



# INVESTMENT PROCESS

## NEW STAR UK DYNAMIC FUND



Edward Collins

- Performance driven by bottom-up stock selection with a macro-economic overlay
- Stock-picking fund with a growth bias
- Focus on high-quality companies with improving underlying circumstances
- Not benchmark constrained
- Relatively diversified portfolio of 50-70 stocks

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### Fund manager

Edward Collins joined New Star in 2002. He worked as assistant fund manager on the New Star Select Opportunities Fund with Patrick Evershed for three years before taking over management of the New Star UK Dynamic Fund in February 2006.

### Fund approach

The Dublin-domiciled New Star UK Dynamic Fund offers a relatively diversified portfolio composed of companies either located in the UK or deriving a preponderant part of their income from the UK. Edward's aim is to generate outperformance through active stock selection reinforced by macro-economic views. The New Star UK Dynamic Fund focuses on absolute returns as opposed to trying to beat a benchmark, leaving it free to deviate significantly from index weightings.

### Investment style

Edward typically targets good-quality companies that are improving their returns faster than their peers and have high and improving profit margins. This gives the fund a growth bias. The fund holds a relatively diversified portfolio of 50-70 actively-managed stocks. While there is a bias towards larger companies as the fund's core holdings, Edward seeks to add further value through buying medium-sized companies and special situation smaller companies. In market capitalisation terms, the fund typically has about 60% of its assets in larger companies with the rest spread roughly equally between small and medium-sized companies.

### Investment process

Edward looks for anomalies across all sectors and within the market capitalisation spectrum. He employs the following process to assess whether companies should be included within the portfolio, monitored or disregarded as unsuitable.

- The UK market is analysed to identify initial opportunities at a sector and company level.
- A macro-economic overlay is applied to determine sustainability of profits.
- A 'five-pillar' investing approach is used to assess company prospects and filter for the most compelling opportunities.
- Share prices and valuations are tested.
- Suitable companies are added to the portfolio.

### Step one:

**The UK market is analysed to identify initial opportunities at a sector and company level.**

Edward constantly monitors the UK market for investment opportunities. He uses his own research combined with technical analysis from systems such as HOLT<sup>TM1</sup> and Quest<sup>TM2</sup> for cashflow and returns analysis to identify undervalued companies that have good growth prospects. In monitoring larger companies, Edward particularly seeks instances where an acquisition or other management action may lead to a stock trading on a higher rating relative to its peers. Valuation discrepancies are particularly sought within sectors and companies that have above-average growth prospects.

In addition, Edward turns to outside research from investment bank analysts to identify opportunities among small and medium-sized companies. As a result of experience gained from investing in smaller companies while working as assistant fund manager to Patrick Evershed, Edward has developed expertise in finding special situation opportunities to complement his larger company holdings.

<sup>1</sup> HOLT<sup>TM</sup> is a corporate performance and valuation advisory service of Credit Suisse.

<sup>2</sup> Quest<sup>TM</sup> is Collins Stewart's proprietary brand of on-line share valuation models.

## Step two:

### A macro-economic overlay is applied to determine sustainability of profits

Edward places great emphasis on economics and does not like to invest against the cycle. He uses economic analysis as a top-down sector and stock filtering tool to maximise the fund's exposure to growing companies that are well positioned in the cycle. Edward forms his own macro views but also benefits from the insights of Simon Ward, New Star's chief economist and strategist, and Gregor Logan, New Star's joint chief investment officer.

## Step three:

### A five-pillar process is used to assess company prospects and filter for the most compelling opportunities

Those stocks that are identified for further analysis have to meet the strict criteria listed in Edward's 'five-pillar' investing approach shown below. This filters for companies with identifiable business strategies that should deliver sustainable revenue growth, strong margins and sustainable cashflows.

The 'five-pillar' investing approach	
<b>Pillar one: strategy</b>	Edward seeks companies that have clear and identifiable business strategies; that deliver or are developing strong products; and that have defensible business models that can generate robust earnings.
<b>Pillar two: sustainable revenue growth</b>	Such companies should be operating in or moving into strong growth markets; they should have strong market positions because this leads to faster growth and higher profit margins; they should also have a strong focus on innovation to drive future growth.
<b>Pillar three: margins</b>	Potential portfolio stocks should have operational leverage, enabling them to grow their margins, with managements having a constant focus on input costs and operational efficiencies.
<b>Pillar four: cash</b>	Edward targets companies with improving cashflows and those that improve their returns to shareholders by distributing excess cash.
<b>Pillar five: management</b>	The fund's focus is on strong corporate managers with proven track records. They should be able to demonstrate that they can improve operational performance and instill a culture in their companies in which dynamism and innovation are encouraged.

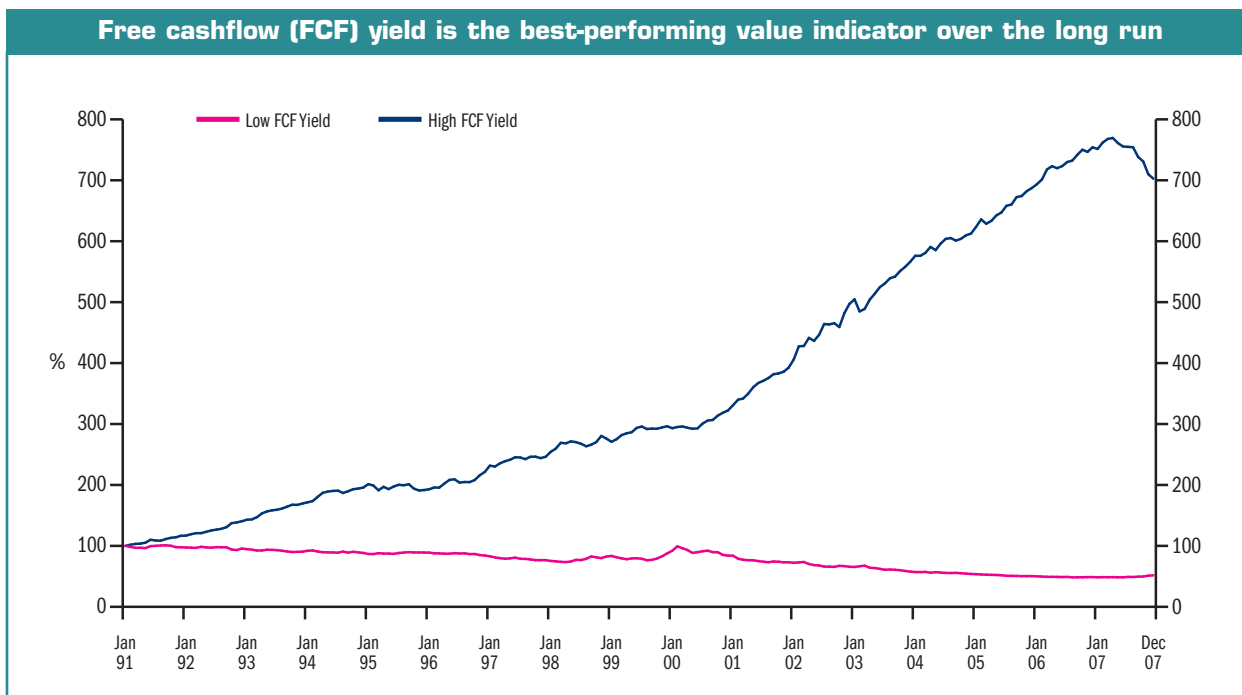
Edward believes that good management is crucial if a company is going to realise its potential and he undertakes approximately 300 management meetings a year. A company with sound management that matches the criteria listed in the 'five-pillar' investing approach should, Edward believes, grow faster than its peers, and thus potentially attain a premium rating.

## Step four:

### Share prices and valuations are tested

Once a share has met the fund's selection criteria, its price and valuation are monitored and tested so that Edward can identify an attractive buying opportunity. The quality of profits and how they have been produced are studied so an appropriate rating for the stock can be determined. This is then compared to the sector and the wider market. Edward's intention is to spot anomalies and avoid over-priced companies.

Cashflow yields and dividends are also analysed. Companies with high free cashflow yields have typically outperformed those with low free cashflow yields in the past, as shown in the chart overleaf, and Edward believes such trends will be sustained in the future and, therefore, he favours their inclusion in his portfolio.



Source: Credit Suisse, at 31.12.2007.

**% of times high FCF stocks have outperformed the market**

Period	Since Jan 1991	Last 5 years	Last 10 years	Last 15 years
Monthly	77%	80%	75%	76%
Quarterly	82%	90%	80%	80%
Annual	81%	100%	80%	80%

Source: Credit Suisse, at 31.12.2007.

## Step five:

### Suitable companies are added to the portfolio

Larger companies typically have higher individual weightings within the fund. When larger company holdings are bought, the purchase is typically made in two or three tranches, generally starting with an investment of no more than 1.5% of the overall portfolio. The fund's holdings are added to when Edward is optimistic about a company's prospects relative to its rating. A holding may also be increased during periods of market volatility or when the stock is out of favour among investors generally. This may allow the fund to take advantage of a lower entry point. If a core holding is looking over-valued profits may be taken with a view to buying the shares back at a later date.

Shares in smaller companies are purchased in small amounts, and typically account for no more than 0.7% of the overall portfolio when the holdings are initiated. A weighting may be increased if Edward believes a stock has particularly positive prospects.

Larger companies are bought taking a one-year view of their prospects while smaller companies are reviewed on a shorter timescale because their businesses are inherently more risky.

## 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.

This document is for professional advisers, professional investors and other financial institutions only and should not be provided to or relied upon by private investors. This document should not be distributed to any third parties.

The New Star Global Investment Funds PLC (the Fund), of which the New Star UK Dynamic Fund is a sub-fund, should be viewed as an investment suitable only for investors who can fully evaluate and bear the risks involved. This document does not constitute an offer or solicitation to anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such offer or solicitation.

Details of where the sub-funds of the Fund are authorised for distribution are provided inside this document. Distribution of this document and the offering of shares in certain jurisdictions may be restricted and accordingly persons into whose possession this document comes are required to inform themselves about and to observe such restrictions. If this is the case, these funds cannot be the subject of active marketing in your jurisdiction. Full details of the Fund can be found in the prospectus or, in the case of Hong Kong, the offering document. 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 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.

Fortis Foreign Fund Services AG, 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 Fund is registered. Issued by New Star Asset Management (Bermuda) Limited.

## Sell discipline

Edward believes a strong sell discipline is crucial to the performance of the fund and he takes an unforgiving view of companies that start to underperform. He will consider selling shares in a company that no longer meets the criteria of the 'five-pillar' investing approach. Companies that start to deviate from their business models are also a cause for concern. Edward regularly monitors all stocks within the portfolio and regularly reassesses each investment case. He will seek to take profits or sell a holding completely if the investment case deteriorates or if he identifies better opportunities elsewhere. While Edward is able to act quickly to sell a stock if required, the investment approach has at its heart the identification of good-quality growth companies that can be bought and held for the long term.

## Risk

Edward actively monitors sector and market risk but is not bound by benchmark constraints. The fund uses the FTSE All-Share Index for comparative performance purposes only. The tracking error and volatility of the fund tend to be low compared to the wider market. This is largely due to the stabilising effect of the fund's holdings in larger companies.

## Portfolio attribution & investment risk

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. Portfolio attribution analysis, ex-ante risk and style decomposition is performed in relation to the FTSE All-Share Total Return Index. Performance attribution analysis allows the fund managers to understand the performance of the fund at a stock, sector and country level. Risk forecasting and style decomposition provide more information to assist the fund managers in ensuring that they are not taking unintended risks. They also provide senior managers and clients with assurances that the fund managers are adhering to the investment objective of the fund.

## 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 standard.

### 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