Oldfield Partners LLP
Newsletter Q4 2008

Oldfield Partners has a total of $1.6 billion under management for 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, Tom Taylor, Nigel Waller, and Robert White.

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

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

	Start date	Assets at end Dec 2008
Overstone Global Equity Fund	June, 2005	$761m
Overstone European Equity Fund	October, 2005	$14m
Overstone Opportunity Multi Fund	November, 2005	$22m
Overstone Japanese Equity Fund	October, 2007	$3m
Overstone Smaller Companies Fund*	October, 2007	$2m
Overstone Emerging Markets Equity Fund	November, 2008	$5m

*Overstone Smaller Companies Fund changed its name from Overstone All Cap Equity Fund on 13th October 2008.

We also advise two pooled funds, with assets of $86 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. The focus is on investing in individually attractive companies rather than on considering the respective attractions of different 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 Carrefour, Bovis Homes, AP Moller-Maersk and Siemens. The fund has 20 holdings.

Overstone Smaller Companies Fund (previously known as 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 Toll Brothers, Sekisui Chemical and Catlin Group. The fund has 20 holdings.

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 21 holdings, the maximum targeted level, predominantly in medium and large stocks with a capitalization above US$1 billion. These include Heiwa Corp, Ryohin Keikaku and Tsuruha Holdings.

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, concentrated), but who are operating in areas some of which are too specialized for us to be investing in directly – for example, property shares, European micro cap and gold shares.

Overstone Emerging Markets Equity Fund, managed by Tom Taylor, is a concentrated, index ignorant, value-focused approach similar to that of the other funds. The portfolios invest globally across the market cap range, focusing on stock selection rather than a comparison of the attributes of different countries. The portfolios currently hold 16 stocks. These include Thai Beverage, Chaoda Modern Agriculture and Turkcell.

Performance Summary as at 31st December 2008

Global Equity

US$ terms	Global Equity Composite 1	MSCI World (NDR)
Q4 2008	-25.5%	-21.8%
2008	-38.6%	-40.7%
Since inception *	+42.7%	-24.9%
Since inception per annum *	+4.0%	-3.1%

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)
Q4 2008	-25.2%	-21.8%
2008	-38.1%	-40.7%
Since inception *	-9.1%	-13.7%

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)
Q4 2008	-25.1%	-22.2%
2008	-48.0%	-44.0%
Since inception *	-27.8%	-28.3%

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).

Smaller Companies

US$ terms	Smaller Companies Composite 4	MSCI Small & Mid-Cap (NDR)	MSCI World (NDR)
Q4 2008	-24.2%	-24.5%	-21.8%
2008	-44.0%	-43.0%	-40.7%
Since Inception *	-17.7%	-17.8%	-14.1%

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

Japanese Equity

US$ terms	Overstone Japanese Equity Fund 5	Topix TR
Q4 2008	-7.9%	-7.0%
2008	-34.4%	-25.8%
Since Inception *	-37.5%	-31.0%

5 The performance shown is that of the 'A' shares 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)
Q4 2008	-18.6%	-21.8%
2008	-41.6%	-40.7%
Since inception *	-12.2%	-18.0%

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 31 December 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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Emerging Markets Equity

US$ terms	Emerging Markets Equity Composite 7	MSCI Emerging Markets (NDR)
Q4 2008	-24.2%	-27.6%
2008	-46.6%	-53.3%
Since inception *	+237.9%	+105.9%
Since Inception per annum *	+16.4%	+9.4%

7 The performance shown is of a composite of all emerging markets equity portfolios. Performance is calculated on a total return basis, net of all fees and expenses. A full GIPS® compliant presentation of the emerging markets equity composite performance is available from Oldfield Partners.
* Inception 1 January 2001. Source of data: Alta Advisers Ltd, Pictet, Rawlinson & Hunter (Jersey), Oldfield Partners LLP, MSCI © and Bloomberg.

Commentary

Even knowing broadly what we do know about the awfulness of 2008, we feel there are many surprising things about it. Japan was the best performing of the 23 developed markets in the MSCI World Index, but only because the Yen was so strong. In fact, 25 of the 30 top performing company share prices over the last 12 months were Japanese. In local currency terms it was tenth out of 23, behind most of the Anglo-Saxon markets though ahead of Germany, the Netherlands, Italy and Scandinavia. The best performing market in local currency terms was the United Kingdom. But to speak of the best performing in a year in which the best performing in US dollar terms was -31% and the best performing in local currency terms -32% may be a little like debating whether being hit over the head with a frying pan is better than being kicked with Olga Klebb shoes. The best thing about 2008 is that it is over.

Modern diversification did not work. Private equity and, with some glowing exceptions, hedge funds did not provide the non-correlation with equity markets which some people expected of them. Old-fashioned diversification, on the other hand, did work. A portfolio denominated in US dollars and 50% in World equities and 50% in World government bonds would have provided a return of -14%, pretty awful but not half as bad as many purportedly diversified portfolios. The same portfolio, but denominated in sterling, would have given a return of +17%.

Within equity markets, there were no hiding places in terms of sectors. The best performing sector was down 21% in US dollar terms. Over the years the baton tends to be passed between “value” stocks – those companies with low valuations in terms of earnings, cash flow and assets - and “growth” stocks - companies with high historic rates of growth in profits. In 2008 there was no difference: the world value index gave a return of -40.4% and the world growth index a return of -41.1%. The majority of managers - whether value, growth or something else - performed worse than the indices. In terms of size of companies invested in, there was again little difference, the World Small Cap Index giving a return of -41.9%.

All our portfolios are pure equity portfolios, and our returns were about as awful as equities generally. During the six years up to 2008 in which there have been reasonably strong markets, we have always emphasised that if equities do badly, we will do badly. After 2008 such a warning is superfluous. Nobody now needs convincing that we know how to lose money.

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Although fire and brimstone were all-encompassing, there were nonetheless in our own global portfolios a few stocks which did an overwhelming amount of damage, RBS and AIG leading the field. One of Sir Siegmund Warburg's aphorisms was that one should always cry over spilt milk. There was plenty of milk spilt in 2008, and we have spent plenty of time, internally and in summary in monthly newsletters, crying over it. We have discussed but not excused the way in which we underrated the capital requirements of AIG and RBS, requirements which eventually have left the public shareholders diluted almost to extinction. RBS is now at a tenth of the price at which we sold, but that is cold comfort.

There were a few good bits. Barrick Gold, though hugely volatile, has been doing, along with gold, what we hoped and expected. British Energy, which we had held for two and a half years, was a great success, ultimately bought by EDF. WalMart was as steady as we hoped, too. We sold too early as we did with IBM, another steady eddy, quality growth, company whose value had fallen, when we bought, because of specific doubts about the company which have so far turned out to be unjustified. The most surprising exception to general gloom was Pulte Homes, the second largest US home builder, up 4% over the year.

Only six months ago the topic *du jour* for every investment committee was inflation: how to protect against it. Commodity prices were roaring upwards, including oil, which reached $145 per barrel. Now the immediate threat of inflation has vanished. There may be a more distant threat, but that is another matter. These six months have illustrated just how quickly the economic backdrop, and the consensus about what is to come, can change.

There is no dissent now about what is happening economically, though there is disagreement about what will come and about the right policy prescription. When the present is black the future seems black too. But, as Warren Buffett said in 1979, "the future is never clear". He added that "you pay a very high price in the stock market for a cheery consensus", but the converse is also true: you pay a very low price for a cheerless consensus, and that seems to us to be the present position. In 1999 a Gallup poll showed that most investors expected returns of between 13% and 22% per annum from equities. That was a totally unrealistic expectation, and so it has proved. Over the last ten years, the return from US large company shares has in fact been negative, the first time that the return over a ten year period has been negative for such shares certainly since 1939, possibly since 1812.

Expectations for returns from equities now are very low, and may be just as unrealistic, in the opposite direction, as they were in 1999. The value of the US stock market as a proportion of GDP is now close to its lowest levels in the last 60 years, while the price-earnings ratio of emerging markets has fallen from 39 in 1998 and 16 as recently as 2007 to 8. The advice of Sir John Templeton, who died during 2008, was "Don't get carried away by enthusiasm. Don't get carried away by despondency. Don't buy things you don't understand."

We do not believe in our own ability to predict, or that of many others. We tell at least once a year the story of the Nobel laureate Kenneth Arrow who, employed as a meteorologist in the US Air Force in the Second World War, was expected to give medium and long term weather forecasts. He quickly realised that the results were no better than random and asked to be relieved of his duty. The answer came back: "The Commanding General is well aware that your forecasts are no good. However, they are needed for planning purposes."

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There is a chance, of course, that profits in the major countries will not only fall, say, 50% this year, but another 50% also next year before stabilising, without much growth thereafter for some years. That is the depression scenario, and it cannot be ruled out entirely. An investor needs to make some sort of allowance for this scenario. But it is probably excessive to regard this as the most likely prospect. If, instead, earnings were to fall from 2008 levels by, say, 50% over the next 18 months, but then to stabilise, markets might well have already discounted more than adequately. Even if earnings were to halve, the earnings yield (earnings divided by share price) of the UK market would be close to 7%, quite attractive compared with bond and cash yields. Currently, the earnings yield of the major stock markets compared with government bonds has made equities more compelling than at any time for more than 50 years. The current earnings yield of the US market, based on the average of the last five years of earnings, is more than three times the yield of the US Treasury ten year bond. Valuations have, historically, fallen to much lower levels than now only when unemployment was around 15-25% and interest rates in double figures.

Our job is, as usual, to try to choose companies which, in the long term, will provide good returns, irrespective of what happens in the immediate future. There are a few themes in our global and other portfolios.

Balance sheets are naturally vital. (One of the redeeming factors amidst present problems is that corporate balance sheets are in general strong.) In all portfolios, global, Europe, Japan, smaller companies, emerging markets, we hold a number of companies with high dividends (Vodafone and Vivendi each have yields of more than 6%) which are, we think, not likely to be cut because they are well covered by free cash flow; and others with little or no debt, strong profit margins which, even if sharply reduced, would still result in free cash flow – in global, Barrick Gold, British Land, Canon, Conoco, eBay, Fanuc, Johnson & Johnson, Legg Mason, Microsoft.

In global portfolios we have a sprinkling of Japanese companies – apart from Canon and Fanuc, we hold Mitsubishi UFG, Shinsei, and Hitachi. After fifteen years of economic misery Japan appeared, a couple of years ago, to be poking its head above water but it has been smartly pushed under again by global recession and the strength of the yen. It has some of the cheapest companies, market leaders in their fields, in the world. At the macro level Japan has some advantages. Household debt is about 63% of GDP, compared with more than 100% in the US and UK. Individuals have had little exposure to the stock market and half of the financial assets of households are in cash, an enormous $15 trillion. One day, who knows when, some of this is likely to be drawn to shares, much more attractive now they have dividend yields much higher than either bonds or cash rates.

In both global and emerging market portfolios a gold share – Barrick in global, Buenaventura in emerging – is one of the largest holdings. In 1976 Jim Slater advised everyone to buy a bicycle, a shotgun, baked beans and Krugerrands. This time around, sales of baked beans (up 23% year on year in Britain, apparently), bicycles and Krugerrands are certainly strong – gold coins to such an extent that in Australia, the United States and Canada sales of coins have had occasionally to be suspended because of too much demand. We are minor gold bugs, for all the obvious reasons. There is an infinite supply of paper currencies. Gold is perceived by people and to some extent by central banks as a monetary asset, and it is finite. All the gold in the world would fit inside a cube with the length of a cricket pitch. Gold shares are remarkably undervalued in relation to the price of gold itself.

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