# MARGIN OF SAFETY FUND

Audited annual report

at 31/12/05

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# Management and Administration

REGISTERED OFFICE
5, Allée Scheffer
L-2520 Luxembourg

PROMOTOR
CACEIS Bank Luxembourg
(formerly known as Crédit Agricole Investor Services Bank Luxembourg SA)
5, Allée Scheffer
L-2520 Luxembourg

CUSTODIAN AND
CENTRAL ADMINISTRATION AGENT
CACEIS Bank Luxembourg
(formerly known as Crédit Agricole Investor Services Bank Luxembourg SA)
5, Allée Scheffer
L-2520 Luxembourg

INVESTMENT MANAGER
Pastel & Associés S.A.
27, rue de Marignan
F-75008 Paris

CO-PROMOTOR
Pastel & Associés S.A.
27, rue de Marignan
F-75008 Paris

AUDITOR
KPMG Audit S.à r.l.
31, Allée Scheffer
L-2520 Luxembourg

# Board of Directors

Chairman of the Board

M. Jean-Marie RINIE, Business Development Director, Vice-Président de CACEIS Bank Luxembourg

Members of the Board

M. Hervé SCHUNKE , Business Development Director, CACEIS Bank Luxembourg

M. John MILLS, Managing Director, Maitland J. Co. Sàrl

M. David PASTEL, CEO of Pastel & Associés S.A.

# Information to the Shareholders

**Supplementary information to Shareholders on Savings Directive 2003/48/EC**

The following Sub-Fund is out the scope of the Law for the realised and the distribution income for the period from 1st July 2005 to 30th april 2006 : Fund 1.

# Manager's Report

Class B shares

In 2005, the Fund's NAV Class B shares increased by 5.3%, resulting in a cumulative performance since inception on February 2nd, 1998, of 187.9%. As a result, while $1,000 invested at inception in the Margin of Safety Fund Class B would now be worth $2,879, the same $1,000 invested in the MSCI World index would now equal $1,509.

Class A shares

The Fund had only one class of investors shares until August 16, 2002, on which date the first Class A shares were issued. From August 16th, 2002, to December 30th, 2005 the performance of the Class A shares was 70.2% in USD and 41.8% in €. The performance of the Class A shares for the year ended December 31, 2005 was 5.2% in USD and 21.4% in €.

**The top ten portfolio holdings in 2005**

Electrocomponents (United-Kingdom)

Portfolio weight: 9.8% - Market capitalization: £1,223M - Revenues: £791M - Net income: £56M - 2005 stock performance excluding dividends: -1.3%.

Although a worldwide leader in odd-lot distribution of electronic components, Electrocomponents has continued to meet some strong headwind in 2005, as corporations have kept shifting their manufacturing resources out of Western Europe and the United Kingdom into Asia and Eastern Europe. The group has also encountered some significant delays and cost overruns in the implementation of its new SAP-based ERP system. However, these shortfalls do not alter the main factors behind our decision to invest in Electrocomponents. Its presence in Asia should, in time, more than offset the manufacturing decline of the West while its sterling balance sheet and profitability allow for a sustainable dividend yield of close to 6.5% at year end closing prices.

Wm Morrison (United-Kingdom)

Portfolio weight: 9.7% - Market capitalization: £5,145M - Revenues: £12,367M - Net income: £13M, of which exceptional loss of £196M for the year - 2005 stock performance excluding dividends: -6.5%.

The fourth supermarket player in the United Kingdom went through one of its most eventful years. Over the past eighteen months, it managed to complete the conversion, to the Morrison format, of the stores acquired as a result of last year's acquisition of the Safeway group. The feat of integrating in such a short span a group twice its own size has predictably caused Morrisons' P&L to move into the red, albeit only momentarily. This transitional period has been made even more challenging as neither food deflation nor competition have let up. Despite this quite grim picture, we keep expecting good to excellent returns from this investment as its case looks to us even stronger now. The upcoming rationalization of the group's logistics should help lift its bottom line firmly into the black. Moreover, the group's position as a quality and value food retailer, with a market share of more than 10%, its very valuable real-estate portfolio and its experienced management team headed by Sir Ken Morrison, himself a significant shareholder, make this investment all the more attractive to us.

## Manager's Report

TJX (United-States)

Portfolio weight: 6.4% - Market capitalization: $10,702M - Revenues: $15,671M - Net income: $621M - 2005 stock performance excluding dividends: -7.6%.

This leading North American off-price retailer had a tough 2005 year as both its revenues and its profits suffered a sharp slowdown. However, its 8% operating margin helped it remain in the black. Although its core Marmaxx division is a slow-grower, it is also highly profitable and cash-generative thanks to its higher-income female customer base and its business model built around the liquidation of unsold apparel inventory. However, TJX's attempts at diversifying its revenue base have been much less successful: neither its two other domestic divisions (Homegoods for furniture and AJ Wright targeted toward a less affluent shopper) nor its foreign ventures (Canada and the UK) seem to have really taken off to the level of its core Marmaxx unit. However, despite this mixed picture, we remain comfortable with our investment in TJX as its competitive position in off-price retailing remains strong. Moreover, the recent return of its founder, B. Cammarata, as Chairman and CEO, should herald a new beginning for the group akin to the one currently underway at Charles Schwab. Time will tell.

Harley-Davidson (United-States)

Portfolio weight: 6.2% - Market capitalization: $14,140M - Revenues: $5,221M - Net income: $939M - Stock performance since inception in 2005, excluding dividends: -0.7%.

In 2005, the renowned bike manufacturer hit some bumps on its growth path, especially when compared to the heady years leading to its centennial in 2003. However, we believe that the reasons that led to our decision to invest in its stock remain valid: an efficient manufacturing organization combining outsourcing and in-house assembly, a network of motivated, and quite often exclusive, dealers, and a loyal, if not fanatical, customer base that has been growing at a healthy rate over a number of years. The brand's presence outside of the US, especially in Great Britain and Japan, should in the future keep adding to growth. The main source of concern to us lies in the credit division, which one may rightly wonder whether it belongs to its core business or not. However, the division, has until now been profitably as well as seemingly conservatively managed, its contribution to the group's profit reaching 27.9% for the past year. All in all, we remain confident in the stock's return potential.

Premier Farnell (United-Kingdom)

Portfolio weight: 5.3% - Market capitalization: £627M - Revenues: £791M - Net income: £37M - 2005 stock performance excluding dividends: 1.0%.

Premier Farnell is very comparable to Electrocomponents both in size and by the very nature of its business. It, too, is primarily an odd-lot distributor of electronic components. However, it is also more diversified with 12% of its revenues coming from outside its distribution arm. Moreover, its product range geared more toward manufacturers, its geographic exposure with less of a presence in Continental Europe and Asia, and its higher level of net debt leave Premier Farnell in a less favorable position than Electrocomponents. Anyhow, like its rival, it is faced with the same challenges as its customer base keeps moving out of Western Europe and the UK. This situation led the board, in July 2005, to dismiss the then-CEO, John Hirst, while looking to recruit a new leader. Despite a number of unknowns, we must stress how profitable Premier Farnell still remains and how attractive its stock-market valuation currently is.

Montpelier Re (United-States/Bermuda)

Portfolio weight: 4.8% - Market capitalization: $1,685 M - Revenues: $981M - Net income: $-589M, of which exceptional loss of $972M for the year - Stock performance since inception in 2005, excluding dividends: -38.1%.

From its inception in November 2001 to early 2005, this property catastrophe and specialty insurer/re-insurer had been highly profitable. However, its track record took a turn for the worse in 2005 following the advent of an unusual number of natural disasters. We made our first purchase of Montpelier Re shares, following a sharp decline in its stock price a few days after Katrina's devastation was over. Unfortunately, we did not expect the next two hurricanes, namely Rita and Wilma, to strike and the ensuing aggravation they caused, resulting in even more red ink at Montpelier Re. Despite an obviously terrible 2005 year, we remain confident in the profit potential of our investment. The group is well capitalized, its management team, headed by the experienced Anthony Taylor, is first class while, White Mountains, its main shareholder and a major insurance player in its own right, is a partner we feel very comfortable to be associated with. As a final note, we shall just mention the significant improvement in the competitive environment caused by the very events that have unleashed such mayhem.

Ryanair (Ireland)

Portfolio weight: 4.8% - Market capitalization: €6,356M - Revenues: €1,572M - Net income: €321M - 2005 stock performance excluding dividends: 58.1%.

In 2005, Ryanair maintained its leadership in Europe as a low-cost short-haul airline. Its controversial strategy ended up being vindicated, especially its choice of linking so-called "secondary" or out of the way airports in order to avoid the higher cost and lower punctuality inescapable at better located but more crowded airports. At 24,3%, its operating margin reached a new record in 2005 as did the number of its airborne passengers with more than 33 millions. Despite achieving such milestones, Ryanair has still room to grow profitably as its route network is far from being fully interconnected (especially in Eastern and Southern Europe). Moreover, it has one of the strongest financial structures of the airline industry. And although quite complex, its still litigious relationships with the European Community and the French Administration seem to be on the mend. We are very pleased with our investment in Ryanair so far and remain quite optimistic about its future profitability.

McDonald's (United-States)

Portfolio weight: 4.6% - Market capitalization: $42,439M - Revenues: $20,236M - Net income: $2,372M - Stock performance since inception in 2005, excluding dividends: 11.0%.

The fast food operator, North American by birth but truly multi-national by its restaurants' locations, went through some difficult times, from 1995 to 2003, after developing too many sites at too fast a pace while loosening its standards in terms of customer service and product innovation. In 2003, following the return from retirement of Jim Cantalupo, one of the group's veterans, to head the management team, a back-to-basics plan was successfully launched that has resulted in a steady improvement in the system's like for like sales, and more recently in its profitability. In 2004/2005, the management team suffered some heavy losses as Jim Cantalupo and then its successor Charlie Bell both passed away. The CEO is now Jim Skinner, another veteran of the group who had worked closely with both deceased leaders. The revitalization plan is still under way as attested by the recent promotion to head of Europe of Denis Hennequin, the CEO of McDonald's-France, one of the group's most prosperous divisions. The strong competitive position of McDonald's, its growth potential as well as the strategy that has been implemented since 2003, all comfort our confidence in this position that was set up in 2005.

# Manager's Report

Charles Schwab (United-States)

Portfolio weight: 4.6% - Market capitalization: $18,916M - Revenues: $4,344M - Net income: $591M - 2005 stock performance excluding dividends: 22.7%.

After its eponymous founder came back at the helm in 2004, the North American financial services group engaged in an aggressive recovery plan that has begun to bear fruits as attested by its recent market share gains and improved profitability. As a result, and for the first time in many years, the group’s long term prospects look much brighter. In 2005, Charles Schwab’s online discount brokerage and asset management arm has enhanced its competitive position while a thorough restructuring of US Trust, its high-net-worth advisory business, is in the process of being implemented. According to how successful this plan will be, either US Trust will remain a part of Charles Schwab or it will end up being divested. To sum it up, not only are we already happy with the return on our investment in the company but we are also confident in its future upside.

Southwest Airlines (United-States)

Portfolio weight: 4.3% - Market capitalization: $13,024M - Revenues: $7,251M - Net income: $517M - Stock performance since inception in 2005, excluding dividends: 12.1%.

In 2005, Southwest enhanced its lead over its competitors, some of them stumbling in or out of bankruptcy filings, while managing to remain profitable despite rising oil prices. It did so while staying loyal to the business model that has made it famous: a low cost operation linking so-called “secondary” or out of the way airports in order to avoid the higher cost and lower punctuality inescapable at better located but more crowded airports. Despite already carrying more than 70 million passengers in 2005, we believe the airline has still room to grow profitably as its route network is far from being fully interconnected (60 airports but only circa 380 non-stop routes). Moreover, it has one of the strongest financial structures of the airline industry. Its management team is also, one of the most experienced in the business with its legendary founder, Herb Kelleher, still Chairman of the Board. To sum it up, the reasons behind our investment have not changed while our return expectations remain high.

## Main transactions in 2005 and portfolio structure at year-end

2005 was also a significant year with regard to changes brought to the portfolio structure:
New stakes were built in companies such as Next (specialty retailing) in the United-Kingdom, and Dell (hardware and equipment), Harley-Davidson (leisure equipments), McDonald’s (fast food restaurants), Montpelier Re (insurance - reinsurance), and Southwest Airlines (discount air travel) in North America.
A number of positions were entirely disposed of, of which for the Euro area, Accor (lodging), Hunter Douglas (building materials), Kone (equipments), and Randstad (temporary staffing) as well as American Express (financial services) in North America. Several positions were downsized, such as Ryanair (discount air travel), Coca-Cola (consumer goods manufacturing), Charles Schwab (financial services) and Target (retail distribution).

As a result of these transactions, the Fund’s equity portion represented 96.7% of the Net Asset value. As was already mentioned in previous reports, Euro and Sterling-denominated portfolio assets are partially hedged back into the US Dollar through forward currency sales.

# Manager's Report

On December 31st, 2005, the breakdown by geographical areas of the Fund's portfolio, before currency hedging, was as follows (2004 figures are provided herein for comparison purposes):

| | 2005 | 2004 |
|---|---|---|
| - Euro Zone: | 7.2% | 33.5% |
| - United Kingdom: | 43.6% | 31.5% |
| - United States: | 49.2% | 35.0% |

- On December 31st, 2005, the breakdown by sector of the equity portion of the Fund's portfolio was, as follows (2004 figures are provided herein for comparison purposes):

| | 2005 | 2004 |
|---|---|---|
| - Non food retailing: | 27.1% | 19.8% |
| - Business to business services: | 18.7% | 23.2% |
| - Consumer goods manufacturing: | 13.0% | 12.4% |
| - Food retailing: | 12.2% | 12.9% |
| - Financial services: | 9.7% | 10.5% |
| - Transportation: | 9.4% | 9.0% |
| - Lodging/Restaurants: | 4.8% | 4.8% |
| - IT hardware and equipment: | 3.8% | 0% |
| - Conglomerates: | 1.3% | 0% |
| - Industrials and materials | 0% | 7.4% |

**Outlook for 2006 and beyond**

Although we have no opinion about the rate of return the Fund will achieve in 2006, we trust that its performance, over the next five years, should be quite satisfactory.

This outcome should primarily result from the implementation of our investment methodology whose core principles we shall now reiterate:
We focus on a few, carefully screened and researched companies that tend to share some common features such as a good and historically profitable business and a competent and honest management.
We demand that a significant margin of safety be present, at the time of initial purchase, in every one of our investments.
We do not shift course and dispose of or increase some of our holdings because of changes in macro-economic or financial market expectations. In fact, we do not harbor any kind of expectations as to where the economy or the markets are supposed to go.
Please let me thank you for your support and continuing trust.
Regards,
David Pastel,
Pastel & Associés S.A.

# Independent Auditor's Report

To the Shareholders of
MARGIN OF SAFETY FUND
5, Allée Scheffer
L – 2520 LUXEMBOURG

We have audited the financial statements, which consist of the statement of net assets, the securities portfolio, the statement of operations and changes in net assets and the notes to the financial statements of MARGIN OF SAFETY FUND (the "SICAV") at December 31, 2005. These financial statements are the responsibility of the Board of Directors of the SICAV. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors of the SICAV in preparing the financial statements, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the attached financial statements give, in conformity with Luxembourg legal and regulatory requirements, a true and fair view of the financial position of MARGIN OF SAFETY FUND at December 31, 2005 and the results of its operations and changes in its net assets for the year then ended.

Supplementary information included in the annual report has been reviewed in the context of our mandate but has not been subject to specific audit procedures carried out in accordance with the standards described above. Consequently, we express no opinion on such information. We have no observation to make concerning such information in the context of the financial statements taken as a whole.

Luxembourg, April 5, 2006

KPMG Audit S.à r.l.
Réviseurs d'Entreprises

| | |
|---|---|
| Nathalie Dogniez | Patrice Perichon |
| Partner | Director |

# MARGIN OF SAFETY FUND - Fund 1

## Financial Statements at 31/12/05

### Statement of net assets at 31/12/05

*Expressed in USD*

| | | |
|---|---|---|
| **Assets** | | **52,428,733.06** |
| Securities portfolio at market value | Note 2 | 50,428,107.63 |
| *Cost price* | | *48,419,133.19* |
| *Unrealised profit on the securities portfolio* | | *2,008,974.44* |
| Cash at banks and liquidities | | 1,207.98 |
| Time deposits | | 1,352,000.00 |
| Interest receivable | | 135.20 |
| Brokers receivable | | 100,766.43 |
| Unrealised profit on forward foreign exchange contracts | Note 6 | 293,102.17 |
| Other assets | | 253,413.65 |
| **Liabilities** | | **275,032.56** |
| Bank overdrafts | | 2,082.47 |
| Accrued management fees | | 124,767.61 |
| Other liabilities | | 148,182.48 |
| **Net asset value** | | **52,153,700.50** |

### Changes in number of shares outstanding from 01/01/05 to 31/12/05

| | **Shares outstanding at 01/01/05** | **Shares issued** | **Shares redeemed** | **Shares outstanding at 31/12/05** |
|---|---|---|---|---|
| Class A | | | | |
| Capitalisation shares | 20.00 | 16,853.61 | 642.28 | 16,231.33 |
| Class B | | | | |
| Capitalisation shares | 16,080.67 | 511.00 | 13,648.01 | 2,943.66 |

### Key figures relating to the last 3 years

| | *Year ending at:* | **31/12/05** | **31/12/04** | **31/12/03** |
|---|---|---|---|---|
| Total Net Assets | USD | 52,153,700.50 | 44,000,747.49 | 27,214,205.93 |
| **Class A** | | USD | USD | USD |
| **Capitalisation shares** | | | | |
| Number of shares | | 16,231.33 | 20.00 | 224.80 |
| Net asset value per share | | 2,691.01 | 2,558.40 | 2,128.38 |
| **Class B** | | USD | USD | USD |
| **Capitalisation shares** | | | | |
| Number of shares | | 2,943.66 | 16,080.67 | 11,858.95 |
| Net asset value per share | | 2,879.09 | 2,733.07 | 2,254.48 |

# MARGIN OF SAFETY FUND - Fund 1

## Securities portfolio at 31/12/05

*Expressed in USD*

| Quantity | Denomination | Quotation currency | Market value | % of net assets |
|---|---|---|---|---|
| Transferable securities admitted to an official stock exchange listing | | | 50,428,107.63 | 96.69% |
| **Shares** | | | **50,428,107.63** | **96.69%** |
| *Bermuda* | | | *2,528,820.00* | *4.85%* |
| 133,800 | MONTPELIER RE HOLDINGS LTD | USD | 2,528,820.00 | 4.85% |
| *France* | | | *1,111,277.40* | *2.13%* |
| 15,000 | L'OREAL SA | EUR | 1,111,277.40 | 2.13% |
| *Ireland* | | | *2,506,469.90* | *4.81%* |
| 255,984 | RYANAIR HOLDINGS PLC | EUR | 2,506,469.90 | 4.81% |
| *United Kingdom* | | | *21,992,048.93* | *42.17%* |
| 110,200 | CARPETRIGHT PLC | GBP | 2,096,209.67 | 4.02% |
| 482,300 | DSG INTERNATIONAL PLC | GBP | 1,359,531.95 | 2.61% |
| 1,052,958 | ELECTROCOMPONENTS PLC | GBP | 5,093,405.07 | 9.77% |
| 209,200 | J SAINSBURY PLC | GBP | 1,135,292.12 | 2.18% |
| 190,896 | KESA ELECTRICALS PLC | GBP | 854,399.58 | 1.64% |
| 1,514,014 | MORRISON SUPERMARKETS PLC | GBP | 5,043,147.94 | 9.67% |
| 78,500 | NEXT PLC | GBP | 2,074,287.18 | 3.98% |
| 927,365 | PREMIER FARNELL PLC | GBP | 2,757,779.92 | 5.29% |
| 355,300 | SAGE GROUP PLC | GBP | 1,577,995.50 | 3.03% |
| *United States of America* | | | *22,289,491.40* | *42.74%* |
| 162,000 | CHARLES SCHWAB CORP | USD | 2,376,540.00 | 4.56% |
| 28,900 | COCA-COLA CO | USD | 1,164,959.00 | 2.23% |
| 18,760 | COLGATE-PALMOLIVE CO | USD | 1,028,986.00 | 1.97% |
| 63,800 | DELL INC | USD | 1,913,362.00 | 3.67% |
| 44,390 | ETHAN ALLEN INTERIORS INC | USD | 1,621,566.70 | 3.11% |
| 63,150 | HARLEY DAVIDSON INC | USD | 3,251,593.50 | 6.23% |
| 13,700 | LEUCADIA NATIONAL CORP | USD | 650,202.00 | 1.25% |
| 71,300 | MC DONALDS CORP | USD | 2,404,236.00 | 4.61% |
| 135,500 | SOUTHWEST AIRLINES CO | USD | 2,226,265.00 | 4.27% |
| 10,600 | TARGET CORP | USD | 582,682.00 | 1.12% |
| 45,000 | TIFFANY CO | USD | 1,723,050.00 | 3.30% |
| 144,040 | TJX COS INC | USD | 3,346,049.20 | 6.42% |
| **Total securities portfolio** | | | **50,428,107.63** | **96.69%** |

# MARGIN OF SAFETY FUND - Fund 1

## Statement of Operations and Changes in Net Assets from 01/01/05 to 31/12/05

*Expressed in USD*

| | | |
|---|---|---|
| **Income** | | **1,171,265.23** |
| Net dividends | | 1,094,372.77 |
| Bank interest on cash account | | 828.79 |
| Bank interest on time deposits | | 76,063.67 |
| **Expenses** | | **957,991.69** |
| Management & advisory fees | Note 4 | 536,273.32 |
| Custodian & sub-custodian fees | Note 5 | 38,343.14 |
| Taxe d'abonnement | Note 3 | 24,527.51 |
| Administrative expenses | Note 5 | 43,023.14 |
| Incentive and performance fees | Note 4 | 412.42 |
| Domiciliation fees | | 8,600.00 |
| Professional fees | | 17,123.89 |
| Bank interest on overdrafts | | 90.55 |
| Legal fees | | 12,048.91 |
| Other expenses | | 277,548.81 |
| **Net income from investments** | | **213,273.54** |
| Net realised profit on sales of investment securities | | 6,053,017.71 |
| Net realised profit on foreign exchange | | 427,560.02 |
| Net realised profit on forward foreign exchange contracts | | 194,232.36 |
| **Net realised profit** | | **6,888,083.63** |
| Movement in net unrealised appreciation / depreciation on forward foreign exchange contracts | | 1,418,404.85 |
| Movement in net unrealised appreciation / depreciation on investments | | -5,524,846.42 |
| **Increase in net assets as a result of operations** | | **2,781,642.06** |
| Subscription capitalisation shares | | 43,937,889.13 |
| *Class A* | | *42,595,393.40* |
| *Class B* | | *1,342,495.73* |
| Redemption capitalisation shares | | -38,566,578.18 |
| *Class A* | | *-1,630,287.51* |
| *Class B* | | *-36,936,290.67* |
| **Increase in net assets** | | **8,152,953.01** |
| **Net assets at the beginning of the year** | | **44,000,747.49** |
| **Net assets at the end of the year** | | **52,153,700.50** |

# *MARGIN OF SAFETY FUND*

## **Notes to the financial statements**

# Notes to the financial statements at December 31, 2005

## 1. General

**MARGIN OF SAFETY FUND** is a “société anonyme” with the status of a “société d’investissement à capital variable” under the Luxembourg law of December 20, 2002 on Collective Investment Undertakings and under the law of August 10, 1915 on Commercial Companies. The Fund is incorporated with limited liability for an unlimited duration. The Fund is submitted to Part I of the Law.

The Fund was incorporated under the name “Margin of Safety Fund Limited” with limited liability on January 19, 1998 in the British Virgin Islands as an open-ended investment company. The decision to transfer the Fund’s head office to the Grand Duchy of Luxembourg was taken by way of a resolution of the Board of Directors dated 15 May, 2002, and the Fund was transformed into a Luxembourg SICAV by way of an extraordinary General Meeting held on 14 August, 2002. At the same time, preference shares of the Fund were converted into Class B shares of the SICAV.

The Fund is registered under the number B 88649. Its registered office is in Luxembourg, 5, Allée Scheffer, L-2520 Luxembourg.

As at December 31, 2005 only the sub-fund MARGIN OF SAFETY FUND - Fund 1 is open. This sub-fund has issued two Classes of Shares: Class A and Class B. Both Classes A and B may be issued as accumulation shares or distribution shares at the investor’s discretion.

A Net Asset Value was calculated on December 31, 2005 using the closing prices as at December 30, 2005, in the sole purpose of establishing this annual report. No subscriptions or redemptions were performed with this Net Asset Value per share.

## 2. Summary of significant accounting principles

The financial statements have been prepared using accounting principles generally accepted for funds in Luxembourg including the following significant accounting policies :

### 1. Valuation of investments

The value of any transferable securities which are listed on a Stock Exchange or dealt on a regulated market shall be determined according to their last available price. If such prices are not representative of the fair value, securities will be valued at a fair value at which it is expected that they may be resold, as determined in good faith by and under the direction of the Board of Directors.

In the event that any transferable securities held by the Fund at the valuation day are neither quoted on a Stock Exchange nor dealt in on another regulated market, they are valued at their probable realisation value on the relevant Valuation Date, determined prudently and in good faith.

### 2. Realised profit and loss on investments

The profits and losses on sales of investments are determined on the basis of average cost.

### 3. Foreign exchange

The combined financial statements of the Company are established in USD. The combined financial statements are the sum of the sub-fund’s financial statements converted into USD at the rates of exchange ruling at the year end.

The market value of the investments and other assets and liabilities expressed in currencies other than the base currency of each sub-fund have been converted at the exchange rates as at the year end date.

# Notes to the financial statements at December 31, 2005

## 2. Summary of significant accounting principles (continued)

The costs of investments in currencies other than the base currency have been converted at the exchange rates as at the purchase date. Gains and losses arising on foreign exchange transactions are included in the result of operations.

As at December 31, 2005, the following significant exchange rates were used:

| | | |
|---|---|---|
| 1 EUR | = | 1.1797 USD |
| 1 GBP | = | 1.7214 USD |

**4. Income from investments**

Dividends are recognised as income on the date securities are first quoted ex-dividend, to the extent that information thereon is available to the Company. Interest is accrued on a weekly basis.

## 3. Tax Considerations

Under legislation and regulations currently prevailing in Luxembourg, the Fund is subject to a capital tax on its net assets at an annual rate of 0.05 % (“Taxe d’abonnement”), calculated and payable quarterly on the basis of the value of the net assets of the Fund at the end of the relevant quarter.

## 4. Management and Performance fees

For its services the Investment Manager receives from the Sub-Funds a management fee payable quarterly, at an annual rate calculated on the Class’s quarterly average Net Asset Value.

**Class A**: the Sub-Fund shall pay to the Investment Manager a management fee, payable quaterly at an annual rate of maximum 0.90% calculated on the class’s quaterly average Net Asset Value.
**Class B**: the Sub-Fund shall pay to the Investment Manager a management fee, payable quaterly at an annual rate of maximum 1.15% calculated on thee class’s quaterly average Net Asset Value.

The Sub-Fund shall pay to the Investment Manager an annual performance fee of up to 20% of the annual increase in the aggregate net assets of the Class A shares and Class B shares over a 12% annual benchmark as defined in the prospectus (this rate was 15% until 1st July 2005). For the year ended December 31, 2005 an incentive fee amounting to 412.42 USD was charged for the Class A and Class B shares, futher crystallisation of performance subsequent to redemptions. The Fund’s performance during the full year did not exceed the benchmark.

## 5. Custodian and administration fees

The Sub-Fund shall pay to the Custodian Bank an annual fee between 0.04% and 0.08% of the Net Asset Value.

The Sub-Fund shall pay to the Central Administration an annual fee up to 0.08% of the Net Asset Value subject to a minimum annual fee of 19,600.00 USD

# Notes to the financial statements at December 31, 2005

## 6. Open positions on forward exchange rate contracts

At 31/12/05, MARGIN OF SAFETY FUND - Fund 1 had the following open positions:

| Purchase | Sale | Maturity date | Unrealised Appreciation/ Depreciation in USD |
|---|---|---|---|
| 4,791,150.00 USD | 3,900,000.00 EUR | 25/01/06 | 184,563.83 |
| 121,612.50 USD | 100,000.00 EUR | 25/01/06 | 3,496.39 |
| 186,570.00 USD | 150,000.00 EUR | 25/01/06 | 9,390.85 |
| 220,000.00 EUR | 271,139.00 USD | 25/01/06 | -11,279.25 |
| 315,000.00 EUR | 387,702.00 USD | 25/01/06 | -15,630.71 |
| 480,000.00 EUR | 607,536.00 USD | 25/01/06 | -40,550.10 |
| 92,000.00 EUR | 111,439.60 USD | 25/01/06 | -2,773.31 |
| 400,000.00 EUR | 483,120.00 USD | 25/01/06 | -10,659.57 |
| 500,000.00 EUR | 591,950.00 USD | 25/01/06 | -1,388.82 |
| 290,000.00 EUR | 349,450.00 USD | 25/01/06 | -6,917.16 |
| 200,000.00 EUR | 240,380.00 USD | 25/01/06 | -4,151.20 |
| 9,100.000.00 USD | 5,200,000.00 GBP | 25/01/06 | 149,392.27 |
| 347,440.00 USD | 200,000.00 GBP | 25/01/06 | 3,185.62 |
| 174,620.00 USD | 100,000.00 GBP | 25/01/06 | 2,492.89 |
| 515,562.00 USD | 290,000.00 GBP | 25/01/06 | 16,394.25 |
| 245,119.00 USD | 133,000.00 GBP | 25/01/06 | 16,191.16 |
| 120,000.00 EUR | 145,542.00 USD | 25/01/06 | -3,807.63 |
| 177,280.00 USD | 100,000.00 GBP | 25/01/06 | 5,152.66 |
| | | **TOTAL** | **293,102.17** |

## 7. Co-management

In order to reduce operational and administrative charges while allowing a wider diversification of investments, the Company may decide that part or all of its assets will be co-managed with the assets belonging to other collective investment schemes.

Each Co-Managed Entity holds a proportion of the Co-Managed Assets corresponding to the proportion of its net assets to the total value of the Co-Managed Assets.

In 2005, the SICAV did not use the co-management’s facility and has no plans in the near future to do so.

## 8. Statement of changes in Portfolio

The statement of changes in portfolio is available free of charge at the SICAV’s head office.

## 9. Change occurred during the year

From October 3, 2005, any references to *Crédit Agricole Investor Services Bank Luxembourg (CA-IS BL)* shall be understood as CACEIS Bank Luxembourg (CACEIS BL); this change of name results from the partnership between Crédit Agricole Group and Groupe Caisse d’Epargne at the level of Securities and financial Services. Moreover on October 3, the Registered Office of CACEIS BL and of the Fund has moved from 39 allée Scheffer, L-2520 Luxembourg to 5 allée Scheffer, L-2520 Luxembourg.

# Notes to the financial statements at December 31, 2005

## 10. Post balance sheet events

Pastel & Associés SA has obtained from the Commission de Surveillance du Secteur Financier (« CSSF ») the authorisation to act as sole Promotor. Consequently, CACEIS Bank Luxembourg will no longer pursue its co-sponsorship upon issuance of the next prospectus.