Oldfield Partners LLP

Newsletter Q2 2008

Oldfield Partners has a total of $2.5 billion under management from families, individuals, charities, trusts, endowment funds and pension funds, either through separate portfolios or through pooled funds. The executive partners are Claus Anthon, Jamie Carter, Richard Oldfield, Nigel Waller, Robert White and since June, Tom Taylor.

Tom joined us from Alta Advisers where he worked with Richard Oldfield managing emerging markets equity portfolios. We have also been joined by Abri Fourie, who also comes from Alta Advisers. Abri joins the investment team as a research analyst.

This quarterly newsletter is the companion to our monthly reports on clientsqportfolios and the pooled funds which we manage.

We manage global equity portfolios, emerging market portfolios, a European equity fund, an all cap global equity fund, a Japanese equity fund, and a fund of funds. Overstone Fund plc includes the following:

	Start date	Assets
Overstone Global Equity Fund	June, 2005	$930m
Overstone European Equity Fund	October, 2005	$34m
Overstone Opportunity Multi Fund	November, 2005	$38m
Overstone Japanese Equity Fund	October, 2007	$4m
Overstone All Cap Equity Fund	October, 2007	$2m

On the 1st November 2008 Overstone Emerging Markets Equity Fund will open.

We also advise two pooled funds, with assets of $121 million, for US taxable investors, and we manage a number of separate portfolios.

We produce monthly newsletters for each of the pooled funds. If you do not currently receive a newsletter for any of these but want to in the future, please email info@oldfieldpartners.com.

Our approach in the management of global equity portfolios, managed by Richard Oldfield, is long-only, no leverage, value-focused, large-cap, index-ignorant, highly concentrated, and anti-short-term. The portfolio has never had more than 22 holdings and currently has 20. There is little *ex ante* decision-making about the attractions of particular countries. With rare exceptions the country weightings are the result of stock selection. The largest holdings include Barrick Gold, Microsoft and Hitachi.

The European fund, managed by Claus Anthon, has much the same features and philosophy, except that it digs deeper in terms of company size, and generally has a bias towards under-researched markets such as those in Scandinavia. Current holdings include Kone, Storebrand, AP Moller-Maersk and Siemens. The fund has 24 holdings.

Overstone All Cap Equity Fund, managed by Nigel Waller, focuses on interesting and undervalued small and mid-sized companies. The approach is, as with the other funds at Oldfield Partners, concentrated and index-ignorant, with the usual emphasis on cash flow and value. Holdings include Credit Saison, KAS Bank and M&C Saatchi. The fund has 22 holdings.

Oldfield Partners LLP,
130 Buckingham Palace Road, London, SW1W 9SA.
Telephone: +44 (0)20 7259 1000 Email: info@oldfieldpartners.com
www.oldfieldpartners.com
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Overstone Japanese Equity Fund, managed by Robert White, invests exclusively in Japanese equities. The fund is index-ignorant in its sector allocation and seeks to outperform the TOPIX benchmark combining a thematic approach with the identification of significantly undervalued assets. There are currently 20 holdings, the maximum targeted level, predominantly in medium and large stocks with a capitalization above US$1 billion. These include Daiwa Securities, Ryohin Keikaku and ORIX.

Overstone Opportunity Multi Fund (%OOMF+) is a fund of funds, aiming at return without much concern with volatility, and focused eclectically on a few (6-18) funds with managers who have a philosophy similar to our own (value-focused, index-ignorant, highly concentrated), but who are operating in areas some of which are too specialized for us to be investing in directly . for example, Taiwan, the water industry, gold shares.

Tom Taylor manages emerging markets equity portfolios using a similar concentrated, index ignorant, value-focused approach to the other funds. The portfolios invests globally across the market cap range, focusing on bottom-up selection. The portfolios currently hold 16 stocks including Thai Beverage, Chaoda Modern Agriculture and Turkcell.

Performance Summary as at 30th June 2008

Global Equity

US$ terms	Global Equity Composite 1	MSCI World (NDR)
Q2 2008	+1.0%	-1.7%
2008 to date	-4.2%	-10.6%
Since inception *	+122.8%	+13.3%
Since inception per annum *	+9.9%	+1.5%

1 The performance shown is of a composite of global equity portfolios. Performance is calculated on a total return basis, net of all fees and expenses. A full GIPS® compliant presentation of the global equity composite performance is available from Oldfield Partners.
* Inception 1 Jan 2000. Source of data: Alta Advisers Ltd, Pictet, Oldfield Partners LLP, MSCI © and Bloomberg.

US$ terms	Overstone Global Equity Fund 2	MSCI World (NDR)
Q2 2008	+1.2	-1.7%
2008 to date	-3.4%	-10.6%
Since inception *	+41.9%	+30.2%

2 The performance shown is that of the ±Aqshares in the Overstone Global Equity Fund and is calculated on a total return basis, net of all fees and expenses.
* Inception 1 June 2005. Source of data: Oldfield Partners LLP, MSCI ©, Bloomberg and Northern Trust Intl Fund Administration Services (Ireland).

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European Equity

Euro terms	Overstone European Equity Fund [3]	MSCI Europe (NDR)
Q2 2008	-7.3%	-3.7%
2008 to date	-19.9%	-18.8%
Since inception *	+11.2%	+3.9%

3 The performance shown is that of the ±Aqshares in the Overstone European Equity Fund and is calculated on a total return basis, net of all fees and expenses.
* Inception 3 October 2005. Source of data: Oldfield Partners LLP, MSCI ©, Bloomberg and Northern Trust Intl Fund Administration Services (Ireland).

All Cap Equity

US$ terms	All Cap Equity Composite [4]	MSCI Small & Mid-Cap (NDR)	MSCI World (NDR)
Q2 2008	-9.7%	-0.7%	-1.7%
2008 to date	-12.2%	-8.9%	-10.6%
Since Inception *	+31.7%	+31.4%	+29.6%

4 The performance shown is of a composite of all cap global equity portfolios. Performance is calculated on a total return basis, net of all fees and expenses. A full GIPS® compliant presentation of the all cap equity composite performance is available from Oldfield Partners
* Inception 1st April 2005. Source of data: Oldfield Partners LLP, MSCI ©, Bloomberg and Rawlinson & Hunter (Jersey) and Northern Trust Intl Fund Administration Services (Ireland).

Japanese Equity

US$ terms	Overstone Japanese Equity Fund [5]	Topix TR
Q2 2008	-2.5%	+2.4%
2008 to date	-13.3%	-4.0%
Since Inception *	-17.4%	-10.7%

5 The performance shown is that of the ±Aqshares in the Overstone Japanese Equity Fund and is calculated on a total return basis, net of all fees and expenses.
* Inception 1st October 2007. Source of data: Oldfield Partners LLP, MSCI ©, Bloomberg and Northern Trust Intl Fund Administration Services (Ireland).

Fund of Funds

US$ terms	Overstone Opportunity Multi Fund [6]	MSCI World (NDR)
Q2 2008	-4.1%	-1.7%
2008 to date	-10.8%	-10.6%
Since inception *	+34.1%	+23.7%

6 The performance shown is an **estimate** of the performance of the Overstone Opportunity Multi Fund, using provisional prices of the underlying funds as at 30 June 2008. Performance is calculated on a total return basis, net of all fees and expenses.
* Inception 1 November 2005. Source of data: Oldfield Partners LLP, MSCI ©, Bloomberg and Northern Trust Intl Fund Administration Services (Ireland).

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Commentary

The long-serving chairman of a large family investment committee told us recently that he had cancelled the last two meetings because he feared that if the committee met it would want to decide on some sort of action, and that any action amidst today's confusion had a high chance of being wrong. "Do nothing" has been the frequent advice of another vastly experienced investor, useful, when delivered with sufficient gravitas, at moments when we are most likely to be running around like Corporal Jones. We are all well aware of the dilemma which markets pose: the fundamentals (economic growth, inflation, debt levels, deleveraging) look pretty awful; but valuations are low and there is masses of investor liquidity available as a result of very negative sentiment, generally, about markets.

We have, first, a tendency towards optimism, because we are equity investors; and, second, a preference to base our views on valuations rather than predictions, not because the future does not matter but because we are not much good at predicting it, a shortcoming we share with most other people. "It is a mistake to look too far ahead. Only one link in the chain of destiny can be handled at a time," said Churchill, whom we will be quoting regularly as a special contribution to the crisis effort until further notice.

As we have written from time to time, the Armageddonists may be right. Paul Volcker former Fed Chairman, has described this as "the mother of all crises." But usually the expectation of disaster, particularly when it is a matter of extrapolation of present awfulness, turns out to be wrong. This time it may be different. Churchill's foremost financial adviser, Bernard Baruch, sent him a cable in November 1929: "Financial storm definitely passed." Needless to say it had not. We may be at one of those truly pivotal times in economies and markets. We have been in a period of, essentially, disinflation and declining interest rates for more than 25 years, roughly the career of those of us here who are longest in the tooth. If all that is now over, possibly the next few years, even the next 25 years, may be a time when, because of both the effect of deleveraging and the ravages of inflation, companies struggle with growth and profit margins and markets struggle in addition because of rising long term bond yields.

But we would not bet on it. On the contrary, we feel with increasing conviction that, following sharp declines in so many equity prices, valuations are at a level at which it is quite reasonable to expect at least average, even above average, returns over the next couple of years, maybe more. The MSCI World Index is now at its lowest price earnings ratio since 1985. This fall in valuation has coincided with an increasing dislike of equities by those who are natural holders of equities. The fact that the total value of US money market funds is 28% of the market capitalisation of the US stock market, a record level matched in 1982 (not a bad time to buy equities) is testimony to this. In Japan, households have financial assets of an astonishing $14 trillion, not far short of the size of US GDP, and half of that is in cash. Life insurance companies have only 8.6% of their funds in the Japanese stock market.

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If in a year or two we look back on above average equity returns, what on earth will have brought this about, given all the current difficulties? We have had a glimpse of the possible during the last couple of weeks. Oil prices have fallen sharply from their highs and equities have rallied. If oil were to be weak over the next year, that would remove much of the present inflationary pressure on profit margins and on interest rates. It is not an unlikely scenario. In the US, unit labour costs are rising at only 1% or so. With a weak economy, inflation is not likely to become much of a problem. During the last three months there have been dramatic changes in demand for oil. SUVs are suddenly old hat. Petrol consumption in the US has dropped. It is not just US consumers who are trying to cut back on use of fuel. Ikea has opened its first factory in the US because, they say, %transporting products can cost as much as manufacturing them.+Rio Tinto was able to get from the Chinese a premium price for its Australian iron ore because the cost of transporting is much lower than from Brazil. The raw long term fundamentals for oil may still be good, but the oil price is twice the level at which it stood a year ago, and yet the fundamentals are if anything weaker. There is a price for everything.

Until recently it has been suggested that even if oil consumption in developed countries drops in the short term, consumption in emerging economies will more than make up for this. That is not so clear now. Over the past five years Chinaqs demand for primary energy has grown by nearly 12% a year. In 2010, based on GDP growth slowing to a mere 9% and on an improvement in energy intensity (the amount of energy used per unit of GDP), then Chinaqs growth in energy demand will be less than 2%. One analyst has suggested that globally spare production capacity in 2010 may reach 5 million barrels a day, similar to levels in 2002-2003 when the oil price was $30 a barrel.

A fall in oil prices, being a prediction, is by no means a dead cert; but it is a reasonable scenario, and share prices which have fallen, bringing down valuations, inspire us to greater enthusiasm rather than less. The economic outlook may not be as terrible as it now appears. The most recent news from Europe, with the largest fall in German survey of business conditions since 9/11, is worse than in the US. In fact, the US, having been first in, may be first out. Manufacturing labour costs in the US are 30% lower than the average in the rest of the industrialised world. This accounts for the rise in foreign direct investment in the US of 11% over the last year.

The huge recent uncertainties produce all kinds of dislocations. *The Daily Telegraph* pointed out that the whole housebuilding sector in the UK was now valued at £4.2 billion. These companies are too small for the global portfolios but we have bought some of them in the Europe and All Cap Funds. It seems to us a reasonable bet that in, say, five years time, it will cost a great deal more than £4.2 billion to buy all the seven quoted UK house builders with their associated land banks, even if by that time the seven have become five or four. Dislocations are caused not only by acute worry but by distressed selling. The sale of Dawnay Dayqs stake in F&C (owned in the All Cap and Europe Fund), at a price which puts F&C, a longstanding and respected fund management firm, on a valuation of only 0.5% of assets under management, is an example. In Japan, some real estate companies are in trouble because of a general worldwide revulsion to property investment and a financing

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130 Buckingham Palace Road, London, SW1W 9SA.
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squeeze on the part of the banks, particularly so far as second tier companies are concerned. One company, Suruga, said quaintly to be connected with %antisocial forces+ has gone bust and others may follow. These dislocations produce opportunities.

General Motors at a share price lower than at any time since anyone at Oldfield Partners has been alive may be another example though we have not been brave enough to do anything about it (and if we did it would belong to the area of the portfolios which we call Toxic Corner, where there is room for one or two, but not more, stocks in which the downside could be total but the upside is enormous, so that the probability-weighted target return is excellent). We think, as we wrote in January, that a touch of bravery is called for; but, were we choosing a motto for an investment manager‡ coat of arms, *Audacitas et Prudentia* might do nicely. If we had no self-restraint, our (global) portfolios would now consist of nothing but Japanese shares and financial shares. But we do have self-restraint. We believe in diversification because, while managers should always have convictions, they should not be too convinced that their convictions will be right.

So Barrick Gold and steady eddies such as Johnson & Johnson, intrinsically attractive as we find them, have an important part in global portfolios. This is just as well, because any time we have dipped a toe in the *Audacitas* water it has turned out to be fairly poisonous. Nonetheless, we have in recent months added to RBS, bought American International Group and bought British Land. When they have gone wrong, as they all have, we have bought a little more. We believe that these three are so cheaply valued that they are very likely to provide excellent returns over the next few years.

Tom Taylor, who joined us recently from Alta Advisers where he has been managing emerging market portfolios for the last eight years, will be managing Overstone Emerging Markets Equity Fund to be launched on 1st November, applying the same concentrated, value-focussed, index-ignorant approach that we have across the board in what we do. In emerging markets, in 20 years there have been eight bull and bear markets. The average bear market took prices down by 33% and the average length of the fall was seven months. The average bull market took prices up by 124% and the average length of the rise was 24 months. %The best time to invest in emerging markets is when you have money,+ said someone notable (we forget who and Google will not tell us). It is easy to recoil from the problems which, for example, India is now facing; but the price earnings ratio has halved and become almost respectable. In a few years time one might well regret being too fastidious.

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