

OLDFIELD PARTNERS LLP

NEWSLETTER Q3 2007

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

In addition to the global equity portfolios which constitute most of the firm's assets under management, we manage also a European equity fund, an all cap global equity fund a Japanese equity fund, and also a fund-of-funds. Overstone Fund plc includes the following:

	<u>Start date</u>	<u>Assets</u>
Overstone Global Equity Fund	June, 2005	\$722m
Overstone European Equity Fund	October, 2005	\$27m
Overstone Opportunity Multi Fund	November, 2005	\$41m

The Eccleston Special Situations Fund is a sub-fund of a Jersey-based OEIC, and is currently \$23 million in size. On 1st October we launched an identical version of this fund under the Overstone umbrella: Overstone All Cap Equity Fund.

In addition we advise two pooled funds, with assets of \$138 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 22. 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, Sandvik and Siemens. The fund has 23 holdings.

Overstone All Cap Equity Fund, managed by Nigel Waller, invests globally across the market cap spectrum but focuses mainly 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 Natuzzi, KAS Bank and M&C Saatchi among small companies and Johnson & Johnson among large ones. The fund has 21 holdings of which 14 are below \$5 billion in market capitalisation.

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

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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 much too specialized for us to be investing in directly – for example, Taiwan, the water industry, gold shares.

Oldfield Partners has a total of \$2.3 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 and Robert White.

Simple but not easy, a slightly autobiographical and heavily biased book about investing by Richard Oldfield, was published on 27th June. Copies may be ordered from simplebutnoteasy@oldfieldpartners.com

Performance Summary as at 28th September 2007

Global Equity

US\$ terms	Global Equity Composite ¹	MSCI World (NDR)
Q3 2007	-2.1%	+2.4%
2007 to date	+6.8%	+11.7%
2006	+22.0%	+20.1%
Since inception *	+132.4%	+29.8%
Since inception per annum *	+11.5%	+3.4%

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)
Q3 2007	-1.5%	+2.4%
2007 to date	+7.8%	+11.7%
2006	+21.4%	+20.1%
Since inception *	+46.6%	+49.2%

² The performance shown is that of the 'A' shares 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)
Q3 2007	+1.3%	-3.3%
2007 to date	+19.4%	+6.0%
2006	+22.7%	+20.0%
Since inception *	+49.5%	+31.8%

³ The performance shown is that of the 'A' shares 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

GBP terms	All Cap Equity Composite ⁴	MSCI World (NDR)
Q3 2007	+0.3%	+0.7%
2007 to date	+3.8%	+7.2%
2006	+22.3%	+5.5%
Since Inception *	+46.2%	+37.5%

⁴ The performance shown is of a composite of all cap 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). Performance is calculated on a total return basis, net of all fees and expenses.

Fund of Funds

US\$ terms	Overstone Opportunity Multi Fund ⁵	MSCI World (NDR)
Q3 2007	+2.7%	+2.4%
2007 to date	+15.3%	+11.7%
2006	+19.2%	+20.1%
Since inception *	+54.6%	+41.7%

⁵ The performance shown is an **estimate** of the performance of the Overstone Opportunity Multi Fund, using provisional prices of the underlying funds as at 28th September 2007. 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).

Commentary

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“Across the wires the electric message came,
It is no better, it is much the same.”

These lines, originally with a “he” instead of an “it” about King George V on his deathbed, might well have been written of Japan recently. The King, who purportedly responded “bugger Bognor” to the suggestion that he might like to convalesce at Bognor Regis, died shortly afterwards. Rumours of the impending death of Japan are much exaggerated, though what the equivalent for Japan of a rejuvenating sojourn in Bognor Regis might be is not clear.

There are lots of signs of the extreme neglect which frequently signals something close to the end of a market’s underperformance. Japan scarcely gets a mention at investment conferences. People would rather pretend that it is not really there at all. A major European bank has announced the closure of its Japan fund. A former director of that bank has pointed out that the last time it closed a fund devoted to a significant investment country was in 1974 when it closed its UK fund, just before, in the first quarter of 1975, the stock market doubled.

We have gone in the opposite direction, starting - launching would be too extravagant a term as it begins with a little seed money and no attempt to market it - a Japan fund on 1st October.

We hold a quarter of the global portfolios in Japan and this has hurt their recent performance. If told on 1st July all the details of the credit crunch which emerged in the following few weeks we would have said that at least Japan should be out of all that; but on the contrary Japan did worse in the fall in markets up to the middle of August, worse in the recovery since then, and worse in the relapse in mid-October. We do not have much of a reason to explain this, except that the reduction in interest rates open to most countries is not open to Japan because they do not have any to reduce. Hanging our hat as usual on valuations, we remain enthusiastic about the two banks which we own whose shares are at close to book value, also true of two of the industrial companies whose shares we own.

The last quarter has seen more than a blip. Paralysis in the commercial paper market, a rush to US treasury bills, a run on a bank in the UK for the first time since the 19th Century: these are not ordinary events.

The Overstone funds are named after a road in Hammersmith, which in turn took its name from a wise 19th Century banker, Lord Overstone. One of his musings was about the “premonitory rumblings” in markets which signal an earthquake not far down the road. The question in everyone’s mind is whether it is those sorts of rumblings which we heard a few weeks ago and which may return.

Things have changed. Between 2000 and 2003 there were 22 months in which the movement of the MSCI World, up or down, was more than 3.5%. Between 2004 and 2007 there have only been six such months. The average monthly move in the MSCI World since we opened for business in March 2005 has been 2.1%, compared with an average monthly move of 4% in 2002–2003. Like many, we have been expecting

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that the smooth ride of the last few years would give way to something choppier – not necessarily a fall in markets over the medium term, but much more volatility.

A recent MoneyWeek cover was labelled “the spectre of 1929” and within the magazine were headlines of a similar tone: “Gloomy? It’s time to get gloomier”, “The blood bath to come”. It is rare for serious down-markets to begin when there is so much negativism around. It is also rare for down-markets to begin when valuations are so moderate, and when there is plenty of liquidity of the non-borrowed variety. The US price earnings ratio is roughly 80% of its twenty year average level; Germany 60%; Japan 30%; Europe as a whole 80%. The price earnings ratio of the MSCI World Index is close to its lowest level since early 1991.

Sceptics of the valuation argument point out that profit margins are at a high level, earnings having grown at an unsustainable rate. Over the last ten years, US earnings have grown at 7.2% per annum, and the S&P total return has been 6.8% per annum. Neither of these figures is unsustainably excessive.

It is true that margins are high. Profit margins may come down, but growth in earnings per share in the major markets may still approximate growth in revenues because of continuing share buybacks. Buybacks recently have slowed because industrial companies, as well as banks, have put the emphasis on hoarding cash. Net interest payments as a proportion of pre-tax income are 9.3%, a thirty year low. Given the level of net cash in many balanced sheets, we would expect buybacks to resume. So far in 2007 Conoco, IBM and Johnson & Johnson – all companies whose shares we hold – have had buyback programmes of respectively \$15 billion, \$15 billion and \$10 billion. Since the beginning of 2005, US companies have bought back shares at a value of \$430 billion. In Japan in August 29 companies bought back shares with a total value of \$9 billion, Canon’s programme alone amounting to \$2 billion.

Alan Greenspan writes in his “The Age of Turbulence” that panic in a market is like liquid nitrogen – it can quickly cause a devastating freeze.” This happened in the last quarter; but its corollary is that central banks throw everything they can at the problem: Bernanke is said to be ready to use “all available tools” to head off a surge in mortgage foreclosures, as the later reduction in the Fed funds rate by 0.5% demonstrated. Despite the reluctance of the European and UK central banks to follow suit, they probably will if growth fades, and adopt the same order of priorities as the Fed: avoid recession first, worry about inflation second. This is something to be concerned about over the long term as the disinflationary benefits of globalisation peter out, and other pressures have appeared. The oldest partners at Oldfield Partners started managing portfolios in 1981. With occasional interruptions, some of them sharp, the whole of the last twenty-five years has been a period of disinflation and declining interest rates.

Phase Two, with higher inflation, may be a time to worry. Phase One looks all right for equities in general. There will no doubt be some more disconcerting lurches.

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