31 December 2010

Market Overview

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Over the course of Q4, there emerged some evidence that economic conditions around the world were gradually improving. Overall activity was still well below pre-recession highs, but in the US and the UK in particular, consumer expenditure was stronger than expected. The relatively soggy overall recovery should not morph into a double dip, either in the US or the Global economy (the UK and Japan possibly excepted) and growth should be positive in 2011, if unspectacular. Business confidence appears to be on the mend, but consumer confidence and attitudes toward renewed borrowing remain cautious; this is hardly new news, irrational, or something we should expect to change in the near future.

The US economy, still the fulcrum, for global growth, is hovering around "escape velocity" and the quality and durability of the recovery there leaves something to be desired. However, one must not confuse an incredibly low quality recovery (and the irony is that is it is still nevertheless the best that newly printed money could buy) with no recovery at all. Some countries, particularly some well known European countries with several golf courses, might rejoice at the prospect of 2% growth. The recent decision to extend the Bush tax cuts, and add the new payroll tax holiday, has laid to rest fears of a double dip recession in the US in 2011.

Throughout 2010 we have consistently been of the view that housing and employment remain the keys to sustainable growth in the US The Chairman of the FOMC Ben Bernanke noted recently:

"It's very close to the border. It takes about 2.5% growth just to keep unemployment stable. And that's about what we're getting. We're not very far from the level where the economy is not self-sustaining."

The simple truth is that an overall unemployment figure of almost 10% and underemployment of 17% is politically unacceptable. Inroads *must* be made on the employment situation in 2011 if we are to see any movement away from ultra-low short-term interest rates and the renewed quantitative easing (or if you prefer the Fed's euphemism "Large-Scale Asset Purchases") we were endowed with beginning on 4 November 2010. As for housing, we remain of the opinion that true recovery in that sector is a long way off as measured by any indicator; new home sales, existing home sales, prices, or refinancing activity. In short, household balance sheets will continue to be in repair-mode for the foreseeable future and this will keep inflation uncomfortably low and subsequently weigh heavily on the more dovish factions of the Fed (including Bernanke). Recently downgraded FOMC expectations of 3-3.5% growth for 2011 are still too high and we expect a more subdued 2.0-2.5% for the year.

SELECT FIXED INCOME FUND

The net asset value (NAV) per share of the Fund was 15.89, down -1.97%, against a benchmark return decrease of -2.54%. Year to date the Fund increased 2.85% vs. a benchmark return of 5.56%.

The bond market in Q4 reminded participants that it is quite possible to obtain a negative total return in the short-run. It was the first negative quarter for Treasuries since Q2 of 2008 and their worst loss since Q2 of 2004. In fact, the 5 year Treasury measured its near-term low yield the very day of the Fed's announcement of further quantitative easing and spent nearly the entirety of the rest of the quarter rising substantially. Better economic news, at the margin, contributed to forcing yields higher, but we attribute much of the back-up in rates to a reallocation of portfolios out of risk-free, zero-yielding assets and into riskier assets. We maintain, as does Bernanke himself, that the primary purpose of asset purchase programmes is to affect just that type of asset shift, not necessarily to lower or target longer-term interest rates. We also stated in no uncertain terms at the end of last quarter that the rates market was fully pricing in a very aggressive Fed and a remarkably poor economic scenario and we were not comfortable changing our conservative stance to interest rate risk in the face of the substantial move to lower yields in August and September. We were proven correct and our underweight duration stance paid off with outperformance versus our relative benchmark in the quarter.

SELECT EQUITY FUND

The net asset value (NAV) per share of the Fund rose from $9.33 to $10.05 over the quarter, an increase of 7.72%, against a benchmark return of 8.95%. For 2010 the Fund increased 8.53% vs. a benchmark return of 11.76%.

While bond markets performed poorly, global equity markets had a strong and steady upward move over the quarter with the MSCI World Equity Index finishing up almost 9.0%. Interestingly, despite supporting higher betas, emerging markets underperformed developed markets as rising prices (especially food prices) in these countries have started to force the hands of monetary policy makers to raise interest rates.

While a sluggish global economy may well be the perfect recipe to spur people to shun low yielding debt instruments for riskier assets, too much growth too quickly would likely derail the recent upswing of equity markets. Our base case scenario remains for sluggish growth in most developed markets with a gradual normalisation of interest rates in emerging markets but the strong global economic momentum as of late must be monitored carefully. For now, rates and equity prices remain positively correlated and that is good news for equity investors. In addition, we continue to see plenty of opportunities and value in the large multi-national companies capitalising on emerging markets' domestic growth, whether they are listed on emerging market exchanges or developed market exchanges.

Irrespective of the global macro environment, it is becoming increasingly evident that management teams are directing more of their attention to the income statement rather than simply focusing on improving the balance sheet and liquidity. Higher capital expenditures, increased activities in the merger and acquisitions space and greater buyback activities and dividend payments are just a few examples of a change in mentality for more shareholder friendly activities (to the detriment of bondholders in some occasions) likely to shape the upcoming year.

SELECT ALTERNATIVE FUND

The net asset value (NAV) per share of the Fund rose from \$14.44 to \$14.72 over the month, an increase of 1.94%; against an early indicated benchmark return of 3.41%. For 2010 the Fund increased 4.55% vs. a benchmark return of 5.33%

The current environment provided broadly constructive market conditions and gains were produced across all of our hedge fund strategies. Unsurprisingly, the largest gains this month were produced by those managers that had high conviction positions in equities and commodities. The best performers were thus amongst the Commodity specialist managers and Long/Short Equity strategies.

The one strategy where gains were not universal was in Macro funds. Significant rises across the curves of most government bond markets, particularly in the US, caused problems with those with a fixed income strategy. The managers with a trading orientation in fixed income relative value coped better with poor market conditions.

Elsewhere, gains were also produced in the Credit, Multi-Strategy and Event Driven strategies, as rising levels of M&A activity and constructive conditions in credit markets proved beneficial.

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	NAV as at				Performance Period		
					% change	% change	Annualised
Fund	6-Jun-02	31-Dec-09	30-Sep-10	31-Dec-10	Report Period	1 Year	Since 06-06-02
BF&M GIA *	n/a	n/a	n/a	n/a	0.31%	2.03%	2.95%
Butterfield Select Equity	7.38	9.26	9.33	10.05	7.72%	8.53%	3.13%
Butterfield Select FI	11.71	15.45	16.21	15.89	-1.97%	2.85%	3.81%
Butterfield Select Alternative	10.50	14.08	14.44	14.72	1.94%	4.55%	3.83%

PENSION PLAN PERFORMANCE PER PROFILE
BF&M - PENSION PLAN AS AT 31 DECEMBER 2010

	Fund Allocations (%)					Performance Period		
						% change	% change	Annualised
						Report Period	1 Year	Since 06-06-02
Profile Returns:	BF&M GIA	Select: Equity Class	Select: Fixed Income Class	Select: Alternative Class		Weighted Average Return: Per Profile		
Interest Rate Profile								
All Ages	100%	0%	0%	0%	100%	0.3%	2.0%	3.0%
Conservative Profile								
Age 18 - 34	20%	50%	30%	0%	100%	3.3%	5.5%	3.3%
Age 35 - 44	20%	40%	40%	0%	100%	2.4%	5.0%	3.4%
Age 45+	40%	25%	35%	0%	100%	1.4%	3.9%	3.3%
Moderate Profile								
Age 18 - 34	0%	60%	35%	5%	100%	4.0%	6.3%	3.4%
Age 35 - 44	15%	45%	35%	5%	100%	2.9%	5.4%	3.4%
Age 45+	20%	35%	40%	5%	100%	2.1%	4.8%	3.4%
Aggressive Profile								
Age 18 - 34	0%	70%	20%	10%	100%	5.2%	7.0%	3.3%
Age 35 - 44	5%	60%	25%	10%	100%	4.3%	6.4%	3.4%
Age 45+	10%	50%	30%	10%	100%	3.5%	5.8%	3.4%

Note: BF&M GIA returns are compounded daily using the prevailing rate at the beginning of each month.

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