



Butterfield

Fourth Quarter 2010

Investment Review

Butterfield Bank (Guernsey) Limited
Fourth Quarter 2010 Investment Review

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SUMMARY OF MARKETS AND OUTLOOK

GLOBAL EQUITIES

After a very volatile first six months, the latter half of 2010 proved a far more stable environment for equity markets. During the final three months of the year, the Morgan Stanley Capital International (MSCI) World Index extended its third quarter rally, gaining a further 8.56%. Returns were again enhanced for Euro and Sterling investors, as the US currency gained ground on the foreign exchanges, resulting in gains of 9.51% and 10.62% in Sterling and Euro terms respectively.

With a background of historically low interest rates, high profile sovereign credit issues, the daunting prospect of fiscal austerity, and constant talk of “double dips”, it is tempting to be left with a very negative feeling about 2010. However, reality belies this perception. It is true that volatility spiked towards the middle of the year, with the CBOE SPX Volatility Index reaching a peak of over 45 in late May, which is almost twice the average level of the last five years. However, this measure has gradually traced back, reflecting the persistent upward trend in equity markets since mid-year. The result has been a gain of 9.55% for the year as a whole, despite a fairly inauspicious start. In short, a far better outcome than it has generally felt.

On balance, the evidence is that economic conditions around the world are continuing to gradually improve, which is consistent with modest growth in the year ahead rather than the much feared “double dip”. Business confidence is on the mend, but consumer confidence and attitudes to credit generally remain cautious.

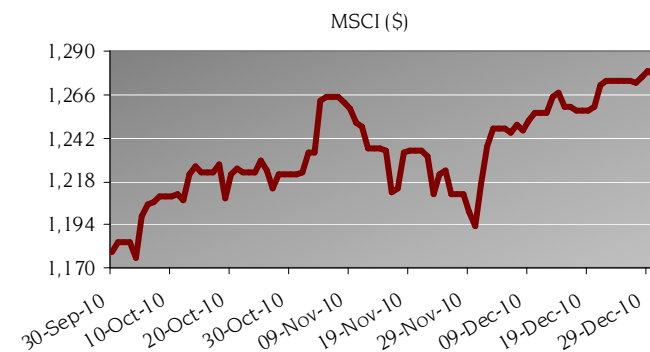
The US obviously remains a major focal point for world equity markets and here the quality of the recovery remains relatively patchy. Nevertheless, a low quality recovery is undoubtedly better than no recovery, and the recent decision to extend the Bush tax cuts, in conjunction with new payroll tax measures, should put to one side fears of a double dip recession in 2011. That being said, recent upgrades have taken GDP expectations into the 3 - 3.5% range, which may well prove to be over exuberant.

The two key issues in the US remain housing and employment. In terms of the housing market, until prices start rising it is likely that household savings will continue to be rebuilt. So, whilst another big leg down is unlikely, the housing market will probably continue to place a similar drag on the economy in the year ahead as was the case during 2010.

For 2011, unemployment is probably of even greater importance. At almost 10% this is undoubtedly a significant drag upon the growth outlook, and is also wholly unacceptable from a political perspective. It is therefore no accident that the main innovation in the recently announced tax deal was aimed squarely at increasing jobs. On balance, things are likely to continue improving in the US during 2011, if for no other reason than policy will focus upon getting GDP growth above 2.5% in order to make headway on the employment front.

Staying with the developed world, Europe's ongoing issues have been a very major focus during 2010. Unfortunately, the actions taken to date have only addressed short term liquidity issues, rather than dealing with longer term solvency concerns, and the EU and ECB still need to find a way to separate banking sector and sovereign risk. In the near term consensus expectations for 2% growth in 2011 look reasonable, although the gap between the fortunes of the core and periphery of Europe are likely to remain stark. As a minimum, it should be assumed that the Eurozone will create further points of pressure for investment markets during 2011.

As has been the case throughout 2010, a reasonable outcome for the global environment in 2011 will be dependent upon the emerging world continuing to play a very significant role. In general terms, the emerging markets are characterised by growing domestic demand, strong investment levels, structural reform, and increasing productivity. In areas such as Asia and parts of Latin America, banking systems are also not suffering the problems faced in the developed world, and can therefore continue to fulfil their critical role of fostering economic growth. Furthermore the relatively good state of fiscal conditions means that, unlike in the developed world, there is not the same impending urgency to remove stimulus. Unfortunately, expectations for the emerging world are already high, so it may be difficult for policy to surprise on the upside. The differences within the countries that fall within this very broad category are also significant, and individual country crises are always a potential threat. In the current circumstances, there is no reason why this should be contagious from an economic perspective, but it is far less clear whether equity investors would be so able to differentiate.



SUMMARY OF MARKETS AND OUTLOOK

Consideration of the emerging world also raises what will probably remain another key dilemma for markets in the year ahead, namely the inflation / deflation debate. A lack of excess capacity indicates why inflation needs to be the focus of emerging world policy makers, as opposed to the deflation focus of the developed world. China in particular has a lot of work left to do, although food cost inflation is the predominant issue, rather than more systemic inflationary pressures. Nevertheless, bubbles will need to be avoided, especially in property. Ongoing policy tightening in Asia and China over 2011 should therefore be expected. This will, in turn, only heighten the international pressures which are ever present, not least of all on the currency front. We believe that a middle way will be found over time, mainly because a full trade war is, at this stage, potentially even more painful for the emerging world than it is for the developed world.

Staying with inflation, in the developed world a huge amount of money has clearly been thrown at avoiding disaster in the recent years. This has caused many commentators to focus upon inflation as an inevitable long term outcome, and inflation expectations have increased in recent months, albeit to relatively modest levels. Given the size of output gaps in the industrialised world, we do not see inflation becoming a significant problem any time soon, although periodic inflation scares seem inevitable. As such, monetary policy in the developed world will remain very accommodative, potentially without generating inflationary pressures for far longer than markets currently anticipate.

For equity markets, the current environment is far from dire, not least of all because competing asset classes are likely to remain unattractive to investors looking to protect their capital in real terms. Furthermore, net free cash flow in the corporate sector, and balance sheet strength, are at multi-decade highs. In part, this is because businesses slashed spending amidst the credit crisis, and business leaders remain sceptical of the sustainability of the recovery in final demand. Valuations also look acceptable, especially on a relative basis.

In conclusion, nothing we have seen during recent months has caused us to significantly alter the long term themes which drive every decision culminating in our overall equity positioning. We continue to believe that we are operating within an environment where our thematic investment framework is particularly well placed to highlight areas of relative strength and, even more importantly, to allow us to avoid the worst disasters that a challenging environment is likely to present.

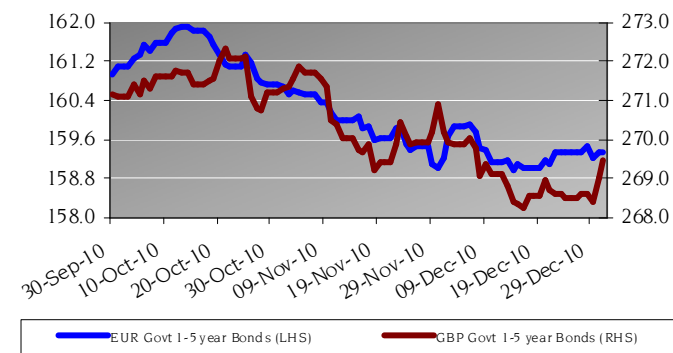
GLOBAL FIXED INTEREST

After three strong quarters, fixed income markets corrected sharply during the final three months of the year. Varying combinations of monetary stimulus, positive economic data, increased expectations of inflation and heightened concerns over fiscal imbalances have weighed heavily on investment grade bond markets across all regions. By way of example, the 10-year US Treasury yield rose from 2.51% to 3.25%, creating a capital loss of some six percentage points. Similar yield shifts were seen in the UK and core European markets.

Increased globalisation and inter-dependence between nations has seen bond markets perform in a similar fashion over much of the year. However, the latter weeks of 2010 saw an increased divergence between nations, both in terms of the policies they are using to combat the current economic crises and the factors that are likely to shape the economy and financial markets in the coming year.

Turning first to the US, recent market movements have been influenced by two key factors – quantitative easing (QE) and additional fiscal stimulus. In the run-up to the widely anticipated announcement on QE, bonds had performed strongly with the spectre of a significant, price insensitive buyer about to re-enter the market. However, with the market perhaps getting a little ahead of itself, the confirmation of US\$600bn in additional monetary stimulus proved to be the peak of US bond prices and the market started to correct. Treasuries then took a further leg down following the anticipated announcement that the ‘Bush’ tax cuts on dividend income would be continued and the unexpected announcement of a cut in payroll tax.

The success of US policy is currently under much debate. From a bond market perspective, it is important to understand whether yields are rising due to increased optimism that the US economy will continue to improve and the prospect of deflation has passed, or whether monetising debt and not addressing the fiscal deficit are putting the US Treasury’s credit rating in jeopardy. The answer, we expect, is a bit of both. There is no doubt that the recent tax cuts and extensions will prove beneficial to the economy, while further ‘creation’ of money will no doubt result in higher inflation at some point. To this extent, higher bond yields as a reflection of a better economy are probably justified.



SUMMARY OF MARKETS AND OUTLOOK

However, the US economy needs to gain sufficient traction for the recovery to become self sustaining and start addressing its fiscal imbalance. If not, US Bonds and/or the US Dollar will be at risk.

After a relatively quiet summer, debt woes in peripheral European nations returned with a vengeance. After the bailout of Greece earlier in the year and the creation of the European Financing Stability Facility (EFSF) it was hoped that the EU had created enough firepower to ward off concerns over the solvency of individual member countries. However, a weakened economic outlook in the face of austerity programs, and in Ireland's case an over-levered finance sector, caused bond markets to shun the nation when Germany suggested the potential for future bailouts to be shouldered by bondholders as well as taxpayers. Ultimately, the need to re-capitalise/nationalise their banks, left Ireland with little choice but to tap the EFSF.

Ireland's woes, and contagion to other peripheral nations has led many to re-visit the EFSF, noting that it is both temporary (expires in 2013) and too small to supply enough funding for the region, should the likes of Spain not be able to access bond markets in the usual manner. While the EU searches for a new mechanism that provides a long-term solution without exacerbating near-term concerns, risks will remain elevated in peripheral European bond markets and the spectre of default and/or some form of break-up of the Euro will hang over these markets.

Conversely, German and Dutch bonds have outperformed their European counterparts. While yields on long dated bonds have drifted higher, this is due to improving economic conditions, rather than fiscal concerns. With official interest rates set to stay low for some time to come in the Eurozone, the positive slope on the yield curve gives investors in highest quality positions the opportunity to enhance yield over cash.

In the UK, the austerity measures implemented by the coalition Government have been taken well by the market, suggesting, at least for the time being, that among other issues, the UK will not be facing a funding crisis. However, yields have still risen, driven by stronger than expected GDP data and stubborn inflation data. To date, the inflation figures have been driven by the weakness of Sterling in 2009, rising commodity prices and increases in taxes. As such, they should prove transitory. We maintain that in an environment of 'cost push' inflation, it is inappropriate to raise interest rates, however, if the current rate of inflation filters through to higher wage costs, we would revisit our prediction.

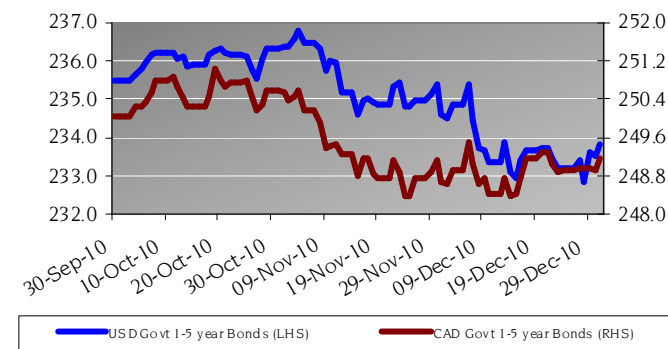
In all, the recent back-up in bond yields certainly makes the market appear more attractive than it did at the start of last October. While pockets of the Western world are starting to show signs of improved economic activity, there seems to be sufficient slack in the economy in terms of unemployment for improved activity to flow through to sustainably higher inflation. In addition, deleveraging still remains prevalent and the implementation of austerity programs through many nations suggest that it is too early to predict the economy will not slow through 2011. This certainly points towards bonds being better value than they have been for a number of months.

While the outlook for economic growth, inflation and interest rates suggest bonds are reasonable value, we maintain that the key factor driving bond markets in the coming months will be fiscal. Such pressures will likely be seen first in the peripheral European economies. However, there is only so long that even the US can rely on its status as reserve currency of the world. At some point, excessive QE and a spiralling deficit will repel bondholders across the globe.

We reaffirm our policy of short duration and high quality bonds.

CURRENCY

Looking back over final quarter of 2010, and indeed the year as whole, sovereign debt financing problems within the Eurozone's peripheral countries has been pivotal in determining sentiment and direction within global currency markets. The depth of the economic challenges that face not only Greece and Ireland, which have already been recipients of IMF / EU bail-out packages, but also Portugal and Spain, suggests that the Euro will likely remain under pressure during the first half of 2011.



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However, the Eurozone is not alone in terms of facing a series of tough fiscal challenges; other highly indebted countries such as the US, UK and Japan all have their own issues to address. In the US, the Federal Reserve (Fed) has announced a further huge Quantitative Easing (QE) program, totalling USD600 billion, which will be implemented at a rate of about USD75 billion per month.

The Market had largely discounted an extension to the QE program and, well before the increase was confirmed in early November, the Dollar began to weaken steadily from its mid summer sub 1.20 highs versus the Euro. Having fallen to just under 1.42 by early November, Ireland's woes and the stress this caused for the Eurozone as a whole saw the Dollar recover, ending the year at 1.3366. Therefore during the course of 2010, the Dollar appreciated by just under 7% against the Euro, despite QE and record deficits.

The Dollar's sell-off on the prospect of more QE was logical and confirmed the Market's view that the Fed's focus in terms of initiatives to revive the US economy remain on this policy. However the scope and size of the economic problems in other highly indebted developed areas such as Europe, the United Kingdom and Japan have limited the Dollar's demise for now.

The Euro will likely remain under pressure in the near term, as Sovereign debt financing issues dominate the headlines during the first half of 2011. That being said, with the Fed's focus remaining on QE and zero interest rates, we can envisage a scenario in which downside in the Euro is more limited than would be the case if the other major industrialised countries weren't in such poor economic shape. In terms of our outlook, we see further Euro weakness in the first half of the year, but see Dollar strength as being capped and it ending 2011 broadly unchanged from current levels. A trading range against the Euro of 1.30 – 1.40 is entirely possible during the second half of the year.

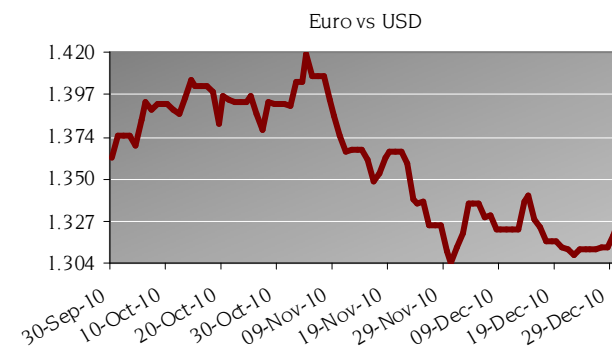
In the United Kingdom, Sterling's fortunes have also been influenced by talk of further QE measures to help support economic activity. However, rising inflation and slightly better GDP data have put off any immediate thoughts of additional QE for now. A further program of QE remains a strategy that is open to the Bank of England's Monetary Policy Committee (MPC), should the UK's slow economic recovery show any sign of faltering.

Budget deficit reduction in the UK means reduced Government spending and tax increases that will commence from the beginning of 2011. These policies will be implemented against a backdrop of rising inflation which, in part, is a result of Sterling weakness in 2009. Therefore some of the current inflationary pressures could be viewed as being transient in so much as they are a consequence of higher taxes and earlier currency devaluation.

The MPC continues to face significant challenges in maintaining stability and economic momentum. We would therefore see limited scope for any material Sterling appreciation against either the Dollar or the Euro during 2011. However, while Sovereign debt issues dominate the news-flow within the Eurozone, Sterling will likely trend a little higher against the Euro in the first half of the year. Ultimately, the UK's trade links and the significant exposure of UK Banks to the indebted EU countries, will limit the Pound's ability to strengthen materially from current levels.

In Japan, the Bank of Japan (BOJ) continues to wage war on deflation by way of its QE program and maintaining a zero interest rate policy. Despite Japan's economic problems, the Yen has remained relatively strong versus the US Dollar and while many believed the Yen to be overvalued, the currency appears to be perceived as some sort of safe-haven in the midst of a destabilised world. This view is predicated on the basis that the Country's banking sector was deemed to be in much better shape than that of the US and Europe. Japan's economy has benefited from its proximity to China, with exporters enjoying a prosperous period, which is helping offset weakness in other areas.

The BOJ will not be comfortable with the Yen's appreciation and it has intervened in currency markets in an effort to stem the currency's advance, trying to ensure that Japan's export competitiveness is not further eroded. However with other countries unwilling to see their own currencies appreciate, the BOJ is unlikely to receive much in the way of international cooperation and support.



SECTOR REVIEW

CONSUMER DISCRETIONARY

The Consumer Discretionary sub-group continued its exceptional run during the fourth quarter, gaining a further 10.68% and making it the third best performing of the ten MSCI World sectors. This means that for 2010 as a whole the sector was the best performing by some considerable margin, reflecting how Consumer Discretionary stocks continue to behave as if we are in a “normal” market recovery.

In reality, we find ourselves in anything but a “normal” recovery. Consumers face persistently high unemployment rates in the developed world, in conjunction with an ongoing drag on the wealth effect from depressed property prices. It therefore appears unrealistic for the sector to continue with its current level of outperformance indefinitely.

There is no doubt that the ongoing robust nature of consumer spending has been a surprise. As we have said previously, this is partly due to a trend for consumers to target their spending far more specifically than might historically have been the case, thus creating significant performance differentials within the sector. Focus therefore remains upon companies whose products are seen as “must haves”, both to developed and emerging world consumers. Fortunately, many of these are produced by the very same companies that display the positive characteristics highlighted by our long-term themes, such as; strong brand recognition, high barriers to entry, relatively high levels of emerging world exposure, and demonstrable track records in terms of cost reduction.

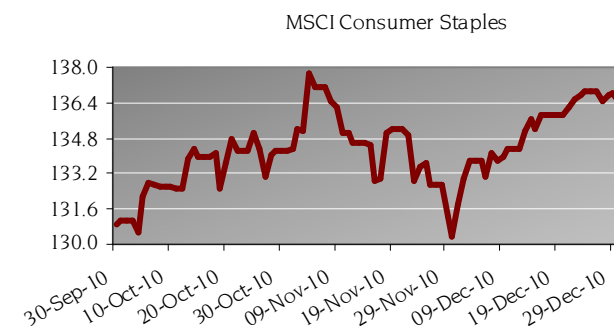
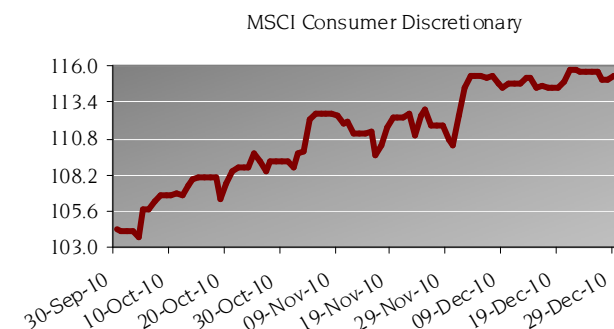
In summary, we remain cautious of the Consumer Discretionary sector as a whole, but feel that significant opportunities exist at a more granular level.

CONSUMER STAPLES

During the fourth quarter of 2010, the staples sub-group under-performed the broader market, coming in as the seventh best performing sector. Consumer Staples stocks gained 4.52% against the overall market's improvement of 8.56%

Throughout recent history, this sector has continued to demonstrate its classically defensive characteristics, and it is therefore unsurprising to see a performance lag as markets have continued to make upward progress.

As with the Consumer Discretionary sector, we see significant opportunities within the staples arena for individual situations, with many companies characterised by large franchises, a dominant market position, high free cash flow, high dividend cover, and attractive dividend yields. Indeed, such companies are particularly prevalent within the Consumer Staples sector. As opposed to the Consumer Discretionary sector, Staples have the advantage of being more generally defensive in nature. Together with the predominance of individual opportunities, this leads us to maintain an overweight stance in the sector. This is also considered particularly important from a diversification perspective.



SECTOR REVIEW

ENERGY

The Energy sector maintained the momentum that began in the third quarter, gaining 16.31% during the final three months of the year. This move represented an out-performance of the broader market, which appreciated by 8.56% over the same period. In terms of 2010 as a whole, the first half of the year saw the Energy Sector underperform, however during quarters 3 and 4, as oil prices firmed and inventories began to unwind, the Energy sector reversed this trend to end the year broadly in line with general increase in equity markets.

For the majority of last year, oil prices remained within a USD65 – USD85 trading range, with higher than average inventories and the fact that OPEC has significant spare production capacity capping upside. However, during the final quarter of 2010, the oil price pushed through the upper end of this trading range, bolstered by a particularly cold start to winter and the publication of data indicating that a draw down in excess inventories had begun. Despite the strong end of year rally, oil prices have, in the most part, lagged the price moves in other commodity and resource orientated sectors. That being said, December's strong rally saw the oil price end the year at USD 91.38, which represented a gain of 15.15% over the course of 2010.

One of our longer-term core themes supporting our over-weight stance in the Energy sector is for continued strong growth in consumption from developing economies such as China, where oil imports have increased by around 10% this year. Within OECD economies such as the US, demand has remained resilient and this trend is expected to continue unless petrol prices again reach their 2008 highs of around USD4.50 / gallon.

A combination of steady demand from within the OECD countries and robust growth in demand from non-OECD economies is helping bring down inventory levels and in turn push prices higher. These trends are expected to continue into 2011 and 2012. Taking a medium to longer term perspective, we remain of the view that if global demand continues to grow at current levels, it is likely that existing spare production capacity within OPEC could be fully utilised earlier than consensus thinking suggests. Once existing spare capacity is utilised and inventories are run down, the industry will have to develop more marginal fields, supporting higher oil prices off a higher cost base.

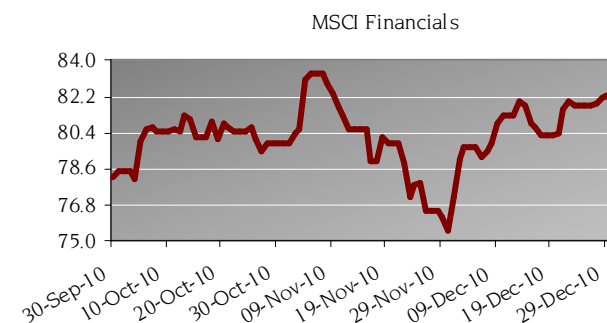
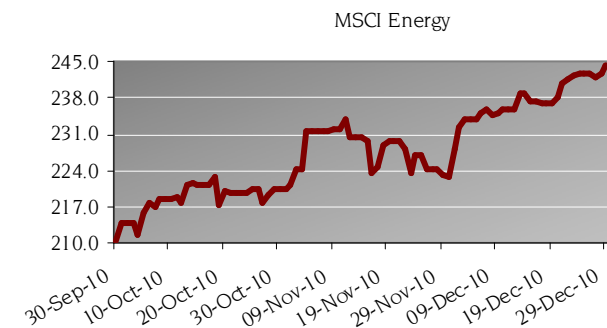
We continue to believe that our overweight strategy remains supported by compelling medium to longer term demand / supply dynamics and modest valuations, with PE multiples remaining well below their historic averages. In addition, particularly within the global integrated companies, strongly positive cash flows support attractive dividend yields. Over the longer term, the Energy Sector is viewed as being a key beneficiary of the bulk of our core secular themes.

FINANCIALS

The Financials Sector failed to keep up with the broad market, both during the quarter and through 2010 as a whole. However, returns of 5.23% for the final quarter did at least bring the overall yearly return into positive territory, at 2.33%. Within the sector, it has been the banking industry that has lagged behind, with both European and US banks struggling with their own particular issues.

In the US, the quarter has been difficult for many of the larger banks due to issues with regard to the potential for the Banks being required to buy back from investors a number of underperforming mortgage backed securities they constructed during the housing boom. The situation will no doubt stay in the courts for a protracted period of time, but the potential for losses well ahead of the levels currently provisioned for could weigh on valuations for an extended period to come.

Turning to Europe, concerns over peripheral Eurozone sovereign debt are being reflected in the prices of European financials, where much of the debt is currently owned. With peripheral bond yields soaring and financials facing heavy funding requirements in 2011, we anticipate that banks in the region will remain under pressure for the coming months.



SECTOR REVIEW

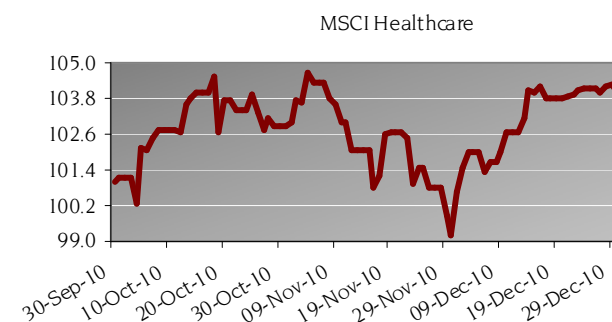
We have remained underweight to the sector during the quarter and envisage maintaining the position for the time being. In addition to the near-term risks and lack of visibility outlined above, we believe that a flatter yield curve will also weigh on net interest rate margins. Furthermore, any renewed economic weakness may reverse the recently improving trend in loan loss provisions.

HEALTHCARE

The fourth quarter proved to be somewhat difficult for the MSCI Healthcare Index, as its 3.07% gain represented an underperformance of the MSCI World for the second consecutive quarter. The relatively modest return in the final two quarters has taken the sector's return for the year to 0.38%, the second worst performance of all the ten sectors that comprise the MSCI World Index.

The ongoing challenges faced by the large Pharmaceutical companies have caused a drag on the performance of the sector during 2010. The US Healthcare reforms have contributed to disappointment in the shorter term profitability of many companies in the sector. In addition, many investors remain concerned that the rate of patent expiries will negatively impact revenue in the medium term. Whilst these factors are clearly important to the earnings potential for companies in the sector, it is possible to differentiate between the most and least impacted by patent expiry and exposure to changes in the US Healthcare system. Generic drug manufacturers are likely to be a beneficiary of both Healthcare reforms and patent expiry, as Governments will be keen to use all possible means to reduce spending on Healthcare, whilst maintaining the quality of care. Medical device makers are also attractive as they are less exposed to patent expiry.

In addition to Generics and Medical Devices, we continue to advocate exposure to Pharmaceutical companies that have demonstrated a track record of bringing new treatments to the market and have a solid portfolio of existing treatments that generate sufficient cash to fund further research and development. The stable earnings profile that many companies in the sector exhibit is also attractive in a low economic growth environment. The stable and predictable earnings growth provides a solid footing for balance sheets and dividend policies of companies in the sector. We therefore remain overweight due to the positive long term effects of ageing populations and solid fundamentals, ensuring that we gain exposure to areas of the sector with the most attractive growth potential.

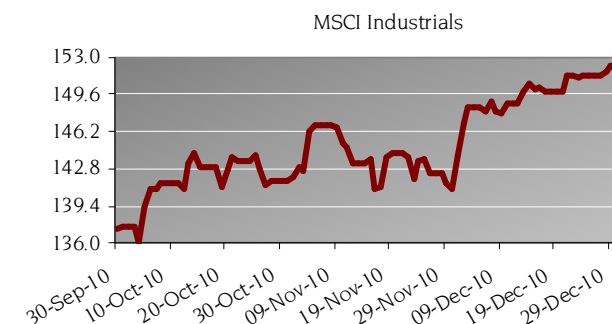


INDUSTRIALS

The Industrial sector has posted another strong quarter, increasing in value by 11.01%, versus a broad market return of 8.56%. Over the year as a whole, the sector has been the second strongest within the MSCI World Index, with returns of 21.30% compared to 9.55% for the composite. Performance for the quarter, and the year, has been driven by those companies most closely associated with the infrastructure development that is prevalent most notably within the emerging market economies.

Continued demand, combined with efficiencies from large scale cost savings implemented through 2008 and 2009 suggests that margins have scope for additional improvement and earnings have the potential to surprise on the upside. This should support the sector during the coming months, although further weakness in developed markets in the wake of austerity programs being implemented throughout Europe may potentially weigh on the sector as the year progresses.

At present we remain neutrally allocated to the sector, seeing it very much as a bell-weather for the broader economy and equity markets in general. From a sub-sector and geographic standpoint, we prefer to remain overweight to the themes that have been beneficial through 2010. To this extent, portfolio exposure within the industrial space will continue to focus upon those companies which are anticipated to be beneficiaries of the steeper growth trajectory of emerging markets relative to the developed Western World.



SECTOR REVIEW

INFORMATION TECHNOLOGY

The MSCI World Information Technology Index increased by 10.5% during the fourth quarter of 2010, outperforming the 8.56% rise in the broader MSCI World Index. When considering the performance over the course of 2010, the gain in the last quarter has taken the sector's overall increase for the year to 9.53%, virtually in line with the 9.55% gain in the broader index.

Corporate spending on information technology is relatively sensitive to the underlying economic growth. As growth in some of the World's largest economies has recovered, albeit at a relatively modest pace, shares of companies in the sector have made steady progress, particularly in the latter half of 2010. Historically, technology companies have also been able to drive demand increases through innovation, as products and services that allow businesses to operate more cost effectively and efficiently have enabled companies to increase both productivity and margins. In an economic environment where global growth is subdued by historic standards, it is likely that demand for certain types of technology will therefore remain well supported.

Unquestionably, enabling companies to deliver their products and services from the Internet will remain a key driver of growth for the sector going forward. The increasing use of the internet for all aspects of consumers' lives, from shopping for food to the delivery of entertainment such as movies and video games, will require a continued investment in hardware and software infrastructure. This is likely to support spending on networking equipment, data storage and security. With the upcoming release of a new version of the programming language that internet pages are written in, it will be far easier to incorporate high quality graphics and video into web sites. This is likely to lead to even greater levels of demand for data storage and delivery.

In addition to the positive trends noted above, many companies within the sector should be well supported by characteristics such as strong balance sheets, increasing focus on shareholder returns and attractive fundamentals. We therefore remain overweight the sector, focusing on companies that are likely to benefit from our preferred thematic drivers, and have the attractive characteristics that have been mentioned above.

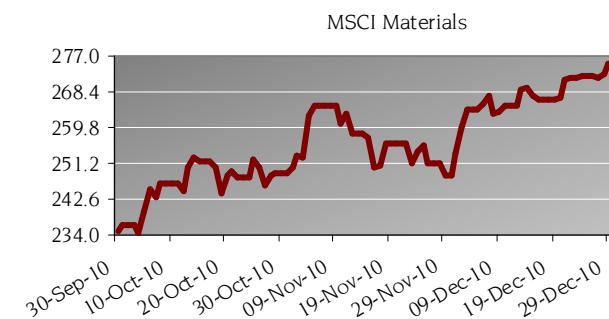
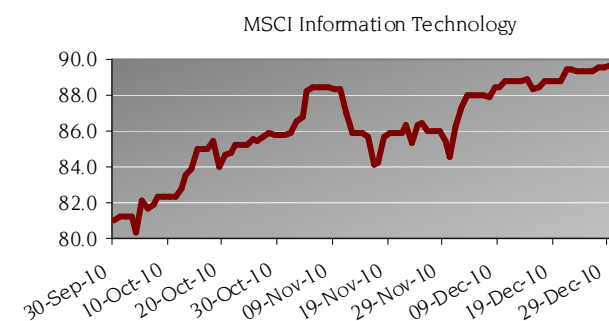
MATERIALS

The Materials sector enjoyed another strong quarter, increasing by 17.67% and again outperforming the 8.56% advance in the overall market. Commodity and Resources sub groups have generally enjoyed a very positive year as many investors have looked to increase their exposures in an effort to broaden diversity, protect against paper currency weakness and provide some sort of hedge against rising inflation.

From a fundamental perspective, commodities and raw materials prices are being driven by a combination of strong demand growth from developing economies and relatively tight capacity constraints within certain base metals such as Copper and other bulk commodities including Thermal Coal, where demand has been driven by continued strong economic expansion in China and India, where it is widely used in fuelling power generation plants.

We remain of the view that measures taken to moderate China's economic expansion, with particular focus on reducing speculative activity in property, should ultimately support more sustainable longer term trends. While raw materials demand from China may slow in the near term, longer term demand dynamics will likely remain relatively supportive. The authorities continue to allocate spending towards infrastructure projects and will look to try and moderate inflationary pressures and property speculation through controlling bank lending.

We will therefore maintain a moderate overweight stance within portfolios. Our emphasis remains upon the large cap resource and mining companies, where valuations are compelling compared to the price gains witnessed in many of the underlying commodities.



SECTOR REVIEW

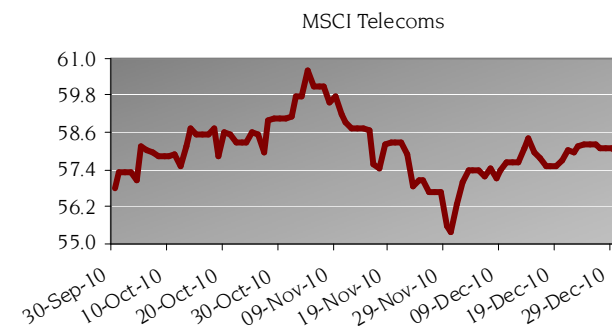
TELECOMMUNICATION SERVICES

Whilst the headline performance of the MSCI World Telecommunication Services Index during the fourth quarter has been a rather disappointing gain of 2.66%, the Wireless sub sector has posted a return of 4.04%, comparing favourably to the 2.1% increase in the Diversified sub sector. The outperformance of the Wireless group has also been reflected in the return figures for the whole of 2010, with a 17.57% gain during the year, versus the 0.96% rise in the Diversified companies.

One of the key trends within the telecoms industry going forward will be how fixed line and mobile operators are able to monetise increased data traffic across their networks. Within the fixed line space, there are an increasing number of operators who are offering ultra fast broadband based on fiber optic networks, which are able to handle a far greater volume of data at faster speeds. There have also been advancements in the speed that copper based networks can operate, which is more cost effective as existing cable can be utilised. The Wireless operators are also investing to ensure that their networks are capable of handling the increased data traffic that Smartphone's allow users to access. This is particularly important in the developed markets, where growth in the number of Smartphone's is expected to be considerable in the next three years.

Within the emerging markets the dynamics are somewhat different, as growth in the number of subscribers is arguably the most powerful trend. Despite the very fast growth in subscriber numbers, operators in the emerging markets do face healthy levels of competition, which makes margins somewhat lower than in developed markets. Margins are also affected by lower Smartphone penetration, which means consumers do not have as much demand for data when compared users in developed markets.

Whilst we remain underweight the sector, there are a number of interesting trends developing, particularly in relation to the provision of data services. The question of how operators are able to monetise this trend remains key, therefore ensuring the appropriate companies are held is very important. Our focus remains on those operators that have a mix of developed and emerging exposure, and have maintained investment in their networks that will allow them to handle increased data traffic.



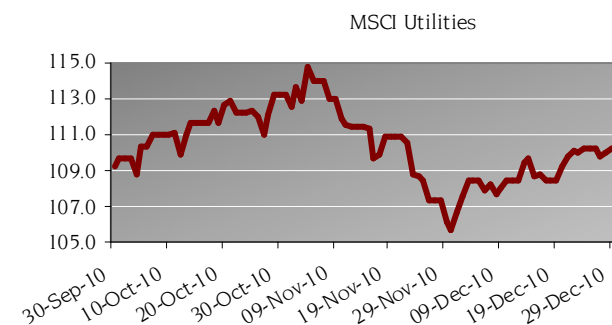
UTILITIES

In what has been both a relatively difficult quarter and year, the Utilities Sector has been the poorest performing of the ten economic sectors that comprise the MSCI World Index. The final quarter saw the sector rise in value by a modest 1.14%, but it still leaves it down 4.52% for the year versus a broad market rise of 9.55%. The water sub-industry was the one bright spot in an otherwise poor environment for the power generation and distribution businesses.

A number of factors have been weighing on the sector. In the first instance, the reliance of the sector upon dividends made it particularly susceptible to the protracted political debate as to whether the 'Bush tax cuts' on dividends would be allowed to expire at the end of 2010. Looking forwards, the resolution reached in December to extend the dividend cuts should now allow for a certain level of positive re-rating within the sector.

Political and regulatory matters continue to be of concern to us. The majority of the industry is regulated, with returns primarily set as a function of capital investment and cost. However, in the current economic environment, there is increasing pressure from politicians on the various regulatory bodies to limit the ability of utility companies to pass on higher costs to end consumers. Fears of a near-term tightening of the regulatory regimes are certainly weighing on company valuations and expectations at present.

Over the long-term, the regulatory bodies will need to allow sufficiently generous returns in order to attract the extensive level of new capital into the industry both to replace and enhance current generation and distribution capabilities. However, near term political and regulatory concerns will continue to hold the sector back and, as such, we remain underweight to the sector at present.



GOLD

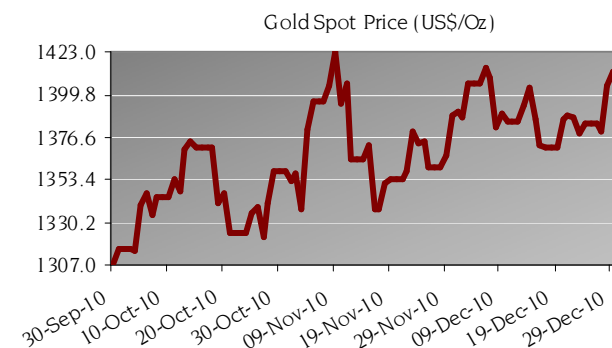
The final quarter of 2010 saw the price of Gold continue to move higher, ending the quarter up 16.01%, to stand at US\$1,418.75. Over the course of 2010, the price of gold has increased by 29.14%, its tenth consecutive annual gain. During the fourth quarter, the metal recorded its highest ever close of US\$1,422.75, however, this remains below its inflation adjusted record of over US\$1,830, reached in the early 1980's.

Concern that some Government balance sheets are precariously positioned has seen an increase in demand for gold during the last quarter, largely due to its historic standing as a store of value, particularly during time of heightened uncertainty. It is likely to take some time for many deficit countries to work back towards more normalised levels of leverage, therefore during this process there will undoubtedly be further periods where investor nervousness leads to spikes in demand for the metal. In contrast, some Governments that operate budget surpluses, such as China, have been increasing the amount of gold that is held in reserve. It is likely that any emerging market Central Bank that is seeking to increase its holding will look to take advantage of any short term weakness in price, which should provide further support in the medium term.

According to data from the Commodity Futures Trading Commission (CFTC), speculative derivative positions in gold declined from net long 795 tonnes at the end of September, to net long 651 tonnes at the end of the year. The fact that the gold price trended higher during a period of derivative unwinding provides further evidence that other sources of investment demand, such as physical bars and coins, was robust during the fourth quarter.

In terms of supply, whilst mine production has only increased modestly from last year, the relatively high price has seen strong growth in recycled gold. Central Bank selling was very limited during the year, with just 6.9 tonnes being sold by the participants of the Central Bank Gold Selling Agreement, although the IMF did sell 129 tonnes in the open market. Looking forward, it is unlikely that the supply of gold will increase greatly from the levels seen over the past three years, particularly as Central Banks seem to be turning toward being net buyers, rather than consistently providing metal to the market as they have done in previous years.

The price of gold is likely to be driven by the macro-economic environment, and the resultant appetite for risk that investors demonstrate. With the US undertaking further rounds of quantitative easing as a path to recovery, the UK undertaking a bold austerity package and Europe battling to keep its over indebted periphery from defaulting, gold should continue to be well supported in the next 12 months.



QUARTERLY STATISTICS

EQUITY INDICES

	30 September 2010	31 December 2010	Percentage Change
Global			
MSCI World Index	1,179.19	1,280.07	+8.56
MSCI World Index (Sterling)	749.74	821.03	+9.51
MSCI World Index (Euro)	865.78	957.71	+10.62
United States			
Dow Jones Industrial Average	10,788.05	11,577.51	+7.32
S & P 500 Index	1,141.20	1,257.64	+10.20
NASDAQ Composite Index	2,368.62	2,652.87	+12.00
Europe			
DAX Index	6,229.02	6,914.19	+11.00
FTSE 100 Index	5,548.62	5,899.94	+6.33
Dow Jones Euro Stoxx 50	2,747.90	2,792.82	+1.63
Far East			
Nikkei 225 Index	9,369.35	10,228.92	+9.17
TOPIX Index	829.51	898.80	+8.35
FT World Actuaries Pacific Rim X Japan (US Dollars)	432.13	473.86	+9.66
FT World Actuaries Pacific Rim X Japan (Sterling)	406.57	448.72	+10.37
Hang Seng Index	22,358.17	23,035.45	+3.03

MSCI WORLD SECTORS

Consumer Discretionary	104.35	115.49	+10.68
Consumer Staples	130.87	136.79	+4.52
Energy	210.50	244.83	+16.31
Financials	78.18	82.27	+5.23
Healthcare	100.99	104.09	+3.07
Industrials	137.37	152.49	+11.01
Information Technology	81.04	89.55	+10.50
Materials	234.82	276.31	+17.67
Telecommunications Services	56.80	58.31	+2.66
Utilities	109.17	110.41	+1.14

QUARTERLY STATISTICS

BOND INDICES

	30 September 2010	31 December 2010	Percentage Change
Bloomberg Bond Indices - Global Bond Index (US Dollars)	269.83	265.09	-1.76
Bloomberg Bond Indices - Global Bond Index (Sterling)	288.30	285.79	-0.87
Bloomberg Bond Indices - Global Bond Index (Euro)	250.55	250.82	+0.11
Bloomberg Bond Indices - US Govt 1-5 Year	235.46	233.82	-0.70
Bloomberg Bond Indices - UK Govt 1-5 Year	271.17	269.49	-0.62
Bloomberg Bond Indices - Canada Govt 1-5 Year	250.06	249.15	-0.36
Bloomberg Bond Indices - Euro Govt 1-5 Year	160.95	159.35	-0.99

FOREIGN EXCHANGE RATES

Sterling versus US Dollar	1.5728	1.5591	-0.87
Sterling versus Euro	1.1548	1.1665	+1.01
Sterling versus Swiss Franc	1.5427	1.4562	-5.61
Sterling versus Canadian Dollar	1.6186	1.5504	-4.21
Sterling versus Japanese Yen	131.2500	126.5800	-3.56
US Dollar versus Euro	1.3620	1.3366	+1.86
US Dollar versus Swiss Franc	0.9808	0.9339	-4.78
US Dollar versus Canadian Dollar	1.0292	0.9943	-3.39
US Dollar versus Japanese Yen	83.4600	81.1900	-2.72

LIBOR 3 MONTH RATE

Sterling	0.7323	0.7575	+3.45
US Dollar	0.2900	0.3028	+4.42
Canadian Dollar	1.2533	1.2317	-1.73
Euro	0.8475	0.9388	+10.77
Swiss Franc	0.1783	0.1700	-4.67

COMMODITIES

Reuters/Jefferies CRB Commodity Price Index	286.86	332.80	+16.01
Gold Spot \$/Oz	1,307.52	1,418.75	+8.51
Brent Crude Index (London)	79.26	93.49	+17.95
Crude Oil Futures (New York)	79.97	91.38	+14.27

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