

MARKET OUTLOOK

NICK SHERIDAN ON EUROPEAN EQUITIES – JUNE 2008



Nick Sheridan, manager of the New Star European Value Fund, comments below on the recent stockmarket volatility, his outlook for Europe and his conviction that we are entering classic value-investing territory.

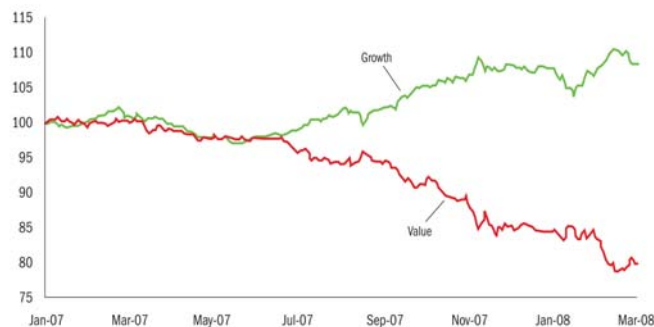


The past year has been challenging for European value investors. While the New Star European Value Fund has not been immune from this volatility, it returned 1.82%* over the six months to 30 May 2008 versus a fall of 0.06% in the IMA Europe excluding UK sector, placing it 22nd out of a total of 108 funds.

Nick Sheridan, the manager of the fund, believes this performance is largely as a result of a disciplined process based on his proprietary quantitative analysis screens as well as his preparedness to sell underperforming stocks. Since the fund adopted its current investment process on 1 August 2004, it is ranked first quartile having risen 109.06%* to 30 May 2008.

As shown in the chart below, value investing performed broadly in line with growth investing from January to July last year. As uncertainty and recession fears grew, however, earnings prospects were called into question. This resulted in losses for value stocks from the middle of last year onwards.

Recent Performance of value and growth investing styles in Europe



Source: Lehman Brothers Equity Strategy.

While momentum investing has had the upper hand as a strategy recently, value tends to reassert itself when valuation disparities reach extremes. Such a point was reached recently following the strong run in growth stocks at a time when value stocks fell significantly. At end-May levels, valuation dispersions were more than two standard deviations wider than usual in the US. This has historically been a strong sign that valuation factors will begin to reassert a positive influence.

*Source: Lipper, NAV to NAV, net income reinvested.

Since the summer of 2007, investors have been rewarded for buying growth companies but a turning point now appears to have been reached, with valuation criteria such as price-to-book ratios and dividend yields at compelling levels. According to Lehman Brothers, analysts have aggressively cut forecasts for value stocks, with these stocks experiencing net downgrades of 18% in the first quarter of this year alone. By contrast, earnings for growth stocks have yet to be significantly revised down. As a result, whilst value stocks are reaching the point of maximum downgrades, growth stocks may have further to fall. Growth stocks in Europe were trading on a 40% premium to value in April. This compares with a 20-year average premium of 30%. Likewise value stocks have been de-rated and the spread in price/earnings (P/E) multiples across the market has widened, with value stocks ending May trading at half the P/E multiple of growth stocks.

Several events also suggest that an inflection point in investor sentiment may have been reached. The mea culpa attitude among banks as they disclose their losses and seek to restore their balance sheets is particularly encouraging. Morgan Stanley research shows that deeply-discounted rights issues used for balance sheet repair have tended to lead to significant outperformance for a company over the following year.

Analyst downgrades of company earnings have, paradoxically, been a positive signal since markets tend to perform better when there is the possibility of positive earnings surprises.

Structurally the eurozone and the companies operating within its borders have changed from a decade ago. At a corporate level, costs are being stripped out, production is being moved overseas effectively and returns on invested capital have increased.

More attractive valuations do not, however, conceal the fact that the economic waters are becoming choppy. According to the European Union statistics office, eurozone inflation rose to a 16-year high of 3.6% in May, from 3.3% in April, and European retail sales have declined as the effects of rising food and commodity prices have fed through to consumers. Moreover the effects of the credit crunch are likely to have a lagged impact on the real economy.

Investors are anticipating either a significant economic growth slowdown or a recession, causing a substantial fall in corporate profits. It is not, however, all bad news. These are ideal circumstances for companies that do deliver healthy results to receive a re-rating as previously pessimistic investors become less gloomy. This is classic value investing territory and is typically when Nick's strategy comes into its own.



Originally authorised as the Tilney European Growth Fund on 1 October 1997. The fund merged with the New Star European Value Fund on 29 June 2007, which was set up specifically for this purpose. The performance history has been carried over from when it was the Tilney European Growth Fund. Past performance is not necessarily a guide to future performance.



NEW STAR EUROPEAN VALUE FUND

Important information

Past performance is not necessarily a guide to future performance. The value of investments and any income from them may fall as well as rise and investors may not get back the amount originally invested. The value of investments may also increase or decrease as a result of changes in exchange rates between currencies. The opinions expressed here are solely those of the fund manager at the time of print and should not be interpreted as investment advice.

The New Star European Value Fund (formerly the Tilney European Growth Fund) (the "Fund") opened to retail investment on 29 June 2007. Performance history for the Fund includes that of the Tilney European Growth Fund which was launched on 1 October 1997.

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Full details of the Fund can be found in the prospectus. Any decisions should be made solely on the basis of the relevant documents, which are available on request from New Star. The Simplified Prospectus is also available upon request.

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FUND FEATURES

- Active portfolio management
- Distinctive value investment process
- Stock specific, with no deliberate sector or country bias

FUND AT A GLANCE

Launch date:	01.10.1997*
Base currency:	Sterling
Other currency classes:	€ share class: launch date 03.09.2007
ISIN EUR:	GB00B1XQM616
Bloomberg:	NEWSEVE LN
Sedol:	B1XQM61
Registration:	UK, Italy, Spain, France and Singapore (recognised).

Fund information at 30 May 2008.

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