



Butterfield

Fourth Quarter 2009

Investment Review

Butterfield Bank (Guernsey) Limited Fourth Quarter 2009 Investment Review

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SUMMARY OF MARKETS AND OUTLOOK

GLOBAL EQUITIES

During the final quarter of 2009 equity markets managed to extend the rally that began in March, albeit at a rate considerably slower than the stellar pace of the previous two quarters. The Morgan Stanley Capital International (MSCI) World Index gained a further 3.68% in US Dollar terms during the last three months of 2009, bringing the gain for the year to 26.98%. Even more notably, the rally from the lows reached in March was an impressive 69.7%. On a slightly more sanguine note, it is worth remembering that this still leaves global equities 30.5% below their high point, reached in October 2007.

At the end of the calendar year, it is traditional to review the events of the last twelve months. This always feels a little arbitrary in investment terms, and is also covered by every other investment commentary and news paper at this time of year. In somewhat of a departure, we have therefore chosen to take a step back on this occasion. Instead, we will review the key long-term considerations that are important to the construction of our current equity strategy, and how these relate to our investment process. We hope that this will give clients a further level of insight into why portfolios are positioned as they are at this point.

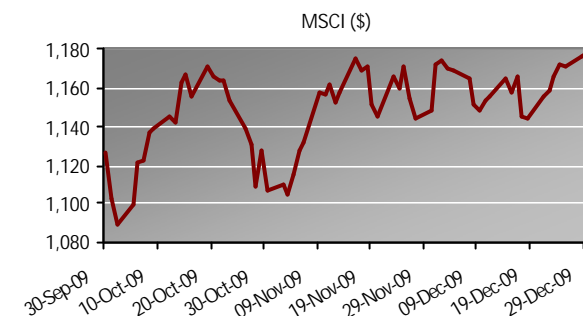
Our approach to equity investment is fundamentally grounded in core long-term investment themes, which are reflected in every aspect of what we do. These change over time but, at this point, there are five core themes which are highlighted throughout this commentary. These are constantly balanced against near-term factors which are considered likely to dominate more immediate progress. The following comments attempt to provide a relatively high level summary of how these factors interlink, and feed through to our current conclusions.

The memory of the credit crisis will lean authorities towards a "Governments - growth at all costs" approach for far longer than would otherwise be the case. This has already created the foundations for the world to avoid depression and return to a level of sustainable growth. Such policies also have the inevitable consequence of creating localised anomalies, the signs of which have already emerged. This environment is good for providing specific investment opportunities, but strategy needs to constantly adapt in order to avoid bursting bubbles. As highlighted in last quarter's commentary, the most obvious example of this is an apparent disconnect between the equity market and economic progress. Experience tells us that such anomalies invariably last far longer than can fundamentally be justified, so we remain skewed towards this theme in many aspects of our equity positioning. However, we have offset this by maintaining a more cautious stance from an asset allocation perspective.

As governments seek to reflate, growth in the developed world will be restricted by a number of factors, not least of all "deleveraging of the public and private sectors", which will create a gradual reduction in spending in favour of higher savings rates. This encourages us to believe that the growth at all costs approach can be pursued for a relatively extended period without an immediate inflationary concern, or a near-term repeat of the debt inflated bubble which brought us to where we are today. This has clear implications in terms of our fixed interest strategy, which is covered elsewhere in this commentary. However, it also feeds directly into asset allocation, as well as individual sector and stock positioning.

Another powerful force in terms of the world's long-term trajectory is "demographic change". Ongoing global population growth has the potential to offer significant support to global growth rates. However, differing trends in population growth as well as population aging will significantly alter the shape of spending in both the developed and developing world. Whilst complex at the granular level, it can generally be concluded that demographic change has the potential to be more supportive for the developing world. That being said, enthusiasm must be tempered because, whilst positive demographics offer a good base, authorities will still need to execute appropriate strategies in order to gain real economic advantage. This points us towards investment opportunities in the emerging world, and in companies and sectors which benefit from robust emerging world growth. However, we are again adopting a relatively cautious approach, with highly diverse exposure, often indirectly through companies which have a proven track record of execution in these areas.

The sustainable differential in growth rates created by the themes already highlighted will cause a very gradual, and undoubtedly often challenging, "power shift to the east". This has a very significant bearing upon many aspects of our investment strategy, not least of all long-term currency trends. However, it also impacts strategy at lower levels, with investment opportunities again arising in companies that are able to benefit from global brand strength, proven execution strategies, and the flexibility to adapt to local



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market requirements. Further up our strategy chain, there are some economic sectors which are far more exposed to this theme than others, which offers an additional level of opportunity.

Relatively high emerging world growth rates, in conjunction with expansive government strategies, create an environment where infrastructure spending on a global basis is likely to remain well supported in the long-term. This brings us to the last of our five long-term themes, "higher commodity prices". Clearly recent history demonstrates that volatility can be high in terms of commodity prices, and that movements are sometimes unpredictable. Nevertheless, we believe that throughout the investment cycle significant investment opportunities will persistently be presented in this area for those willing to take a committed but conservative stance.

These long term themes upon which we ground our investment strategy are obvious to all, and our interpretation of them is not unique. The question is therefore why our investment strategy should be able to benefit from them in any meaningful way. The answer is simply a matter of disciplined focus. Themes are considered as part of every decision, whether that be; asset allocation, sector positioning, stock selection, fund selection, or portfolio construction. This ensures that strategy always keeps at least one eye upon reliable long-term factors, which the market often fails to focus upon amidst the pursuit of near-term momentum. The long-term nature of these themes also encourages us to be unashamedly long-term in our strategic thinking. At the same time, they provide us with a structured framework within which to constantly consider how near-term developments influence the way that the market values longer-term trends. On balance, this helps us to tilt strategy in order to benefit from our long-term focus, whilst reducing the potential for near-term setbacks.

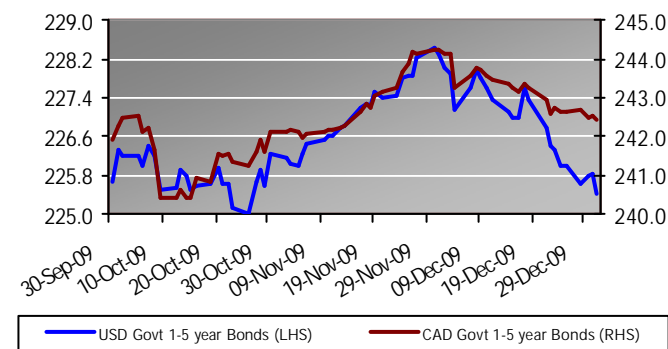
In conclusion, we believe that the long-term outlook is for a world that can continue to grow at a pace both sufficiently rapid and stable for global equity investors to be rewarded in a way that has simply not been the case for the last decade. At the same time, we are acutely aware that the rally in equity markets over the last nine months has encompassed a great deal of hope about the future, in addition to reflecting a step back from the brink of disaster. As such, portfolios are characterised by a reasonably sharp focus upon positive and dominant long-term trends, and this has contributed significantly to portfolio returns in recent months. Offsetting this, we have adopted a relatively conservative overall stance, in an attempt to ensure that portfolios remain relatively well supported should the general momentum in equity markets disperse.

GLOBAL FIXED INTEREST

After another strong two months, the final weeks of 2009 proved somewhat more challenging for bond markets, with benchmark yields rising across the yield curve. In all, returns were almost flat over the final quarter of 2009 for US Bond markets, while UK and European markets made nominal progress. For the year as a whole, benchmark Government bonds in the US made very little progress in 2009 after a strong 2008. Conversely, Government bonds in the UK and Europe posted strong returns relative to deposit rates, reversing the weaker performance posted during 2008.

Despite the recent reversal in the market, bond yields remain at relatively low levels on a historical basis, suggesting that interest rates in the developed world are likely to remain low through much of 2010. Such a view remains consistent with the thesis that a global economic depression appears to have been averted, but a return to self-sustaining economic growth will be a slow and laborious journey. Furthermore, while most economies in the world appear to have reached the bottom and started to recover, growth is building from a low base with a large amount of spare capacity available (especially labour), limiting the chance of near-term price pressures.

In all, we tend to agree that growth in 2010 will be positive, but below both trend, and what would normally be expected from an economic recovery. Our view is predicated upon the 'type' of recession this has been, as well as the global nature of the recession. In the first instance, it needs to be understood that the economy has suffered a balance sheet recession, caused by over-leverage in all aspects of the economy – consumers, corporate entities, investment markets, physical assets and now, Governments. It will take a prolonged period of de-leveraging to re-balance these, rather than a short period of de-stocking associated with a more normal, over-production driven recession. Such an environment will be consistent with lower consumption and investment, relatively weak asset prices and higher taxation.



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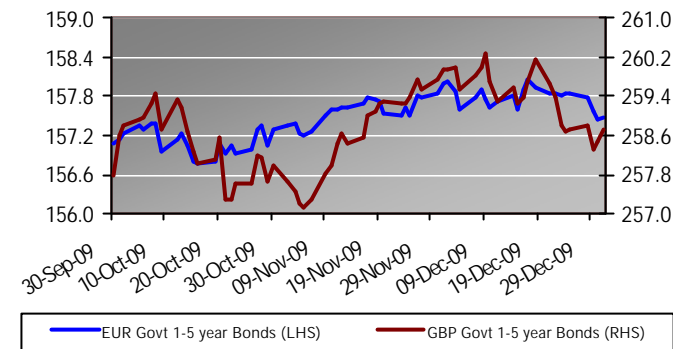
The global nature of the recession also suggests that the recovery will be less robust. Increased globalisation has led to the entire world economy slowing at the same time, rather than any single region. In effect, this means that demand has been destroyed globally and there is not a natural source of new demand that will pull the economy through. Many have pointed to China as a source of potential demand. We have no doubt that this will indeed be the case in time, but it will be a multi-generational move that sees China's economic balance shift from producing to consuming, not something that will resolve global economic imbalances in 2010.

The economic environment will see Central Banks maintain very easy monetary conditions throughout 2010. Furthermore, we believe authorities will be keen to keep rates lower for longer to firstly, ensure that economy recovery is entrenched and secondly, counteract the drag on growth of tougher fiscal policy. In turn, low official interest rates should anchor bond yields at the front end of the yield curve. However, we have concerns about the longer end of the yield curve and anticipate greater steepness as longer dated bond yields rise further.

Concerns over longer dated yields are driven by the risk that interest rates could rise sooner than expected and also by over expanding Government deficits. From an interest rate perspective, a change in inflation expectations, either from a brighter than anticipated economic outlook or as a reaction to quantitative easing programs, could force Central Banks hands in raising rates. Similarly, a side effect of over easy monetary policy has been an increase in the value of risk assets. A fear that new asset bubbles are forming, thus risking the long-term stability of the economy could again see Central Banks raising rates sooner than would be justified based purely upon underlying economic fundamentals.

Perhaps one of the most important consequences of Governmental rescue packages has been the rapid deterioration of public finances. Greece and Dubai are the more extreme examples, but G7 economies such as the UK and US have been highlighted as possibly having their AAA ratings come under question. With rapidly rising fiscal imbalances, questions are justifiably being asked as to who will buy all the debt to fund the short-fall – especially when 10-year yields are 3.8% and 4.1% in the US and UK respectively.

On balance, this leaves strategy in a similar place to where we started the year, investing in bonds at the front end of the yield curve. As detailed in previous reports, this enables portfolios to benefit from yields substantially in excess of deposit and money market rates, whilst not committing to what are still historically low yields for an extended period when there is a risk that rates may go up sooner than anticipated. In addition, we shall maintain exposure to sovereign guaranteed, supranational and high grade corporate bonds rather than benchmark government bonds. The yield enhancement they have provided over the last year has been a welcome boost to performance. It is unlikely that they will add a similar level of return over the coming twelve months, but should still provide a suitable level of yield enhancement for the marginal increase in credit and liquidity risk.



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CURRENCY

In previous commentaries we have highlighted how risk appetite and market sentiment had become increasingly influential in determining direction and flows in global currency markets. In recent years the value of the US Dollar in particular has been very susceptible to these trends, and for much of 2009 these influences have continued to dictate direction. However, the final weeks of the year we started to see some evidence of a change in market sentiment in respect of the Dollar and in particular, its value versus the Euro. From the 2009 highs of over 1.51 witnessed in late November, the Dollar has rallied and ended the year trading just below the 1.44 level. Over the same period, risk assets such as equities continued to appreciate, representing a contrast to the inverse correlation between the Dollar and equity market movements during 2008 and much of 2009.

The Dollar's recovery was primarily driven by US economic data coming in a little ahead of expectations, which led to speculation that the Fed may start to unwind its current extremely accommodative policies sooner than had previously been expected. These factors, in combination with short covering ahead of the year end, contributed to the Dollar's rally. While the Fed have begun to be a little more positive in their overall outlook on the economy, they have further reiterated their mantra of rates remaining at extreme lows for an "extended period".

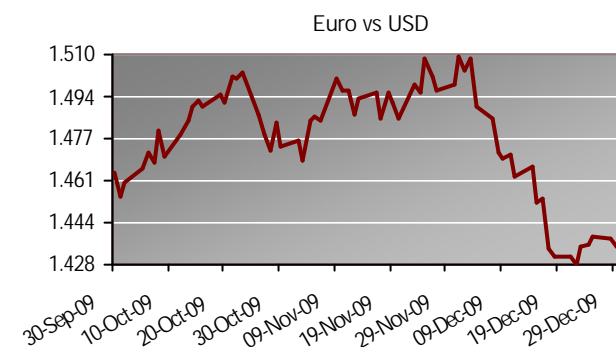
The Fed justify their policy on the basis of continued subdued inflationary forces and high levels of unemployment, neither of which look likely to materially improve in the immediate future. This suggests that it may still be a little too early to signal that we are on the cusp of a major Dollar revaluation. It is however important to keep in mind that as the US was one of the first countries into recession, and the overall impact of the expansionary fiscal and monetary policies pursued by the US authorities are now starting to have a positive impact. This suggests that an ongoing deterioration in the Dollar's value in 2010 is becoming less and less likely.

We therefore reiterate the view articulated in our last commentary, that the Dollar could continue to recover further ground, as the economy improves and Foreign Exchange markets anticipate a change in monetary policy. While suggesting that a further Dollar recovery will play out during 2010, we are not at this stage calling for a significant revaluation, more a recovery of some of the ground lost during the second and third quarters of 2009. It is also perhaps worth considering that although the Dollar has appeared, at least for now, to have decoupled from its inverse relationship with equity market direction, it would undoubtedly also benefit from any renewed risk aversion triggered by a meaningful correction in equity markets.

In the wake of events in Dubai, the Euro bloc as a whole has been the subject of increased scrutiny, as worries about some of the weaker economies within the Eurozone have increased. Greece in particular appears to have polarised concern, as the new Government has struggled to convince the market of its ability to cut deficits and present a credible course of action towards a balanced budget. While this issue has almost certainly impacted the Euro in the near term, the market's current take on the situation is now some way to being factored in. However, any further negative developments in this regard would likely lead to additional pressure on the Euro.

In the UK, sentiment towards Sterling has been impacted by data releases showing that the UK is falling behind both the US and the Eurozone in terms of the rate of economic recovery. It was therefore not entirely surprising when the BOE announced that it had voted to extend its QE programme and had not ruled out further action post February 2010, when it is next due to present its forecasts on the economy. This somewhat disappointing news has translated into further selling pressure on Sterling and having nudged through USD1.70 in early August, the Pound generally traded easier during the final quarter of 2009, ending the year around the USD1.60 level.

In the Government's 2010 pre Budget report the UK Chancellor outlined some high level goals and objectives focused toward improving the state of public finances. However with an Election due by the middle of the year, the Government has so far been reluctant to outline any real detail in terms of spending cuts focused toward reducing current extended debt and deficit levels. This lack of detail has therefore increased speculation that the UK is potentially vulnerable to a downgrade of its sovereign credit rating, which in turn has translated into increased volatility in currency markets. These issues will likely see volatility remain elevated until after the Election. During the course of the last two years, Sterling has suffered a devaluation of over 20% versus both the Euro and the US Dollar and we continue to expect the risk to be toward the downside, particularly during the first half of 2010.



SECTOR REVIEW

CONSUMER DISCRETIONARY

The Consumer Discretionary sub group of the MSCI World Index rose by 5.42% during the fourth quarter of 2009. This was slightly ahead of the broader market gain of 3.68%, and placed consumer discretionary stocks mid-table amongst the ten MSCI world sectors.

From the lows reached in March 2009, the Consumer Discretionary sector has significantly outperformed the broader market, as might be anticipated from an area that classically plays a leadership role between market bottoms and the subsequent end in recessionary conditions. During the final quarter of 2009, the sector's outperformance was less pronounced, possibly reflecting the reality that developed world consumers are likely to remain subdued for a somewhat extended period, as they seek to rebuild household balance sheets. In the very long term this will be more than offset by the power of wealth creation in the emerging world, especially for companies who are able to tap into aspirational purchasing trends. However, this will be a prolonged transition and, in the meantime, we feel that caution is required in the sector until far clearer evidence emerges of a sustainable increase in global GDP growth. Where we do have exposure to the consumer discretionary sector, focus is upon companies who should be relatively early beneficiaries of this "power shift to the East", as well as situations which show the potential to benefit from any increase in consolidation amongst existing 'Mega-brands'. Companies with a demonstrable track record in cost reduction are also favoured at this time.

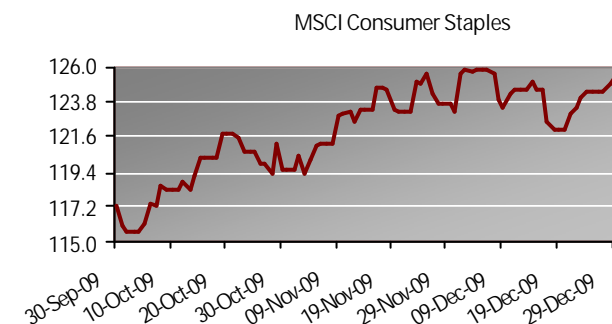
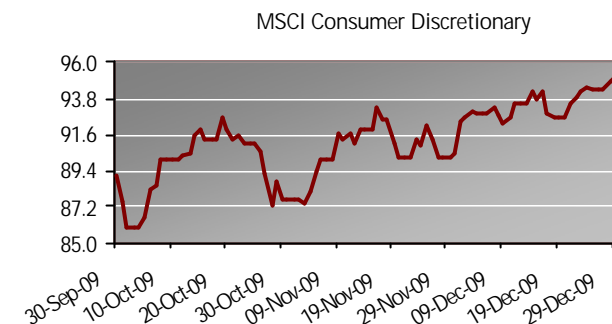
CONSUMER STAPLES

During the final quarter of 2009, the staples sub-group gained a further 5.94%, making it the fourth best performing MSCI sector. This also represented an outperformance of the broader market by 3.68%.

The outperformance of staples stocks towards the end of 2009 reflects a slightly more subdued overall market environment. This has somewhat benefited a sector that demonstrated classically defensive characteristics during the credit crisis and subsequent market recovery.

As we have said previously, the sector is made up of an exceptionally broad range of companies, some of which are clearly far more defensive than others, and it will always be extremely important to be selective in terms of sub-sector and stock positioning. However, some supportive trends are evident across many areas of the sector. In particular, growth rates related to developed consumers have shown that they can remain very resilient to any economic downturn, and many management teams have shown that impressive ongoing cost reductions remain possible in these areas of their business. Add to this the proven benefits of strong execution in the developing world, and it is clear that significant opportunities exist within this area of the market, especially when held in conjunction with more cyclically oriented positions.

Success in the staples sector is tied into domestic dominance, and we will continue to focus upon companies with this characteristic, who have proven their ability to cut costs and sustain their market share in developed countries, whilst driving margins and volume growth in the emerging world.



SECTOR REVIEW

ENERGY

During the final quarter of 2009 Energy stocks continued to steadily appreciate, rising by 5.22% and outperforming the broader market, which posted a 3.68% advance. When viewed from a longer term perspective, over the last three years our overweight positioning within the Energy sector has made a significant contribution to relative performance versus the market overall.

When reviewing 2009, investors will remember a year of significant volatility within the Energy sector overall, and the price of crude oil in particular. By the middle of February last year, the price of a barrel of crude had fallen below USD34, before recovering sharply to end the year at USD79.36, which is over 133% above its 2009 low. One of the key factors that helped to support this recovery has been OPEC's management of supply. Unlike the early 1980's, when the cartel failed to implement a cohesive strategy to manage supply relevant to contracting demand, to date OPEC have done a reasonably effective job in managing reduced quotas to reflect lower demand dynamics. Thus far, Saudi has been prepared to take the brunt of lower quotas and has cut production by around 4 million barrels per day in order to keep the market "balanced".

Looking forwards, 2010 will no doubt represent further challenges for OPEC, as inventories within the OECD countries are currently around 10% above their average levels. This would suggest that some level of de-stocking will have to take place during the course of the next few months, which will likely put both OPEC and oil prices under some near term pressure. We therefore do not expect a further strong rally in the oil price in 2010, rather an oil price that trades in a range whereby the current price represents a level towards the upper end of the range, with downside some 15% / 20% lower.

In respect of the longer term, the fundamentals remain attractive. Compelling demand supply dynamics are supported by modest valuations, with PE multiples in the sector below their historic averages. In addition, particularly within the global integrated sub-group of companies, strongly positive cash flows support attractive dividend yields. We therefore remain of the view that an overweight position toward this sub group remains an appropriate strategy within client portfolios.

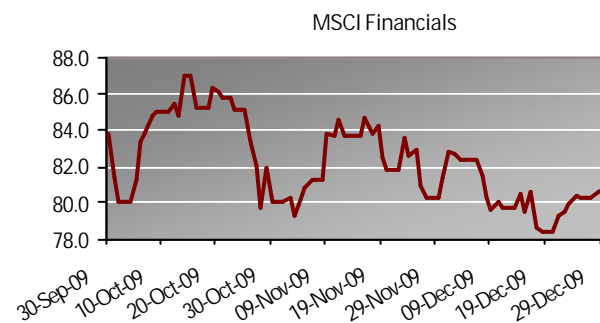
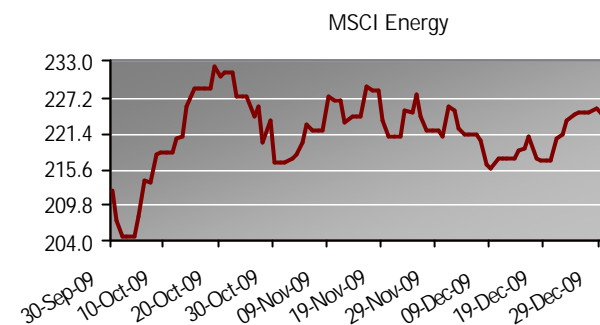
FINANCIALS

After two quarters of strong returns, the Financials sector posted the only loss of the ten sectors that make up the MSCI World Index during the final quarter of 2009. The sector fell by 4.05% during the fourth quarter versus the headline index that increased by 3.68%. For 2009 as a whole, the sector was broadly in line with the index, posting an increase of 27.72% versus the 26.98% return on the MSCI World.

Over recent quarters we have commented upon the support the financial sector has received, in the form of lower interest rates from Central Banks and the liquidity and capital injections supplied by government bailouts, as reasons for the improvement from the March lows. However, we also noted our concerns that improving results were being flattered by changes to accounting policies, a temporary boost to margins, and strong trading results that are not necessarily repeatable.

It now appears that the market is taking greater note of the potential for the sector to disappoint in the coming months as the sustainability of the factors detailed above comes into question. Furthermore, while the underlying economy appears to be turning, the lack of visibility in the potential path of recovery and the opaque nature of bank balance sheets is causing many to look elsewhere for investment opportunities. In particular, we would highlight sustained high levels of unemployment as a key risk to further losses in the sector as more customers with borrowings, previously considered as 'prime', struggle to meet repayments as their employment situation deteriorates.

In light of the above, we remain strongly underweight in the sector at present, and will maintain this position until we become more confident in the strength of economic recovery and see an improvement in credit quality.



SECTOR REVIEW

HEALTHCARE

During the fourth quarter, the MSCI World Healthcare Index was led higher by companies within the Health Care Providers & Services group, following U.S. Senate approval of the proposed reforms to the Healthcare system. Gains in the Health Care Equipment and Pharmaceutical sub sectors offset a decline in Biotechnology companies, which resulted in a gain of 7.92% for the sector as whole. This represents a strong out performance of the 3.68% gain in the broader MSCI World Index. For 2009 as a whole, the Healthcare sector rose by 16.40%, an underperformance of the broader market rise of 26.98%.

The proposed change to U.S. Healthcare legislation represents the largest expansion of health coverage since the initiation of the Medicare program for the elderly, which was introduced in 1965. The aim of the new bill is to extend insurance coverage to tens of millions of currently uninsured Americans, which could see a huge increase in customers for healthcare insurance providers, should the Government decide against setting up a state run Insurance company. The House and the Senate have passed different versions of the Bill, therefore a compromise will need to be found on issues such as funding for the program, provisions for abortion, and whether a state run insurance company is required, before the Bill can be passed into law.

Looking ahead, whilst the US Healthcare reforms will provide a benefit to some companies within the group, it is likely that the US administration will look to cut costs in other areas of healthcare, with a reduction in spending on pharmaceuticals being high on the agenda. This leads us to seek exposure to those companies that are likely to be less impacted by the changes in U.S. legislation, in addition to avoiding companies that face significant expiration of patents in the years ahead.

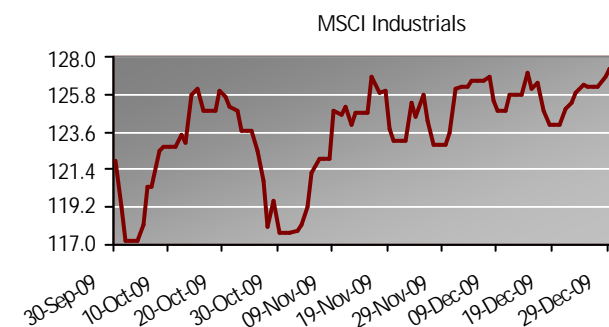
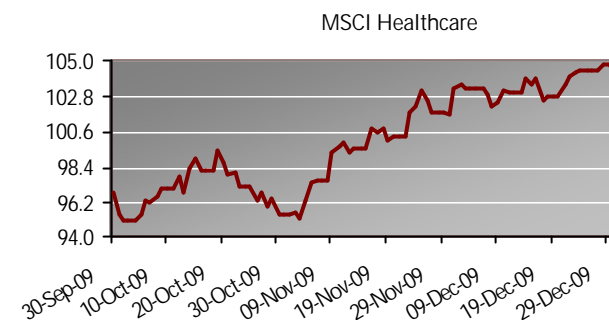
INDUSTRIALS

The final quarter of 2009 saw the Industrials sector increase in value by 3.03%, closely in line with the headline index which posted a return of 3.68%. Over the full twelve months, the sector marginally underperformed, but still posted a return of 23.95% versus 26.98% for the MSCI World Index. Returns were broad-based, although the areas of Transportation and Commercial Services failed to keep pace with the Capital Goods sub-sector.

Industrial activity in the US remained buoyant through the final quarter of 2009, with the latest economic releases suggesting that US manufacturing continues to rebound. While this is obviously a comfort to investors, it remains too early to ascertain whether increases in industrial production are as a result of new demand, or just the result of re-building inventories after destocking at the end of 2008.

What is perhaps more clear, is that the sub-sectors that are likely to outperform from here will be different from those in the last economic cycle, as Government fills the void vacated by consumers. The Engineering and Construction sub-sector is the area that is most focussed upon increased Government infrastructure spending, although it does not come without risks or volatility. Consumer related goods and services are the most at risk in the near-term, while transportation and freight will also suffer through a period of lower global trade.

We chose to reduce our exposure to the industrial sector in the latter part of 2009. From a revenue perspective, we have concerns that recent strength in manufacturing is unsustainable in the low growth environment we anticipate. Furthermore, margins are likely to come under pressure from commodity prices. Spare capacity, especially in the workforce should ease employment related costs and offset commodity costs to some degree, but will be a drag on demand.



SECTOR REVIEW

INFORMATION TECHNOLOGY

The MSCI World Information Technology Index increased by 7.92% during the fourth quarter, the second best performance of the ten MSCI World Index sectors. Optimism over the strength of economic growth led investors to focus upon the attractive margins and strong balance sheets that are prevalent within the sector, with the Software and Services sub group performing particularly well. The fourth quarter return added to the out performance in the first three quarters of 2009, and took the return to 50.88% for the year.

According to a survey of over 100 US and European Chief Information Officers, conducted by US Brokerage firm Alliance Bernstein, corporate spending on Information Technology is likely to remain largely unchanged in 2010, following estimates for a 2.4% decline in 2009. Whilst these estimates seem rather conservative, given the improving economy, specific areas of technology are a key focus for spending. We expect strong growth in spending for the storage and networking segments, as support should come from both an ever increasing demand for high quality media to be delivered from the internet, as well as the corporate sector. The survey also suggests that the interest in upgrading to Windows 7 is far greater than Microsoft's previous version of Windows, although most will wait for the release of the first major update before committing to the new system. Microsoft typically releases the first service pack for a new operating system a year after its introduction, therefore this pick up in demand is likely to be in the fourth quarter of 2010. The upgrade cycle of Windows will also have ramifications for PC demand, as almost 60% stated that they intend to upgrade PC's at the same time. As Windows 7 is able to operate on relatively low specification computers, there is a possibility that the PC upgrade cycle will not be as strong as forecast, as cost control remains high on the agenda for many companies.

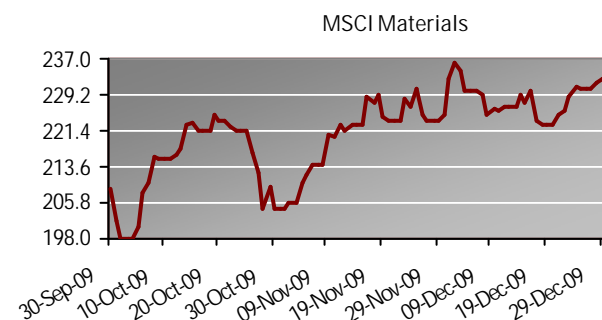
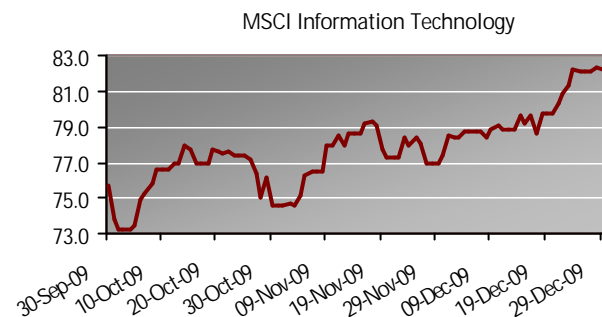
We remain focused on areas of technology that are likely to be well supported despite muted growth in overall spending, such as storage, security, networking and core operating systems.

MATERIALS

The final quarter of 2009 again saw the Materials sector as the leading performer of the sub groups that make up the MSCI World Index, appreciating by 11.06% versus a rise of 3.68% in the broader market. While the Materials sector endured one of the sharpest sell offs of all sectors during the final months of 2008 and the first quarter of 2009, during the year as a whole the sector outperformed all other sub groups that comprise the MSCI Index.

Within the Materials sector, the companies that make up the Metals and Mining sub group outperformed the other sub sectors, rising by 15.27% during the final quarter of last year, and by 77.63% over the course of 2009. China's restocking and inventory building of commodities and raw materials led to a strong rebound in base metals and other raw materials prices during the second half of the year. Some transitory price weakness during coming months may be witnessed as China works through recent activities, however the medium term trends remain supportive.

Looking forward, global demand for resources and materials will continue to be driven by the sustainable upturn in growth from the ongoing industrialization and urbanisation programs underway in China and other developing economies. Furthermore, OECD economies are expected to begin re-stocking in 2010 as economic recovery gathers traction. The backdrop in terms of productive capacity within the resource group of companies remains generally supportive for pricing and increased capacity will, in many cases, take years to come on stream. This will keep overall market tightness an ongoing theme in the medium term. We therefore continue maintain our overweight stance in client portfolios.



SECTOR REVIEW

TELECOMMUNICATION SERVICES

Companies within the MSCI World Telecommunication Services Index posted a modest gain of 2.86% during the fourth quarter of 2009, underperforming the broader market rise of 3.68%. The sector was the second worst performing during both the quarter, and the year as a whole. Although the sector performed largely in line with the market during the first quarter, it failed to keep pace with both more cyclically sensitive sectors during the rally in the final three quarters of the year, resulting in an 8.63% gain for 2009.

Within the Wireless sub sector, many companies have aggressively cut investment in their networks in order to protect cash flows and dividend cover. The increasing demand for data services, which require as much as 10 times the bandwidth of voice calls, means that many of the wireless operators need to invest in their networks in order to ensure that they are able to offer customers competitive connection speeds. The attraction of data services for the providers is that it is one of the highest margin segments of their businesses, and with the increasing adoption of smart-phones and netbooks, demand for data is likely to also remain an attractive growth area.

We maintain an underweight stance to the sector, with focus on those companies that have continued investment in their wireless networks to enable a competitive data service, as well as diversified exposure to the sector more broadly. There are also interesting opportunities in diversified telecom companies that have exposure to faster growing, emerging market regions.

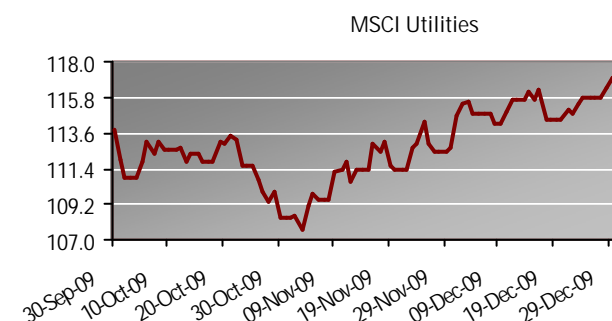
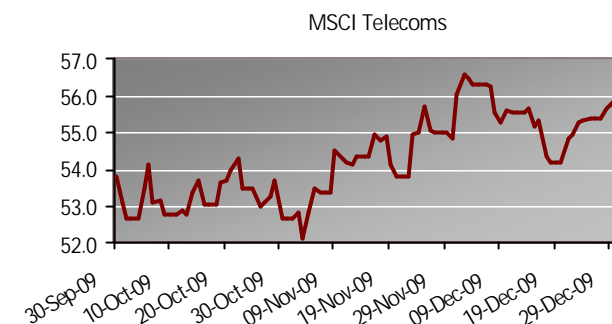
UTILITIES

The sector posted modest returns during the fourth quarter, increasing in value by 1.56% versus the broad index which increased by 3.68%. For 2009 as a whole, the sector was the poorest of the 10 which comprise the MSCI World Index, posting a return of just 2.01% versus the headline index return of 26.98%.

While returns were disappointing relative to the broader market, they should be viewed within the context of the lower risk and more predictable nature of cashflows within the utility industry. In fact, since the onset of the credit crisis, it is the one of the sectors where dividends have generally remained intact and the underlying companies have always been considered as going concerns and not at risk of failure.

From an investment standpoint, our long-term, core themes tend to point in favour of the industry, as it should benefit in an environment where commodity prices thrive and developing countries continue to develop faster than G7 economies. However, near-term political and regulatory concerns keep us from taking a full allocation to the sector at present.

From a Capitalist's point of view, regulation and political will need to move in favour of the industry, allowing it to make an appropriate level of return on investment in order to attract the capital required to maintain and enhance ageing water and power networks in the West. However, near-term political pressure to keep utility prices low to consumers at a time of economic stress, or to meet a particular 'green' agenda, may result in periods where margins in the industry are put under stress. This in turn could weigh on earnings and hence current company valuations.



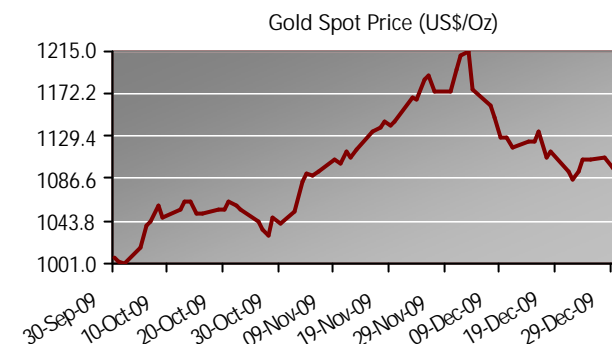
GOLD

The price of gold rallied to reach a high of US\$1,215 per ounce during the fourth quarter of 2009, before correcting to end the year at US\$1,098. This represents a gain of 9.03% from the end of September 2009, and takes the 2009 return to 25.51%. The metal has continued to benefit from sustained demand, as the weakness in the US Dollar has led many investors to add positions in gold, which many consider is a store of wealth.

According to a report from the World Gold Council, reviewing data for the third quarter of 2009, consumption of gold for the manufacture of jewellery was down by over 30% on a year over year basis. The report shows that whilst year over year demand is weaker, the third quarter represented a significant improvement on the first two quarters of the year. Whilst strong investment demand served to offset some of the weakness in jewellery sector, the first three months of the year also saw increased supply, largely due to greater levels of scrap entering the market. The supply of gold through the scrap market is likely to remain robust, as the high margins of mail order and internet based "cash for gold" merchants support large advertising budgets. Whilst the price of gold will have to remain high enough to encourage consumers to sell their scrap gold, some merchants only offer 20% of the spot price, therefore there is some scope to narrow margins somewhat, in order to maintain volumes.

Investment demand is likely to remain a key factor in determining the direction of the gold price in the short and medium term. Weakness of the US Dollar during the early part of the period led some investors to increase exposure to gold as a strategic holding, due to the metal's perceived properties as a store of wealth during times of uncertainty surrounding the long term value of paper money, particularly the US Dollar. Short-term speculative interest in gold also remains at elevated levels, with non commercial contracts on the Chicago Mercantile Exchange reaching a net long position of over 700 tonnes as at the end of 2009. Whilst such high levels of speculative interest are not necessarily negative, they do tend to lead to an increased level of volatility in the gold price.

In the short-term, given our view that the US currency could recover some of the ground it has lost to the currencies of its major trading partners, coupled with the high level of speculative interest, gold might suffer some downward pressures in the early part of 2010. In the longer term however, there are a number of supporting factors that we expect to drive the price of gold higher. There is no doubt that Emerging Market Central Banks are actively seeking to increase their holdings in gold, as demonstrated by India's purchase of 200 tonnes at over US\$1,000 from the IMF. We also expect consumers in Emerging regions to increase holdings in the metal, as disposable income grows. The large fiscal deficits that are being built in Western Economies are also likely to result in higher demand for gold, as unlike paper currencies, due to the metal's limited supply, Governments and Central Banks are unable to devalue its worth by artificially creating more supply. Therefore, investors who are concerned with possibility that stresses in the international financial system will lead to a further decline in the value of paper currencies, may potentially seek to protect their wealth through ownership of gold.



QUARTERLY STATISTICS

EQUITY INDICES

	30 September 2009	31 December 2009	Percentage Change
Global			
MSCI World Index	1,126.98	1,168.47	+3.68
MSCI World Index (Sterling)	703.66	723.60	+2.83
MSCI World Index (Euro)	769.64	815.34	+5.94
United States			
Dow Jones Industrial Average	9,712.28	10,428.05	+7.37
S & P 500 Index	1,057.08	1,115.10	+5.49
NASDAQ Composite Index	2,122.42	2,269.15	+6.91
Europe			
DAX Index	5,675.16	5,957.43	+4.97
FTSE 100 Index	5,133.90	5,412.88	+5.43
Dow Jones Euro Stoxx 50	2,872.63	2,964.96	+3.21
Far East			
Nikkei 225 Index	10,133.23	10,546.44	+4.08
TOPIX Index	909.84	907.59	-0.25
FT World Actuaries Pacific Rim X Japan (US Dollars)	385.30	405.38	+5.21
FT World Actuaries Pacific Rim X Japan (Sterling)	357.17	372.18	+4.20
Hang Seng Index	20,955.25	21,872.50	+4.38

MSCI WORLD SECTORS

Consumer Discretionary	89.19	94.02	+5.42
Consumer Staples	117.27	124.23	+5.94
Energy	212.44	223.52	+5.22
Financials	83.79	80.40	-4.05
Healthcare	96.82	103.70	+7.11
Industrials	122.01	125.71	+3.03
Information Technology	75.76	81.76	+7.92
Materials	208.31	231.35	+11.06
Telecommunications Services	53.82	55.36	+2.86
Utilities	113.86	115.64	+1.56

QUARTERLY STATISTICS

BOND INDICES

	30 September 2009	31 December 2009	Percentage Change
Bloomberg Bond Indices - Global Bond Index (US Dollars)	254.09	249.12	-1.95
Bloomberg Bond Indices - Global Bond Index (Sterling)	265.27	258.52	-2.54
Bloomberg Bond Indices - Global Bond Index (Euro)	221.02	220.26	-0.34
Bloomberg Bond Indices - US Govt 1-5 Year	225.69	225.45	-0.11
Bloomberg Bond Indices - UK Govt 1-5 Year	257.78	258.73	+0.37
Bloomberg Bond Indices - Canada Govt 1-5 Year	241.93	242.43	+0.20
Bloomberg Bond Indices - Euro Govt 1-5 Year	157.07	157.47	+0.26

FOREIGN EXCHANGE RATES

Sterling versus US Dollar	1.6016	1.6148	+0.82
Sterling versus Euro	1.0937	1.1269	+3.04
Sterling versus Swiss Franc	1.6602	1.6708	+0.64
Sterling versus Canadian Dollar	1.7120	1.6895	-1.31
Sterling versus Japanese Yen	143.64	150.39	+4.70
US Dollar versus Euro	1.4643	1.4331	+2.13
US Dollar versus Swiss Franc	1.0365	1.0347	-0.17
US Dollar versus Canadian Dollar	1.0688	1.0458	-2.15
US Dollar versus Japanese Yen	89.68	93.14	+3.86

LIBOR 3 MONTH RATE

Sterling	0.54	0.61	+11.65
US Dollar	0.29	0.25	-12.64
Canadian Dollar	0.50	0.47	-6.02
Euro	0.71	0.66	-7.34
Swiss Franc	0.29	0.25	-12.71

COMMODITIES

Reuters/Jefferies CRB Commodity Price Index	259.39	283.38	+9.25
Gold Spot \$/Oz	1,007.65	1,098.60	+9.03
Brent Crude Index (London)	65.27	77.85	+19.27
Crude Oil Futures (New York)	70.61	79.36	+12.39

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