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Dear Paul

Health Professions Council

I am writing to enclose the quarterly report for the period 30th September to 31st December 2004. Over this period the portfolio has increased in value from £1,348,424 to £1,453,653 an increase of £89,172. In addition £16,056 of accumulated interest and dividends were paid away during the quarter.

On a time weighted total return basis the portfolio produced an appreciation of 7.7% for the three month period to 31st December and 13.2% for the calendar year. These performances were supported by a strong performance in fixed interest where for the calendar year the fund returned 13.9% compared to 6.6% for the FTA Government All Stocks Index as a result of the funds exposure to PIBs and preference shares. In UK equities the fund also outperformed the comparative benchmarks over both the three month and twelve month period. Returning 13.4% for the year compared to 12.8% for the FT All Share Index and 11.2% for the FTSE 100 Index. Again the fund has performed well in overseas equities returning 18.0% compared to 7.8% for the comparative indices.

Over the last year most economies worldwide continued to recover from the aftermath of the bursting of the technology bubble. Economic growth in the UK was 3.4%, for the US it was 4.4% and 4.0% in Japan. Mainland Europe however continued to lag, rising by 1.8%. The Far East, including China showed particularly strong growth of probably over 8.3%.

Consumer demand also remained buoyant putting pressure on already large physical trade deficits for both the UK and US, with the trade gap between imports and exports now reaching the equivalent of 3.5% of total economic activity in the UK and 3.6% in the US.

Stockmarket sentiment also continued to improve from the lows seen at the start of the Iraq war. Increased corporate profitability and takeover activity helped equity markets produce gains in 2004 of 12.8% in the UK, 10.9% in the US and 11.6% in Europe, in local currencies.

Against this background raw material prices showed strong increases, particularly oil which increased by over 50%, as Middle Eastern problems and supply constraints kept a tight balance between supply and demand. The oil price reached a high of US$55 in October, before falling back to the low US$40's at the year end providing, recently, some comfort to markets, albeit still a third higher than this time last year. Whilst it is said oil is now used more efficiently than in the 70's and we are less dependent, the fact the UK on occasions in the last year has been a net importer, will not help our balance of trade, or sterling, if the oil price starts to rise again.

The economic improvement (and some concerns about medium term inflation) have prompted authorities in the UK and US to introduce some monetary tightening from their excessively lax positions. In the UK there were four base rate increases in 2004 to 4.75% and in the US the Federal Reserve started to increase rates in June and, by December, had increased the Fed Funds rate five times to 2.25%. There is an old stock market adage "three steps and a stumble", relating to interest rate increases, and the fact that we have not yet seen a "stumble" in stock markets shows how low rates have been recently.

In the UK, however, the effects of interest rate tightening have started to materialise with a sharp drop in new mortgage applications, "the lowest for nine years", slowing mortgage demand and a Christmas period where, but for the introduction of pre-Christmas discounts and sales, would have one of the poorest for many years. Being wary of this, we have taken a low exposure to consumer related stocks at this time. Sentiment in these sectors swings on a daily basis from concerns about a sharp deterioration in consumer spending to a more positive view that rates no longer need to be increased further and, indeed the next move may be down. It normally takes a year to 18 months for interest rate movements to be fully reflected in consumer habits and therefore at this point it is too early to know whether the weakness in consumer spending is over. Also, the corporate activity in the sector, including the bid for Marks and Spencer, means that valuation levels are not particularly cheap and therefore I am biding my time.

Clearly resource stocks benefited from rising raw material prices, but the performance in capital terms has been surprising over the last quarter, with Shell (where we have a higher relative weighting to the market) increasing by 9.5%, but BP falling by 3.7% and the mining stocks virtually unchanged. The two large pharmaceutical stocks had equally divergent performances with Glaxo rising by 2.6% but AstraZeneca (which we did not hold) falling by 16% following high profile problems with drugs Exanta, Iressa and Crestor. In food producers Unilever staged something of a comeback appreciating by 13.7%.

The banking sector, which accounts for around 20% of the UK market, and the utility sector, where we are well represented, both appreciated in line with the market.

The US economy has benefited from low interest rates and a weak US$. Concerns had been expressed for the US dollar because of the twin budget and trade deficits, but in principle a weak US$ is less of a problem for the US than for those companies or countries who trade with it. Also, as both China and Mexico have pegged their currencies to it, it is European countries and Japan who have most to lose from a weak dollar policy.

For example, the integration of Eastern and Western Germany has been particularly adversely affected by the flow of "low paid" manufacturing work to the Far East and China where wages are substantially lower.

Currency movements had a large influence on quarterly returns with similar returns in local currencies for mainland Europe and the US translating for sterling investors into 3.4% for the US and 12.0% for Europe.

Whilst the US appears the more outwardly attractive market with strong economic growth and corporate profitability, the possibility of a sharp fall in the US$ at some point undermines confidence. Also, the Federal Reserve have suggested they wish to raise rates to a more "neutral" position which could involve a further four ¼% rate increases before Fed policy is reached, which may sap confidence. At some stage a "stumble" by the market may show that a neutral rate has been reached, or that the market believes the authorities will raise rates too far. Consequently our weightings are currently in favour of Europe over the US but if a sell-off in the US materialises we may take the opportunity to increase weightings.

China has for the moment shrugged off concerns about attempts to contain the rate of economic growth but the influence of China on stock markets, at both a sentiment as well as an economic level, should not be underestimated and a close watch maintained. Japan's rate of growth stalled towards the end of the year causing some concern but economic restructuring is still developing positively and therefore we continue to give it the benefit of the doubt.

Bond markets appear to have taken more comfort from the fact interest rates are being increased and the authorities are taking action rather than discomfort from the fact that they need to be increased at all. Yields on long dated bonds are now lower than on short or medium dated securities. Ordinarily a "backward sloping yield curve" would suggest a slowing economy but I feel it is more a reflection of the excess demand over supply being caused by pension and insurance companies as they match assets and liabilities, even though they are locking in to low levels of return by historic standards. As a result, even though long dated bonds have outperformed short dated bonds with a return of 8.4% compared to 4.7% over the year we would not suggest increasing weightings in longer dated stocks, as they do not provide good value. Inflation may be only 1.5% on the new HICP method of calculation, but RPI is 3.4% and wage inflation is now 4.1% which is not far behind long bond yields of 4.4%.

Looking forward, views do appear to be mixed with some expectations for slightly higher inflation as a result of higher oil prices and shipping costs, but also slightly lower growth following this years rate rises and higher oil price. That said the valuation of the UK equity market has continued to fall to the extent that the price earnings ratio of the UK equity market is now approximately half the peak in 2001. Also, we are seeing good dividend growth, which could be 6-10% this year, and without any further offsetting reduction in the tax credit for charities, this year's increase will flow through to the charity.

Therefore we have a current preference for equities over bonds, however, the first year of a new Presidential term is normally the most difficult for stock markets and this may well be an election year in the UK, so it is probable that our more positive view will have to be changed in due course.

If you would like to discuss the report in more detail please do not hesitate to contact me.

With kind regards.

Yours sincerely

James Minett

James Minett

Encl.