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Big Oil and Small Furry Animals

“Nonsense. It just isn’t. There are certain things like that, myths, that are floating around. I’m glad you asked. It has nothing to do with oil, literally nothing to do with oil.”

Donald Rumsfeld, USA Secretary of State, 2002

“So where is the oil going to come from? The Middle East, with two-thirds of the world’s oil and the lowest cost, is still where the prize ultimately lies.”

Dick Cheney, while still CEO of the oil services company, Halliburton, 1999

“Let me tell you something that we Israelis have against Moses. He took us 40 years through the desert to bring us to the one spot in the Middle East that has no oil.”

Golda Meir, Fourth Prime Minister of Israel, 1973

I’ve always been fascinated by oil, the major part of GTI’s “Energy and Alternative Energy” theme, today the biggest part of our GTI fund. It always seemed to me that the oil business was not a business like any other, but rather an extension of politics (rather as Clausewitz viewed war) where outsized egos in outsized cowboys boots and stentorian voices strutted like characters in a John Le Carré novel, forming complex relationships with sinister foreign governments. Nothing came or went cheap, everybody had a price and nothing was ever quite what it seemed. The model was Dallas the TV series, not Harvard the business school. The oil industry was, like Le Carré’s 1969 novel of that name, a “looking glass war”.

My first brush with Big Oil was as a callow teenager some thirty years ago. A university friend had invited me for a week on Big Oil’s Big Yacht in the Baltic Sea. Sam’s Dad was a Big Wheel in Big Oil and famed for his wry humour, salty stories of the oil busi-

ness and Havana cigars. We sunbathed like pashas on the polished wooden deck, laid fishing lines behind the yacht and caught skinny mackerel off the Skaggerak. We triumphantly smoked our prey inside the yacht’s on-board smoker, washed down by German wine and the whiff of the Havanas. The yacht – like the Havanas – was an icon of the Cold War and no mere plaything. Should the Russian tanks rumble over the German plain, the Directors of Big Oil Germany would be chauffeured away from Hamburg to the Kiel Canal, thence by Big Yacht to safety in Little Britain. I never checked but I’m sure there was some useful artillery stowed away below in case the going got rough or the natives turned restless.

When Bruce and I started in the finance business, in the late ’70s, the glamour pussies in our world were the oil industry analysts. Their selections dominated the asset allocations of the big investment houses. They crammed nearly a third of client money – yes, a third – into oil stocks.

Is Now the Time to Sell/Buy Energy Equities?

S&P 500	1980	1984	1988	1992	1996	1998	2000	2002	2004	2006	2007	1980 to 2007
Consumer Discretionary	10	14	14	13	10	9	3	4	11	11	11	1
Consumer Staples	8	10	13	17	16	15	9	10	11	9	10	2
Energy	27	14	12	10	9	6	8	6	7	10	10	-17
Financials	6	8	9	11	15	14	18	21	21	22	21	15
Health Care	6	6	7	9	10	12	13	15	13	12	12	6
Industrials	11	11	11	9	10	8	8	7	12	11	11	0
Materials	8	7	8	7	6	3	3	3	3	3	3	-5
Technology	10	12	9	7	13	19	21	15	16	15	15	5
Telecomm. Services	6	8	8	9	6	8	9	8	3	4	4	-2
Transportation	2	2	2	2	1	1	1	1	-	-	-	-2
Utilities	6	8	7	6	4	3	3	2	3	3	4	-2

Sources: **Investec Asset Management**. Industry Data. 1. Standard & Poor's incorporated the Global Industry Classification Standard (GICS) in 2003 to better correspond to the current make-up of the world. The original S&P 11 sector and 115 industry group system was adjusted to a four-tier system incorporating 10 sectors and 24 industry groups. Dated as of April 12, 2007. AG Edwards & Sons, Inc. Equity Research; Integrated Oil and Gas/Ethanol, 12.4.07

The energy sector in 1980 was 27% of the S&P 500. Now it is 10%.

Who Pinched My Porsche?

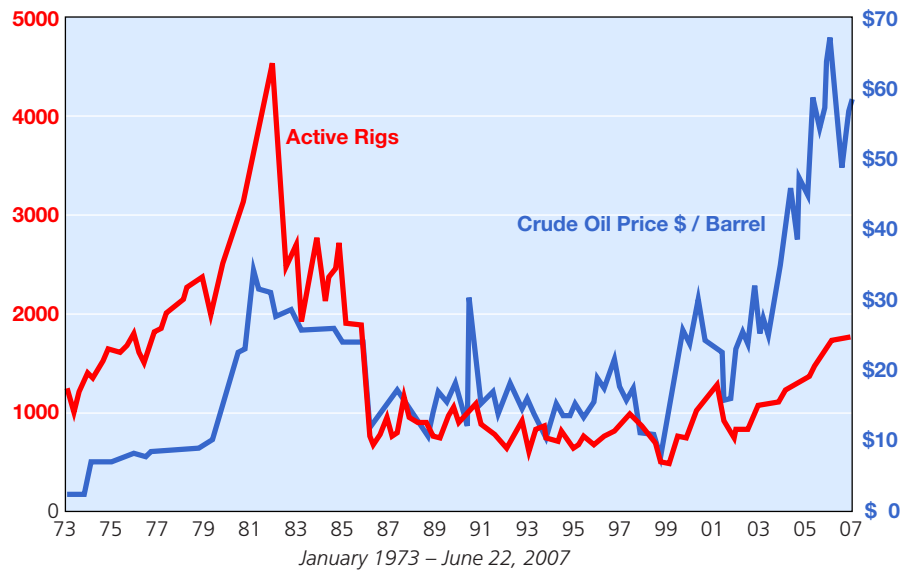
Reputations soared and plunged on oil pundit predictions. Eccentrically dressed men from middle America became household names as seers of the oil price. As inflation nudged 20% pa and the coal miners held Britain to ransom, UK government foreign policy WAS energy policy. The jobs sought by the brightest graduates were in large corporations the size of small countries called BP or Shell.

In finance, it was almost a sackable offence for a portfolio manager to have less than 15% of assets in oil service stocks like Schlumberger or Baker Hughes. An oil stock – like a diamond – was forever. The complacency was breathtaking. It reminded me of a colleague's client, once a runner on the De Beers diamond mines in South Africa, who stuffed his entire life savings into De Beers shares and made a fortune. When the merits of stock diversification were pointed out, he'd bark: "Young man, companies are just companies. But De Beers is an

EMPIRE". One day, when the De Beers share price collapsed, he loaded his South African hunting rifle and shot himself. Schlumberger's share price peaked near USD 20 in 1980 and in

2003, nearly a quarter of a century later, it was still there. Even today, the US rig count (a key variable for Schlumberger, since they service the things) is well below the levels of 1981.

U.S. Rotary Rig Count, Active Rigs



Sources: Baker-Hughes, Energy Information Administration (DOE), WTRG Economics



A whole generation of oil analysts saw their prestige, their Porsches and sometimes their livelihoods, confiscated by an oil price that peaked near USD 60 per barrel in the early '80s, and collapsed to about USD 15 in the late '90s. Since inflation had also cratered over this period, the beneficial effect on consumption through greater purchasing power was dramatic. Yesterday's goats became today's heroes. The retailing, pharma and finance analysts now drove the Porsches, whilst the poor old oil analysts, once the toast of the town, stood alone and dejected like rusty oil rigs in a barren sea.

All the while, despite the headline drama of the markets, quietly and unnoticed like a melting glacier, oil fundamentals were changing once again. Power was returning to the oil producers (a small elite) and away from the consumers (the rest of us). The events of 2001 and the invasion of Iraq have only served to remind us what this means.

The Cupboard Is Bear

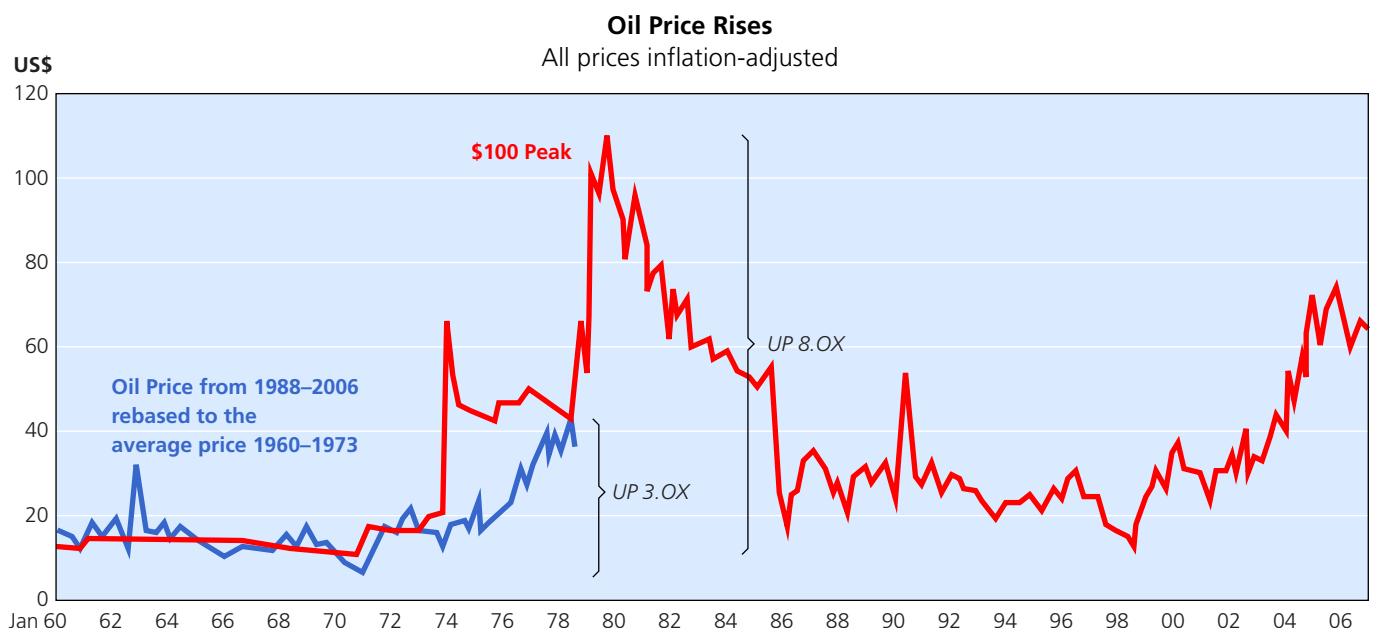
Even the most jaundiced oil bear must now admit that the energy story – one of GTI's 8 global themes – is here to stay, and perhaps for decades to come. To save time, much of it being familiar

to GTI readers, here's the bull argument on oil (once again over USD 60 a barrel), in bullet point format:

- Oil demand growing at 2% pa thanks to "Chindia", supply growing at less.
- Oil discoveries peaked 40 years ago.
- According to M King Hubbert Production peaks follow Discovery peaks after approximately 40 years.
- US Oil production already peaked in 1970.
- Non OPEC Oil production already peaked in the early '90's.
- World Oil production will peak when OPEC peaks.
- OPEC peaks when Saudi Arabia peaks.
- Saudi Arabia peaks when the Ghawar field (half of total Saudi oil production) peaks.
- Ghawar is ageing rapidly and its life expectancy isn't rosy. Oil analyst Matthew Simmons says that the end is in sight.
- Bank of Montreal says that Ghawar is already in decline.
- Prof. Kenneth Deffeyes says PEAK-OIL happened in 2005.
- World Oil peak production means the End of Cheap Oil.

- The End of Cheap Oil means continuing rising Oil prices which translates itself into Oil shocks.
- French investment bank Ixis-CIB has warned crude oil prices could touch USD 380 a barrel by 2015.
- Goldman thinks USD 100 a barrel is coming soon
- Previous Oil shocks were a perfect call for recession/inflation
- Oil (and gold) is the ultimate hedge against inflation

Whilst we agree with much of this, we've also got to blank out some of the shriller noises. Yes, OPEC has regained much of its former power. But it's also learned from its earlier experience that begging your neighbour is begging yourself. Much will be done by OPEC to avoid a re-run of the '70s, when OPEC pole-axed the major OECD economies; USD 380 a barrel oil-Ixis-CIB's rather fanciful prediction – may be a little long in coming. And much of the spare capacity – and hence the ability to turn on the oil spigot – remains in OPEC. But it's also the case that the inflation-adjusted oil price is still fairly low and allows the world economy to tick along despite a higher oil price:

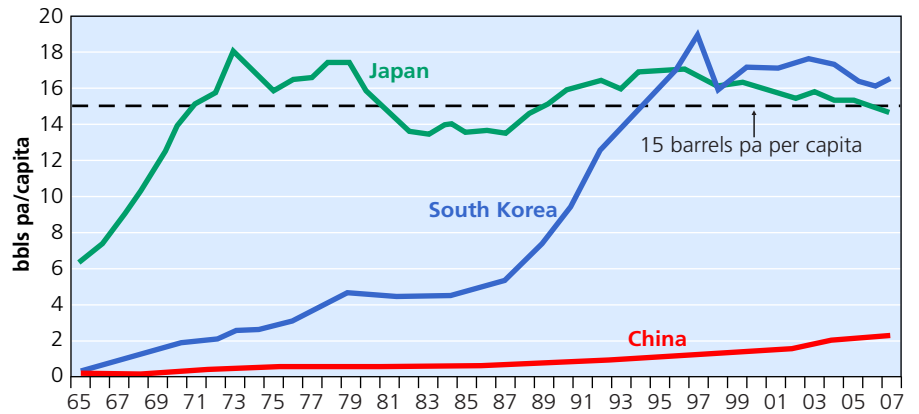


Sources: Investec Asset Management. Datastream 1960-2000 (USOCCONF; UKI76AAZA), Bloomberg 2001 (CPIINDEX; WTI CUSHIN) to 31.05 07

Peaking Supply. Peking Demand. Piquing Consumers.

In terms of demand, the major factor is China and the developing economies. If China demand rises to the levels of “developed” Korea and Japan demand (15 barrels pa/capita), we’re going to see increased incremental demand of nearly 20bn barrels pa. 20bn barrels is roughly 2/3 of total world demand today (about 30bn barrels pa). Over 80% of this expected demand growth will come from developing countries (the darlings of the GTI portfolio). The old economic supply/demand models dominated by the USA are becoming as out of date as Grandma’s kerosene lamps.

Demand Oil Consumption per Cap Comparisons

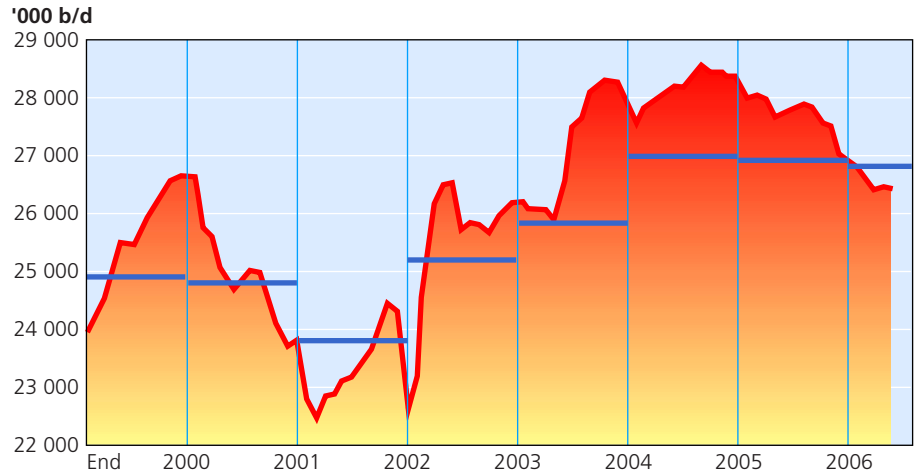


Sources: Investec Asset Management. BP Statistical Review archive copies to 2004. International Energy Agency Oil Market Reports 2005 to date; latest: June 2007

What if China follows Japan and Korea? If China’s consumption rises to 15 barrels pa/capita, this is 1.2bn X 15 = 18 bn barrels pa total demand vs 2 bn today and vs world demand of 30.5 bn barrels pa today.

Supply is tricky. No-one quite knows. People cheat. People “spin”. People fudge numbers. People get it wrong. But it’s clear that OPEC production peaked in 2005.

OPEC Production



Source: Investec Asset Management

OPEC apparent production (ex Angola and Iraq) vs call on OPEC 2000–2007.

Oil Production Peaks

And here’s a Brief History of oil production peaks with some surprising places on it, courtesy of Gregory D Croft of Greg Croft Inc, an oil consultancy in California:

Where?	When?	Peaked at what level?	Production 2005
Oklahoma	1927	0.70 mn BOPD	0.17 mn BOPD
USA	1970	9.66 mn BOPD	5.18 mn BOPD
Libya	1970	3.32 mn BOPD	1.64 mn BOPD
Kuwait	1972	3.28 mn BOPD	2.13 mn BOPD
Iran	1974	6.03 mn BOPD	3.89 mn BOPD
Saudi Arabia	1981	9.64 mn BOPD	9.06 mn BOPD
Russia	1983	11.5 mn BOPD	9.19 mn BOPD
Alaska	1988	2.14 mn BOPD	0.80 mn BOPD
Mexico	2004	3.38 mn BOPD	3.33 mn BOPD
Malaysia	2004	0.86 mn BOPD	0.77 mn BOPD

Source: Greg Croft Inc.

Now, of course there are lots of technical reasons for peaking in every case, some of them enforced by good old OPEC discipline. But at least let's admit that there's an awful lot of "peaking" going on. And "peaking" supply is good for the oil price longer term.

On the other hand, some countries (particularly Africa, one of GTI's major investment areas) saw their oil production at an all-time high in 2005. Come to think of it, most are countries where GTI is an active investor:

- China 3.63mn BOPD
 - United Arab Emirates 2.45mn BOPD
 - Nigeria 2.41mn BOPD
 - Angola 1.24mn BOPD
 - Qatar 0.80mn BOPD
 - Canada in 2005 2.37mn BOPD
 - Kazakhstan in 2005 0.99mn BOPD
- were slightly down from 2004 in 2005, but increased in 2006.

Leave That Small, Furry Animal Alone, Boris

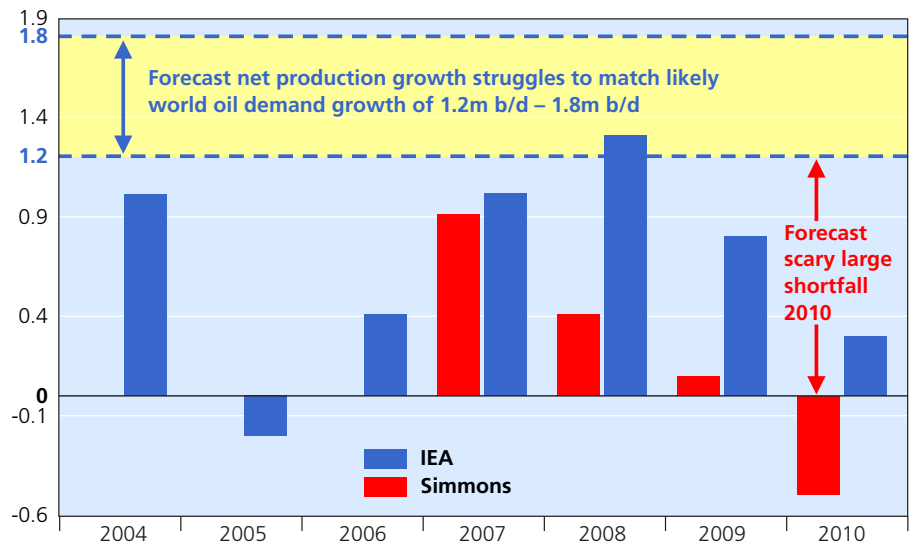
Nearly all of the world's largest oil fields are in decline. Only one super-giant (>5 bn barrels recoverable) field has been found since 1980. That field (Kashagan in Kazakhstan) is located on a geological structure that was identified prior to 1980, but was not drilled until 2000 because of sea ice conditions.

The bad news for the oil companies is that the populations of small and large furry animals are also in decline. The prospects for finding any more oil are limited, and most of them are in the Arctic offshore region. The environmentalists won't be so easy to by-pass or pay off this time round. The spotted owl, the sage grouse, the polar bear, the whales ... they all act as unofficial stewards of the oil price. This swimming polar bear may be off to buy himself some oil futures.

OK, So What Are My Alternatives?

Grubby oil stocks are not the only story in a well-balanced "energy and

Non OPEC Supply Response



Sources: Investec Asset Management. IEA Oil Market Report, 11 May 2007 and IEA Medium Term Oil Market Report Update, February 2007; Simmons & Company International Energy Industry Research, 20-10-06

Non OPEC supply response – very anaemic, well below demand growth

alternative energy” thematic portfolio. The alternative energy sector – long regarded with disdain by serious energy investors – is also enjoying a renaissance. The US National Energy Bill, the California Global Warming Solutions Act of 2006, the Chinese Renewable Energy Law, Sir Nicholas Stern’s UK report on the economic implications for climate change, even Al Gore’s film “An Inconvenient Truth”... all these factors, plus USD 70 oil, are adding up to a potential bonanza for alternative energy stocks.

China, often portrayed as the big bad boy of the environmental debate,

intends to source at least 15% of total energy consumption by 2020 from renewables. Of course, the Chinese could be bluffing ahead of the 2008 Olympics, but who'd want to bet against them? GTI's markets adviser, Eoin Treacy of Fullermoney, writes after a visit a few weeks ago to China:

“E90 (ethanol based fuel) is starting to be rolled out in Beijing as a test project. I saw a number of service stations offering it on the outskirts of the city but none inside the third ring road (3rd of 6). Chinese ethanol is made from corn. I suspect that in the competition between energy and



food, the latter will win out in the end. I wonder, "is the ethanol rollout more of a superficial exercise to improve China's environmental image?" because I find it hard to believe that China can make ethanol from corn more efficiently than anyone else.

The government has also mandated that all air conditioners in public places must have air filters installed before the Olympics. This is in an effort to improve the air quality for international visitors. Day to day I found that the air quality has improved since my first visit in November 2005 and is best after a rain shower but it still has a long way to go. I believe that it is likely they will force industry to close prior to the Olympics in an effort to clean the air."

Global wind power generating capacity grew by a fifth in 2006, solar

by nearly a third. Companies in the alternatives area are finding that their earnings visibility – for so long a problem in the alternative energy sector – has greatly improved. Oil giant BP has swallowed its pride and moved into the wind turbine business in a joint venture with comparative minnow **Clipper Windpower**, the biggest holding in GTI's alternative energy adviser's portfolio. BlackRock Investment Management say there were 57 IPOs in the alternative energy sector last year.

Here's what some experts are saying our energy supply looks like now: 2% wind, 2% solar, 96% coal, oil, gas, hydro, nuclear, and all the rest. Here's what experts say it'll look like in the next 20 years: 20% wind and solar, 20% nuclear, geothermal, 20% biofuels, hydro, 40% fuel cells, coal, oil and gas. That's one heck of a change. And

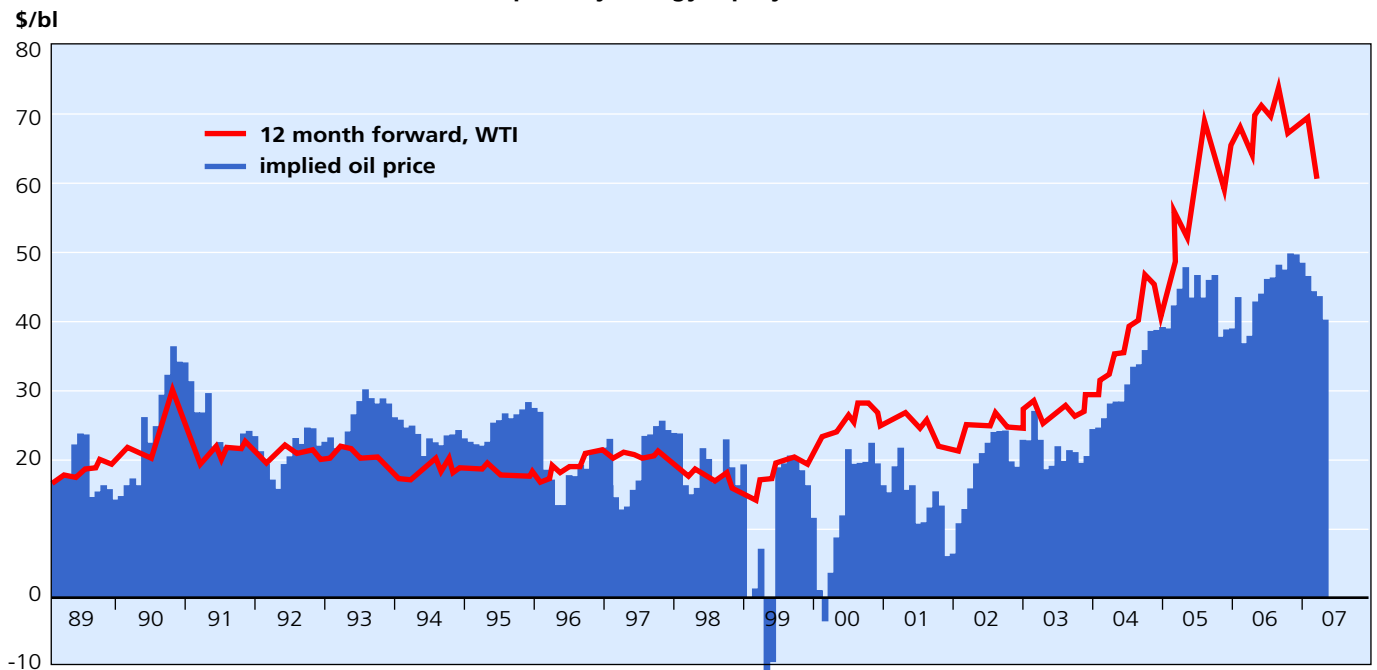
where there's economic change going on, there's pocket change to be made. Gideon Rachman reports in the Financial Times that: "... four new nuclear reactors a month would have to be built from now to 2070 to make any difference to global carbon emissions ('Too Hot to Handle? The Future of Civil Nuclear Power', Oxford Research Group)". Fancy a little dose of Uranium, anyone?

Sounds Good But What's The Price?

Remember the number one rule in share investment. If market perception is significantly better or worse than reality, opportunity exists to make or lose money. So what's today's perception?

Investec say the market is valuing oil stocks at under USD 50 per barrel of oil. Other commentators agree.

Oil Price Implied by Energy Equity Valuations vs WTI



Source: SGAM

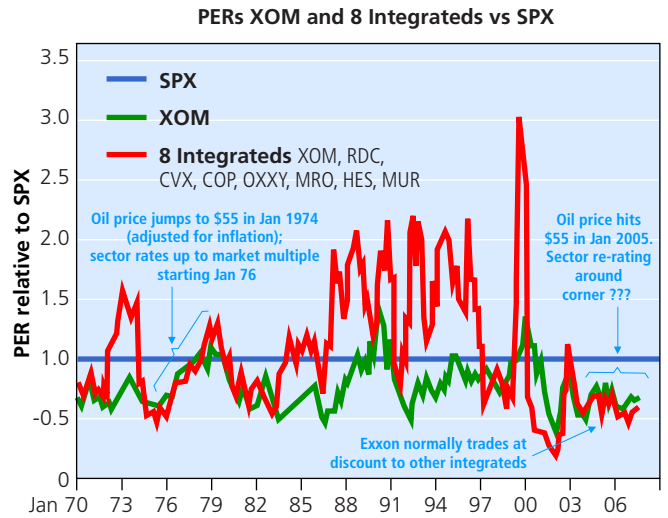
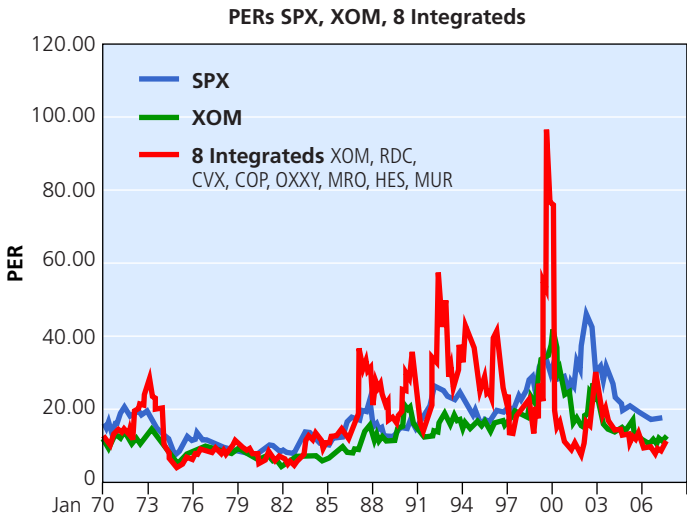
The current oil price is in a band of USD 65–75. This provides a 25%+ “value cushion” (Ben Graham, the inventor of Value Investing, would have called this a “Margin of Safety”). If the oil price were to move to USD 80 or beyond, oil stocks could fly. GTI has an energy stock adviser who runs the portfolio on the assumption that his

investors want to see “bang for their buck”. Or else, he says, they should redeem his fund (the late and much missed Julian Baring, who used to run the Merrill Lynch Gold and General Fund, had a similar view). Our energy adviser considers that – until 2009 – a USD 50–70 trading range is a 50% probability, USD 70–80 oil is a 25%

probability and above USD 80 also 25%. He thinks there's almost a zero chance of a sub USD 50 oil price, except on a downward spike.

For another valuation check, look at the Price Earnings Ratios in the oil sector (sorry, rather a busy chart). This is hardly the stuff of bubbles.

Oil and Gas Equity Prices Languish at Low Multiples



Source: Investec Asset Management

This chart shows actual multiples

Integrated oil stocks now trade at multiples around 60% of S&P 500; historically they have traded above broad market early 70s, late 70s; 84-96, 00; 03

In the California gold rush of 1848-1855, the people who really made out like bandits were the shopkeepers who sold the picks, the spades and the jeans. So it is with alternative energy. The bandits of tomorrow will be energy technology providers. They'll command

- and keep - high margins for alternative energy products in an increasingly desperate and politically correct world. GTI has investments with two advisers who are experts in picking these new energy technology stocks.

Oh, and what happened to my college friend? Well, today he runs an energy company with 30,000 employees. He tells me that Havana cigars receive no mention in the company's "Working Well" employee wellness booklet. Quite right.

So What Do 2007 and 2008 Hold For GTI?

Bull markets don't die natural deaths, they are assassinated

We hate writing this part of the GTI newsletter. It fills us with dread that readers zoom into the part that pretends to predict the near future, instead of focusing on these eight simple themes that are changing our world longer term. Short-term prediction is a lower order decision, but a skill that most people spend their lifetime trying to hone. Sensible long-term asset allocation is a higher order decision. GTI is all about long-term asset allocation. Market timing is “for the birds” (birds like Nassim Nicholas Taleb’s “Black Swans”, see our note at the end).

GTI is not a timing tool. GTI changes its investment positions according to the degree of confidence and outlook of its specialist advisers. Bruce then screens these forecasts through his Investment Strategy Network system – the same system that he used when managing a few hundred billion of Abu Dhabi government money – and if the numbers add up, we usually feel brave enough to adjust the portfolio. The other major input is our GTI markets advisers, David Fuller and Eoin Treacy at Fullermoney

(www.fullermoney.com). David and Eoin have helped us into the 5th calendar year of 20% USD performance. Thanks again, David and Eoin. We urge readers to subscribe to Fullermoney’s daily audio and chart service. David is producing the best work of his long and distinguished career. He is a classy and honest act in a flawed and flaky analytical world.

David’s line, one we agree with, is pretty simple. *“Bull markets don't die natural deaths, they are assassinated.”* So what kills equity bull markets?

Three things kill bull markets. Interest rates, interest rates and interest rates. This is why the most liquid and widely followed security in the world is also the most important for our financial health: the US treasury long term bond. It is the ultimate measure of liquidity and investor confidence. Rising US treasury yields killed the equity markets in 1929, 1987, 1990 and 2000 in the US, UK, Germany, Hong Kong, Japan and all points north, south, east and west. It will do the same to the bull that started charging in October 2002. True, other factors weaken a dying bull. The oil price can wound it

badly (but see our Energy and Alternative Energy Adviser’s comments on how much further the *real* oil price has to climb to near 1979 levels.) Valuations can do damage (equity markets are in “fair value” territory ... not cheap but not expensive either). But neither rising input costs (eg oil) nor valuations on their own kill bulls. Interest rates, and particularly *USD* interest rates (since the greenback is still the reserve currency of the world) are the silent assassins – or cheerleaders – of equity bull markets.

So where are we now, given the fact that rates have been rising?

Rates rises not yet critical

The good news, and the reason we’re still tactically bullish, is that we’re not yet critical, despite the rate rises seen this year. Monetary policy – the driver of interest rates since, ultimately, central banks decide the level of interest rates – was abnormally loose following the bear market of 2000 to 2002. The rises shown in this chart are only an adjustment to take us back to more “normal” territory.

Long Term USD 30yr Bond Interest Rates



Source: www.fullermoney.com

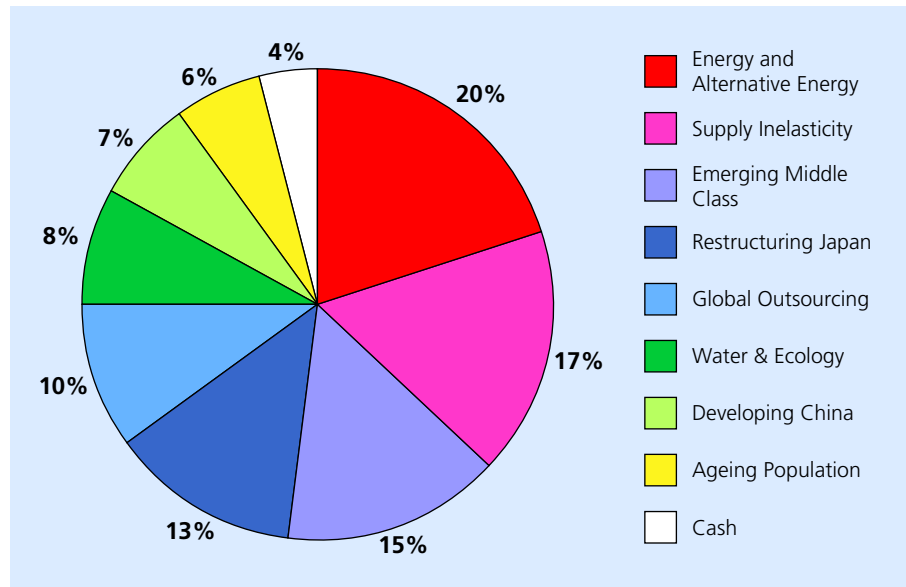
GTI advisers still positive but 5% to 10% correction sometime in the autumn

Most of our GTI investment areas (see the individual adviser reports) ... emerging markets, energy, commodities ... seem to be doing fine. Others (pharma, Japan) are unexciting at present, but represent good value and are under owned. In these areas, the GTI advisers seem astonished by the lack of interest in their areas. We like this.

We're overweight in the "Scarcity" themes in the portfolio (*Energy and Alternative Energy* and *Supply Inelasticity*) and underweight in the *Ageing Population* theme.

We still think there will be a worldwide stock market correction of 5-10% in 2007. Many of our GTI advisers agree. So far this year, we have only been treated to 3-4% corrections, which David Fuller prefers to call "adjustments" rather than "corrections". Our best bet is that it will occur in September or October, seasonally vulnerable months.

Here's our current GTI thematic allocation, which shows us fully invested:



And here's our USD performance

in balanced accounts, audited by Horwath International of Zurich for 2003, 2004 and 2005:

GTI	2003 (4Q+)	+ 23.6%
GTI	2004	+ 18.6%
GTI	2005	+ 19.8%
GTI	2006	+ 20.1% (unaudited)
GTI	2007	+ 19.5% (unaudited)

Our EUR based P&C GTI Fund

a largely invested fund of equity advisers – in EUR since its launch on 1/8/06. Our lawyers say we can't tell you more about this fund, but if anyone is curious, they can contact Iain Little on iain.little@butterfield.ch.

GTI	2006/07	+ 15.0%
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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 fund¹, 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.

Our eight winning global themes that are shaping our economic and investment lives are:

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

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.

GTI investment advisers all share five distinguishing characteristics:

- | | |
|--|---|
| 1. Investment edge | The best managers have an “edge” in their chosen market. It doesn’t particularly matter what it is, as long as they’ve got it. |
| 2. Research | The best managers are research – and not marketing – intensive. |
| 3. Good performance in a bad market | Good friends are staunch in bad times. Good managers do better than the crowd in bad times. Road-holding on slippery corners is important for cars. |
| 4. A good idea at a good price | Great managers – like great generals – usually have the “luck” to be in the right place at the right time. We require that they understand that the good idea must also be attractively priced. |
| 5. People, people, people | Venture capitalists usually seek companies run by people who are serial successes in the same field over many years. Investment adviser selectors should do the same. The best of them have excellent ego-control despite their success |

¹ 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.

Restructuring Japan

Blow fish and poison pills

News from our advisers

Our principal specialist Japan adviser – a mid and small cap value manager – wrote at the end of June:

*At annual general meetings, the majority of which happen in June, most resolutions introducing “poison pills” were passed in spite of opposition from such advisory bodies as Institutional Shareholder Services. Similarly, requests from largely activist shareholders to increase dividends substantially also failed. However, the plan to expand the shares in issue at **Fujifilm** to facilitate the potential issue of warrants was voted out by 80% of shareholders. The situation at **Bull-Dog Sauce** continues to develop. **Steel Partners** (private equity firm in NYC) had raised their offer price from Y1584 to Y1700 and extended the offer period. The poison pill was passed by shareholders and the Tokyo Court subsequently upheld the legitimacy of its introduction, arguing the action was approved by shareholders and not to the detriment of any one shareholder. Steel Partners will receive cash from exercising their warrants rather than receiving shares so their bid fails due to dilution. Nevertheless, they walk away with quite a comfortable second prize.*

*It is interesting to note that **KK DaVinci** has raised its bid for **TOC** to Y1308. Bearing in mind this company traded around Y600 only six months ago, it perhaps demonstrates the interesting real value of often overlooked little companies. Buybacks also continue with **Kuraray**, as part of its target to return 70% of net profit to shareholders, intending to purchase up to Y30bn worth of its equity. **Sekisui House** and **Sekisui Chemical** have unravelled a considerable part of their cross-shareholding.*

Regardless of the outcome of the Upper House elections we hope that Japanese interest rates will start to rise thereafter. The Japanese currency is at very low levels and the stockmarket remains, in our view, inexpensive but we do need local sentiment to turn and capital outflows to reduce.

This adviser’s USD performance numbers since their fund’s inception in 4/8/99, acquired in the teeth of a horrible Japanese bear market are:

	Year-to-date (end 6/07)	Since inception
Manager performance	+ 4.7%	+ 103.3%
TOPIX Index	+ 1.9%	+ 12.6%
Nikkei 225	+ 1.6%	– 5.1%

GTI comment: We are not encouraged by our Adviser’s comments about Poison Pills. Change in corporate Japan is absolutely critical for our Restructuring Japan theme to play out.

Underperforming management should be shown the door. We therefore have this investment under review. We recently saw the Adviser in Zurich. He was as confident as ever in the valua-

tion metrics of the portfolio. We see his point. We are slightly overweight in this theme, looking to increase, but won’t do so until this corporate change issue is resolved.

Supply Inelasticity

There used to be gold in them thar hills

News from our advisers

Our principal specialist commodities advisers wrote at the end of June:

*Merger and acquisition activity shows no sign of slowing up with **Yamana Gold** and **Northern Orion** joining forces to jointly acquire **Meridian Gold** ... Mined supply is decreasing as depletion outstrips the rate at which new mines are currently being brought into production. The USD will also suffer due to the US current account deficit and likely diversification by holders. All of this creates a positive environment for the gold price.*

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

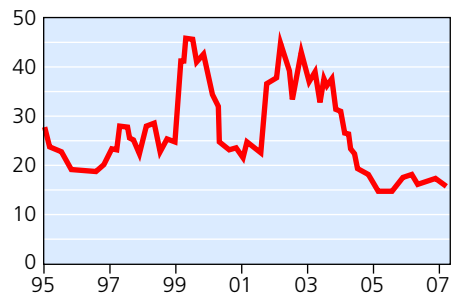
	Year-to-date (end 6/07)	Since inception
Adviser performance	+ 6.6%	+ 291.6%
FTSE Gold Mines Index	- 9.6%	+ 97.8%
Gold Bullion	+ 2.0%	+ 92.5%

GTI comment: This news report underlines our much repeated mantra: substantial mining resources in politically secure parts of the world are now as rare as unicorns: "Rio Tinto Group Chief Executive Officer Thomas Albanese says he's buying Alcan Inc. for \$38.1 billion before the competition beats him to it. 'You ask the question of why now?' Albanese told investors during a conference in Montreal yesterday. 'This is competitive. There aren't that many top-quality, global resources in any of the mining sectors that are available.' Albanese is making the industry's biggest

acquisition just two months after taking over at the world's third-largest mining company. The cash offer from London-based Rio Tinto overwhelmed a hostile bid for Alcan by Alcoa Inc. and would create the world's largest aluminium producer."

Here's a chart of the PER for the basic materials sector, the producers of these scarce resources, which shows that the market is certainly not overvaluing them, hence RTZ's confidence in buying them. We are not in bubble territory yet, but hang around for a year or so ... we might be:

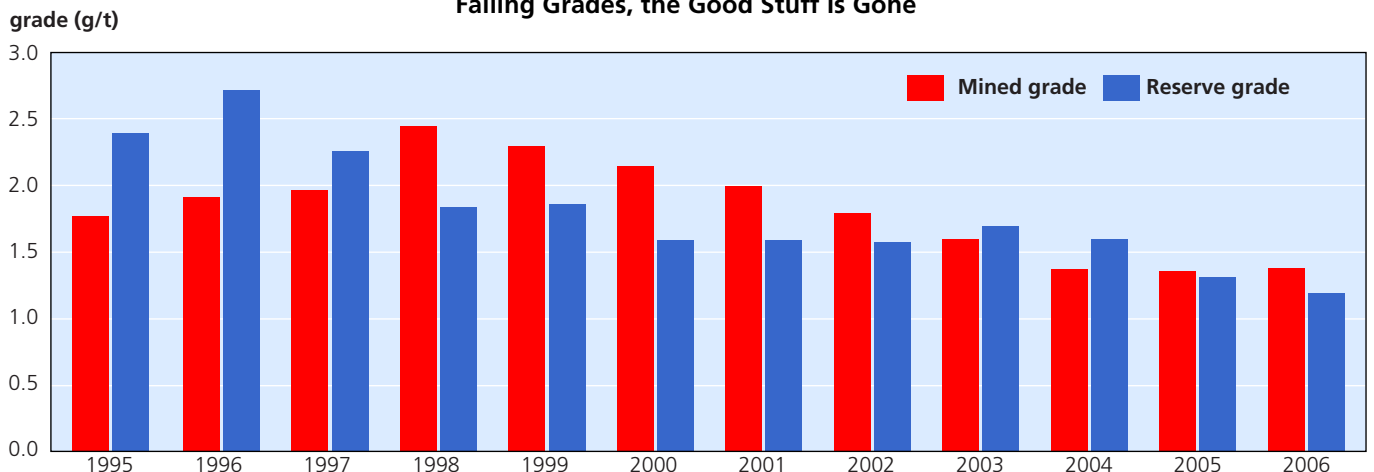
MSCI World Materials P/E and Price



Source: Bloomberg

Plus, the easy pickings have gone, with so much high-grading (mining out the profitable, easier materials) going on.

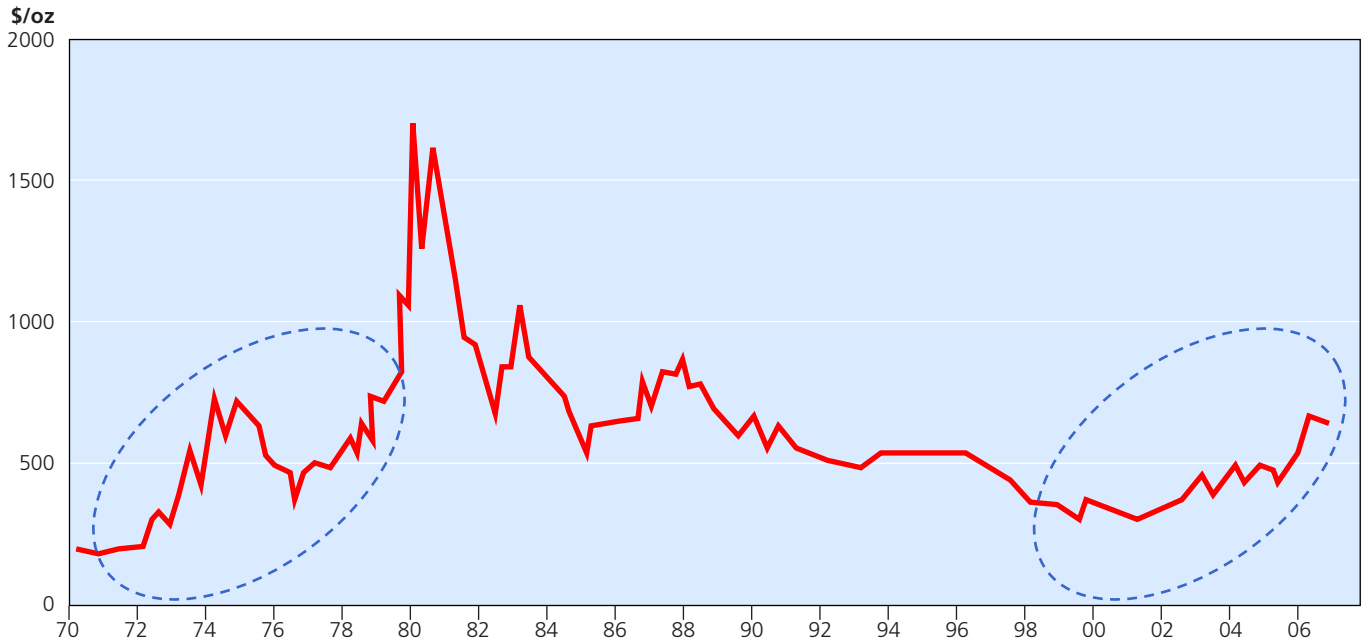
Falling Grades, the Good Stuff Is Gone



Note: Mines included in this analysis are: Nevada (Newmont), Yanacocha, Goldstrike, Porgera, Granny Smith, Campbell, Dome, Kalgoorlie Superpit, Eskay Creek, Golden Giant, Hemlo, Korri Kollo, Fort Knox, Round Mountain, Kubaka. Sources: **Investec Asset Management**. Company data, Macquarie Research, May 2007

In addition, the gold price (and other industrial materials, take our word for it) is low in real terms:

Real Gold Price (in Today's Dollars)



Sources: Investec Asset Management, Bloomberg

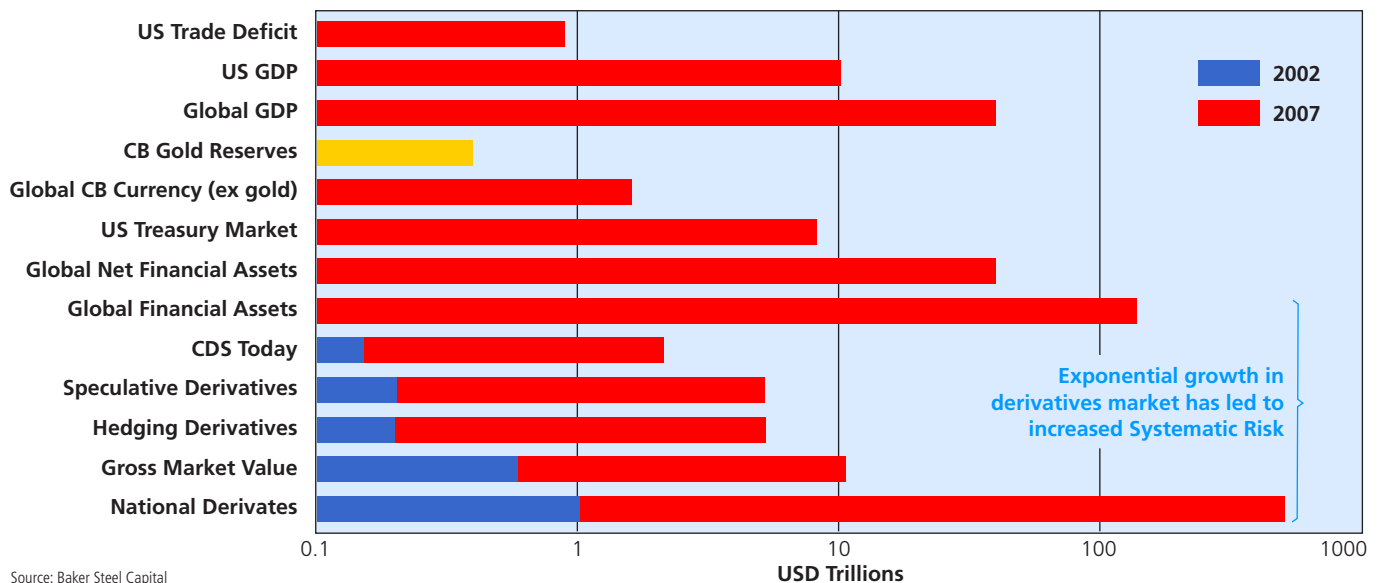
1970s	Parallel	Now
Nixon	Low Presidential Approval	Bush
Hostages	Iran	Nuclear Program
Supplies Threatened	Oil	Peak Oil?

Cheap companies, cheap underlying materials, cheap financing, a global search for scarce extra capacity by cash-rich corporate players ... come on, what

do you think is going to happen to this GTI sector? It's going to boom. The Supply Inelasticity theme (particularly mining) is our second largest bet after

the Energy and Alternative Energy theme. Our only major issue is whether we increase it further or not.

Relative USD Value of Gold, Currency, Treasury and Derivatives Markets



Source: Baker Steel Capital

Energy / Alternative Energy

Historically low valuations

News from our advisers

Our principal specialist energy fund advisers wrote at the end of June:

*Our integrated and similar stock exposure (c30%) is comprised of a mix of mid- and large-cap stocks. Mid-caps are **Conoco-Phillips, Statoil, OMV, Hess and Petro Canada**. Our three large-caps are **Royal Dutch Shell, BP and Chevron**. The median price/earnings/(PE) ratio of this group is 10.8x 2007 earnings, which looks cheap when you consider that Exxon is on 12.7x 2007 earnings.*

This adviser's USD 5 year performance numbers to 30/6/07 are:

Adviser performance	+ 279.44%
Sector performance	+ 180.81%

GTI comment: we've written enough on energy. Suffice it to say that this is our biggest single theme at present and we are unabashed bulls. All the more

so as the energy sector is cheap (see above) and under-represented in global portfolios.



Emerging Middle Class

Dear Mr Mugabe, may I emerge please?

News from our advisers

Our principal specialist emerging middle class advisers wrote at the end of June:

It is a constant source of amazement to us that any investor could be more wary than us about investing in emerging markets. Yet we continue to talk to and read about investors that prefer to watch the rising market rather than participate in it ... we have interviewed nearly 400 companies around the emerging markets and ... they are telling us broadly the same story.

- 1. Cost pressures are rising, both for labour and materials. Nevertheless, few companies expect substantial margin pressure as a result. Demand is too strong ... Companies prefer to buy competitors rather than add capacity. In short, profits may stay higher for much longer than investors are expecting.*
- 2. The demand side of the equation is stunning ... buy and sell side analysts are simply going to have to accept that growth will continue to surprise on the upside for the foreseeable future.*
- 3. There is no question that the investment risk is rising along with share prices ... the problem is that the markets appear to have fully discounted these risks ... caution and risk aversion are widespread among sell side strategists.*

Another of GTI's emerging middle class advisers (a specialist Sub-Saharan African Adviser) wrote at the end of June about Africa:

*Nigeria rose strongly but the gains were negated by a further devaluation of the Zim dollar. Botswana and Malawi steadily improved. In terms of stocks, **OCI** in Egypt performed well. We met with the Bank of Zambia and learned that Zambia could record a current account surplus for the first time and the government's budget would be in surplus. Most (companies) are growing at a multiple of real GDP which for the past few years has been in the region of 6% per annum or so. 2007 will be another strong year. Almost all are in the process of capital investment projects. **Zambian Breweries** for example is spending USD 100mn over a 5 year period to install new plant and equipment. In Nigeria...we prefer the industrial sector which, to us, looks much better value than the banks. Zimbabwe's officially recorded inflation rate for April was 3,700%, but 9,000% using the PriceWaterhouse survey. **Delta**, the brewery and soft drinks supplier, is now adjusting its prices twice a month, the last being a 135% increase. 85% of management time is spent on day-to-day problem solving or political lobbying rather than on the normal business of brewing and selling beer and Coke!*

GTI comment: we worked with GTI's Emerging Middle Class adviser in the early '90s. He can best be described as a Perma-Bull of emerging markets. But his version above is verified by our talks with his competitors. As long as the animal spirits of the emerging markets don't translate into an investment-led

boom (like Asia 1997, Japan 1989), the strong growth will not create a similar bust. GTI readers know we're big bulls of Africa. There continue to be no signs of bubbles yet in the vast majority of these markets. Earnings growth is keeping pace with the fund price. If the situation in Zimbabwe resolves itself

This manager's USD performance numbers since their fund's inception in 1/4/02 are:

	Year-to-date (end 5/07)	Since inception
Adviser performance	+ 35.7%	+ 363.7%
MSCI Emerging Markets Index	+ 11.2%	+ 209.7%

This manager's USD performance numbers since their fund's inception in 1/7/05 are:

	Year-to-date (6/07)	Since inception
Adviser performance	+ 18.2%	+ 59.7%
MSCI Emerging Markets Index	+ 11.2%	+ 79.6%

(it can't last forever), we expect a big kicker from this part of the GTI portfolio. We advise Mr Mugabe – if he is reading this – to hedge out his own precarious political position with a fully invested position in his own undervalued stock market.

Global Outsourcing/Internet Hub

Anyone for 5400 times their investment?

News from our advisers

Our principal Global Outsourcing / Internet Hub advisers (an India Fund) wrote at the end of June:

A weighted average EPS growth number of 45% for the year to 2008 has now popped out of the bottom of his (their analyst's) spreadsheets. Whilst there is talk of cost pressures and capacity constraints etc, it is hard, unless one takes the time to meet the businesses on the ground, for outsiders to comprehend the scale of the opportunity in India over the coming many years. Indeed, one of the most exciting aspects of the India stock market is the way in which new businesses appear from nowhere and in a flicker become multi billion dollar activities ... we were a founder investor in **Infosys** back in 1993 when the market cap was only USD 5mn – fourteen years later this number is USD 27bn. The case for running one's winners personified if ever it was. We have several examples in our portfolio of stocks with the same potential. **Educomp**, for example, is positioning itself to revolutionise public sector education by digitalizing syllabuses and computerising class room delivery. With a ratio of over 50 children per teacher and state governments desperate to find ways of spending their IT education budgets, and with only three thousand of the country's one million schools catered to, blue sky beckons. **Champagne Indage**, where we own 5.6% of the company, controls 70% of India's domestic wine market and still sells only a nano-spoonful per capita per annum. Surprising perhaps to some, large tracts of India are extremely fertile for wine growing (indeed we expect Indian wine soon to feature on dining tables in the West alongside those from the likes of Chile and New Zealand). Less surprising is that newly bulging wallets and unleashed aspirations are likely to result in the company doubling sales yearly for some considerable time to come. Only two million out of India's total of 140mn hectares of farm land is drip irrigated. **Jain Irrigation** has a 50% market share in drip irrigation systems and sees only upside, given increasing government support for this sector now that food shortages are becoming such a hot topic. Less than 3% of India's household savings are currently invested in the equity markets. For this number merely to reach double figures over the next decade (the number in, say, Korea, today is 26%) would result in annual market inflows of over USD 75bn. This compares to a local mutual fund industry still only USD 35bn in size. One of our new holdings, **India Infoline**, with its pan-country footprint and top-notch management, looks set to exploit this massive opportunity.

Our adviser's USD performance numbers since their fund's inception are:

	Year-to-date (end 6/07)	Since inception
Adviser performance	+ 21.3%	+ 464.2%
FTSE India Index	+ 18.2%	+ 190.7%

GTI comment: We make that return (in Infosys shares) over 5,400 times in 14 years. OK, a great part of that needs to be adjusted for stock issues, but who said the internet bubble was the death knell to technology investment? The

five stocks mentioned here all look like winners. The Global Outsourcing theme played through places like India means that through GTI we can participate in what could one day become a "bubble" market à la Japan in the 1990s.

Ageing Population

The pulse is weak on the USS Enterprise

News from our advisers

Our principal specialist pharma and biotech adviser wrote at the end of June:

(In June) ... NAV decreased 4.5% during the month, approximately equal to the 4.4% fall in the benchmark ...

*... European pharma companies were particularly hard hit. **GlaxoSmithKline** continues to suffer from a 50% decline in sales of its blockbuster diabetes drug Avandia after a recent academic study suggested that the drug posed cardiovascular risks to patients. **Sanofi-Aventis** suffered a major setback to its obesity drug Zimulti (also known as Acomplia) as the company failed to convince US regulators that the drug's effectiveness outweighed the apparent risk of suicidality for patients. Finally, **Novartis** continues to suffer an approval delay for Galvus, its potential blockbuster diabetes drug. The biotechnology sector has also had its share of headline problems, as **Amgen's** blockbuster Epogen franchise has come under regulatory scrutiny for the alleged overuse of these products.*

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

	Year-to-date (end 6/07)	Since inception
Adviser performance	+ 2.4%	+ 425%
Datastream World Pharmaceutical Index	+ 0.1%	+ 241%

GTI comment: it's all bad news, isn't it? The pharma / biotech sector has had precious little to recommend it for several years except for the hilarious focus-group generated drug names,

which sound like characters from a Star Trek episode. We've tried to protect investors by keeping the Ageing Population theme as near as possible to a rock-bottom 5% of portfolio, the lowest

we can go to in the GTI fund. We are nonetheless intrigued by this sector and the out and out bearish tone of our GTI adviser. We hope to interview him in New York in the next few weeks.

Developing China

Stan by your man

News from our advisers

Our principal specialist Asian advisers wrote at the end of June:

We have added a fifth leg to our Asia Fund stool in the guise of the ... Central Asia Fund, just launched, which focuses primarily on the “Stans”, those countries with unpronounceable names that sit between China, Russia and eastern Europe. For now, Kazakhstan is the only one with a stock market of any real depth. We have made three trips this year to the region and are starting to unearth some interesting and, thus far, undiscovered investment opportunities. This fund will account for less than 2% of the Asia Fund as we gradually delve more deeply into what is a fascinating region. It will not be open, at this stage, to third party investors.

This adviser’s USD performance numbers since their fund’s inception in 1996 are:

	Year-to-date (end 6/07)	Since inception
Adviser performance	+ 19.0%	+ 351.5%
FTSE Asia Pacific Large Cap (ex Japan)	+ 16.5%	+ 55.4%
FTSE Asia Pacific Small Cap (ex Japan)	+ 32.3%	+ 38.0%

GTI comment: we have spent so much time preaching the virtues of our “Developing China” theme adviser that we won’t repeat ourselves. But we are delighted they are taking on the

“Stans”. I tried to do some research on the Stans in 1996 and found that there were only two people in London who really knew much about them ... a deposed drunken politician and a

missionary. We do not doubt that our adviser will unearth some more interesting opportunities today.

Water Shortage / Ecology

Uncle Sam loves ya, baby

News from our advisers

Our principal specialist water and ecology advisers wrote at the end of May:

*During the month President Bush unveiled a U-turn towards climate change, calling on the world's leading economies to join the US in agreeing a long-term global goal for reducing greenhouse gases by the end of 2008. Bush's proposals included boosting investment in research and development for energy-efficient technologies, but again rejected firm caps on carbon dioxide emissions ... global leaders and commentators ... were optimistic that this could be the start of a policy shift ... measures will be taken from the "20-in-10 plan" announced in the State of the Union address, which aims to cut America's gasoline usage by 20 per cent over the next 10 years. In the water sector, the US Senate passed the Water Resources Development Act, a USD 13.9bn bill to be implemented by the Army Corps of Engineers, which contains provisions to repair and maintain existing infrastructure, whilst authorizing projects that address environmental infrastructure, including municipal water and wastewater. In the meantime the Water Quality Financing Act of 2007 ... will provide USD 14bn through 2011 ... on waste water projects. If successful both bills are positive news for water technology and equipment suppliers. Stocks that contributed to the increase in the Company's NAV during May include **Tanfield** (electric vehicles and powered access, UK), which climbed 26% following key contract wins during April, **Nibe** (ground source heating, Sweden) and **Kurita** (water treatment, Japan), which gained 15% each ... on the downside **Energy Developments** (landfill gas development, Australia) retreated 11% on project delays and cost overruns.*

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

	Last year (end 5/07)	Last 3 years
Adviser performance	+ 19.1%	+ 93.6%
MSCI World Index	+ 15.7%	+ 43.7%
Impax Environmental Technologies 50 Index	+ 34.3%	+ 101.8%

GTI comment: There is a saying that the best businesses to invest in are those that are not dependent on government. Government is a capricious master and its beneficence can be withdrawn just as quickly as it is granted. Yet, there is no doubt that the weight

and dynamism of governmental support is like a following wind to this theme. Even George W Bush, the bad boy of international ecology, is towing the line now. Our Adviser estimates that the PER of its sector is about 15x. This is cheap for such a growth sector.

Remember. Water isn't like oil. It has no viable alternatives. When governments get behind a sector where the underlying commodity is in short supply and creates economic viability for previously unviable businesses, the whole sector starts to shine.

Oh, and One Last Thing ...

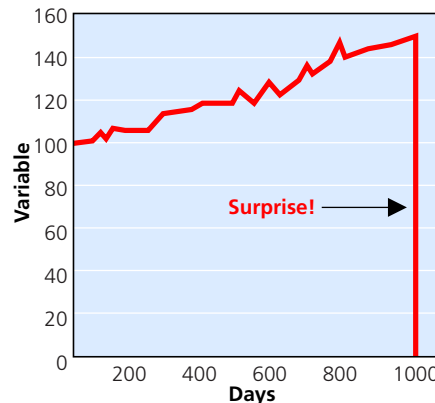
The black swan – the impact of the highly improbable

Anyone who's interested in human behaviour or suspects that statisticians, economists or environmentalists are the charlatans of today should read "The Black Swan: The Impact of The Highly Improbable" by Nassim Nicholas Taleb. Taleb's web site starts by saying: "My major hobby is teasing people who take themselves & the quality of their knowledge too seriously & those who don't have the guts to sometimes say: **I don't know** ...". "The Black Swan" is really a philosophical study of knowledge, or, to use its fancy word, epistemology.

A "Black Swan" event is an event that has three characteristics. It's completely unpredictable (in the jargon, it's "a statistical outlier"). Two, it's extreme in its consequences. And, three, it can be rationalised "ex post facto". "9/11" is a great example of a Black Swan event. "Black Swan" itself is derived from the discovery by early explorers in Australia that there were such things as black swans (till then all swans were presumed to be white since there were no black swans where the explorers came from). Taleb's conclusion is that we can seldom trust "knowledge" absolutely (because an improbable event can easily destroy that "knowledge"). As a species we're not wired for complex probabilistic thinking. Our evolutionary background has induced us to make snap decisions on the basis of minimal evidence and facile theories. We don't hang around to find out if the saber-toothed tiger is friendly. Far safer to just run away: better to assume that all saber-toothed tigers are bad news (even if they're not). As a species, we prefer to avoid being someone else's lunch rather than achieve intellectual precision in our thinking.

"Knowledge" is deceptive and data- no matter how reliable it seems to be- has severe limitations in telling us much about the future. Taleb describes how turkeys' naïve presumption of the Good Life (4 square meals a day plus housing) could lead them (but not the farmer) to a dangerous feeling of complacency. Life seems pretty good – and the historic data pretty convincing – till the shock of the Black Swan event arrives (turkey for dinner at Christmas).

The Impact of The Unexpected Event



What does this mean for GTI investors?

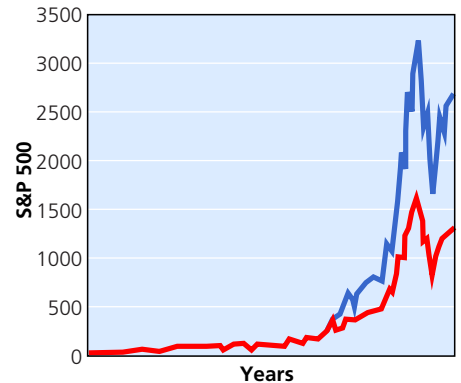
GTI is an approach that tries to avoid complex probabilistic thinking. It keeps things simple. There are no simulated performance data predicting the future, no statistical pyrotechnics, no finger-in-the-air forecasts, in fact no short-term presumptions at all beyond checking to see if valuations are getting out of whack with reality. GTI has simple, long-term beliefs. China will develop. We in the West are all growing older. Energy will be a prized commodity for years to come. Taleb's Black Swan could emerge to threaten our the-

sis (a new Black Death, Worldwide Bird Flu Virus, Islamist Extremism etc) but it would affect other investments just as hard and we're certainly not claiming to predict Armageddon.

GTI doesn't try to predict short-term market movements. It follows Edwin Lefèvre's ("Reminiscences of a Stock Operator") belief in constancy of behaviour and low turnover:

"It never was my thinking that made the big money for me. It always was my sitting. Got that? My sitting tight. Men who can both be right and sit tight are uncommon. The market does not beat them. They beat themselves, because though they have brains they cannot sit tight."

Take Out The Top Ten



By removing the ten biggest one-day moves from the U.S. stock market over the past fifty years, we see a huge difference in returns-and yet conventional finance sees these one-day jumps as mere anomalies.

Of course, Black Swans are always possible. But GTI tries to sit tight and not count its chickens – or cygnets – till they've hatched into White Swans.

The Team That Developed the Global Thematics Philosophy

The editors – two professional fund managers each with over 25 years in the international investment business, half of it working together



Iain Little

Iain is British 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 and with Pictet et Cie, the largest Swiss private bank in Geneva, London and Tokyo.

Iain now works as Managing Director of Butterfield Asset Management (Switzerland) Ltd, Butterfield Bank's Swiss private banking arm.

Iain is also a Director and co founder of P&C Global Wealth Managers SA in Zurich and on the board of GTI Fund Investment, Cayman, managers of the P&C GTI Fund. He serves as a non-executive director of other specialist funds, including the Arisaig India Fund.

Iain is principal advisor to the P&C GTI Fund.

Iain is principal advisor to the P&C GTI Fund.

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Bruce Albrecht

Bruce is British and has held a number of high profile jobs as head of investment over 30 years in the industry. He was Head of European investment for the Abu Dhabi Investment Authority (the single largest pool of own-managed money in the world, reported to be several hundred billion USD), Chief Investment Officer for Pictet London, and Chief Investment Officer for Rothschilds. He worked closely with Iain Little for a decade in Pictet London.

Bruce is Senior Vice President, Group Asset Management of Butterfield Bank Bermuda, so has overall responsibility for investment in the Butterfield Bank Group worldwide.

Bruce is a Director of P&C Global Wealth Managers SA in Zurich and on the board of GTI Fund Investment, Cayman, managers of the P&C GTI Fund, and Director of Investment Strategy Network (ISN), a systematic stock selection tool: www.investment-strategy.net.

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