



INVESTMENT PROCESS

NEW STAR JAPAN RECOVERY FUND



Chris Burling



Andrew Gibbs

- Diversified portfolio of Japanese investments
- Bottom-up investment approach used to identify recovery and growth prospects
- Highly disciplined, process-driven investment approach
- Proprietary research used to identify companies with growth potential but off the radar screen of many fund managers
- Pricing anomalies exploited in companies with attractive valuations and healthy business prospects
- Concentrated portfolio of about 50-60 stocks that the managers believe are well placed to offer superior capital gain

HOW TO CONTACT NEW STAR INTERNATIONAL

INTERNATIONAL BROKER SUPPORT
Phone: +353 1 475 8000
Email: dublin@newstaram.com

INTERNATIONAL DEALING AND
ADMINISTRATION
Phone: +353 1 853 8732
Fax: +353 1 853 8536

Fund manager profiles

Chris Burling

Chris Burling is head of Japan equities at New Star and manager of the New Star Japan Recovery Fund. Chris has 25 years' investment experience, including over 11 years investing in Japanese equities. Prior to joining New Star in 2006, Chris was a fund manager at Gartmore Investment for over 13 years. In addition to Japan, his experience includes investing in North American and Asia excluding Japan equity markets. Chris lived and worked in Tokyo in 2000. He holds a BA Honours degree in Economics and Econometrics from Nottingham University.

Andrew Gibbs

Andrew began his career managing Japanese and Asian portfolios at Manulife in London. From 1993 to 2001 he managed Asian excluding Japan accounts and Eastern European investments for Carlson in Hong Kong and London. In 2001 Andrew moved to Quaestor, where he managed a Japanese equity market neutral fund. In 2002, he joined Pavilion, where he managed pan-Asian accounts and in July 2004, he joined the New Star Japanese team to manage institutional accounts. He holds a BA Honours degree in history from Cambridge University.

Fund aim

To seek long-term capital growth, principally through investment in the securities of Japanese companies.

Investment style

In managing the New Star Japan Recovery Fund, Chris Burling and Andrew Gibbs operate a bottom-up investment approach to identify growth and recovery prospects within the Japanese market.

The team believes that the Japanese market is full of pricing anomalies. Proprietary research is used to seek out companies that offer the greatest potential for capital gain. Careful fundamental analysis produces a portfolio of about 50 to 60 stocks – the stocks the fund managers are most convinced will outperform.

Supporting the fund managers

The managers have access to other Asian specialists at New Star as well as the global equity and fixed income specialists, all of whom work in close proximity. Drawing on the talent within New Star allows them to monitor external developments, global capital flows, market trends and investment themes.

Investment process

Chris and Andrew follow a five-step investment process:

1. Narrow the stock universe to 250 companies
2. Undertake fundamental analysis to explore valuations and prospects
3. Identify catalysts for medium-term performance
4. Select the stocks with greatest 'breakout' potential
5. Employ risk controls to determine the final composition

Active management is crucial in today's Japanese environment

Blue chip exporting companies, such as Canon, provided some of the few successful investment opportunities during Japan's long bear market between 1990 and 2003. The challenging economic conditions of this period forced corporate Japan into considerable reform and this resulted in significant improvements in profitability, both in export-led industries and domestic-focused companies. Much of this reform so far, has been unreported.

Business practices were reformed in a number of ways, including extensive cost cutting, as implemented at Nissan; debt repayment, as undertaken by Mitsubishi UFJ; corporate realignment, as seen at Matsushita Electric; product innovation, as achieved at Teijin; and improvements in corporate governance, as put into place by Japan Tobacco.

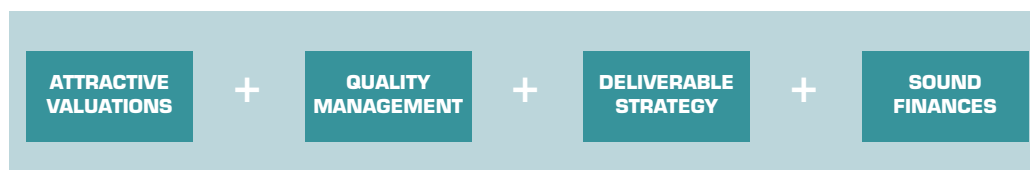
The years of reform led to a streamlining of business practices and balance sheets for many companies and there have been notable gains in the Japanese market since 2003. Extensive opportunities, however, remain for further improvements in productivity. The fund managers of the New Star Japan Recovery Fund actively seek out these opportunities and invest in the companies that they believe are best placed to benefit from these growth and recovery trends.

Step one: initial screening – narrow the stock universe to 250 companies

The Japanese stock market comprises more than 2,000 companies, many of which are under researched by the major brokerage houses. The fund managers at New Star carry out an initial filtering process to narrow the universe down to about 250 companies. These stocks are selected based on a range of key criteria, including balance sheet strength, liquidity conditions and growth potential. This is the first stage in the process of extensive fundamental research and produces a pool of companies from which the final 50 to 60 stocks are selected.

Step two: fundamental analysis to explore valuations and prospects

Fundamental analysis is at the core of the team's investment process. The pool of 250 stocks that initially demonstrate attractive qualities are subjected to rigorous analysis. This allows the fund managers to build up a picture of the company and assess whether its strategy is likely to deliver good returns. An analysis of the growth and return drivers within the relevant industry is also undertaken to help determine the competitive pressures effecting the company. In addition, the Japanese team looks at valuations, the quality of management, the viability of the business strategy and the quality of a company's finances. Ideally, the company should score well on all factors although it is possible for weakness in one factor to be compensated by strength in another. Indeed, it may be that the perceived weakness is not contributing to the stock's under-valuation but that catalysts exist that can alleviate this and drive the share price higher.



Attractive valuations

The starting point for Chris and Andrew is to value potential stocks using traditional accounting ratios such as earnings and cashflow ratios. They also use Economic Value Added (EVA)[®] * analysis to evaluate companies. This analysis restates the accounts to determine the true return the company is achieving from its capital to reveal whether it is creating or destroying value for its shareholders.

This method of analysis is also useful in adjusting for creative accounting and ensuring that all off-balance sheet items are included. The magnitude of returns and, importantly, whether they are rising or falling, is, according to Chris and Andrew, a more accurate guide to a company's earnings potential and the abilities of its management than traditional analysis that focuses mostly on stated sales and profits. This EVA[®] -based approach has helped the managers to identify ahead of the market a number of big corporate turnaround situations.

*Economic Value Added and EVA[®] are trademarks of Stern Stewart & Co.

Quality management

Management is almost always crucial in converting a business strategy into value for shareholders. This is particularly important in a country where corporate reform is a necessary ingredient of success. New Star's Japan team regularly speak to and meet with company executives and typically will come into contact with more than 400 company management teams each year. They are particularly interested in management teams that have proved themselves and are committed to delivering enhanced returns for shareholders. Ordinarily, this will involve improving the cashflow and using this to raise dividends or carry out share buy-backs. This may require a forward-looking incumbent management team or outsiders prepared to take difficult decisions and make vital changes.

Deliverable strategy

Companies are expected to demonstrate that they have an achievable plan to deliver returns above their cost of capital. A company's business model, the future of the market in which it operates and the level of competition are the main determinants.

Sound finances

Companies with sound finances are favoured. Balance sheet strength is the solid foundation on which improved performance can be built. Although financially distressed companies can be turned around, the risk is lessened if an under-performer is soundly financed at the start of the restructuring process. Careful analysis of the accounts can reveal companies with the potential to restructure successfully.

Step three: identify catalysts for medium-term performance

A company may have intrinsic value but it often requires a trigger to unlock that value and trigger a share price rise. Chris and Andrew have identified six factors that can contribute to a company turn around:

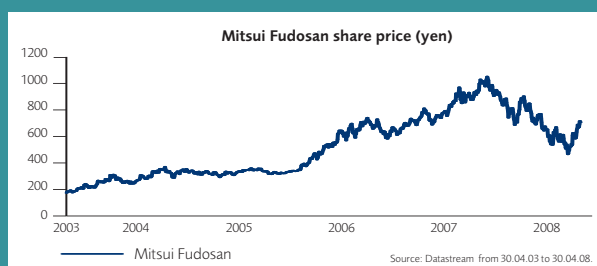
- Management change – the arrival of new management committed to driving strategy and implementing difficult decisions often leads to improved performance.
- Ownership change – this can spur transformation because new owners tend not to be burdened by sentimentalism and can admit past mistakes without losing face.
- Foreign investment – beyond financial support, overseas links and synergies, this often leads to the introduction of new techniques and working practices that can transform a company.
- Restructuring – signs of change such as moves to cut costs or the introduction of a cost reduction programme indicate the commitment of a management to improving returns.
- Business model – A renewed focus by management on core business areas and expertise redirects resources to areas where the company has competitive advantage.
- Corporate governance – the alignment of management interests with shareholder interests can result in improved returns through activities such as share buy-backs.

Step four: select the stocks with greatest 'breakout' potential

Once the catalyst for raising returns has been identified, the Japanese team attempts to discover how much a company's prospects will be improved and the degree to which such anticipated improvements are already reflected in its current market valuation. Technical analysis, although not a principal factor in investment decisions, is used by the managers to optimise the timing of trades and thus can help to maximise returns. The managers look at technical data such as moving averages, volume movements and trend lines. Through such analysis they hope to buy positions at the optimal point and, equally importantly, to reduce holdings when share prices become overstretched.

Mitsui Fudosan

Mitsui Fudosan is an example of an attractive stock within the fund. It is one of Japan's premier real estate companies specialising in the development, sales and leasing of property across the country. After fifteen years of land price deflation, Japan is undergoing inflation of real estate assets. This is most evident in office property in central Tokyo but is also occurring across the whole country – not only in prices but in the volume of transactions. This appears to be the start of a long term revaluation of Japanese assets and Mitsui Fudosan is well placed to be a major beneficiary.



Sector allocation

Sector allocation is a function of stock selection. The need for change in Japan often means that restructuring in one company can lead to restructuring by others in the same sector as they begin to appreciate the improvements being made by their competitor and the need to respond to them. This can produce wholesale improvements across an entire sector, with consequent effects on profitability and returns to shareholders, a phenomenon from which Chris and Andrew aim to benefit. Conversely, the fund managers are content to avoid sectors entirely if they deem them to be fundamentally unprofitable.

Step five: employ risk controls to determine the final composition

Risk control is a key component of the investment process.

Size limits

The fund adheres to UCITS III rules relating to size limits on individual stock holdings within the portfolio and the percentage of the issued capital held in any one company. The fund follows strict size limits on individual shareholdings within the portfolio and the level of issued capital held in any one company. The liquidity in the company's shares will be considered before an investment decision.

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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 relevant prospectus. Any opinions expressed in this document may vary without prior notice and do not constitute investment advice.

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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 New Star Global Investment Funds PLC (the Fund), of which New Star Japan Recovery is a sub fund, is regulated by the Irish Financial Services Regulatory Authority (Irish Financial Regulator).

The Manager of the Fund, 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 Authority, 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 Banca d'Italia. Fortis Foreign Fund Services Ltd., Rennweg 57, PO. Box 8021, Zurich 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 funds are registered.

For your protection, calls are recorded and may be monitored.

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Strong sell policy

The fund managers are ruthless in cutting losses in poor performers. The wider Japanese market had stagnated for more than a decade so it is important to be unemotional about individual stocks.

Stock-driven process

By operating a bottom-up approach to stock selection, the managers concentrate on the stock fundamentals in detail and look for companies that are likely to raise returns regardless of the macro-economic environment.

Attribution analysis

Performance attribution analysis allows the fund managers to understand the performance of the fund at the stock and sector level. Risk forecasting and style decomposition provide more information to assist them in ensuring that they are not taking unintended risks. Such analysis also provides senior managers and clients with confidence that the fund managers are adhering to the fund's investment objective.

Currency risk

The fund managers typically do not hedge the yen exposure of the underlying assets but reserve the right to do so should they feel the need.

New Star risk framework

Detailed below are New Star's internal controls, which provide an added layer of risk control for investors. The internal controls 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 checklist stating that the risk parameters have been met, fund objectives adhered to and any breaches reported