FORTRESS European Equity Fund

Investment Review

Fund Highlights

Fourth Quarter 2009

Market review

The year ended on a positive note for markets. Over the past few months, equities have been bolstered by stronger earnings, good cost control, reasonable valuations and signs of mergers and acquisition activity re-emerging.

Ben Bernanke, Chair of the U.S. Federal Reserve, announced the end of emergency lending programs from February 1, 2010, citing the improvements in the functioning of financial markets. The European Central Bank also announced plans to start withdrawing stimulus measures. Both these moves, and an improved outlook from central banks, generally bolstered markets.

Toward the end of the quarter, there was a growing focus on credit worthiness of governments that accumulated debts during the financial crisis. Worries over debt concerns in Greece, and Dubai in particular, caused nervousness amongst investors. The euro weakened on fears that core euro countries may have to come to Greece's aid. The U.S. dollar benefited from this, and also from generally favourable U.S. economic data.

Cyclical sectors outperformed in 2009 with the Technology, Consumer cyclical and Financials sectors having the best performance and the more defensive Healthcare and Telecom/Utilities sectors lagging behind.

Portfolio review

Top contributing stocks year-to-date:
The radical transformation in investors' perceptions from March onward dramatically influenced the performance of the fund, with exceptional strength in some of its holdings in Financials, Industrials and other cyclicals, in particular. The top three contributing stocks were all companies we were confident would survive a significant downturn due to financial robustness, favourable long-term prospects and, particularly in the early part of 2009, traded on extremely low valuations. **DnB Nor**, the Norwegian bank, has rebounded sharply from a very low valuation after it was aggressively sold by investors in the second half of 2008. The company announced a capital-raising in Q3, which further removed uncertainty from the stock. The share price of **DCC**, the diversified distribution company, suffered from the perceived cyclicality of its business, as well as its small cap, Irish stock status. Despite a seemingly catastrophic prognosis, while activity has declined somewhat, cash flows have remained quite robust and the balance sheet has actually strengthened. A positive of the downturn is that DCC has managed to make a couple of strong acquisitions. **Swatch Group,** the luxury watch maker similarly became far too cheap, early in 2009. Despite its rock solid balance sheet, diversified watch brands, market- leading position in watch components and its significant presence in China and other emerging markets, investors were anticipating a substantial and prolonged contraction in profits at Swatch. This now seems highly unlikely and the stock has rebounded accordingly.

Bottom contributing stocks year-to-date:
Two out of our three worst performing stocks were in the relatively defensive sectors of Telecoms and Utilities, reflecting the pattern in the broader market. Apart from the rise in government bond yields, rarely a supportive backdrop for supposedly defensive, predictable businesses, **United Utilities** suffered from another problem. The U.K. regulator carried out a pricing review, which it does every five years, and concluded that United Utilities return on equity should be reduced for the 2010-2015 period. We believe the stock is priced attractively after the consequent fall. **Belgacom's** underperformance was probably a function of its quite defensive nature (stronger than average balance sheet and stable operating environment) and the fact that it has outperformed quite significantly in the preceding year. We remain comfortable with the stock. **Nokia** was a key outlier, as it was one of the few cyclical stocks to perform poorly in 2009. The market continues to fear that increased competitive threats in the high-end from Apple (iphone) and RIM (Blackberry) and in the low-end from Korean manufacturers will lead to structurally lower profitability. We continue to believe that Nokia will remain the market leader and the current weakness is overly discounted. We will however continue to monitor the situation for a further deterioration in business fundamentals.

During the quarter we added new positions in **Fortum** and Telefonica O2 Czech Republic (aka "Cesky Telecom"). Fortum is the Finland-based electricity provider, which also supplies the Baltic and Russian markets. The company is financed and operated in a conservative manner and has competitive advantages, in the form of a modern nuclear infrastructure and a natural terrain, which is suitable for the production of electricity from hydro sources. The stock trades at a similar valuation to peers, yet has a stronger balance sheet and seemingly more sound growth prospects and, consequently, fits our quality/value style nicely. **Cesky Telecom** is the former incumbent fixed/mobile phone operator in the Czech Republic. It is now 69% owned by Telefonica O2. The fixed line business is coming under pressure from cable and other competitors, however, the mobile business (60% of profits) is more benign, with only two serious competitors (subsidiaries of Vodafone and Deutsche Telekom). Cash flow remains good and the balance sheet is debt-free, in contrast to most telecom companies. Free cash flow yield is comparable to peers, at greater than 10%, despite superior quality characteristics.

Any amount that is allocated to a segregated fund is invested at the risk of the contract holder and may increase or decrease in value.

This report is published to provide additional information on economic conditions and investment performance. It was prepared by Setanta Asset Management Ltd.

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