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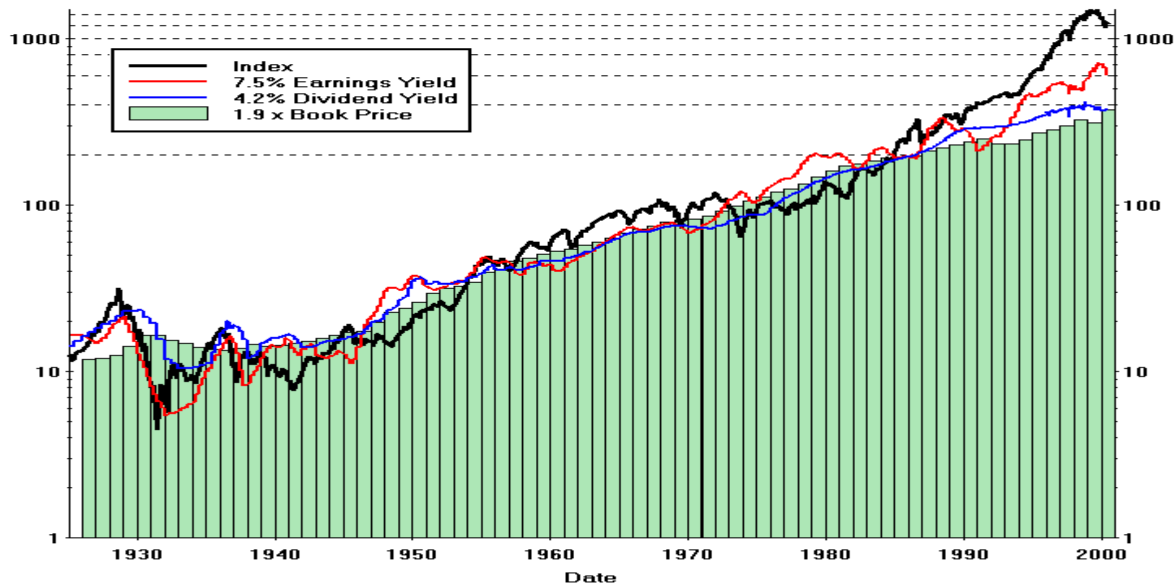
The tragic events that occurred in the USA have left a trail of destruction around the world in terms of stockmarket losses. In short, the news has had a profoundly negative impact on share prices and to date, any attempts by the markets to rally have been short lived. In order to gain a perspective of where the markets might eventually be headed, we believe that very long-term history may prove helpful.

Study the time series graph below which compares U.S. shares (in the form of the broadly representative S & P 500 Index) to their historical fundamental values.

S&P 500 Index and Fundamentals – 30 June 2001



The graph shows:

1. The level of share prices as expressed by the index – in black.

2. The level share prices would be if they traded at their average (since 1925) earnings yield of 7.5% – in red.

3. The level share prices would be if they traded at their average dividend yield of 4.2% - in blue.

4. The level share prices would be if they traded at their average price to book value of 1.9 times – in green.

In recent years, we have often referred to the record overvaluation of shares in the U.S. compared to its own history, including the share binge, which took place in the late 1920's. To illustrate this point, compare the highly elevated position of the index compared to its fundamentals in recent times. Due to this excess speculation in shares, our expectations were for very disappointing returns in the years ahead.

Although shares have been falling rapidly subsequent to the terrorist attacks, the U.S. stockmarket actually peaked in the first quarter of 2000, and has been coming down for the past 18 months. What should one expect from this point onwards?

It has always been our expectation that the U.S. stock market will ultimately revert to normal values, which are quite clearly illustrated on the graph. How it will reach them is of course unclear. Note that in 1929 the reversion to mean values and then to well below these averages was abrupt. In the mid-sixties the reversion was more of a rolling action over a prolonged period.

Following the 1929 collapse, shares were unable to better their previous peak for over two decades, in what was a period of low inflation. Following the period of higher inflation experienced in the seventies, shares only moved to significant new highs in the early eighties.

Nobody knows how the current situation will play out, but the background is more akin to the 1920's than the 1960's. Suffice to say, with the latest reading on the S & P Index at 985, we still believe the balance of probabilities points to significant further falls (interspersed of course by sharp rallies as short sellers are forced to cover.)

Commentary by Jack Mitchell: Director