Setanta
ASSET MANAGEMENT

FACTSHEET

Setanta Fixed Interest Fund – Q2 2011

Fund Description

The **Fixed Interest Fund** ('the Fund') is managed by Setanta Asset Management Limited ("Setanta") and is a representative account of the Fixed Interest strategy.

The Fund is an actively managed portfolio invested mainly in government, government agency and covered bonds. The bulk of exposure is in Euro, although the fund can take advantage of non Euro fixed income investments, up to a maximum exposure of 40% of fund assets. The Fund invests in the highest quality investments with a minimum credit rating of "A" at time of purchase and an overall minimum portfolio credit rating of "AA". Maximum exposure to a single Government with a credit rating below "AA" is 15% of fund assets. Duration of the fund is kept within +/- 2 years of this benchmark.

All investments are taken after careful analysis of all relevant metrics and on a long term view. Bond investments offer investors the potential for regular income, capital preservation and diversification from other types of investments. Returns are likely to be less volatile than equity returns and offer investors the potential for good risk-adjusted returns over time.

Investment Philosophy

We in Setanta do not believe the market is efficient. Our aim is to purchase and own assets at a price below a reasonable assessment of their worth. This is where we focus our resources. Our process is akin to assessing a part ownership of a business rather than trading a security. This assessment of value must always encompass a thorough understanding of where this value is derived. We have a long term investment horizon and risk management is always central. We regard risk as the potential for permanent impairment of value. Integrity is a key tenet of our professional DNA and we embrace a culture of continued learning.

Portfolio Manager

David Ryan

Investment Principles

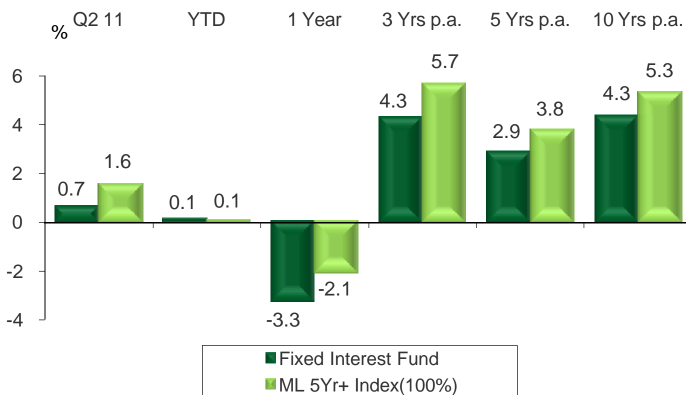
- We do not believe the market is efficient.
- We aim to make investments at a price below our assessment of intrinsic value.
- We make an investment in a business rather than trade securities.
- We believe risk is the possibility of permanent impairment of value.
- We make investments for the long term.
- We invest where we see value and are not afraid to be contrarian and swim against the tide.
- We don't make forecasts, we consider scenarios.
- We demand financial strength from the companies we invest in.
- We will act with integrity and communicate with our clients in a manner representative of our investment style.
- We have the humility to know we make mistakes and embrace the need to continue learning through both experience and study.

Contact Details:

Setanta Asset Management Limited,
College Park House, 20 Nassau Street,
Dublin 2, Ireland.

Alan Hickey, Tel: + 353 1 612 4903
Email: alan.hickey@setanta-asset.com
www.setanta-asset.com

Fund Performance to 30.06.11



Yearly Performance

Year	2006	2007	2008	2009	2010
Fund	-1.5	0.0	9.1	5.5	-3.3
Benchmark	-1.8	0.4	10.4	4.0	0.9

The investment objective of the Fund is to outperform the Merrill Lynch EMU Government 5yr+ index and the peer group.

Performance Source: Setanta Asset Management Limited. Benchmark: Bank of America Merrill Lynch EMU Government 5 yr+ index. The Fund returns stated are based on the movements in the unit prices of a representative account, based on mid to mid prices, and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Credit Rating Source:** S&P.

Fund Duration & Credit Metrics

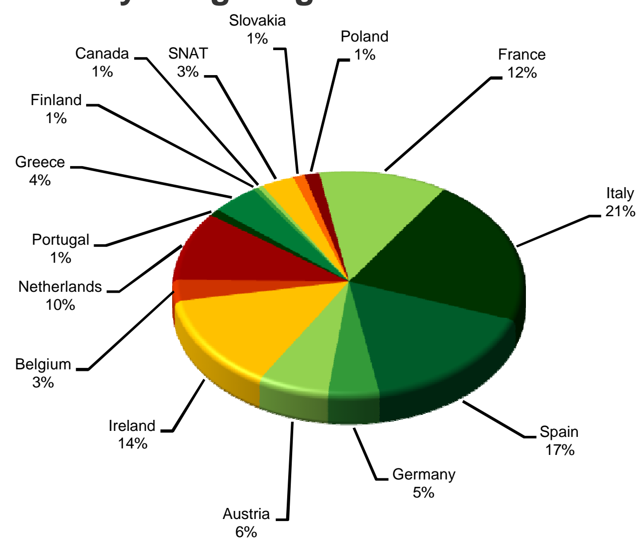
YIELD CURVE POSITIONING		
DURATION (Yrs to Maturity)	FUND WEIGHTING	BENCHMARK WEIGHTING
0-5	32.2%	10.7%
5-10	46.6%	60.2%
10-15	17.9%	21.7%
15-30	3.3%	7.3%
	100%	100%

CREDIT RATING WEIGHTING		
CREDIT RATING TYPE	ASSET TYPE WEIGHT	BENCHMARK WEIGHT
AAA	43.5%	55.0%
AA	37.5%	41.6%
A	3.4%	0.5%
BBB	5.2%	3.0%
BB	6.0%	0.0%
CCC	4.3%	0.0%
C	0.1%	0.0%
	100%	100%

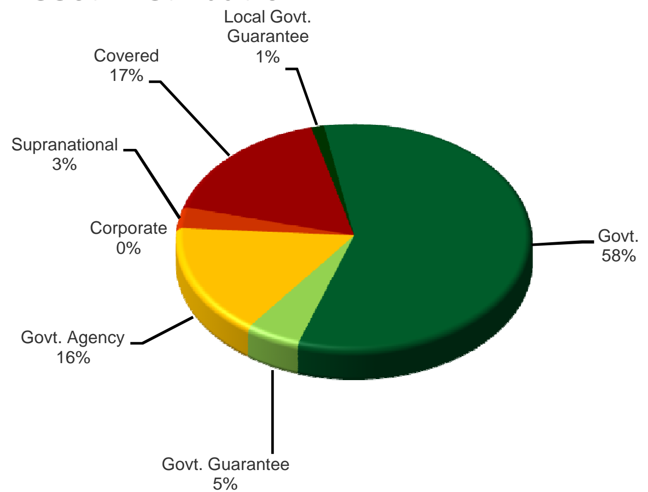
Top 10 Holdings

ISSUER	COUNTRY	COUPON %	MATURITY	% OF FUND
FRANCE (GOVT OF)	FRANCE	3.75	25/04/2021	4.2%
BUONI POLIENNALI DEL TES	ITALY	2.1	15/09/2016	3.2%
INSTITUT CREDITO OFICIAL	SPAIN	5.125	25/01/2016	3.0%
REPUBLIC OF AUSTRIA	AUSTRIA	3.5	15/09/2021	2.9%
BUONI POLIENNALI DEL TES	ITALY	3.1	15/09/2026	2.9%
DEPFA ACS BANK	IRELAND	4.875	21/05/2019	2.8%
REPUBLIC OF AUSTRIA	AUSTRIA	3.9	15/07/2020	2.6%
GERMAN POSTAL PENSIONS	IRELAND	3.75	18/01/2021	2.5%
NEDER WATERSCHAPSBANK	NETHERLANDS	3.5	14/01/2021	2.5%
INSTITUT CREDITO OFICIAL	SPAIN	6	08/03/2021	2.4%

Country Weighting



Asset Distribution



It has certainly been a tale of two quarters. In Q1 the benchmark dropped 1.45% and we outperformed by 0.90%, then the index rallied 1.56% and we underperformed by 0.90%. So, on that basis along with some pick up in yield, we are +0.13% YTD versus a benchmark of +0.09% YTD.

In a nutshell there has been a continued theme of risk on/risk off trades within the markets played out amongst the periphery. In Q2, the market has resorted back to the view that Europe has not taken hold of the crisis and there has been marked sellers of peripheral debt and a run up in core AAA bonds (Germany/France/Holland).

This goes against our positioning. We are positioned for bond yields to move higher over time, and for peripheral spreads to tighten over time, though that "time frame" seems to be getting longer and longer.

Nonetheless, that is the view and I have not yet changed it. I believe that our positions in the periphery which has been the marked driver of our under performance year to date will bounce back. I also believe that lending money at the long end of the curve at such paltry levels (3.40%) is not prudent. Looking to forward themes and worries, some views on inflation.

Expecting the unexpected…

As ideologies go, there are few more different than the views of Capitalism and Communism on economic society. Leaders of countries epitomising both have highlighted over time a common risk, inflation, or more pertinently, unexpected inflation. Vladimir Lenin lectured *"The way to crush the bourgeoisie is to grind them between the millstones of taxation and inflation…"* while President Ronald Reagan opined that *"Inflation is as violent as a mugger, as frightening as an armed robber and as deadly as a hit man."*

Given polar opposite views on how economic society should be run, why such common concern with inflation? Ultimately it boils down to the erosion of the real purchasing power of savings. Inflation, through the general rise in price levels, will slowly reduce the value of your money and savings, transferring wealth from lenders (savers) to borrowers (governments in this case).

For a bond fund manager, given that the stream of payments of both coupon and capital tend to be fixed, higher than expected inflation will consistently erode returns. Outside of outright default this unexpected nature is the main worry of bond fund managers.

Inflation's recent persistence is a 20th century phenomenon. Historically prices had a tendency to vary wildly, with deflation just as likely as inflation. That trend changed post the full transfer to a *fiat* money system in the 1970's, which marked the end of the backing of money by gold.

The *fiat* money system is often cited as the root cause of the post 1970's increase in prices. It is argued that as governments can print money, the temptation would be to increase the money supply when needed, pushing prices higher. However, inflationary concerns can arise from numerous sources; supply side-shocks through higher oil or foodstuff costs feeding into consumer prices or demand side-shocks such as the huge demand for commodities from the urbanisation and industrialisation of China.

The erosive effect of inflation can even be seen in the benign central bank policy of inflation targeting. Targeted inflation by the ECB of close to 2% would see the Euro lose 33% of purchasing power within twenty years. This risk is sometimes overlooked given our tendency to focus on nominal rather than real returns - the error of *money illusion*.

Given the current stock of Debt to GDP in advanced economies at record peacetime levels, I believe there is a risk of higher than expected inflation. Previously, to manage debt loads, monarchs or governments could behead the creditor (old form of bond haircut) or debase the currency by lowering the gold or silver content in the coinage.

Modern day management of debt loads have become more subtle. Post World War II governments successfully engaged in the liquidation of debt through, among other policies, inflation and financial repression. In my opinion governments will try all methods, bar outright default, to reduce the current onerous debt levels.

Financial repression essentially forces lenders to lend to the government at uneconomical rates. This could be through explicit management of government yields (QE1 & 2), forcing domestic participation in lending to governments (upcoming liquidity regulations) or direct ownership of the banking system (Freddie & Fannie Mae or Anglo).

These lower lending rates along with persistent inflation reduce the real cost of debt. An example of this form of debt management was evident in the US during the period 1945 – 1980's, (e.g. Treasury accord of 1951 where the Fed pegged US yields at 2.5% for long-term money), allowing for approximately a 4% reduction in the Debt/GDP ratio per year.

A form of financial repression is already occurring in the US. Quantitative easing allows the monetisation of the large and growing fiscal deficits by the Federal Reserve purchasing government bonds, thereby limiting yield increases. Interestingly, albeit worryingly, the notable cases of hyperinflation that have been experienced, have all started post-political printing of money to finance growing deficits.

The way to protect against inflation is to earn a positive real return over time, by allocating to "real assets". Various asset classes have been shown to perform better under different time periods and different inflation regimes. An investor's risk profile is key given the different asset volatilities and the horizon you are willing to invest for. It is important to note that there are periods of negative real returns from real assets. Equities for example (S&P500), have posted a negative real return in local terms since 2001, while historically giving the best real returns over the long term.

This is where inflation linked bonds (linkers) could prove an important addition to investor's portfolios, as an insurance against unexpected inflation. The premise of linkers is that the principal is increased along with inflation, thus ensuring payment of a real return if held to maturity. If inflation increases over the life of the bond the amount you invested increases in line with the coupon paying off the larger amount. The bonds also have what is called a deflation floor, meaning barring default, at a minimum you will receive back par (100%) at maturity.

Inflation linked bonds only form sub 10% of the global market for government bonds. The idea however has been around for centuries with the State of Massachusetts first issuing bonds linked to a basket of goods back in 1790. Some argue that the necessary political discipline to control inflation, allowing cheap funding for governments through linker issuance, has been left wanting.

The implied real return will be evident from purchase, if the real yield is positive, and assuming no default risk, an investor can choose a horizon and be confident that their real purchasing power will be maintained up to the date of maturity, allowing for some basis risk, where the relevant consumer price index does not capture the investors true inflation risk.

If inflation starts to increase beyond current implied expectations, linkers will outperform the equivalent nominal bond returns and should lower overall portfolio risk. Inflation linked bonds are an explicit hedge on unexpected inflation. They also act as an implicit hedge on political interference in central bank autonomy. As noted by Keynes *"By a continuing process of inflation, government can confiscate, secretly and unobserved, an important part of the wealth of their citizens."*

It is with these numerous headwinds in place, high global liquidity/Food & Oil volatility/ & Political risk, that I have started to build a position in Italian inflation linked bonds. The value looks attractive given the high real yields (3.75%). I believe these will prove their worth versus nominal bonds over the next five to ten years.

IMPORTANT INFORMATION

The Fund is currently available in Ireland via a unit-linked offering of Canada Life Assurance (Ireland) Limited. For this life assurance product, investors should refer to the relevant policy conditions. The strategy is also available on a segregated basis. Investors should consider the investment objectives, risks, charges and expenses carefully before investing. See 'WARNING' and IMPORTANT INFORMATION' sections below.

Setanta Asset Management Limited is regulated by the Central Bank of Ireland, PO Box 559, Dame Street, Dublin 2, Ireland. This factsheet, which is for information purposes only, does not form part of any contract. This is a marketing communication that (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and (b) is not subject to any prohibition on dealing ahead of the dissemination investment research. The information contained in this document is based on current legislation and is, therefore subject to change. The contents are intended as a guideline only and should not be construed as an interpretation of the law. You should always seek the advice of an appropriately qualified professional. Performance disclosures are stated above.

WARNING: Past performance is not a reliable indicator of future results. The price of units and the income from them may go down as well as up and investors may not get back the amount invested. The return may increase or decrease as a result of currency fluctuations. Forecasts are not a reliable indicator of future performance.