



Butterfield

Second Quarter 2011

Investment Review

Butterfield Bank (Guernsey) Limited Second Quarter 2011 Investment Review

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SUMMARY OF MARKETS AND OUTLOOK

GLOBAL STRATEGY

At the beginning of 2011, most investors were confident they already knew the script for the first half of the year. The tale of the first half of the year has now been told, and it was not the story people were expecting. But the half year point offers an opportunity to look back and gain perspective on some key events. Not all were among the most high profile events of a very eventful six months, but we may be feeling the implications for years to come.

Several months after being outed by Wikileaks, the Kingdom of Saudi Arabia finally came out of the closet. Saudi Arabia's effective annexation of Bahrain in mid March marked the start of a new phase of volatility and instability in a region not previously lacking in either. We now face the prospect of Greater Saudi Arabia and Iran facing off across the Persian Gulf in a full-on cold war. The concept of a Cold War implies an arms race, and it is therefore deeply unhelpful in this context that Iran is getting the Bomb. It is extremely difficult to see how this ends, but the first tangible signs were seen when the meeting of oil cartel OPEC in early June broke down in disarray. Saudi Arabia had sought to raise production quotas, but Venezuela, Iran and "our allies" in Iraq, voted down a measure intended to ease pressure on the oil price.

However, the West's response was swift. Governments in the US and Europe were aware of how weak their economic recovery is, and concerned that high oil prices would snuff it out. The International Energy Agency is the West's oil watchdog. For the past two decades, the IEA has seen the strategic petroleum reserve as the oil market equivalent of a nuclear weapon: only to be used in the most extreme circumstances. The IEA first released the reserve in 1991, on the first day of the First Gulf War. The second use came after Hurricane Katrina in 2005. Since then, it has not been used on a number of occasions which might otherwise have warranted it. The third time was last month when, out of the blue, the IEA announced the release of 60 million barrels of oil reserves in response to supply problems in Libya. It is clear the intention is, from now on, to use the strategic petroleum reserve as a "smart bomb" rather than the "nuclear option". As such, the IEA's action now reduces substantially the chances of further price spikes.

For speculators, this is undoubtedly bad news; everyone else will find it hard to be too negative. The IEA's reserves are huge but not infinite, so their ability to manipulate prices is constrained. But the experience of similarly-positioned central banks is that targeted and well-timed intervention, particularly if it involves stinging too-confident speculators, can keep prices closer to a level supported by fundamental considerations. However, we should remember that the Arab Spring forced the Saudi Arabian government to introduce \$130 billion of social spending to buy off their population. As a result, the Kingdom's breakeven oil price is now \$91, up from \$74 previously. So, the West has indicated intolerance at \$115-120, and the world's largest producer (and possessor of 70% of global spare capacity) is likely to be equally firm on the lower limit. A relatively tight range may therefore ensue. A risk is that any further Arab Spring developments would force the Kingdom into even more spending, and cause them to revise up the bottom of the range. The bigger picture is a further extension of government interference in markets. This is an issue we will discuss in greater depth in future commentaries. For the time being, the key point is that interfering with incredibly complex, adaptive open systems, such as global markets, can often have unintended consequences.

The recurrent drama of the Greek bailout is in many ways a sideshow. There is tacit acceptance the evermore austere conditions the Greek government are signing up to won't be met. Hospitals in Greece are already running out of critical supplies because the government hasn't been paying its bills, the very politicians who negotiated the deal are seeking to pass the blame on to the IMF/ EU who "made" them accept the conditions, and the austerity programs haven't even properly started yet. More important was the example set by Icelandic voters in April, who voted down an "opportunity" to pay huge extra amounts in tax (€13,000 per head) which would immediately be transferred to the UK and Dutch governments. The money was characterised as being effectively "war reparations". However, the Icelandic banking collapse was not the "fault" of the Icelandic electorate. The same is true of Ireland: the Irish collapse didn't occur because of some recklessness or oversight of Irish taxpayers. Yet the Irish bill equates to €20,000 per head. According to GaveKal Research, this is a bigger amount relative to GDP than the reparations imposed on Germany after the First World War. No-one doubts the resolve of the Irish political establishment, and the Irish electorate, to see this through. But the idea the Irish population should pay – that school teachers should take more than 20% in pay cuts - just so the foreign investors who imprudently made loans to Irish banks, ie the French and German banks who bought the bonds issued by the Irish banks, don't themselves suffer the consequences of their actions, becomes ever more surreal and ultimately unsustainable.

SUMMARY OF MARKETS AND OUTLOOK

In early June, the IMF's computer system was apparently hacked into. This is only the latest in a string of high-profile cyber security breaches: Google (presumably one of the most tech-savvy companies in the world), Sony (one of the world's leading consumer electronics companies), Lockheed Martin (probably the world's most advanced defence manufacturer) and now the IMF (one of the world's most respected and influential inter-governmental organisations). The IMF stated it did not believe the hackers wanted information as part of a fraud. This has led some experts to suggest the most likely culprit was a national government, and the name of one particular national government seems to crop up more often than others in many of these incidents. It is difficult to say what are the investment implications of this chain of events – except there seems little doubt it is a chain, rather than a random pattern. In security parlance, the network is being “twanged” – to find weak-spots, develop technical capabilities, and observe reactions and after-effects. This is what you do if you're planning a surprise attack or sustained incursion against an entrenched opponent.

The events noted above give some indication of the scale of challenges facing investors, and the volatility we should expect going forward. But the implications are far from universally negative. For example, the prospect of a lower and more stable range for oil prices, the likelihood it will dampen inflation expectations, and the possible implication that growth is already picking up in Emerging Markets, are positive factors. Adding to this is the news that food price inflation is perhaps already peaking, and the prospects for risk assets, and Emerging Markets in particular, in the second half of the year look commensurately brighter. But for the moment, we are in the “anxious months” and therefore continue to pursue a cautious investment strategy. The arguments are finely balanced, but relative valuations and our expectation of stronger economic growth in the second half of 2011 support our fundamentally positive view on risk assets for now. However, the next couple of months may well be critical.

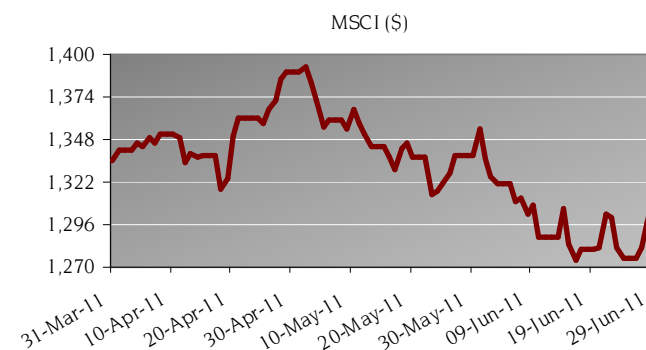
GLOBAL EQUITIES

Equity markets, as measured by the Morgan Stanley Capital International (MSCI) World Index lost 0.28% in US Dollar terms during the second quarter of 2011. However, during the three month period equities traded almost 4.5% above and below their starting point. Just four days before the end of the quarter, the MSCI was firmly at the bottom of this range, only to be bolstered by improving sentiment on; Greece, US economic growth, and the likely outcome of the upcoming earnings reporting season.

The Greek Government's successful austerity vote in the final days of the quarter, renewed investor confidence that the potential exists for disaster to be avoided in Europe, at least for the time being. From the market's perspective time is important, as it offers potential for the capital bases of European Banks to be bolstered sufficiently to deal with the knock on effects of a European Sovereign “default”, whatever shape that might eventually take. Based upon our outlook for the region, we do not anticipate Europe being a final nail in the coffin for global equities. Rather, we believe that the measures required for Europe to work its way through current difficulties increase the likelihood of a prolonged low interest rate, low growth environment, which offers significant opportunities for specific market segments. However, the environment in Europe does mean that we remain extremely cautious on European financials.

Another focus of the quarter was relatively soft economic growth in the US, and the potential for this to translate into disappointing corporate earnings. As the quarter drew towards a close, the pre-announcement season had been uneventful; indicating that second quarter earnings may not present the headwind for equities that many had feared. If, as we expect, economic activity rebounds a little in the second half of the year, assisted by Japan supply chain issues abating, then we do not see valuations being the factor which halts global equity markets in their tracks. Again, at least not for the time being.

Within the current environment there are clearly many potential threats to global equities, but the threats posed by investing in cash or fixed interest appear potentially more immediate and challenging. We therefore continue to believe that equities play an important role in overall strategy. The key to returns will be to remain selective, with focus upon solid companies that are still able to grow amidst a challenging environment featuring relatively stubborn inflationary pressures. Unfortunately, the price that investors will pay for relatively attractive equity returns is likely to be an inflated level of volatility.



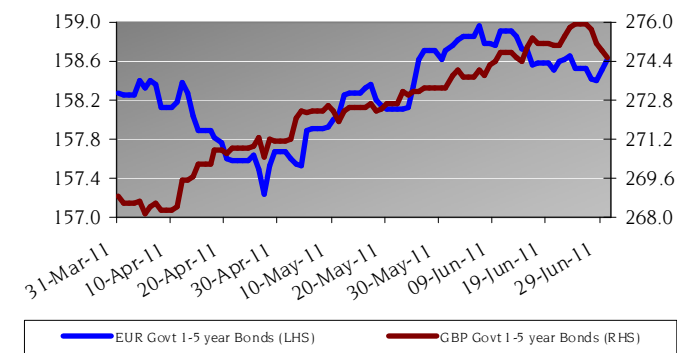
SUMMARY OF MARKETS AND OUTLOOK

GLOBAL FIXED INTEREST

Bond markets have continued to perform through the second quarter, in a similar manner in which they ended the first quarter of 2011. Yields have continued to compress in response to increasing evidence that the global economy is going through what can currently be considered a 'soft patch'. In the US and UK, expectations of higher interest rates have now been shifted out until 2012 while concerns over inflation have tempered. Even in the Eurozone, where the ECB have recently made an initial move to tighten monetary policy, the degree of tightening priced into the market has softened substantially in recent weeks.

From a valuation perspective, bonds look relatively expensive, with risks skewed towards higher, rather than lower rates. Markets are currently pricing in an exceptionally low interest rate outlook and a benign level of inflation into perpetuity, despite the reality that in the near-term at least, inflation in the US, UK and Europe will remain above implicitly and explicitly targeted levels. At the same time, the recent 'flight to quality' trades and subsequent bounce in the US Dollar on European debt concerns suggests that the market may have moved ahead of fair value on a technical basis.

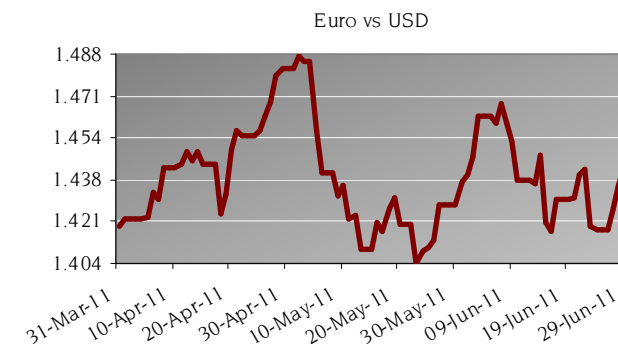
We therefore anticipate that bonds will struggle to make further progress in anything but an economic environment that exhibits stable, yet low growth, easy monetary conditions and where near-term inflationary pressures prove to be transitory. While we would like to believe that the market will muddle through in an orderly fashion, we anticipate there being surprises along the way, which would tend to be detrimental to fixed income markets. To this extent, we remain both underweight to the asset class and short of market duration at present.



CURRENCY

The US Dollar ended the second quarter virtually unchanged versus Sterling and approximately 2.7% weaker against the Euro. In contrast to the European Central Bank (ECB), the US Federal Reserve (Fed) continues to leave the market in little doubt that they have no plans to raise interest rates any time soon. Current expectations are for the ECB to raise rates again in July, therefore further increasing the interest rate differential in favour of the Euro over the Dollar. After falling sharply in early May, the Euro has been steadily recouping ground against the Dollar, despite ongoing turmoil in Greece and the other heavily indebted Eurozone countries. In the absence of a major economic shock or geo-political event, we expect that the Euro has potential to remain reasonably firm versus the Dollar during the second half of the year, trading in a range between 1.41 and 1.4950.

Sterling's fortunes would also appear to be closely aligned with investors' expectations on the timing of any rise in UK interest rates and the rate of economic recovery. During the first half of the last quarter, the Pound gained ground against both the Euro and the Dollar on the basis that persistently high inflation would push the Bank of England's Monetary Policy Committee (MPC) into hiking interest rates ahead of earlier expectations. More recent data has pointed to a slowing in the overall economy and an easing in upward pressure on inflation. These factors have delayed expectations for a rise in UK interest rates. Having traded as high as EUR1.16 in late May, the Pound has weakened sharply against the Euro, ending the quarter just above EUR1.10. It has also fallen versus the Dollar and by the end of June was trading just above USD1.60, having almost broken through USD1.67. We remain of the opinion that Sterling will struggle to appreciate significantly against both the Dollar and the Euro. The UK Economy is still battling rising unemployment and fiscal tightening, which suggests economic growth will in all likelihood remain subdued through 2011.



Following Japan's earthquake and tsunami, the Yen spiked in value on the basis that the cost of reconstruction would necessitate a massive repatriation of the Country's international holdings. Since then authorities in Japan have acted to check the Yen's rally, fearing that any material appreciation of the currency would further damage the economy at a time when the Country was struggling to re-stabilise. In our view, the Bank of Japan will maintain extremely accommodative policies for the foreseeable future and this will only deepen deficit and budgetary imbalances. We therefore continue to hedge Japanese Yen exposure within client portfolios, believing that for now upside in the Yen is unlikely.

SECTOR REVIEW

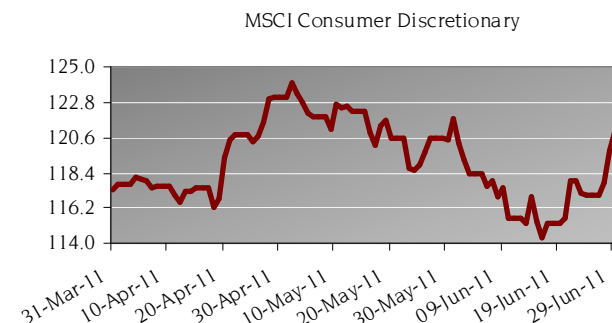
CONSUMER DISCRETIONARY

After falling back from its leading position during the first quarter of 2011, the Discretionary sector regained its composure during the period, increasing by 4.10% against the market's overall decline of 0.28%. This placed the sector as the third best performing of the quarter.

Reasonably strong performance from the consumer discretionary sector came despite dramatic declines within the Household Durables sub-sector, led by market heavyweight Sony. This followed the company warning its PlayStation Network and Qriocity online service customers that their credit-card data, billing addresses and other personal information may have been stolen.

One of the major supports to the sector during the quarter was auto related companies as the market began to look beyond near-term supply chain disruptions associated with the Japanese earthquake. Expectations are for overall volumes to remain relatively robust throughout this year, especially in the US and China. However, questions remain over the sustainability of volumes in Europe, especially as government subsidy programs end. Furthermore, the sub-sector is naturally vulnerable to high raw materials prices which increase input costs, whilst high oil prices also have the potential to restrict consumer demand.

Throughout the post financial crisis period, the sector has behaved very much as it might in a "normal" market recovery. With unemployment levels elevated in many key consumer countries, at a time when consumers spending power is also being impacted by persistently high inflation, the Consumer Discretionary sector looks particularly vulnerable in terms of potential earnings disappointments. As highlighted previously, we have been too cautious on this sector throughout the market recovery, but we continue to believe that our underweight position is justified. As highlighted by the above comments, the diversity of companies and performance within the sector means that being selective is particularly important. We remain of the opinion that consumers will target their spending far more specifically than might historically have been the case, meaning that focus needs to be upon companies whose products are seen as "must haves", both to developed and emerging world consumers. However, Sony's recent tribulations clearly demonstrate that even high quality consumer companies with market leading product can encounter unforeseen difficulties.

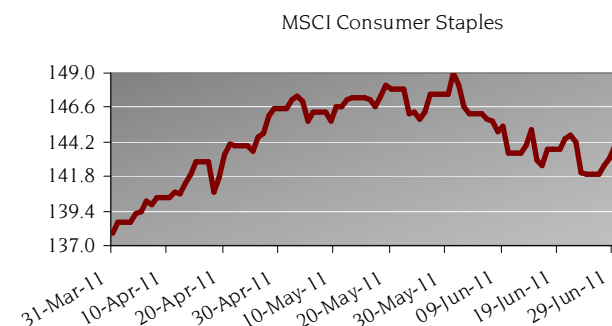


CONSUMER STAPLES

During the second quarter of 2011 the staples sector recovered from a very disappointing first three month of 2011, rising in value by 7.41%. This represented a significant out-performance of the overall market's 0.28% decline, and placed the sector second in the performance tables for the quarter, only lagging Healthcare.

As has been the case throughout recent history, the sector demonstrated classically defensive characteristics during what was a fairly difficult quarter. Performance was strong across all sub-sectors, although "Personal Products" and "Beverage and Tobacco" enjoyed a particularly powerful rally.

In the long term, we still believe that significant opportunities exist within the staples arena. Many companies are characterised by large franchises, a dominant market position, high free cash flow, high dividend cover, and attractive dividend yields. This has allowed them to maintain profitability in their more developed markets, despite the drag of stubbornly high input costs. At the same time, they are able to benefit from more dynamic growth rates in the developing world, supported by more favourable demographics, population growth, and the development of aspirational consumers. In addition, the generally defensive nature of the sector remains attractive to us from the perspective of diversification. We therefore continue to hold an overweight stance in consumer staples companies.



SECTOR REVIEW

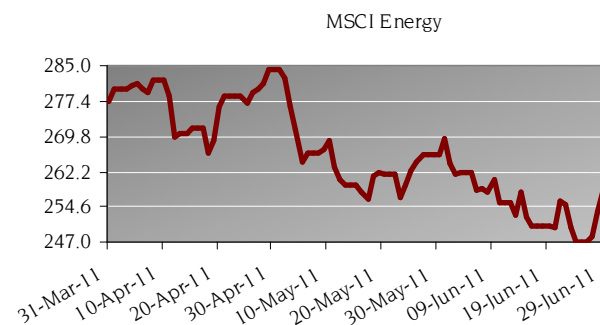
ENERGY

Having strongly outperformed for much of 2011, the Energy sector corrected sharply during May and June, ending the second quarter down 5.44% versus a 0.28% fall in broader market.

Geopolitical instability in the Middle East and North Africa led to a sharp rally in oil prices and the Energy stocks generally during the first quarter of 2011. By the end of April, the price of a barrel of West Texas Intermediate (WTI) traded at just under USD114, its highest level since September 2008.

During May, a series of weaker economic data releases cast doubts about the strength and sustainability of economic recovery in the major western economies. This data, in conjunction with more Sovereign risk issues in the Eurozone and monetary tightening in China, saw the Oil price fall back below the USD100 level. The downward moves in Energy prices reflected weaker commodity prices and a general shift in investor sentiment toward the traditionally defensive sectors, such as Healthcare and Staples. More recently, the IEA's announcement that it will supplement crude oil supplies by releasing 2 million barrels a day from strategic reserves over the next thirty days further depressed prices.

Overall, we do not expect a "double dip" recession in the high energy consuming Western economies and believe that global demand growth for Oil will continue at about 1.5% per annum, led by China and other developing economies. When assessing the Energy sector on a medium and longer term basis, the fundamentals supporting our overweight stance in this area remain compelling. We expect continued expansion in global demand in an environment where capacity remains constrained. A marked step up in the technological challenges associated with the operation of deepwater offshore wells and ongoing geopolitical risks in the Middle East and North Africa, increase the marginal cost of developing new fields and therefore provide a positive backdrop for prices.



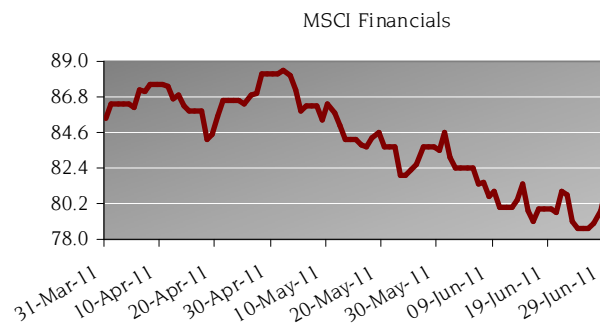
FINANCIALS

The Financials Sector has fallen in value by 3.61% during the second quarter versus a fall of 0.28% for the broad market. The return ranks the Financials sector as one of the worst performing sectors during the quarter and year-to-date. Returns have been poor across all financial industries, although primarily, it is concerns within Bank balance sheets which are leading the sector lower.

Heightened anxiety over the peripheral economies within the Eurozone and in particular, the increasing spectre of a Greek default/restructuring are at the heart of the problem. In the first instance, it is well understood that vast quantities of Greek debt are held on the balance sheets of large, systemically important German and French Banks. Therefore, any losses caused through a default or restructuring of Greek debt would have implications for the profitability and capital ratios of these institutions. The issue is then compounded by the as yet unknown level of credit default swap (CDS) exposure that exists. While precise details of exposures are unknown, there remain real concerns that many US institutions have written CDS contracts and, as such, could well be drawn into the mire.

Recent indications suggest that the Greek Government in conjunction with the ECB and IMF will continue to implement additional 'bail-out' funds to delay the day of reckoning until Bank balance sheets are healthy enough to be able to absorb losses. However, such action does little to encourage investors into Banks when the prospect of as yet unannounced losses remains clearly on the horizon.

In addition to the escalating problems in Europe, we remain concerned over the myriad of issues in relation to Financials, as detailed in recent quarterly reports. With the economy also currently in a slow-patch, we are therefore wholly committed to our underweight stance within the sector at present.



SECTOR REVIEW

HEALTHCARE

The MSCI World Healthcare Index posted the strongest performance of all of the 10 sector indices that comprise the MSCI World Index, gaining 7.41% versus the 0.28% decline in the broader market. The Healthcare sector was led higher by the larger pharmaceutical companies, as the somewhat uncertain economic environment led investors to seek exposure to companies with defensive earnings profiles.

Many companies within the Healthcare sector exhibit relatively good fundamentals, such as consistent revenue growth, strong balance sheets, and attractive cash flow generation. This proved to be particularly attractive to investors as geopolitical and economic uncertainty has increased over the past 6 months. Companies within the sector have also benefited as the market has become more comfortable with the longer term impact of the US Healthcare Reform that was passed in 2010, as the eventual outcomes were difficult to predict at the time the bill was passed.

Regulatory challenges and patent expiry remain medium term risks for many companies within the sector, however there are a number of longer term positive drivers that should provide support. Two of the most powerful longer term trends for companies within the sector are demographic change, particularly in developed markets, and the increasing wealth of emerging market consumers. As populations age in developed economies, there will be a structural increase in demand for medication, which should be particularly powerful in the US as the “baby boomers” are beginning to enter retirement. As consumers in the emerging markets become wealthier, it is likely that their spending on medication will increase, particularly on treatments for preventable diseases, such as vaccines.

Due to the powerful macro drivers for the sector we remain overweight, taking care to avoid exposure to companies that are more likely to suffer with patent expiry. This leads us to maintain exposure to generics and the medical devices sub-sector, along-side our favoured large capitalisation pharmaceuticals.

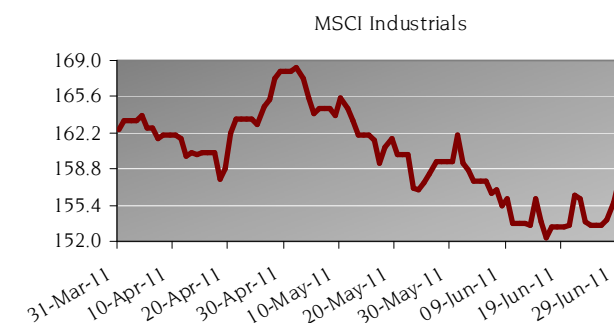
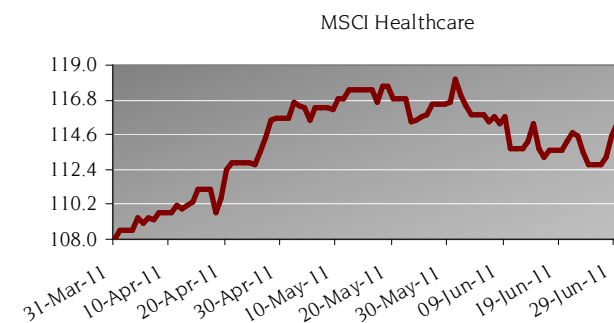
INDUSTRIALS

The Industrials sector fell in value by 1.29% during the second quarter of 2011 as weaker economic data and higher commodity prices weighed on investors' outlook for companies within the sector. Returns have fared worse than the market aggregate which fell by 0.28%, although year-to-date, the sector still remains ahead of the index.

Industrials remain a good bell-weather for the health of the global economy as a whole. Given the recent economic weakness, it is therefore understandable that the sector has endured some times of difficulty as economic data has disappointed. From a sales perspective, companies have seen a degree of slowdown, although this is primarily in the consumer facing industries, with management still cautiously optimistic about sales as the economy moves through the current soft patch.

Near-term commodity price pressures have weighed on sentiment, although we feel that current margins are not under particular pressure at present. Companies still exhibit good pricing power and productivity gains, therefore, unless costs were expected to escalate from current levels, top line growth should still flow through to the bottom line.

Given our broad economic outlook for continued, although, unremarkable growth through the second half of 2011, we shall maintain a neutral allocation to the sector. Within the sector, our positioning will remain skewed towards industries that should benefit from continued infrastructure development in Emerging Markets, rather than being reliant on the Western consumer.



SECTOR REVIEW

INFORMATION TECHNOLOGY

Stocks within the Information Technology sector posted disappointing returns during the second quarter of 2011, with the MSCI World Information Technology Index falling in value by 1.71%. This compared to the 0.28% decline in the broader MSCI World index, and represented the third worst performance of the 10 MSCI sectors. The sector was led lower by companies within the Communication Equipment and Internet Software subsectors, as some bell-weather companies within those groups indicated that orders were likely to be at the lower end of guidance.

The order books of communication equipment companies that rely most heavily on corporate expenditure were somewhat weaker during the second quarter of 2011, as business customers responded to the softening in economic growth by delaying the purchase of new equipment. Looking ahead, there are a number of factors that are likely to support the sales for the companies that offer comprehensive product ranges within the communication equipment space. As the internet becomes more widely used as a medium to deliver and store data, continued investment is required in order to ensure fast and stable connections to the internet are maintained. This is particularly important for the mobile network operators, as data consumes a significantly greater amount of bandwidth compared with voice traffic and text messages. In addition, many Western Governments have stated targets for the proportion of their populations that must have access to fast broadband.

The outlook for spending on technology remains good. In response to the Global financial crisis, many companies have aggressively cut costs, naturally focusing on the easiest cuts first. Company management now have to ensure their operations run as efficiently as possible, and due to the bumpy nature economic recovery it is important that cost is not loaded back onto the business prematurely. This should support spending on IT services and certain parts of the Hardware sub sectors. In addition, a number hacks against very high profile targets should see continued demand for security related technology.

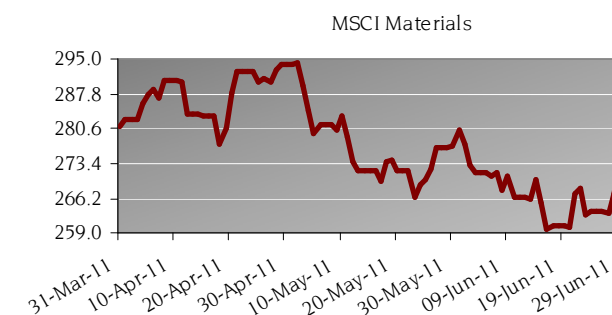
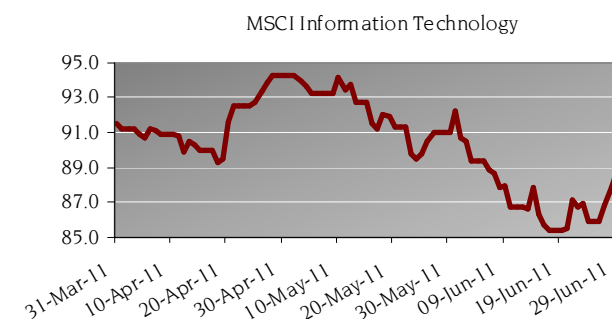
MATERIALS

During the course of the second quarter, the Materials sector of the MSCI Index lagged the performance of the broader market, correcting by 1.29% versus a fall of 0.28% in the broad Index.

Having rallied quite strongly through to the end of April, stocks in the Commodities and Materials sectors have traded weaker through May and June as investor sentiment shifted towards a more defensive profile. This consolidation reflects investor concerns about the ongoing rate of growth in the US, Europe and Japan, in combination with continuing monetary tightening policies in higher growth economies such as China.

In our view, the global economy is unlikely to suffer a “double-dip” recession and the current weakness in data is transitory. A combination of a tighter monetary policy in China and supply-chain disruptions post the Japanese Earthquake/Tsunami disaster are the most obvious near term issues for this sector. In the case of Japan, we would expect to see the situation improve during the second half of the year.

While the short term demand for raw materials and base metals from China has moderated as a result of credit tightening, longer term demand dynamics will likely remain relatively supportive. The authorities in China remain committed to their policy of allocating spending towards infrastructure projects, which in turn will provide underpinning to our core holdings.



SECTOR REVIEW

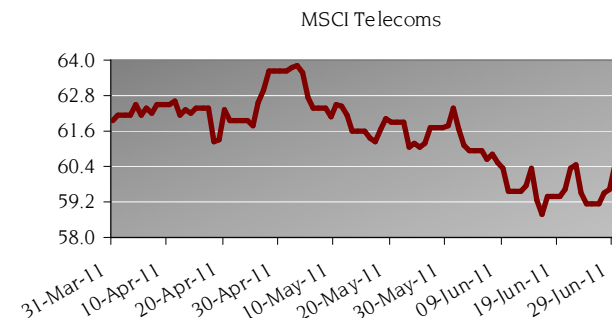
TELECOMMUNICATION SERVICES

The Telecommunication Services sector underperformed the broader index during the second quarter, with the MSCI World Telecommunication Services index declining by 1.13%, versus the 0.28% decline in the MSCI World. Within the sector, declines were similar for both the wireless and the diversified operators as investors became increasingly concerned that slower economic growth might impact sales.

Many companies in the telecommunications sector exhibit relatively defensive characteristics, such as high free cash flow generation, which supports some of the highest dividend yields in the market. In addition, the largest companies within the sector benefit from having relatively stable subscriber bases in the developed markets, which generate higher average revenue per user. In the emerging markets, these companies benefit from faster growth in subscribers, although average revenue generated per user tends to be lower. Unfortunately for companies in the sector, investors have recently been more focused upon the negative factors, such as increasingly tight regulation, and high levels of competition.

Data utilisation remains the key long term driver for the sector, particularly for the wireless operators, as consumers have an ever increasing number of devices that can keep them connected to the internet. In order that sufficient network capacity exists, continued investment in infrastructure is required, which means that capital expenditure could be higher than average in the coming years.

We are cognisant of the top down issues that telecom operators face, which leads us to maintain an underweight exposure to the sector. Our holdings are therefore focused on companies that are diversified from a geographic and product perspective, and have the potential to monetise the growth in data usage.



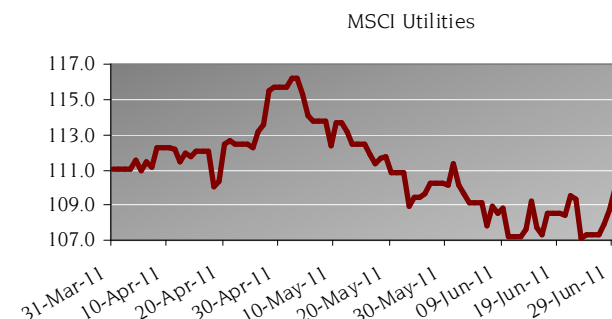
UTILITIES

The Utilities sector fell in value by 0.20% during the second quarter of 2011. While the fall in value is disappointing, the defensive nature of the sector has seen it decline less than the broader market, which fell in value by 0.28% over the same period. Within the sector, those businesses involved in traditional, regulated transmission and distribution type enterprises have performed better than the deregulated power generators.

A soft economic environment traditionally points towards reasonable performance of the sector, at least on a relative basis. In a weak economic environment where the earnings backdrop is likely to be questioned in the coming months, steady cash flows and good dividends will be sought after by investors. Similarly, a continued demand for yield amidst a low interest rate environment should see funding costs via bond issuance well contained.

Contrary to the supportive economic backdrop, we maintain that political and environmental issues will move to the fore and will continue to dampen sentiment in the sector. In particular, we would highlight recent rises in household gas and electricity prices. While the increases are a natural consequence of higher commodity prices and weaker currencies, political rhetoric is already looking towards utility companies to reduce margins. Similarly, utility companies are still reeling from the recent backlash against nuclear power following the earthquake and tsunami in Japan. Pressure to decommission nuclear capacity early will naturally weigh on profitability as capital investment is written down over a shorter timeframe.

While the current economic outlook would tend to see portfolios take a healthy exposure toward the sector, we believe that political and environmental factors are sufficiently important to effect our weightings. To this extent, we shall maintain the underweight exposure at present.



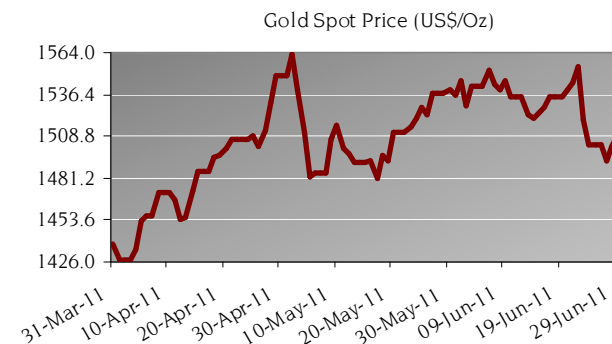
GOLD

The price of Gold fine ounces rose to a record of US\$1,577.57 during the second quarter, before falling back to end the period at US\$1,504.32, locking in a gain of 4.63%. Demand for gold remained robust from the jewellery sector, and from investors who were concerned that the Greek debt crisis might cause further stress in the European banking system.

Demand for gold from the Jewellery sector has been largely driven by consumers in India and China. According to data published by the World Gold Council, in the first quarter of 2011, India and China accounted for 63% of the World's gold jewellery demand. As average earnings in India and China grow, it is likely that the demand for jewellery in these countries will continue to be well supported, despite the relatively high price. Demand from the investment sector also increased during the period, with the uncertainty surrounding Greece leading to a 68 tonne increase in the holdings of the largest gold exchange traded funds.

In terms of supply, whilst mine production increased by 9% year over year in the first quarter, Central Bank buying and a decline in the supply of recycled metal led to a 4% year over year drop in open-market supply. The continued purchase of gold by Central Banks to diversify their foreign currency reserves is likely to remain a key variable in the supply/demand equation for a number of years to come, as it is leading them to become net buyers rather than net sellers. Mexico was the latest emerging market Central Bank to announce a large purchase, with an increase of 93.3 tonnes in the first quarter of 2011.

Looking forward, ongoing geopolitical uncertainty in the Middle East is likely to remain a supportive factor for the price of gold. In addition, the large amounts of debt that Governments have accumulated increases investor demand, as it is becoming more widely accepted as a store of wealth. This is a particularly powerful driver during times of heightened inflationary pressures. This comes against a backdrop of Central Bank buying, which is likely to lead to the continued tightening of the supply of gold.



QUARTERLY STATISTICS

EQUITY INDICES

	31 March 2011	30 June 2011	Percentage Change
Global			
MSCI World Index	1,334.93	1,331.18	-0.28
MSCI World Index (Sterling)	831.01	828.52	-0.30
MSCI World Index (Euro)	940.75	917.42	-2.48
United States			
Dow Jones Industrial Average	12,319.73	12,414.34	+0.77
S & P 500 Index	1,325.83	1,320.64	-0.39
NASDAQ Composite Index	2,781.07	2,773.52	-0.27
Europe			
DAX Index	7,041.31	7,376.24	+4.76
FTSE 100 Index	5,908.76	5,945.71	+0.63
Dow Jones Euro Stoxx 50	2,910.91	2,848.53	-2.14
Far East			
Nikkei 225 Index	9,755.10	9,816.09	+0.63
TOPIX Index	869.38	849.22	-2.32
FT World Actuaries Pacific Rim X Japan (US Dollars)	482.37	481.60	-0.16
FT World Actuaries Pacific Rim X Japan (Sterling)	446.15	444.74	-0.32
Hang Seng Index	23,527.52	22,398.10	-4.80

MSCI WORLD SECTORS

Consumer Discretionary	117.35	122.16	+4.10
Consumer Staples	137.94	145.26	+5.31
Energy	277.56	262.46	-5.44
Financials	85.52	82.43	-3.61
Healthcare	108.02	116.02	+7.41
Industrials	162.48	160.38	-1.29
Information Technology	91.48	89.92	-1.71
Materials	281.21	277.57	-1.29
Telecommunications Services	61.95	61.25	-1.13
Utilities	111.07	111.29	+0.20

QUARTERLY STATISTICS

BOND INDICES

	31 March 2011	30 June 2011	Percentage Change
Bloomberg Bond Indices - Global Bond Index (US Dollars)	265.43	274.11	+3.27
Bloomberg Bond Indices - Global Bond Index (Sterling)	276.30	285.28	+3.25
Bloomberg Bond Indices - Global Bond Index (Euro)	238.26	240.62	+0.99
Bloomberg Bond Indices - US Govt 1-5 Year	233.83	237.71	+1.66
Bloomberg Bond Indices - UK Govt 1-5 Year	268.91	274.54	+2.10
Bloomberg Bond Indices - Canada Govt 1-5 Year	249.45	252.88	+1.38
Bloomberg Bond Indices - Euro Govt 1-5 Year	158.28	158.62	+0.22

FOREIGN EXCHANGE RATES

Sterling versus US Dollar	1.6064	1.6067	+0.02
Sterling versus Euro	1.1320	1.1071	-2.20
Sterling versus Swiss Franc	1.4712	1.3527	-8.05
Sterling versus Canadian Dollar	1.5579	1.5491	-0.56
Sterling versus Japanese Yen	133.0560	129.4330	-2.72
US Dollar versus Euro	1.4190	1.4510	-2.26
US Dollar versus Swiss Franc	0.9158	0.8420	-8.06
US Dollar versus Canadian Dollar	0.9698	0.9642	-0.58
US Dollar versus Japanese Yen	82.8300	80.5600	-2.74

LIBOR 3 MONTH RATE

Sterling	0.8181	0.8256	+0.92
US Dollar	0.3030	0.2458	-18.89
Canadian Dollar	1.2008	1.1742	-2.22
Euro	1.1800	1.4906	+26.32
Swiss Franc	0.1800	0.1750	-2.78

COMMODITIES

Reuters/Jefferies CRB Commodity Price Index	359.43	338.05	-5.95
Gold Spot \$/Oz	1,437.80	1,504.32	+4.63
Brent Crude Index (London)	115.16	110.82	-3.77
Crude Oil Futures (New York)	106.72	95.42	-10.59

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