

12 Portfolio Review

United Kingdom

LISTED EQUITIES £738.3m
 PRINCIPAL HOLDINGS £'000

VODAFONE 54,214
 World's largest mobile telephone operator with the financial strength to support investment in new technology and growth markets.

BP AMOCO 43,545
 Integration of acquisitions Atlantic Richfield and Burmah Castrol has improved oil and gas reserves and product range.

HSBC HOLDINGS 37,463
 One of the leading international banks following acquisitions in Europe and the US.

GLAXO WELLCOME 35,484
 The proposed merger with SmithKline should create a market leader in most therapeutic categories.

SHELL TRANSPORT 28,151
 Continued attention to improving return on investment and the strong oil price will significantly lift profits.

ROYAL BANK OF SCOTLAND 22,257
 The purchase of NatWest earlier this year provides opportunities to rationalise and to refresh a strong brand.

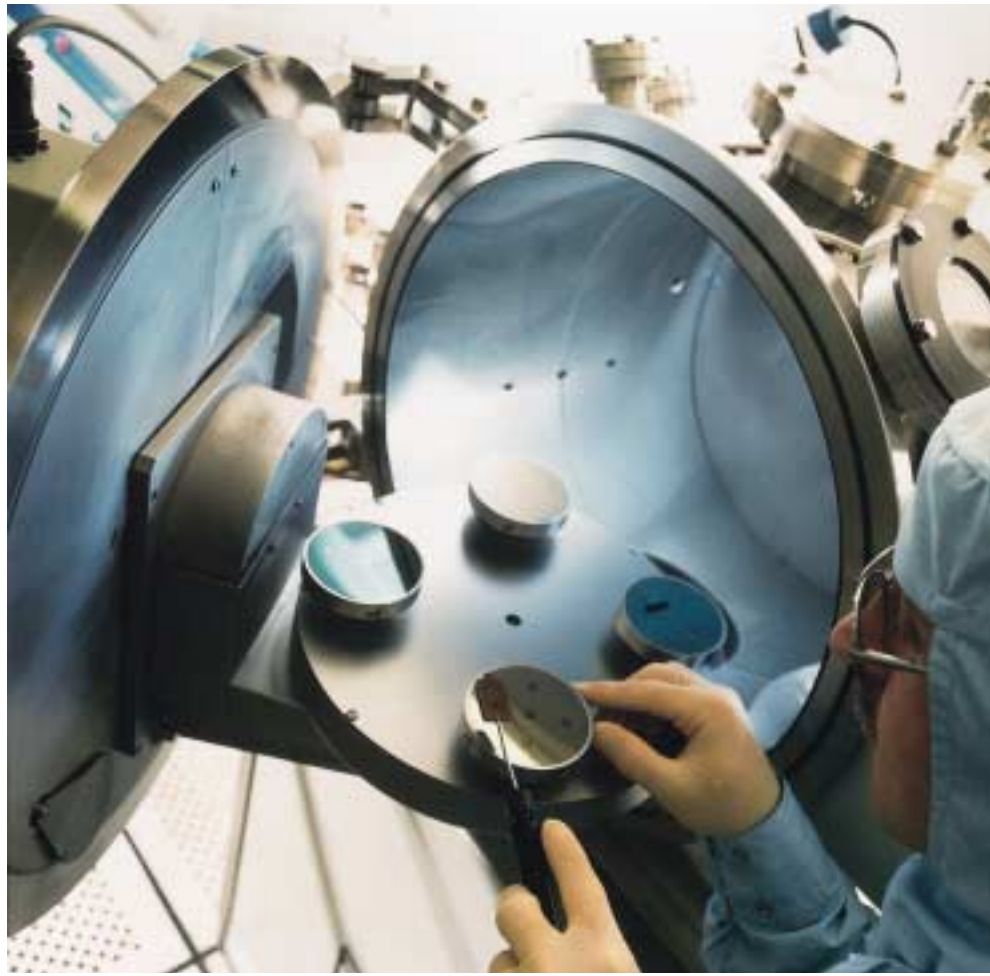
LLOYDS TSB 22,218
 The management has built a strong franchise but seeks further expansion to become a leading European financial services provider.

SMITHKLINE BEECHAM 21,801
 Merging with Glaxo Wellcome; expecting strong growth from new products and existing portfolio of drugs.

BRITISH TELECOM 20,038
 Taking full control of Cellnet and developing internet capabilities for retail and business customers highlights the changing focus of the group

BARCLAYS 18,083
 Expanding with the acquisition of the Woolwich and the development of one of the fastest growing internet bank operations.

TOTAL 303,254



Marconi's unique semiconductor wafer processing technology (our holding valued at £18.1m)

The UK market should perform relatively well in the coming year.

Investing in the UK stockmarket last year was a switchback affair. High volatility within the broad market indices was accompanied by rapid rotation of leadership between major sectors. The market rose to a new high at the end of December 1999 in thin volume as trading almost ground to a halt in trepidation over perceived millennium computer bugs. A sharp fall in the first few weeks of the New Year preceded another rise in March driven by TMT stocks only to be followed by yet another steep fall in April. While shares in the FTSE 100 index of largest companies demonstrated the greatest volatility, middle-range companies fared better by comparison, partly due to a high level of corporate activity.

Over the summer, the focus returned to TMT stocks driving the market up again. However, worries over the high debt

incurred by the telephone operators in buying third generation licences, and profit warnings by a number of American technology companies, reversed the trend. Investment in these sectors has been exceptionally difficult. While our selection of media stocks and a significant position in information technology both contributed to performance, we were late in reducing the telecom sector and lost part of the profits which had been available.

The FTSE All-Share finished only 6.0% higher over the twelve months. By a combination of sector balance and stock selection our portfolio rose by 9.2% in comparison. Once again we have participated in the market strength in smaller companies through our portfolio of small company investment trusts which we assembled over two years ago. We also benefited from the takeover of middle capitalisation companies such as property developer MEPC and McKechnie, the engineering company.

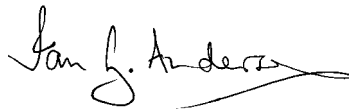
Commencing in the spring we took advantage of depressed valuations among shares which had been left behind in the headlong rush into TMT, investing £91.0m of the proceeds of our bond issue in sound companies such as Abbey National, Great Universal Stores and Powergen. Other 'value' purchases included the life companies Allied Zurich and Sun Life both of which were subsequently acquired by their parent companies. At our year end this portfolio was valued at £104.8m, an appreciation of 15.2% on cost, and we also generated income of £2.7m. These gains were in addition to the good performance of the main UK portfolio.

During the year £78.2m was realised from the UK, primarily towards the repurchase of SIT shares. The opportunity was taken to eliminate a number of consumer stocks suffering from a lack of pricing power in a low inflation environment.

The economy has continued along a modest growth, low inflation path and the Bank of England announced only

three 1/4% interest rate increases during the year to reach a rate of 6%. Many commentators believe that rates are near a peak and will fall slowly as we move into 2001. Persistent weakness of the euro has been unhelpful to British companies exporting into our most important trading market. While the substantial increase in the oil price has had a negative impact on certain industries, as an oil producing nation this has not held the UK economy back. Our large holdings in BP and Shell have both benefited.

Economic growth has generated greater tax receipts than forecast and with the next General Election drawing closer there are some concerns that the Chancellor will rekindle inflation in an election giveaway. If his "prudence" prevails then the outlook for modest growth and falling interest rates sets an acceptable backdrop for a stockmarket that should perform relatively well in the coming year.



Ian G. Anderson

Continental Europe

LISTED EQUITIES £223.2m
 PRINCIPAL HOLDINGS £'000

NOKIA (Finland) 10,479
 Renowned for its innovative mobile phones, Nokia is the global market leader and a prominent player in mobile network infrastructure.

NESTLÉ (Switzerland) 8,089
 International food giant now focused on a select number of thriving business lines.

SOCIÉTÉ GÉNÉRALE (France) 7,521
 Attractively valued French bank with core activities of domestic retail banking, corporate and investment banking and asset management.

AXA (France) 7,326
 A leading international insurer and asset manager which has established strong global positions.

TOTALFINAELF (France) 6,631
 A product of a Franco-Belgian merger, this oil producer and refiner is now regarded as one of the world's supermajors.

ALLIANZ (Germany) 6,524
 A leading global insurer and asset manager at the heart of the European finance sector and poised to benefit from German tax reforms.

UBS (Switzerland) 6,302
 Swiss banking group with leading asset management, investment banking and private banking operations.

AVENTIS (France) 6,202
 One of Europe's pharmaceutical majors, the result of a merger between Rhone Poulenc and Hoechst.

ROYAL DUTCH PETROLEUM (Netherlands) 5,707
 Benefiting from both cost cutting and the strong oil price.

TELEFONICA (Spain) 5,583
 Spanish telecommunications giant building strong positions in European mobile and Latin American fixed and mobile telephony.

TOTAL 70,364



German pharmaceutical group **Schering** has leading franchises in therapeutic and diagnostic treatments (our holding valued at £5.3m)

Longer term, European markets can make good progress based on the scope for raising productivity levels.

Of the major markets Continental Europe provided the strongest returns in local terms over the year, rising 24.9%. However, the well-publicised weakness of the euro saw that return reduced in sterling terms to 14.6%. The strongest performances came from Italy, France and Germany but there was greater variation among the smaller markets. For the third consecutive year, our European portfolio outperformed the Europe (ex UK) index, rising 19.4% in sterling.

Our year began with the European markets breaking out of a narrow trading range to start a dramatic rally which, between mid October and early March, saw a rise of 34.2% in sterling terms. This was attributable to the extraordinary performance of the TMT sectors. Investor conviction over the potential for growth in the new economy sectors drove these stocks to remarkable heights.

Between March and October, the market remained within a trading range as the TMT sectors became overpriced and investors sought value on a broader basis.

Over the year, expectations of GDP growth in the euro-zone for 2000 were revised upward to 3.5% as the region benefited from the strong global economy and the stimulus to exports from the weak currency. The European Central Bank (ECB) remained in a quandary over the decline of the euro which has fallen considerably against the dollar since launch in January 1999. Headline inflation, which is running at around 2.8% year on year, exceeds the ECB's policy target of 2%. The main response has been steadily to increase interest rates from 2.5% last October to the current intervention rate level of 4.75%. Much of the rise in price inflation is related to the jump in oil prices since core inflation is running at only 1.4%. One of the other main events of the year was the passing in Germany of widespread tax reform legislation which has positive long-term implications for the German corporate sector.

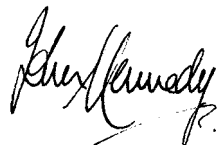
Part of the strong portfolio performance stemmed from good positioning ahead of the TMT sector rally. Large profits were later realised in a number of media holdings, particularly French television group TF1. Other media stocks which performed well and were sold into the sector rally included French advertiser Havas Advertising, German television group ProSieben and Italian publisher Seat Pagine Gialle. Excellent profits were realised on our holding in Mannesmann, which was acquired by UK's Vodafone early in the year. The single largest gain in the portfolio resulted from our large holding in Nokia, another stock reduced heavily near the sector peak.

Significant new holdings include German pharmaceutical group Schering, Nestlé and Swedish bank Svenska Handelsbanken, all of which made material contributions to performance.

Other recent new purchases were Swiss watch company Swatch, Peugeot and several medium sized companies with good growth prospects including German pharmaceutical group Altana and French services group Penauille Polyservices.

Among sizeable holdings sold because of diminishing prospects were Roche and AstraZeneca (pharmaceuticals), German industrials Bayer and DaimlerChrysler, and Electrolux.

The European market has been range-bound over recent months during which time the large supply of new equity overhanging the market has eased and TMT valuations have adjusted to more realistic levels. Value in the European market as a whole is currently reasonable. Following an advance in corporate earnings of around 17% this year, forecasts point to another good year with growth of 15%. However, slowing economies in 2001 and a possible modest revival in the euro could see earnings growth nearer 10% next year. Longer term, there is good reason to believe European markets can make good progress based on the scope for raising capital returns and productivity levels nearer to those of the United States.



John Kennedy

Americas

LISTED EQUITIES £355.4m
 PRINCIPAL HOLDINGS £'000

GENERAL ELECTRIC 14,986
 The largest multi-industry company in the US with leading market positions in its many businesses including financial services.

AMERICAN INTERNATIONAL GROUP 12,708
 A major international insurance group with a long record of delivering consistent earnings growth.

CITIGROUP 11,959
 One of the largest financial services groups in the US focusing on three main businesses; global consumer, asset management and international banking.

MICROSOFT 11,052
 The world's largest producer of software with strong new product potential linked to the growth in internet technology.

INTEL 10,537
 The leading manufacturer of microprocessors serving the personal computer market.

MERCK 10,529
 Leading research driven pharmaceutical company with a good pipeline of new drugs and a history of steady earnings growth.

BANK OF AMERICA 8,937
 Major bank holding company formed by the merger of NationsBank with BankAmerica.

INTERNATIONAL BUSINESS MACHINES 8,900
 Is now emphasising software and service revenues which are expanding rapidly.

EMC 8,525
 Leading producer of storage products for mainframe and open computer systems with strong earnings growth potential.

EXXON MOBIL 8,414
 After the merger with Mobil Oil, Exxon is the world's largest oil group benefiting from substantial merger synergies and high oil prices.

TOTAL 106,547



The Pembroke refinery of **Texaco**, one of the world's major oil companies (our holding valued at £4.3m)

The overall market is looking much better value.

The US stockmarket rose by 19.4% in sterling terms over our year but the bulk of this gain related to dollar strength with the underlying market only advancing 5.7%. Up to March the market rose strongly, led by the technology sector, but the NASDAQ index (predominantly technology) peaked that month and since then there has been a more broadly based, though still very volatile, market.

The economy has again been strong with GDP expected to be up 5% in 2000. The unemployment rate is very low but six rises in short term interest rates implemented by the Federal Reserve since June 1999 have begun to impact the economy. In fact, like the stockmarket, the economy has been split into the high growing technology sector and the slower growing manufacturing sector. Strong corporate earnings growth has been concentrated into two sectors, technology and energy, where earnings for 2000 are forecast to rise by 36% and 94% respectively. Inflation has increased modestly but does not appear to be a threat. However, the trade deficit has widened further.

Over the year the US portfolio rose by 17.4%. We underperformed the market over the first four months of our year when technology stocks rose to excessive valuations. Although we had added to technology we were still underweight and this was costly over that period. Since then the portfolio has outperformed its benchmark strongly as we benefited from having heavy positions in a number of sectors which did well, including energy, financials, healthcare and utilities. We remained actively invested in energy for the full year, believing that oil prices would stay high and push up earnings growth. We built up an overweight position in utilities, which was the best performing sector of the market. The US needs to increase its power provision and Duke Energy and Enron have been innovative and aggressive in increasing their market share. They outperformed the market by 45% and 94% respectively. Our healthcare holdings, Cardinal Health and Medtronic, rose strongly and defensive stocks, Walgreen, a pharmacy chain, PepsiCo, and Sysco, a food distributor, also performed well.

At present there is a tug of war between those who are negative, expecting a recession or at least a hard landing, and those who expect a slowdown with interest rates soon peaking. Our own view is tilted towards the latter. High energy prices and unrest in the Middle East contribute to the bear case for the market. The credit outlook has also worsened with increasing default rates. However, many of the excesses of recent years have been squeezed out and the overall market is looking much better value on a forward price earnings ratio at a level not seen for three years. Pessimism in the market is rising as nearly 80% of stocks in the NASDAQ index are down by more than 20% from their highs, and 45% are off more than 50%. Towards our year end we took advantage of this pessimism, investing £23.3m of our bond proceeds in a selection of growing companies on relatively modest valuations.

Investment has been flowing into money market funds where assets have grown by 22% year on year to \$1.8 trillion and cash levels at mutual equity funds are at a high level. This means that there is plenty of liquidity that could go into the market when sentiment changes. On the economic front, while growth is slowing, the government has accumulated a budget surplus of a record \$237bn, creating the best conditions for public finances since the 1950s. This should provide comfort to the Federal Reserve even if a new administration is tempted to cut taxes and increase government spending. Productivity gains are still being achieved and latest economic reports point to modest growth and fairly stable core inflation. We remain cautiously optimistic.



Hilary Vandore



This VAIO notebook pc incorporates a network connector as well as Sony's unique Jog dial control (our holding valued at £4.9m)

Japan

LISTED EQUITIES £119.8m
 PRINCIPAL HOLDINGS £'000

TAKEDA CHEMICAL INDUSTRIES 8,525
 This top Japanese pharmaceutical company continues to expand into USA and Europe with a range of innovative drugs.

ROHM 8,409
 Leading manufacturer of customised IC chips for mobiles, computers and other electronic goods.

INVESCO GT JAPAN ENTERPRISE FUND 6,909

FLEMING JAPANESE SMALLER COMPANIES INVESTMENT TRUST 5,373
 These two funds specialise in smaller companies in the technology and service sectors with future growth potential.

NTT DOCOMO 5,056
 Japan's leading cellular operator now starting international expansion following success of 'i-mode' mobile internet function in Japan.

TOTAL 34,272

There are some good technology companies in Japan.

Japan's gradual economic recovery has continued and GDP growth for the fiscal year to March 2001 is expected to meet the government's target of 1.5%. However, performance is very patchy and while industrial production, capital investment and exports are quite buoyant consumer demand remains depressed.

The Japanese stock market started our year well and rose by 12.6% in yen terms to a peak in February as investors continued to push up the valuations of the fashionable technology and telecoms companies. We performed very well over this period. These sectors then fell from favour and there have been no other major areas showing sufficient growth within the Japanese economy to compensate for their weakness. As a result the market has declined steadily since February and over our full year it fell by 8.0% in local terms, although the strength of the yen reduced this fall to 0.7% in sterling terms. Our portfolio declined by 5.5% (in sterling).

We diversified our holdings away from a heavy dependence on technology and telecoms through reductions in holdings such as Matsushita Communications Industrial (mobile handsets), Advantest (semiconductor manufacturing equip-

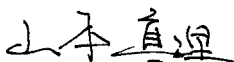
ment) and Nippon Telegraph & Telephone (NTT) all of which had been very successful investments for us. The proceeds were used to start new positions in domestic growth companies such as Chugai Pharmaceutical, Amada (machine tools) and Fast Retailing.

Apart from its world class technology companies, investors in Japan have been attracted to the potential for corporate restructuring. There are some high profile examples, such as the nine major banks and city banks that are merging into four large groups to meet global competition; and many companies are introducing early retirement schemes and closing factories. But despite these encouraging signs change is slower than expected. After ten years of miserable economic growth there is still a distinct lack of urgency.

In the meantime bankruptcies are on the increase. Sogo, a nationwide store chain, was a spectacular failure in July and since then three medium sized life assurance companies have gone under. While this weeding out process is painful in the short run it is necessary to achieve a soundly based long term recovery.

Within the stockmarket the supply/demand situation is unhelpful. Changes in accounting rules are encouraging companies to reduce cross holdings in each other and this is likely to be a continuing feature. Supply is rising with additional stock coming to the market in the form of new flotations, the recent government sale of a further tranche of its holding in NTT, and a likely fundraising from that company's subsidiary, NTT DoCoMo.

Despite these negatives there are some good companies in Japan, particularly in the technology area, which are continuing to grow and are now on reasonable ratings. Better share price performance from these may have to await a revival of interest in technology in the US. In the meantime we will continue to keep a strong representation in this sector.



Mari Yamamoto

Pacific (ex Japan)

Listed Equities	£56.4m
Principal Holdings	£'000
HUTCHISON WHAMPOA (Hong Kong)	3,417
Expansion by the world's largest port operator in Europe and China has accompanied strategic repositioning of mobile telecoms interests.	
CHEUNG KONG HOLDINGS (Hong Kong)	2,780
Expectations of an upturn in the residential property market during 2001 complements the value of a 49.9% holding in Hutchison Whampoa.	
CHINA MOBILE (China)	2,640
Shareholder value is being enhanced through a major asset acquisition in the lowly penetrated but fast growing wireless market.	
SWIRE PACIFIC (Hong Kong)	2,472
A beneficiary of improving demand for office and investment property; major interest in Cathay Pacific airline experiencing strong traffic growth.	
DAO HENG BANK (Hong Kong)	2,209
Hong Kong's fourth largest bank has invested heavily in IT systems for its growing retail, mortgage and credit card franchises.	
TOTAL	13,518

Prospects for Singapore, Hong Kong and China remain positive.

The buoyancy of world economies has been reflected in strong intra-Asian trade with area GDP growth close to 7% for 2000. While most regional stockmarkets rose over our first two months a sharp setback followed the bursting of the global technology bubble. Hong Kong/China, Singapore and Australia recovered some ground later to maintain a positive trend despite rising interest rates. Our concentration in these markets was rewarded with a 16.1% increase in portfolio value for the year. Meanwhile growing uncertainties in the more peripheral areas of Taiwan, Korea and Thailand, where markets plumed twenty month lows, restricted the regional index to an increase of just 1.9%. Our strong outperformance continued the trend of recent years.

China provided a positive impetus, achieving 32.0% growth in exports and 13.0% for fixed asset investment. Ongoing reforms, spurred by imminent World Trade Organisation membership, are liberating areas of an economy growing at 8.2% this year. China's relative immunity to external problems has been reflected in the performance of Hong Kong with stocks like Hutchison Whampoa benefiting from trade and telecom-related activities. We heavily overweighted Hong Kong all year and outperformed the local index significantly, led by holdings in China Mobile (telecoms), Dao Heng Bank and HSBC (banking).

Singapore's heavy reliance on electronics exports will partially outweigh its traditional regional trading strengths. Corporate restructuring continues and growth is reviving in the banking and real estate sectors. Our holdings in Overseas Union Bank and Keppel Land benefited from these trends.

Despite a continued strong economic performance, market sentiment in Australia has been affected by a radical mid-year tax package, anticipation of a slowdown in world growth and demand for commodities. The currency has fallen



PetroChina – optimising its crude oil and natural gas exploration and development activities (our holding valued at £1.3m)

to an all-time low with local equities increasingly seen as “old economy” rather than of the high technology, new paradigm age. Yet services now account for 80% of GDP and while reducing our commitment in favour of Hong Kong/China, we reinvested in leading energy utility AGL.

We recognised that investor confidence in the region was being eroded by the failure in a number of the fringe economies to resolve endemic problems left behind by the 1997/8 stockmarket and economic setback. These include the highly indebted and troubled Korean conglomerates, political risks in the Philippines and Indonesia and financial instability in Taiwan and Thailand. Malaysia has yet to restructure its corporate sector and retains a 10% investment exit tax. Sharply higher oil prices reduce the growth prospects of an import-dependent area. Meanwhile weakening orders for electronic components are adverse for the regional outsource beneficiaries of leading US and European manufacturers.

Though a slower pace of economic and export growth will occur in 2001 and investors require remedial action in the troubled economies, the prospects for Singapore, Hong Kong and China remain positive and are beneficiaries of likely lower world interest rates. China’s equity base is broadening and the country is moving towards greater integration with the developed world. These markets have retraced to levels seen in May, due mainly to external factors, yet earnings growth is strong and investment ratings undervalue the prospects. Accordingly we anticipate further progress from our portfolio.

Michael Dick