

**Fund objective**

The Fund's objective is to deliver real returns over the medium and longer term. More specifically, the target is to achieve a return on a compound annualised basis exceeding the UK CPI plus 6% over a 3-5 year time period. The Fund aims to achieve its investment objectives by investing in global equities, bonds, cash and derivatives.

**Fund Information**

**Fund Managers**

Andy Headley,  
Charles Richardson

**Fund Size**

£37.9 million

**NAV per share**

£8.71

**Launch price**

£8.54

**Dividend payment**

Annually (September)

**Inception date**

08 January 2010

**Sedol**

B5W1LR9

**ISIN**

IE00B5W1LR97

**Bloomberg Ticker**

VERRRGA

**Index**

MSCI World Index

**Hurdle Rate**

UK Consumer Price Index ('UK CPI') plus 2%

**Domicile**

Ireland

**Structure**

ICVC

**Tax status**

UK Distributor Status

**Dealing**

Daily by 4.30 p.m.

**Management fee (%)**

1.0 (institutional A Class)  
1.5 (retail)

**Performance fee (%)**

20% with high water mark and hurdle rate

**Custodian**

HSBC Institutional Trust Services (Ireland) Ltd

**Administrator**

HSBC Securities Services (Ireland) Ltd

**Manager**

Veritas Asset Management (UK) Ltd

**Investment Enquiries**

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**Authorised and Regulated by the  
Financial Services Authority**

**Veritas Global Real Return Fund  
(GBP 'A' Institutional Class)**

**Q2 2010**

**Actual Fund performance to 30th June 2010**

Current UK regulatory requirements preclude the inclusion of actual performance data until the Fund has a one-year track record. We have therefore provided simulated past performance.

**Simulated Past Performance to 30th June\***

(total simulated returns, including dividends reinvested, net of fees and expenses) - GBP 'A' Class

Year to end:	Jun-10	Jun-09	Jun-08	Jun-07	Jun-06
Fund:	23.72	7.32	-3.95	15.37	10.46
UK CPI +2% p.a.	5.40	4.26	5.41	4.59	4.24

\*Prior to 8.1.2010 the simulated performance figures are based on the actual performance of the Real Return Global Fund, an unregulated collective investment scheme. After 8.1.2010 the simulated performance figures are based on the actual performance of the Veritas Global Real Return Fund, a UCITS III scheme. The investment objectives, investment strategy and weightings of these two funds are the same.

Past performance and past simulated performance should not be seen as a reliable indicator of future performance. Returns may increase or decrease as a result of currency fluctuations.

**Fund holdings as at 30th June 2010**

Long	84.8%
Short	22.2%
Gross	107.0%
Net	62.6%
Long	35
Short	1

**Top Ten Long Holdings**

Vodafone	5.1%
UnitedHealth Group	4.0%
CVS/Caremark	3.8%
Roche	3.6%
Telstra Corp	3.4%
Fresenius Medical Care	3.3%
BP	3.1%
GlaxoSmithKline	3.0%
COPASA	2.9%
Merck & Co.	2.9%

Region allocation	Long	Short	Gross	Net
Africa	5.3%	0.0%	5.3%	5.3%
Asia Ex Japan	17.2%	0.0%	17.2%	17.2%
Europe	34.9%	0.0%	34.9%	34.9%
North America	24.4%	22.2%	46.6%	2.2%
Latin America	3.0%	0.0%	3.0%	3.0%
<b>Total</b>	<b>84.8%</b>	<b>22.2%</b>	<b>107.0%</b>	<b>62.6%</b>

Sector allocation	Long	Short	Gross	Net
Energy	10.6%	0.0%	10.6%	10.6%
Materials	0.0%	0.0%	0.0%	0.0%
Industrials	10.1%	0.0%	10.1%	10.1%
Consumer Discretionary	2.2%	0.0%	2.2%	2.2%
Consumer Staples	5.0%	0.0%	5.0%	5.0%
Health Care	21.5%	0.0%	21.5%	21.5%
Financials	11.9%	0.0%	11.9%	11.9%
Information Technology	2.0%	0.0%	2.0%	2.0%
Telecommunication Services	16.8%	0.0%	16.8%	16.8%
Utilities	4.7%	0.0%	4.7%	4.7%
Index Futures & Options	0.0%	22.2%	22.2%	-22.2%
<b>Total</b>	<b>84.8%</b>	<b>22.2%</b>	<b>107.0%</b>	<b>62.6%</b>

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**a) Walking a Tightrope**

The global economy is as unsustainable today as it was at the height of the credit super-bubble in 2007. Developed country governments are running excessively large budget deficits as a result of the vast private to public debt swap that has occurred. Overall debt including public debt remains too high and needs to be reduced as a proportion of GDP. This reduction in overall debt levels will be painful and prolonged even if it is successful: debt deleveraging takes time. Unfortunately, the chances of a smooth and successful deleveraging are remote. The journey is akin to walking a tightrope suspended over a deep chasm: the prize should we reach the other side is a more balanced global economy with lower debt as a proportion of GDP and more balanced consumption and production around the world. However to make a successful crossing will require many things falling into place including increased collaboration between nations and an end to politicians acting in self interest. Given such requirements it may be wisest to plan for a bumpy ride and probable failure.

What needs to go right for us to reach the other side? Most obviously government budget deficits need to be reduced but clearly not at the expense of creating another major recession. Most developed market government spending is running at around 50% of GDP but Government revenues are typically capped at around 40% of GDP (hence the approximate 10% budget deficits we are witnessing in the US, UK, Spain, Portugal etc ...). Governments need to make a choice as to whether they tackle budget deficits now (as in the UK) or whether it is better to let them continue for a period to try and kick start the economy (as in the US). Neither approach is without risk. Immediate fiscal consolidation runs the risk of lower employment and higher taxes reducing aggregate demand and forcing the economy into a new recession at a time when the tools required to respond to a recession are broken. Delayed fiscal consolidation runs the risk of countries becoming perceived as insolvent and the effect of the market then treating them as such (currency collapse and forced interest rate rises). Increased deficit spending as promoted by certain governments simply adds to the problem, heightening the risk of inflation.

In this environment, policy matters. Most politicians will opt for delaying fiscal consolidation (unless they have been newly elected and can therefore lay the blame for austerity measures at the feet of the previous government, as in the UK). Delayed fiscal consolidation always seems the least painful option as until the market reacts negatively there appears to be no downside from more and more borrowing and spending. Unfortunately, it is unclear at what level of public debt to GDP the market "reacts". In their excellent book "This Time is Different: 8 Centuries of Financial Folly" professors Reinhart and Rogoff show that when public debt increases above 90% of GDP it results in lower GDP growth but there is no hard and fast rule as to when markets take fright and refuse to lend to the country in question. The process is clearly not linear – debt can be increased for a while and nothing happens. At some point though an invisible line is crossed and all of a sudden a cascade of downturns, deficits, more debt and downgrades results, perhaps even leading to default. This has to a large extent already occurred in the case of Greece but there is no reason why it will not happen elsewhere should government profligacy continue.

**b) Implications for the fund**

High and sustained deficit spending can lead to fiscal insolvency which has historically been the catalyst for monetary debasement. Over time more money (created by the printing presses) chasing the same amount of goods can only lead to one outcome: inflation. The actions of monetary authorities over the past 2 years have heightened the potential for inflation in the years to come. Therefore unless central bankers undergo a "Damascene conversion" and hastily remove all the excess liquidity they have injected before inflation takes hold it would seem worthwhile to at least plan for the possibility of higher inflation. In this light, one of our high conviction themes remains Scarcity and Supply Constraint which seeks investments that own scarce or irreplaceable assets (at least from an economic perspective). Using this theme as a filter we have managed to find a number of investments which we assess as having substantial pricing power in the event of inflation as a consequence of their scarce assets. Furthermore, some of these companies are available at attractive current valuations despite the inherent inflation protection that they afford.

One such example is a new addition to the portfolio over the quarter, TransDigm. This US company is a leading global designer, producer and supplier of highly engineered aircraft components for use on nearly all commercial and military aircraft in service today. The company's thousands of different components are designed into and sold as original aircraft equipment, and the company then generates recurring aftermarket revenue over the lives of the aircraft, which average about 30 years. Approximately 60% of revenues are generated from aftermarket sales, which are made at extremely high margins. Such high margins are a result of more than 95% of sales coming from proprietary products for which TransDigm owns the design and around 80% of sales coming from products for which TransDigm is the sole source supplier. Stringent and costly regulation and certification requirements and the vast number of proprietary products produced by TransDigm create substantial barriers to entry. In addition TransDigm's excellence in engineering together with its high levels of customer service have led to the company gaining a greater shipset value in new aircraft platforms such as the Airbus A380 and Boeing 787. This will lead to future profit growth as the components supplied are purchased in the aftermarket. TransDigm typically increase prices by between 4% and 7% annually as a result of their exceptionally strong position in the niche component markets in which they operate.

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**c) Longer term perspective**

In the previous quarterly report we noted that while an economic recovery was underway, it would likely prove to be anaemic overall but volatile due to the interaction of strong but opposing forces. This conclusion was borne out in the most recent quarter when most economic data came in weaker than anticipated and equity markets took a turn south, falling by 11.5% (MSCI World in GBP) after their rise in the first quarter. This performance left the MSCI World (in GBP) down 2.7% for the first half of 2010 and the same index is now broadly flat (down 6.9% including dividends received) over the past three years. The Veritas Real Return Approach is grounded in applying absolute valuation techniques to good quality cash generative companies. In the Veritas Global Real Return Fund this fundamental analysis is coupled with various hedging strategies in an attempt to mitigate the effect of market movements on the portfolio at times when valuations appear higher than fair. Over the past quarter the fund has benefited from the 25% index short position we established in the first quarter and consequently the fund's simulated past performance\* only declined by 3.2% in the second quarter (MSCI (GBP) -11.5%). At quarter end the fund had reduced both long (to 85%) and short (to 22%) positions, resulting in a broadly similar net exposure (62%) as at the end of Q1 (65%). The benefit of our real return approach is most evident over longer investment periods: over three years the fund's simulated past performance\* has delivered returns of 27.5% which can be compared against 15.8% for CPI+2% and -6.9% for a broad all-equity index (MSCI World in GBP) and since inception (1 July 2004) the Veritas Global Real Return Fund's simulated past performance\* has delivered a return of 71.3% versus 31.3% for CPI+2% and 34.7% for the MSCI World.

Our performance of the first half has been affected by the disappointing performance of our BP investment during the period. Our analysis of BP subsequent to the oil spill and marked share price decline is that on the balance of probabilities BP represents a cheap investment with an attractive expected total return over our investment horizon. Clearly in the short term PR, speculation and sentiment will have a substantial impact on the share price of the company but over the longer term we believe that the value inherent in the company's resources, assets and market positions will be realised and consequently we are maintaining our position although we are continually assessing the situation and are using external advice including discussions with legal experts when appropriate.

In the same sector as BP but on a more positive note, our holding in CNOOC the Chinese oil exploration and production company performed well, rising by almost 6% in the quarter and by over 10% for the half year. Furthermore, the performance of our holdings in Singaporean Real Estate Investment Trusts (REIT's) performed well with notable performance from CapitaCommercial REIT which appreciated more than 13% in the quarter.

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