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Client Letter 19 April 2007

Quarter End: 31st March 2007

Dear Investor

After enjoying returns considerably above the market in 2006, and in particular in the final quarter of last year, we are pleased to report that our clients have captured the full benefit of the market's gain in the first three months of 2007.

In the recent financial reporting season, many of the companies held by our clients announced truly impressive results and very substantial earnings growth. However, it is critical that investors do not make the classic error of extrapolating from this extraordinary rate of increase in earnings to calculate future share price valuations.

While we do not expect earnings growth to reverse, we equally do not anticipate companies reporting future earnings gains of the order of magnitude as we have seen in the past few years. Realistically, we would expect future earnings to grow at an increasingly moderate pace and ultimately to normalise.

This applies equally to the stockmarket as a whole which can continue to appreciate; but probably at a more modest and increasingly normalised rate.

We explore these thoughts more fully in our Market Report and, after what has been a recent period of very heady returns, focus attention on the rate of return which clients can anticipate in the long term.

Despite this cautioning, our ongoing research continues to identify attractive investment opportunities in the market and will incrementally rotate our clients' portfolios towards these. The key ingredients of successful long term investing have not changed. Rigorous research, disciplined investing and patience. It is worth reminding ourselves that: "someone is sitting in the shade today, because someone planted a tree a long time ago".

As has been the case for the past decade, we are confident that over the long term, we will continue to generate returns greater than the overall market and that our clients will be well rewarded for the faith they have placed in Northstar.

Yours sincerely

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It is well documented that over the long-term shares have, by a wide margin, outperformed all other asset classes and remain the asset class of choice for those intent on growing their wealth.

Despite this, history teaches us that extended bull markets have often ended in tears. Whether we to go back to the Dutch tulip bulb mania or the South Sea bubble of hundreds of years ago; or more modern day stockmarket bubbles; the outcomes were often the same. After the euphoric peaking there followed a decline in which investors surrendered up to 75% of their earlier gains.

Mindful that one of the most expensive expressions in investing history has been: “this time it is different” we need to analyse the current market rally to assess the magnitude of the risk of permanent loss to which we are exposing our precious capital.

The ongoing JSE rally has some critical differences. Unlike the 1960’s when global stockmarket frenzy sucked in punters and speculators who drove the JSE price to earnings ratio to an unprecedented 25 times, this current rally is earnings led. Investors have not inflated share prices above growth in company earnings.

Indeed, over the last 10 years, fully two thirds of the gains made by the JSE are attributable to earnings growth and the remaining third is made up in equal parts by dividend income and stock market re-rating. In terms of “expensiveness,” the JSE is today, despite its massive gains over the past decade, only 16% more expensive than it was ten years ago. This implies that a crash from over-priced levels is less likely than some commentators suggest.

Importantly, the quality of companies’ earnings on the JSE is currently substantially better than it has been in the past. Most companies are benefiting from the broad economic growth in both the local and global economy. In the past quarter many companies held by our clients reported financial results and the magnitude of their earnings growth is at worst solid and at best astounding.

For their prior accounting period Anglo American Plc reported a 46% increase in earnings per share (EPS), African Rainbow Minerals up 318%, Impala Platinum up 138%, Metorex up 141% and non-commodity companies such as Sun International grew EPS by 32%, Standard Bank Group by 20%, AECI by 77%, Sanlam by 33% and MTN by 72%.

This is in stark contrast to the late 1970’s bull run which was based on the gold price soaring to US$850 per ounce – before plunging at even greater speed. Even with the current commodity run the resource sector constitutes just 40% of the JSE, as compared to the peak of 69% of the 1980’s.

It is worth reminding ourselves that, while pleasing, recent returns have been exceptional. While markets are unlikely to crash from current levels, so too are they (and company earnings) unlikely to continue to appreciate at their extraordinary recent rates.

Nominal returns are those which are reported by the media and the investment industry. These are the actual percentage by which an investment may increase (or decrease) over a period. Nominal returns can be misleading as they make no allowance for inflation. Returns equalling the rate of inflation are required by investors to merely retain their buying power.

Nominal returns less the rate of inflation equal real returns; or returns after inflation. Real returns measure the extent by which real wealth is created, or not. Additionally, real returns allow us to accurately compare returns over periods of differing rates of inflation; thus should be used by investors in planning their future.

To illustrate the impact of using nominal versus real returns we can look at the US Dow Jones index. The Dow has, from 1925 to 2007, appreciated from 134 to 12,600; or some 93 times in nominal terms. However, once the inflation is removed, it has, in real terms, increased from 1,900 to 13,000 or just 7 times its 1925 value.

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Having lived in times of high inflation and normal returns and, more recently, a period of low inflation but unusually high real returns; investors' expectations of future returns may be unrealistically high.

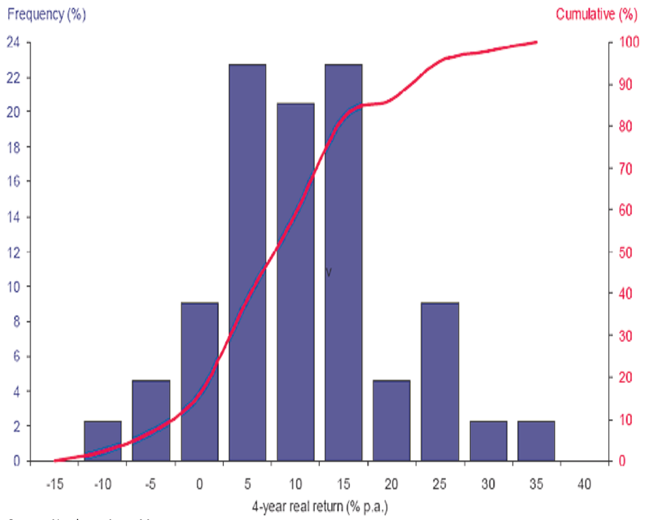
In their seminal study on the subject, the authors of "Triumph of the Optimists – 101 Years of Global Investment Returns" calculated that in the Twentieth Century real returns (in US dollars) from South African equities were approximately 6.8% p.a., which, interestingly, is slightly higher than that in the US at 6.7% p.a. and much higher than the world average of 5.8% p.a.

The current rally in the Johannesburg Securities Exchange (JSE) is in its fourth year and during this four year period the market has delivered the remarkable performance of increasing by 30.9 % per annum in real terms.

This compares favourably with the 31% pa (3.9x) increase over 3 years which the market delivered in the late 1970's and the 20.5%pa. (4.5x) increase over 8 years in the 1960's.

Over any rolling four year period, since 1960, the JSE has produced an average real return of 7.6%.

JSE - Distribution of 4 year rolling real returns – 1960 to present



Source: Northstar Asset Management

As is evidenced by the above graph, in the past 47 years, the JSE has only once had a rolling four year return that equals the current rally and on one other occasion has it exceeded the current rally on a rolling four year basis.

These are exceptional times to be invested in the JSE. Moreover, unlike some prior bull markets, this rally is unlikely to end in tears. However, we would caution investors to ratchet down their expectations of future returns to more normalised levels.

This implies that the JSE should, over time, revert to four year annualised rolling returns of 7.6%p.a.

If an investor employs an asset manager that is able to enhance the long term average return by just three percent per annum, then, at the end of a 25 year period, the client with 10.6% real returns would enjoy exactly double the wealth of the average investor. If, on the other hand, a manager was able to produce real returns just 3% below the long term average, the investor would end the 25 year period with only one quarter the wealth of the 10.6%pa investor.

Just as risks matter, plainly, so do returns. While they are often presented as two sides of the same coin, this is not necessarily so. Northstar's research driven and conviction-led investment style has consistently delivered above market returns at lower than market risk. In the past 5 years the average Northstar client has, after all fees and expenses, outperformed the JSE by an average of 12.4% per annum in real terms.

While the quantum of any future Northstar outperformance is impossible to predict, we are confident that in the long term our proven investment style will continue to generate greater than market returns at lower than market risk.

And, it is through the compounding of these superior real returns that we have the pleasure of rewarding the confidence which our clients have placed in us with meaningful wealth creation.