



INVESTMENT PROCESS

NEW STAR ASIAN OPPORTUNITIES FUND



Ian Beattie



Lucy Bernays

- Disciplined, research-driven investment process
- Bottom-up stock selection blended with macroeconomic analysis to identify growth opportunities throughout Asia Pacific
- Focus on companies that are genuinely creating shareholder value and are exhibiting positive future trends, with particular use made of EVA[®] † analysis
- Not benchmark constrained
- Well-diversified portfolio of 80-100 stocks

Lead manager profile – Ian Beattie

Ian Beattie is a City University, London, economics graduate with previous fund management experience at Royal Insurance. Ian has specialised in Asia for more than 15 years and has been head of Asian excluding Japan funds for New Star Institutional Managers* for more than nine years. Ian is the lead fund manager for the New Star Asian Opportunities Fund.

Manager profile – Lucy Bernays

Lucy Bernays is an investment manager on the New Star Asian equities and emerging markets team and joined New Star in 2001. Lucy specialises in North East Asian markets, especially Korea and Taiwan.

*Formerly WorldInvest, which was acquired by New Star on 31 December 2000.

Fund objective

To provide long-term capital growth principally through investment in the securities of Asian companies excluding Japan.

Investment style

The Asian team blends bottom-up stock selection with macroeconomic analysis to identify growth opportunities throughout Asia Pacific. They believe that the investment landscape has fundamentally changed in recent years and that significant structural dynamics are in play. This has opened up opportunities to detect tomorrow's winners and avoid those companies which are likely to struggle in the new environment. They look to identify those companies that are genuinely creating shareholder value and are exhibiting positive future trends, with particular use made of EVA[®] † analysis. Complementing their stock analysis is a careful consideration of liquidity and macroeconomic trends which seeks to exploit opportunities among countries and sectors in Asia. Careful risk control is applied throughout the process.

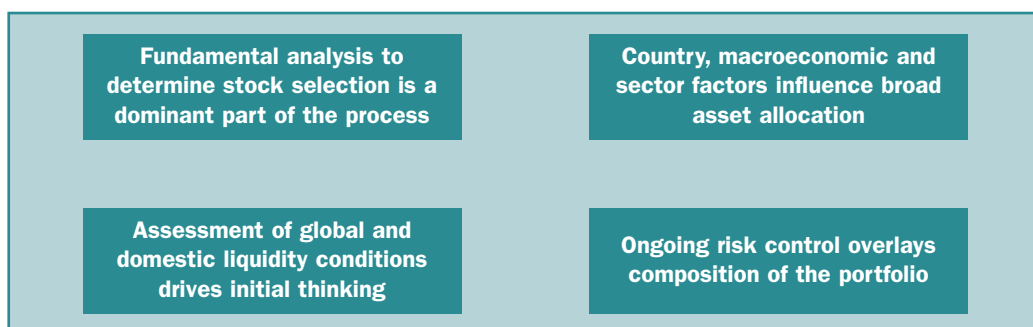
The diagram below illustrates the four important steps which Ian and Lucy follow in constructing the portfolio. None of the steps should be considered in isolation, nor should they be considered as especially chronological. The process is essentially holistic with all factors contributing to a final decision, although stock analysis dominates the process.

†Economic Value Added and EVA are trademarks of Stern Stewart & Co.

Supporting the fund manager

As well as Ian and Lucy, the Asia ex Japan team also includes Connie Chien, an analyst based in Taiwan. New Star's economist Simon Ward and Mark Hurley, New Star's specialist Asian equities dealer also provide invaluable input.

The Asian team shares and debates stock ideas and economic trends with the other international fund managers at New Star. Additional research and idea generation is provided by brokers and third party specialists. Live news and data feeds keep the fund managers up to date with the latest market events.



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Step one: assess global and domestic liquidity conditions

Most Asian countries have large trade current and capital accounts relative to the size of their economies, so they are heavily exposed to global trade and capital flows. A key consideration in looking at Asian countries is, therefore, to consider liquidity factors, both inside and outside the region.

Global influences – The Asian team assesses the direction of capital flows and how these may impact on the financial markets and the region as a whole. The enthusiasm of foreign investors for Asian assets can affect valuations and may cause distortions among relative ratings as outsiders chase particular stocks. Monetary policy abroad can affect Asia. For instance, US interest rates have tended to have a strong influence on liquidity-sensitive south east Asia.

Regional and domestic influences – Individual country monetary policies are considered both in isolation and in tandem with their impact on neighbouring countries. For instance, exchange rate intervention by the Bank of Japan can affect the prospects for the Korean economy. The supply and demand for equities is important as there is a tendency for heavy issuance in Asia when investor confidence improves, whilst domestic institutions' buying of equities is on a long-term uptrend. The team considers savings rates in individual countries, changes in credit activity and sentiment among local investors. The Asian team is careful, however, not to get blinded by local hysteria and aims to remain loyal to more solid fundamentals and long-term trends.

Step two: consider individual country, macroeconomic and sector factors

With Asia Pacific developing so rapidly and covering such a diverse range of countries, from highly industrialised Australia to developing China, the market performance of individual countries can differ dramatically. The dispersion can be so wide that asset allocation can be the critical factor in delivering performance.

Country characteristics – There is often a higher level of political risk in Asian countries – traditionally a result of their developing economies or relatively young political systems. It must be remembered that only four countries in Asia outside of Japan – Hong Kong, Singapore, New Zealand and Australia – qualify as developed markets in most major indices. The other countries are rapidly catching up but there can still be examples of weak regulation, poor shareholder practices and structural economic or fiscal impediments. Countries such as the Philippines, China and Thailand, for example, may continue to display the risks associated with emerging markets.

Countries may have a comparative advantage in certain areas. Australia is blessed with large natural resources and, therefore, has several commodity-related companies. In contrast, Hong Kong, as an established trading port and entrepôt, is more closely associated with trade, financial services and property.

Macroeconomic factors – The Asian team gauges a country's macroeconomic policy, such as the promotion of an inflationary policy or infrastructure projects that may boost demand. Levels of regulation, taxation and shareholder protection are considered as these vary considerably between countries, distorting the ease with which valuations can be compared. The team also looks at prospective GDP levels, since GDP growth should help support companies reliant on domestic sales. GDP trends in larger economies such as China, Japan or the US can affect the rest of the region.

Sector trends – Countries may be different but there are some similarities at the sector level. For instance, semiconductor firms are all affected by similar conditions, so if the outlook is positive for chip prices, this is likely to benefit manufacturers wherever they are located in Asia. The Asian team may then isolate those stocks within the sector that look attractive.

The Asian team at New Star is helped in its analysis of sector dynamics by the working environment at New Star. The international and regional fund managers at New Star sit within close proximity of one another. This permits the ready exchange of ideas and information so that even subtle shifts in opinion are not diluted or lost by distance. The value of this for the Asian team can be seen in the following examples. If the European fund managers report a gloomy outlook for mobile phone operators, that may have a bearing on the prospects for Asian handset manufacturers. Similarly greater confidence in Japanese retailers on the part of the Japanese team may herald an improvement in fortunes for Chinese textile manufacturers.

Step three: evaluate individual stocks using fundamental analysis

Once the Asian team has established the attractive areas, their attention turns to individual stocks.

Economic Value Added:

The Asian team uses in-house EVA models to determine those companies that are genuinely creating shareholder value. This method restates accounts to reflect true economic profit rather than accounting profit. It prompts the team to adjust for creative accounting and provides a standard for companies across markets so it is possible to make international comparisons, which is ideal for a multi-country fund. The team calculates the Return On Invested Capital (ROIC) and compares this to the cost of the capital required to generate this return by calculating the Weighted Average Cost of Capital (WACC), which takes into account equity and debt financing. The ROIC/WACC then provides an EVA ratio. Broadly, if it is greater than one then the company is generating added value. This gives a measure of profitability that the Asian team believes is more sophisticated than Return on Equity. A valuation yardstick is created by dividing Enterprise Value (market capitalisation and market value of debt) by Invested Capital (EV/IC).

The EVA ratio lets the team know whether the company is creating shareholder value and the EV/IC lets them know what price is being paid for this return.

Analysis of stock fundamentals:

Other standard fundamental measures are assessed. In particular the team looks at:

1. **Deliverable strategy** – The company must have an achievable plan, with a product that is destined to succeed. A company's business model, the future of the market in which it operates and the level of competition are key determinants. Business prospects are cross-referenced against competitors and suppliers to determine a company's likely success.
2. **Quality of management** – The team meets with management and travels to Asia to undertake direct company visits. The team sees in excess of 350 companies each year. Meeting management allows the team to establish the competency of those tasked with delivering the business strategy. With Asia being such a dynamic region, it is imperative that company managers have the skill, experience and drive to meet new challenges and are prepared to take difficult decisions or implement rapid change. Demanding questions are asked of management to discover how they intend to implement their vision and equally supplier, customer and competitor companies may be cross-referenced for a more rounded view.
3. **Sound finances** – A strong balance sheet ensures a solid foundation on which improved performance can be built. The team avoids companies with distressed finances unless they are convincing turnaround candidates. Careful analysis of accounts and management can reveal companies with the potential to restructure successfully.

Attractive stocks fall into two main categories:

1. Those with a positive EVA that are exhibiting a rising earnings trend. These stocks are proving that they can add value and if the valuation is attractive they are considered for the portfolio.
2. Those which are attractively valued but require a catalyst to release that intrinsic value. The Asian team seeks to identify the catalyst, such as new management, ownership change, restructuring moves or foreign investment that might spark an improvement in the company's fortunes.

In all cases the team is looking for positive future newsflow, so that when it arrives, the market will react and generate a rise in the share price.

Sell discipline:

Stocks compete not only to be included in the portfolio, but also to remain there. Each day the Asian team is confronted with possible investment ideas and each stock has to earn its place in the portfolio. Stocks are sold for several reasons:

1. The dynamic which had propelled a sector or stock may have come to a conclusion and there is an opportunity cost in remaining invested in the company. Profits are, therefore, taken.
2. The liquidity environment may prompt a reduction in a country weighting and this causes a sell idea to crystallise.
3. There could be a rapid deterioration in a company's earnings outlook or an external event which triggers a sale.



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. Investments made in the fund involve certain risks, as described in the prospectus. Any opinions expressed in this document may vary without prior notice and do not constitute investment advice.

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Full details of the Fund can be found in the prospectus or Offering Document, in the case of Hong Kong. Any investment decision must be made solely on the basis of the information contained in the prospectus/Offering Document, which is available on request from New Star. The simplified prospectus and most recent annual and interim reports are also available upon request.

The shares referred to in this document have not been and will not be registered under any United States securities laws, and, except in a transaction that does not violate the United States securities laws, may not be directly or indirectly offered or sold in the United States of America, or any of its territories or possessions, or areas subject to its jurisdiction or to or for the benefit of a United States person.

The Fund is regulated by the Irish Financial Services Regulatory Authority (Irish Financial Regulator). The Manager, New Star Investment Funds (Ireland) Limited, is regulated by the Irish Financial Regulator. The Investment Manager, New Star Asset Management Limited, is regulated by the Financial Services Authority of the United Kingdom (the FSA). The custodian is State Street Custodial Services (Ireland) Limited.

The Fund has been registered for distribution in Denmark with the Danish Financial Supervisory Authority, in Sweden with the Swedish Financial Authority, in Finland with the Finnish Financial Supervision Authority, in Malta with the Malta Financial Services, in France with the Autorité des Marchés Financiers, in Spain with the Comisión Nacional del Mercado de Valores under number 407, in the Netherlands with the Autoriteit Financiële Markten and in Italy by the Bank of Italy. The Carnegie Fund Services SA, 20 rue du Conseil Général, 1205 Genève, Suisse (Postal address: Casa Postale 5656, 1211 Genève 11), Tel: +41 22 7051177, Fax: +41 22 7051179 has been appointed as the representative of the Fund in Switzerland. For Hong Kong: The Fund has been authorised by the Securities and Futures Commission (the SFC). Authorisation by the SFC does not in anyway imply any official approval or recommendation by the SFC. In Singapore the sub-funds are recognised as Restricted Collective Investment Schemes by the Monetary Authority of Singapore.

This document has not been verified or approved by any relevant supervisory authority in the jurisdictions where the Fund is registered.

Issued by: New Star Asset Management (Bermuda) Limited.

Step four: ongoing risk control

Risk control is a key component of the investment process.

Size limits – The fund follows strict size limits on individual stock holdings within the portfolio and the level of issued capital held in any one company. The fund will consider the liquidity in a company's shares before investing. The fund is diversified and typically targets between 80 and 100 individual stocks.

Ex-ante tracking error analysis – ex-ante tracking error is employed to analyse the benchmark relative risk contributed by an investment decision. The objective of risk measurement is to describe the potential future behaviour of a portfolio. Good risk management clearly quantifies the relative likelihood of different changes to a portfolio's future value as well as potentially unintended bets. Essentially, ex-ante tracking error allows the Asian team to extract better performance by allocating its risk budget to where they have the highest conviction rather than accepting potentially weaker returns.

Performance & risk attribution analysis – Regular attribution analysis allows the fund manager to source the performance & risk of the fund as broken down by stock selection, country allocation and currency effect. This communicates more clearly the sources of performance & risk, highlighting successful or non-performing stock selection decisions so that the fund manager can respond more accurately.

Currency risk – The fund managers may hedge the currency exposure of the underlying assets back to US dollars.

Detailed below are New Star's internal controls, which provide an added layer of risk control for investors. The internal controls also ensure that fund managers fully comply with the regulatory standards.

Independent oversight and functional segregation

Segregation of duties

- Separate dealing desk and back office functions
- Separate reporting lines to senior management

Risk and compliance function

- Covers all aspects of the business, ensuring adequate procedures and controls are in place
- Monitors that procedures and controls are being followed

Use of experienced and independent third parties

- Shareholding servicing, fund accounting, custody and independent net asset value calculations

Independent checking

Regular performance and attribution

- Performed by department segregated from the fund manager
- Reviewed by management

Regular compliance review

- Review of fund against investment restrictions and guidelines

Monthly investment risk review

- Identifies, quantifies and communicates investment risks, ensuring they are understood, appropriate and accepted

Processing controls

Experienced back office function

- Settlement of transactions
- Automatic matching of confirmations
- Review of valuations and pricing
- Reconciliation of cash and holdings

Weekly sign-off

- Fund manager signs off weekly compliance with fund objectives and the monthly valuation