SCEPTRE
INVESTMENT MANAGEMENT
7 Pembridge Place, London, W2 4XB

The fund aims to achieve excellent long-term investment returns by investing in undervalued listed European equities with a specific focus on the UK.

Chris Broadhurst, Fund Manager **Year ended 31 December 2008**
Luke Howard Taylor **Sceptre UK Fund**

Fellow Shareholders:

In 2008, the third full calendar year for the fund and the worst calendar performance of the stock market since 1931, the net asset value per share declined by 39.9% net of all fees to £734.04. As a reference to the general market performance over the same period the FTSE All-share index (TR) decreased by 29.9% over the year. The largest companies have fared better, with the FTSE100 only down 28.3%, the FTSE Smallcap index was down 43.9% and the FTSE250 down 38.2%. The fear and, at times, panic prevalent in the market has resulted in volatility reaching levels not seen on a sustained basis since the Great Depression.

Our own activities during the year have been less dramatic; the fund is now fully invested and has had minimal cash balances for most of 2008 and we end the year with 15 holdings and overlap of roughly two thirds on the closing 2007 portfolio. During the year we have attempted to take advantage of the high volatility in the market and average down our positions in our long-term core holdings, increasing the weighting of the fund in those businesses we believe have very strong franchises and will emerge from the downturn as stronger and generally with less competition and continue to produce good returns on our capital.

Our focus on individual fundamentals of the businesses we own and the many we watch means that we have at most times a feel for the general level of the market, as a function of the number of potential investments within our margin of safety that we would consider for inclusion in the fund. In a reminder of how quickly the market can swing from one extreme to the other we remind you what we said in last years letter *'The vicissitudes of the market will provide a varying number of undervalued opportunities to us and the first 6 months of 2007 was a period in which we found it increasingly difficult to identify quality businesses we could invest in at sufficiently low prices – as a result the fund saw its cash weighting increasing as the year progressed and peaked at 22% of assets in July.'* Whilst in hindsight it would appear that we were calling the market by keeping over a fifth of our assets in cash, our cash weighting is always driven by a function of available potential investments which we believe after thorough analysis fulfil the principal criteria of providing 'safety of our principal and an adequate return'. It should be noted therefore that whilst we run counter to the prevailing sentiment of most other market participants by being nearly 100% invested, this too is a function of the large number of opportunities we now see which meet this criteria. This is definitely the best environment for equity investment that we have seen in our careers.

Performance Summary

Year	NAV	Cumulative	FT All-Share	Cumulative
2005*	+ 7.8 %	+ 7.8 %	+ 4.2 %	+ 4.2 %
2006	+ 21.6	+ 31.1	+ 16.8	+ 21.7
2007	- 8.5	+ 20.0	+ 5.3	+ 28.2
2008	- 39.9	- 27.9	- 29.9	- 10.2
Annual Compounded Rate		- 9.5		- 3.2

* from 30 September 2005. After all fees, bid-to-bid with dividends reinvested.

As the depth of the economic slowdown became apparent various predictions and investment themes swung from the prevailing wisdom to the inverse position – decoupling of emerging markets became the weakness of export-led economies, inflationary fears and the peaking in commodity prices gave way to deflationary concerns and talk of fire-sale disposals by mining companies. The violent swings in market sentiment that accompanied these u-turns caught many funds (especially those employing leverage) off guard and further contributed to volatility. In the middle of the year we were preparing a research piece which we published in September where we outlined some of the particular reasons we believed investors in commodities and commodity-producing companies should be extremely concerned. In fact the phrases we used were '*the recent bull market in industrial metals has been the greatest seen in at least the last 100 years … this review is intended to demonstrate that commodity investment at the peak of a bull market can produce massive losses… and to give caution to investors in commodities when anticipating the losses which will occur when the next bear market in commodities arrives.'* At the time we did not realise quite how quick the falls would be or how imminent that collapse was. However, we have never been invested in the commodity sector and whilst this proved a drag on relative performance during the first half of the year (and in previous years) we did see some relative out performance result as the sector underwent a severe decline with some valuations falling 60%+ in a matter of months.

This year we have only changed 4 stocks in the portfolio and end the year with 15 names but have a much higher weighting in cyclical stocks and those that have been particularly heavily sold by off the market. In all cases we believe that their market position and cashflows will allow them to come through the recession and in many cases emerge with fewer competitors as these fall by the wayside.

Portfolio of the Sceptre UK Fund on 31 December 2008

Holding	% Assets	31 Dec 2007	Line of Business
Travis Perkins	16.1	11.6	DIY & builders merchant
JD Wetherspoon	15.9	6.5	Managed pub company
ASML	11.6	11.6	Semiconductor manufacturing equipment
RPC Group	9.3	6.5	Rigid plastic packaging manufacturer
Inchcape	7.4	-	International car dealerships
British Airways	7.1	4.6	Commercial airline
Nokia	5.9	-	Mobile phone manufacturer
Costain	4.9	4.4	Engineering contractor
Diploma	4.4	5.7	International parts supplier/distributor
Ashtead	3.7	-	Industrial rental equipment
Collins Stewart	3.4	-	Stockbroker & corporate finance house
Cambridge Silicon Radio	3.2	5.6	Bluetooth & wireless chip designer
Holidaybreak	3.0	3.3	Travel company
C&C Group	1.7	2.6	Alcoholic beverage group
Ideal Shopping Direct	1.4	3.7	TV shopping channel
Cash Reserves	0.9		
	100.0	66.1	

The NAV of the fund trailed the market in the second quarter when resource company valuations soared as commodity prices reached the top of their long bull market. Through July and August we recovered this underperformance before the months of September and October where the market was characterised by what we would describe as ‘panic selling’ and when the heavily weighted FTSE100 significantly outperformed the mid-cap and small cap indices. During this phase of high intra-day volatility it seems that many market participants were ‘going liquid’ – in many cases seemingly regardless of the valuation of the assets which were being sold. In some cases this process was driven by margin calls on highly leveraged entities, in others fear overtook greed and individuals rushed for the safety of government bonds (which as a consequence now appear to display signs of significant overvaluation), others opened several different bank accounts, worried about their savings or even rushed to purchase physical gold at record premium over the spot.

We are not ‘market timers’ and spent much of 2008 fully invested and moving weightings from undervalued stocks to even more undervalued stocks. Our comfort at this time is a strong belief in the economic cycle and that the painful but necessary reduction in capacity experienced during this period will result in recovery for the stronger businesses which remain. With overall stock market valuations (based on 10-year trailing earnings) at multi-decade lows we have been able to buy companies at fractions of their true through-the-cycle worth. As unleveraged investors we can patiently wait for the market to recognise these extremely low valuations.

Considerations on the size, fees and performance of the fund

It is not sufficient to identify and invest in excellent companies at good prices to achieve the performance that we seek to deliver to shareholders. We concentrate the assets of the fund into a much smaller number of securities than the typical investment fund. We also invest in a range of different sized companies; giving very little consideration to whether we are overweight the FTSE250 or SmallCap for example, our focus is ultimately on the discount at which a specific company trades to its intrinsic value. We do not consider that a smaller company is riskier than a larger company per se; we acknowledge and build into our valuations on a case-by-case basis the drawbacks of a lower credit rating or smaller number of customers for example. Market risk (or volatility) we see more as an opportunity than a factor affecting valuation, consistent with our belief that in the short-term the stock market is not efficient and is influenced by crowd mentality. However, from a liquidity perspective we are mindful of the size of positions which we can comfortably take in smaller capitalised companies, for this reason we have limited the size of the fund, after which point we will close to new investors. This will ensure that the performance of the fund is not sacrificed for the sake of accumulating assets under management. The performance fee structure of the fund aligns our interests; our reward comes from outperforming, not simply from in-line performance with a bigger pool of assets. We also have the majority of our own capital in the fund and investors can be confident that investment decisions are made with security of capital and maximisation of return as the overriding considerations.

Our trading activities are simple and infrequent; the fund is un-leveraged and has no restrictions on the proportion of cash that it may hold, although this will only rarely be a significant portion of assets. We principally invest directly in common stock, unless there is some significant anomaly which makes another form of security preferable (such as a preference share or convertible). We seek to maintain long-term holdings in the excellent businesses that we identify and aim not to 'trade' around these positions, we increase and reduce the weighting of a particular company in the portfolio based on upside to our assessment of its intrinsic value or if there are exceptional events which present short-term uncertainties. The maximum position size we would increase an individual company to is 20% of assets, although this would have to be an exceptional opportunity.

Communication with shareholders

Along with this annual summary letter to shareholders we publish monthly updates which are available electronically to all shareholders who wish to receive them. We also maintain a website, which has an archive of the monthly investor updates and a summary of the funds performance and strategy. On a monthly or quarterly basis the vicissitudes of stock market will have a much greater effect on the net asset value of the fund, but over a medium to long term horizon we expect our performance to more accurately reflect the advantages of our strategy. We calculate an estimate of the net asset value on a daily basis and publish this figure, for convenience, on the website. The official independent net asset value is agreed at the end of each month with the funds administrator and at the end of each month the fund will accept subscriptions and redemptions from investors.

Performance details

The funds official inception was 2nd May 2005 with an NAV of £1,000 per share, during the period of May-September the fund held large cash balances and establishment of the portfolio caused exceptional dealing costs which do not reflect the normal level to which the fund will be exposed. The first external investors in the Fund subscribed in October 2005.