Global Perspective – Q2 2012

Global Equity and Bond Indices	2012 YTD %	3 Yrs p.a. %	5 Yrs p.a. %	10 Yrs p.a. %
MSCI World	8.3	14.7	-1.7	2.6
S&P 500 (US)	12.2	20.5	1.6	2.8
Hang Seng Index	11.0	9.0	2.6	7.4
FTSE 100 (UK)	6.2	16.0	-2.7	3.7
S&P Euro Stoxx 600 (Europe)	3.7	2.7	-8.8	0.6
MSCI High Dividend Yield	7.0	12.8	-5.7	-0.5
Euro Govt. Bonds (5yr+)	5.3	4.6	5.7	5.4
EMU Corporate Bonds (Credit)	5.5	6.7	4.8	4.8

Source: Bloomberg. Returns are in Euro to 30.06.12

The Challenges of Investing in Technology

In today's world technology is ubiquitous, from the alarm we use to wake us in the morning; to the TV we relax in front of in the evening. In the Capital Markets world, Technology is the second largest global sector, accounting for just shy of 13% of the MSCI World Index. Technology is as diverse and as fast moving in capital markets as it is in our everyday lives.

As investors in Technology companies, we need to be acutely aware of the fast pace of change and the obsolescence risk inherent in the sector. As John Maynard Keynes once stated "in the long run we are all dead", but for many companies in the technology sector death comes, all too often, a lot sooner.

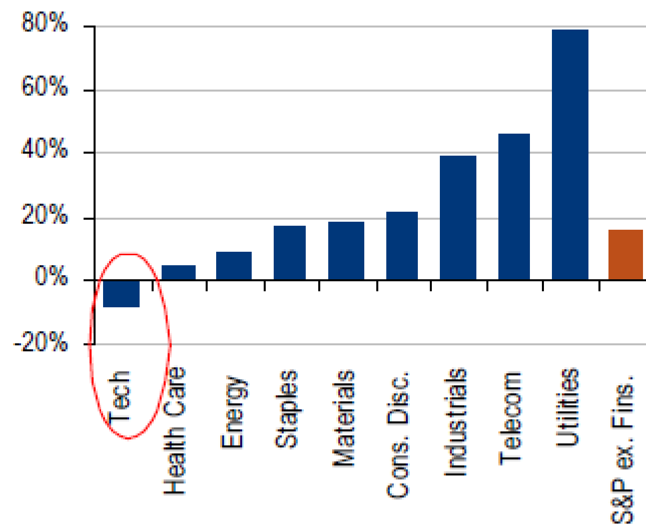
Obsolescence risk is a key risk when it comes to investing in technology companies. It is "the risk that a process, product or technology used or produced by a company for profit will become obsolete and is no longer competitive in the market place". The evolution of technology is rapid, new technology and tech companies are at risk of becoming obsolete fast; paradigm shifts can occur at breathtaking speeds rendering technology companies obsolete in a very short timeframe. The stock market graveyards are littered with dead technology companies whose products were once consumer favourites: Atari, Eastman Kodak, Palm, Gateway, Nintendo to name but a few.

In order to steer clear of the pitfall of obsolescence, as investors we need to be extremely disciplined and diligent in sticking to our investment process. It is also imperative that every investment we make comes with an adequate margin of safety that helps protect us from downside risks. We are by no means perfect investors, we have made investment mistakes in the past and we will likely make investment mistakes in the future, but it is important that we learn from our mistakes and use these mistakes to fine tune our process.

So how does one navigate the tricky minefield of investing in Technology companies?

1. Avoid financial leverage

Historically tech companies have been operationally leveraged; software companies are challenged to achieve new license sales quarter after quarter, semiconductor companies challenged by their high fixed cost base and correlation to global GDP while consumer electronics companies are challenged by the fickle nature of their end markets. To offset this to some extent technology companies tend to be cash rich, sitting on cash to help them withstand future volatile trading periods. As investors, the last thing we want is a technology company with both financial and operational leverage. Thankfully Tech companies rank as the only S&P sector to be sitting on net cash, so that's one red flag we need not worry about!



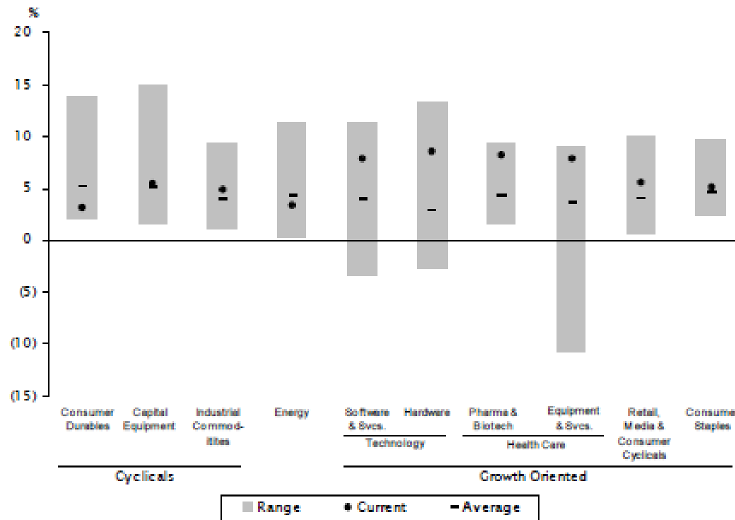
2. Lean towards companies with a wide/deep moat and market leading positions

Analyzing companies while looking exclusively in the rear view mirror is far from optimal but it often helps to track a company's progress within an industry over a lengthy period of time. If a company is the market leader in a particular area and has been for some time it is important to understand why this is the case, if it indicates a moat or sustainable competitive advantage that can help them defend their position and if it gives us enough comfort that they are likely to remain the market leader in the future. Fair Isaac is a prime example of a company with a market leading position and a wide moat. The FICO score is the de facto credit score in the US and Fair Isaac has an effective monopoly in the credit scoring market. Financial institutions use software systems that rely on the FICO score as a key input into credit making decisions while consumers are conscious of attaining the highest FICO score in order to gain greater access to credit. This brand awareness and integration into Financial Institutions IT platforms have served as a key competitive advantage and we don't believe that it is likely to dissipate any time soon.

3. Buy companies with an adequate margin of safety

As Warren Buffett once said, "Price is what you pay, Value is what you get". Buying good companies with good management at good prices is a central tenet of our investment philosophy. Buying at good prices helps minimize the risk of losses while also exposing ourselves to greater potential upside. To help compensate us for higher risk the Tech sector, in general, is more attractively valued than many other sectors, for example as the chart below shows, FCF/EV for the Tech sector is attractive relative to other global sectors. Thus, so long as we can pick Technology stocks with strong and sustainable market positions, with management that are good stewards of those assets, then over the long term, we should be able to make decent returns by investing in the Tech sector.

Exhibit 26: Free Cash Flow-to-Enterprise Values By Sector[1] Current, Average and Historical Range 1952 Through January 2012



Source: Corporate Reports, Empirical Research Partners Analysis.

[1]Drawn from the largest 1,500 stocks; software & services data since 1970.

As mentioned earlier the Tech sector is the second largest global sector. It is both exciting and challenging. We will continue to invest in superior companies with good management that are trading at good prices and by sticking to this strategy we hope to minimise the risk of a permanent impairment of capital and increase the potential for outsized returns.

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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' below.

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