Newsletter Q2 2005

Partners: Richard Oldfield, Claus Anthon, Jamie Carter, Nigel Waller

This is our second quarterly newsletter. Oldfield Partners opened for business on Monday, 14th March, 2005, assuming the management of global equity portfolios which until Friday, 11th March had been managed by Richard Oldfield at his previous employer, Alta Advisers Ltd.

Performance Summary as at 30 June 2005

US$ terms	Global Equity Composite 1	MSCI World 2
Q2 2005	-1.8%	+0.4%
Since 14/03/05 3	-4.1%	-2.0%
Year to date	+2.1%	-0.7%
Since inception *	+182.4%	+57.8%
Since inception per annum *	+13.0%	+5.5%

1 Composite of global equity portfolios managed by Oldfield Partners LLP from 14th March, 2005 and by Alta Advisers Ltd. before 14th March, 2005.
2 Net dividends reinvested
3 Oldfield Partners began managing portfolios
* Inception 01 Jan 1997. Performance is calculated net of commissions, custody fees and investment management fees. Source of data: Alta Advisers Ltd. and Oldfield Partners LLP

Our website, www.oldfieldpartners.com, was launched in June.

Oldfield Partners currently manages $1.2 billion in global equity portfolios including Overstone Global Equity Fund, and will be launching a European fund, Overstone European Equity Fund, and an opportunistic fund of funds, Overstone Opportunity Multi-Fund (“OOMF”) (see website for further information) in October.

Our approach in the management of global equity portfolios is, in a nutshell, long-only, no leverage, value-focussed, large cap, index-ignorant, highly concentrated, and anti-short term. The European fund, under the management of Claus Anthon, will have much the same features except that it will dig deeper in terms of company size. OOMF will be eclectic and opportunistic, angled towards funds with managers who have a philosophy similar to our own (value-focussed, index-ignorant, concentrated), but who are operating in areas some of which might be much too specialised for us to be investing in directly (for example, Korean small companies).

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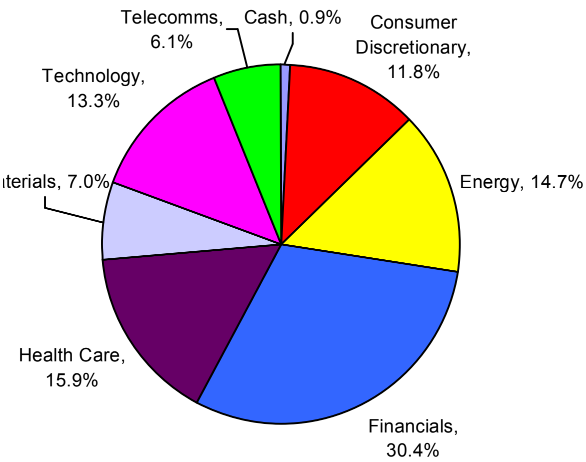
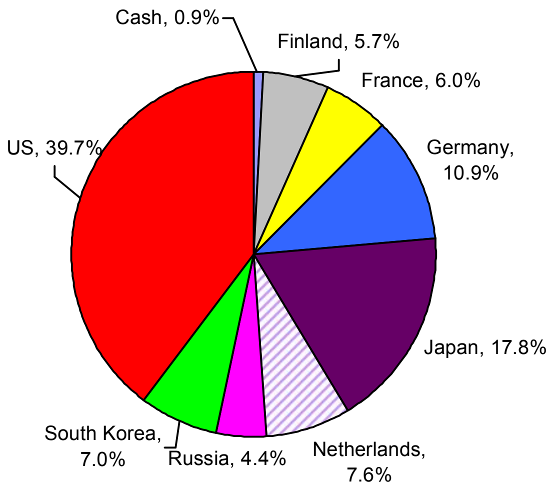
Newsletter Q2 2005

Sector and country breakdown as at 30 June 2005





Source of data: Oldfield Partners LLP. Representative global equity portfolio used.

Performance of Five Largest Holdings *

	Portfolio Weighting * %	Quarterly Performance (local terms) %	Quarterly Performance (US$ terms) %
Anadarko Petroleum	10.3	+8.0	+8.0
Merck	8.3	-4.9	-4.9
Morgan Stanley	7.8	-8.3	-8.3
Takeda Pharmaceutical	7.6	+7.6	+4.0
Microsoft	7.6	+2.8	+2.8

* as at end of period. Representative global equity portfolio used

Source: Oldfield Partners LLP

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Newsletter Q2 2005

Commentary

The last quarter was reasonable in stock selection terms, the overall underperformance resulting wholly from currency movements. While stock markets have been rather un-volatile, exchange rates have been more than normally volatile. The Euro has fallen by 12.5% and the yen by 8.5% in relation to the US dollar this year. This hurts both absolute returns (60% of the portfolio being in currencies other than the US dollar) but also performance by comparison with the MSCI World Index, which has much more in US dollars than the portfolios we manage. Currency is always an accidental contributor to performance whether plus or minus, since we do not hedge, believing it doubtful whether we would add any value over the long term.

The portfolio had its fair share of shockers over the quarter. Merck has fallen back to the level at which it stood immediately after the withdrawal of Vioxx in 2004. The first litigation about the damage caused, allegedly, by this drug is about to begin and will no doubt determine the short term future of a stock whose price we remain convinced is, in the long term, a remarkable bargain. The quarter for Morgan Stanley culminated in the departure, poorly handled by the board but for months inevitable, of the chief executive. The appointment of John Mack as the new chief executive will, we expect, prove beneficial.

The other main faller was Posco. This is more difficult. The shares are at less than 3.5x earnings. Recent news has been poor: the Chinese have increased their own steel production with staggering speed over the past two years and in the last quarter of last year were net exporters. They have now reduced some of the incentives to export (which had arisen because of their over-production). Other steel companies have reduced production plans, the price of steel itself has slipped, and Posco has cut production of stainless steel. In the long term Posco is an absolutely first class company with excellent technology, and a strong balance sheet – 10% of its market capitalisation is in net cash. It was recently described privately by the chief executive of another major steel company as the best steel company in the world. At the beginning of the quarter we slightly reduced holdings at higher prices but we do not feel inclined to make any further sales in view of the valuation.

Having used the phrase “in the long term” in consecutive paragraphs, we are conscious of the adage that a long term investment is a short term investment which has gone wrong. Posco has been, despite the recent fall, a winner, while Merck and Morgan Stanley have not; we feel committed to all three.

The three strongest holdings in the quarter were Anadarko Petroleum, Takeda Pharmaceutical, and Deutsche Borse. All of these remain cheap shares in strong companies. We have in fact slightly reduced holdings in all three to make room for other shares we find especially attractive, but they are still among the largest holdings. We do feel somewhat cautious about oil: the consensus has swung so dramatically, from an overwhelming view that the price of oil would fall to a majority view (though still not really evident in the valuations) that it will strengthen further. BP apparently regard $15 of the current price of oil as being the result of speculation, and point to the planned 5% increase in production of the majors.

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Newsletter Q2 2005

We have made purchases of shares in two Dutch banks, ABN Amro and ING, each at about 8x earnings and with a yield of 5%, with different dynamics in each case. We have recently bought Nokia, a company double-tainted, first by the fall from grace of telecom stocks after the bubble and second by problematic guidance to the market about quarterly earnings results last year. The company has improved the range of its handsets, its market share having fallen from the dizzy heights of close to 40% three years ago to about 33% now; and the valuation is reasonable, with extremely strong surplus cash flow.

It is not really our business to opine on asset allocation matters since in the global equity funds we manage we will always be fully, or nearly fully, invested, leaving it to the client to take an asset allocation decision. There are few things more irritating for clients (we think) than to discover that the fund which they thought gave exposure to global equities has 40%, say, in cash at a time when equities have risen strongly.

But the overall outlook does impact on our view of individual stocks. We recently attended a conference for families – generally long term investors – at which there was almost no interest in equities, the quintessential long term investment. It is notable how often the focus of discussion in investment fora is on alternatives, which, as their name suggests, one might expect to be the gravy and horseradish sauce of a balanced portfolio rather than the roast beef and potatoes.

The reasons for this, no doubt, are that, first, over the last five years (though not in the past two) equities have given poor returns and, second, that we have all got into the habit of regarding equities as overvalued, a claim which is made especially of the US market. That claim is, we suggest, at least questionable. The price-earnings ratio of the MSCI World Index (admittedly based on expected earnings) is now 13.9, its lowest level since 1991. The US market has a higher p.e., around 17x this year's estimated earnings. That is high though not outlandish.

Many commentators refer, however, to the work done by the Yale economist Robert Shiller. In order to reduce the influence of the most recent profit margins (which are generally regarded as being unsustainably high), Shiller produces a "normalised" price-earnings ratio which uses for earnings the average of the last ten years. The current figure can then be related to all figures calculated on the same basis. This measure shows the US stock market to be unusually expensive. But we wonder whether the last ten years are in fact normal. They included two years, 2001 and 2002, when, post-Bubble and post-Enron, there were quite exceptional, record-breaking, write-offs. The result is that the average earnings for the last ten years of the Standard & Poors Composite, at $40, is much nearer its starting level in 1995, $33, than its finishing level in 2004, $63.

Although the best quality US companies do not appear really cheap, they are strikingly cheaper than they used to be. A portfolio made up of Coca-Cola, Microsoft, Walmart, IBM, Pfizer, and Colgate-Palmolive would have given a return of zero since March 2003, during which period the overall market is up by 50%; and the average p.e. (on historic earnings) of that portfolio would be 20 now compared with 50 in 1999. This makes us look at least with interest at these stocks.

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