



Presenters

- Mark Harris (head of funds of funds)
- Jon Hodesdon (fund of funds sales director)

Operator: Thank you for standing by and welcome to the New Star teleconference on the Tactical Portfolio. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session at which time if you wish to ask a question you will need to press *1 on your telephone. I must advise you this conference is being recorded today, Tuesday 24 June 2008.

Before we start I would like to make you aware that the opinions expressed here represent the views of the Fund Manager at the time of preparation and should not be interpreted as investment advice, past performance is not necessarily a guide to future performance, due to the live nature of teleconferences not all figures may be correct, for up to date performance figures please visit the [New Star website fund centre](#) for the latest factsheets. New Star Asset Management is authorised and regulated by the Financial Services Authority. I would now like to hand the conference over to your host Jon Hodesdon. Please go ahead sir.

Jon Hodesdon: Good morning ladies and gentlemen. My name is Jon Hodesdon and I am responsible for distribution of the New Star Fund of Funds range. I am delighted to welcome you today to your conference call with Mark Harris, head of our fund of funds investment team. Mark and the team manage New Star's comprehensive range of eight funds of funds and, at the end of May 2008, I am pleased to report that five of the eight funds are in the top quartile rankings with four of them top decile since launch. In fact, two of them are actually number one within their sectors. I thought today we would try and focus on some of the more topical questions that have been submitted prior to this conference call and to get into some greater detail for the New Star Tactical Portfolio which again has produced top decile returns over three and five years and since launch and is top quartile over the last year.

As a bit of background information before we start, I thought I would remind you that the Tactical Portfolio was originally launched back in December 2000 as a fairly straightforward global fund of funds, based in the global growth sector, managed in the same way as our other funds of funds. However, Mark changed the mandate and

investment process for this fund in 2004 – ironically, changing it after the fund had enjoyed an exceptionally strong year in 2003, in fact a top decile year where returns were over 30%. There were a variety of reasons behind the change. Notably that one of our other funds, the Active Portfolio Fund, had also enjoyed very strong returns that year from a similar process. Mark, therefore, decided that, rather than having two similar funds with similar risk profiles, similar performance objectives; he would like to create a very different fund, a fund that could take far greater advantage of tactical asset allocation i.e. in Bull markets it might be much more active and aggressive in the position in funds held and in Bear markets, far more defensive. It would also be a fund that was very much a “best ideas” fund with no restrictions on geography, a fund that had a total return mindset.

Mark also wanted to create a fund focusing on tactical asset allocation using all of the multi-asset classes available that could be actively managed. Hence the name - Tactical. As a more focused fund that can take these very active positions, I should also say that it is effectively our highest risk fund and we position it that way. We made the changes and it is now a very different fund. However, I am very pleased to report that over the last three years, the global growth sectors returned just under 11% per annum and Tactical returned well over 17% per annum, so hopefully it has worked pretty well and it is listed top decile for the end of May.

So, Mark if I can, what is the investment process you would opt for the range of five managed funds? How does Tactical differ in terms of performance and risk objectives?

Mark Harris: Right thank you Jon and good morning to everyone and thank you for taking your time out to listen to me. Just to remind everyone Tactical is as Jon said probably perceived as our highest risk fund, because it is a concentrated portfolio of our best ideas. As you know, our investment process relies on two main constructs: detailed fund research of which I won't go into all the where's and why for's today, but the other important element is strategy. Strategy really is thinking about what are the drivers of asset prices in the markets, where are the anomalies and where can we see potential rewards in the future. And to draw on that we have to look at many unloved areas of the markets, which we can see potential for change. We have to use a lot of independent research. In fact our independent research budget is, I think, now knocking on the doors of nearly \$400,000 per annum and it is money well spent, believe it or not. As always we had in mind the best sources of future return.

So, how does Tactical differ from the other funds? Really Tactical is a global mandate, totally unrestricted by risk and by geographic representation. I have regard to risk - obviously I run it through all our risk engines. I am aware of the risks within the portfolios, but obviously we can take very concentrated positions in quite unusual assets and, in

particular, you will have seen that we have been very, very heavily overweight. Asia last year and we are building up quite big positions once again in a number of commodities which we will speak of later.

But Tactical's primary difference is that it is driven by strategy, asset allocation first and foremost - that's where we add the value and that's why the returns can be more variable and much more volatile as you have no doubt witnessed. Now just to say I have got money in this fund a lot of my own money in this fund, so I have to live and bear with the performance with everyone else. So when I am having a tough time, I feel it in my pocket.

Jon Hodesdon: Excellent thank you. Mark, you appear to be fully embracing multi-asset investing and since the advent of the NURS rules the investment opportunities available have further widened. Can you talk a little bit about what you can invest in and touch on the product structures available?

Mark Harris: Okay yes, sure. NURS has been a godsend really to us, because Tactical was a pretty adventurous portfolio. We did take big positions in funds, but just to go through it, NURS rules - what does that actually mean to us? Well, now we can look at just about every asset class, so we can look at equities, fixed interest, property, commodities, private equity, currency and indeed cash management, and we can do that via a wide range of investment instruments. So not only can we use the old unit trust - OEICs, but we can now use investment trust, exchange traded funds, exchange traded commodities, hedge funds, we can use derivatives and we can actually now, one of the things that you will perhaps have seen, is we occasionally use these instruments to short markets, i.e. benefit for markets going downwards, and that has been a major change, but at the heart of it obviously what I am trying to do is capture the big themes that are out there and benefit from those.

Jon Hodesdon: Mark there has been an increase in the use of ETFs by you and the team - would you like to comment on the uses and benefits of ETFs, ETCs and what you have been invested in lately?

Mark Harris: Okay Jon. Well there are two main benefits of using exchange traded funds. Number one, liquidity. We can come and go as we please, very easily, there are no real restrictions on the liquidity; and secondly it has reduced our overall expenses so that our total expense ratios have come closer to two from being up around 2.5 mark on average, I won't say specifics. But more than anything, it has opened up a whole new range of asset classes for us and as I say earlier this year, just to give you an example, in the early sell-off in late January through to February, we were looking and bought what was a short on the Chinese indices and a short position on the emerging markets, and I think at the peak, that represented about 10% of our exposure for Tactical and we made

something like 13% profit in four days by shorting the Chinese indices, and we made 22% profit over 15 days by shorting the emerging markets indices, so that really held the fund up in good stead in that initial sell-off.

Jon Hodesdon: In my intro I have touched on the performance of Tactical over the last few years. It is currently top decile over the last five years and since launch. Mark, have you achieved this excellent performance over those last few years that have been very different years?

Mark Harris: Jon is being very kind to me and obviously that's a marketing ploy and I think you will really like this fund. All I do is set out and try and make money in any given year and we try our best for you. As I say, I vote with my feet. My money is in this fund, so I want to do well, but I think what we have done is independent thinking as a team in New Star and New Star has been a great place to do that - all credit to the company for allowing us the freedom to operate in this fashion and obviously we are very aware of all the risks that we are running; but what I have got to say is we have managed to buy a lot of...capture a lot of the themes that are in the market place, by thinking about what is the environment looking like, what are the asset price drivers, what is going to reward in future and sometimes we have got that wrong, sometimes we have been a little early, but when we have managed to get that, we really put in big positions, very high conviction positions. We had over 30% in China in the run-up, we have had 10/15% in gold, we have had similar positions in energy, emerging markets; at the start of this year we bought US house builders and we put what 9% nearly 10 in that. These are very high conviction positions and obviously that does come along with a bit of risk; but what I would say is our asset allocation has done very well. We have benefited from the resurgence of emerging markets and we have also captured the themes of commodities, energy and all the countries that benefit from all these price increases.

Jon Hodesdon: So, in light of the high volatility and uncertain market conditions this year can I ask what actions you have taken since the start of the year for the fund of funds range in general, and specifically for Tactical?

Mark Harris: This year has been extremely testing and I think I stood up after about three or four months into the year and said it feels like a year has passed already because we have done so much and that's just carried on really; so to talk about all the activity is quite difficult because we have done so much. To give you a feel, early in January we raised the best part of 25% cash for this portfolio because we felt that there was going to be a correction in markets. As I said, we have put 10% of that cash to work by shorting markets, so by February we were doing very nicely and we had held up very well.

When the March lows came in, we unfortunately thought that markets were recognising that there had been almost a panic with Bear Stearns and I am afraid we started entering into risk trade such as China and India and put money back to work about a week early and that cost us in all of a week, nearly 2% of performance which was an expensive mistake for which I can only apologise. But we carried on and the balance, which we have captured. We got from 20%+ cash we put all of that money in at or around the lows, we bought a number of cyclicals as I have said, we bought some commodities, we bought US home builders, we bought China, we bought India, we bought Turkey and all of those rallied very, very well.

We took some of that money off and by May we were feeling that markets had rather overstretched themselves and become over bought again. What we did is something quite unusual in that we shorted FTSE futures and we took a short on those about 10%, even though we had no underlying UK exposure and we are allowed to do that. This fund is allowed to speculate and we also raised a little bit of cash, but mainly the position was taken by a short in FTSE futures and we thought that FTSE has become a much more volatile market now and so it has proved to be. I think the market is off something like 12% from its highs. But I have got to say that we yet again underestimated how far this market would go down and we did sell all of our US house builders and we have actually made profits on those. We had a very small position in US financials - we sold that and we also sold a great deal of the China and India positions. What we did do is buy soft commodities such as Soya beans and wheat and I have also introduced a few other interesting positions that we're just in the current position of building up.

What can I say? In the round we have taken a lot of action. I think, in brutal honesty, we put a little bit of money back to work a bit early, earlier in the year in March and we have underestimated a little bit the market setback right now. All of that, I am afraid, has led to a slightly disappointing performance.

Jon Hodesdon: That is very honest, thank you. Mark, I think most people would be interested in your views just going forwards now, let's say the next six or twelve months. Could you give us an idea of what you think the prospects are for the remainder of the year and, I suppose, are you pessimistic or optimistic?

Mark Harris: Yes it is always, I think from the start of this year we said, look it is going to be a tough year, but don't expect huge returns, but we think the second half of this year could be quite rewarding and that we felt that the US was unlikely to go into anything that looked like a deep recession. We are still of that view and it is interesting that US leading indicators are now turning up and the Fed almost is sort of advocating those kind of raised rates. I don't actually think they will do, but that's another argument. But I have got to say, I might be foolish, but I am in the minority and I am still quite optimistic; what I can

see is that all the investor sentiment surveys are getting to extreme lows. There is a massive amount of pessimism. That is the over-arching sentiment in the markets and you might have seen that in the fund manager survey that was published in the FT late last week. And these levels are getting to quite extremes; I mean, we are looking at 2003 for the last time that we saw such levels. Valuations globally are not too bad, and interest rates are quite accommodative.

What I think is on everyone's mind and we did mention that this would be a recurring theme, is that inflation is coming back. Now I don't think right now it is quite as bad as most people imagine, but saying that, central banks have to be tough, because we can't let inflationary expectations get out of control. So that is quite an important point, but I do think if the markets can hold at or around these levels, i.e. re-test those March lows or at or around lows and move forward, we could see a much better second half to this year. Beyond that I must admit things are going to get tough again, because we've still got to go through the de-leveraging process that the financial system has created for us and that means that there are a number of second round effects that come out of the sub-prime crisis. But, in simple terms, I think the worst of the credit crisis has been seen.

Jon Hodesdon: Thank you very much Mark. I will take three questions - we have had a list of questions that have been submitted from the audience and then we will take some from the audience, but I will run through these that we have first. Robin Hurst of Eurosure asks, do you think you are too early returning to US house builders?

Mark Harris: Well it depends what you mean by too early; look this was a tactical trade, it was purchased on or around the market lows around 22 January and we have actually made money out of this, amazingly, and I have got to say that the instrument that we used XHB which is an ETF (exchange traded fund) - and that's about 35/40 US home builders - is back near the lows; but what I would say to you is we halved our holdings in mid May at a profit off the lows of about 23% and we don't hold any US home builders now. The straight answer to your question is - were we too early? If you look at the trade, no, because we made profit. If you are looking at the medium to long-term; are US home builders a great place to be right this second - probably not; but what I said back in January was an awful lot of the bad news is priced into the shares and I still think that is the case, but I do think we are going to see worsening conditions in the US housing market and for that matter in the UK housing market. I can't see that that was anything much more than a relief rally that we participated in. It's a good question and I think it is fair to say that would I go back and buy them right this second, the answer is no.

Jon Hodesdon: Chris Law of Meyado asked: "You have had exposure to iShares Brazil for sometime, how do you see Brazil's prospects over the next twelve months and will the

US going into recession have a large impact on this index and how do you see the currency?" I think that is about four questions to be honest.

Mark Harris: They are all good questions. Brazil is big constituent of Tactical now. Why buy Brazil in the first place? Simply, because it is one of the major beneficiary countries of what is going on in the world. You have got vast resources of soft commodities i.e. it's a producer of a major number of soft commodities including sugar and Soya beans. It has got hard commodities as well, as we have just seen in the news - if you look in the papers today you've got iron ore prices up something like 98% on the new contracts and obviously you got CVRD, major index constituent which is a prime beneficiary of this. Yet again we have now got Petrobras, which is an oil company; major constituent of the indices – something like 20 something per cent. I think I might be under doing it slightly there and they've had a number of major offshore oil finds and gas finds. All of this leads you to setting up what will be a virtuous circle for Brazil where they get trade surpluses; inflation is a little higher than they would like but it has come down from a very high level and is under reasonable control. They have got a strong currency because of this and they have paid down a lot of their debt. These are great things and Lula, who has been elected obviously for his second term, is very well aware of why he has been elected i.e. stability and growth. The markets have really liked that and obviously we saw Fitch's and Moody's and S&P upgrade, sorry I might be wrong with the Fitch's I think it is Moody's and S&P upgrade Brazil sovereign debt credit rating. All of these things are good for Brazil.

The problem is now simply that people are aware of that, so valuations have gone up somewhat to match that, but still you have got very, very strong earnings growth. For us, as long as they keep inflation under reasonable control, it still remains one of the prime beneficiary countries of all these trends. I think unless I see anything that would move against these trends I am likely to keep the position. The only thing as I say would be, simply, that just everyone keeps pushing the valuations up. The other thing I should say is, obviously, Brazil really hasn't got impacted by the US sub-prime crisis in any systemic way and, as I was saying earlier in conversation, I don't think any recession at this stage in the US is going to be that deep.

Jon Hodesdon: Final question I think really from the pre-sent questions. Andrew Graham asked: "How much further is the crisis for the banks got to go?"

Mark Harris: That is a good question and very topical because I think you might have seen last night David Costin of Goldman Sachs basically admit they have got it clearly wrong on financials. They decided to tell people to start putting money back into this area and obviously it's been disastrous. If you look at a chart of the S&P banks back in 1990 to 1991 the S&L crisis, everyone was saying, well this is the time where they should start

recovering. Indeed, I put 1 to 2% in the financials just in case, which I have taken out. I have got to say this looks like a much longer and drawn out cycle to rectify all the problems. There will be major winners in this and firms like JPMorgan obviously stand front and centre along with Goldman Sachs. But you've still got a number of housing problems that need to be worked out. You are going to get credit card problems and credit default problems, second round effects and all of this has got a long way to go. Plus, you have got to have a de-leveraging of the whole financial system that has been built up on leverage over the last, you could argue, seven or eight years, maybe longer. I think this could take two to three years to work out; but the point being I guess is, is all the bad news priced into these stocks?

Well, it doesn't look like it at the moment because you are still seeing impairments to their book value and what I do have a problem with seeing is, they have lost some of their critical sources of earnings growth. I am not sure how they replace those just right now. Equally, I do think you will see consolidation and it's interesting to see Clive Cowdery and Resolutions go to Bradford & Bingley along with TPG private equity. There is plenty going on there, but I am less inclined to take any positions there until I see some positive news come out of the sector, albeit there are some very stock specific opportunities starting to appear.

Jon Hodesdon: We would now like to give the opportunity to the audience to ask further questions. Operator, could you please open the line for questions?

Operator: If you wish to ask a question please press *1 on your telephone and wait for name to be announced. To cancel your request, please press the # key. Your first question comes from Helen Lupton, please ask your question.

Helen Lupton: Good morning gentleman. Firstly apologies on behalf of Ian Hemmingway of Lidlow; he has asked me to ask your views on gold moving forward as a commodity.

Jon Hodesdon: Thanks for the question.

Mark Harris: That is an excellent question actually, because you've seen my book obviously. As you know we have not held any gold recently and we have seen a stall of the gold price around the 900/850 area; but obviously it is becoming an issue again because we are seeing inflationary pressures build up in the global economy. It is my own belief that we might see a short-term setback in the physical price of gold, but if we do, I shall look to buy gold shares. Gold shares in my mind are looking very cheap relative to oil price and oil stocks, albeit that oil stocks in a global context are very cheap as well.

What we have done, literally yesterday, we took a very tentative step and just added half a percent back into the BlackRock Gold and General Fund; and I think what we are going to do over the course of the next few months is see how the gold price reacts and we will be looking to add to our position and start building that up to quite a significant position again. So, very simply, I think there could be a short-term setback on gold physical price, but the gold stocks are really pretty cheap in a global context and I think that we could make some pretty good gains out of these again; and I also like it because it's a hedge against the real crisis at a geo-political level and also a great inflationary hedge. Yes that is very topical and literally we just started taking action again.

Helen Lupton: Lovely, thank you very much.

Operator: Next question comes from Claire Milhench, please ask your question.

Claire Milhench: Hi I am calling from Thomson Investment Management News. I have quite a specific question. You talked about unloved sectors at the start, I am hearing a little bit about people looking at technology, digital communications stocks again; what do you think about that, do you think that is a reasonable bet, is it time to go back into that?

Mark Harris: That is a great question actually. I really struggle with that because what you can see globally is a lot of capex picking up and that would sort of incline you to think that people want to increase productivity once again. Use enhancements to their systems because obviously we have got some wage pressure out there. The problem is I can't really see it coming through in the earnings at the moment but I do think, I can't answer you directly as in – will I add right now, but it's a sector that we are watching like hawks for any sign of positive price news or higher price momentum coming back again; and if I was putting my head on the chopping block I think you might see that in late Q3.

Claire Milhench: Great, thanks very much.

Mark Harris: ...that we are going to have a look at it, but it's not an obvious play right this second. Every time it recovers it seems to falter again and you get the impression that investors don't quite believe it right now.

Operator: Next question comes from Roisin Duffy, please ask your question.

Andrew Roberts: It's actually Andrew Roberts from the Roberts Partnership. The latest geographical breakdown that I have seen which maybe out of date would indicate that you have little confidence in the United Kingdom market. Would that be a correct assessment of your current views?

Mark Harris: Can I answer that in a slightly wider context as well, because you have raised an important point. I think that at a headline indices level, the fact that the UK now is a very global indices and constitutes a lot of energy and material stocks sort of appeals. But I am afraid I think the UK consumer is facing a huge number of difficulties both in the amount of credit that they have outstanding and with the fact that the housing market is going through a very tough time which I think will continue and the fact that the Bank of England is really between a rock and hard place. I can't see that they can bring interest rates down. I think the UK is going to be a very narrow market in terms of leadership i.e. materials, energy and industrials related to infrastructure stocks and then very, very stock specific stories in between that. As a whole, what I can see is better opportunities elsewhere. I can't say I am wildly optimistic for the UK other than it does have a number of interesting stocks in key areas.

Really what I am looking for is going forwards, I think and I hope I am right here, is that market leadership continues on a very narrow base i.e. that I am afraid that the energy stocks, perhaps the gold stocks, the material stocks, infrastructure plays i.e. industrials around the world are going to remain the leaders; and as much as the contrarian in me looks at banks, financials and consumer discretionary stocks you can't see any real catalyst for those turning right now. Just in here what I am trying to do, I think if I am brutally honest with you, I over complicated the portfolio. I looked at a number of indirect plays on these themes because I wondered if they were getting a little overextended and these indirect plays have not rewarded at all. I have removed a lot of those and gone for very direct plays and that has been much, much more rewarding in the last month and the performance is starting to show through again and I am hoping that will continue. I have been very active in the portfolio, but once again to directly answer your question I personally don't like the UK that much.

Andrew Roberts: Thanks very much.

Jon Hodesdon: Take one more question – do we have any more questions operator?

Operator: Yes you have got one more question from Simon Wales, please ask your question.

Simon Wales: Good morning to you, thanks for your interesting information. I have recently taken some money out of Europe and you were talking about territories out of Europe and into emerging countries and Hong Kong and China. I was just wondering what your view on my reaction was?

Mark Harris: I have got to say Europe; I mean Trichet obviously made it very clear he is worried about inflation. He is going to look to put up interest rates and yet all the, well

just data coming out yesterday shows you that economic activity is slowing. I have got to say Europe is one of my least favoured destinations other than for some very, very specific plays and I think if you are looking at, if you have to hold Europe as we do in some of the portfolios, someone like Hugh Hendry over at Eclectica, his Continental European Fund is certainly worth thinking about. You have put money in China, that appeals on a contrarium basis. These stocks are cheap - long run it is going to be a winner but obviously they have got some short term problems to deal with.

I have one hesitation on China and that is simply a number of our models are starting to roll over and they are starting to tell me that you should be wary of a further correction in this market; and the thing that worries me there is simply that inflationary pressures continue to build and unless they float the currency that could create quite a number of internal problems for China and the Chinese market. I think external investors are looking for some positive catalyst before they commit any money to China. I like it long run, it's been a big theme, we have played it pretty well. I have probably stayed there a little bit too long. Long run I think what you have done will be rewarding, very short run – not entirely convinced but that one is open to debate.

Simon Wales: Thank you.

Jon Hodesdon: Operator, I think we would like to call it to a halt now. If anybody has any further questions they would like answered - if you would like to drop me an [email](#) at New Star we will get you an answer to any specific questions. I would like to thank everybody for their time this morning, it's much appreciated. Thank you for your support. I have just one little question myself Mark for you to close on: you mentioned you have got your own cash in it, is it true you have actually got your mother-in-law's cash in it?

Mark Harris: That one is going down well this year, I can tell you. Yes it is true Jon and I take the beatings for it. As I say I would just like to round up; please do remember that most of our funds are doing pretty well this year, they are in the second to top quartile; this fund because it is more extreme has suffered a little bit more. As I say I am hopeful of it returning, I have seen all this before, short-term performance is picking up, I have been very active, I have changed a lot of things and as I say I have taken some of the pain. I am really hopeful that I can have a good second half to this year and repay your faith for staying with us.

Jon Hodesdon: Thank you very much Mark, thank you very much everybody goodbye.

Operator: That does conclude our conference for today, thank you for participating you may now all disconnect.