

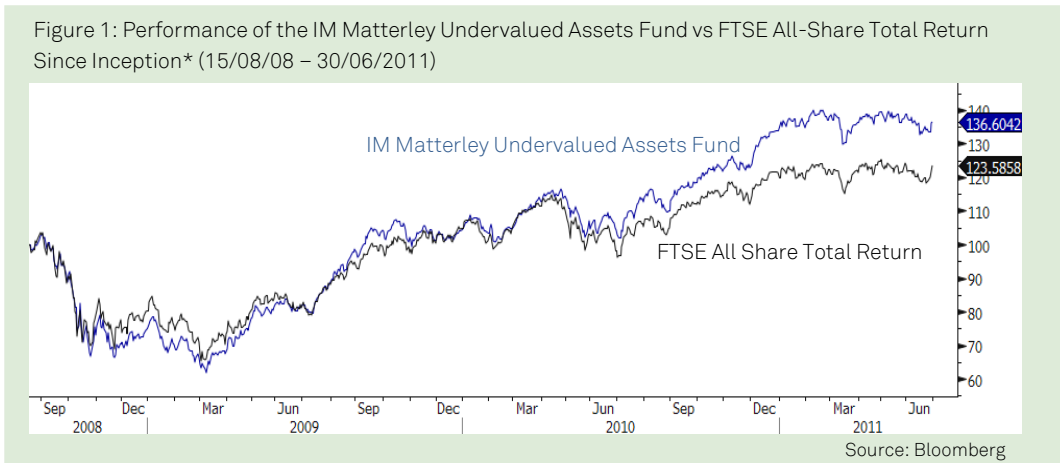


IM Matterley Undervalued Assets Fund Outlook for the Second Half of 2011

Matterley

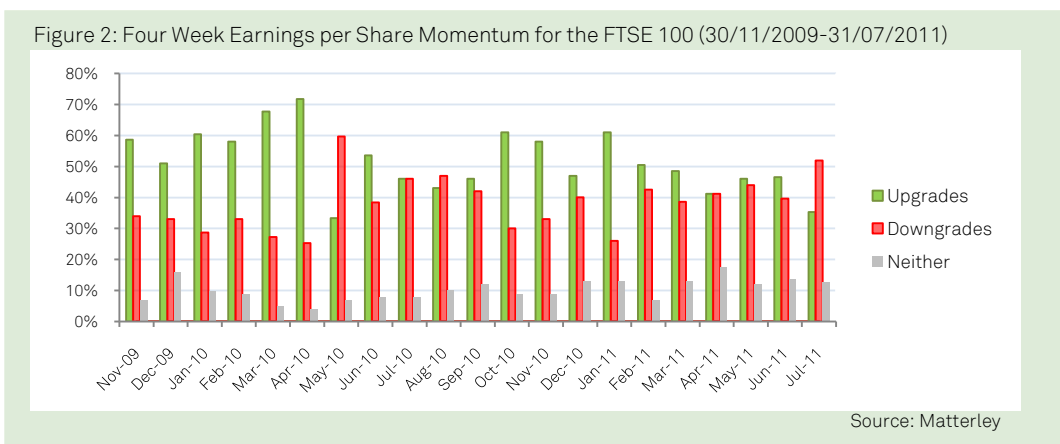
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The return of 3.0% from the FTSE All-Share Total Return in the first half of 2011 was impressive when set against the backdrop of an earthquake in Japan and the recent sovereign debt issues in Europe which both resulted in material pull-backs. Middle Eastern and North African unrest also provided the unhelpful backdrop of an elevated oil price. The Fund slightly lagged this rise and for a more detailed discussion on the reasons for this please see our latest factsheet.



*Retail accumulation (A) share class, inception date 15/08/08. The figures refer to the past. Past performance is not a reliable indicator to future results. Please refer to discrete annual performance in the appendix.

In our opinion, while the value argument was apparent at the outset of the year, we noted that, in the main, it was predicated on earnings support rather than asset support. Estimates momentum has, therefore, been a key area of focus for us and we cannot deny that downgrade momentum has gathered pace in recent months at a time when upgrades are subsiding.



Please refer to the Important Information at the end of this document

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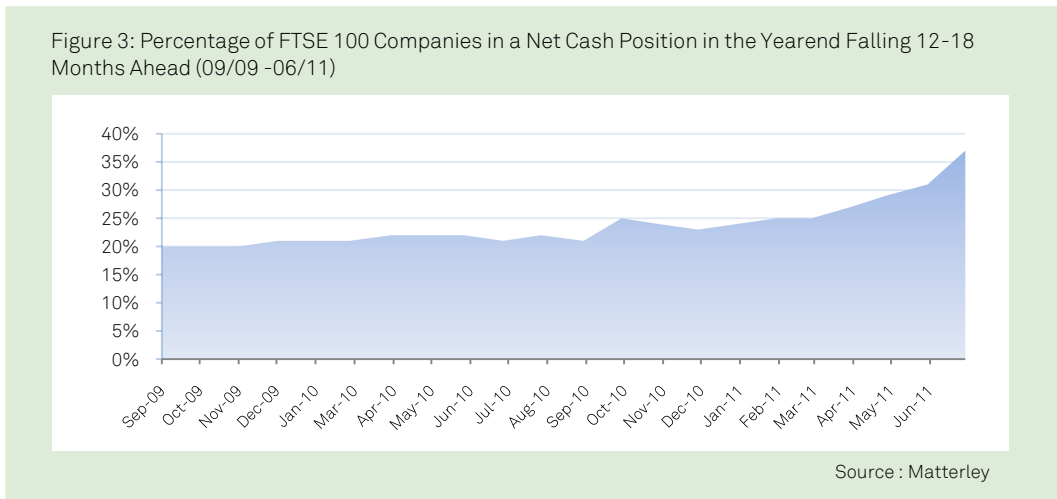
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However, in aggregate the earnings picture for the first half was a positive one and despite its modest rise the market has once again found itself being de-rated, albeit modestly to c10x earnings.

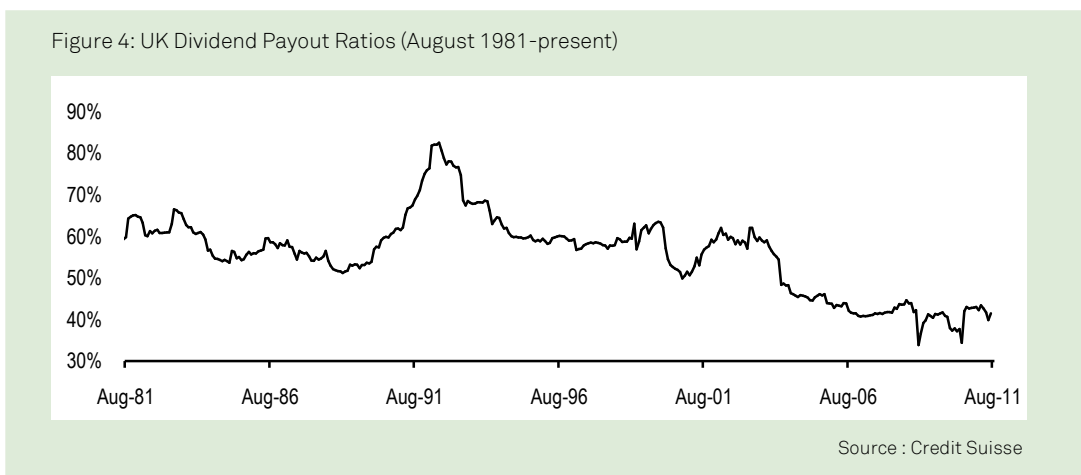
At a sector level the best estimates momentum has been recorded by the oil and gas sector with earnings for this year now expected to be some 10% higher than they were at the start of the year. Banks have been the key disappointment where earnings have been revised down by 20%. Lloyds has been the worst offender within this with earnings estimates for 2011 now some 60% lower than at the start of the year. This, combined with concerns about balance sheet strength makes banks an emotive subject as we look out to the second half. We outline our thoughts as well as our investment strategy for the sector in the coming pages.

Balance Sheet Strength and Dividend Yield

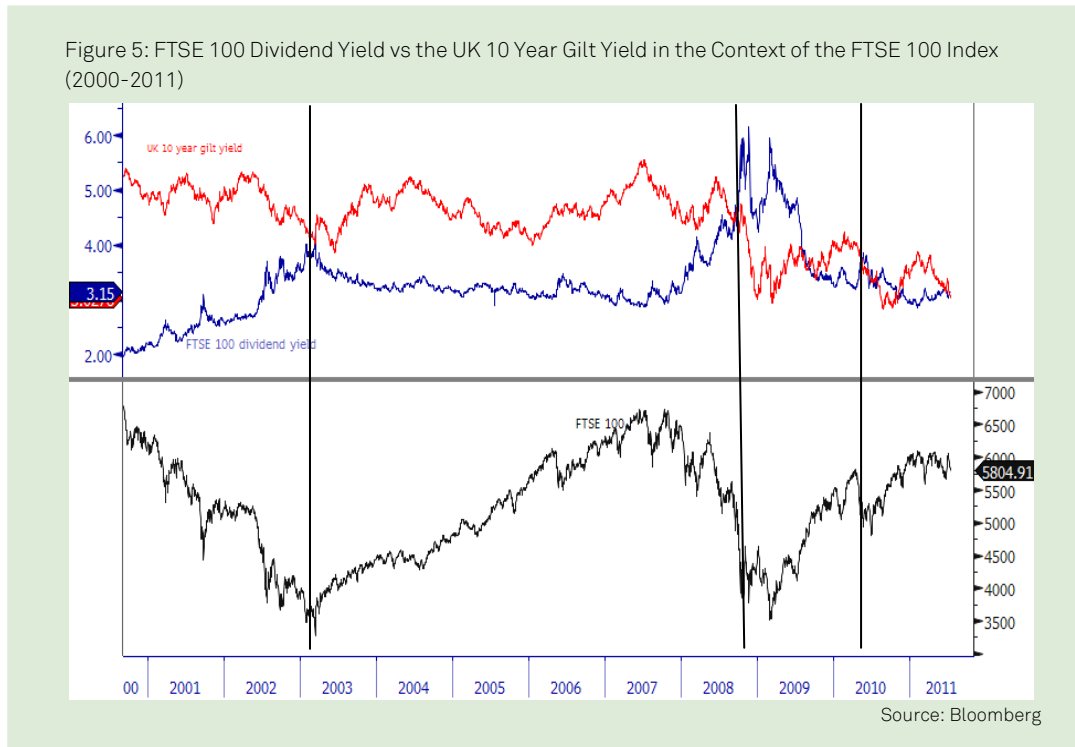
The key positive during the period remains the ongoing accumulation of cash on company balance sheets and now slightly more than a third of FTSE 100 companies find themselves net cash. The aggregate amount of this net cash is £57bn which represents 3.65% of the current market capitalisation for the FTSE 100.



The most quantifiable use of this cash is for M&A and shareholder returns in the form of dividends and share buybacks. All of these were in evidence in the first half but the key long-term driver of equity returns is a growing dividend stream. We continue to believe this is eminently achievable given that the ongoing cash accumulation is complemented by a payout ratio that is low in the context of history.



The starting point of absolute yield for the equity market is also attractive when placed in the context of gilt yields. In the chart below we highlight equity yields and gilt yields as well as showing the FTSE 100 Index level since 2000. In the closing days of June we had a yield crossover that has only occurred three times before in the last ten years. We believe the value proposition of the equity market is considerable given the probability of dividend growth in an inflationary world.



The previous three occasions that equities yielded more than gilts, namely the bottom of the bear market in 2003, the fallout post Lehmans and the growth slowdown experienced in Q2 of last year, all provided positive equity returns in the ensuing months. The overriding cause of the yield crossover this time is the European sovereign concerns and the knock-on effect this will have to the banking sector.

Banks

Our approach this year in the financial sector has been to back absolute valuation based on book value multiples, complimented with relative valuation awareness. This has served the Fund well in the first half but given events in recent weeks we feel a more detailed discussion is appropriate in justifying why, on a selective basis, we now see the banking sector as the source of greatest opportunity in the second half within financials. As at the time of writing we have c4% of the Fund exposed to the sector but envisage this growing.

Given our focus on book values, with an adequate margin of safety, we have outlined how the balance sheets of the sector's domestic constituents have evolved since 2007. We have also added information on Santander in both instances (although excluded it from the aggregate data) as it has ultimately become the owner of both Alliance & Leicester and Bradford & Bingley. Northern Rock is now in Government hands and HBOS has been consumed by Lloyds.

Domestic UK Banking Statistics

December 2007

	RBS	HBOS	Lloyds	Barclays
Tangible Assets £bn	1852.0	664.1	350.9	1220.4
Total Liabilities £bn	1809.1	644.7	340.9	1194.9
Tangible Equity £bn	42.9	19.4	10.0	25.5
Assets/Equity (Leverage)	43.2	34.2	35.1	47.9
January 2007 Market Capitalisation £bn	64.2	43.4	33.0	48.6
Price to Book Multiple	1.5	2.2	3.3	1.9

	Northern Rock	Alliance & Leicester	B&B	Santander €
Tangible Assets £bn	109.3	79.0	52.0	896.9
Total Liabilities £bn	107.7	76.6	50.8	855.4
Tangible Equity £bn	1.6	2.4	1.2	41.5
Assets/Equity (Leverage)	68.3	32.9	43.3	21.6
January 2007 Market Capitalisation £bn	5.0	5.1	3.0	90.6
Price to Book Multiple	3.1	2.1	2.5	2.2

December 2010

	RBS	Lloyds	Barclays	Santander €
Tangible Assets £bn	1439.2	986.1	1480.9	1188.9
Total Liabilities £bn	1376.7	944.7	1427.4	1136.6
Tangible Equity £bn	62.5	41.4	53.5	52.3
Assets/Equity (Leverage)	23.0	23.8	27.7	22.7
June 2011 Market Capitalisation £bn	42.1	33.7	31.3	67.2
Price to Book Multiple	0.7	0.8	0.6	1.3

Source: Company Reports & Accounts and Matterley

We apologise for the data download but felt splitting out each company had its merits. However, perhaps the above information is best summarised in aggregate below.

Aggregate Data for Domestic UK Banks

	Dec 2007	Dec 2010
Tangible Assets £bn	4327.7	3906.2
Total Liabilities £bn	4224.7	3748.8
Tangible Equity £bn	103.0	157.4
Assets/Equity (Leverage)	42.0	24.8
Market Capitalisation £bn	(Jan 07) 202.4	(June 11) 107.1
Price to Book Multiple	2.0	0.7

Source: Company Reports & Accounts and Matterley

Our observations would be that the tangible equity within the domestic sector has risen by over 50% to over £150bn while gearing levels have almost halved. However investors are currently only ascribing half the market capitalisation to the sector for this progress and in price to book terms the multiple has contracted by 65%. The current reason for such a sizeable discount to book is the Euro sovereign crisis.

Euro Zone

The recent stress tests have been widely criticised but in our opinion it is a valuable exercise in disclosure, as it allows us to work out the capital requirements of isolated institutions. Taking market implied haircuts (56% for Greek, 47% for Irish and 45% for Portuguese debt) to the disclosed individual exposure of the UK banking institutions leaves only RBS breaching the 7% Core Tier 1 Capital ratio (Source: Morgan Stanley). Under this scenario a £4-6bn capital shortfall will occur but this ignores the £8bn of contingent capital that is available under existing agreements.

The vast majority of this write-down will therefore reside in the European banking sector and it is estimated that c€60bn will be required in order to maintain capital ratios that will appease the regulator. An analysis of the aggregate balance sheet of the Euro Stoxx 600 Banking sector, however, shows a similar level of recapitalisation to that seen in the UK since 2007. Tangible equity has risen by close to 50% to c€1.5 trillion and gearing levels have fallen materially. Despite this progress there has also been a 65% contraction in price-to-book multiples that investors are willing to pay.

Euro Stoxx 600 Banking Sector Statistics €bn

	Dec 2007	Dec 2010
Total Assets Less Goodwill	33883	35313
Total Liabilities	32796	33846
Tangible Equity	1087	1467
Assets/Equity (leverage)	31	24
Market Capitalisation	(Jan 07) 1796	(June 11) 881
Price to Book (multiple)	1.7	0.6

Source: Bloomberg and Matterley

A shortcoming of this analysis is that we should look at the total government debt outstanding as this is the level of capital that is risk in the most troubled regions. Below is the total government debt of the Eurozone nation and this is put into the context of GDP. As at the end of 2010 the government debt of Greece, Portugal and Ireland stood at €637bn. Interestingly the balancing figure between the Euro banking systems, tangible equity and the current market capitalisation of the sector broadly equates to this figure.

	Government debt (€ billion)				% of GDP			
	2007	2008	2009	2010	2007	2008	2009	2010
Belgium	282	309	326	341	82	92	96	97
Germany	1579	1644	1761	2080	72	58	72	84
Ireland	47	80	105	148	37	44	66	96
Greece	239	262	299	329	105	111	127	143
Spain	381	434	561	639	36	40	53	60
France	1212	1319	1493	1591	63	68	79	82
Italy	1602	1666	1764	1843	102	105	117	119
Cyprus	9	8	10	11	57	46	59	63
Netherlands	258	347	348	371	49	61	61	63
Austria	165	180	191	205	63	61	69	72
Portugal	116	123	140	160	67	71	83	92
Estonia	1	1	1	1	4	5	7	5
Luxembourg	3	5	6	8	7	14	14	18
Slovakia	18	19	22	27	29	29	35	41
Slovenia	8	8	12	14	36	21	34	39
Malta	18	19	22	27	338	319	375	430
Finland	63	63	75	87	35	34	43	49
Total	6000	6487	7135	7882	69	68	79	86

Source: Oriel Securities and EuroStat

The sector however has still assumed “uninvestible” status for some and doubts remain about the integrity of the data that is presented to us. Japan is frequently cited as an example. However, as we look at the evolution of the Japanese banking sector it was not until 2003 that sector ultimately traded at a meaningful discount to book despite its well documented issues in the 1990s.



From this valuation level the sector would triple in value in the ensuing three years and it is worth noting this was during a time of almost zero economic growth and modest deflation. This price performance was also achieved in the face of operating losses in 2003 and 2004.

Given this precedent we will look to expose ourselves to the banks that offer us the best combination of discounts to book and cash generation. While not calling for 300% upside we do believe that returns of c50% are achievable from this sector on a 12-month view. With valuation in

mind our observation would also be that this sector is the only sector that is being valued at anything like the level seen in the market trough in March 2009. Given the integral part they play in the economy and wider market this looks anomalous to us. What will make us reconsider our stance is a lack of cash generation and deteriorating employment data.

Conclusion

We continue to believe the portfolio is better value than the market as a whole. While we experienced two disappointments in the closing days of June, which are discussed in our latest factsheet, our main relative drag is the ongoing rerating of growth. While a lack of exposure to this theme has been an opportunity cost we hope investors will take comfort from the value credentials of the portfolio and its move into a net cash position. We hope this will drive dividend growth ahead of the market, the potential for enhancing deals and offer downside protection when taken in conjunction with superior tangible asset backing. Upside, we believe, can be delivered from the undemanding PE ratio of the portfolio of c9.5x and the potential we have within our sales line for margin expansion.

What Do You Get for Every £1 Invested?

	IM Matterley Undervalued Assets Fund	FTSE 100
Sales	176.9p	96.6p
Earnings	11.0p	10.3p
Net Tangible Assets	68.9p	27.6p
Net Cash (Debt)	6.2p	-10.8p

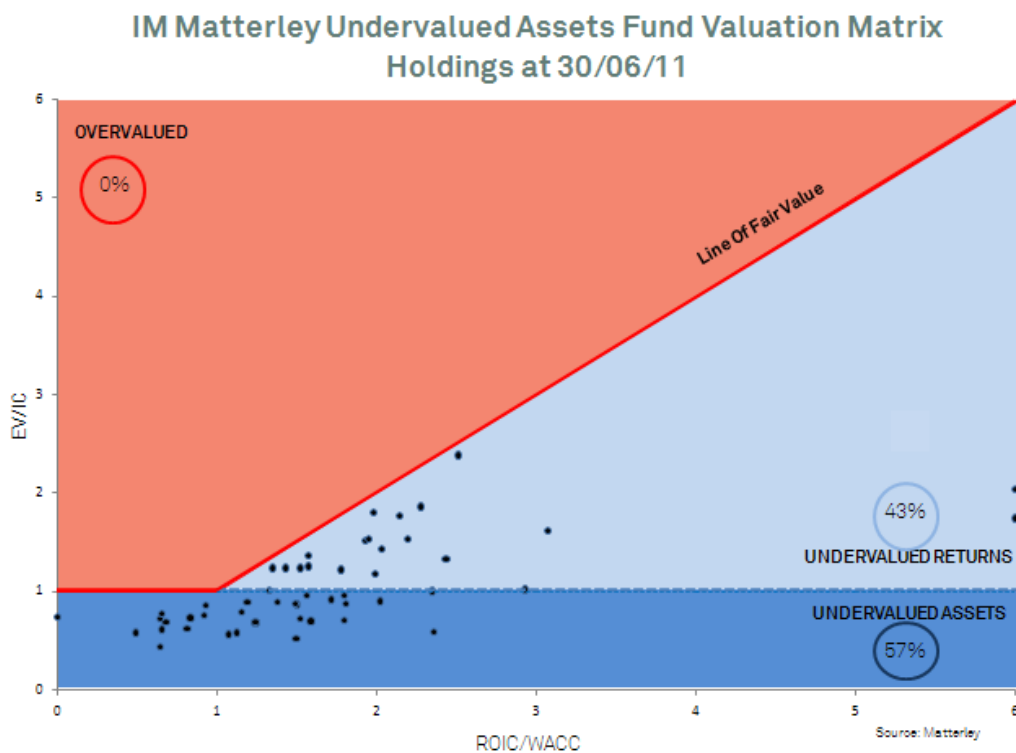
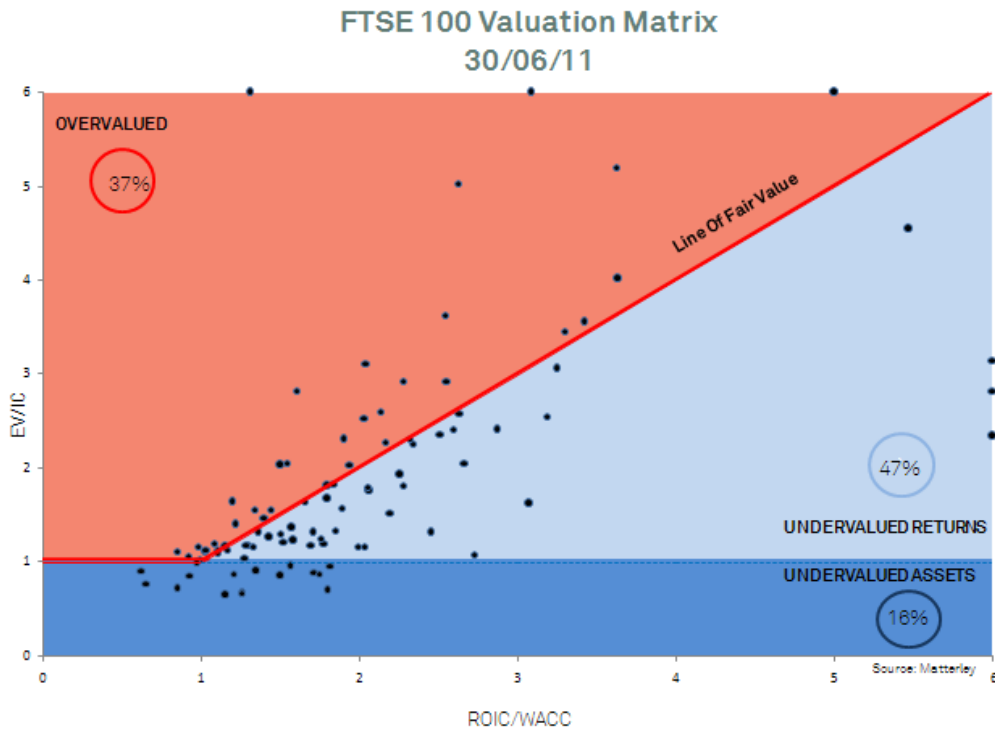
Source: Matterley. Bloomberg consensus data for full year 2012e quoted on 30/06/11. Excludes Banks and Insurance stocks.

Henry, George, Henry and Georgina

The IM Matterley Undervalued Assets Team (31/07/2011)

Appendix

- FTSE 100 Valuation Matrix
- IM Matterley Undervalued Assets Fund Matrix
- Performance Table
- Important Information



Performance	3 mth	6 mth	30/06/10 30/06/11	30/06/09 30/06/10	Since launch*
IM Matterley Undervalued Assets (Retail) (A)	0.1	1.2	31.0	27.5	36.6
IM Matterley Undervalued Assets (Institutional) (B)	0.2	1.5	31.6	28.3	38.1
FTSE All-Share Total Return	1.9	3.0	25.6	21.1	23.9
IMA UK All Companies Total Return	0.7	1.4	24.4	19.8	20.9
Quartile	3	2	1	1	1

Source: Financial Express Analytics at 30/06/11. Total Return. Sterling, net income reinvested. Sector and Quartile performance is based on the institutional share class (B). *Since launch performance data is measured from the institutional share class (B) inception date 12/08/08 with the exception of the retail share (A), measured from its inception date 15/08/08. The figures refer to the past. Past performance is not a reliable indicator of future results. All yields are historic.

Important Information

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The information in this document is based upon sources we believe to be reliable, but its accuracy cannot be guaranteed.

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