INTEREST

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Hume Performance Commentary

It's been a reasonable start to 2012, with markets rebounding since the start of the year. Equities have risen 10.5% through to end April in their first best start to the year since 1998, while bond markets have been supported by persistent central bank accommodation.

Of the 12 bond, equity, and multi asset funds in the Hume stable, seven have beaten their benchmarks year to date.

We have made a number of changes to the investment management of the funds since being appointed to manage them over the course of the last 12 months. We have in particular repositioned the multi manager funds to fit a more precisely defined tactical asset allocation approach. In the equity funds we have restructured them to reflect more accurately the Hume style of investing in growth companies at attractive valuations. In the case of our bond funds, performance has started well in 2012 with three of our five funds outperforming their benchmarks.

Going forward, we are looking to emphasise the combination of discipline and flair that were the key factors behind our success at Northern Trust, while tapping into the strength and depth of resources of a highly experienced group of analysts and portfolio managers here at Hume.

We are confident that with the people we have here, our investment capability as well as the robust infrastructure we have taken on with the platforms we have built in 2011, we can now move to the next stage of our development.

It is pleasing that in a market that has made such a positive overall start to the year, our funds have broadly matched or bettered benchmark returns across our bond, equity and multi manager range.

Our vision is to build a first class investment management company with quality research capability, top class people and excellent customer service. However, it is the investment performance that is at the heart of any successful asset management firm and it is this that we were keen to address when we took this family of funds on during the course of 2011.

2012 has seen a good start but we still have some work to do to address the investment issues we inherited and to reposition the funds to more accurately reflect our approach. Once there, we are keen to build onto this platform industry leading standards of performance that will attract clients to invest in our funds.

Stephen Dowds
CIO

FUND	Month April FUND	Month April INDEX	3 months FUND	3 months INDEX	YTD 2012 FUND	YTD 2012 INDEX
International Bond	0.4	0.1	1.8	0.3	1.8	0.4
Alpha Bond	-1.3	-1.6	-2.3	-2.7	-2.4	-4.1
US Dollar Bond	-1.4	-1.1	-3.0	-2.8	-4.4	-4.0
European Bond	-1.9	-1.8	0.1	0.1	0.6	1.3
European High Income	-1.5	-1.8	2.6	0.1	5.6	1.3
Asian Equity Model	0.8	0.1	2.6	2.7	14.9	13.8
EU Growth Fund	-3.5	-3.8	-1.6	0.4	3.2	3.5
Global Opportunities	-2.8	-2.7	-0.2	1.9	6.1	6.0
International Growth	-2.3	-2.7	1.4	1.9	6.8	6.0
MM International Equity	-2.9	-2.7	1.4	2.3	4.9	5.8
MM US$ Balanced	-2.7	-1.4	-0.3	-0.6	2.0	1.0
MM European Balanced	-2.8	-2.3	0.1	-0.2	2.6	1.6
MM European Growth	-2.7	-3.4	0.9	1.2	4.3	4.5

This newsletter is a general commentary on markets and companies; it is not an invitation to make an investment nor is it intended as an offer or recommendation to buy or sell any financial instrument. Hume's views are at the time of writing and are subject to change.

INSIDE THIS ISSUE...

Hume Capital

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German Companies continue to power ahead

Germany is busy. I spent three days in Dusseldorf and Frankfurt seeing many of Germany's leading company managements. Trains are packed. Shops are full and surprisingly for a Monday evening in winter, it was difficult to get a table for dinner in downtown Frankfurt. Full employment and high savings are driving consumer spending and companies like tyre maker Continental and software maker SAP are hiring thousands of workers to keep up with demand. The infrastructure in Germany is world class with new runways at Frankfurt and the gleaming new Brandenburg airport at Berlin will have initial capacity designed to serve 30m people when it opens on 03 June this year.

I saw 25 CEO's and CFO's of many of Germany's leading companies and the message coming through loud and clear was just how confident German managements were about the outlook for 2012. Audi CFO Axel Strotbeck was saying deliveries were up 19% in 2011 following a 15% rise in 2010. Audi has built up a net cash position of EUR10bn and is building new plants in the US and China to meet demand for its products. Compare this to Peugeot which has managed to build up net debt of EUR20bn and the contrast could hardly be clearer. Werner Brandt, SAP CFO, was explaining how the new SAP software system, successor to the iconic R3 ERP system used in 300 out of the Fortune 500 companies, is now being sold successfully to millions of small and medium sized enterprises. Adidas CFO Robin Stalker was explaining how upbeat he is about 2012 prospects in a year of an Olympics and Euro 2012 football which will boost sales and profits to a record high. Finally, Bayer has got its pharmaceutical pipeline in a sweet spot with four US$1bn blockbuster drugs for treatments ranging from cancer to strokes.

I was also fortunate enough to spend some time with the MD's of several smaller companies whose businesses were booming around the world. Duerr and Elringklinger are global leaders in paint making machinery, auto engine cylinder heads, seals and gaskets and respectively. The key thing they pointed out was that in the high growth markets of China and India, with 400-500m aspiring consumers each, the demands for quality was rising fast too and heavily capital intensive practices such as car manufacturing was becoming highly automated. The number of competitors is coming down reduced as weaker ones fall away, leading the Germans and two or three others to come to dominate the market on the back of reliability and quality of products.

It's also worth pointing out that it's not all about exports. There's a lot happening in domestic Germany too. Germans spent US$77bn last year alone on holidays and 2012 will see a further probable rise of 3%. Thomas Cook's woes and the tragic accident off Italy of the Costa Conccordia means TUI will have a busy year for bookings and the stock is undervalued in our view on a price earnings ratio of 6 times. Meanwhile, world's number 3 lift maker and number 5 steel maker Thyssen is merging its stainless steel business with competitor Outokumpu to improve returns. Finally, Germany's leading cosmetics retailer Douglas is in the throes of being the target of a takeover by its largest shareholder. Average annual incomes of EUR43,000 and full employment makes for an enticing outlook for German retailers.

Of course, Germans know ultimately they will have to write a cheque to underwrite the euro-how large a cheque is pointless to speculate. Suffice to say, German people know it will be a sizeable. Hence, hard bargaining will continue throughout 2012 and most likely 2013 to force concessions out of other euro zone countries from Greece through Italy to France. These will involve greater deregulation, opening up of the single market to German companies and more rigorous budgetary discipline. Chancellor Angela Merkel and her ruling CDU party does not face new elections until autumn 2013 and is currently riding high in the polls. German equities are below their 2000 levels and yet their market positioning is improved, while sales and profits levels are higher. This makes for a powerful combination.

Stephen Watson
Portfolio Manager

A hard landing in China?

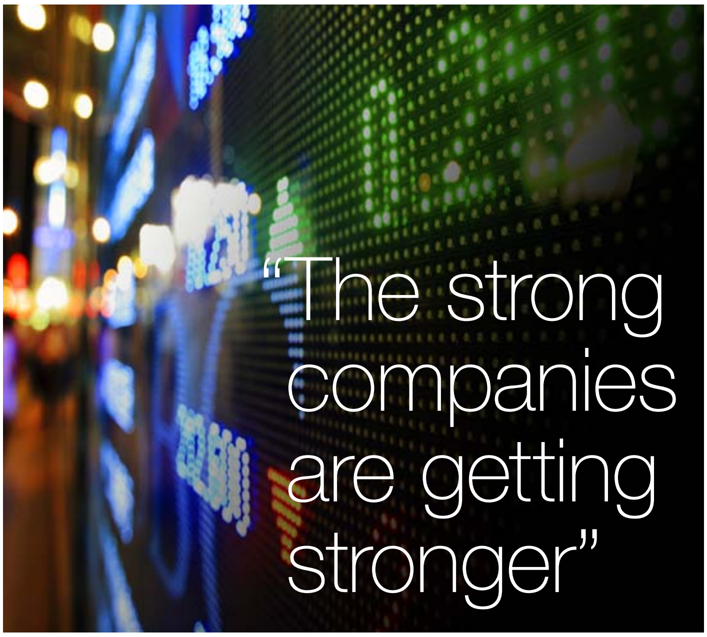
What would be the implications?

While in Hong Kong in Q1 we were attempting to gauge sentiment among businesses against a background of China's economic slow-down.

While we were there, new Chief Executive CY Leung was elected and being seen as a Beijing man, the concern we had was that he would come down hard on the Hong Kong property tycoons in favour of a campaign pledge to build more social housing in a cramped Hong Kong bursting at the seams.

On the economy, the overall message we are getting is that the slowdown in China is becoming quite marked. Chinese industrial profits have turned negative, down 5.2% year on year in Q1, while GDP estimates have been cut to 7.5% growth after the 9.5% growth rate in 2011.

While this is problematic in certain industries such as steel and related sectors like coal and iron ore, we believe the market is underestimating the growth engines in South East Asia (650m people with combined GDP of US$3trn), India and the booming Middle East and Russia (all growing at rates in excess of 4% in 2012) as well as the huge US$15trn US economy which is turning better and forecast to post a GDP growth rate of 2.5%-3% in 2012. Global nominal GDP will therefore likely grow at 6.5% in 2012, in line with historical averages, with the better mix of growth coming from outside China offsetting relative Chinese weakness.



The bankruptcy of Japanese DRAM manufacturer Elpida and record profits announced by US technology group Apple are two sides of the same coin and part of a notable feature that has emerged in recent years – namely, that many industries, whether in luxury goods, automobiles or aerospace, are becoming dominated by a small number of highly profitable companies. Think LVMH in luxury, VW in cars and Boeing and Rolls in aerospace, which, along with companies like Apple and Samsung in technology and Caterpillar in construction machinery, are succeeding in establishing a dominant global presence.

The flip side is the driving down of costs that are forcing uncompetitive suppliers like Elpida out of business. Strikes at Fox Conn, Bombardier's struggle to compete with the new generation of narrow bodied airliners, along with a desperate plan by Peugeot to sell a 7% stake to fellow struggler GM just shows the size of the challenge facing those not in the first tier. While such trends are hardly a new phenomenon in the context of capitalism's history, it is the sheer scale of the dominance today given the global reach and penetration by these winners into so many areas of people's lives that is so striking.

Trip to Seoul highlights Korea's impressive corporate outlook

We were in Seoul in March to meet with several CEO's and CFO's of some of the major quoted South Korean companies.

South Korea has been and continues to be a rich source of world class companies. Hard to believe, but South Korea is now the world's seventh largest exporter and a global force in industries from automobiles (Hyundai, KIA) and electronics (Samsung) and ran a current account surplus of US$26bn in 2011, or 2.5% of GDP.

We met with bosses of largest internet portal business NHN, national telecoms operator SK Telecom, construction machinery giant Doosan Infracore (owner of Bobcat), as well as major financial groups KB Financial and Samsung Life and Korea Development Bank, national refiner S-OIL, as well as meeting up with managers from the National Pensions Service.

Emblematic of how far the country has come in such short time is the forcing into bankruptcy of Japanese semi-conductor supplier Elpida such has been the strength of the Koreans in the Dram market as well as Korea National Oil's bid for El Paso's upstream assets in the US.

It's not all a bed of roses however. The on-going stand-off between North and South remains a feature of daily life. The two countries are still technically at war (the 1953 agreement to end hostilities is officially classified as a ceasefire), while the recent death of Kim Jong Il and his replacement by son Kim Jong Un has increased fears of instability on the Korean peninsula. Indeed while we were there Seoul hosted a regional security conference hosted by the South Korean Government and attracting heads of governments from around the world, including US President Barrack Obama.

Ultimately, South Korea's success has made it the largest economy in Asia ex Japan after China, impressive indeed for a population of 49 million people. The stock market has reflected this, the KOSPI index closing Q1 2012 at 2015, close to an all-time high. A rating of 20 times 2012 earnings however makes us guarded in the short term, even while positive drivers in the longer term we believe will underpin the market.

The Middle East, Africa and South East Asia are developing considerable momentum

2012 is turning out to be another year of significant change in Asia and the Middle East. Change in the Middle East and North Africa started last February in Tunisia, spreading quickly to Libya and Egypt, and is now starting to pervade other parts of the region east towards Syria and south to sub-Saharan Africa.

Change is coming fast too to Burma. The recent sweeping wins for Aung San Suu Kyi's National League for Democracy party on 01 April where they won 43 out of 45 seats contested has made it the official opposition party in Myanmar's parliament. The country used to be the world's largest producer of rice, and has in addition abundant resources of hydrocarbons. With a young and hard-working populations of 57m, change here could have a significantly positive impact on the region.

One final observation about Asia: the likely greater focus on equity income as a source of return. Asian equity and bond income will emerge as a major investment theme. In much the same way as income funds became popular in Western markets in the 1980's and 1990's, a similar trend we believe is underway in Asia as family owned businesses mature. Dividend payout ratios are likely to rise and income investors should see the benefits.

French Presidential Election 2012 and Impact on French Asset Prices

We believe that an important inflection point is approaching in French asset prices. The background is that French asset prices (bonds, equities, property) have performed extremely poorly versus both both European and global peers over the last one, three and ten year periods. For example, for much of the last three year period, French 10 year bond yields have been consistently 100 basis points over those of their British (gilts) and German (bunds) counterparts, yielding regularly over 3% whereas British and German bonds have been closer to 2%. A new year spat between UK Treasury Minister George Osborne and his French counterpart Francois Fillon was emblematic of this ill feeling between the two powers, Fillon claiming Britain doesn't deserve its own AAA rating and France's economic fundamentals were superior.

It has become accepted wisdom that France is now very much a second tier economic power versus its biggest two European neighbours, a 'fact' seemingly stamped by the authority of the ratings agency S&P when on 13 January it downgraded the sovereign debt of France.

With Socialist Francois Hollande elected as the first Socialist President since Francois Mitterand on 06 May, and pledged to introduce a wide ranging series of supposedly radical left wing policies, it seems France's place to lie down and accept genteel decline against the modernising British and German economies, far better suited to today's globalised world than the antediluvian French…

So goes the conventional wisdom, however…

We argue that on the contrary, French assets are at their cheapest in a generation and poised to enjoy a spell of strong performance. We are overweight French assets against benchmarks. French companies like Sanofi and Biomerieux lead the world in many segments of scientific innovation, such as diabetes and vaccines, their construction companies like Bouygues and Vinci are everywhere, their food and drink companies like Danone and Bongrain produce some of the best food, Accor is the world's largest hotels company, their luxury goods and cosmetics companies like LVMH and L'Oreal lead their industries, while even in dirty old industrials, global number one in vehicle tires to this day is a French company, Michelin. Finally, dividend yields of 5-8% are quite widely available in French blue chip stocks like AXA, France Telecom and Vivendi.

While it is true that Hollande's victory is the first time the left has won in France since 1995, Hollande's government is hardly being greeted with the shock the first Mitterand government of 1981 was met with when the French stock market fell 20% in two days, banks were nationalised and the franc collapsed as Mitterand's government dashed for growth against the prevailing economic orthodoxy of the time. While Hollande has pledged to renegotiate the EU's fiscal discipline treaty, to slap a 75% tax on the rich and to come down heavily on the banks, we believe that if elected, he will come to the table with a conciliatory line towards his counterparts in Berlin, the inexorable moves towards greater fiscal and political integration started by Germany in November 2011 will come to the fore and the bogeyman will be shut out of la maison!

The global Civil Aerospace Industry is booming

The boom goes on…one sector of the global economy that is in a no holds barred good old fashioned boom is the global civil aerospace industry. Both Boeing (increasing output a staggering 60%) and engine manufacturer Safran (creating 6,000 jobs in France) increased their guidance for the year following stronger than expected Q1 results. The July Farnborough air show will once again highlight the positively rude health the industry is in. The key reason-the airline industry is undergoing a new ordering cycle as powerful as any since the 1970's during the genesis of the long range airliner the Boeing 747 or Jumbo Jet as it came to be known. New airlines like Air China, Emirates, and Etihad are ordering several hundred long range jets, the B787 from Boeing and A350 and A380 from Airbus (sticker prices US$100-US$300m each) as these customers gear up to challenge the historical dominance of western carriers. Companies like GKN, Lisi and MTU Aero, Parker Hannifin, Rolls Royce, Safran and Toray Industries are generating enormous cash flows from such projects, creating jobs for thousands and profits for shareholders.

The Greek Financial Crisis-Coming to its inevitable conclusion?

After more than a year labouring through the 'Denial' stage, the Greek saga is reaching the denouement of the 'Bargaining' process this month, with Greece finally defaulting on its Greek-law private creditors and a credit event being declared. Incredibly, for all of the fanfare surrounding the 'landmark debt reduction', the simple fact remains that Greece now has more debt than at the start of the process, and almost all of it now of a character which any future - perhaps more democratically-minded – Greek government will find it almost impossible to declare odious and renege upon.

So what comes next? The Kübler-Ross model of coping with catastrophic loss suggests 'Depression' and it seems clear that this is exactly where Greece is headed. To torture the analogy further, we would posit that this will be followed by 'Anger', as Greek and other European citizens realise just how badly they have been served by their political masters, and finally 'Acceptance' as creditors concede that significant further losses are inescapable, not only in Greece, but in Portugal, Ireland and possibly Spain. The question only remains: how much more of these can be foisted upon an unwitting public? Watch this space…

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