THE ACTIVE BANKING FUND

Annual Performance Report

August 2014

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Fund's Performance in last 12 months

Performance review period: August 1st 2013 – July 31st 2014	
Current fund size: €4.3mn Fund size at end July 2013: €4.1mn Fund size at launch (July 2012): €2.9mn	
Fund's gross performance (after trading commissions)	**-0.7%**
Fund sub-portfolios return • US banks • European banks	 +1.5% -3.5%
Charges Recurring • Investment management fee • Administration fee • Performance fee* • USD/EUR hedging costs** • Other charges Charges One-Off • Fund set-up cost fees (3rd instalment paid in September 2013)	 1.0% 0.65% 0.15% 0.10% 0.05% 0.35%
Net Fund Return	**-3.00%**
Net Fund Return (excluding one-off charges)	**-2.65%**

* Accrued and paid for period August 2013–December 2013, a period when NAV per share was increasing; no performance fee has been accrued in 2014

** During the 12 month period, the euro appreciated by 1.2% vs the US dollar; hedging ensured that the euro value of the Fund's US investments was unaffected

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US banks portfolio performance and strategic repositioning in 2014

Underlying/benchmark	Performance Aug 13 – July 14 (EUR equivalent)
Fund's US banks portfolio	+1.5%
KBW Bank Index*	+2.1%
Big 4 US banks**	+1.4%

* Index comprises the 24 leading national and regional banks in the US

** Arithmetic average of the last 12 months performance of the big 4 US banks (JPMorgan Chase, Bank of America, Citigroup and Wells Fargo)

- Fund's US banks portfolio marginally underperformed the KBW US Banks Index and matched the average performance of the big 4 US banks during the 12 month period.
- US megabanks, with the exception of Wells Fargo, underperformed the broader market due to a marginal slowdown in revenue growth and substantial fines paid to the US authorities in the last 12 months in relation to their role in promoting sub-prime mortgages securities that led to the 2008-9 financial crisis; US regulatory probes of banks have now been completed and no more fines are expected to be paid moving forward.
- As from March 2014, the Fund began switching funds away from underperforming megabanks towards outperforming US regional banks focused on commercial banking and banks with significant consumer finance operations; these institutions will benefit substantially as the US economic recovery gathers steam via the combination of two factors:
    - Higher loan volumes to consumers and small/medium sized corporates as demand for credit increases
    - Higher net interest rate margin and higher profits once Federal reserve starts increasing the US base rate in 2015 (base rate determines banks' lending and deposit rates)

European banks portfolio performance and strategic repositioning in 2014

Underlying/benchmark	Performance Aug 13 – July 14
Fund's European banks portfolio	-3.5%
Basket of major European banks in non-peripheral countries*	-9.9%

* Arithmetic average of the last 12 months performance of the top 10 banks (by market cap) in the UK, Germany, France and Switzerland. Basket excludes state-owned banks with problematic balance sheets (Royal Bank of Scotland and Commerzbank) and banks in peripheral countries (Spain, Italy, Portugal and Greece) which are still considered to be high risk

- The Fund's European banks portfolio significantly outperformed the performance of a basket of major European banks in non-peripheral European countries.
- 2014 has a been a particularly bad year for European stock markets due to:
  - Anaemic eurozone growth
  - Low eurozone inflation viewed as bad indication for corporate profits
  - Escalating situation in the Ukraine, US/EU sanctions against Russia and Russian countersanctions, including the possibility of increases in the price of natural gas exported to Europe
- The key European German and French stock markets are down by more than 10% from their peak in the last 6 weeks (the official definition of a correction).
- The peripheral Eurozone Portuguese and Greek stock markets are down 30% and 20% respectively since April, partly due to concerns about the health of their banking sector (following the recent collapse of Banco Espirito Santo in Portugal).
- European banks share price performance in 2014 was negatively impacted by concerns about the outcome of the ECB stress tests (to be announced in October) and by US authorities investigations of the activities of a number of major European banks (with major fines imposed on some of these banks).
- The Fund's European banks portfolio performed relative well in a very challenging environment due to a combination of factors:
  - Good stock selection (picks with solid profits and very strong capital ratios)
  - Avoided banks facing major US regulatory investigations and fines (with the exception of BNP Paribas, a very solid and profitable bank which was nonetheless hit with a very big US fine of $9bn in Q2 2014)
  - Avoided European banks with significant activities in Russia and Eastern Europe (mainly Austrian and Italian banks, whose shares were very badly hit recently)
  - As from June 2014, and in view of escalating geopolitical concerns and worries about ECB stress tests, the Fund started investing in Scandinavian banks operating exclusively in the Nordic region (solid economies with few downside risks and banks with stable profits and very strong capital ratios)

Fund's biggest holdings in the US

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Security	% of total Fund NAV	Investment rationale
Wells Fargo	4.6%	World's largest bank by market capitalisation; share price has been by far the best performer amongst US megabanks in the last 12 months; very well managed commercial bank with 35% market share in the US mortgage market; pays the highest dividend yield amongst the top 30 US banks (2.8%)
Capital One Financial Corp.	4.3%	A very profitable bank focused on consumer lending; ranked amongst the 5 cheapest financial stocks in the US with a current P/E of 10.3*
Discover Financial Services	3.3%	A very profitable and fast growing company focused on credit card loans and other consumer loans; has achieved very strong growth in earnings per share in the last 12 months; still undervalued given its growth prospects (current P/E of 11.3)
US Bancorp	3.0%	The biggest US regional bank by market cap; a consistently profitable and well managed franchise with high quality earnings, good dividends and a very strong balance sheet
KBW Regional Banking ETF	2.8%	US regional banks will be the biggest beneficiaries of the imminent increase in US interest rates; Fund's objective is to increase exposure to this ETF as Federal Reserve's interest rate hike timeframe becomes clearer
PNC	2.4%	The second biggest US regional bank by market capitalisation (after US Bancorp); consistently profitable and currently the cheapest US regional bank with a P/E of 11.1
JPMorgan Chase	2.1%	World's second largest bank by market capitalisation; pays the highest dividend yield amongst the top 30 US banks (2.8%), jointly with Wells Fargo; put all its regulatory problems and fines behind it last year via settlement with the US Department of Justice for an amount of $13bn

* Historically, the average P/E of US banks has been 13 to 15; high growth financial stocks with stable earnings can command a P/E > 15; banks with volatile earnings/investment banking activities typically have lower average P/Es

Fund's biggest holdings in Europe

Security	% of total Fund NAV	Investment rationale
BNP Paribas (France)	3.5%	Eurozone's second largest bank by market capitalisation and currently the eurozone's most profitable bank in terms of absolute quarterly profits (excluding one-off items); share price hit badly recently following payment of $9bn fine to US authorities for US sanctions violations; bank's capital ratio and dividend payments not impacted by US fine and profitability remains very strong; one of the cheapest banks in the eurozone at current valuation levels
Credit Agricole (France)	3.1%	Has significantly strengthened its balance sheet and profitability by selling or exiting non-core businesses in peripheral eurozone countries (including loss making Emporiki Bank in Greece); has completely written-off its 15% shareholder stake in Portugal's Banco Espirito Santo without any impact on its capital ratios due to substantial profits in the first half of 2014; one of the cheapest banks in the eurozone at current valuation levels
DNB (Norway)	2.2%	Norway's biggest bank and one of the biggest banks in Scandinavia. Norwegian Ministry of Trade and Industry has a 34% stake in the bank. A low risk institution with consistent profitability, operating in one of Europe's richest economies; it is by far the cheapest bank in Europe with a current P/E of 8.5. Seen as a safe haven investment in Europe given current geopolitical developments and anaemic eurozone growth
Nordea (Sweden)	2.1%	Biggest Scandinavian bank with HQs in Sweden and a major presence in Norway, Denmark and Finland; highly profitable with a dividend yield of 4.2%
SEB (Sweden)	2.1%	SEB is Europe's second best capitalised major bank with a core tier 1 capital ratio of 16% (Sweden has the strictest bank capital ratio requirements in Europe); highly profitable with a dividend yield of 4.5% (returning surplus capital to investors)

Future outlook and strategy

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US banks

- Expected to continue to outperform as US economic growth picks up steam and unemployment drops to 5 year lows.
- Regional commercial banks and consumer lenders expected to outperform megabanks in 2015 as increased demand for credit and higher interest margins boost profitability.
- Only major downside risks for US banks are global geopolitical factors and internal partisan US politics; Fund is currently overweight in US banks with zero activities outside the US, hence they are likely to be insulated from any potential escalation of the US/EU vs. Russia sanctions war.
- Fund will gradually increase its exposure to regional banks and the Regional Banking ETF as the Federal Reserve's interest rate hike plans become clearer.

European/UK banks

- Eurozone remains vulnerable to anaemic growth and the escalating US/EU vs. Russia sanctions war.
- Lack of uniformity in performance and underlying dynamics of European banks.
- The Fund will maintain a cautious investment strategy vis-à-vis European banks.
- The Fund will avoid investments in high risk banks in Spain, Italy and Greece (high non-performing loans and stress tests concerns).
- The Fund will maintain and possibly increase Scandinavian banks holdings.
- UK banks appear to be good investment targets. With UK economic growth picking up, the Bank of England is expected to embark on UK interest rates hikes even before the US's Federal Reserve. A well-tuned UK interest rate hike will benefit UK banks with sizeable commercial banking operations. Already, some UK banks have reported an increase in their net interest margin in the first half of 2014. This margin (and profits) will go up further as UK rates start increasing in a controlled manner.
- The Fund has started to selectively invest in UK banks via their US listed, dollar denominated ADRs (hence avoiding the 0.5% stamp duty imposed on the purchase of UK shares on the London Stock Exchange). Will gradually add to these positions as the Bank of England's rate hike plans become clearer.

	UK (Bank of England)	US (Federal Reserve)	Eurozone (ECB)
Average economic analysts' forecast of when interest rate hikes will begin (a big positive for bank shares)	Q4 2014 or Q1 2015	Q1 2015 or Q2 2015	Not before late 2016