Portfolio Review

United Kingdom

Listed Equities	£408.1m

Principal Holdings	£'000

BP 28,180
One of the world's major oil groups, BP has recently added a significant investment in Russia to an attractive range of energy assets.

GLAXOSMITHKLINE 27,575
New drug pipeline provides long-term potential whilst more mature products are adapted for new uses through the consumer healthcare division.

VODAFONE 25,926
New "Live!" brand garnered 3m subscribers in first countries where offered. This enhanced mobile phone service, a stepping stone to 3G, will be introduced gradually across the extensive global network.

ROYAL BANK OF SCOTLAND 24,265
Offers a wide range of banking, insurance and financial services. Recently acquired Churchill Insurance to augment strong Direct Line brand. Citizens Financial continues to grow organically and by contiguous acquisitions in New England.

HSBC HOLDINGS 16,771
Global banking operations have been supplemented by purchase of leading US consumer credit company, Household, whose model will be used to develop similar operations in other countries.

HBOS 16,352
Largest provider of mortgages in the UK. Successful integration of Halifax and Bank of Scotland is delivering greater cost savings than targeted.

SHELL TRANSPORT & TRADING 13,506
Anglo-Dutch based global energy group. Drive for greater efficiency in all oil and gas operations has led to the disposal of some under-performing assets which will improve future returns.

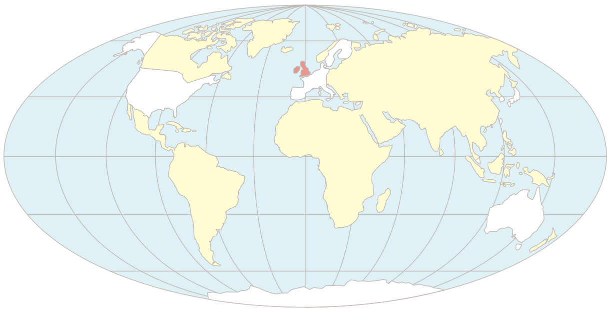
BARCLAYS 11,903
Barclaycard franchise continues to expand internationally. Active corporate lending operation will benefit from greater economic activity.

ANGLO AMERICAN 11,517
International mining group geared to economic recovery. Prominent in African diamonds, platinum and in gold where their subsidiary is to be merged into a joint venture with Ashanti mines in Ghana.

LLOYDS TSB 10,456
New CEO is reorganising bank's portfolio of brands including Scottish Widows and Cheltenham & Gloucester. Recent disposal of New Zealand interests releases capital for growth and will support the attractive yield.

The outlook for 2004 profits is positive.

Over the twelve months to September 2003 the UK economy grew by 2.0%. Although this was only a modest improvement on the prior twelve months and still below the long-term trend, the UK has produced a more stable performance than most other developed economies. Recently, a greater contribution from the corporate sector has reduced an imbalance that had seen GDP growth driven primarily by government spending and increasingly indebted consumers.



United Kingdom **45.7**%

The UK base rate was further reduced to 3.5% in July 2003, the lowest level for over forty years. Subsequently, in November the Bank of England added 0.25%, the first increase since 2000, and it seems likely that further increases will follow. We anticipate that these will be introduced gradually with a view to controlling the unsustainable rate of house price appreciation and the build up in household borrowing seen in recent years.

Although economic growth has been reasonable it has not matched the Treasury's original expectations and so the gap between tax receipts and increased government spending has widened leading to a rising budget deficit. The recovery underway in corporate profits will ameliorate this situation but there are fears that the Chancellor will try to close the gap through increasing business or consumer taxes which may dilute growth prospects.

In June ten year gilt yields reached 3.9%, their lowest levels for over 40 years, on fears that deflation was taking hold in the major western economies as it had already done in Japan.

United Kingdom

However, as it became evident that economic growth both in the UK and US was starting to recover, gilt yields began to rise reaching 5.0% at year end. With a growing budget deficit likely to lead to increased gilt issuance, and with base rates rising, gilt yields are likely to continue to move upwards.

The outlook for company profits in 2004 is positive and continues to improve. After costly restructuring by many companies, increased economic activity should have a beneficial geared effect on profits. Shareholders should be rewarded with a resumption of dividend growth and share buy-backs.

Equity prices continued to fall in the first five months of our current year but since March the FTSE All-Share index has risen steadily to stand 9.6% higher over twelve months. Our portfolio was ahead of the index for most of the period but was overtaken towards the year end by short term underperformances from a small number of our larger holdings and finished 8.0% up.

Our overweight position in the building sector performed well, despite a sharp fall in the housebuilders in the last few days of our year on interest rate concerns. However, these shares remain undervalued in the light of a continuing shortage of new homes. A revival in two mid-cap stocks BBA (aviation services) and First Group (bus & rail operator) rewarded our faith in the transport sector where a new investment in Peninsular & Oriental (container ports) post the cruise-ship demerger was also added.

Three sectors – banks, oils and pharmaceuticals – comprise over 40% of the market. Oil share price volatility rose during the Iraq conflict but none of these sectors, which primarily comprise large blue-chips, performed well with market attention focused on more speculative recovery situations. Of our bank holdings Lloyds TSB was particularly weak. Technology shares bounced back, including our holdings in software companies LogicaCMG and Xansa, and a new investment in Sage (accounting software) performed strongly.

In general, middle-sized and smaller companies outperformed their larger counterparts resulting in a strong relative performance from our portfolio of small company specialist investment trusts. Towards the end of the period we took some profits in this area and increased our exposure to larger companies.

The number of individual holdings in the portfolio has been reduced. ICI and BAE whose disappointing results were further depressed by pension fund deficits, Shire Pharmaceuticals whose principal drug came under generic pressure and Britannic Assurance which stopped paying a dividend were all sold.

Energetic members at a David Lloyd Leisure Club, a division of Whitbread. (Our holding valued at £6.0m).

Good performances from retailers GUS, Next and JJB Sports were partly offset by Dixons' poor share price performance due to an investigation into its warranty sales and this prompted us to take a loss on the holding.

As deflation fears have dissipated and corporate earnings recover, bond yields and equity prices have both risen from historically low levels. The re-rating of shares from a dividend yield above 4% to around 3.2% has brought many to fair value and further upward movement will require sustained profit growth. With economic improvement evident in the US and anticipated in Europe, our two major trading partners, companies should benefit from renewed expansion. Domestically, greater corporate profits should sustain record levels of employment and offset any loss in consumer confidence following further modest increases in interest rates from the current historically low level.

Portfolio Review

Continental Europe

Listed Equities	£90.3m

Principal Holdings	£'000

UBS (Switzerland) 4,212
World's largest asset manager now experiencing strong new money inflows with investment banking and wealth management exceeding expectations.

NOVARTIS (Switzerland) 3,893
Gaining market share from its current pharmaceuticals portfolio with important new launches ahead and capitalising on strong position in burgeoning generic drugs.

TELEFONICA (Spain) 3,854
Reversing prior diversification to focus on core domestic fixed and mobile telephone operations, complemented by Latin American recovery and strengthening cash flows.

TOTAL (France) 3,803
Delivering superior upstream growth from an immature oil and gas production base, while divesting non-core downstream operations.

BNP PARIBAS (France) 3,741
Expansion of domestic retail banking and successful western US operations are allied with asset management and private banking strength.

SANTANDER CENTRAL HISPANO (Spain) 3,538
Significant upside recovery potential from important Latam operations and sustained domestic banking volume growth demonstrate high asset quality.

AXA (France) 3,532
Global multi-line insurer growing through selective acquisitions and taking advantage of improved pricing and cost reductions in life assurance.

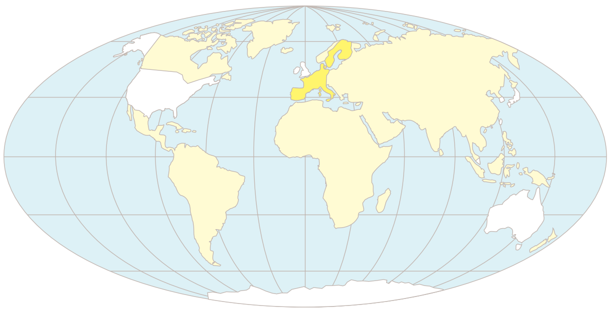
ENI (Italy) 3,265
Leveraged to the growing European gas market with an expanding upstream oil and gas portfolio.

SOCIETE GENERALE (France) 3,007
Profitable central and eastern Europe expansion, improving corporate and investment banking, allied with cost reduction, will generate rising returns.

UNICREDITO (Italy) 2,700
Italy's most profitable bank is focusing on the small to medium corporate sector, consumer credit and Eastern European initiatives.

2004 is the year of EU enlargement from 15 to 25 countries.

The majority of the Eurozone moved into recession during 2003 hampered by structural rigidities and the need to reduce budget overspends by France and Germany. This prompted three successive interest rate cuts by the European Central Bank from 3.25% to 2%. The 14.8% rise in the euro against the US dollar created a headwind for exporters among European companies which as a whole derive over 25% of profits from dollar-related revenues.



Continental Europe **9.6%**

After a brief autumn rally European stockmarkets fell by 23.3% in local currency terms to mid-March against a background of looming Middle-East conflict, rising oil prices, deteriorating economic data and the SARS epidemic. Analysts' forecasts of corporate profits were cut back while cost reductions and balance sheet repair, notably in the financial sector, followed the ravages of the longest bear market in a generation. This was particularly apparent in Germany where major concerns over the economy and the banking system saw the DAX Index fall by 30.1% between October and March.

The subsequent cessation of outright hostilities in Iraq, the stabilisation of energy prices and lower interest rates produced a powerful market rally. This was led spectacularly by twenty or so troubled companies which had suffered severely during the 2001/2 downturn. Often with fragile balance sheets and poor cash flows many of these had previously reduced or passed their dividends. Examples included ABB, France Telecom, Alcatel, Commerzbank, Ericsson and

Continental Europe

Swiss Life all of which outperformed the European index by 70% or more during the year. Our portfolio, which emphasised balance sheet and cash flow quality, allied with well covered dividends, did not match the 15.2% index rise, advancing by 8.7%.

Despite the uncertain background, investors increasingly anticipated economic recovery, encouraged by improving world business expectations and demonstrated by six successive months of rising German IFO business sentiment surveys. Companies geared to a cyclical upturn, particularly in the technology sectors, outperformed their more defensive counterparts, and this trend gathered pace amongst perceived "recovery" stocks. We continued to increase our exposure to more economically sensitive companies, concentrating on strength of franchise, financial quality and positive profits growth rather than companies clawing back from the brink of bankruptcy.

During the year we purchased a new holding in the German tyre manufacturer, Continental, which is now also a leader in auto-electronics. We also took new holdings in the employment agency Adecco to benefit from rising demand for temporary staff, and in the recovering French based global insurance company, AXA. These new purchases have been well rewarded. We benefited from a bid for major aluminium processor, Pechiney, by Canadian Alcan while the information technology operator Atos Origin took advantage of the opportunity to make a further judicious acquisition. An overweight position in autos saw Renault gain through the turnaround in the fortunes of its major Japanese associate, Nissan, while Banco Santander outperformed due to recovery in Latin America and strong domestic growth in Spain. Although our bank holdings outperformed the index they failed to match the 31% sector improvement. This was led by German banks where spectacular share price recoveries followed serious concerns over rising bad debts, cut dividends and credit rating downgrades. Less successful were holdings in the defensive areas of pharmaceuticals and food while energy also underperformed, despite a consistently high oil price and above average dividend yields.

Recent months have seen some gratifying signs of restructuring across the European Union. Pension reform in France, Germany and Italy is underway, helping to address the excessive social security burden that hampers entrepreneurial endeavour and consumes an inordinate share of resources. Allied with signs of US-led economic recovery, a revival of Government share placings and increasing merger and acquisition activity, prospects for European economies are improving with GDP growth of 2.0% possible for 2004 against 0.4% for the current year. Real recovery is still dependent on private consumption.

Photograph from Continental showing the colossal braking power needed to bring a car to a hard stop from a high speed. (Our holding valued at £2.4m).

Recent quarterly corporate profits have improved and largely matched expectations, albeit with few signs as yet of revenue growth or pricing power. However, modest inflation, the lowest interest rates for a generation and equity valuations at reasonable levels provide a background from which stockmarkets can continue to recover and broaden to embrace a range of quality companies which recently have underperformed significantly. We are actively pursuing opportunities in this area, together with additions to more cyclical companies, bearing in mind the impact of potential further euro strength on profits. With 2004 the year of EU enlargement from 15 to 25 countries, the faster growth and younger populations of certain new members may provide positive longer-term potential for a less than dynamic and currently underperforming Eurozone.

Portfolio Review

USA

Listed Equities	£208.8m

Principal Holdings	£'000

CITIGROUP 10,670

The world's largest financial services company; international operations will drive growth and the economic recovery will benefit the investment banking business.

BANK OF AMERICA 7,462

The company's consumer business has performed well, led by mortgage banking, and management will look to cut costs further after the recent FleetBoston Financial acquisition.

JOHNSON & JOHNSON 7,355

New medical technology products and the recent biotechnology acquisition should help drive sales for this diversified health care company.

LOWE'S COMPANIES 7,241

Home improvement retailer which has successfully gained market share through new store openings, better service and more product offerings.

MICROSOFT 7,147

The software company has been investing heavily in R&D and several major new product launches are expected over the next few years.

PFIZER 6,995

The world's largest drug company has been able to make significant cost savings as a result of its two recent large acquisitions and has promising new drugs coming to market.

PEPSICO 6,855

The maker of Pepsi-Cola, Gatorade, Tropicana, Walkers Crisps and Frito Lay's has been enjoying good growth as a result of its snack food business and international operations.

INTEL 6,806

Demand for Intel's microprocessors has increased significantly as the US economy recovers from recession, and new products offer further growth potential.

EXXON MOBIL 6,338

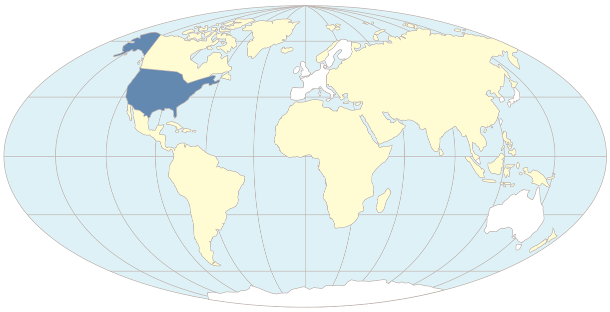
The oil giant's earnings have benefited from higher energy prices over the past year and it maintains attractive assets in regions across the world.

CONOCOPHILLIPS 6,119

Returns at the third largest US energy company should increase as it generates productivity gains from recent acquisitions, sells off assets and pays down debt.

2004 is an election year.

Recent economic news in the US has improved significantly and GDP growth for the third quarter of 2003 accelerated to its fastest rate in nineteen years. As stimulative fiscal and monetary policies have taken effect, US consumer spending has remained surprisingly robust and business investment has now started to pick up. Earlier in the year there was considerable uncertainty about the direction of the economy and real concerns about the risk of deflation which caused the Federal Reserve to reduce interest rates twice from October to June down to just 1%, the lowest level since the 1940s.



USA **23.9**%

After almost three years of decline the US stock market recovered by 18.4% (in dollar terms) last year. While much of this was lost due to the weakening US dollar, the US index still rose by a respectable 9.2% in sterling terms. The catalyst for the rise has been the improving macroeconomic news which is now being reflected in improved corporate profitability. The primary beneficiaries of this rebound have been the more cyclical industries, particularly technology. Our portfolio was positioned more defensively and did not participate as aggressively in the rally rising 4.5% in sterling terms.

The market reached its low in March, showing concern over the Iraqi conflict, and has since rebounded by 30.8% (in dollar terms); the technology sector has led the recent market rise, up by 41.6% (in dollar terms) over the year. Our technology holdings are concentrated in larger, less speculative companies and appreciated by 37.6% (in dollar terms) over the year with Intel,

USA

Adobe Systems and Cisco Systems performing particularly well. Investors have shown that their willingness to bear risk has not been diminished by the bursting of the technology bubble and smaller capitalised companies with high operating leverage have outperformed significantly as a result.

Outside technology our performance was affected by disappointing returns from four stocks: Sara Lee, which failed to deliver expected benefits after a significant restructuring; Cardinal Health and Automatic Data Processing which have both seen a slowdown in their core businesses, drug distribution and payroll processing respectively; and Marsh & McLennan whose strong insurance broking performance was undermined by a Federal investigation into its asset management subsidiary. More positively our holding in United Technologies, a diversified capital goods company, and three of our retail stocks: Family Dollar, Lowe's and Target performed very well, as did our large position in Citigroup, the diversified financial services company. During the year we increased our exposure to cyclical industries by taking a position in Ingersoll-Rand, a machinery manufacturer. We also took new positions in two high quality names that have underperformed the market while the cyclical rally has been in progress namely Harley-Davidson, the motorcycle manufacturer, and Moody's the credit rating agency.

The year 2004 is an election year and so the Bush Administration will do all it can to keep the current economic recovery on course. Growth in the US should again exceed other developed countries. However, the Administration will have to deal with the poor state of federal and state finances, the cost of the war on terrorism and the rebuilding of Iraq and Afghanistan, and the potential for further domestic terrorist attacks. The growing current account deficit is also a problem and it seems probable that this will continue to have an adverse effect on the dollar.

Following the recovery in share prices, valuations in many sectors are starting to look full, particularly in technology. However, in the short term, valuations tend to be overlooked while profits are rising and the news remains positive. During the downturn many companies undertook significant restructuring and their balance sheets are now healthier. They are now generating significant free cash flows which they are starting to use to increase capital expenditure. Corporate activity has picked up considerably in the last quarter, generally a sign that companies are seeing better growth prospects and opportunities. Another positive sign for US investors has been the increase in the number and size of dividends being paid largely as a result of tax changes.

Harley Davidson has created an iconic motorcycle brand that has significant potential for overseas expansion. The firm celebrated its centenary in 2003. (Our holding valued at £4.9m).

Japan

Listed Equities	£31.1m
Principal Holdings	**£'000**

JP MORGAN FLEMING JAPANESE SMALLER COMPANIES INVESTMENT TRUST **2,168**
Exposure to cyclical services within the trust has been increased to benefit from the turnaround in the economy.

DAITO TRUST CONSTRUCTION **1,968**
The company specialises in building flats for letting, offering a range of services to landowners from mortgage advice through to letting administration.

HONDA MOTOR **1,908**
Strong Chinese joint venture and improving European business are offsetting subdued domestic and US demand.

RICOH **1,900**
The company is benefiting from rising demand for digital and colour multi-functional printers which have higher profit margins.

DAIKIN INDUSTRIES **1,659**
Leading manufacturer of air conditioners taking advantage of growth in overseas markets.

The current recovery in Japan appears to be more sustainable than its predecessors.

The Japanese economy has grown faster than expected and has now expanded for six consecutive quarters. Growth has been led by exports to Asia which, in turn, have stimulated domestic capital expenditure. While consumer spending has remained sluggish it has not deteriorated further. Employment has slowly started to improve and there are some signs that the deflation which has dogged Japan for the last four years is gradually dissipating.

Ten year bond yields fell below 0.5% in June but have since risen sharply to the current level of 1.5%. The equity market hit a nineteen year low in April since when it has rebounded by 40.0% in sterling terms. Over the full year the market rose by 22.4%.

The first half of the year was marked by numerous political and economic concerns such as the war in Iraq, the potential threat from North Korea and the SARS epidemic in the Asian region. Domestically there were poor results from some leading companies such as Sony and there was heavy selling of equities from bank cross-shareholdings and, for technical reasons, from pension funds.

Investor sentiment turned when the Government rescued the weakest of the large banks through a quasi nationalisation after it was revealed that the bank was significantly under-capitalised. Subsequently, the other major banks have been able to take some action on non-performing loans and the credit risk rating agencies have become less negative on the outlook. The cyclical economic recovery also became more evident encouraging overseas investors to adjust their low exposure to Japanese equities.

Our portfolio rose by 14.6% which was behind the index. The yen was very strong against the US dollar in the last quarter of our year and a number of our holdings, such as autos, were adversely affected by this. In addition, having sold all of our bank holdings some two years ago, we did not participate in their recent sharp price recovery.

Early in the year we sold our holding in Nomura Research Institute, an IT software company, due to falling orders. We also sold Skylark, a restaurant chain experiencing pricing pressures, and Acom, a consumer finance company, which we believed would suffer from rising personal bankruptcies. We increased our position in Fuji Photo to benefit from the growth in digital cameras and photo minilabs and established a new position in Mabuchi Motor which makes miniature electric motors increasingly used in audio visual equipment and autos.

The current recovery in Japan appears to be more sustainable than its predecessors. It is being driven by the private sector which is benefiting from growth in the Asian region and there should be some further impetus from the revival in the US economy. In addition, the bank sector is in a better condition than it has been for several years. Provided the yen and the oil price do not rise sharply from current levels the momentum of company profits should remain positive. This should be beneficial for Japanese shares which now offer better value in relation to other world markets than has been the case for many years.

Portfolio Review

Pacific (ex Japan)

Listed Equities	**£57.6m**
Principal Holdings	**£'000**

SAMSUNG ELECTRONICS (Korea) **4,180**
World's largest manufacturer of memory chips also achieving strong growth in mobile handsets and consumer electronics.

BHP BILLITON (Australia) **3,677**
Major diversified resources company with industry leading positions in alumina, iron ore and coal along with growing oil interests.

NATIONAL AUSTRALIA BANK **3,301**
Largest bank in Australia benefiting from consistent growth in the Australian economy.

ANZ BANK (Australia) **2,964**
Australia's fourth largest bank. Increasing New Zealand presence through acquisition of National Bank of New Zealand from Lloyds TSB.

HUANENG POWER (China) **2,571**
Eastern Chinese power station operator benefiting from growing demand for electricity in the People's Republic.

Valuations in most of the region's markets are still attractive.

The year started with weak economic data from much of the region and the uncertainty was increased by the outbreak of SARS in the spring. Fortunately this was contained and cuts in official interest rates, a quick resumption of trade and continued strong growth in the Chinese economy led to an improving outlook by our year end.

After falling in the first half of the year, the regional index recovered and finished the year 21.2% higher in sterling terms. All the constituent markets contributed to the increase although Chinese-related stocks were particularly strong. The performance of our Hong Kong listed Chinese stocks including Huaneng Power, Sinopec and Beijing Capital International Airport was particularly satisfying and helped our portfolio rise by 28.7% over the year.

From the low point in March the regional index rallied by 37.5% led by economically sensitive stocks and the technology hardware sector. Both foreign and local investors have participated, notably in Taiwan where there was also a loosening of the controls on foreign investors. We have started investing in Taiwan through a holding in Hon Hai Precision, an electronics outsourcing business.

During the year we added £3.7m to the region to supplement our overweight position. New purchases included Venture in Singapore, an electronics outsourcing business and KT&G, the dominant tobacco company in Korea. We added to BHP Billiton which is benefiting from rising demand for raw materials; to Samsung Electronics for its leading international position in memory chips and mobile phones; and to Hite Brewery, the leading Korean brewer. We made complete sales of Mayne (private healthcare) and AMP (insurance) because of their disappointing trading.

Esprit Holdings continues to expand its international presence in apparel through wholesale and retail distribution. (Our holding valued at £1.5m).

The outlook for the region remains positive with valuations in most markets still attractive. We expect an improving economic outlook to be accompanied by rising profits growth. Increasing dividends are also evident and indicative of the greater attention being paid to shareholders' needs in these markets. Interest rates remain low across the region and there are signs that deflation may be coming to an end in Hong Kong after five years. The rapid growth in the Chinese economy is expected to moderate but still provide investment and growth opportunities for the region's companies.