

# JANUARY UPDATE

Stock Codes	Capital Shares	Income Shares	ZDP Shares
Topic	EQPC	EQPI	EQPZ
Bloomberg	EQPC LN	EQPI LN	EQPZ LN
Reuters	EQPL	EQPi.L	EQPZo.L
ISIN	GB0030735483	GB0030735376	GB00B114S147

31 January 2009	Capital Shares	Income Shares	ZDP Shares
Mid Price	42.00p	85.50p	115.00p
NAV	52.15p	101.35p	116.69p

Issue twenty

January 2009

**Fund Manager:**  
EPIC Asset Management Limited (EPAM)



Fund Manager Profile  
Jo Welman

Jo Welman graduated in economics from Exeter University in 1979. He joined Baring Brothers where he managed several large segregated UK and US public company pension funds and The Barings UK Smaller Companies Unit Trust. In 1989 he was recruited by Rea Brothers to become the managing director of their investment management subsidiary. He resigned as a director of Rea Brothers Group plc in August 1999 following the bank's take-over by Close Brothers and became Chairman of Brit Insurance Holdings PLC. He resigned from Brit in September 2002 and is Chairman of EPIC Asset Management Limited, the investment manager to the Company.

## Corporate Details

Launch Date:	17 August 2001
Launch Assets:	£67.63m (net of expenses)
Total Assets:	£65.9m
Capital Structure:	Capital Shares: 40,304,312 Income Shares: 20,736,333 ZDP Shares: 20,000,000
ZDP Shares:	Redemption Price: 139.3p due 31 July 2011 At time of issue this equated to a 6.5% GRY
Year End:	31 July
NAV:	Monthly
Directors:	Dr C McPhail, Chairman, DC McCrickard, M Richardson, PP Scales
Winding up Provisions:	31 July 2011
Annual Management Fee:	1%
Brokers:	Numis Securities Limited

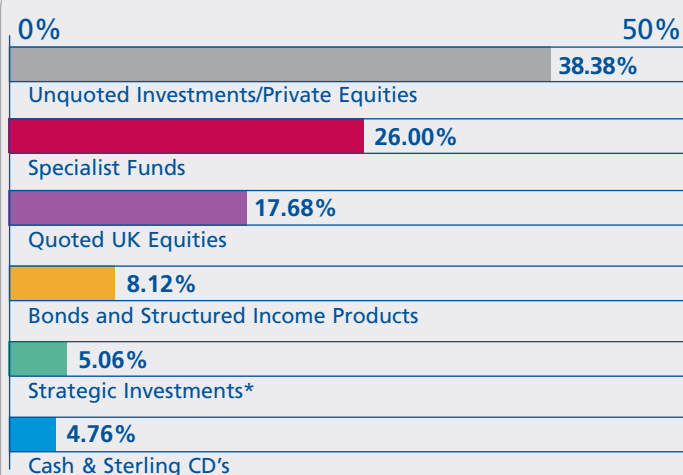
## Investment Objective

The Company can invest in quoted and unquoted equities, bonds and structured income products and investment funds to generate capital growth for capital shares and an initial 10% yield for income shares.

## Benchmark

**Capital Share NAV:** Libor + 3% per annum  
**Income Shares:** Entitled to 10% per annum with annual RPI increases (capped at 5% per annum)

## Asset Allocation as at 31 January 2009



\*Syndicate Asset Management PLC, Strand Partners Limited,  
Note: figures do not include the exposure to EPIC Securities PLC

## Contact

Jo Welman  
EPIC Investment Partners Limited  
Tel: +44 (0)20 7553 2311  
e-mail: jo.welman@epicip.com  
www.epicip.com

Nathan Brown  
Numis Securities Limited  
Tel: +44 (0)20 7260 1426  
e-mail: n.brown@numiscorp.com  
www.numiscorp.com

## Manager's Report

### Market Commentary

Economic data on the UK economy at the start of the quarter continued to show deterioration, particularly with respect to consumer confidence, retail sales and the labour market. None of these are likely to improve in the near future although our indicators and other anecdotal evidence suggest that property prices may already have experienced their most severe rates of decline and should begin to fall more slowly in the coming months and quarters.

The quarter saw a combination of lower base rates (which were cut from 3% in November to 1.5% at the end of the period) and a modicum of normalisation in the transmission of monetary policy into money market rates. Following a tumultuous November the MPC slashed interest rates by 1% at the start of the month, lowering the benchmark rate to 2%, stating that the economic downturn had intensified and disinflationary forces had built up.

December brought another disappointing set of data releases with weak manufacturing and house prices being accompanied by an extraordinary rise in unemployment claims. The UK was hit harder than other economies with GDP for 3Q contracting by 0.6%. The downturn has already led to the failure of big-name retailers including Woolworths and MFI, while further similar failures will come as no surprise in 2009. The start of the year brought some hope with eagerly awaited fiscal packages to be announced in all major economies. In the UK money market rates continued to head lower and the spread between corporate and government debt has begun to fall, suggesting that confidence is returning and that the liquidity measures implemented by the BoE have begun to have an effect. The treasury announced guarantees of up to £2.3 billion of loans to the auto sector, while the Chancellor authorised the BoE to set up and operate the UK Asset Purchase Facility to purchase up to £50 billion of "high quality private

sector assets". This could be extended in the future to include purchases of syndicated loans and asset backed securities.

While year-on-year growth of the Euro economy remains well above zero, the region's deterioration in economic data in the last two months has been perhaps the most severe among the advanced economies, with a broad based worsening in confidence and activity. Particularly notable in November was the weakness in manufacturing surveys and in industrial production figures. The ECB delivered a 50bp cut in the repo rate, from 3.75% to 3.25%, and some of this was passed on through the money markets. The ECB followed the Fed and the BoE with a surprising 75bp cut (markets were expecting 50bp) in early December with inflation expected to remain in line with the central bank's target level of 2%.

Activity indicators have deteriorated in both the services and manufacturing sectors and with demand for Euro exports weakening the effect on industrial output and new industrial orders has been alarming. Unemployment in the Eurozone has continued to rise with November's figure at 7.8%. Economic sentiment indices for December were slightly higher than expected, possibly due to a weaker Euro but also from the cut in the Repo rate. With the ECB having delivered a larger than expected cut in December, they indicated a pause in January which would be followed by further cuts in March. Economic data

surprised on the downside, especially in Germany where unemployment rose by 56,000 in January following an upward revision. With inflation now out of the picture, the flash CPI release for the Eurozone showed inflation dropping to 1.1% from 1.6% in December.

In the US the Federal Funds rate remained unchanged at 1% in November despite further continued signs of economic weakness and elevated money market rates. Consumer and business confidence are at historic lows and the woes in the housing market show no signs of abating. Lower gasoline and energy prices will have the benefit of the equivalent of a fiscal stimulus. The main problem, however, other than the housing market, remains a broken financial system, symbolised by the Federal rescue of Citibank at the month-end. Total support to the financial system from both the Federal Reserve and the US Treasury now totals in excess of US\$8,500 billion.

The economic data in December continued to show a bleak picture for the economy, especially for employment and activity. Non farm payrolls fell by 533,000, the largest monthly decline since 1974 and the unemployment rate rose to 6.7%, the highest level in 15 years. The economy ended the year in a steep decline with factory orders, home sales and service industries all contracting further. Indicators looking at manufacturing activity showed renewed weakness with the indicator

## Manager's Commentary (cont.)

coming in at 32.4 in December, the lowest level on record. The Federal Reserve cut its policy rate in December from 1% to a range of 0% to 0.25%. The FOMC also stated that they will employ all available tools in order to restore damaged credit markets, financial institutions and consumer and business confidence. At the start of the year sentiment in the markets was changing between optimism regarding the \$819 billion stimulus package and the possibility of a "Bad bank" being set up, and record weak economic data. New home sales plunged to the lowest level in history and unemployment continued to rise. Q4 GDP was posted at a much better than expected -3.8% but this was due to inventory build up.

Looking forward, the global downturn is expected to see the entire developed world contract in 2009, with some economies being more exposed than others and likely to see a more severe downturn. Government bonds will become increasingly vulnerable to large issuance necessary to fund substantially increased budget deficits and this will bring yield curve steepening pressures. UK banks that are part of the UK government's re-capitalisation programme offer attractive yields and will, we believe, be supported by the government at time of crisis. If nationalised, then senior unsecured bonds will have to be supported.

### Quoted Equity

During the period the FTSE All Share Index fell by 4.8% as an interest rate engendered rally was punctured by renewed fears over the health of the UK banking sector and government finances.

Two EPIC portfolio companies failed during the period. Lenders lost patience with automotive body

parts manufacturer Wagon and UK retailer Woolworths. As at 31 October the combined valuation was £425,000.

**Aurum Mining** should have been producing gold and copper from its low cost Andash mine in Kyrgyzstan by the end of 2008. However, an impossible business climate in this FSU republic prevented this. The company is applying for court permission to return assets of up to £19.5 million (40 pence per share) to shareholders. This should occur in spring 2009.

**Barclays** had incurred considerable shareholder wrath at the end of last quarter when plans to raise money after the publication of the 2008 results were scrapped in favour of a highly dilutive fund raising from Middle East investors that trampled over existing shareholder pre-emption rights. Despite the whole board submitting themselves for re-election at the next AGM and pledging not to take any bonus payments for 2008, market confidence was fragile. When the UK government announced plans for a massive bank insurance scheme in the middle of January the shares lost two thirds of their value despite a positive trading update concerning profitability and capital ratios.

EPIC had retained a holding in Barclays because, like the board of the bank, it believed that Barclays would be in a good position to profit when economic conditions improved unencumbered by any interference from the UK government. If the UK government does force Barclays to let it have influence through a shareholding, the above rationale would be invalidated. Furthermore, any issue of shares at recent levels might trigger the legally binding pre-emption rights of the Middle East consortium. After nine days of a falling share price a robust

trading statement on 26 January finally steadied confidence.

**British Airways** declared an interim profit of £52 million for the period ended 30 September 2008, described by the chief executive as "a good performance in incredibly difficult trading conditions." Airline consolidation is a logical response to the downturn so talks with Spanish operator Iberia continue as do those with US carrier American Airlines. A scheme to merge British Airways with Australian operator Qantas was aborted in December. In late January British Airways warned that for the year ended March 2009 a loss of £150 million is expected.

**Castings** released unchanged interim profits of £6.2 million for the six months ended 30 September 2008. A £5.7 million deposit (roughly a quarter of the company's net cash) was written off in the Icelandic banking crash. The outlook was uncertain as much of the company's output goes to the beleaguered European car and truck industry.

**Cryo-Save** issued a profit warning in late November. Volumes in the second half would be the same as in the first half. EPIC had been left with a tiny holding following earlier sales. The shares fell to a level where this cash rich market leader in European cord blood storage was on a prospective P/E ratio of 4. EPIC added 1.6 million shares at 15 pence per share.

**Dialight** issued a satisfactory trading update in November. Despite some slowdown in the indication division trading was in line with the board's expectations.

**Diploma** released a fine set of annual figures for the period ended 30 September 2008 in November. Profit was £27.5 million (£23.3 million), the

## Manager's Commentary (cont.)

dividend was increased to 7.5 pence (5.4 pence) and strong cash generation created net cash funds of £15.7 million or 14 pence per share at the period end. A trading update in January stated that despite some slowdown in the US Seals business, currency movements meant that overall volumes in the first quarter of 2008/9 were 2% ahead.

**Electrocomponents** produced a reasonable set of interim figures for the period ended 30 September 2008 in November. Profits were £42 million (£37 million) but the group was seeing a downturn. A further trading update in December suggested that demand had fallen by 5% in the last three months. Margins were stable and the depreciation of Sterling meant that group sales were 2% ahead of the same period last year.

**Heywood Williams** issued a poor trading statement in November. Sales for the year to date were down 12% and despite headcount cuts and tight control of working capital the group is likely to make a loss of the year. Heywood Williams is effectively in the hands of its bankers who, so far, have been supportive.

**Lupus Capital** forecast a difficult end to the year when it reported interim figures in September. A trading update is not expected until the end of February. It is unlikely to be encouraging as apart from oil services its end markets remain depressed and Lupus has a large tranche of US dollar debt which on translation will impact the balance sheet severely.

**Macfarlane** issued a trading update in November. Profits for 2008 would be in line with expectations. In January 2009 the company announced that it had sold its loss making Irish plastics business for £1.4 million.

**Managed Support Services** released good interim figures for the six months ended 30 September 2008 in November. The company now has three profitable businesses and cash balances in excess of the market capitalisation.

**Matchtech** will issue a trading update covering the six months ended 31 January 2009 in early February. Demand across most of its specialist recruitment areas is expected to have held up well although it would not be surprising if there were to be some softness in construction.

### Private Equity

The **Private Equity** division did not make any new investments during the period. The Manager is starting to see very good opportunities due to the current lack of liquidity, although it is currently very difficult to leverage such investments. The focus over the next 6-12 months will be confined to bolt-on acquisitions to the existing portfolio which may be required in order to achieve profitable disposals.

### Manager and Investment Style

EPIC Private Equity ("EPE"), founded in 2001, has completed over 40 transactions and deployed £80 million of capital in £300 million of Enterprise Value. EPE aims to generate a strong yield through investment in mezzanine debt coupled with significant capital appreciation by investing in equity stakes. EPE targets leveraged buyouts at EV/EBITDA valuations of less than 5.0x, backing experienced managers to leverage their positions within established, successful businesses and investment in growing smaller businesses in attractive niche markets with good prospects for growth. Investments in the latter take the form of significant minorities, generally no more than 29.9%.

EPE is seeing good investment opportunities due to the current lack of liquidity in the market, although leveraging such investments is proving to be difficult. The focus of the next 6-12 months will be on bolt-on investments to the existing portfolio.

The current Private Equity portfolio consists of £8.2 million of Mezzanine, yielding between 9% and 12.0% (blended yield 11.0%) interest, and £15.5 million of Equity and Shareholder Loans, invested in 9 companies. Private Equity equates to 40% of EPIC PLC's gross assets.

The businesses within the Private Equity portfolio are trading to expectations. Whilst the effects of the current recession can be seen in terms of lower growth rates in some of the companies, so far the impact has not been as large as anticipated. The Private Equity portfolio was valued at the end of July 2008 on a prudent basis, in line with the standard BVCA guidelines, and in the context of the recession. The current performance of the portfolio is in line with those valuations, and whilst it would not be prudent to make any write-ups until the economic outlook has improved, no further write-downs are currently anticipated.

**Palatinat Schools Limited** (20% of total PE funds invested, 8.1% of fund) is a schools group in central London, in which EPIC invested £3.0 million in mezzanine and £1.3 million in equity and shareholder loans, to fund a management buy out in February 2005. EPIC holds 29.9% of the share capital. Sales have grown in excess of 10% per annum since 2004, and were £8 million in 2008. EBITDA margins run at 30% on average. The business continues to perform to expectations. Comparable companies would be Alpha, Cognitas and Gems.

## Manager's Commentary (cont.)

**Pinnacle-psg Limited** (19% of total PE funds invested, 7.5% of fund) is a social housing management company, in which EPIC invested £3.0 million of shareholder loans and equity in December 2001, as replacement and working capital. £1.0 million of shareholder loans have been returned. EPIC acquired a further 13.8% in September, and now holds 26.3% of the share capital. Sales achieved in the last 12 months were £55.0 million, sales CAGR ("Compound Annual Growth Rate") from 2003 to 2008 has been 28% and operating margin runs at around 5% on average. Comparable companies would be Inspace, Mouchel Parkman, Parkwood Holdings and Tribal.

**Nexus Limited** (19% of total PE funds invested, 7.4% of fund) is a distributor of electrical and wiring accessories. EPIC backed members of the existing management team to buy the business in January 2005, investing £3.1 million in mezzanine and £1.2 million in equity and shareholder loans. Sales have been stable since 2004, were £54 million in 2008 and EBITDA margin runs at around 8% on average. Significant overhead reductions were made in the early part of this year in anticipation of the forthcoming downturn in demand, but so far, whilst there has been a reduction in demand, it has not been as severe as expected and the business is therefore performing ahead of expectations. Comparable companies would be Electrium Ltd, GET plc (recently delisted), Schneider (acquired GET plc) and Legrand SA.

**Pharmacy2U Limited** (4.0% of total PE funds invested, 1.7% of fund) is an internet based medicine retailer and deliverer of NHS prescriptions to the home using the government approved Electronic Transmission of Prescriptions protocol. EPIC invested £0.25 million of growth capital in Pharmacy2U in November 2002 and now holds 8.2% of the equity, having sold 20% of EPIC's

stake in 2005 to EMIS to de-risk the initial position. Sales budget is £20 million for 2009, sales have grown by 37% per annum since 2002. The business is cash flow positive and profitable. Operating margin is not disclosed. No UK comparables but similar companies exist in the US, and Doc Morris in Europe.

**Indicia Group** (19% of total PE funds invested, 7.4% of fund) is a buy and build strategy in the marketing services sector. EPIC originally invested £0.7 million in October 2006 to acquire the first business, Marketing Databasics, and has since acquired Results Europe in December 2006 and most recently, Entire, in March 2008. Recent underperformance in the public markets is expected to provide significant opportunities for acquiring assets from the larger, listed, marketing services groups. The business is performing to budget. Comparables are marketing services businesses such as Cello Group, Chime, M&C Saatchi, Direct Marketing Group and Media Square.

**Ryness Electrical Supplies Limited** (4.0% of total PE funds invested, 1.5% of fund) is retails electrical goods via high street and wholesale and internet channels. EPIC originally invested £0.7 million to acquire the company. Sales mix strategy has shifted towards wholesale (c.50% of sales) with the acquisition in August 2008 of Lama Electrical Limited, a wholesaler with two outlets in West London. The acquisition was funded with £0.4 million bank debt and a further £0.1 million from EPIC, bringing total funds invested to £0.9 million including rolled-up interest. In September the company acquired a further wholesale outlet funded via cash flow. The business is performing ahead of budget despite challenging retail conditions, and is expected to achieve c.£11.0 million sales to June 2009. Comparable companies are Maplin and Robert Dyas.

Other investments (15% of total PE funds invested, 6.1% of fund) are Bighead Bonding, a small precision engineering business, Evolving Media, a digital media agency, and Driver Require, a temporary driver recruitment business.

### Specialist Funds

The **Specialist Funds** portfolio is targeted at diversifying assets to achieve non-correlated returns in excess of the Company's Libor + 3% per annum performance benchmark.

**Jupiter Hyde Park Hedge Fund Limited** (\$6.7 million) is an open-ended limited liability company incorporated in Bermuda. The fund is run by Philip Gibbs and is mandated to invest in a wide range of international investments. Although volatility has picked up significantly over the past year, the fund enjoyed a marked long-term out-performance and has consistently shown a low level of correlation with equity markets in general.

**CCFM Bristol & Stone Baltic Property Limited** (€2.8 million) is incorporated in the Isle of Man and registered as an Exempt International Scheme, focused on property investment in the Baltic States of Estonia, Latvia and Lithuania. The Company's British property advisers are based in Tallinn and have considerable experience of property development, investment and design in the region. In 2004 the Baltic States joined both the EU and NATO and were the fastest growing economic region in Europe for some years. Whilst the portfolio was secured at attractive levels through the availability of "off-market" opportunities at prices that offered some insulation against the inevitable slowing of economic growth in the region following the financial crisis affecting the region's neighbours and trading partners we have marked down the value of our investment by ca.€500,000 (18%).

## Manager's Commentary (cont.)

**EEA Life Settlement Fund** (\$3.8 million) is a Guernsey domiciled. Regulated Class B Fund listed on the Channel Island Stock Exchange and its objectives are to purchase, hold and manage a portfolio of US life settlements, provide a minimum benchmark return of 8% per annum and generate a consistent total net return of between 9% and 10% per annum. The Fund provides an opportunity to invest in an asset class that is wholly uncorrelated with traditional investments and continues to achieve consistent and stable returns. The Fund continues to enjoy positive price movements with 38 months of continuous growth.

**CCD Leisure Investments** (\$3.2 million) has been set up to invest in prestige holiday developments in emerging destinations. The first investment has been into the popular emerging tourist destination of Grenada which is located south of the usual hurricane path and whose tourist industry remains relatively undeveloped. The land for the project has been bought cheaply and potential returns therefore remain high. A small number of major players, such as Four Seasons Hotel Resorts, have highlighted the Island as an attractive emerging destination with direct flights from London and Frankfurt. Properties are priced at a fraction of its better known competitors in the Caribbean and the Island has strong potential for boutique and eco-sensitive development. ERA's and CBRE's research and analysis suggests a significant price uplift can be achieved even in the present financial climate.

**King & Shaxson** (£1.2 million) continued to outperform the general market. The current stance is a weighting towards large international companies rather than UK domestics.

**EPE Special Opportunities plc** (£0.8 million) is a closed-end Fund listed on AIM, focused on the control and

ownership of distressed assets. The advisers believe that there remains potential to create value within the distressed investment market place and that the economic cycle will provide a wide range of investment opportunities. The Fund's largest investment is in Past Times, a niche retailer of historically inspired jewellery, gifts, books and house-wares which was acquired at the end of December 2005. Past times has undergone a major restructuring process with a number of stores and the head office cost base reduced and the product range improved. The business is now benefiting and because of these operational improvements its performance is holding up relatively well in a difficult retail environment.

The Fund acquired Whittard of Chelsea during the period, a specialist retailer of tea and coffee. The business was acquired from Landsbanki/Baugur, and is currently being restructured to return it to profitability.

The Fund has smaller investments in Kemutec, manufacturer of mixing and sifting equipment for the chemicals, pharmaceutical and food industries, Autocue, a manufacturer of prompting equipment for the media industry, and Morada Home Limited, focusing on contracts with the Ministry of Defence to supply curtains and blinds for living accommodation.

**Avarae Global Coins plc** (£0.7 million) is an AIM listed specialist investment company which is in the process of purchasing an impressive portfolio of high quality rare coins which will be held for the long term. The shares were purchased at a price which the Managers believe to be at a significant discount to the underlying value of assets which are generating growing interest among investors globally as an alternative asset class. Delivery of the shares has been delayed as they were caught in the freeze on the assets of

Landsbanki in the UK we are presently seeking to resolve this issue but it appears likely to be prolonged.

In addition to Wagon and Woolworths mentioned in the Quoted Equity section, Equity Special Situations Ltd appointed liquidators in December. We had already written down our shareholding to nil in November due to concerns over their assets having been disposed of by Landsbanki.

### Strategic Investments

The share price of **Syndicate Asset Management PLC** continues to trade at low levels due to the confusion and concern as to the whereabouts of shares pledged to Icelandic banks. However, as mentioned in previous newsletters, the majority of the Funds' consideration from the sale of EPIC Investments Partners at the end of 2006 is retained in Loan Notes which paid a 6% coupon during the period under review.

Over the last quarter, **Strand Partners**, while continuing to see high levels of general client enquiries, suffered from the uncertainty that such deals can be completed in the current market conditions. As a result of this and a general de-rating of financial investments in the quoted sector, the Managers have written down the valuation of this shareholding.

## Market Data

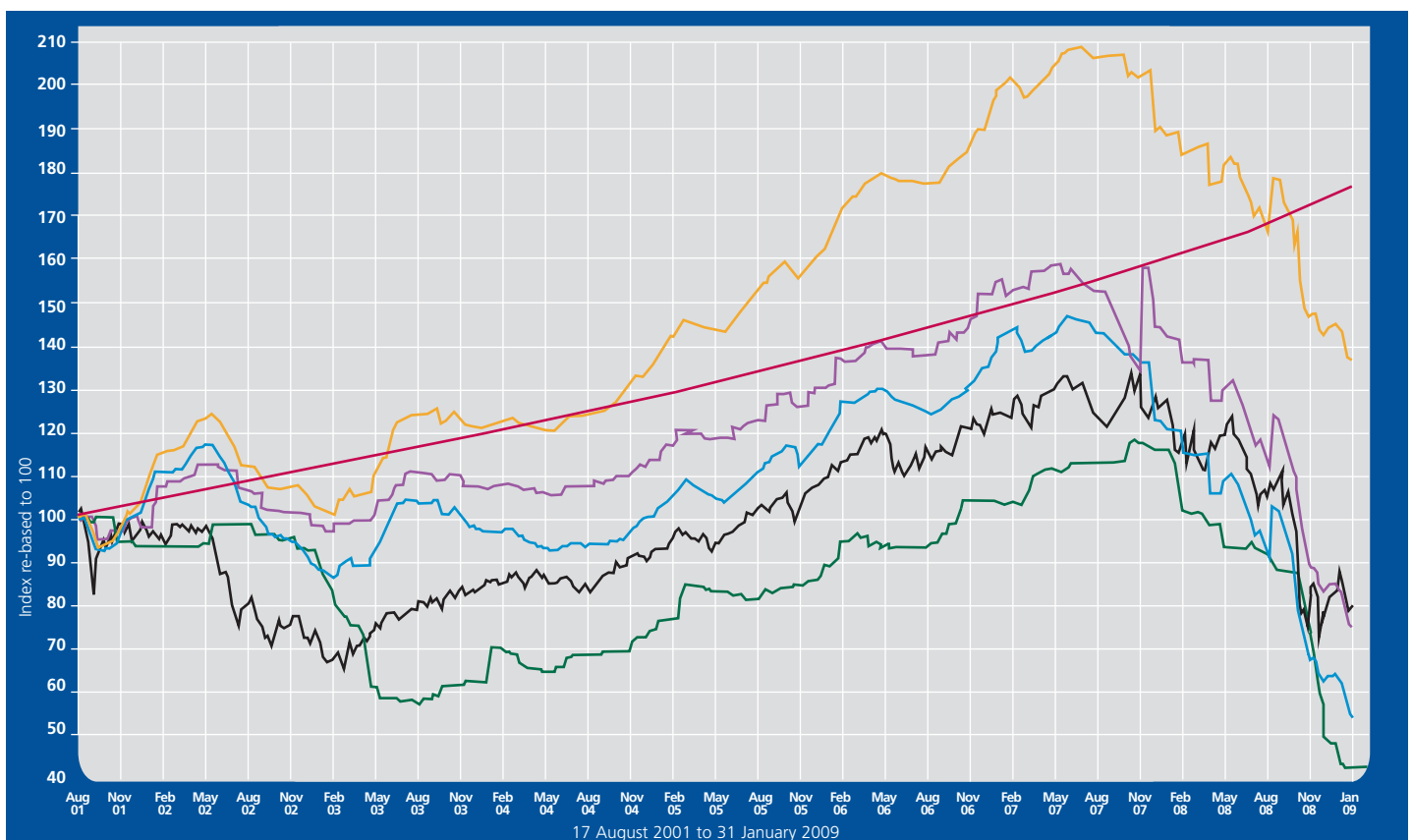
	<b>89.5 months since launch</b>
Capital Shares	-57.58%
FTSE All Share Index	-19.75%
NAV	-45.70%
Benchmark	77.49%

- Capital Share Price
- Capital Share NAV
- Benchmark (Liber + 3%)
- FTSE All Share Index
- NAV + Inc Nav (Div Reinvested)
- NAV (Cap and Cumulative Div)

## Largest Investments

Largest Investments as at 31 January 2009	Cost	Market Value	% of total investments
Pinnacle-Psg Limited	4,920,717.00	4,921,008.00	8.22%
Nexus Industries Limited - £1m Convertible Loan Note 30/06/2008	7,398,925.45	4,748,446.00	7.93%
Jupiter Hyde Park Hedge Fund	2,000,000.00	4,501,056.63	7.52%
Alpha Real Estate GmbH 8% February 2010	3,446,137.00	4,444,246.92	7.42%
Indicia - DDB A - 30/09/2016	4,236,538.00	4,428,538.00	7.39%
Palatinat Schools Holdings - DDB A - 31/12/2014	4,250,007.00	4,250,007.48	7.10%
EEA Life Settlement Fund (USD)	1,579,268.85	2,650,408.86	4.43%
CCFM Bristol & Stone Baltic Property Limited	2,816,822.80	2,561,781.25	4.28%
Syndicate Asset Management PLC 6% Loan Note 31.12.10	2,502,450.00	2,502,450.00	4.18%
Diploma	1,771,901.43	2,204,715.60	3.68%
CCD Leisure Investments Conv Loan	1,488,833.75	2,080,876.74	3.47%
Evolving Media - DDB A - 25/06/2008	1,707,408.00	1,465,116.00	2.45%
Aurum Mining	2,997,914.91	1,428,825.03	2.39%
Bighead - DDB A 31/12/2016	750,000.00	750,000.00	2.30%
King and Whaxson Premier Fund Limited	1,000,000.02	1,215,475.65	2.03%
<b>Total of Largest 15 Holdings</b>	<b>42,866,924</b>	<b>44,152,952</b>	<b>71.42%</b>
<b>Other investments</b>	<b>41,501,986</b>	<b>14,728,403</b>	<b>23.82%</b>
<b>BGI Sterling Liquidity Fund and Cash deposits</b>	<b>2,984,053</b>	<b>2,943,407</b>	<b>4.76%</b>
	<b>87,352,963</b>	<b>61,824,763</b>	<b>100.00%</b>

## Share Price and NAV Performance vs Benchmark (from 17 August 2001 to 31 January 2009 - re-based to 100)



Source: Bloomberg

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