

# managed income solutions

## fourth quarter 2009 review

This document provides you with commentary on the economic and market environment and performance of the Equity Income and Bond Income funds during the fourth quarter of 2009. However, please be aware that past performance is not a guide to the future.

*Terms in italics are explained in the glossary of terms at the end of the document.*

### economic and stock market environment

The UK equity market continued to make progress over the fourth quarter, although gains were much smaller than in the previous three months. After falling slightly in October, the market recovered in November and rallied strongly in December, with the FTSE All Share Index returning 5.5% over the quarter as a whole. At sector level, the basic materials sector performed extremely well, driven by strength in commodity prices. Following an impressive third quarter, the financial sector posted a negative return as concerns about debt and increased regulation resurfaced and investors took profits. Some of the more defensive sectors fared well as risk appetite dipped somewhat, notably consumer goods, utilities, and healthcare, while industrials and information technology lagged. The UK economy has lagged most other countries, with the economy officially remaining in recession in the third quarter. However, more recent data suggested that the economy grew in the final quarter of the year. Inflation remained below the Bank of England's target and interest rates were kept unchanged at 0.5%.

Continental European equities also rose overall during the quarter but performance across the region's markets varied widely. In local currency terms, Norway recorded a double-digit gain while Sweden, the Netherlands, Germany and France also performed relatively well. In contrast, the Greek stock market fell sharply on concerns about the country's debt levels as several agencies downgraded its debt rating. Similar concerns affected the Irish equity market, while Austria was also weak. Both Greece and Ireland have had to sharply accelerate their plans to improve their countries' fiscal position. At sector level, basic materials outperformed, followed by consumer goods, while information technology and financials lagged. The MSCI Europe ex UK Index returned 3.1% in local currency terms, but with the British Pound strengthening against the Euro, the index returned just 0.6% in Sterling terms.

In the US, corporate news was broadly positive, with many companies reporting results that exceeded estimates. The economic backdrop continued to strengthen, with the US economy officially exiting recession in the third quarter, and more recent data suggested that the economy

accelerated in the fourth quarter. Some of this strength is the result of the inventory cycle, with companies increasing production to stop inventories falling too low. There were pockets of strength elsewhere, with auto sales improving despite the end of the 'cash-for-clunkers' scheme and further signs that the worst has passed for the US housing sector. With inflation remaining low, the Federal Reserve kept interest rates unchanged in a range of between 0% and 0.25%. The US stock market gained 4.8% over the quarter, as measured by the S&P 500 Index. In terms of sectors, information technology was the best performing area of the market, followed by healthcare and consumer discretionary, while financials were the clear losers.

Japanese equities continued to underperform other major stock markets over the quarter. After a weak October the market fell sharply in November as investors continued to worry about the strength of the Yen, which makes Japanese exports less competitive overseas, and that ongoing deflation could hamper the economic recovery. However, this trend reversed in December, when Japanese equities staged a strong rebound as the Bank of Japan announced it would pump more

money into the financial system. This helped weaken the Yen and boost confidence that the central bank would take action to end deflation. The Topix Index ended the period as a whole broadly unchanged in Yen terms, but fell 5% in Sterling terms as currency movements pushed the return into negative territory. Corporate earnings and economic news were broadly positive. The economy expanded by more than expected during the third quarter; machinery orders and industrial production rose while unemployment eased.

Excluding Japan, Asia Pacific equities posted further gains for the quarter, with the MSCI AC Asia Pacific ex Japan Index returning 5.1%. The strongest-performing market was Singapore, helped by news that the country's economy grew by 14.9% in the third quarter. China and Taiwan also performed well on signs that their economic recovery is broadening. New Zealand was the weakest-performing market. Korea also lagged as investors took profits following a strong rally in the previous quarter, while Thailand was undermined by political tensions. The Asia Pacific ex Japan region's economic recovery continued, led by ongoing strength in China. While government stimulus measures were largely responsible for the strength in the first half of 2009, domestic

demand and exports have recently picked up. Australia became the first G20 country to raise interest rates since the financial crisis began, with the central bank announcing rate rises in each of the three months.

Global emerging market equities had another good quarter and continued to outperform developed equity markets. The MSCI Emerging Markets Index returned 7.5% over the quarter, with Poland, Russia, Brazil and Turkey among the best performers. Emerging European markets performed very well, supported by higher commodity prices and the region's attractive equity valuations. In an attempt to boost the recovery, the Russian and Turkish central banks cut interest rates. Latin American markets also continued to rally strongly, led by Brazil which is driving the region's recovery. Brazil's economy grew by 1.3% in the third quarter; retail sales strengthened, unemployment eased and industrial production surged. Within emerging Asia, China was the best-performing market as economic data continued to underline the strength of its recovery.

In fixed income markets, UK government bonds (gilts) posted a negative return for the quarter. Performance in December was particularly weak on concerns about the size of the UK government's

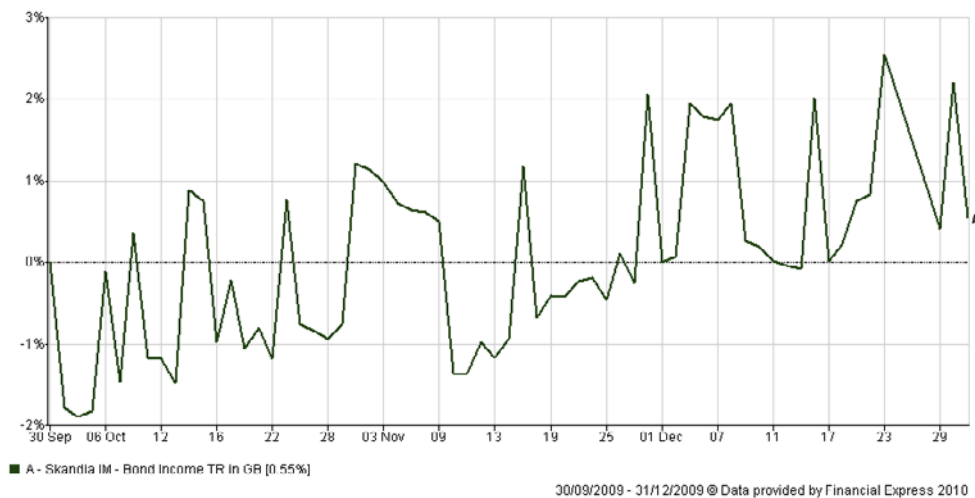
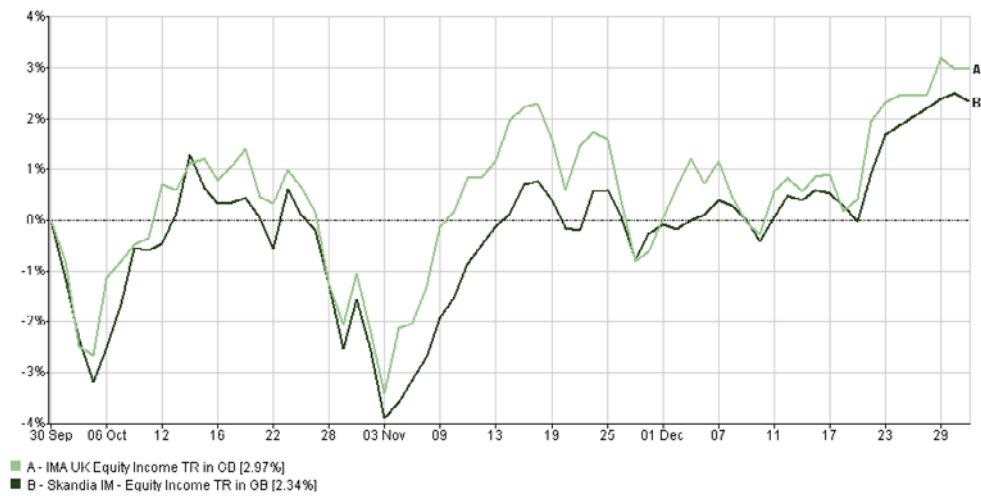
budget deficit and the likelihood that the government may stop its programme of buying back bonds in the not too distant future. Economic data also strengthened and investors favoured riskier assets. The FTSE British Government All Stocks Index fell 2.0% over the quarter. Corporate bonds continued to outperform, although weakness in the gilt market meant that gains were less marked than in the previous quarter. The Iboxx Sterling Corporates All Maturities Index returned 1% over the period. Subordinated financial bonds continued to perform well, helped by bond buybacks and exchanges, while lower-rated bonds outperformed higher-quality issues.

US and European government bond markets also posted small losses as the economic backdrop continued to improve. Corporate bonds in both markets outperformed, with the high yield segment in particular continuing to rally. Emerging market debt also posted a positive return for the quarter as investors' risk appetite remained high.

fund performance

Fund	year ending				
	31/12/09	31/12/08	31/12/07	31/12/06	31/12/05
Equity Income Fund	22.14%	-26.54%	-6.17%	15.17%	19.76%
Bond Income Fund	26.05%	-16.80%	-0.68%	0.79%	5.02%

fund performance over the quarter

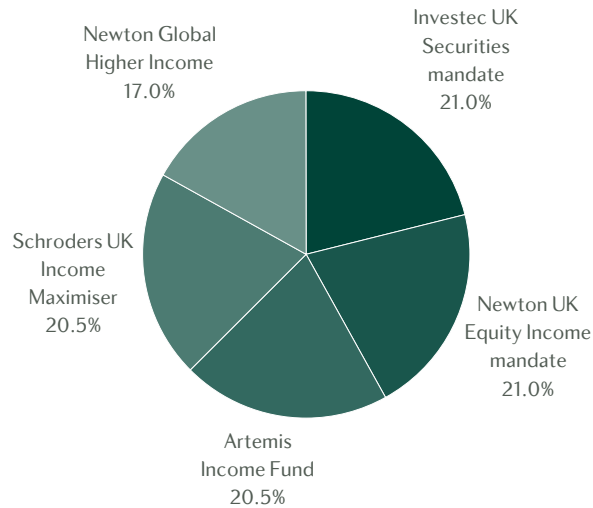


Source: Financial Express, Total return bid to bid with net income reinvested into the Funds. Performance is in Sterling terms. While Financial Express and Skandia Investment Management have used all reasonable endeavours to ensure the accuracy of the information contained in this document neither accept any liability in respect of the investment decisions of investors nor any loss arising from such decisions.

Past performance does not indicate future performance.

## Equity Income Fund

target asset allocation as at 31 December 2009



The Equity Income Fund lagged the IMA UK Equity Income sector during the fourth quarter, undermined by weaker performance from the Schroder Income Maximiser Fund. Following significant outperformance for much of 2009, the Schroder fund suffered in the final quarter of the year largely due to its zero weighting in basic resources stocks and large positions in Barclays, Royal Bank of Scotland and Lloyds Banking Group, as all three banks were subject to heavy profit-taking.

On the positive side, the Newton Global Higher Income Fund significantly outperformed its

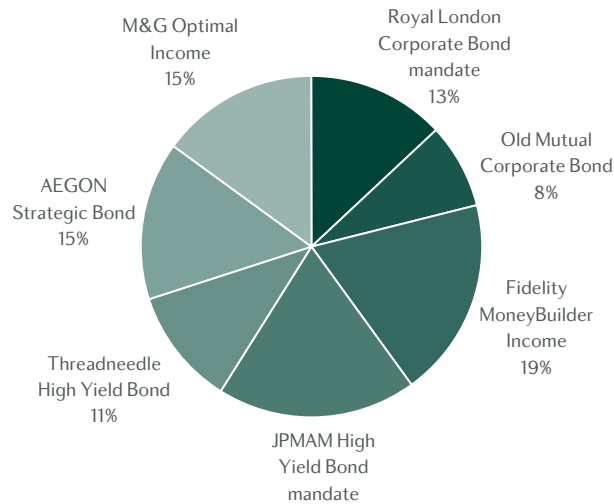
global benchmark, the FTSE World Index, and was the best-performing holding within the Equity Income Fund. Top contributors to performance included Singapore healthcare provider Parkway Holdings, tobacco group Reynolds American, Singapore Technologies and Brazilian telecoms company Tele Norte Leste Participações.

Newton's UK Equity Income mandate and the Artemis Income Fund also finished the quarter well ahead of the sector. Performance of both portfolios was helped by a low exposure to banks, offsetting their lack of exposure to basic resources stocks.

During the quarter, Investec were appointed to replace UBS as managers of the UK Securities mandate. Investec focus on stocks that have fallen substantially out of favour and with cheap valuations, and typically invest for the long term. While we continue to rate UBS highly, we have a greater level of conviction in Investec's long-term potential.

## Bond Income Fund

target asset allocation as at 31 December 2009



The Bond Income Fund posted a small gain over the final three months of the year. With riskier assets still in favour, the JP Morgan High Yield Bond mandate recorded the largest gain for the quarter, performing broadly in line with its high yield market benchmark. Stock selection within the chemicals, automotive and homebuilder sectors enhanced performance compared to the market. The manager still sees value in the high yield market, despite its very strong performance over the past year, as the economic and corporate backdrop continues to improve.

AEGON's Strategic Bond Fund and M&G's Optimal Income Fund continued to perform well, benefiting from good security selection, a high weighting in corporate bonds and a short *duration* position. The Old Mutual Corporate Bond Fund outperformed the IMA Sterling Corporate Bond sector over the quarter and was the best-performing fund in the sector for 2009 as a whole.

Both the Royal London mandate and Fidelity MoneyBuilder Income Fund also outperformed the sector. Royal London's security and sector selection was positive, with the

portfolio's bias towards higher-yielding investment grade corporate bonds, notably subordinated financial debt, making a strong contribution to returns. Meanwhile, Fidelity benefited from its corporate bond holdings, particularly within the consumer staples and telecommunications sectors. The overweight exposure to asset-backed securities also boosted returns.

## about managed income solutions

	Equity Income Fund	Bond Income Fund
Launch date	22 August 2003	
IMA sector	UK Equity Income	Unclassified
Initial charge	5%	
Annual Management Charge	1.25%	
Total Expense Ratio	1.99%	2.03%
Minimum investment	Lump sum £1000, regular saving £50 per month	
ISA eligibility	Yes	
Type of share	Income	
XD dates	31 December & 30 June	31 December, 31 March, 30 June & 30 September
Payment dates	28 February & 31 August	28 February, 31 May, 31 August & 30 November
Historic yield as at 31 December 2009	5.8%	6.2%
SEDOL number	3347630	3347641
ISIN	GB0033476309	GB0033476416
MEXID	SNUKEB	SNBI
Fund size as at 31 December 2009	£71.7m	£64.6m

### glossary

**Benchmark** - a standard against which the performance of a security or fund can be measured. The benchmark could be an index or the average for all similar funds, also known as the sector average.

**Duration** - the remaining term (or 'life') of a bond in years, adjusted for the timing of future cash flows. In general, the shorter the duration, the lower the bond's volatility.

**High yield** - the generic name for bonds rated as below investment grade by the major credit rating agencies. High yield bonds offer higher interest payments to compensate for the perceived greater default risk.

**Index** - an imaginary portfolio of securities representing a particular market or portion of it, often used as a benchmark. An index is usually expressed in terms of change from an arbitrary base value, so the percentage change is generally more useful than the numeric value.

**Investment grade** - a bond rated BBB (Standard & Poor's) or Baa (Moody's) or higher and traditionally regarded as being of sufficient quality for long term investment.

**Overweight** - refers to an investment position that is larger than the generally accepted benchmark.

**Style** - the investment approach a manager takes to achieve his or her objectives. There are many different kinds of style, but the two most common are value and growth.

**Subordinated** - debt which ranks after other debts should a company fall into receivership or be closed.

## availability

These funds are managed by Skandia Investment Management Limited (SIML).

The Open-Ended Investment Company (OEIC) funds are available for ISA, ISA transfer or direct investment either from Skandia Investment Group or through Skandia Investment Solutions and life and pensions versions of the funds are available through Skandia. However, you should note that the performance of the life and pension funds will not be the same as for the relevant OEIC because of the life company fund charges, taxation adjustments and investment process.

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## how we invest

These managed income solutions offer well-diversified, carefully constructed portfolios, run by a range of highly rated investment managers. Managers are selected for their expertise in particular areas – where they are free to deliver strong performance – while the overall portfolios are managed to offset the risks taken by each individual manager.

Managers are then monitored closely to ensure they remain the optimum choice, while the overall make-up of the portfolios is kept under constant review with the aim of delivering more consistent performance within each area.

We seek outperformance primarily by using the most skilful managers rather than trying to ‘second guess’ markets or take major ‘bets’ on any particular sector (type of company), size of stock or investment style as we believe that this can introduce unnecessary risk into the portfolios. Each fund is therefore carefully constructed by our team of experts – one of the largest in the industry – to provide a well-balanced and high quality investment portfolio.

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## retail funds and segregated mandates

Our structure allows us access to the skills of managers in the institutional or corporate market as well as managers who are already available to individual investors through retail funds.

Managers that we select in the institutional market are asked to manage a segregated mandate (essentially this is simply a written agreement between us on how we want our investment to be managed on our behalf).

This allows us to control the investment boundaries, including the types of investment and the level of risk we want the manager to take. By tailoring the mandate we can also get each manager to focus on the areas where we think they are most skilled - giving them the best chance to outperform.

## important information

Where the Fund invests in securities designated in a different currency to the Fund, the value of the Fund may rise and fall purely as a result of exchange rate fluctuations.

The level of any income may fluctuate and is not fixed or guaranteed.

Bond funds carry a risk of default of either income payments or capital repayments or both by underlying investments in the Fund. The Bond Income Fund may invest partly in high yielding corporate bonds, which are generally regarded as higher risk investments. The solvency of the companies that issue these bonds cannot be guaranteed, and any difficulty (such as default on payment) may adversely affect the Fund's performance.

The source for all performance figures is Financial Express unless otherwise stated. Fund performances are bid to bid, net income reinvested. Unless otherwise stated, performances are from 30/09/09 to 31/12/09 in Sterling terms.

Past performance does not indicate future performance.

All opinions expressed are those of Skandia Investment Group and are not a recommendation to buy or sell.

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## for further information

If you would like further information about our managed income solutions, please contact your Financial Adviser.

Skandia provides you with access to its investment platform, known as Skandia Investment Solutions. Within this platform you can open an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Skandia MultiFUNDS Assurance Limited and an Offshore Collective Investment Bond, distributed by Skandia MultiFUNDS Limited but provided by Old Mutual International (Guernsey) Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited and Skandia MultiFUNDS Assurance Limited are registered in England & Wales under numbers 1363932, 1680071, and 4163431 respectively. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom. All companies are authorised and regulated by the Financial Services Authority with FSA register numbers 110462, 165359 and 207977.

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The Authorised Corporate Director for the Skandia Equity Income and Skandia Bond Income funds is Skandia Investment Management Limited.