SCEPTRE
INVESTMENT MANAGEMENT
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Year ended 31 December 2006
Sceptre UK Fund

Fellow Shareholders:

The year of 2006 was the first full calendar year of the funds operation and one in which the net asset value of the fund has risen to £1,334.25 an increase of 21.6% net of all fees. As a reference to general market performance over the same period the value of the FTSE All-share (TR) index rose 16.8%. We begin 2007 with a portfolio of 15 companies and 15% cash weighting. The portfolio is made up of broadly 3 categories. Firstly a number of the businesses have strong niches, are run by good quality management whom we trust to allocate capital astutely and we expect these companies to generate a good return on our investment over the long-term. Other companies are currently restructuring their operations or are strong operators in an industry which we expect to appreciate in value from a cyclical recovery; the final category of holding generate reliable and stable cash flows which in our view the current price of the equity does not adequately reflect. The common factor to all of our investments is that we have acquired stakes in these businesses at prices significantly below what we appraise their *intrinsic value* to be.

The fund aims to achieve excellent long-term investment returns by investing in undervalued listed European equities with a specific focus on the UK.

Particular attention is drawn to the ambiguity of the statement – we do not aim to outperform any particular index by a certain fixed percentage year on year, nor do we expect to be able to predict a fixed absolute return year on year. The vicissitudes of the market will provide a varying number of undervalued opportunities to us and the investment returns the fund achieves will be dependent on the price levels at which we can invest in these attractive businesses. Some periods will present many opportunities to acquire stakes in materially under priced equities whilst at other times we will require much more patience, hard work and thorough analysis to locate value. What we can say regarding our approach to investment is that it has achieved very satisfactory results in the past and has greatly rewarded investors who have a sufficiently long-term investment horizon and have the discipline to indulge what is sometimes described as a contrarian approach.

Performance Summary

Year	NAV	Cumulative	FT All-Share	Cumulative
2005*	+ 7.8 %	+ 7.8 %	+ 4.2 %	+ 4.2 %
2006	+ 21.6	+ 31.1	+ 16.8	+ 21.7
Annual Compounded Rate		+ 24.2		+ 17.0

* from 30 September 2005. After all fees, bid-to-bid with dividends reinvested.

As stated above, we ended 2006 with a portfolio of 15 stocks and around 15% cash. The cash weighting reflects the lack of new opportunities that we can find and the fact that only two of our stocks have recently dipped to levels that we feel are attractive to add to our existing positions. Whilst we do not try to forecast market direction, we feel that we can afford to be patient to wait for buying opportunities to top up positions given the overall market strength during the second half of 2006.

2006 was a strong year for the fund with only a single down month and a solid out performance of the index. The fund returned 26.9% gross and 21.6% net of all fees with low volatility versus the index. We started the year with 14 holdings (19% cash) and ended with 15 (15% cash) having sold 10 and bought 11 stocks – we retained 4 stocks from the portfolio that ended 2005 and these now make up 35% of the stock portfolio (versus 28% at 31/12/05). This is a fairly big change to the portfolio for us as long term value investors but we did close 5 (or 50%) of the positions in the last 3 months of 2006 as they had very strong price performances and believe that the changes we have made to the portfolio have eliminated holdings that have reached 'fair value' and replaced them with holdings with bigger margins of safety. This leaves us with a portfolio that has an upside of about 50% on our current estimates.

Portfolio of the Sceptre UK Fund on 31 December 2006

Holding	% Assets	Line of Business
SES Global	8.9	Global operator of commercial satellites
Travis Perkins	8.6	DIY & builders merchant
RPC Group	7.9	Rigid plastic packaging manufacturer
Chaucer	7.8	Lloyds insurance underwriter
BSkyB	7.6	Satellite TV & broadband supplier
Wagon Group	6.8	European automotive parts manufacturer
Diploma	6.0	International parts supplier/distributor
Augean	5.4	Hazardous waste disposal operator
Kensington Group	5.4	Specialist mortgage provider
Xaar	4.5	Industrial inkjet print head manufacturer
nCipher	4.3	Cryptology & computer user management
NewMedia SPARK	4.3	Technology & media investment
Greggs	3.7	High-street bakery chain
Ideal Shopping Direct	2.9	TV shopping channel
British Airways	1.8	Commercial airline
Cash Reserves	14.1	
	100.0	

A drawback to our style of investment is that the most attractive companies in which we would like to invest are often priced at a premium or at not a significant enough discount to their intrinsic value (or fair value) to make them a sufficiently attractive *investment*. The distinction between a great company and great investment being that whilst a great company may achieve superior returns on its assets and have strong barriers to entry, if the company's securities already factor this into their price then it will not prove a great investment. We identify and monitor a large number of attractive companies in which we would like to invest, at the right price. Patience is one of the most significant factors in value investing and whilst waiting for the stock market to under price excellent companies which we intend to hold for many years can prove frustrating, there is often much value which can be created by shorter-term investments in more cyclical undervalued companies.

Brief discussion of the fund in 2005

The increase in the net asset value of the securities which the fund held from the 31st May to 31st December in 2005 was 9.5%, this compares rather unfavourably with the increase in the FTSE All-share index during the period which was 14.6%. The funds performance was dampened by the necessarily high level of dealing costs and the significant cash weighting within the fund during the first months of building the portfolio. This period also saw very large increases in the market price of commodities; oil, copper and others, which in turn led to significant increases in the market prices of companies involved in the commodity business.

In the final quarter of 2005 as shown in Performance Summary the fund NAV was up 7.8% versus the FT All-share TR up 4.2%.

The bulk of mutual funds will ultimately aim to outperform the stock market by a small margin year on year and will over and underweight sectors trying to identify the next sector which will outperform (funds that were overweight commodity stocks were very likely to have produced superior returns in 2005). Our belief is that this form of investment is over the medium to long term index-hugging and does not often add real value since the returns achieved by the majority of its practitioners over time have been to match the index less the fees charged. This is not our approach and we avoid investing in companies whose primary business is the production of commodities and this remained the case in 2005 resulting in the short-term underperformance. We prefer to invest in companies where we can expect long-term pricing power. The advantage of pricing power means we can be more confident in our projections of the future cash flows which ultimately drive the valuation of businesses in the medium to long term.

Considerations on the size, fees and performance of the fund

It is not sufficient to identify and invest in excellent companies at good prices to achieve the performance that we seek to deliver to shareholders. We concentrate the assets of the fund into a much smaller number of securities than the typical investment fund. We also invest in a range of different sized companies; giving very little consideration to whether we are overweight the FTSE250 or SmallCap for example, our focus is ultimately on the discount at which a specific company trades to its intrinsic value. We do not consider that a smaller company is riskier than a larger company per se; we acknowledge and build into our valuations on a case-by-case basis the drawbacks of a lower credit rating or smaller number of customers for example. Market risk (or volatility) we see more as an opportunity than a factor affecting valuation, consistent with our belief that in the short-term the stock market is not efficient and is influenced by crowd mentality. However, from a liquidity perspective we are mindful of the size of positions which we can comfortably take in smaller capitalised companies, for this reason we have limited the size of the fund, after which point we will close to new investors. This will ensure that the performance of the fund is not sacrificed for the sake of accumulating assets under management. The performance fee structure of the fund aligns our interests; our reward comes from outperforming, not simply from in-line performance with a bigger pool of assets. We also have the majority of our own capital in the fund and investors can be confident that investment decisions are made with security of capital and maximisation of return as the overriding considerations.

Our trading activities are simple and infrequent; the fund is un-leveraged and has no restrictions on the proportion of cash that it may hold, although this will only rarely be a significant portion of assets. We principally invest directly in common stock, unless there is some significant anomaly which makes another form of security preferable (such as a preference share or convertible). We seek to maintain long-term holdings in the excellent businesses that we identify and aim not to 'trade' around these positions, we increase and reduce the weighting of a particular company in the portfolio based on upside to our assessment of its intrinsic value or if there are exceptional events which present short-term uncertainties. The maximum position size we would increase an individual company to is 20% of assets, although this would have to be an exceptional opportunity.

Communication with shareholders

Along with this annual summary letter to shareholders we publish monthly updates which are available electronically to all shareholders who wish to receive them. We also maintain a website, which has an archive of the monthly investor updates and a summary of the funds performance and strategy. On a monthly or quarterly basis the vicissitudes of stock market will have a much greater effect on the net asset value of the fund, but over a medium to long term horizon we expect our performance to more accurately reflect the advantages of our strategy. We calculate an estimate of the net asset value on a daily basis and publish this figure, for convenience, on the website. The official independent net asset value is agreed at the end of each month with the funds administrator and at the end of each month the fund will accept subscriptions and redemptions from investors.

Performance details

The funds official inception was 2nd May 2005 with an NAV of £1,000 per share, during the period of May-September the fund held large cash balances and establishment of the portfolio caused exceptional dealing costs which do not reflect the normal level to which the fund will be exposed. The first external investors in the Fund subscribed in October 2005.