GAM - Contrarian investment for the longer term - July 2010

In April, the Investment Committee took the decision to re-open the range of St. James's Place funds managed by Andrew Green at GAM. This paper sets out why, with insight from Stamford Associates, the Committee believe Andrew remains a high quality manager with the ability to deliver superior returns over the long term.

Disciplined contrarian approach

A disciplined investment philosophy is a critical requirement of managers appointed by the Investment Committee. Andrew Green and his team have applied their approach rigorously over more than twenty years, in the face of hugely varied market conditions.

Andrew's philosophy is to seek to identify areas with excessively negative sentiment, especially where he sees an identifiable catalyst for change, such as a change of management or structure of the market place. The portfolios are constructed with little attention to index weightings, but instead with a view to finding investments that have been out of favour, often for long periods of time. To make these assessments he uses as long a perspective as possible, and combines this with macroeconomic and fundamental company analysis.

One of the features of this strategy is that it is typically more volatile than the market as a whole and the long term nature of the process can lead to periods of underperformance in the shorter term. This has been the experience of St. James's Place investors since April 2000 and reflects the trend for Andrew's performance over more than twenty years.

Performance can diverge significantly from the market

The deeply contrarian nature of Andrew's approach means that he is often an early investor into opportunities where it may take several years for the value to be realised. Consequently, portfolio returns can at times diverge significantly from their respective benchmarks. This is because market sentiment often stays behind a consensus or fashionable idea for longer than the fundamentals warrant. However, once expectations adjust to reality, the change in market leadership is often rapid and underlines the importance of Andrew's prepositioning.

The allocations to stocks in Japan and the Information Technology sector - approximately 20% for each area - are the most significant recent examples of this contrarian value approach. The technology companies within the portfolio have yet to make a positive relative contribution; indeed they have been material detractors over the last three years. However, there are exceptions that illustrate the approach. Infineon Technologies was the third worst relative performer in the portfolio in 2008, but was the best relative performer in 2009 (and continues to be lowly valued by traditional measures). Andrew remains confident that the financial strength and under-appreciated growth within the technology sector is still being inappropriately valued by the markets.

The chart below illustrates the relative performance trend for annual returns from the SJP/GAM Managed Pension fund and needs to be considered in the context of a compound annual growth rate of 6.9% compared with -0.4% from the MSCI World index.

SJP/GAM Managed Pension fund v MSCI World Index - annual returns to 30/6/2010

Source: Lipper. All figures are percentage growth on a bid to bid basis for accumulation units, income reinvested and in fund currency. Please be aware that past performance is not indicative of future performance. Equities do not include the security of capital characteristic of a deposit with a bank or building society. The price of units and the income from them may go down as well as up. You may not get back the amount invested.

Similarly, it is also worth comparing returns over the 'lost decade' of the last ten years. £1,000 invested in the MSCI World Index from April 2000 to the end of June 2010 would have reduced in value to £932. The SJP/GAM Managed fund has returned £1,985 over the same period.

SJP/GAM Managed Pension fund v MSCI World index – returns since April 2000

Source: Lipper. All figures on a bid to bid basis for accumulation units, income reinvested and in fund currency. Please be aware that past performance is not indicative of future performance. Equities do not include the security of capital characteristic of a deposit with a bank or building society. The price of units and the income from them may go down as well as up. You may not get back the amount invested.

An analysis of the portfolio strategy over recent years provides some insight into the reasons for periods of under and out-performance.

2002-03

This period provided examples of the advantage of pre-positioning ahead of a change in market conditions. After a difficult 2002 in global equity markets, Andrew bought into stocks that were deeply out of favour, despite having strong franchises. These included technology and construction stocks, as well as certain Japanese stocks, whilst defensive plays in food stocks were sold on the back of strong relative performance in 2002.

Although the first quarter of 2003 proved a challenge to performance due to the Iraq war, risk appetites recovered once the war finished and led to a sustained rally in areas where the portfolio was focused - particularly technology and Japan - leading to strong outperformance by the fund.

2006

Relative performance was strong in a volatile market environment, due largely to the continued underweighting in the US market, which underperformed global indices and was additionally hit by a weaker dollar. Outperformance was achieved despite the raised weighting to Japan, which remained out of favour due to political worries and slow progress on governance issues.

2007-09

A number of factors contributed to relative underperformance. Exposure to Japan was increased during 2007, given exceptionally low valuations and many good quality companies trading at a discount to book value. However, sentiment towards the market remained negative and Japan ended up being the worst-performing major market over the year.

The portfolio had benefited from its utility holdings between 2000 and 2006, but these were liquidated during 2007 when Andrew concluded that the sector had become over-owned and relatively expensive compared with better value investments elsewhere (including technology, which at the time offered higher dividend yields). However, in the financial crisis of 2008 the clamour for defensive stocks sustained the utilities sector longer than anticipated by the manager and the portfolio's returns were hampered by its lack of exposure to one of the best performing sectors.

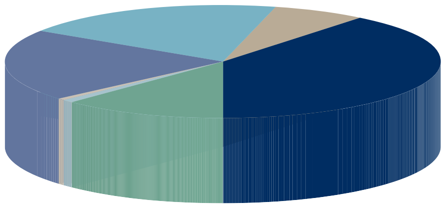
Similarly, following their falls in 2008, mining companies and emerging markets performed particularly strongly, but Andrew had little exposure to these sectors as he considered them over-owned and overvalued. Banks and consumer goods have also been material detractors over the last three years as Andrew moved into banks too early in the fourth quarter of 2008, in the belief that the initial rights issues had helped put a floor to valuations.

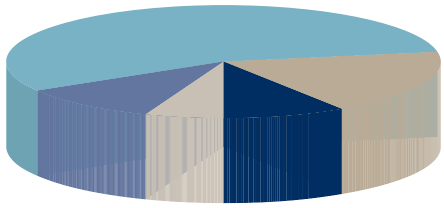
2010 to date

The anticipated recovery of the Japanese market appears to be materialising on evidence of strong earnings momentum and the authorities' recognition of the need for change, as well as a weaker currency. There are signs that improved export performance is translating into higher employment and wage growth - giving the economy a much-needed boost. Andrew has maintained his overweight exposure, which consists of a large number of relatively small positions, as well as some larger allocations to Japanese banks.

The divergence from index weightings is illustrated in the asset allocation chart below.

SJP/GAM Managed Pension fund v MSCI World index - asset allocation (31/05/2010)





SJP/GAM Managed Pension fund

UK equities	39.4%
Europe ex-UK equities	6.8%
US equities	19.9%
Japan equities	20.4%
Far East ex-Japan equities	0.5%
Emerging Mkt equities	0.8%
Cash	12.2%

MSCI World index

UK equities	9.4%
Europe ex-UK equities	18.4%
US equities	56.0%
Japan equities	10.4%
Far East ex-Japan equities	5.8%
Emerging Mkt equities	0.0%
Cash	0.0%

Summary

A change in investment approach would be a key cause for concern for both the Investment Committee and Stamford Associates. The continued confidence in the skills and abilities of Andrew and his team is based on a host of factors, but of vital importance is the fact that the contrarian value philosophy continues to be evident in the portfolio and trading activity and that Andrew remains able to express his investment convictions unhindered by committees or liquidity issues. Andrew has followed this strategy for more than twenty years and it has delivered a track record which builds wealth over time, consistent with the wider philosophy of St. James's Place.

As the Investment Committee would expect of a high conviction style, the manager will typically add to positions on share price weakness and will continue to hold those positions until they are rewarded. The modest turnover in the portfolio also reflects Andrew's adherence to his strategy and, whilst sometimes difficult, investors need similar patience to allow time for long-term value to be realised.

The superior long term results have been interspersed with periods of relative underperformance - a consequence of the high conviction approach, but this also means the turnaround can be swift when it happens, with longer term results transformed by positive short-term numbers.

The SJP/GAM Pension Managed fund is ranked in the fourth quartile over 5 years, however, it is only 2% per annum below the first quartile which, given the nature of Andrew's approach, can be recovered relatively quickly. The fund exceeded the peer group by 26% in 2001 and 13% in 2003, which followed on from previous lacklustre periods.

Looking forward, although there can of course be no guarantees, the current portfolio appears to be relatively cheap and has the characteristics the Investment Committee would expect from this style of manager, being typically more lowly valued and higher yielding than the peer group. In addition, the future earnings growth of the underlying holdings (based on consensus estimates) is expected to be superior to that of the index in the next one to three years.

The Investment Committee continues to believe that Andrew is an exceptionally talented investor who has demonstrated his skills over a prolonged time period and that nothing material has occurred that will jeopardise the opportunity to repeat his success in the future.