

**THE MUNRO FUND**

**INTERIM SHORT REPORT**

**For the six months ended 31 July 2010**

## **THE MUNRO FUND**

### **CONTENTS**

	<b>PAGE</b>
Company Information	2
Authorised Corporate Director's Report	3
Investment Adviser's Report	6
Fund Performance	7
Portfolio Information	10

## **THE MUNRO FUND**

### **COMPANY INFORMATION**

#### **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**

Jeremy Boadle

Michael Fosberry

Michael Lea

Giles Murphy

Gareth Pearce

Kevin Stopps

Paul Wyse

#### **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

15 Canada Square

London E14 5GL

## **THE MUNRO FUND**

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

The Authorised Corporate Director ("the ACD") presents herewith the interim long report for The Munro Fund ("the Company") for the six months ended 31 July 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 than 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**

The sub-fund, in pursuing its investment policy and objective, holds a number of financial instruments, which may comprise the following:

- Equity shares, equity-related shares, warrants and debt securities;
- Cash, short term borrowings and other short term debtors and creditors arising from operations;
- Collective Investment Schemes;
- Derivatives in the form of forward foreign exchange contracts, exchange traded futures and options contracts for the purpose of efficient portfolio management in accordance with the COLL Sourcebook.

The ACD is responsible for monitoring the portfolio of the sub-fund in accordance with its investment objective and seeks to ensure that individual assets also meet a risk reward profile that is acceptable.

Adherence to the investment guidelines and the investment and borrowing powers as set out in the prospectus and in the rules of the COLL regulations also mitigates the risk of excessive exposure to any particular type of security or issuer.

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

## THE MUNRO FUND

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

The main risks arising from financial instruments are market risk, credit risk, and liquidity risk which are summarised below.

#### **Market risk**

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk to the sub-fund comprises two types of risk: currency risk and other price risk.

##### ***Currency risk***

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The ACD monitors currency exposure and the effects of fluctuations in exchange rates. The ACD considers the effect on the sub-fund's net asset value and income of a movement in the rates of exchange to which the sub-fund's assets, liabilities, income and expenses are exposed.

##### ***Other price risk***

Other price risk is that the fair value of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk and currency risk), whether those changes are caused by factors specific to individual financial instruments or its issuer, or other factors affecting similar financial instruments traded in the market.

The risk can be reduced by diversifying (investing in debt securities with different durations) or hedging (e.g. through an interest rate swap).

#### **Credit risk**

Credit risk is the risk of suffering a loss due to another party not meeting its financial obligations. This includes counterparty risk.

##### ***Counterparty risk***

The sub-fund will only buy and sell investments through brokers which have been approved by the ACD as an acceptable counterparty. This is overseen by the Depositary to ensure that the exposure to any counterparty remains appropriate for investors.

The Depositary of the sub-fund has appointed the Custodian to provide custody services for the assets of the sub-fund. There is a credit risk that the Custodian could cease to be in a position to provide custody services to the sub-fund. The sub-fund's investments (excluding cash) are ring fenced so the risk is considered to be negligible.

#### **Liquidity risk**

The sub-fund's assets comprise mainly readily realisable securities which can be sold promptly to meet liquidity requirements. The main source of risk comes from the obligation of shareholders to meet any redemption proceeds of the sub-fund.

The ACD regularly monitors the sub-fund's liquidity levels (cash and securities) to ensure redemptions can be readily met. Some investments may be less liquid than other securities and can be more sensitive to economic factors. The rules of the COLL regulations mitigate the risk of holding excessive assets which are not readily realisable.

#### **REVENUE**

Where net revenue is available it will be distributed semi-annually on 30 September (interim) and 31 May (final). In the event of a distribution, shareholders will receive a tax voucher and a distribution warrant unless they have given instructions for payment to be made direct to a bank.

#### **BUYING AND SELLING SHARES**

The property of the sub-fund is valued at 12 noon on each business day and prices of shares are calculated as at that time. Share dealing is on a forward basis i.e. investors can buy and sell shares at the next valuation point following receipt of the order.



## THE MUNRO FUND

### MUNRO UK FUND

#### INVESTMENT ADVISER'S REPORT For the six months ended 31 July 2010

##### Investment Activities

The fund invested in accordance with the model portfolio created by the fundamental tracking process. It has adhered to this investment policy of investing in stocks in the FTSE 350 index using its proprietary fundamental tracking process. This process allocates weights to stocks according to their contribution to the gross forecast cash dividend for all the constituents of the index excluding investment trusts.

As the fund grew in size from new money invested it was able to increase the number of stocks in its portfolio. As the fund grew the threshold for the minimum dealing size declined as a percentage of the fund. This results in more stocks exceeding the £2,000 minimum dealing size. Stocks added over the period were: Aberdeen Asset Management, Cobham, Capita Group, Hays, Intercontinental Hotels, IMI, Informa, Intermediate Capital, Kazakhmys, Northumbrian Water and Vedanta Resources. The number of holdings also increased as result of corporate actions. Cable & Wireless was split into Cable & Wireless Communications and Cable & Wireless Worldwide. Liberty International became Capital and Counties Properties after changing its name from Liberty International and spinning off Capital Shopping Centres Group. Enquest was a new company created when it was spun off from Petrofac.

During the period the fund took up a holding in Royal Bank of Scotland which was bought at the beginning of March for 38p when analysts started estimating a small dividend from the Company in 2011. However, the position in RBS was sold a month later for 45p after analysts revised their forecasts and a dividend was no longer being forecast. The only other stock sold during the period was Cadbury after it was taken over by the American listed Kraft.

In addition to these trades rebalancing was carried out as appropriate to keep the fund in line with the model. In February the fund traded on 4 days, March 10 days, April 9 days, May 9 days, June 14 days and on 13 days in July.

##### Investment Performance

In the period under review the X Class accumulation units rose by 0.9% compared with an increase of 3.0% in the FTSE 350 Total Return index (Source: Bloomberg). This relative underperformance is due to three reasons that are all a function of the small size of the fund. These are:

- It cannot precisely follow the model, it currently only holds 110 stocks out of a universe of over 200.
- The small size of the fund also increases the impact of drag from fees.
- The small size inhibits its ability to exploit pricing anomalies in the market.

Furthermore, the fund held an overweight position in BP at the time of the Macondo Well MC252 disaster and the subsequent fall in the value of BP shares had a negative impact on the fund. However, some of those losses were recovered in the last month of the period under review.

##### Investment Strategy

The fund will continue to use its fundamental tracking process to allocate capital to stocks in proportion to a company's contribution to the gross cash dividend income for the FTSE 350 Index. Rebalancing the model portfolio every month ensures that the fund always incorporates the latest forecast data. Reconciling the fund to the model on a daily basis allows the fund to benefit from the short term volatility in the market. This allows it to acquire more shares in companies that are temporarily out of favour and reduce holdings in companies that are overvalued by other investors relative to our model.

Fundamental Tracker Investment Management Ltd

**Date:** 11 August 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 sub-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 sub-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*	84.43	70.61

#### 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*	81.84	68.46

#### 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*	87.42	73.14

#### 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*	90.63	75.80

#### 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*	105.00	87.80

#### 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**	1.290	0.848	2.138

#### 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**	1.263	0.822	2.085

\* to 31 July 2010

\*\* to 30 September 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**	1.341	0.868	2.209

#### 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**	1.397	0.900	2.297

#### 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**	1.630	1.043	2.673

#### 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	628,099	76.68	77.02	819,119	1.87%
31/07/2010	853,585	75.69	76.94	1,127,730	1.73%***

#### 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%
31/07/2010	54,182	73.38	74.60	73,842	2.52%***

#### 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%
31/07/2010	161,381	79.74	79.71	202,378	2.52%***

#### 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	581,333	81.40	81.76	714,151	1.89%
31/07/2010	573,274	82.64	82.60	693,690	1.77%***

#### 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%
31/07/2010	120,096	95.72	95.68	125,459	2.27%***

\* to 31 July 2010

\*\* to 30 September 2010 (payment date)

\*\*\* annualised

## THE MUNRO FUND

### MUNRO UK FUND

#### FUND PERFORMANCE (continued)

Accounting date	Portfolio turnover rate %
31/01/2009	8.73%
31/01/2010	26.00%
31/07/2010	nil

#### TOTAL PURCHASES AND SALES IN THE PERIOD

Total purchases in the year were £421,815

Total sales in the year were £259,393

**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 July 2010

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

##### Investment classification

Investment type	Percentage of the Company as at 31 July 2010	Percentage of the Company as at 31 January 2010
Equities	91.35%	90.99%
Net other assets	8.65%	9.01%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

##### Geographical classification

Region	Percentage of the Company as at 31 July 2010	Percentage of the Company as at 31 January 2010
United Kingdom	91.35%	90.99%
Net other assets	8.65%	9.01%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

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

Holding	Percentage of the Company as at 31 July 2010
BP	8.27%
HSBC	7.29%
Vodafone	7.14%
Royal Dutch Shell 'A'	5.16%
BHP Billiton	4.56%
GlaxoSmithKline	4.47%
Royal Dutch Shell 'B'	4.13%
British American Tobacco	3.67%
AstraZeneca	3.49%
Rio Tinto	2.31%

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

Holding	Percentage of the Company as at 31 January 2010
BP	9.40%
Vodafone	7.45%
HSBC	7.14%
Royal Dutch Shell 'A'	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%

**Smith & Williamson Fund Administration Limited**  
25 Moorgate, London EC2R 6AY  
*Telephone: 020 7131 4000 Fax: 020 7131 4001*

Authorised and regulated by the Financial Services Authority

[www.smith.williamson.co.uk](http://www.smith.williamson.co.uk)