Tenax Absolute Return Strategies Fund
Investment process

Church House
Investment
Management

Contents

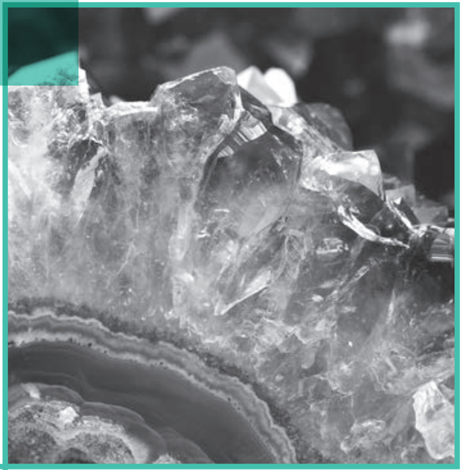
Introducing
Church House Investments

Church House Investments Limited was established in 1999 as a wholly owned subsidiary of Church House Trust PLC. The Investment Management team completed a successful MBO in January 2010 following the sale of Church House Trust to Virgin Money holdings.

Church House Investments Limited is a private company, majority owned by the directors with a 20% stake held by The Cayzer Trust Company. Church House has been authorised and regulated by the Financial Conduct Authority (and predecessors FSA and IMRO) since inception.

Church House manages six UK authorised funds, all established in the period 2001 to 2007 as 'building blocks' for private client portfolios. The firm also manages a bespoke discretionary private client service (along with a Managed Portfolio Service) through a range of risk-designated portfolios. Long-term track records for all the funds are available.

Focus on
Church House Tenax Absolute Return Strategies Fund



Background

In 2007, a private client of Church House Investments sold his business and needed a safe place for £10m. The client had taken risk in accumulating his wealth through his own company and CH recommended a lower-risk absolute return approach.

This was the catalyst for Church House to launch the Tenax Absolute Return Strategies Fund. The aims of that seed investor, and we believe the aims of all investors in absolute return funds, were long-term preservation of capital in real terms, and avoidance of the worst extremes of short-term volatility in financial markets.

Although long-term preservation of capital may not be an attribute sought by portfolio managers blending different investment styles, they do value these qualities for their contribution to reducing portfolio drawdowns and lowering overall volatility.

Objective and policy

The Tenax fund's objective is a positive return in excess of cash returns plus fees over rolling twelve-month periods, at low levels of volatility.

The fund's benchmark was originally set in relation to three-month GBP LIBOR. With the imminent demise of LIBOR, we are currently considering an appropriate replacement, potentially SONIA (Sterling Overnight Index Average) plus, or annual inflation rates.

The broad policy is to embrace diversification across multiple, liquid asset classes within a strict limit structure. Bearing in mind the absolute objective and the importance of preservation of capital, we do not limit cash (or near-cash) exposure. Cash is the benchmark, don't be afraid of it!

Investments are principally direct (Tenax is not a fund-of-funds). Closed-ended investment vehicles and other funds may be used tactically and to gain diversification, to a limited extent.

The fund managers

The Tenax fund has been co-managed by James Mahon and Jeremy Wharton since its launch in November 2007.

James Mahon
Chief Executive and Joint Chief Investment Officer

James Mahon is the Chief Executive and Joint Chief Investment Officer of Church House. His background includes being an options trader, involved in equities hedging, then portfolio management before establishing Church House Investment Management in 1999.

He became a member of the London Stock Exchange in 1980 and has held a number of senior posts, including being a partner in stockbrokers Galloway & Pearson, a director of Hoare Govett and Managing Director of Archdale Securities.

Working with the Investment Committee, he is responsible for the overall asset allocation strategy for all client portfolios.

He is a Chartered Fellow of the Chartered Institute for Securities and Investment (FCSI).

Jeremy Wharton
Director and Joint Chief Investment Officer

Jeremy Wharton is a Director of Church House and Joint Chief Investment Officer with a particular involvement in credit markets. He had a fourteen-year career in the City during which he worked in the Gilt market for Laurie Milbank, Chase Manhattan and Butler Harlow before co-founding an independent Gilt broker, Liberty Gilts.

He then spent five years as a professional investor in derivatives, trading a global macro derivatives book, before joining Church House in 2004.

He is lead manager of the Church House Investment Grade Fixed Interest Fund and co-manages the Tenax Absolute Return Strategies Fund.

He is a Chartered Fellow of the Chartered Institute for Securities & Investment (FCSI).

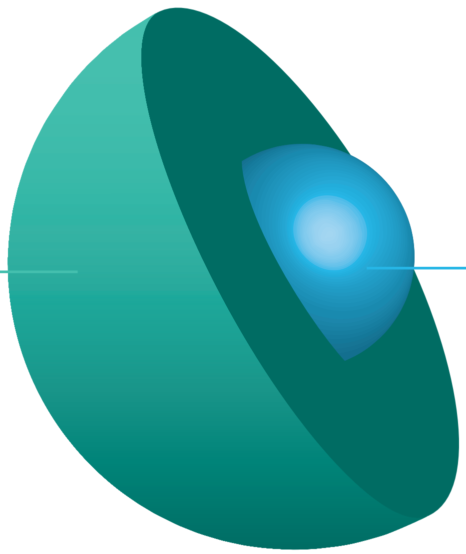
The managers have the support of credit and equity analysts and also liaise with the other Church House fund managers for ideas.

Investment methodology overview

The investment process combines a strategic top-down framework, which contains the risk controls and asset allocation parameters and controls the volatility and beta of the portfolio, with tactical bottom-up, valuation-driven security selection, which is the main driver of performance.

STRATEGIC OVERLAY

Top-down framework comprising risk controls and asset allocation parameters. The bedrock of the absolute return objective, controlling the volatility and beta of the portfolio.



TACTICAL STOCK SELECTION

Bottom-up, valuation-driven, shorter-term, tactical approach. Returns are derived from investments selected based on their valuations. Enables the Fund to profit from short-term market volatility.

The overall asset allocation at any one time is the decision of the managers, acting jointly, within the strict bounds of the limit structure. Individual security investments within each of the asset and sub-asset classes is also the subject of joint decisions by the managers. Investments are undertaken when we consider there is the opportunity to achieve an absolute return; these may be run to maturity (principally debt instruments) or such time as we consider their valuation to no longer be attractive. We have a low tolerance for losses and close positions quickly in the event of new risks or poor performance.

The process actively looks to benefit from opportunities arising from short-term market volatility in any of its target asset areas. Corporate actions and capital market fund raising are also useful sources of opportunities. Ideas from some of the other Church House funds can often crystallise in the Tenax fund, particularly fixed income, which is a key part of this fund.

The management team look to invest across a broad range of asset classes within a liquid, diversified portfolio of mainly direct investments with maximum, but no minimum, limits on asset class weightings and a focus on fundamental investing.

Strategic asset allocation

The strategic overlay, the top-down framework, provides the backbone of the Fund, the resulting asset allocation structure is set out below. The first column sets out the broad outline, the second shows how we sub-divide this into eleven asset classes and the third provides further detail by sub-class:

Outline Structure	Max Weight	Main Asset Classes	Max Weight	Sub-asset Classes	Max Weight
Cash/nr. Cash	None	Cash	None	GBP Deposits	None
				Foreign Currency Deposits	10%
		UK Gilt/T-Bills	50%	UK T-Bills/Short Gilts/AAA Supra	50%
		FRN £ AAA	50%	FRN Sterling AAA (short-dated)	50%
Fixed Interest	50.0%	Other FRN	20%	FRN Sterling <AAA	15%
				FRN capped/collared GBP	15%
				FRN Foreign Currency	10%
		Other Fixed Interest	40%	Sovereign/Supra debt GBP	40%
				Corporate debt GBP	25%
				Corporate Debt EUR	10%
				Corporate debt USD	10%
				Hybrid corporate debt GBP	7.5%
				Hybrid corporate debt ex GBP	5%
				Distressed debt	5%
		Index-Linked	20%	Index-linked sovereign debt	20%
				Index-linked corp. debt GBP	10%
Convertible/ZDP	20.0%	Convertible/ZDP	20%	Convertible debt GBP	15%
				Convertible debt ex GBP	5%
				Zero coupon debt GBP	7.5%
Alternative/Hedge	20.0%	Infrastructure	10%	Infrastructure - physical	10%
				Infrastructure - renewables	5%
		Hedge Fund	15%	Macro hedge	15%
				Hedge - equity long/short	15%
Property/Real	15.0%	Property/Real	15%	Commercial property	15%
				Commodity	7.5%
Equity	25.0%	Equity	25%	Direct equity	20%
				Equity hedge/volatility	5%
				International equity	15%
				Small cap equity	7.5%
				Private equity UK/Euro	10%
				Private equity US	7.5%

The columns do not sum to 100%, they are maximum exposure figures to any one asset or sub-asset class. We do not set a 'normal' or 'model' strategic allocation, a rough guide might be inferred from the proportions in the first column.

We wish to have the ability to hold a broadly diversified book of assets/investments at any time (within the limit structure) as we see opportunities to achieve our objectives. Equally, we do not wish the structure to put us in a straight-jacket and wish to maintain the ability to 'stand back' and be patient when we feel it is prudent to do so. This strategic structure is the product of the Managers' experience over many years, refined with our experience in running Tenax over the past eleven.

Origins and rationale

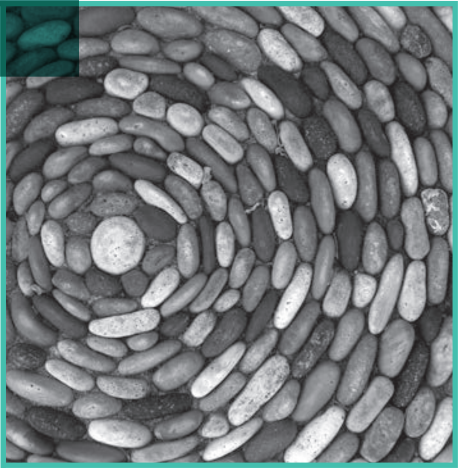
At the outset in summer/autumn 2007, when we were planning the Fund, we considered a number of possible structures, but settled on a broadly diversified multi-asset class fund, biased towards fixed interest instruments, as the most satisfactory and the one most likely to deliver our objective.

We had been managing funds and portfolios to different levels of risk for a number of years but the absolute return objective brought a new dimension. Given our backgrounds, we naturally considered a hedged approach first, making extensive use of derivatives. But, and bearing in mind that this was 2007 when a number of 'derivative instruments' appeared to us to be testing the outer limits of sense, we concluded that a more straightforward approach would be more appropriate and have a lower risk profile (how many of these new instruments would survive a downturn?). Two other considerations in particular weighed with us in this decision: one was a desire to avoid the over-complexity of many hedge funds and hedge-based strategies, which frequently brings more risk than is admitted to or is obvious, e.g. pyramiding of counter-party risk, mismatch of 'short' and 'long' positions, hidden gearing or open-ended exposure etc; the other (linked), was a wish to be able to present the Fund's policy in explicable terms without clouds of technical jargon.

The ability to own a broad range of assets, hopefully with different attributes and low correlation of returns appealed to us. We had followed the policy and progress of David Swensen's model for the Yale Endowment for a number of years and were fascinated by his approach, which might seem counter-intuitive to anyone familiar with his Yale Model as it has a significantly higher risk profile. David Swensen took on the Yale Endowment portfolio in 1985 and set about switching it from a traditionally invested portfolio consisting primarily of listed US equities with some US Government debt to a radically different approach comprising broad diversification across four / five 'buckets' of risk assets with an emphasis on equity in all its guises, e.g. including: private equity, smaller companies, international and emerging market equity and hedge funds. Fixed interest and cash instruments were demoted to an occasional sixth/seventh position, essentially for short-term cash management. His contention was that liquidity came at the price of lower returns (an interesting observation in the light of current concerns). Our view was that this was a fascinating, and probably ideal, approach for an ultra-long-dated investment portfolio of sufficient scale (just as is the case with the Yale Endowment). We liked the 'mould-breaking' structure and its layers of diversification, but were concerned that there was potential for violent shorter-term volatility. This was borne out by a near 30% fall in 2009.

Equally, we had long been admirers of Buffett and Monger's Berkshire Hathaway, but, while each strategy has merits over different time periods and for different investment requirements, we did not find any of them to be satisfactory when considering our objective to provide consistent, low volatility returns, with capital preservation as a central tenet. We readily accept that a properly managed and diversified portfolio of good quality international equities is likely to out-perform other asset classes over the long-term (more than ten years, preferably longer) but that this is only probable if these assets are held for the long-term. Over any shorter period such a portfolio will exhibit higher volatility and be subject to periodic significant down-drafts. Our objectives are absolute, for positive rolling twelve-month returns.

We settled on a multi-asset approach for the diversification but, effectively, one that reverses the asset split utilised by Yale, recognising our absolute objective. We wish to hold a diversified pool of assets, though the 'carry' and compounding from fixed interest instruments (in the broadest sense) dictates that these will always represent the greatest proportion of the Fund.



Tactical asset allocation

The main focus day-to-day is on tactical asset allocation, the management of individual positions and stock/ security selection within each asset class. The managers consider this gives them the best chance of achieving the overall absolute return objective, whilst minimising drawdowns and volatility.

The fund managers adopt a bottom-up, valuation-driven approach to individual investments, in particular assessing the risk/likelihood of achieving an absolute return from the investment. They look through the corporate structures to seek out the most attractive entry level (debt, convertible, equity etc.).

Tactical positions are influenced principally by valuations in the various asset classes. When bond spreads tighten and equity valuations appear stretched, the allocation to money market instruments is increased to shore up the Fund's defence against a likely increase in the volatility of risk assets.

However, during a spike in volatility, it is usually possible to take advantage of mis-pricing opportunities and the fund's performance history shows that periods of volatility in markets are usually followed by periods of strength in the fund as positions taken at the height of that volatility come to fruition in the recovery.

For example, in January 2016, concerns over the viability of Deutsche Bank caused spreads on investment grade bonds to widen considerably, as much as 30% in a number of cases. A number of positions were added in the fund and as spreads on these tightened again when the 'panic' passed, the Fund delivered strong performance.

The management of these tactical situations is largely intuitive and it is the experience of the fund managers that has made them successful over the years since the fund was launched.

Idea generation

The managers generate and monitor ideas on a daily basis, none are acted upon without agreement between them.

Specific investment ideas are sourced through internal research, company meetings and external research*. We draw on research from a number of sources including: JP Morgan, Barclays, Jefferies, RBC, Stifel, Peel Hunt, TS Lombard, Canaccord Genuity, Bloomberg and Winterflood. We also subscribe to third party investment and analytics software, which enables us to screen potential investments according to various risk and return metrics. Specifically, we are looking for investments that have a good probability of delivering out-performance of our cash benchmark over the specified period.

We have a monthly Investment Committee meeting, which considers the investment strategy, a macro overview, and reviews tactical investment selection. The committee Chairman is Michael Baines, who was a main Board Director at Robert Fleming; Deputy Chairman and Head of Trading at Robert Fleming Securities and their Global Head of Risk. The committee also monitors risk at all levels of the portfolio and specifically the monthly compliance reports, and is made up of experienced individuals who have run money for many years, bringing a pragmatic perspective to decision-making.

The output from the Investment Committee helps steer the bottom-up research effort by identifying particular geographic areas, industry sectors or investment strategies that are likely to outperform in the future.

*All costs associated with external research are paid by Church House Investments, not passed on to clients or funds.

Portfolio construction

Although both of the Tenax fund managers have managed hedge funds in their careers, our strategy is to derive absolute returns from what is essentially a long-only portfolio, using managed cash, diversification and patience to defend against downside risk.

In a long-only portfolio, the purest form of absolute return investment is compounding interest. This is our starting point and any investments beyond cash must have the potential to exceed the return from cash on a rolling twelve-month view. Cash is the starting point for an absolute return fund. Cash returns are meagre at present but simple three-month UK Treasury Bills have provided positive real returns (at the lowest level of risk) in 65 of the past 100 years. We like to be paid to own a holding so a yield, coupon or dividend is an added attraction to any asset.

Typically, the fund maintains 125/150 investment positions. Investments are principally direct although, to a limited extent, closed-ended investment vehicles and other funds may be used tactically or to gain further diversification. Position size decreases with increasing risks so lower risk assets, such as AAA floating rate notes, have larger position sizes c. 2% to 2.5% while a direct equity position will be closer to 0.5%.

The managers seek to exploit mispricing opportunities that arise during periods of heightened volatility. These opportunities may occur in any asset class so the managers look through the entire capital structure of a company to determine the most appropriate entry point. Equities are not an asset class to which one can easily attribute absolute return characteristics, there may well be better opportunities to be found in hybrid or convertible debt or investment grade corporate debt in any particular company.

The fund managers maintain close contact with markets, aiming to capitalise on short-term volatility and take advantage of events (e.g. the Brexit referendum). They do their own dealing, which helps to reduce commission costs and gives them a real feel for how the market is trading, something lacking when fund managers give their trades to a central dealing desk.

Managed cash

Investments are looked at from the viewpoint of being able to beat cash returns. If the managers are unable to find enough opportunities they are willing to hold high levels of cash whilst maintaining diversification amongst the remaining positions. The allocation to managed cash is the only one with no upper limit.

We do not leave cash at the fund's bank awaiting opportunities, we consider it to be an asset class to be worked in the manner of 'treasury' and do not wish to have idle funds. Cash remains in the bank for the shortest possible period; initially we will invest in ultra-short Gilts or Treasury Bills, occasionally in ultra-short supra-nationals. Currently the next most attractive near-cash asset is AAA-rated floating rate notes (FRN). To qualify in the fund as near-cash, these will typically be senior, secured, covered debt issued by financial institutions at institutional 'benchmark' scale with triple-A ratings.

The floating coupons of these bonds have, until recently, been set at a margin over 3-month LIBOR, providing us with a respectable return and positive carry, along with a 'free' hedge against rising short-term rates. With the demise of LIBOR in a few years, most new FRN issues in this area are now being linked to SONIA, and we have cleared out all LIBOR-linked issues with maturities beyond 2021 when banks are no longer required to calculate the rate.

We do not place a limit on the fund's cash/nr. cash weighting as this is the starting point. We consider it to be important not to be afraid of cash when we can't see attractive alternatives to meet our criteria.

Fixed Interest

Fixed income and money market instruments will comprise the majority of the underlying assets in the fund at any one time, corporate bonds have been a big contributor to returns. The managers are active within the fixed income part of the portfolio, trading existing holdings and looking for relative value opportunities, so turnover is relatively high. Positions have principally been short-dated and investment grade but the Fund is not restricted to investment grade and may invest in other areas when valuations are attractive.

Fixed interest covers a wide range of bond-related instruments. At its simplest, the fund must be attracted to what are longer-term deposits, providing the opportunity to compound returns to a future date. Our approach to the asset class has to encompass a range of variables starting with our view as to the yield curve. This must be set within an economic framework and to this end we take economic research from a variety of major banks and independent sources to assist us in forming a view. For sovereign bonds, principally Gilts, this points us to the area of the yield curve and redemption yield that we consider most likely to meet our criteria.

In the light of our yield curve view, we then consider the creditworthiness of the many other corporations and financial institutions that seek to borrow money in the market by issuing debt securities. Again, we utilise external research and credit ratings to assist with our research. The book of corporate debt is built in the light of this and, most importantly, the available spread of the individual credits. We are active traders of the price and spread of corporate debt.

When looking at any company we consider the relative attractions of the securities that make-up their capital structure. For example:

Hybrid Debt Securities These sit just above equity in the capital structure of a company (as a rough rule of thumb, the agencies count them as 50/50 debt/equity) and as such, normally carry a higher yield. Being more susceptible to equity market volatility, we have found opportunities in this asset class on a number of occasions.

Convertible Securities The market in convertible debt securities has shrunk in recent years as corporates have found it relatively easy to raise money in conventional fixed interest debt. But convertibles are a good investment for Tenax, when available. We seek to buy these from issuers that we trust at a reasonable price as a straight bond, leaving the convertible element as an attached call option or warrant on the equity.

Equities

It is hard to ascribe absolute return characteristics to equity but as a class it is a great diversifier of risk. 'Equity' risk in the overall portfolio is higher than the simple equity exposure percentage indicates as many of the other asset classes exhibit correlation to equity markets to varying degrees. We calculate an equity beta for the entire portfolio at all times.

We take equity exposure principally via direct investments and listed closed-ended funds, we can utilise open-ended schemes but keep this below 5% in total. Investments tend to be split into short-term holdings and longer-term, strategic holdings, such as private equity investment companies (all listed, we do not hold un-listed investments) and, for example, Berkshire Hathaway, which had been held for ten years until a recent sale.

Individual equity positions are selected for their fundamental and technical attractions, feeding off the research undertaken for our equity funds. But we have a low tolerance for losses in this volatile area and utilise stop-loss limits when appropriate.

Other Asset Classes

Hedge Funds As an asset class and diversifier, hedge funds should be an interesting area for Tenax. In practice we find few that meet our disclosure and transparency requirements and performance has been patchy at best. Liquidity can also be a problem for these funds.

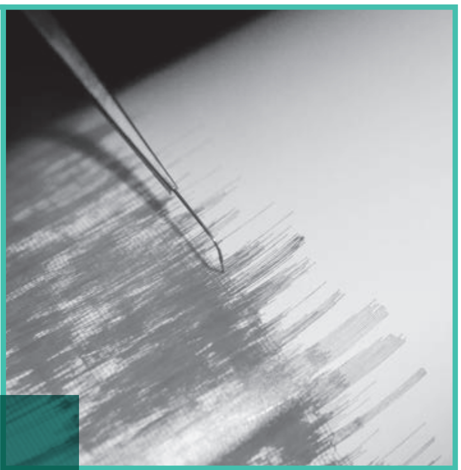
Infrastructure Infrastructure investments have been a feature of the fund for many years. The attractions of long-term revenue streams from government backed projects is clear. In recent years, the area has become much more politicised and we have scaled-back involvement. Recently we have been adding exposure in less politically sensitive areas, such as energy storage and efficiency.

Property Property exposure is undertaken via real estate investments trusts (REITs), we do not invest in physical or unlisted assets and do not like the risk profile of open-ended structures investing in illiquid property assets. Listed REITs provide opportunities in all areas of the commercial property market and significant scope across corporate structures.

Foreign Currency Tenax is a sterling-based fund and the majority of investments are in sterling assets, exposure to other currencies is normally in the range of 8% to 15%. The Managers do consider investments in assets in other (principally hard) currencies, regarding these as a further diversifier of returns.

Risk Controls and Volatility

In addition to the asset allocation/limit parameters set out in the appendix, we limit exposure to any one counterparty to 5% (excepting UK Treasury paper). This relates to all exposure to a counterparty across their capital structure, be it covered AAA paper, equity or cash deposit. There is an absolute maximum limit of 10% in collective investment schemes though, in practice, we limit this to 5%.



The Managers maintain and monitor the Fund's portfolio live via Bloomberg and on Church House's internal portfolio management system. The portfolio is maintained and monitored by the Authorised Corporate Director, who provide detailed daily valuations and cash accounts, in association with the Depositary, National Westminster Bank. A minimum of weekly reconciliations is carried out between the three.

Detailed monthly positions, performance, limit and volatility reports go to compliance each month and to members of the Investment Committee. Compliance reports any exceptions or concerns to the Investment Committee in the first instance but also has direct access to the main Church House Board.

Volatility

We do not consider volatility and risk to be inter-changeable but one of Tenax's principal aims is to provide low volatility returns. We do not target volatility as such, but do expect the investment process to produce returns at low levels of volatility. As a part of this, we seek to keep draw-downs to a minimum.

The Fund has a proven history of low volatility since launch in November 2007.

Volatility is monitored daily by the managers at individual stock and portfolio levels and monthly by compliance and the Investment Committee.

UK Stewardship Policy

We are delighted to announce that Church House has been included in the Financial Reporting Council's list of successful signatories to the UK Stewardship Code.

The Code establishes a high standard of stewardship for asset managers, asset owners and service providers when investing money on behalf of UK savers and pensioners.

While the focus of the Code, when first published in 2010, was on improving the quality and quantity of engagement between investors and companies, the updated 2020 code has gone further, to also target the integration of Environmental, Social and Governance matters into the investment approach and decision-making process.

Signatory of:

UK STEWARDSHIP CODE | 2021

We are pleased to increase transparency in our commitment to stewardship and sustainability through our report, in which we have demonstrated (and look to continue to demonstrate) our commitment to responsible investment in the allocation and management of capital. We run our funds and monitor/ assess companies with a long-term time horizon and always with the best interests of our clients at the heart of our investment decisions.

An important element of stewardship and keeping abreast with ESG matters is through our active engagement with existing or potential investee companies. This is crucial to our investment approach, with the purpose of safeguarding and increasing value for our clients.

We believe the importance of sustainability has never been more prominent and while we have always considered that investing in companies with sustainable business practices and run by people with integrity as central to our approach, we are happy to be formally embedding this in our equity, fixed income and multi-asset class funds.

A link to the Code and our ESG policy be found on our website:
https://ch-investments.co.uk/professional-investors/propositions/sustainability-esg/

Risk warning

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Church House Investment Management is a trading name of Church House Investments Limited, which is authorised and regulated by the Financial Conduct Authority (190548).

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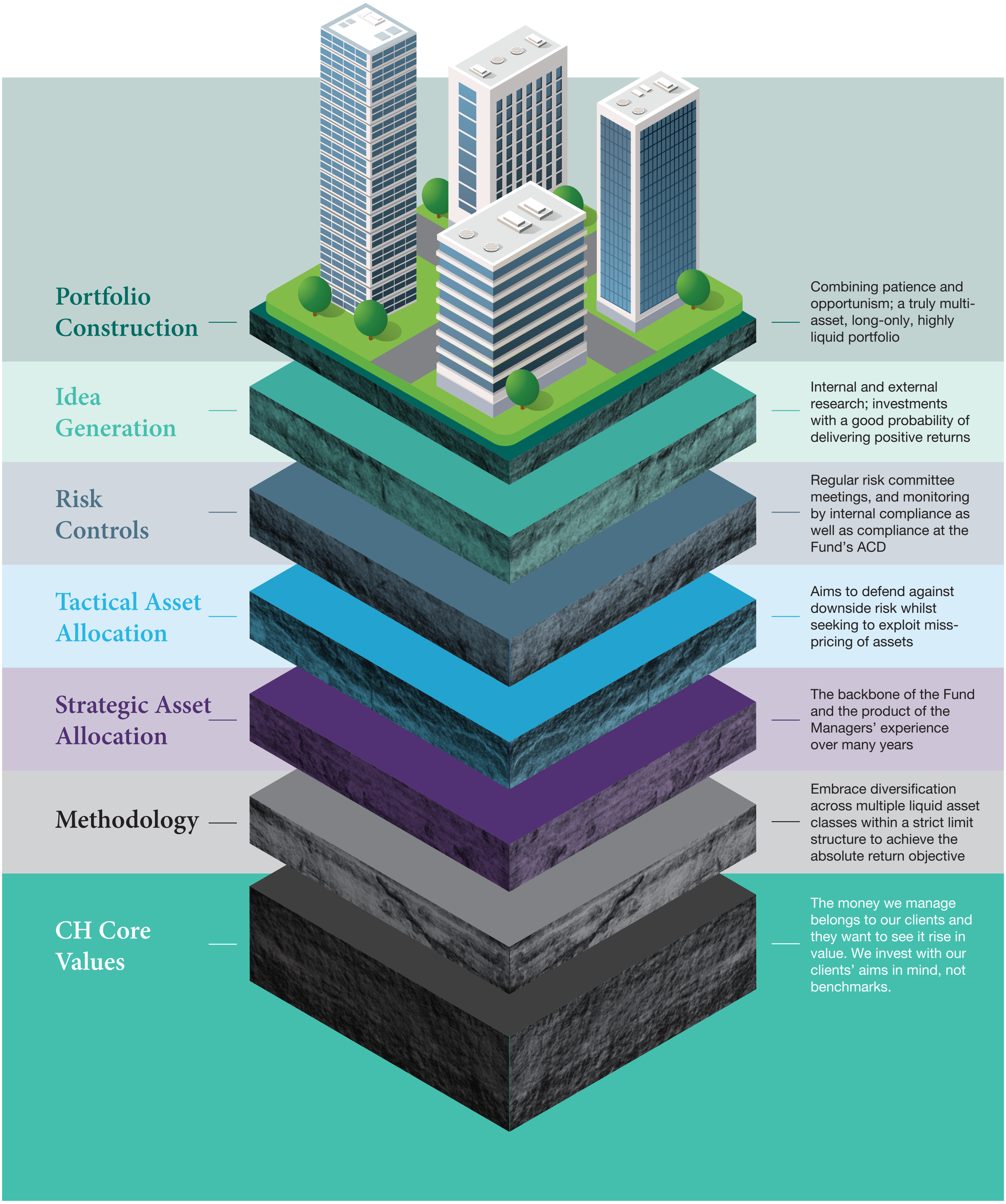
Summary

The bedrock of the Tenax Absolute Return Strategies Fund Investment Process is a sound methodology, based on the company's long-standing investment philosophy of risk management being the key to performance.

The methodology combines a multi-asset framework derived from historically successful precedents, with robust risk controls. Idea generation is derived from tactical asset allocation, in turn leading to bottom-up, valuation-driven portfolio construction.

It is a process that combines intuitive fund management skills with long-held, proven investment principles, and at its core is a constant awareness of the aims, objectives and risk tolerances of the Fund's investors.



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