



WITH PROFITS FUND

Investment Report

First Half 2008 and Outlook

L V = LIVERPOOL VICTORIA

WITH PROFITS FUND

Investment Report

First Half 2008

This report provides information on the performance of the Equities, Property and Fixed Interest investments held in the Liverpool Victoria Friendly Society With Profits fund, for the period 31st December 2007 to 30th June 2008. These investments are managed by Liverpool Victoria Asset Management Ltd. The performance of each of the investment types is measured against an external benchmark, which our fund managers are targeted to beat. Our fund managers have also provided a commentary on each investment type together with their personal outlook. This information does not constitute investment advice and we recommend you to speak to a suitably qualified financial adviser before making any investment decision based upon this, or any other, information.

OVERALL COMMENT

It's been a difficult year for global stockmarkets generally. January saw the worst start to a year for equity markets since 1935, when records began. Global markets enjoyed a brief Spring rally followed by further weakening in June when they were pummelled by negative news and outlooks. Central banks around the world attempted first to inject capital into the money markets and lower interest rates only to be faced with growing concern about a shrinking global economy and rising inflation. The conundrum here lies in the fact that one can be tackled by lowering interest rates, while the other needs to be tackled by raising rates – both of which cannot be achieved at the same time. The LV= With Profits fund suffered, especially in the first three months, although it has managed to recoup some of the relative losses to end the period ahead of the benchmark index against which its performance is measured.



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Chief Investment Officer,
LV= Asset Management



Howard Meaney

Head of Property Investment,
LV= Asset Management



Michael Wright

Head of Fixed Interest,
LV= Asset Management

EQUITIES

	LV=	BENCHMARK
3 months	-0.5%	-1.8%
6 months	-10.5%	-11.1%
12 months	-10.2%	-12.3%

This table complies with the Financial Services Authority's regulations to compare different products from different providers.

These figures measure the growth of our equities portfolio against the Weighted Composite of FTSE Regional Total Return Indices. The figures are as measured at 30th June 2008.

Standardised Performance

These figures show the percentage growth of the equities portfolio each calendar year in the fund for the last five years.

Yr to 31st Dec 2003	20.5%
Yr to 31st Dec 2004	10.9%
Yr to 31st Dec 2005	24.0%
Yr to 31st Dec 2006	14.1%
Yr to 31st Dec 2007	8.6%

12 months total return % (mid price to mid price basis) gross income reinvested. Source: LVAM.

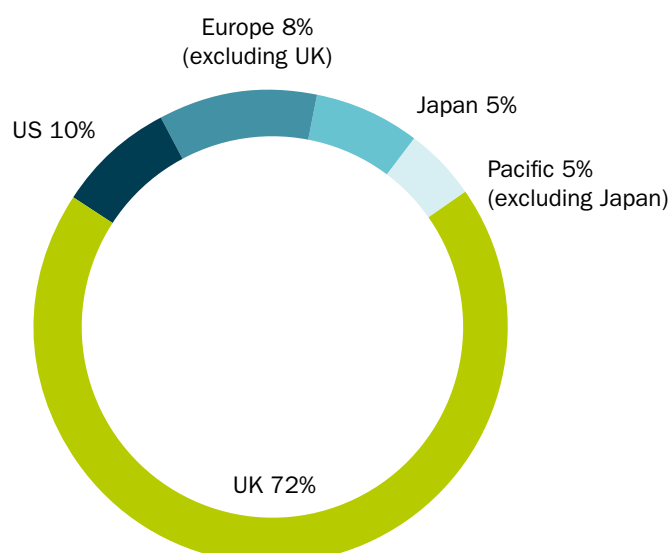
Past performance is not a guide to future performance.

TOP 10 UK HOLDINGS

as at 30th June 2008

1 Royal Dutch Shell	6 BHP Billiton
2 BP	7 Rio Tinto
3 Vodafone	8 Anglo American
4 HSBC	9 Glaxo Smith Kline
5 BG Group	10 Tesco

Equity Country Weightings as at 30th June 2008



MARKET REVIEW

UK equities experienced a volatile six months ending the period markedly down. Subprime developed into credit crunch with Northern Rock one of the largest victims. The Bank of England (BoE) failed to follow the lead of the US Federal Reserve by not injecting cash into the financial system and was seen to do too little, too late. Increasing worries about the wider economy and inflation – as oil, food and commodity prices continue to rise – have replaced the earlier credit woes, and consumer-facing companies, especially those on the high street, are feeling the effects of tightening belts. The BoE has now put the central interest rate on hold rather than cut it any further but, in our view, is unlikely to actually increase the base interest rate.

For **European equities**, the credit crunch theme carried over from the end of 2007, resulting in a large-scale sell off in January. The market rallied over the next four months only to fall again due to fears about the credit crunch spilling over into the wider economy. Pressures on the consumer increased with rising oil and food costs having a negative impact on inflation which rose to 4% in June. While other central banks cut interest rates, the European Central Bank (ECB) kept them on hold – and, indeed, in July, raised them. As consumer confidence has further eroded, the risk of a recession has increased in most countries although we believe this has been overstated.

US equities markets fell during the period amid ongoing turmoil in the credit markets, a lowering of corporate earnings estimates and continued home price declines. Aggressive actions by the US Federal Reserve (US Fed) to soften the economic slowdown and improve the supply of money within the US financial system provided only short-term relief. The brief Spring rally lasted until mid-May when the market was brought back down again by more mortgage-related writedowns, further housing market deterioration and rising inflation led by record-high oil prices. Also dampening investor sentiment was the view that the US Fed may raise interest rates to bring inflation under control, and in the process, slow an already anaemic economy.

US credit market problems and the uncertain outlook for the US economy led to continued volatility for **Japanese equities**. Despite an interim recovery in global equity markets, fresh concerns over the slowdown in the US economy undermined global equity prices, including Japan's, towards the end of June. Nevertheless, the Tokyo market outperformed major global equity markets during this period. The yen steadily weakened towards the end of the period against the US dollar amid reduced expectations of further interest rate cuts by the US Fed, which aided the recovery in the Tokyo equity market from mid-March to early June.

In **Asia**, strong economic growth continues, fuelling rising inflation and higher interest rates. Neither was supportive of equity prices as overseas investors repatriated funds, reversing the brief gains made during the Spring rally. Accelerating inflation and the rise in crude oil prices saw Asian equity markets register two consecutive quarters of negative performance for the first time since the first quarter of 2003. However, despite high commodity prices, weaker Asian currencies and strong demand from the Middle East and Asia ex-Japan are helping to sustain export growth, compensating for weaker US and European demand.

PERFORMANCE

Under increasingly difficult market and economic conditions, our **UK portfolio** produced a negative return for the period although it produced better results than its benchmark index. Results were hampered by a lower-than-benchmark weighting in oil exploration and production, which benefited from high oil prices, a higher-than-benchmark weighting in aerospace and defence, dragged down by concerns over the outlook for the civil aerospace sector and troubles surrounding the Saudi contract with BAE systems and a higher-than-benchmark weighting in telecoms, which we thought would have behaved more defensively. On the positive side, our positioning and selection among banks benefited returns, with a lack of exposure to mortgage banks and a tilt to the Far East through our exposure to HSBC and Standard Chartered.

The **Europe ex-UK portfolio** produced better-than-benchmark results, benefiting in relative terms from its below-benchmark position in financials, particularly those with exposure to investment banking. The portfolio had much less exposure than the benchmark to UBS which saw its shares fall by over 50% after announcing writedowns to the tune of US\$38bn. Having relatively less weighting in defensive areas such as utilities, as well as food and beverages also added to results. Holdings in E.ON contributed as rising power prices and secure earnings due to forward selling 2008 electricity saw its share price start to rise again after collapsing in January. Shares in Nestlé received a boost due to its ability to pass on price increases and having benefited from the sale of Alcon, its eye care unit.

Positioning of holdings within the various industries and sectors for the **US portfolio** had a detrimental effect on our relative performance, with notable negative contributions emanating from a below-benchmark position in Energy (best performing sector) and an above-benchmark position in Financials (worst performing sector). Results were marginally hampered overall by our choice of particular stock, with losses within Financials, Industrials and IT being partially offset by gains within Energy, Health Care and Materials.

The **Japanese portfolio** produced a negative return for the period and an overall result below that of the benchmark index. Negative results were mainly the result of choice of stock – primarily within the electronics and machinery sectors. The sector-prioritisation strategy, by which we decide how to share out the allocation among the different sectors, had a close-to-neutral effect, with the negative effect from the relatively smaller position in the infrastructure sector offsetting the positive contribution from the relatively larger position in commodities.

First-half results in **Asia** fell back both in real terms and when measured against the benchmark. Most of the real decline was experienced in the first quarter and this coincided with the below-benchmark results. The active positions which benefited the portfolio in the more bullish environment of 2007, proved to be a drag in the first quarter. However, we spent this time moving to a more cautious strategy and this helped in the second quarter as the fund did better than the benchmark despite further weakness in the market. Our relatively small position in Taiwan was negative for results as the market did better than others in the area due to improved relations with China. In addition to our positioning in Taiwan, choice of stock was also unhelpful with too much exposure to the larger technology companies and not enough to the smaller, more domestically focused companies.

OUTLOOK

The outlook for the **UK market** remains uncertain. Volatility is likely to be the recurring theme in the near to mid term as some investors try to make short-term gains. Although inflation is a concern, there is now less likelihood that the BoE will raise interest rates. There are signs that the bleak economic picture with rising mortgage rates and increased food and energy prices are starting to hit the consumer. Investors have already taken into account a lot of the negative economic news but it could be towards the end of 2009 and into 2010 until we see any real economic recovery.

Following a rise in interest rates by the ECB, investors in **Europe** are assuming that there will be a further rise – we disagree. Housing problems are having a negative impact on a number of economies in Europe, and there are increasing signs of a deterioration of the broader economies of France and Germany. Looking ahead to the second half of 2008, we see little reason to alter the basic philosophy of the fund.

Difficult market and economic conditions indicate a greater risk of a recession in the **US**. We believe that business investment will be curtailed, with state and local governments being forced to cut back due to budget shortfalls. After the benefits of a tax refund have worn off, the consumer will be left with a deteriorating

labour market, slowing wage growth, higher energy costs and declining property prices, as well as growing inflation; even without a further rise in oil prices, the rate of inflation could reach 5% later this summer. Additionally, floods in the Midwest are adding to food inflation pressures that were already building. With any crop shortfalls, the US could be facing the highest food price inflation since the early eighties.

For **Japan**, growing uncertainty over the corporate profit outlook is holding back domestic demand, but GDP growth is deriving some support from a promising recovery in housing investment and moderate growth in personal consumption. Our forecasts for Japan's real economic growth rate are 1.5% for fiscal year 2008 (ending March 2009) and 1.9% for fiscal year 2009. Based on projections issued during the 2007 fiscal year-end reporting season, Japanese companies listed on the first section of the Tokyo Stock Exchange expect pre-tax profits to decline by an average of 5%-10% from a year earlier in fiscal year 2008. The deterioration is notably concentrated in the first half of fiscal year 2008. There may be some margin for improvement as a result of a change in Japan's favour to the yen/US dollar exchange rate.

In the coming months, oil price will be the key for **Asian** stock markets. The big risk now is that regional central banks respond by being over-zealous in their actions towards interest rates. The outlook for Asian economies remains good in the medium term relative to other parts of the world, with most economies in Asia – led by China and India – expected to grow at rates two to three times that forecast for the OECD*. Whether the strong economic growth translates into earnings growth is complicated by rising input costs. In our view, prior to hitting bottom, equities need to endure more earnings shocks and forecast reductions.

*Organisation for Economic Co-operation and Development (an organisation with 30 member countries)

PROPERTY

	LV	BENCHMARK
3 months	-2.8%	-2.9%
6 months	-6.6%	-6.2%
12 months	-13.5%	-15.1%

This table complies with the Financial Services Authority's regulations to compare different products from different providers.

These figures measure the growth of the property portfolio against the IPD UK Annual Index. The figures are as measured gross at 30th June 2008.

Standardised Performance

These figures show the percentage growth of the property portfolio each calendar year in the fund for the last five years.

Yr to 31st Dec 2003	13.2%
Yr to 31st Dec 2004	19.7%
Yr to 31st Dec 2005	20.5%
Yr to 31st Dec 2006	22.2%
Yr to 31st Dec 2007	-1.2%

12 months total return % (mid price to mid price basis) gross income reinvested. Source: LVAM.

Past performance is not a guide to future performance.

MARKET REVIEW

Real concerns are now starting to emerge over the occupier market. On the high street and out of town, the retail sector continues to suffer. The housing market is feeling the impact of tighter lending criteria, market activity is slowing and prices falling. The slowdown in the housing sector and general economic concerns are affecting consumer confidence and spending. There has been little evidence of any buying or selling although the concern is that funds may become forced sellers in order to meet redemptions deferred from six to nine months ago and that banks may start to call in loans if they breach loan-to-value covenants. We hear of a number of purchasers holding cash reserves but so far they have been reluctant to part with their cash, suggesting they feel the market has further to fall.

PERFORMANCE

Our strategy has been to acquire quality properties in strong locations throughout the UK. The initial focus has been on the less volatile high street retail sector, seeking properties that are well let to good tenants, with secure reletting prospects. The fund now has a well diversified portfolio with properties in various locations. Each has been carefully selected for the potential growth opportunity it offers and has been acquired from institutional investors seeking to raise cash. As

a result, properties have been acquired at attractive prices as witnessed by the fund's return against the market average despite generally disappointing market conditions. Results were further improved by our relatively high cash weighting in the portfolio.

OUTLOOK

The combined effects of high consumer debt, falling house prices and subdued spending does not bode well for the retail occupier market. The credit crunch is undoubtedly leading to hesitancy in the office sector witnessed by a marked dip in active demand and an increase in the availability of space, particularly in London's financial district. The office sector is expected to suffer the greatest over the forthcoming months, exacerbated by job threats and a growing supply position. Nevertheless, overseas buyers, sovereign wealth funds and high-net-worth individuals still see the UK property market as a good home for cash and will continue to pay high prices for trophy assets, such as Liberty on Regent Street. There will clearly be some exceptional buying opportunities coming out of the current malaise but these are unlikely to emerge before the end of the year. We expect the difficult current conditions to persist for some time before stabilising in 2009.

FIXED INTEREST

	LV	BENCHMARK
3 months	-3.5%	-3.5%
6 months	-4.0%	-3.8%
12 months	4.6%	4.5%

This table complies with the Financial Services Authority's regulations to compare different products from different providers.

These figures measure the growth of our Fixed Interest portfolio against the Composite of 75% FTSE A Over 5 years UK Gilts Total Return Index and 25% Merrill Lynch over 5 years UK Non-Gilts Total Return Index.

The figures are as measured at 30th June 2008.

Standardised Performance

These figures show the percentage growth of the fixed interest portfolio each calendar year in the fund for the last five years.

Yr to 31st Dec 2003	2.9%
Yr to 31st Dec 2004	7.7%
Yr to 31st Dec 2005	9.7%
Yr to 31st Dec 2006	0.3%
Yr to 31st Dec 2007	3.7%

12 months total return % (mid price to mid price basis) gross income reinvested. Source: LVAM. Past performance is not a guide to future performance.

MARKET REVIEW

Economic conditions have clearly deteriorated over the last six months as evidenced by the sharp deterioration in the housing market and forward-looking surveys indicating growing weakness in both manufacturing and services. Increasing energy and food prices have become a growing concern for central banks with inflation pushing multi-year highs. As a consequence, many central banks have felt uneasy about cutting interest rates to stimulate growth, as would normally be the case, for fear of higher inflation expectations becoming embedded within wage demands. Indeed, the ECB was expected to raise interest rates in July (which it did by 0.25%) despite the clear slowdown in economic growth throughout the region.

PERFORMANCE

Market conditions during the first half of the year were extremely volatile, driven in large part by wild swings in interest rate expectations. Overall yields, particularly for shorter maturities, rose sharply and led to negative returns for the asset class during the period. Yields on longer-dated bonds also rose, but not as sharply and consequently total returns were similar for bonds of all but the very shortest maturities. This meant that it was difficult to generate excess returns during the period.

OUTLOOK

Clearly, the economic headwinds that have been building over the past year are unlikely to abate in the near term. Indeed, consensus economic growth forecasts for 2008 and 2009 have been steadily falling over recent weeks and the risk of a recession in the UK has increased noticeably during this period. It is, however, our expectation that the inflationary fears that have built up during the last six months will fall away relatively quickly in 2009 as a result of the above-mentioned weaker growth. This will enable the BoE to cut interest rates in early 2009 so as to stimulate growth. We feel that bond markets will respond positively to the improving inflation outlook and falling interest rates. Furthermore, structural demand for bonds will also tend to push prices higher and add to returns in the medium term.