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OAM European Value Fund

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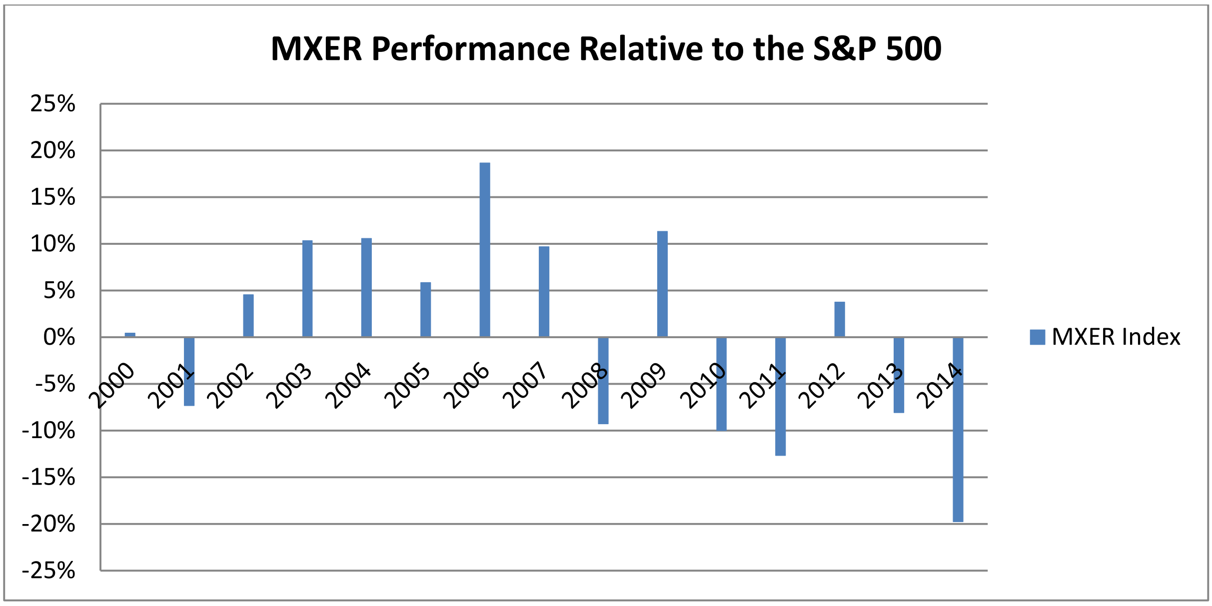
Dear Fellow Shareholder,

Last year was a tough year for European equities. The MSCI Europe (US$) index fell 9.6% last year while the Fund's NAV per share declined 8.7% to end the year at $36.63. The euro fell by 12% against the US Dollar last year so all the decline in the Fund's NAV and in European equities was due to currency losses. During the 12 years since inception, the Fund's NAV compounded at 11.4% per annum, while the MSCI Europe (US$) index rose by 5.2% 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. As clients are aware, we charge investment management fees at the segregated account level rather than within each fund so that returns cited are before investment management fees. It is to clients' benefit that we charge fees in this way as any performance fees are charged on the return generated in the client's account rather than on the performance of each fund. We recently did an analysis of European equity fund returns on Bloomberg. It is not possible to show the total return of European funds since the Fund's inception at the start of 2003. We therefore sorted European equity funds by 10-year total return. OAM European Value Fund ranked 22nd out of 499 funds. This is a pleasing result, particularly when taking into account survivorship bias: a lot more than 499 European equity funds would have been in existence for part of that 10-year period but did not survive, or their Bloomberg ticker would have been abandoned due to poor performance or small size.

CAPE and expected future returns

For some time, I have been singing the virtues of there being better value in European equities than in US equities. The discrepancy between European and US equity valuations has widened further following five years of underperformance by European equities compared to US equities. As this very simple chart of total returns (including dividends) year-by-year during the past 15 years shows, there is a strong pattern of mean reversion. In other words, long periods of outperformance of European equities tend to be followed by similarly long periods of underperformance. We think the probability of a long period European equity outperformance has increased as performance, and by extension, valuations have diverged.



In last year's Chairman's statement, I briefly mentioned CAPE which is the abbreviation for Cyclically Adjusted P/E. It is also referred to as the Shiller P/E, named after the esteemed Yale economist who brought it to the attention of the investing world. CAPE serves a very useful function in that it blunts the effect of cyclically high or low current earnings in measuring equity market valuations. Instead, it takes the average of the past 10 years' earnings as the denominator (the "E") in the P/E. Empirical research has shown that there is a high correlation between the current CAPE and future 10-year equity market returns. In recent years, this empirical research has spread from a study of US equity market 10-year returns to other markets so that we now have a body of research that covers most European equity markets.

Research Affiliates LLC (www.researchaffiliates.com) has done a huge amount of research on CAPE and expected future returns in equity markets around the world, and has generously shared its research results on its web site which I highly recommend. Based on their research, they estimate that US equities will return 0.4% per annum in <u>real</u> (inflation-adjusted) terms over the next 10 years. GMO (www.gmo.com) also publishes their estimated real return estimates for various asset classes over the next 7 years. They currently estimate a <u>real</u> return for large US equities of -1.8% per annum. The reason for such a low expected real return is because US equities have such a high starting valuation: CAPE is currently 27.1. In contrast, Research Affiliates expects <u>real</u> 10-year returns of 3.8%, 5.1%, 6.7%, 7.0% and 17.0% per annum respectively in US Dollar terms from making currency-unhedged investments in equity markets in Germany, France, Italy, Spain and Russia. This is largely because of low starting valuations in Europe. For instance, the CAPE for UK equities is currently 12.0, and for Italian equities it is 9.2. For Russian equities, CAPE is currently 4.6.

<u>A few highly profitable agricultural companies</u>

We tend not to be thematic investors. However, from time-to-time, we find clusters of value in a particular geographic area or industry. Agriculture is one area we have long favoured, and the Fund currently has 9% of its assets invested in agriculture. Yara International has been the largest, or one of the largest, investments in the Fund for more than the past 10 years. We think this is a very well-run company that, in spite of delivering a 21% compound annual return in US Dollar terms to shareholders in the nearly 11 years since it was spun off from Norsk Hydro, 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 returned 8% last year in US Dollar terms, a better result than the market. 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. Meanwhile revenues are denominated in US Dollars as fertiliser is priced in USD.

We think that stricter environmental standards in China where most nitrogen fertiliser is made from coal, as well as urea prices plus transport costs being close to China's average production cost are likely to crimp the global oversupply of urea, not immediately, but over the next few years. When the nitrogen fertiliser market moves from its current supply-driven pricing to demand-driven pricing, we expect earnings at Yara to surge from current levels. Meanwhile, we are invested in a company that generates a free cash flow yield of close to 10%, with a policy of returning 40-45% of earnings to shareholders through dividends and share repurchases. During the past 10 years, Yara reduced its shares outstanding by nearly 15% through share repurchases, whilst eliminating the debt on its balance sheet and paying an attractive annual dividend.

We also like the palm oil plantation business. Palm oil demand is growing much faster than the demand for most commodities, mainly because it is the primary cooking oil used in emerging markets where living standards are rising rapidly and the population is eating more protein. During the past five years, palm oil prices fluctuated between $700 and $1,300 per tonne, averaging $950. Currently, palm oil prices are cyclically depressed at $725/tonne partly because of good harvests and partly because of an oversupply of soy oil which is a substitute. This is largely a result of favourable rainfall patterns in the areas of the world where most palm oil and soy is grown. Many palm oil plantations, including all the ones in which we own shares, also grow significant amounts of rubber on their plantations. During the past five years, the price of rubber fluctuated between $1,800 and $6,400/tonne, averaging $3,800. Rubber prices are currently cyclically depressed at $1,880 per tonne. The time to invest in commodity producers is when their profits are cyclically depressed.

A few months ago, we did a "deep dive" into the palm oil and rubber plantation industry. We concluded that our four listed plantation companies - Socfin, Socfinasia, Socfinaf and Anglo-Eastern Plantations (AEP) – are all better than average quality plantation businesses, all have pristine balance sheets, and trade at huge discounts to the valuation of plantation companies listed in South East Asia or Africa. We think this valuation anomaly is due to these companies being listed in Luxembourg and London. In recent months, two London-listed palm oil companies - New Britain Palm Oil and Asian Plantations – were acquired by leading Malaysian palm oil companies, Sime Derby and Felda. While we do not see any likely prospect of AEP or the Socfin companies being taken over as they are controlled by the Lim and Fabri/Bollore families respectively, we were struck by the valuations paid for these companies. Felda paid nearly $20,000 per planted hectare for Asian Plantations, a small plantation, and Sime Derby paid $25,000 per planted hectare for New Britain Palm oil that owns 78,000 of palm oil plantations in Papua New Guinea, or 23 times average earnings for the past five years. Generally, large plantations are worth more per hectare because of economies of scale. The better-run plantation companies listed in South East Asia are currently valued at $15-20,000 per planted hectare and around 15-20 times enterprise value (EV) to average earnings for the past five years. In contrast, these are the valuations of our plantation operating companies. All of our plantations grow both rubber and palm oil, but palm oil is dominant, and yields and pricing differ in South East Asia compared to West Africa. They are all fully integrated with mills and refineries, and in the case of Socfinasia, it has an important palm oil seeds business. Socfin is a holding company that holds controlling stakes in Socfinasia and Socfinaf and cash which trades at a discount to the sum of its parts. The shares of none of them are terribly liquid, but they each offer compelling value as well as having great track records of compounding wealth for shareholders.

Plantation company	Planted hectares (proportional ownership)	P/E (EV/5 yr earnings)	EV/planted hectare
Socfinaf	81,000	8	$4,700
Socfinasia	48,000	7	$9,100
Anglo-Eastern Plant	52,000	6	$5,600
Astro Agro Lestari	220,000	20	$15,600
First Resources	141,000	17	$18,300
Bumitama Agri	97,000	32	$16,900

Quality merchandise on sale in Russia

During the second half of last year, we decided to invest about 6% of the Fund's net assets in Russia. We have always avoided investing in Russia, barring an investment that we made a few years ago in Raven Russia, a London-listed owner of modern logistics warehouses located principally on the ring roads around Moscow and St. Petersburg. We owned their preference shares which we bought at par in mid-2010 with a tax free yield of 12% and sold them less than three years later at 150% of par, whilst collecting attractive preferred dividends. We also bought ordinary shares in mid-2010 and have traded around our holding, making a decent return on our investment since then. In the latter half of last year, we added to our holding in Raven Russia at various prices equating to a discount to NAV of 25-40%, in spite of an 11% capitalisation rate being used to value its Moscow warehouses and 12.5% rate for its St. Petersburg warehouses. We think that the price that we paid recently for the ordinary shares will equate to a more than 10% dividend yield.

What struck us about Russia is that in spite of the messy political situation and a poor record in corporate governance, we were able to identify two companies with GDRs that trade in London that are extremely profitable, free cash flow generative businesses which pay attractive dividends. We think these two businesses are world-class and are selling at a much lower valuation than far less profitable or free cash flow generative peers based elsewhere. The kinds of returns being projected for Russian equities by Research Affiliates are in line with our expectations for our Russian investments. We are starting from a point where equity valuations are cheap with the CAPE for Russia being one-sixth that of US equities.

The currency also looks cheap following a 46% fall in the ruble versus the US dollar last year. The Big Mac purchasing power parity (PPP) indicator ranks the ruble as by far the most undervalued currency in the world. This is the first time that we have ever seen a country's currency collapse from an already cheap level when it has a current account surplus; very low debt-to-GDP at the government, corporate and individual level; and large reserves of foreign currency and gold. The standard explanation for the collapse is the political uncertainty combined with the sudden sharp drop in oil prices which is obviously a big worry for the Russian economy. We know that Russia is different, but similar concerns could be attributed to many emerging markets. We think it is a combination of capital flight by rich Russians and foreign investors who are paralysed by the fear of capital controls which is a distinct possibility, though one that we would not expect to be sustained over our typical investment time horizon of 4-5 years. To put the currency decline into perspective, the ruble has declined from 34 to 65 vs the USD since the end of June, while PPP is estimated at 17.5. Our best guess is that within a year, the ruble will recover significantly against the USD. That is what happened following a currency over-reaction and capital flight during the Asian financial crisis.

Sberbank is our biggest investment in Russia. Since 2007 it has grown assets at an annual growth rate of 24% and net profit at 23%, and it has achieved an average return on equity (ROE) of almost 20%, yet during that period, the share price has fallen 30% in rubles. There are a few reasons why this bank is so profitable. Firstly, it is exceptionally well-run with a cost-to-income ratio of 41.5%. Secondly, it is dominant in Russia to an extent rarely seen elsewhere in the world. In Russia, it has a 46% market share of retail deposits, 34% of corporate loans and 35% of retail loans, 18 times as many branches as its next largest competitor, VTB. With this high market share, Sberbank essentially has a monopoly on retail banking in Russia and as a result, a cost of funds advantage to other banks. This funding cost advantage relative to its competitors resulted in its net interest margins remaining high at 5.7% (for the 9 months to September 2014). In fact, during every global recession and financial crisis during the past 16 years, Sberbank has increased its domination of the Russian banking market and grown EPS at a very high rate, with temporary dips in each recession or financial crisis.

Given this track record of profitable growth, one would expect Sberbank to trade at a premium valuation. The closest comparable bank that we can think of in emerging markets is Public Bank in Malaysia which generates a 20% ROE and a similar growth rate. Public Bank trades at 15 times earnings and more than 2.5 times book value, whereas Sberbank trades at 5 times earnings and at 0.6 times book value. Over the past 10 years, Sberbank shares traded at a median Price/Book ratio of just over 2 which we think is about right, balancing the political risk of Russia with the exceptional profitability of this bank.

Our other new Russian GDR investment is Gazprom Neft, the oil exploration and refining arm of Gazprom, Russia's largest natural gas company. Gazprom Neft generates a 20% ROE and has been growing rapidly. Over the past 15 years, in US Dollar terms, earnings per share (EPS) grew roughly 15-fold and shareholders generated a return of 21% per annum. In spite of this superb track record, Gazprom Neft has a lower valuation than its Russian peers, Rosneft and Lukoil, its parent Gazprom, and trades at less than a third the valuation of its global integrated peers such as Exxon, Shell, and Total, and state-controlled integrated oils like Petrochina and Petrobras. With a 333% reserve replacement ratio and proven reserves of 9,188 million barrels of oil equivalent (BOE), it is surprising that it is valued at only $3 per barrel of proven reserves and an unleveraged P/E of only 3. The only oil company outside Russia that we can find with valuation metrics and a track record even close to Gazprom Neft is Dragon Oil, one of the Fund's largest holdings. In a sense, Gazprom Neft is even cheaper than it looks because it has a huge refining and retail arm, with a 14% market share in crude oil refining in Russia.

Our foray into Russia has been costly so far. There are two parts to our loss. The first part is the share price decline in local currency. The second part of the loss has been caused by the rapid ruble depreciation. We are down about $7 million from cost on our Russian investments so it has cost the NAV of OAM European Value Fund about 3% this year. On anything close to a reversion to the mean for ruble and the valuation of our three Russian investments, we should recover our losses and make decent returns on these investments. In the meantime, we think all three companies are survivors even with stress-testing quite far beyond anything we have experienced so far.

Research Affiliates recently published an astute commentary on Russia in which they said:

"The present crisis is a solvency problem, not an inability to service debts. Many Russian companies need to refinance their hard-currency debts. Sanctions prohibit this refinancing. Russia's biggest oil company, Rosneft, seems to have created the turmoil which caused the ruble to drop so sharply in December. According to the *Financial Times* (2014), Rosneft has $19.5 billion in debt due next year. If oil prices stay at the current $60 a barrel level, its revenue will cover only $15 billion; it is short $4.5 billion. Rosneft recently placed the equivalent of $10.8 billion in a ruble-denominated bond offering, and it is rumored that the company substantially converted the proceeds into dollars to replenish its reserves. Apparently, this transaction caused the recent panic in the currency and stock markets. ….. In investing, what is comfortable is rarely profitable. Investing in Russia now is definitely discomfiting, but it might pay off in the long run."

Eating the same cooking as some honourable Italian families

Like Russia, the Italian equity market looks particularly cheap. According to Research Affiliates, it trades at a cyclically adjusted P/E (CAPE) of roughly 9 compared to a CAPE of 27 for the US equity market. Nearly a year ago, Matteo Renzi was elected Prime Minister of Italy with major and much-needed reform plans. He is trying to make changes to Italy's constitution and Italy's archaic labour laws that would make it much easier to hire workers and make the rules for terminating them more predictable. One of Mr. Renzi's leading economic policy advisors, Yoram Gutgeld, is a former senior partner of consultants McKinsey. Gutgeld estimates that if the new law is passed by the lower chamber of parliament and is approved by the EU, a worker earning €20,000 a year would see his or her net pay rise from €1,200 to €1,350 per month, while the cost to the employer would drop from €2,200 to about €1,650 per month. The new law has already been passed by the Italian Senate. This could be a major catalyst for change in Italy.

We have long followed Italian family-controlled holding companies and over time have made decent returns from investing in them. There are a few Italian families who have no respect for minority shareholders, but we have learnt over the years who they are. Currently, we have investments in three Italian family-controlled holding companies, ASTM, Cofide and Italmobiliare, and one Italian family-controlled operating company, Danieli, which in aggregate account for nearly 10% of the Fund's NAV. We discussed ASTM and Danieli in last year's Chairman's statement, so all I will say is that both businesses performed well last year and we were able to add to our shareholding in each company at a lower price than a year ago during periods of market weakness in the latter half of last year. Both companies' shares are more undervalued than they were a year ago.

Cofide is a new holding. In September 2013, we sold the Fund's investment in CIR. Cofide controls CIR through a 46% shareholding, and Cofide in turn is controlled by the De Benedetti family through a 52% shareholding. The main reason why we sold CIR was because one of its major investments at the time was Sorgenia, an electricity generator that owned co-generation plants and renewable energy sources. We had concerns about the amount of debt at Sorgenia and its low profitability and when we sold CIR, its share price discount to NAV had narrowed to around 30%. In October, we bought shares of Cofide at a 45% discount to NAV. In July, Sorgenia declared bankruptcy and CIR effectively gave the banks its shares in Sorgenia so CIR has already taken the impairment to its NAV from this investment. Cofide's share price is 35% lower than it was when we sold CIR. What makes the 45% discount to NAV particularly attractive is that 25% of the NAV is accounted for by net cash and another 15% is invested in a portfolio of hedge funds and private equity funds which could probably be liquidated in a few months for close to their carrying value. CIR has a decent track record of investing in hedge funds and private equity funds. The remaining 60% of NAV is split almost equally between stakes in L'Espresso (a leading Italian media business that is listed), Sogefi (a maker of engine filters and auto suspensions that is also listed), and KOS (a leading nursing home company in northern Italy that it owns with AXA Private Equity, now known as Ardian). The big question is what they do with their huge cash pile. CIR recently announced that they would use some of the cash to buy back shares at the current massive discount to NAV which would be accretive to its NAV per share.

Italmobiliare is the company that I chose to profile in my presentation at the Santangel's conference in October 2013. During the year, we traded successfully around our holding, selling a third of our savings shares at an average price of more than €20 per share, and then buying back half of what we sold later in the year at just over €12 per share. Italmobiliare is trading at a 48% discount to NAV and the savings shares trade at a 23% discount to the ordinary shares. The principal asset of Italmobiliare is a 44% shareholding in Italcementi, the fifth largest cement company in the world outside China. Italcementi's share price is slightly higher than it was three years ago in USD terms, whereas its closest peers (with which its share price has historically been highly correlated) – Lafarge and Cemex – have roughly doubled during the past three years. Italcementi is currently valued at only around $60 per tonne of capacity which is less than a third of replacement cost, a third of the implied value of recent industry transactions, and less than half the valuation of its key competitors. We expect Italcementi's profits to recover strongly in the next few years and the company to return to earning around their historic long-term average EBIT margins of 12%. Italcementi's share price should surge from current levels when that happens. Meanwhile, we urged the Pesenti family in 2013 to simplify Italcementi and Italmobiliare. Specifically, we recommended that they buy out the minority shareholders of Ciments Francais; buy back Italcementi and Italmobiliare savings shares in the market before ultimately merging them with the ordinary shares; focus on the cement business and divest Italmobiliare non-core investments; and reduce holding company costs at Italmobiliare. Last year, they implemented some of these recommendations so we are hopeful that during the next few years, they will implement the outstanding recommended changes.

We have used this "playbook" before in Italy with great success. In April 2010, Exor's share price discount to NAV was 50% and its preferred shares that we owned were trading at a 40% discount to its ordinary shares. We made a number of suggestions to Exor's Board during a conference call and in a letter where we recommended that they simplify the structure of Exor, the holding company, and Fiat, its principal investment. Specifically, we asked them to merge the three classes of shares of Exor and Fiat on terms that are fair to all shareholders; pointed out the poor returns generated from their diversification outside the core Fiat business and suggested that share repurchases at a large discount to NAV, starting with the preferred and savings shares would be the best use of cash; and pointing out that the capital used to invest in various listed equities would be better employed to repurchase shares, using an example to illustrate the accretion to NAV per share from repurchasing shares. I followed up to the Exor Board with another letter in June 2010 in which I concluded that:

"If Exor executes the plan that I outlined above and Sergio Marchionne's plan works (and there is every reason to give him the benefit of the doubt based on his track record at Fiat, SGS and Lonza), Exor's Board and management will be regarded as heroes by the market and Exor's discount to NAV will almost certainly narrow very substantially. These factors would all lead to Exor being one of the top performing equity investments in the world over the next five years. At the moment, Exor is being valued as a perpetual destroyer of shareholder value. It is time for the Exor Board and senior management to prove that the market is wrong in this assessment."

In May 2012, I wrote to John Elkann to say:

"I congratulate and thank you for pursuing what I believe is the right agenda. Specifically, you have been absolutely right to buy back shares, focusing on the cheaper savings and preferred shares; merge the three classes of Fiat and Fiat Industrial shares; and increase Exor's shareholding in Fiat and Fiat Industrial). I encourage you to do more of the same. The merger of the three classes of Exor share is still an outstanding issue, but in the meantime you can equally tackle this issue by "mopping up" cheap shares by buying them in the market at a discount to the ordinary shares. If or when you merge the three classes of share, I urge you not to save a few million euros by merging the share classes on terms that might aggravate the savings and preferred shareholders (as was the case with the merger of IFI and IFIL). If Exor savings and preferred shareholders are aggravated in this way, it is likely to take longer for the wide discount to NAV at which Exor shares trade to shrink. I have been critical in the past of Exor having debt which is then largely invested in financial assets. It is good that you have set out in the past two years the return on your financial assets and compared it to the cost of your debt. However, I still believe that it would be better for the company to more aggressively repurchase Exor shares, particularly the savings and preferred shares while they are trading at a discount to NAV in the 40's, than to invest in listed equities where you clearly have less of an "edge". Best wishes and keep up the good work!"

In last year's Chairman's statement, I wrote:

"In the case of Exor which we have discussed several times in the past, we sold the shares for three reasons: the preferred shares that we owned were merged into ordinary shares on a 1 for 1 basis as we anticipated, thereby eliminating the preferred share discount to the ordinary shares; the company's share price discount to NAV declined to less than 30% whilst we were able to buy shares in other well-run Italian holding companies like Italmobiliare and ASTM at around a 50% discount to NAV; and we had concerns about Brazil's economy and currency which is Fiat's most profitable market. As it turned out, we sold too soon, but we made a profit of about $5.5 million on our investment or a multiple of about 4 times. I give great credit to John Elkann, Gianni Agnelli's grandson, who has displayed an incredible grasp of business and capital allocation for someone so young."

Exor's share price discount to NAV has narrowed further this past year to 15% so it shows the huge effect that good capital allocation decisions can have on a company's share price. With the Italian equity market being more than 50% lower than it was in 2000 and 2007, there are a number of Italian companies that could benefit tremendously from taking such an approach. We are doing our part to prod the Italian companies in which we have invested in that direction. In particular, we have encouraged CEOs of our Italian holding companies to read William Thorndike's book "The Outsiders".

<u>Opportunities still exist in listed private equity funds</u>

Since the global financial crisis, we have found numerous investment opportunities in the listed private equity sector. These opportunities are becoming more selective as the discount to NAV at which some funds in the sector narrowed, with a few funds even commanding premiums to NAV. We currently have 13% of the Fund's net assets invested in listed private equity funds.

Our largest holding in the sector, and also the Fund's largest holding is Ashmore Global Opportunities Ltd. (AGOL). After AGOL traded at a discount to NAV over a long period of time, the Board, in consultation with the investment manager and shareholders, proposed a managed wind down of AGOL which was subsequently approved by shareholders at the EGM on 13th March 2013. The Board consequently changed the investment objective of AGOL to an orderly realisation of AGOL's assets in order to return cash to shareholders. On 24th July 2014, AGOL announced that its Investment Manager continues to believe that, subject to market conditions, the target distribution level of 50% NAV (as at 31 December 2012) by 31 December 2014 will be achieved. Shortly after year end (on 15th January), AGOL announced that 24% of its net assets (or a third of its current market capitalisation given that the shares trade a discount to NAV of almost 25%) will be returned to shareholders at the end of January. We have an investment of $13 million in AGOL, representing 6% of the Fund's net assets. The reason why we regard it as such a high conviction idea is that Ashmore is a respected investment manager and even on what we regard as conservative assumptions that AGOL returns just its current NAV over the next three years to shareholders, we would generate a 22% per annum internal rate of return (IRR) from the Fund's year end valuation which is very close to its cost, net of distributions received to date.

Our next largest investment in the sector is APEN, a Swiss-listed private equity fund, of which the Fund owns a 5% stake worth over $6 million or nearly 3% of NAV. APEN's share price discount to NAV at year end was 50%, making it a huge outlier in the sector and among closed-end funds in general. On 4th January 2015, APEN announced that it had divested of 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 (in USD terms) with reference to fair market values at 30th June 2014. This major transaction will make APEN much easier to understand and will immediately transform it to 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 APEN shareholder), is APEN's manager and has ambitious return targets for the new emerging markets strategy. Last year, one of my suggestions to GP Advisors and the Board to tackle the wide discount to NAV at which APEN's shares trade was to report in USD rather than Swiss Francs (to better reflect the reporting currency and exposure of the underlying assets) and to have the shares traded in USD. APEN also announced on 4th January that starting with the interim report as of 31st March 2015, they will report in USD. They also announced that the shares will trade on the Swiss Exchange in USD instead of Swiss Francs from May 2015. Since the announcement, surprisingly, APEN's share price discount to NAV remains unchanged at 50%. The only other request that we made is for APEN to take the opportunity to aggressively repurchase shares while they trade at such a wide discount to NAV.

In aggregate, the Fund has 7% of its net assets invested in APEN, Pantheon International Participations, Altamir, and NB Private Equity. These holdings are all managed by well-respected managers and trade at a dollar-weighted average discount to NAV of 33% which we think is very attractive. Deals in the private equity secondaries market are taking place at an average discount to fair market value of around 5%.

<u>VW/Porsche</u>

We increased the Fund's shareholding in Volkswagen from 25,000 shares to 45,000 shares during the year, while maintaining its holding of 25,000 shares of Porsche SE, the holding company of the Porsche-Piech family which controls Volkswagen. The Fund had an investment at year end in VW and Porsche that was worth $12 million, making it the Fund's second largest holding. The reason why we added to this investment was because the company's fundamentals are strong and when we added to our shareholding, VW's share price was temporarily depressed. Though we are not usually good at picking absolute bottoms, we bought 10,000 VW ordinary shares at the absolute low for the year of €150 per share in October. At that price, if you strip out the €16 billion net cash on Volkswagen's balance sheet, the company on an unleveraged basis was selling at just over 5 times 2014 estimated earnings. The three main profit drivers of VW are: China, where it is the clear market leader; Audi, where it is gaining market share in the luxury segment; and Porsche. Last year, deliveries by the VW Group in China, and by Audi and Porsche worldwide, increased by 12%, 10% and 17% respectively. Estimated EPS for the Group increased by about 19% in 2014 from the prior year.

The Group's longer term prospects are good. Sales of cars in Europe increased last year from a 20-year trough in 2013. The average age of cars in Europe is more than 8 years so any signs of economic recovery are likely to ignite replacement car sales. China is still primarily a first-time buyers' market and car ownership remains at about one eighth of US levels on a per capita basis. In China, about 80% of car buyers pay cash, whereas in the US, the inverse is true. Meanwhile, VW's global market share continues to increase, no doubt helped by its healthy balance sheet which gives it greater flexibility than many of its rivals to spend on R&D

and offer competitive financing for car buyers. VW expects operating margins at the Group to increase from about 6% currently to 8% in 2018. This is expected to be largely driven by an improvement in margins at the VW brand from around 2% currently, and also from a move to using modular toolkits that reduces the number of parts used across the entire model range of the VW Group.

Porsche itself is an attractive investment as it trades at a 31% discount to NAV, largely because of litigation fears. Several US hedge funds have been suing Porsche in US and German Courts, accusing them of manipulating VW's share price which rose to over €900 per share during the financial crisis in late 2008, costing the hedge funds billions in a massive short squeeze. The Court rulings so far in both the US and Germany have not gone well for the hedge funds so the current discount to NAV, which is close to the highest level in two years, is looking increasingly anomalous.

Current portfolio valuation

As I pointed out, we are concerned by the high valuation of US equities and what it portends for future US equity returns. The risk for equities outside the US is that there is a steep decline in US equities and it drags down equity prices worldwide. We have described to clients what we refer to as the purgatory of low returns, with cash yielding nothing, bonds yielding next to nothing, and equities in most markets priced to deliver less than stellar returns. In this context, European equities look relatively attractive. Furthermore, relative to the overall European equity market, the valuation of the Fund's holdings looks very attractive.

About half the Fund's portfolio consists of operating businesses, some of which we discuss here, such as Yara International, Volkswagen, Anglo-Eastern Plantations, Sberbank, and Gazprom Neft. We value these businesses on a P/E basis using 2014 estimated earnings. The average P/E of the operating businesses owned by the Fund on a dollar-weighted basis is about 10.5. This compares to the P/E of the Fund's benchmark which is currently 17. The other half of the Fund's portfolio is invested in closed-end funds and family-controlled investment holding companies which we value based on their estimated discount to NAV. The average discount to NAV of our closed-end fund holdings on a dollar-weighted basis is 33%. This needs to be viewed in the context of the average discount to NAV in the UK investment trust sector currently being 5%, and 40% of UK investment trusts by value now trading at a premium to NAV. AGOL and APEN are examples of our larger closed-end fund holdings. Meanwhile, our family-controlled investment holding companies are currently trading at a 44% discount to NAV on a dollar-weighted basis. The Socfin companies, Porsche, Cofide, and Italmobilare are examples of family-controlled investment holding companies in which we own shares.

At the end of October, we felt that the Fund's portfolio was sufficiently cheap and the quality was high, so we "topped up" our investment in the Fund. OAM, the fund's manager, invested another $1 million in the Fund's shares. The Fund's portfolio has got a bit cheaper since then, and the euro has got a lot cheaper.

At the end of 2013, the Fund had about 21% of its assets in cash. I expressed the view in last year's Chairman's statement that European equities were fairly valued. Since then, we found opportunities to put money to work sensibly, and the Fund's cash level declined to about 14%. There were only three new investments added to the portfolio last year: two were Russian GDRs that I discussed, and the other was a quasi spin-off by a large European financial institution. During the year, we sold seven investments, either because we felt that they were fully valued, had poor future prospects, or we had concerns about their management. In accordance with what I said in last year's Chairman's statement, we added to the Fund's highest conviction ideas at what we felt were opportunistic prices, thereby making the Fund's portfolio more concentrated. If we count the three Socfin companies as one investment, and apply the same approach to

VW and Porsche, and we exclude a few small investments of well under $1 million each that are on the way in or out of the portfolio, the Fund now has 43 investments.

In last year's Chairman's statement, I explained that we sought permission from shareholders to utilise some of the Fund's cash to invest in attractive, but illiquid assets. During the year, we evaluated two such potential investments but passed on each. Currently, the Fund has less than $5 million or just over 2% of its net assets invested in unlisted securities.

Currency

Last year, the euro (EUR) declined by 12% against the USD, Sterling (GBP) by 6%, the Norwegian krone (NOK) by 19%, and the Russian ruble by 46%. The euro is the currency of greatest exposure for the Fund. Rather than look at the listing currency of an investment, we look at the functional currency exposure of the Fund's investments when determining whether to hedge the Fund's currency exposure. For instance, Yara International's shares are priced in NOK, but they sell fertilizer which is priced globally in USD so we consider it to have 100% functional currency exposure to USD. Likewise for Dragon Oil whose shares are listed in GBP but which sells crude oil that is priced in USD, and the Socfin companies whose shares trade in EUR but which sell palm oil and rubber which are priced in USD. Calculated in this way, a bit less than a third of the Fund's functional currency exposure is to the EUR or about $70 million. At the start of last year, we had a $40 million forward sale of EUR against USD in place as a hedge. Starting 2014, the currency hedge was showing a $0.5 million unrealized loss. In October, it matured at a $2.6 million realized gain when the EUR was around 1.26. We had to take a decision at that point whether to renew the hedge and decided not to do so. The currency hedge added about $3 million to the Fund last year or about 1.5% which was not much in the context of the currency declines against the USD. This is why I said at the outset of this statement that all of the decline in the Fund's NAV and in European equities was due to currency losses.

The Fund's directors have developed a methodology of when to hedge its currency exposure. In essence, if the Fund has significant exposure to a currency, which in the case of the Fund is likely to be EUR and GBP, then we will hedge all or part of the Fund's functional currency exposure only when the currency is overvalued against the USD by a meaningful margin. The degree to which we hedge the functional currency exposure depends on the margin of overvaluation. Bloomberg publishes four estimates of purchasing power parity (PPP) for most currencies based on consumer prices, producer prices, the Economist's Big Mac survey, and an OECD estimate. Based on an arithmetic average of these four estimates, PPP for EUR:USD is about 1.23. This explains why we decided against renewing the EUR hedge in October when the rate was 1.26. For GBP:USD, the arithmetic average for PPP is 1.59.

Stable assets and a strong team

The Fund ended the year with net assets of $223 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. From a qualitative point of view, we think that these businesses are likely to increase their earnings per share and our closed-end funds and investment holding companies are likely to increase their NAV per share. If we are correct in our analysis, the intrinsic value of our holdings is likely to increase over time, whilst we wait for the gap between price and intrinsic value to close.

Last year, the Fund had $22 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.

Our other principal strength is having a strong team of investment professionals. Last year, I devoted part of my Chairman's statement to our change to a team approach to managing the Fund. I am pleased to report that this approach is working far better and is more sustainable than our prior approach whereby various people at OAM managed individual silos within the Fund. Last year, there was a discussion roughly every two weeks of either an existing investment in the Fund, or a new investment idea. This discussion followed a review of the investment by Camilla, Rob, Kia and me, with Natalie participating more recently. In many cases, we had extensive calls with senior management of these companies to improve our understanding of certain issues. Last year, I also made a few company visits and met with managers of some closed-end funds in which we have invested.

I am very encouraged by the professional development of our team. We are moving towards our goal of transitioning the Fund over the next few years to the point where Camilla, Rob, Kia and Natalie are able to manage the Fund, with my role in the management of the Fund being reduced to a more supervisory and mentoring role. In March last year, we were fortunate in getting Sue Barnes to join OAM. Sue brings her bright and sunny disposition as well as years of experience as a corporate administrator to OAM. She has taken over a lot of Natalie's former administration and client liaison responsibilities, leaving Natalie with more time to make a transition to a dual investment/administration role. Rob is the only Chartered Accountant in our team and he has taken over much of the audit work from me and Natalie.

Camilla, Rob and I are CFA charterholders and we each bring different strengths to the investment management process. Kia and Natalie are at various stages in sitting exams in the CFA Program. One of the most important aspects of the CFA Program is its strong emphasis on ethics and proper professional conduct. In this era where unethical conduct seems to be less frowned upon than in the past, and where litigation needs to be used ever more frequently as a tool to protect the rights of minority shareholders, we maintain the stance that only CFA Charterholders will be allowed to make investment decisions at OAM.

Desmond Kinch, CFA
Chairman