

IVEAGH WEALTH FUND MONTHLY COMMENTARY

The Iveagh Wealth Fund returned -4.30% in January.

Global markets suffered major setbacks during the second half of the month with Asian and European indices as well as commodities faring the worst.

The second half of the month was characterized by the emergence of two of the risk factors that we had written about in our previous monthly report, namely Chinese monetary tightening and the emergence of sovereign credit risk in Europe. These were further exacerbated by the unexpected announcement by President Barack Obama of plans for a levy on banks as well as significant regulatory reforms.

With regards to Chinese monetary tightening, the only surprise for us and the rest of the market was the pre-emptive nature of the move. We had expected this to occur during the second quarter of the year in response to rising inflationary pressures but in the event the Chinese monetary authorities decided to act early although measures taken so far have not included a hike in interest rates but rather the removal of stimulus measures and curbs on bank lending, in particular to the real estate sector.

The second main event of the month centred on budget and funding concerns for Greece, which is currently running a budget deficit equivalent to 12.7% of GDP and concerns that previous budgetary data submitted to the European Union had been inaccurate. Problems in Greece matter largely because of the threat that they may have unleashed contagion risk that will spread to other highly indebted countries in Europe such as Portugal, Spain and Italy and ultimately spread further to the UK and the US, countries that are all running double digit budget deficits with no credible plans with regards to deficit reduction. This was another event risk we had written about a month ago, although the timing caught us by surprise.

The third main event was not something we had expected as President Barack Obama announced measures to introduce a "levy" on banks and followed

that up with proposals for stringent regulatory reforms based on Paul Volcker's recommendations from a year earlier. Although both measures will need to go through Congressional approval, the damage was immediate with regards to stock prices for major banks. The populist tone to these proposals as well the timing of the announcement of regulatory reforms coming just after a major Democratic Party defeat in the Massachusetts Senate elections only added to the sense of uncertainty.

As far as our inputs go, several major changes occurred over the last month.

Firstly, our growth indicators show that the acceleration in growth that occurred globally and across every major region since last summer is due to tail off in the second quarter of this year. The three month changes to our growth indicators are now negative across the board which was not the case at the beginning of the year and of particular concern is that the US growth indicator has entered negative territory for the first time since the recovery began.

Secondly, we are getting deflationary readings in Europe and the UK for Q2, warning that the lack of a meaningful expansion in broad money may well put renewed downward pressure on asset prices.

The flipside of the above is that chances for monetary tightening in the major regions have lessened although the removal of some of the emergency stimulus measures is still under way as illustrated by the Bank of England announcement with regards to a halt to Gilt purchases and the Federal Reserve plans to suspend the buying of mortgage bonds at the end of this quarter.

Our specialist inputs over the last months have highlighted a series of red flags. The much publicized Greek bond auction of two weeks ago was in reality not as successful and oversubscribed as publicly claimed putting serious questions marks over the Euro 30 billion of financing that Greece will need to do in Q2. Furthermore, although the most advocated solution to Greece's woes may be IMF intervention there seems to be reluctance on the part of Greek and European

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authorities to accept that. Moving on from Greece, the problems in Spain are clearly a lot worse than anyone realized a month or two ago. Spain steadily revised up the budget deficit numbers for 2009 from 5.2% of GDP last September to 11.4% most recently, suggesting that data may have been manipulated. In addition, it has transpired that Spanish banks have purchased 80% of government debt issuance since July 2008 (the next highest number anywhere else in Europe is around 20%) leading to a risk of a negative feedback loop as government bond prices fall. Furthermore, in a speech to real estate developers a couple of weeks ago, the head of the Spanish Mortgage Association Santos Gonzales warned that the size and speculative nature of real estate development loans **“threaten the solvency and credit quality and rating of the whole financial system and the Spanish economy in its entirety”**. This highlights how the current sovereign crisis may well go hand in hand with a renewed banking and credit crisis in some countries with a risk of contagion elsewhere.

A month ago, we described our valuation inputs as being analogous to a glass that is either half full or half empty. Our view at the time was that the backdrop of a strong global recovery in Q4 09 and Q1 10, combined with benign liquidity conditions, low long term real yields and strong earnings reports made the glass look half full. The change in inputs since then (described above) suggests that the glass may now be half empty.

Finally, technical indicators have shown a series of red flags emerge over the last month. Asian equity markets such as China and Hong Kong have broken below their uptrends, as have stock prices for major banks around the world with numerous other risk assets poised at or near technical levels that would suggest a trend change downwards. Although the picture is incomplete and several more weeks are required for trend changes to be confirmed in any asset class, we see enough warning signals in these technical changes, especially in the light of the factors that are driving them to be concerned.

Therefore, looking across our panel of indicators, we have seen a marked deterioration in the last two weeks. Given the potential magnitude of some of the threats which have started to materialise, we have felt it prudent

to buttress the portfolio's defensive characteristics by significantly reducing its equity exposure.

As of the writing of this report, the composition of the portfolio is as follows:

Major Market equities : 20%
(US 6%, Europe 4.5%, UK 4.5%, Japan 5%)

Far East ex Japan equities 8%

Emerging Market equities 4%

Private equity 2%

Natural Resources 4%

Precious metals 4%

Equity Long Short 15%

Alternatives 2%

The currency composition of the above portfolio is 60% in Sterling, 23% in the US\$, Japanese Yen 5%, Far East currencies 8% and Emerging market currencies 4%.

The balance of the portfolio is invested in cash and short dated securities.

In conclusion, we have adjusted portfolio risk in the Iveagh Wealth Fund in order to reflect changes in a number of our inputs. We may well introduce further changes during the month to reflect our desire to preserve capital and will communicate any such changes in our next monthly report.

The Iveagh Team

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