at a record high, we think they are not fully valued, currently trading on 14 times 2009's estimated earnings. Businesses of this quality and visibility with good growth prospects and strong cash flow are rare so we view this as a core long-term holding which ought to continue providing good returns over the long-term.

We view Hiscox in a similar light. Hiscox is a Lloyd's insurance underwriter that recently re-domiciled to Bermuda. While they are in a highly competitive business, we continue to be very impressed by the senior management who we met about five years ago. In the nearly 15 years that Hiscox has been a public company, they have generated returns of more than 12% per annum for shareholders versus 3% per annum for the FTSE All-Share index and zero for the FTSE Non-Life Insurance index over the same period. We think the shares are cheap on 1.35 times book value, yielding more than 4% after-tax, and less than 10 times what we think the company can earn through the underwriting cycle.

The other three large holdings are ASM International, Schweiter Technologies and RAB Special Situations plc. I have written to shareholders several times in the past about ASM International. The company owns two businesses: 100% of a loss-making front-end semiconductor equipment manufacturing business, and 53% of ASM Pacific which is the world's leading back-end semiconductor manufacturing business. ASM Pacific has been an outstanding business with an unrivalled track record in its field. The front-end business is another story. Currently, the stock market attributes a value of about minus EUR 400 million to the front-end business after stripping out the value of the ASM Pacific stake and factoring in the small amount of parent company debt. However, we believe that the front-end business which has been moved to Singapore will be profitable in the next year or two and may eventually be sold. Prior to the financial crisis, Applied Materials, the world's largest front-end semiconductor equipment manufacturer offered to buy the front-end business with another firm for about US$600 million. Due to the financial crisis and opposition from the del Prado family that founded the business, the deal fell through. The fact that Tokyo

Electron and Intel Capital each own about 5% of ASM International and a couple of aggressive hedge funds also have significant shareholdings suggest that there is good value in these shares and something is likely to happen (eventually) to release that value.

Schweiter Technologies is a very well managed Swiss niche engineering company. I met the CEO a few years ago and was very impressed. The Chairman and founder still owns 25% of the company creating a great alignment of interest with shareholders. Prior to the financial crisis, the company sold its largest division at a very good price. They sat patiently on the proceeds, and for much of the crisis, its shares were selling for less than net cash on the balance sheet. In September, they agreed to buy Alcan Composites, a world market leader, from Rio Tinto. They paid less than 4 times 2008 EBITDA which appears to be a very cheap price for a world leader with strong brands. After this transaction, the company still has about CHF 300 million in net cash. This company has a superb track record so I have no fears that it will squander its cash. During the past 20 years, Schweiter has generated a return of 20% per annum for its shareholders.

RAB Special Situations plc is a closed-end fund listed on AIM with only one asset, shares of the RAB Special Situations Master Fund. The shares trade at a 30% discount to NAV. While the Master Fund has a lock-up for shareholders until September 2011, we are trying to create a catalyst to realise the underlying NAV of our investment for shareholders. Since we own more than 10% of the company, it gives us some power to help us achieve that objective. We have high regard for the Master Fund's manager, Philip Richards, and think that he will be able to increase the Master Fund's NAV meaningfully over the next two years. We also have an investment in RAB Capital, the Master Fund's manager, that accounts for 2% of NAV. We like the fact that the founders of RAB Capital still own 50% of the company and are still deeply involved. Although the company lost money in the first half of 2009, expenses have now been brought more closely in line with sharply lower revenues. The company is in a strong position for recovery with net cash and securities equivalent to more than the company's market capitalisation. In other words, we are effectively being paid to take a free call option on its operating business.

As shareholders were advised a few months ago, Georgie Loxton now co-manages the Fund with me. Georgie is responsible for about 25% of the Fund's investments which are investment ideas that she generated or which I suggested that she analyse. Over time, I expect the proportion of the Fund that she manages to rise. The "Georgie portfolio" as we refer to it internally has performed well.

In conclusion, while I am slightly negative about the currency outlook for the Fund (which we hope to mitigate through partial hedging of the Sterling and Euro exposure) and I think that European equities are fairly valued - neither cheap nor expensive - I do not think the market inefficiencies that appeared on a massive scale during the financial crisis have been fully exploited. I am particularly excited by our holdings which are a mixture of great long-term businesses, deeply undervalued holding companies, and very cheap companies that ought to be worth a lot more. All our investments are soundly financed and are survivors regardless of whether we have emerged from a V-, L-, U-, or W-shaped recession. On balance, I think we should be reporting another good year this year, though nothing like last year and volatility can not be ruled out.

The Fund has completed its seventh year. During the past seven years, it generated a compound annual return of 15.1% per annum for shareholders versus 7.7% per annum for its benchmark, the MSCI Europe (US$) Index. According to Bloomberg, this puts the Fund in the top 4% of European equity funds over the past 5 years based on its return and in the top 2% on a risk-adjusted basis (giving equal weight to return and the Sharpe ratio which measures return divided by the standard deviation of the return) over the same period.

Desmond Kinch, CFA
Chairman