

**THE MUNRO FUND**

**ANNUAL SHORT REPORT**

**For the year ended 31 January 2010**

# THE MUNRO FUND

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## **THE MUNRO FUND**

### **THE AUTHORISED CORPORATE DIRECTOR'S REPORT (continued)**

#### **Authorised Corporate Director, Administrator and Registrar**

Smith & Williamson Fund Administration Limited

25 Moorgate

London EC2R 6AY

Telephone: 020 7131 4000 (General)

020 7131 4951 (Dealing & Registration)

Authorised and regulated by the Financial Services Authority

#### **Directors**

Karen Barrow

Tim Lyford

Giles Murphy

Martin Rose

Geoff Windebank

#### **Investment Adviser**

Fundamental Tracker Investment Management Limited

Exchange House

50 Drymen Road

Bearsden

Glasgow G61 2RH

Authorised and regulated by the Financial Services Authority

#### **Depositary**

The Royal Bank of Scotland plc

Trustee and Depositary Services

The Broadstone

50 South Gyle Crescent

Edinburgh EH12 9UZ

Telephone: 0131 523 8487

Authorised and regulated by the Financial Services Authority

#### **Auditor**

KPMG Audit Plc

Chartered Accountants and Registered Auditors

One Canada Square

London E14 5AG

## **THE MUNRO FUND**

### **THE AUTHORISED CORPORATE DIRECTOR'S REPORT**

The Authorised Corporate Director ("ACD") presents herewith the annual short report for The Munro Fund ("the Company") for the year ended 31 January 2010.

#### **INVESTMENT OBJECTIVE AND POLICY**

##### **Munro UK Fund**

The objective of the fund is to maximize the overall return through investment securities listed on the UK stock market.

The fund will seek to outperform the FTSE 350 over the long term by holding all securities, excluding Investment Trusts, in that index that are forecast to pay a dividend. The fund will be constructed on the basis of the underlying fundamental financial attributes of the companies in the index rather on their market capitalisation. The weight of each company in the Fund will be determined by the proportion that its forecast total dividend will be expected to make of the total income of all companies held in the fund. The data will be sourced from consensus forecasts as compiled by information providers such as Bloomberg and Reuters. Allowance will be made for securities forecast to be bought back. Such a rigorous process can be closely defined and will be insensitive to the personal preferences of the Investment Adviser.

The fund may also invest in bonds, collective investment schemes, warrants, money market instruments, cash, deposits and other permitted investments.

It is the ACD's intention that derivatives be used for hedging purposes using efficient portfolio management style techniques.

The ACD does not intend to have an interest in any immovable property or tangible movable property.

The Company will be managed in a manner that maintains eligibility for the stocks and shares component of an individual savings account.

#### **RISK FACTORS - FINANCIAL INSTRUMENTS AND MANAGEMENT OF RISK**

In pursuing its investment objective the Company holds a number of financial instruments. These financial instruments may include but are not limited to:

- Equity shares, equity related shares and non-equity shares, fixed income securities, floating rate securities;
- Cash, liquid resources and short-term debtors and creditors that arise directly from the Company's operations;
- Derivative transactions which the Company may also enter into, the purpose of which is to manage the market risks arising from the Company's investment activities; and
- Short-term borrowings which may be used to finance investment activity.

There is no assurance that the investment objective of the Company will actually be achieved. Past performance is not a guide to future performance.

The main risks and the ACD's policies for managing these risks are summarised below and have been applied throughout the year and the preceding year.

##### **Interest rate risk**

Interest rate risk is the risk of movement in the financial instruments as a result of fluctuations in interest rates. Any changes in interest rate may create a risk of variance on cash interest.

##### **Credit risk**

The Depositary of the Company has appointed the Custodian to provide custody services for the assets of the Company. There is a credit risk in that the Custodian of the fund's investments could cease to be in a position to provide custody services to the Company. However, the fund's investments are ringfenced to reduce the risk of loss.



## **THE MUNRO FUND**

### **THE AUTHORISED CORPORATE DIRECTOR'S REPORT (continued)**

Total expense ratio ("TER")

The TERs for each share class of the sub-fund for the year ended 31 January 2010 are as follows:

Class X Income	1.87% (31 January 2009: 1.63%)
Class A Income	2.38% (31 January 2009: 1.63%)
Class A Accumulation	2.58% (31 January 2009: 2.17%)
Class X Accumulation	1.89% (31 January 2009: 1.63%)
Class B Accumulation	2.39% (31 January 2009: 2.62%)

The TER is calculated on an annualised basis using the total expenses for the year divided by the average net asset value of the Company over the year under review.

### **REPORT AND ACCOUNTS**

Copies of the annual long report of the Company are available free of charge on request from the Authorised Corporate Director.

## **THE MUNRO FUND**

### **INVESTMENT ADVISER'S REPORT For the year ended 31 January 2010**

#### **Investment Activities**

The fund was managed during the year in accordance with its stated objective of delivering the return of the FTSE 350 Total Return index in a better way than conventional market capitalization tracker funds. Despite its small size the fund was able to follow its strategy of tracking the forecast gross cash dividends for over 90% of the constituents of the index. As the fund grows and dealing efficiencies increase it will be able to become fully invested. Over the course of the year additional inflows and a rising market increased the size of the fund. This allowed it to buy additional stocks which increased the efficiency of the process. Nevertheless, the fund probably held an average cash position during the year of about 8% which is sub-optimal.

The year was notable for its extreme volatility, especially in the banking and mining sectors. To some extent this benefited the fund allowing it to add to existing positions when shares had become oversold. New stocks added were: G4S, Capita, Thomas Cook, Inmarsat, ICAP, Tate & Lyle, Sage Group, Hammerson, FirstGroup, Compass Group, Catlin Group, Amlin, Provident Financial, Ashmore Group, Segro, Smith & Nephew, Johnson Matthey, Petrofac, Balfour Beatty, Fresnillo, Pennon Group, Resolution, Schroders, Bunzl, London Stock Exchange, Northumbrian Water, Vedanta and Hays.

Stocks were sold for three reasons. Either it was because they fell out of the index, they were taken over or analysts no longer believed they would pay a dividend. Taylor Wimpey fell below the threshold for inclusion in the FTSE 350. Royal Bank of Scotland, Lloyds Banking Group, DSG International, Barratt Developments and Yell were sold because analysts no longer expect them to pay dividends in the forecast period. Thomson Reuters, Friends Provident and Cadbury were all sold after being taken over.

#### **Investment Performance**

Over the period under review the fund rose 30.3%. This was ahead of the FTSE 350 Index, which gained 29.9%, but behind its benchmark, the FTSE 350 TR, which rose 35.2%. The shortfall was due to three reasons.

Most important was the drag from the cash holding. At an average of about 8% over the course of the year this reduced returns by about 2.4%. More significantly this element of the fund should have been invested in the FTSE 250. That index rose by 52.6% over the year. Had the fund been fully invested, and hence had a full weight to that sector, its return would have been about 4% higher.

Another consequence of the fund being a suboptimal size was that it was unable to take advantage of market volatility that would have added alpha and additional return. Finally, fees reduced the return of the fund by about 1.5%. As the fund grows the negative impacts of all three factors will diminish and it is expected that the alpha created by the process will offset the impact of fees and allow the fund to deliver on its objective.

#### **Investment Strategy**

There was no change in the investment strategy of the fund. The fund uses a proprietary process that allocates weights to shares in proportion to their contribution to the total cash dividend forecast for the FTSE 350 index. In practice the model portfolio had to be adjusted to ensure that the fund stayed within the FSA guideline that no single stock can represent more than 10% of the fund and that all stocks that have weights in excess of 5% cannot, in aggregate, account for more than 40% of the fund. This meant that the positions of BP and Royal Dutch were reduced from their model weights and that on occasions the fund was obliged to reduce its holdings in BHP Billiton and GlaxoSmithKline.

Fundamental Tracker Investment Management Limited

**Date:** 10 February 2010

**Note:** Investments carry risks. Past performance is not a guide to future performance. Investors may not get back the amount invested.

# THE MUNRO FUND

## MUNRO UK FUND

### FUND PERFORMANCE

The following tables show the highest and lowest prices of shares in the fund, the income and accumulation shares distributions, net asset value, quoted prices, shares in issue and total expense ratio for each share class and the portfolio turnover rate since launch of the fund on 14 September 2007.

#### Share prices

Shares were first issued at 100.00p on 14 September 2007.

#### Class X Income shares (share prices)

Calendar year	Highest price p	Lowest price p
2007	104.70	93.37
2008	99.32	56.36
2009	80.58	51.55
2010*	81.46	77.02

#### Class A Income shares (share prices)

Calendar year	Highest price p	Lowest price p
2007	103.50	90.26
2008	95.96	54.40
2009	78.09	50.06
2010*	78.98	74.66

#### Class A Accumulation shares (share prices)

Calendar year	Highest price p	Lowest price p
2007	103.50	90.27
2008	95.98	55.83
2009	82.50	51.81
2010*	83.44	78.86

#### Class X Accumulation shares (share prices)

Calendar year	Highest price p	Lowest price p
2007	104.70	93.42
2008	99.32	57.84
2009	85.54	53.68
2010*	86.48	81.76

#### Class B Accumulation shares (share prices)

Calendar year	Highest price p	Lowest price p
2007	100.00	100.00
2008	107.90	66.99
2009	99.05	62.17
2010*	100.20	94.68

#### Class X Income shares (Net distribution per share)

Calendar year	Interim p	Final p	Total p
2008	2.492	n/a	2.492
2009	1.343	0.817	2.160
2010**	-	0.848	0.848

#### Class A Income shares (Net distribution per share)

Calendar year	Interim p	Final p	Total p
2008	2.492	n/a	2.492
2009	1.303	0.790	2.093
2010**	-	0.822	0.822

\*to 31 January 2010

\*\* to 31 May 2010 (payment date)

# THE MUNRO FUND

## MUNRO UK FUND

### FUND PERFORMANCE (continued)

#### Class A Accumulation shares (Net distribution per share)

Calendar year	Interim p	Final p	Total p
2008	2.492	n/a	2.492
2009	1.349	0.809	2.158
2010*	-	0.868	0.868

#### Class X Accumulation shares (Net distribution per share)

Calendar year	Interim p	Final p	Total p
2008	2.492	n/a	2.492
2009	1.399	0.839	2.238
2010**	-	0.900	0.900

#### Class B Accumulation shares (Net distribution per share)

Calendar year	Interim p	Final p	Total p
2008	2.492	n/a	2.492
2009	1.620	0.973	2.593
2010**	-	1.043	1.043

#### Class X Income

##### Net asset value, quoted prices, shares in issue and total expense ratio

Accounting date	Total net asset value £	Net asset value per share p	Quoted	Income shares in issue	Total expense ratio %
			Income price p		
31/01/2009	369,037	62.06	62.50	594,640	1.63%
31/01/2010	628,098	76.68	77.02	819,119	1.87%

#### Class A Income

##### Net asset value, quoted prices, shares in issue and total expense ratio

Accounting date	Total net asset value £	Net asset value per share p	Quoted	Income shares in issue	Total expense ratio %
			Income price p		
31/01/2009	15,862	59.82	60.37	26,517	1.63%
31/01/2010	45,711	74.33	74.66	61,497	2.38%

#### Class A Accumulation

##### Net asset value, quoted prices, shares in issue and total expense ratio

Accounting date	Total net asset value £	Net asset value per share p	Quoted	Accumulation shares in issue	Total expense ratio %
			Accumulation price p		
31/01/2009	109,663	61.43	61.88	178,504	2.17%
31/01/2010	201,810	78.51	78.86	257,058	2.58%

#### Class X Accumulation

##### Net asset value, quoted prices, shares in issue and total expense ratio

Accounting date	Total net asset value £	Net asset value per share p	Quoted	Accumulation shares in issue	Total expense ratio %
			Accumulation price p		
31/01/2009	391,949	63.68	64.14	615,451	1.63%
31/01/2010	581,332	81.40	81.76	714,151	1.89%

#### Class B Accumulation

##### Net asset value, quoted prices, shares in issue and total expense ratio

Accounting date	Total net asset value £	Net asset value per share p	Quoted	Accumulation shares in issue	Total expense ratio %
			Accumulation price p		
31/01/2009	92,626	73.83	74.36	125,459	2.62%
31/01/2010	118,255	94.26	94.68	125,459	2.39%

\*to 31 January 2010

\*\* to 31 May 2010 (payment date)

## THE MUNRO FUND

### MUNRO UK FUND

#### FUND PERFORMANCE (continued)

Accounting date	Portfolio turnover rate %
31/01/2009	8.73%
31/01/2010	26.00%

#### TOTAL PURCHASES AND SALES IN THE YEAR

Total purchases in the year were £711,467.

Total sales in the year were £422,651.

**Note:** Investments carry risks. Past performance is not a guide to future performance. Investors may not get back the amount invested.

## THE MUNRO FUND

### MUNRO UK FUND

#### PORTFOLIO INFORMATION as at 31 January 2010

The tables below show the percentage of the Company's assets and liabilities by investment and geographical classification for the current and previous year, and the ten largest holdings in the Company for the current and previous year.

##### Investment classification

Investment type	Percentage of the Company as at 31 January 2010	Percentage of the Company as at 31 January 2009
Equities	90.99%	87.42%
Net other assets	9.01%	12.58%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

##### Geographical classification

Region	Percentage of the Company as at 31 January 2010	Percentage of the Company as at 31 January 2009
United Kingdom	90.99%	87.42%
Net other assets	9.01%	12.58%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

##### Ten largest holdings at close of current year

Holding	Percentage of the Company as at 31 January 2010
BP	9.40%
Vodafone Group	7.45%
HSBC (Reg'd)	7.14%
Royal Dutch Shell A (Lon)	5.19%
GlaxoSmithKline	4.50%
BHP Billiton	4.44%
Royal Dutch Shell B	4.04%
AstraZeneca	3.80%
British American Tobacco	3.73%
Rio Tinto	2.08%

##### Ten largest holdings at close of previous year

Holding	Percentage of the Company as at 31 January 2009
HSBC (Reg'd)	9.36%
BP	9.01%
Vodafone	6.50%
Royal Dutch Shell A	5.43%
BHP Billiton	4.52%
GlaxoSmithKline	4.41%
Royal Dutch Shell B	4.12%
AstraZeneca	3.35%
Rio Tinto	3.25%
British American Tobacco	2.82%

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