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The Informed Investor

Who is GTI written for?

This is a newsletter written – free of charge for our clients – by two investment professionals who've spent a lifetime in the investment industry and nearly 25 years working together, off and on. It's not a share tip-sheet and it's not a scandal document. It's not really even primary research. It's designed to help readers make money and avoid disasters and is used by us in our own investment

strategy for actual clients. It's a working document for busy people who want to keep up to date with the big secular, thematic, cyclical and valuation changes in the investment world that shape our lives and economic fortunes and who believe that the best way to invest in them is by finding the best specialists in that area.

Our objective is a report that is intelligently and attractively put together, where readers can skip the bits they find boring, which doesn't patronise clients and where the ego of the writer doesn't protrude on every page. Good writing should be easy to understand but it also shouldn't

assume that the reader's an idiot. Nonetheless, some readers simply have more investment experience than others. So GTI is written both for the informed



The Editors: Bruce Albrecht and Iain Little, two professionals with over 25 years of experience in the investment business

professional or lay private client, and also to provide ideas for the investment committees of fully-fledged investment management firms.

This is our first issue. It'll have many imperfections. We hope that our readers will give us both their understanding and their feedback. Over time, our plan is that GTI will become a web-based newsletter with lots and lots of interesting investment ideas, charts and research, all drawing on the best investment minds of our industry. Our aim is to make money for our readers, but also to have an enjoyable learning experience whilst doing it.

Global Thematics Philosophy

The editors – two professional fund managers each with over 25 years in the international investment business



Bruce Albrecht

Bruce is American by birth and British by adoption. He's been managing international portfolios or researching international securities and markets for 30 years.

Bruce was Head of European investment for the Abu Dhabi

Investment Authority in Abu Dhabi (the single largest pool of own-managed money in the world, reported to be several hundred billion USD), Chief Investment Officer for Pictet in London, and Chief Investment Officer for Rothschilds in London. He worked closely with Iain Little for a decade in Pictet London.

Bruce is a director of the Institute for Quantitative Investment Research. He created and managed the ISN system (www.investment-strategy.net). Bruce is a Director of P&C Global Wealth Managers SA in Zurich and Senior Vice President, Group Asset Management of Bank of Butterfield Bermuda, where he has responsibility for all aspects of the Group's Asset Management business line.

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Iain Little

Iain is Scottish and has spent 25 years in private banking as a global strategist and portfolio manager. He's held senior positions with Kleinwort, Benson in Hong Kong and London; Pictet et Cie, the largest Swiss private

bank in Geneva, London and Tokyo and now works as an independent private client manager based in Zurich, Switzerland.

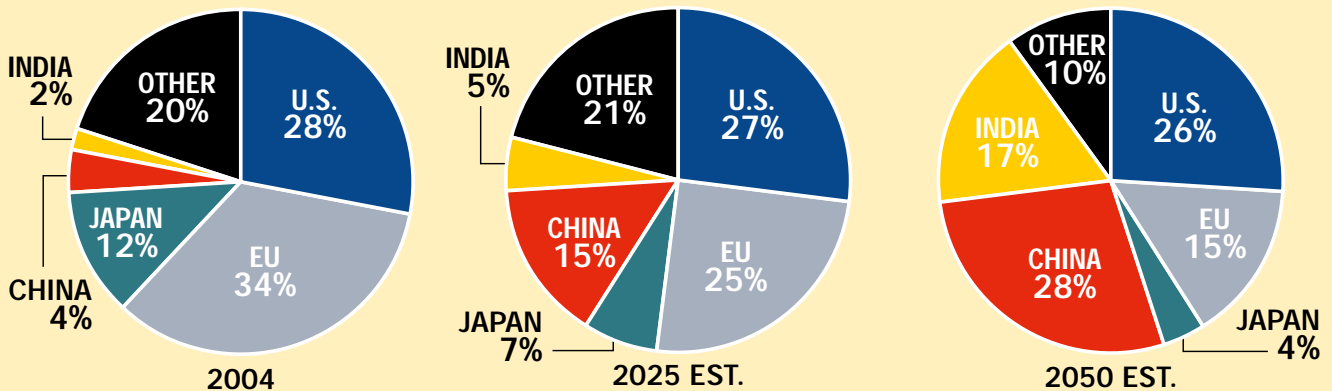
Iain has worked with Bruce Albrecht off and on for 22 years, including a decade with him in Pictet London.

He is currently Managing Director and Founder of P&C Global Wealth Managers SA in Zurich and a Special Adviser to Bank of Butterfield Bermuda on their international private client and investment management business.

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Invest **With** the Reshaping Global Economy **Not Against** It

PERCENTAGE OF WORLD GROSS DOMESTIC PRODUCT



Source: Businessweek

“Because That’s Where the Money Is”¹

Why we invest according to global themes

The investment rationale for Global Thematic investing is simple. In a free global marketplace capital tends to flow to sectors where long term growth rates – and hence returns – are more attractive than the average. This capital – whether of a private or public sector sort – bids up prices of assets in these sectors and creates “sustainability” of growth. As investment managers, it’s our role to “allocate capital” (Warren Buffett’s hallmark phrase) to where the best potential returns (and lowest prices and risks) are available. Pricing is important; “overpaying” for assets is always dangerous. The same theme may be “played” at one stage of the cycle through one fund², then at another stage through another, depending on the attractions of the specialist sector. Robust long term global themes may remain a powerful way to make money

for decades, whilst the funds chosen to “play” them may be – though do not have to be – different at different times.

We believe there are eight great global themes that will shape our investment lives. **What are they?**

-
- GTI** THE RESTRUCTURING OF JAPAN
 - GTI** SUPPLY INELASTICITY IN COMMODITIES
 - GTI** ENERGY AND ALTERNATIVE ENERGY
 - GTI** THE EMERGING MIDDLE-CLASS
 - GTI** GLOBAL OUTSOURCING AND INTERNET HUB
 - GTI** AGEING POPULATION
 - GTI** THE DEVELOPMENT OF CHINA
 - GTI** WATER SHORTAGES AND ECOLOGY
-

Don’t Take Our Word for It, Ask Someone You Can Trust

What the biggest consulting firm in the world says

On the 18th January, the world wide MD of McKinsey wrote an article about the global themes to watch in 2006. The global economy and the corporate world’s landscape could see a paradigm shift this year, according to this article, which was printed in the latest issue of *The McKinsey Quarterly*.

The authors of the article – Ian Davis, world-wide managing director of McKinsey & Company, and Elizabeth Stephenson, consultant at McKinsey’s San Francisco office – said that long-term change can be safely predicted by analysing and identifying trends. The duo has identified three broad categories which will impact the global

economy and the way the world does business, namely,

*Macroeconomic factors,
Environmental and social issues, and
Business and industry developments.*

[This is what McKinsey wrote →](#)

¹ “Slick Willie” Sutton, one of the most famous bank-robbers in history, when asked why he robbed banks, replied, “Because that’s where the money is.”

² Although we refer to “funds” and “managers” in this paper we may use direct shareholdings if appropriate funds do not exist. These directly held shares will be screened using our proprietary ISN system for their correlation to particular themes and factors to ensure efficient portfolio management.

McKinsey's worldwide MD wrote:

GTI Theme

A major trend concerns **the ageing population in the Western countries** which will demand a more productive, efficient and creative public sector to support the enormous burden of pension and healthcare without increasing taxes to unmanageable proportions. Some developing nations too will have to take a decision on what social services should be offered to its citizens.

Ageing population

The authors say that the **Asian economy will boom** during the next two decades and account for more than 30 per cent of world GDP, as big as Europe today

The development of China

The authors predict that the consumer landscape too will undergo a major change and will “expand significantly” with the **entry of a billion new buyers in the global markets within the next 10 years**. The article says that this huge mass of consumers will also have a higher purchasing power and better awareness of products, triggering off major shifts in the global economy.

The emerging middle-class

The strain on global environment will increase due to the **rise in demand for natural resources**.

Energy and alternative energy

Although the USA will continue to “account for the largest share of absolute economic growth” over the next 20 years, **major hubs of economic activity worldwide will shift dramatically**. Manufacturing and IT services sectors too will witness major shifts. This trend will not be limited across nations, but will also happen within regions.

Global outsourcing and internet hub

Company managements will have to employ better and more sophisticated tools to run their organisations, transforming management into science from an art. The **‘gut feel management’ style will not suffice in the new era and managements will have to be on their toes to triumph**.

The restructuring of Japan

The strain on global environment will increase due to the **rise in demand for natural resources**.

Supply inelasticity in commodities

With the economic engine in emerging markets chugging along merrily, **the demand for oil, water, coal and a whole lot of other natural resources will explode**. This could lead to the emergence of new innovative technologies, use of resources and regulations that will be central to creating a world that can both drive robust economic growth and sustain environmental demands.

Water shortages and ecology

When the facts change, as Keynes said, we'll change our mind on some of these eight themes, but our best guess is that we may be retired long before we do.

Find the Drop-outs in the Back-Alleys

Why we invest in funds and not stocks

It's perfectly possible to play our eight global themes using stocks (using Bruce's stock selection ISN system and other thematic advisors). But we've been continually amazed at how major investment houses all trumpet their leadership at the cutting edge of every investment region, sector, country or theme. The reality is that there's huge talent and intellectual brilliance in our market place, but, sad to report, it doesn't all exist in any one organization. That said, even large bureaucratic mastodons have their superstars. The truth is that the best ta-

lent tends to be found in the quiet dimly lit back-alleys of the investment world, not under the neon-signs of main street. The trick is to know where to look and to have the courage to go there.

We're passionate advocates of the investment boutique style of investment. We believe that the best investment minds don't necessarily work in the Big Houses. They set up on their own or "drop out". Bill Gates, Paul Allen, Michael Dell and Larry Ellison all "dropped out". We like to invest with "drop outs".

When all this brilliance and insight and investment "edge" is available, why don't more people use it? We're not sure. We've both worked for some of the largest investment houses on the planet, and feel that we have some insight into why most of this wisdom gets neglected. One word sums it up: EGO. Ego can be corporate ("our analysts are the best in the world") or personal ("I know this subject better than the market"). Whatever the case, over-confidence in one's own abilities is perhaps the greatest "mind trap" of investing.

Nice Talk. But How Did You Do for Your Clients?

Our performance

Our lawyers tell us that we can't talk about our performance without saying that "every client is different", "shares can go up as well as down", "past performance is no guide to future performance" etc. These shibboleths are repeated at the end of this report.

What we are allowed to say is that we are getting our performance audited in the near future and that USD

based investors who invested with us in our global thematic programme using pooled vehicles have seen the following unaudited returns:

2003	+	23.6%
2004	+	18.6%
2005	+	19.8%
2006	+	7.0% (to date)

We've never had an equity exposure that has exceeded 75% of the account, so the approach is, as they say in our business, a "balanced" and not an "equity" one. If we'd been fully invested like an equity manager, the returns would have been higher still. Now in our 4th calendar year of investing for clients in this way, we think the evidence that global thematic investing works is pretty convincing.

Horses for Courses

How to select the best funds and managers

Different "factor skills" are needed for different investment areas. It all depends on the area as these factor skills vary by discipline.

Great managers in gold and mining stocks need factor skills that include metallurgical knowledge, mining experience and – because they have to compare a common product (e.g. gold) that may vary in terms of its quantity or quality across different companies

and regions – a value-based financial discipline.

Biotechnology managers require medical knowledge, preferably acquired within Big Pharma as it's Big Pharma's dollars that drives so much of the biotech industry. A corporate finance background is useful too, as the combination of legal and accounting skills helps a manager spot both likely product successes and patent protection risks.

Fund managers in China or Russia need local knowledge, without which they'll quickly become investment road-kill in these "Wild East" economies. They also need first world research standards in order to screen out what's local hype and what's real. Strong ethics are also needed to survive in these markets since there are many companies who delight in parting soft foreign investors from their hard money.

The 5 Steps to Manager Selection Success

Secrets all great fund managers share

All great boxers share certain qualities (balance, fitness, speed of foot etc.) The same is true for footballers, double-glazing salesmen, ice-cream manufacturers, neurosurgeons and politicians. Great fund managers are no different. If you select a fund or fund manager, make sure he's got what it takes to be successful. We try to find managers who measure up to these yardsticks. Volumes have been written about doing due diligence on fund managers and we'll talk about that later on, but all these volumes are really elaborations of five key features to look for.

Investment edge. *The best managers have an "edge" in their chosen market. It doesn't particularly matter what it is, as long as he's got it.*

If a manager has "edge", you as an investor then have the best odds of beating the crowd. A resources fund manager who has spent all his life looking at large black holes in the ground presided over by a potential liar above it is more likely to find paydirt in the shape of a good mine to invest in than a manager who's never put on a hard hat.

Research. *The best managers are research – and not marketing – intensive.*

They do their sums carefully, even obsessively. There are different ways of doing the sums, and they depend on where you invest. These days, the well-capitalised major markets are well covered because of the billions made by the investment banks in covering them in order to win juicy corporate finance mandates. Major market "edge" is obtained by processing data, not collecting it. In the '70s and '80s, it was the collecting that mattered. Finance Directors were lavish with information and the regulator kept a respectful distance. Nowadays, no Finance Manager of a major corporate dares to release data without paying a big

lawyers' bill first. This can be confusing as the spokesperson still has a business card that says "Finance Department". Whatever the card says, the real name should be "Investor Relations". Forget trying to turn up first-hand nuggets in the major markets. The lawyers got there first. Specialist and emerging markets are different, but we'll come to that later. In either major or minor markets, it's research that matters. But in major markets, it's the processing of it that counts. In the specialist markets it's also the collecting of it.

Good performance in a bad market. *Good friends are staunch in bad times, and good managers do better than the crowd in bad times.*

No sane person would buy a car that hasn't been stress-tested. The wheels might come off. It's exactly the same with managers. Performance relative to the index or peer group is easy to dig up these days. Just look at a down year and see how the manager fared. Better still, see how honest he was in his reports to investors at the time. "Ex post facto" rationalisations, lame excuses, amusing stories and promises of riches to come can be signs of a lack of integrity.

A following wind. *Great managers – like great generals – usually have the luck to be in the right place at the right time.*

Peter Lynch, Fidelity's superstar Magellan fund manager, and Mark Mobius, emerging markets manager of Templeton, both had following winds in their sectors. On the other hand, few great managers have emerged from Japan during its 15 year bear market from 1989–2004. It's just too hard to expect a manager to generate 20% p.a. returns and a mention as a lifestyle guru in Forbes magazine when his market has fallen by 90% in real terms over a decade and a half. Now that Japan's turned, watch while Japan fund

manager reputations – flattered by a following wind and the voracious appetite of the media for successes – build up like tsunamis.

People, people, people. *Venture capitalists usually seek companies run by people who are serial successes in the same field. Fund selectors should do the same.*

It's an odd fact that some people are "successoholics" and some "successophobic". This is one of the reasons we like to invest with "drop-outs", who are usually the former. The principal advisers to P&C gold fund, David Baker and Trevor Steel, had over a decade successfully managed billions at Merrill Lynch, before they dropped out to form their own company. We reasoned that two successful managers who had tripled investor money through a ten year gold bear market as salaried employees of mighty Merrills ought to be able to do even better managing a few millions in a gold bull market when they worked for themselves. Trevor and David managed to double investor money in their gold fund in their first year, 2003. A successful and incentivised manager will do better running a small, nimble fund than a large, unwieldy fund. But, to our advantage as boutique managers, vast expanses of our industry are forced to seek only the mountain-sized funds for reasons of liquidity, leaving the pint-sized nuggets on the table.



GLOBAL THEMATIC INVESTORS

Restructuring Japan

The tide has turned

Background. In 1989 the Emperor's palace in Tokyo – occupying an area barely the size of Central Park, was worth more than California. The Japanese stock market was the largest in the world and sold at a multiple equivalent to nearly a century of earnings. Salary men ate French gateaux topped with gold flakes off gold plates in Roppongi. More Ferraris cruised the streets of Tokyo than in any other city in the world. Over the next 15 years, the real estate and stock markets of Japan vaporised. By 2002 the banking sector, after several false starts, lay in ruins and an acute political crisis led to the election of a reforming Prime Minister, Mr Junichiro Koizumi, with a mandate to return Japan to prosperity.

The opportunity. The Japanese stock market should be able to generate annual returns of 15–20% for many years (it stands at 16,000 compared to 38,915, its peak on 31/12/89). The TSE now sells on a PER comparable to Western developed stock markets. Second section Japanese stocks can be found whose current assets (i.e. cash) exceed the market capitalization of the company itself (thereby valuing the business at zero). Deposit rates are under 1% so that Japanese domestic investors – the biggest savers in the world – urgently need higher yielding alternatives (i.e. stocks). Corporate Japan – previously managed for its employees, now managed for its shareholders – is starting to prosper again. Product lines have been reduced, Western-style management and shareholder activism have asserted themselves, overseas markets (e.g. China) have developed and quality control has further been improved. Toyota is now the largest car company in the world (largely over the body of GM). Western financing techniques have been introduced through a new breed of private equity funds and M&A boutiques. Finally, land prices – victims of an Irving Fisher Debt Deflation – have started to rise.

The banking system has been saved and credit is starting to flow again.

Ways to play the theme. Equity funds, particularly second section and small cap funds, real estate funds, Japanese REITs. Avoid index-hugging managers who will under perform.

Particular factor skills required of selected managers. Local knowledge of Japan and language skills, corporate finance type knowledge for the restructuring story, “value”-investment style, experience of “up / down” Japan cycle.

News from our manager

Our principal specialist Japan manager wrote at the end of December:

It was a good end to an exceptional year for the Japanese stock-market. The share prices of the fund have now more than doubled since inception whereas the market and currency are little changed.

There has been exciting news from the property market where the Nikkei reported that AIG, the large US insurer, plans to purchase a site located near Tokyo station from Mori Trust. If the details are correct then the yield basis of the transaction is in the range of 3.1–3.5%, considerably below the capitalisation rates analysts have been using which have generally been above 4%. This has led to upward revisions to their estimated asset values and share prices have responded accordingly.

Economic figures again have been generally encouraging, with strong capital investment plans indicated by the Tankan. November consumer prices have turned positive year on year. The government's recent forecast for inflation for the next fiscal year coincides with the Bank of Japan's of 0.5%. The official forecast is for the economy to grow in nominal terms by 1.6% this fiscal year and to expand by a further 2.0% for the fiscal year ending March 2007.

News from the portfolio has been sparse. Chiyoda produced good third quarter numbers which should allow them to meet their full year profit forecasts comfortably. Komori Printing's November orders were up an exceptional 76%, but still the share price ended down. House Food has taken a two thirds stake in Takeda Food, the functional/health food subsidiary of Takeda Pharmaceutical, which will boost their net income and looks to be a useful home for some of their excess cash. Whilst we are not involved it was encouraging to see NSK purchase the shares which they didn't already own in Amatsuji Steel Ball at a healthy 30% premium, perhaps a precursor to more acquisitions across the market in 2006.

The domestic situation continues to improve but this has not gone unrecognised. Whereas a couple of years ago nobody even mentioned Japan as a place for investment, it is now a favourite for commentators in their New Year recommendations. Despite this greater popularity our portfolio trades a little above book, a sharp discount to the market, and thus the long term investor should be rewarded.

This manager's USD performance numbers since their fund's inception in 4/8/99, when we were still mired in a Japanese bear market are:

Manager performance	+ 107.0%
TOPIX Index	+ 9.8%
Nikkei 225	+ 11.5%

GTI comment: Land values are starting to rise in many parts of Japan. This is significant not only for real estate companies, but the whole of the banking sector and hence the whole of the economy. It would be logical for there to be increased M&A if the banking system is more willing to lend. This creates a virtuous circle for Japanese equities.

Supply Inelasticity

A complete breakdown in gold's relationship to the US dollar

Background. In the high inflation '70s and early '80s commodity prices soared. Keynesian supply-side economics delivered high growth at the cost of high inflation. Irresponsible financial management led to negative real interest rates as inflation rose to double-digit levels in major economies. Investors and holders of commodities were rewarded by a virtuous cycle of price rises and negative carry costs. Commodity analysts were the toast of Wall Street. In the '80s and '90s, tighter financial discipline and positive real interest rates led to a collapse in commodity prices as investors and corporates de-stocked into a market of excess supply. Gold, which had traded at USD 850/oz in early 1980, fell to about USD 250/oz. As capacity was withdrawn or mothballed, investment in commodities and traded volumes fell to a trickle as selling prices in many

sectors fell below production cost. Major investment houses closed their gold funds and sacked their resource analysts. Swiss banks that had advocated 3–8% in commodities in the early '80s as an orthodoxy, reduced this in the late '90s to 0% as a defence.

The opportunity. Commodity related investments should be able to generate annual returns of 15%+ for many years. Since the collapse of the Berlin Wall and the emergence of Soviet-era acolytes like India and China, two thirds of the world's population – previously a nonentity in economic terms – has come on stream as potential private consumers of commodities as their societies urbanize. Mothballed capacity has been re-opened but it takes nearly a decade to start a gold mine from scratch and several years to cultivate a tea or cocoa plantation. The largest gold miner in the world grew

production four times in the '90s but its reserve life was cut in half. Precious metal production is flat over the past three years despite price rises. A 20-year collapse in commodity prices has led to a chronic shortage of capacity and a shortage of analysts able to identify good investments. Never before in human history have so many new consumers come on stream as potential buyers of commodities.

Ways to play the theme. Commodity funds, gold and natural resource funds, commodity-producing country funds. Avoid index approaches if possible (Jim Rogers' soft commodities fund may be an exception) and Exchange Traded Funds, which lack gearing and value added. In metals, super-dominance of majors RTZ, BHP-Billiton etc. creates need for diversified approach through funds.

Particular factor skills required of selected managers. Geological / metallurgical / mining background and corporate finance / discounted cash flow analysis to be able to compare "like with like" across countries and sectors as common discipline. A good proprietary database as the bear market has created vacuum in many analysts' / stockbrokers' research.

News from our manager

Our principal specialist commodities managers wrote at the end of December:

During 2005 gold broke through numerous resistance levels before reaching an intra-day high of US\$541/oz during December. There was a complete breakdown in gold's relationship to the US dollar with the metal performing well in all major currencies – confirmation of a true bull market. The increasing general market interest in the gold sector drove the large index stocks to trade on significant multiples and a spate of M&A activity characterized the year end. A number of Fund holdings were bid for, validating our methodology of researching quality undervalued companies.

Outlook: The outlook for the gold market in 2006 remains strong and we expect that gold will make new highs driven by strong underlying fundamentals. Both physical and investment demand for gold so far remains undeterred by the rising prices, with Russian, Argentinean and Chinese central banks indicating they may increase their gold reserves.

We continue to find undervalued opportunities in which to focus the investment of the Fund. The bias remains to the undervalued, quality emerging gold producers. These we feel will be both a target of the larger gold miners striving to replace their depleting reserve bases and falling production profiles and a focus of the investment community as they rotate investments out of the expensive large capitalised gold companies into the mid and lower tier producers.

This manager's USD performance numbers since their fund's inception in 1/4/03 are:

Manager performance	+ 169.0%
FTSE Gold Mines Index	+ 94.3%
Gold Bullion	+ 53.2%

GTI comment: with the exception of a few large high profile funds, the gold and precious fund sector has seen net redemptions over the last year or so. With the improvement cited above, it is logical for large fund flows to buoy up the lagging mid cap and small cap mining sector in 2006. This is where new money should be invested.

Energy – Alternative Energy

The world can handle a doubled oil price

Background. Oil prices are high and likely to stay high. Under-investment in exploration by the West has produced a potential threat to world growth via higher energy costs. However, the wild card is the disruption to supplies either through geopolitical events or the opacity of the swing-producer's supply stream (see leading American oil expert Matthew Simmonds' report on oil depletion through water injection in Saudi oil wells).

The opportunity. Alternative energy sectors should be able to generate annual returns of 15–20% for many years. Currently, only around \$20bn a year is invested worldwide in renewable energy capacity; mainly wind and solar, with some in biomass and bio-fuels. A further \$5bn is spent on research each year, particularly into hydrogen and fuel cells. But that figure is bound to grow to over \$100bn within a decade – a sustained compound annual

growth rate of 15–20%. That means there will be opportunities to make money provided investors make the right choice. The first London stock-broker recently announced it would hire a dedicated renewable energy analyst, saying that it “feels that this relatively new and under researched sector will develop into a core sector for both traditional and socially responsible investors alike”.

Ways to play the theme. Global energy funds, global alternative energy funds. Must be global as local knowledge is too coloured by local “success stories”. Avoid country approaches (eg Canada). Very few candidate funds despite recent rise in oil price. Possible opportunities in direct shareholdings as oil and energy is very factor specific (less so for diversified oils and majors than for mid caps and explorers).

Particular factor skills required of selected managers. Global knowledge and database to compare asset and production values in producers. Geopolitical grasp and contacts. Some technical, hydrocarbon or petroleum industries experience an added plus.

This manager's USD 5 year performance numbers since 1/1/01 are:

Manager performance	+ 210.6%
Sector performance	+ 113.7%

GTI comment: a rather subdued forecast by our energy manager. We suspect the hand of a “sensible” investment committee as he has whispered in our presence that he is much more bullish than this. A fund 10.9x PER – or a sub market multiple – sounds way too low for what is becoming a “growth” sector. We love it when our manager tells us about the valuations in their fund (far too few managers do this).

News from our manager

Our principal specialist energy fund managers wrote at the end of December:

Oil Price

2006 will be dominated, absent “events” by investors reacting to and attempting to second-guess OPEC's reaction to the supply and demand response to \$50+ oil. Our best guess is that the effect on demand will be relatively modest and we believe the world can handle a doubled oil price without much difficulty but that the extra supply ex OPEC 10 might be more meaningful pumping oil well above the 1985–2002 average, as they are, means that they are very well placed to ensure a balanced market by measured output reductions but they must make these in timely fashion and they could easily get it wrong. So where does this leave the price – \$55 in our view (v \$56 average in 2005) but investors should expect large swings.

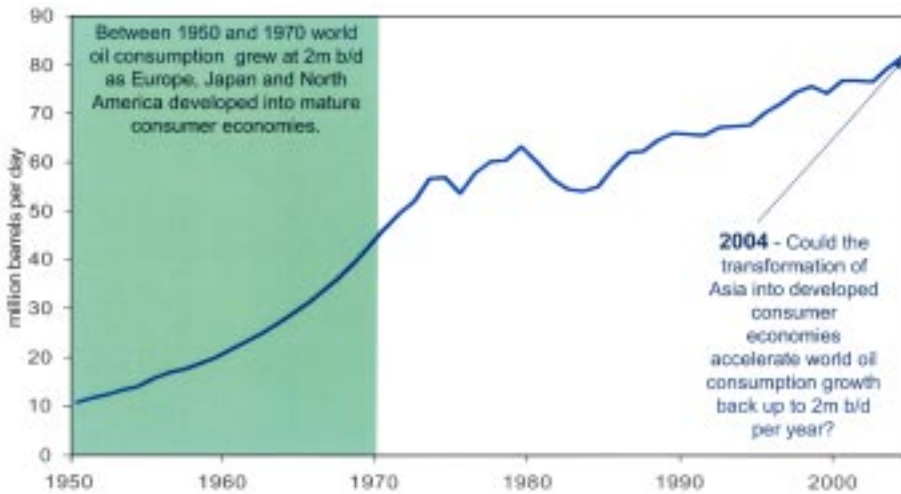
Refining: *Even post a full recovery from US hurricane damage, global capacity is likely to remain tight.*

Service sector. *Strong exploration and development capital expenditure ... continues and is likely to expand further ... this will create increasingly tight supply of equipment and services ... investors need watch however for signs that indicate the cycle is peaking. We do not expect this to occur before 2007.*

Corporate Activity. *Continued and increasing share buy backs are expected as companies have more cash than investment opportunities. More take-over activity is likely as major oil companies find reserves more plentiful and cheaper to buy in the stock market.*

Current portfolio. *The invested fund at 31st December was on a PER (2005) of 10.9x. ... and also on a PER (2004) of 16.8x. By comparison the S&P 500 Index at 1248.3 was on a PER of 16.7x (2005) and of 20.6x (2004). If it (the long-run oil price) is over \$55/barrel (let alone \$65/barrel) ... then we believe a 10.9x multiple looks cheap and there could easily be 41%–59% upside (taking the fund multiple to the market 15.4x/16.7x (2006/2005). If the long-run price falls back to \$30–35/barrel, the PER of 23.1x would likely be expensive. There could be a 25% / 30% downside on the same logic. And if the long-run price is \$42/barrel, we are more or less fairly priced (or even 10% expensive).*





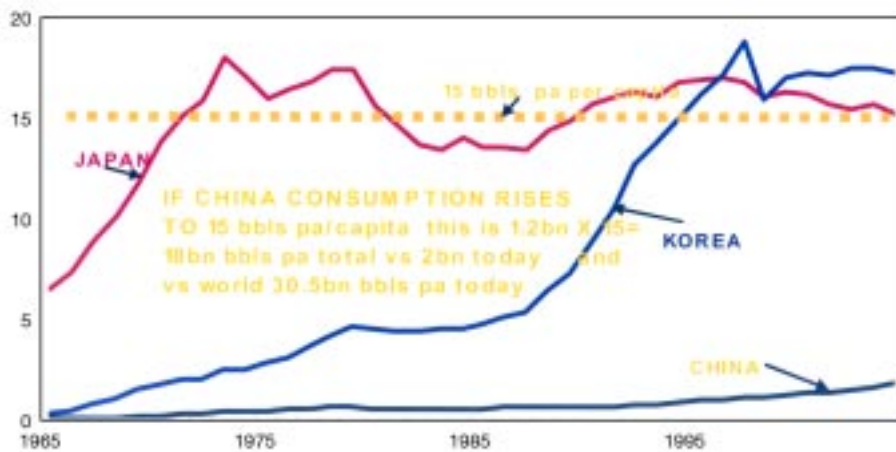
World consumption of oil 1950–2004

Source: BP Statistical Review of world energy

A tough provocative "what if" comparison with the US

Year	US Car Prod'n	Population	Per Head
1910	0.18m	92,000,000	1 per 500
1920	1.9m	106,500,000	1 per 56
1930	2.8m	123,100,000	1 per 44
1940	3.7m	132,100,000	1 per 36
1950	6.7m	152,300,000	1 per 23
China Car Production			
2003	2m	1,200,000,000	1 per 600
2013	21m ??	1,200,000,000	1 per 56 ??

China's car production could grow 10x in the next ten years if it follows the US pattern from 1910 to 1920. Were growth of anything like this magnitude to occur, the implications for oil demand would be substantial. NB: in 2004 car production increased to 3.2m cars p.a. from 2.3m p.a. in 2003. Source: Guinness Asset Management

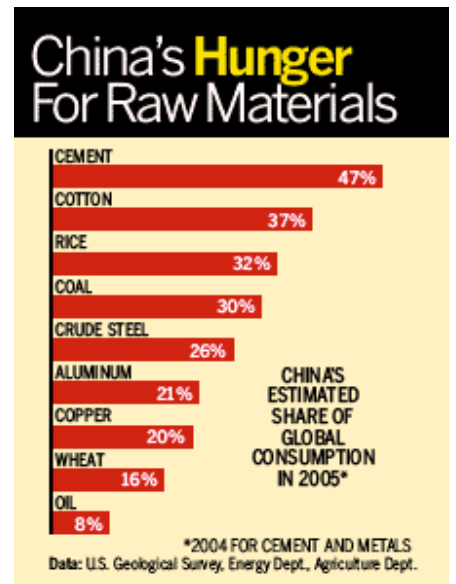


Oil consumption per capita. What if China follows Japan and Korea?

Source: BP Statistical Review 2004 and archive copies up that date

INDUSTRY SECTOR	1980	1981	1988	1992	1996	1997	1998	1999	2000	2001	2002
MATERIALS	8%	7%	8%	7%	6%	5%	3%	3%	2%	3%	3
INDUSTRIALS	11	11	11	9	10	9	8	8	9	12	11
TELECOMMUNICATIONS	6	8	8	9	6	7	9	8	6	6	4
CONSUMER DISCRETIONARY	10	14	14	13	10	9	9	9	7	14	14
STAPLES	8	10	13	17	16	16	15	11	11	9	10
ENERGY	27	14	12	10	9	8	6	6	6	7	7
FINANCIALS	6	8	9	11	15	17	15	13	17	19	19
HEALTH CARE	6	6	7	9	10	11	12	9	14	15	14
INFORMATION TECHNOLOGY	10	12	9	7	13	13	19	30	23	19	18
TRANSPORTATION	2	2	2	2	1	1	1	1	1	1	1
UTILITIES	6	8	7	6	4	3	3	2	4	3	3
INDUSTRY GROUP SUM	100	100	100	100	100	100	100	100	100	100	100

A long way to go to achieve "overweight". The energy sector in 1980 was 27% of the S&P 500. Now it is 10%. Source: Investec Asset Management



These are the building blocks of China's plans ... Source: Businessweek



GLOBAL THEMATIC INVESTORS

Emerging Middle Class

Revolutionary changes

Background. The purchasing power / middle-class story is the big story in emerging markets, though many funds emphasise agriculture or production. The pattern of Gaussian or normal distribution in purchasing power levels means that at low but improving levels of national incomes, huge advances in emerging market propensity to consume are possible (i.e. at \$5000 income per pop, everyone buys a

video, at \$10,000 per pop, everyone buys a car etc.) This story in stock market terms is barely 15 years old. It is much easier to predict consumer champions than producer champions; who knows if India will be a more successful textile producer than Pakistan? Many markets have become “growth / developing” markets from “emerging” markets ten years ago, and therefore more efficient. But there are still areas

capable of steady 25% eps growth over the next decade where the PERs are single digit and the companies unknown internationally but significant as local champions.

The opportunity. Consumer purchasing power plays in emerging markets should be able to generate annual returns of 15–20% for many years. The early '90s saw the creation of many global emerging markets funds. Comparatively poor emerging market returns in the last decade led to atomisation of managers and the formation of more specialist / regional / sectoral emerging market boutiques and funds. GTI knows these pioneers well. In some funds it is possible to invest in strong local champions alongside Nestlé or Unilever, good stable-mates indeed.

Ways to play the theme. Specialist funds investing in developing countries where the middle-class effect is robust but in its infancy.

Particular factor skills required of selected managers. First world research metrics and corporate governance ideas combined with third world local knowledge and contacts.

News from our manager

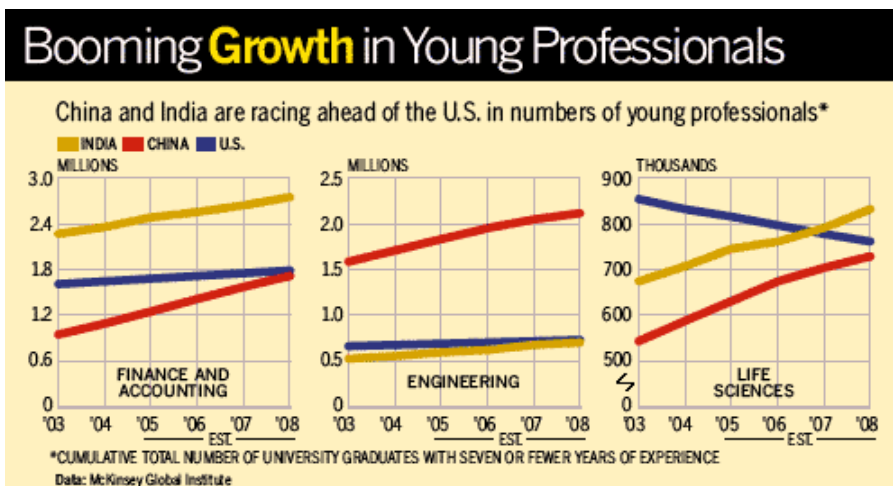
Our principal specialist emerging markets managers wrote at the end of December:

At the micro, or bottom up level, the extraordinary thing about the recent rally in emerging market stocks is that it has not increased valuations to unsustainable levels. This is because companies in high growth industries have been using profits to invest heavily in new capacity giving them very attractive growth profiles. This growth is not dependent on further rises in product prices, but is based on volume and global market share gains. In industries with lower growth rates we are seeing companies re-purchase shares and pay much higher dividends. This is revolutionary in our universe – in the past controlling shareholders were reluctant to share their cash profits with other stakeholders.

This manager's USD performance numbers since their fund's inception in 1/4/03 are:

Manager performance	+ 140.6%
MSCI	
Emerging Markets Index	+ 100.9%

GTI comment: if emerging markets managers are really changing their spots, that must be worth a pip or two onto the PER valuations in their markets.



Also spells decline in the US

Source: Businessweek



GLOBAL THEMATIC INVESTORS

Global Outsourcing / Internet Hub

Higher valuations versus higher growth

Background. China and the Indian sub-continent are a challenge to “rust-bust” / uncompetitive developed world industries. There’s probably not a major manufacturing company in “Old Europe” that doesn’t have a cost-reduction strategy that at least considers out-sourcing. Every day news arrives

of a manufacturer (e.g. Electrolux, Daimler, Philips) announcing some out-sourcing to Hungary or China or India. In the services sector, India is the preferred destination. There are more IT engineers in Bangalore than in Silicon Valley.

The opportunity. Outsourcing beneficiaries should be able to generate annual returns of 20%+ for many years. The combination of global competitive pressures (irreversible), developed world levels of capital investment (enormous) and spare third world labour capacity (almost unlimited) mean that this sector could boom in the next twenty years. Technology will only accelerate its development. Opportunity exists in even the most unlikely and overlooked areas (like Pacific Oceania).

Ways to play the theme. Regional country funds in specific emerging market areas (e.g. India, Pacific Oceania).

Particular factor skills required of selected managers. First world research metrics and corporate governance ideas combined with third world local knowledge and contacts.

News from our manager

Our principal specialist Indian managers wrote at the end of December:

Our mid cap consumer names have continued to march on with Dabur, TVS, United Breweries, UB Holdings (the whisky business), Britannia, Godrej Consumer and Procter & Gamble making steady gains in December.

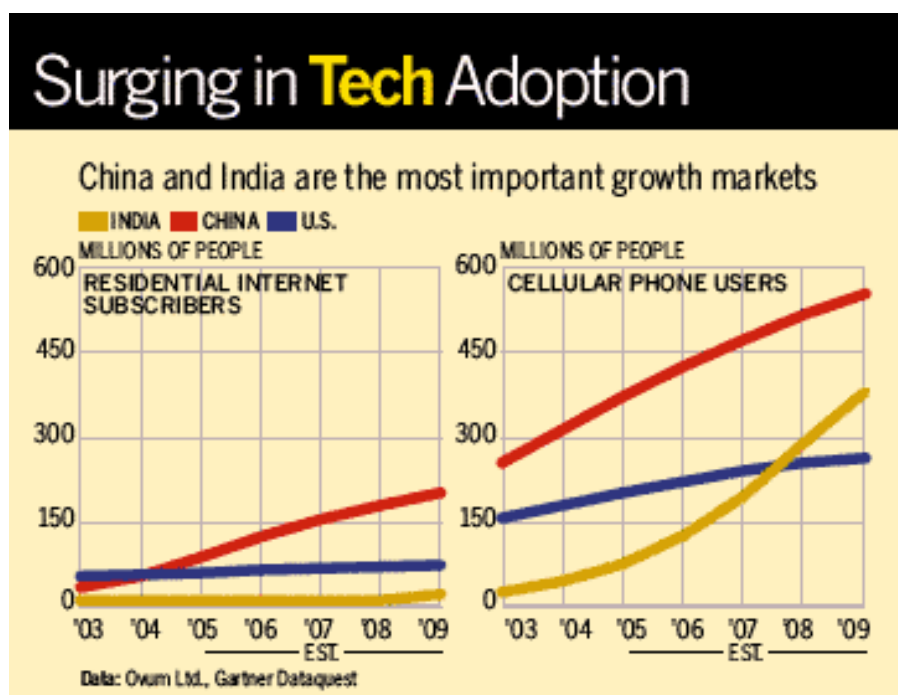
Trading on an average March 2006 PER of 29x it is hard to imagine them making much more progress for a while. That said, we are loath to take profits as we have no doubt that each will be a much larger business five years from now. Buying back would be difficult as the shares remain very illiquid.

Elsewhere, Vinay and his team have unearthed three new micro cap consumer ideas trading at much lower valuations to add to the Champagne Indage, Heritage Foods and Nikamal Plastics that we have mentioned in earlier dispatches.

Unfortunately the performance of the India Fund has been held back by problems in Sri Lanka where renewed fighting (so far mainly between rival Tamil Tiger groups) has spooked local investors. The share prices of John Keells, Richard Pieris and Aitken Spence declined on average by 16% in December alone.

This manager’s USD performance numbers since their fund’s inception are:

Manager performance	+ 275.1%
FTSE	
India Large Cap Index	+ 53.0%



GTI comment: the PERs in India seem high (20x March 2007 earnings). But of all the markets we look at, the Indian market has one of the strongest growth rates and best fundamentals. Our adviser’s Indian company investments have a portfolio weighted average ROCE of 30.1%. This is low compared to the consumer products sector where their big bets are placed.

If you are a tech/telco where will you focus your investment?

Source: Businessweek



Ageing Population

More M&A activity and cheap valuations make this a good defensive sector for 2006

Background. A theme that has been brewing for years but about which the public sector is in denial since it affects only the developed world (it is in fact the opposite in most of the developing world) and spells bad news for over-stretched national / governmental health schemes. It has repercussions in many areas, including medical, biotech and consumer (everything from cruise liners to savings vehicles to retirement homes to stem cell research).

The opportunity. Beneficiaries of this trend should be able to generate annual returns of 15%+ for many years. The medical area's main beneficiaries are the emerging biotech companies (found in USA, Israel, Germanic Europe, parts of Asia) that may be consolidated by predators Genentech and Amgen who have come to dominate this area, or Big Pharma itself. As Big Pharma's drug offerings have shrunk, their valuations have also been reduced. Big Pharma valuation levels are comparable to those found before the 1990s bull market. This offers opportunity to play both biotech and pharma for the first time for years.

Ways to play the theme. Funds that play both Big Pharma and biotech or merely specialists in each area. Specialist vehicles and shares emphasising other beneficiaries ("grey dollar" tourism, retirement homes etc).

Particular factor skills required of selected managers. Biotech: medical knowledge, major company experience, together with FDA and patent law knowledge. Avoid fund managers from "ivory tower" BiotechLand (see failure of companies like Genesis in New Zealand). Consumer: specialist knowledge applies but the best plays may be direct.

News from our manager

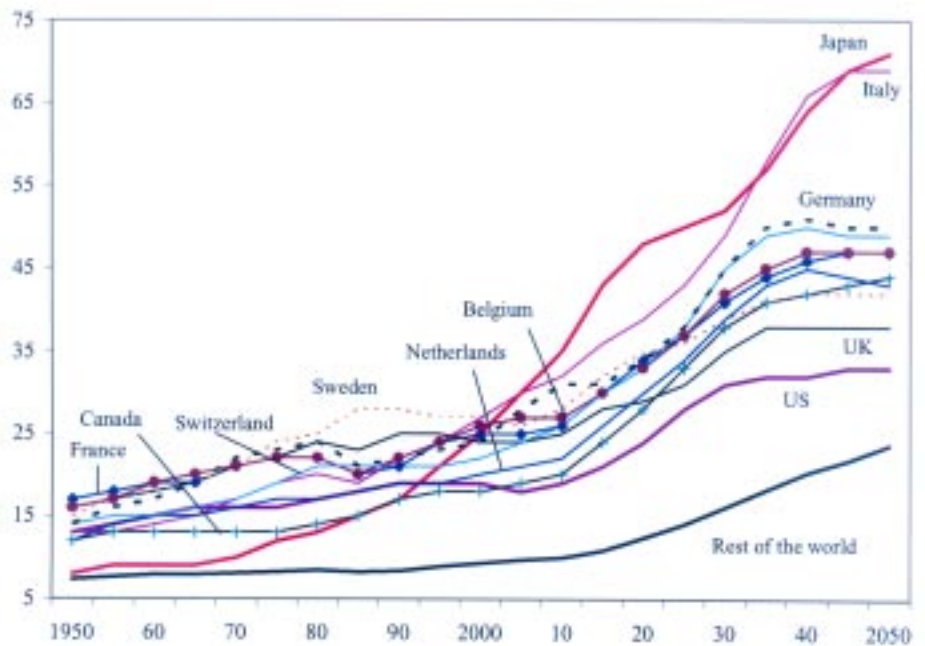
Our principal specialist pharma and biotech managers wrote at the end of December:

The continued high level of merger and acquisition (M&A) activity provided an additional positive catalyst. We anticipate continued high levels of M&A activity in the sector in 2006 and stronger relative performance from small cap biotech companies, which lagged their large-cap brethren over the past year.

This manager's GBP performance numbers since their fund's inception in 4/95 are:

Manager performance	+ 479%
Datastream	
World Pharma Index	+ 240%
Gold Bullion	+ 53.2%

GTI comment: the paradox about this sector is that Big Pharma is relatively cheap and unloved, and biotech is probably over-owned and exciting. The whole area might be a defensive sector for when the inevitable correction occurs in equity markets.

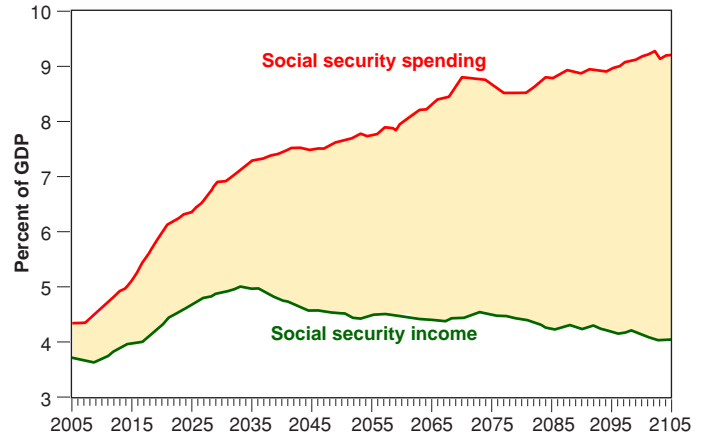


We're all getting older. Percentage of the population aged 65 years over. Compare this to the developing and Muslim world.

Source: United Nations Population Division



	<i>Old-age pension outlays</i>		<i>Health and long-term care spending</i>	
	<i>circa 2000</i>	<i>circa 2050</i>	<i>circa 2000</i>	<i>circa 2050</i>
Belgium	9.0	13.0	6.3	10.6
Canada	4.7	6.4	6.3	10.5
France	12.1	14.5	6.9	9.4
Germany	11.8	13.8	5.7	8.8
Italy	14.2	14.4	5.8	7.6
Japan	7.9	8.5	5.8	8.2
Netherlands	5.2	8.3	7.2	12.0
Sweden	9.2	10.8	8.1	11.3
Switzerland	7.2	10.8	5.8	10.3
United Kingdom	5.0	5.6	7.9	11.0
United States	4.4	6.2	2.6	7.0



Age-related public spending pressures are mounting, in percent of GDP.

Who pays for all this? The financing gap uncertainty increases the further out you go under unchanged legislation in the US.

Developing China

Shift in asset allocation from ASEAN to Greater China

Background. The reforms initiated in the 1980s have accelerated. China is set to grow by 8–10% for years to come. Communist capitalism may not be for real, but China’s need to urbanize a population of half a billion souls is. In the process, some foreign investors will be cheated and disappointed, there will be the occasional geopolitical scare over Taiwan (though we are not as pessimistic as most) and there will be social stress in many regions of China. However, China will develop.

The opportunity. China related stocks should be able to generate annual returns of 20%+ for many years (basically, nominal GDP growth plus a bit extra). The opportunity is less in China itself, whose corporate governance / foreign investor protection is primeval, and more in its acolyte and client Asian countries.

Ways to play the theme. Specialist Asian funds and funds investing in companies that supply China with the raw materials it needs to urbanize. GTI knows of funds run by Asian entrepreneurial fund managers dedicated to companies producing in the key Yellow Sea zone. Avoid pure China plays where foreign investors will end up a day late and a Renmimbi short.

Particular factor skills required of selected managers. First world research metrics and corporate governance

ideas combined with third world local knowledge and contacts.



The Strengths and Weaknesses

China and India have radically different economic models. But given their relative advantages and flaws, both are expected to deliver very high growth for decades

*BASED ON FINANCIAL DISCLOSURES OF 132 TOP PUBLICLY LISTED CHINESE COMPANIES AND 214 TOP INDIAN COMPANIES
**DATA FOR 2004 FISCAL YEAR INCOMPLETE

China will remain the manufacturing giant...

TRILLIONS OF U.S. DOLLARS

Data: Global Insight Inc.

...while India soars in tech and services

BILLIONS OF U.S. DOLLARS

Data: Evalueserve

India's companies are more profitable...

PERCENT

Data: Standard & Poor's Compustat

...and its banks are in better shape...

PERCENT OF TOTAL BANK LOANS

Data: International Monetary Fund

...but China lures more investment

BILLIONS OF U.S. DOLLARS

Data: World Bank, Reserve Bank of India

China and India have radically different economic models. Both are expected to deliver high growth for decades. Source: Businessweek

News from our manager

Our principal specialist Asian managers wrote at the end of December:

In reality, 2005 went relatively according to plan. We were forecasting at the start of the year 23% EPS growth (on a simple average basis) for the 87 stocks still held by our Funds (a number not much changed today). In truth, of course, this bland statistic masks a re-rating in Korea and India and a de-rating of our stocks in Greater China and ASEAN ...

With US short term interest rates topping out, oil prices stabilising and the chart of Asian markets having finally broken through its end-1999 "resistance" point, it seems churlish not to be reasonably sanguine for 2006.

Murphy's law dictates, of course, that this forecast means we can expect a severe shock from an unexpected quarter.

We have been steadily shifting capital out of our India and ASEAN Funds into the Greater China Fund which we sense is now shaping up for its turn in the sun.

This manager's USD performance numbers since their fund's inception in 31/10/96 are:

Manager performance	+	194%
FTSE (ex Japan)		
Asia Pacific Large Cap	+	0.1%
FTSE (ex Japan)		
Asia Pacific Small Cap	-	21.4%

GTI comment: Taiwan is underowned and perceived as high risk (Formosa Straits sabre-rattling). Yet, the market trades at a 20% discount to emerging markets, the largest valuation gap in Taiwan's history. Equities yield almost 6%, 3 times the 10 year bond yield, and the market stands on 10–11x earnings. Taiwan could be the surprise winner of this year's emerging markets Derby.

Water Shortage / Ecology

Legislation remains the key profits driver

Background. Water is one of three largest industries in the world in deployed asset terms. There are 160 companies with water-related revenues having market cap of USD 200bn+. This figure to rise to USD 400bn by 2015. Available fresh water is less than 1% of water on earth. Usable water is less than 1% of this amount. Running water is available to only 20% of the world's population. A third of all nations suffer from "water stress". Every year, the amount of water consumed = the amount of water polluted. 60,000 children die each day from lack of/dirty water: this is by far the largest health problem in the world. Scientists say the 40 percent of humanity living in South Asia and China could be living with little drinking water within 50 years as global warming melts Himala-

yan glaciers, the region's main water source. China needs to prepare a national water policy using pipelines and canals to move water to deficit areas, even though the cost of implementing such a plan could be astronomical. Failing such a move, China could be forced to import water in tankers as an emergency measure.

The opportunity. The number of people served globally by investor owned water companies will rise by 500% over the next 10 years. Water and ecology plays should be able to generate annual returns of 15% for decades. Water demand has little or no correlation to interest rates, "macro schmacro", investor fashion or inventory loss, so is an excellent portfolio diversifier. Demand is price inelastic and the supply of a water conveyance system creates a

natural monopoly with huge barriers to entry.

Ways to play the theme. Specialist funds playing water equipment companies and ecology funds with large exposure to the sector. Some large individual companies present excellent efficient portfolio plays.

Particular factor skills required of selected managers. Value approach with sound dividend payout analysis (many utility stocks carry a rather high current PER since stock prices are supported by higher than average dividend levels). The average dividend level of US water utilities is about 3.5% and the current dividend level of non-US water utilities is 4%+. Engineering / scientific knowledge a "must".



GLOBAL THEMATIC
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News from our manager

Our principal specialist water and ecology managers wrote at the end of December:

In the water sector, the US Environmental Protection Agency announced the finalisation of the Long Term2 Enhanced Surface Water Treatment Rule (LTII) which will require utilities to treat drinking water for harmful microorganisms ... The main contributors to our performance were First Technology which rose 53%, and Amiad Filtration (water filtration, Israel), which climbed 37% after making its debut on AIM. On the downside, Questair (hydrogen purification systems, US) declined by 23% after its annual results, and Zenon (membranes, Canada) fell by 18% on a profit warning”.

This manager's GBP performance numbers over the last 3 years are:

Manager performance	+ 70.1%
MSCI World Index	+ 48.9%
Impax Environmental Technologies Index	+ 53.1%

GTI comment: Water is a good defensive sector, like the pharma (Ageing Population) sector. The actions of governments almost guarantees growth in this sector for decades to come.

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**GLOBAL THEMATIC
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