



## Newsletter Q4 2005

This quarterly newsletter is the more long-winded and discursive companion to our quarterly and monthly reports on clients' portfolios and the pooled funds which we manage. Within Overstone Fund plc we manage three pooled funds: Overstone Global Equity Fund, Overstone European Equity Fund, and Overstone Opportunity Multi-Fund. Overstone Global Equity Fund was launched on 1st June and has assets of \$190 million. Overstone European Equity Fund started on 1st October and has assets of \$4 million; and Overstone Opportunity Multi Fund ("OOMF") started on 1st November and has assets of \$14 million. In addition we advise two pooled funds, with assets of \$51 million, for US taxable investors, and a number of separate portfolios.

We produce monthly newsletters for each of these pooled funds so if you do not currently receive a newsletter for any of these funds but want to in the future, please email [info@oldfieldpartners.com](mailto:info@oldfieldpartners.com).

Our approach in the management of global equity portfolios is long-only, no leverage, value-focused, large-cap, index-ignorant, highly concentrated, and anti-short-term. The European Fund has much the same features except that it digs deeper in terms of company size. OOMF is a fund of funds, focused eclectically on a few (6-12) 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 much too specialized for us to be investing in directly – for example, Taiwan, Korean small companies, gold shares.

Oldfield Partners has a total of \$1.4 billion under management for families, charities, and endowment funds, either through separate portfolios or through pooled funds. The executive partners are Claus Anthon, Jamie Carter, Richard Oldfield, and Nigel Waller.

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### Performance Summary as at 30 December 2005

#### Global Equity

US\$ terms	Global Equity Composite 1	MSCI World (NDR)
Q4 2005	+1.3%	+3.1%
Since 14/03/05	+8.6%	+8.0%
CY 2005	+15.6%	+9.5%
Since inception *	+219.7%	+73.9%
Since inception per annum *	+13.8%	+6.3%

1 The performance shown is of a composite of all US dollar denominated global equity portfolios managed by Richard Oldfield at Alta Advisers from 1997 to 11th March 2005 and at Oldfield Partners since 14th March 2005. Before 2000 the performance of two portfolios is excluded from the composite because their returns were inflated by the inclusion, in those portfolios only, of an unquoted investment which, following its flotation, had a large favourable impact on returns. All returns are gross of fees to 11 March 2005, then net of fees thereafter.

\* Inception 01 Jan 1997. Source of data: Alta Advisers Ltd. and Oldfield Partners LLP

#### European Equity

Euro terms	Overstone European Equity Fund 2	MSCI Europe (NDR)
Q4 2005	+2.0%	+3.6%
Since inception *	+2.0%	+3.6%

2 The performance shown is that of the 'A' shares in the Overstone European Equity Fund.

\* Inception 01 October 2005. Source of data: Oldfield Partners LLP

#### Fund of Funds

US\$ terms	Overstone Opportunity Multi Fund 3	MSCI World (NDR)
Since inception *	+12.7%	+5.6%

3 The performance shown is an **estimate** of the performance of the Overstone Opportunity Multi Fund, using provisional prices of the underlying funds.

\* Inception 1 November 2005. Source of data: Oldfield Partners LLP

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### Commentary

One of the things which investment managers are expected to do is to make predictions, but we don't. James and Alvide Lees-Milne, writers and aesthetes, were once accosted by their neighbour and landlord the late Duke of Beaufort, furious after their dogs had caused some disturbance to his hunting. "What is the point of you Lees-Milnes? You don't shoot, you don't hunt. What is the blasted point of you?" We feel somewhat in the position, mutatis mutandis, of the Lees-Milnes. "You don't make predictions, you don't meet managements. What is the point of Oldfield Partners?" If timidly we responded that we look at valuations and think about probabilities, we suspect that the Duke would have regarded this as intolerably limp-wristed.

This last week has been the time of year, generally a silly season for news (with notable exceptions: 1990; 2005), at which the newspapers are full of quizzes about what happened and predictions about what will happen. Predicting happens to be something which human beings are not very good at doing, and no-one has yet discovered the machine which will do it better. Someone said that the secret of making good predictions is to make them long term, and make them often. The chances of being rumbled are thereby reduced.

Some sorts of prediction can be guaranteed to turn out right, eventually – a stopped clock tells the right time twice a day. Every year that an earthquake does not happen in Tokyo or San Francisco makes an earthquake more likely to happen, and more severely, the subsequent year, because there is an inevitability about the consequences of tectonic plate movements. Many people regard the position of the US economy as earthquake-like. The growth in debt of US consumers has been made possible by low interest rates and a housing bubble, which ultimately must explode. When that happens consumer spending will fall very sharply, damaging the stock market.

The problem with this sort of forecast, as with those for earthquakes, is that nobody knows when. Everyone regards the position as unsustainable. The Chinese and the Japanese central banks have been supporting the US dollar for years, which has allowed interest rates (especially of long term bonds) to remain much lower than they should be, which in turn has kept the housing bubble inflating and the economy growing, and consumers buying Chinese goods.

Investors react to this differently. The half-glass-empty type argue that a position which is unsustainable will not be sustained; the Chinese and Japanese will drop their support for the dollar and the house of cards will collapse. The half-glass-full type take the view that since it is in everyone's interests for the show to continue, it will – even though that means that the severity of the ultimate earthquake is worse. This view is abetted by the surreptitious suspicion that, although it is obvious that the end must be disastrous, some

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deus ex machina will intervene to change the ending. Things very frequently have a way of unexpectedly sorting themselves out.

We have no idea, really, which of these summary views of the world is right. We feel roughly three-quarters half-glass-full about it.

Another sort of prediction which can be guaranteed to be right is the sort which cheered up Daddy Warbucks in the musical *Annie* – “the sun will come out tomorrow,” sang the eponymous heroine – and which propelled Chauncey Gardener to the confidences of the President of the United States in *Being There*. Chauncey, an illiterate gardener, responded to questions about Keynesian economics with his usual conviction on a limited number of topics: “there will be growth in the Spring.” Fed up with the verbose obfuscations of experts, the President greeted this as a profound truth.

Anyone who believes in the certainty of cycles, and in reversion to the mean, is likely to be a fan of Chauncey Gardener. In stock markets, the best candidate for the Chauncey Gardener prize for mean reversion (but with less certainty about timing than Chauncey’s about Spring) is what is known as Large-Cap Quality Growth. We have pointed out before that a portfolio consisting of Wal-Mart, IBM, Microsoft, Colgate-Palmolive, Pfizer and Coca-Cola would have given a return of zero since March 2003 while the Standard & Poor’s Index has given a return of more than 50%. These are the sort of companies which, having underperformed in share price terms for years while their profits have generally continued to grow, are now on unusually attractive valuations. We own for clients the first three in that portfolio of six.

A further usefulness of predictions is for the contrarian. If economic predictions are uniformly in one direction there is no reason that they should be wrong – though perhaps there is a tendency because of what John Kay describes in the Financial Times of 3<sup>rd</sup> January as naïve extrapolation. However, predictions about markets, if uniform, are likely to be wrong, for the simple, all-important reason that if everyone is bullish about a market or a share they are already likely to be invested so there is room only for disappointment, and vice versa. The excesses of enthusiasm and gloom are the fascination of markets.

This means that, while the investor may want to listen carefully to what one wise man says and perhaps do what he advises (because he may be right, say, 60% of the time), the investor should be very sceptical if all twelve wise men are saying the same thing. We noted that in The Sunday Times last week ten out of sixteen experts picked on Japan as their top performer for 2006. We would probably do the same, but this popularity makes us hesitate. We remain very keen on Japan, and own for clients shares in five companies: Shinsei Bank, Dai-Nippon Printing, Kao, NTT, and Takeda Chemical. But we suspect some other major market will do better. Which? Could it be the US, led by Large-Cap Quality Growth?

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