MFM HATHAWAY FUND

INVESTMENT ADVISER'S REPORT

For the year ended 30th September 2009

Performance

We have pleasure in presenting our annual report on the MFM Hathaway Fund – an *equity and bond* unit trust – which posted an overall portfolio advance in the year of +4.3%, resulting in a 3.285p increase in an *accumulation* unit (which class records exactly the *total return* on the fund), against a background of a return of +6.1% in the stock market (+5.3% from blue chips); since we started in November 2002, those units have advanced from 50p to 79.87p – equivalent to annual compounding of approximately 7.0%. The table below illustrates that longer term record in comparative terms.

Year	MFM Hathaway Fund	Benchmark (30% gilts, 70% equities)	FTSE 100 (equities)	FTSE All Share (equities)	FTSE All Stocks (gilts)
2002/2008	+53.1%	+49.6%	+49.9%	+57.7%	+29.2%
2008/2009	+ 4.3%	+ 7.8%	+ 5.3%	+ 6.1%	+11.8%
Cumulative	+59.6%	+61.2%	+57.8%	+67.3%	+44.4%

The fund therefore lagged our benchmark in the year (as it has done several times before), but is up almost level with that guide since launch – it being a good proxy for the average conservative private investor's portfolio, while it is also demanding and tells us, long term, roughly where we ought to be (and more information about it are in notes 2 and 3 at the end). However, that notional index is made up partly of the broader FTSE All Share Index (as to 70%) so, given that our equities are mainly "blue chips", we have also included the FTSE 100 in the exhibit above and you can see that we remain ahead of large capitalisation stocks (which of course constitute that record).

Equally, we have previously described, at some length, how we have favoured bonds as to as much as 45% of the fund since we started (now they are only around 20%) and so, to achieve 101% of the return from large cap stocks and 95% of that from general equities over seven years, while taking materially less risk, represents a fair performance so far.

In this context, it is interesting to see for once how we have fared against general investors with a similar stance: on 3rd October, the "FT" carried a table of 30 large private client managers showing the performance of their "balanced" portfolios, which are broadly comparable with the MFM Hathaway Fund. In the five years to 31.12.08 (a slightly eccentric period to use it has to be said) the average *total return* was +4.5% and the best was +11%; our fund, alongside, recorded +17.3%.

As the article we quote, also contained much handwringing about certain managers' losses in hedge funds, property shares and "structured products", it seems clear that, paradoxically, taking greater risk does not always lead to better returns over the long term. In that context, we could also look at our performance in the league tables of comparable unit trusts or life assurance office (insurance company) funds and it is likely that we will devote space in future reports to these.

Furthermore, it is gratifying to see us ahead of an all-bond commitment (*i.e.* the +44.4% return from the FTSE All Stocks Index) and we also now record a tenth positive result – *i.e.* in *absolute* terms - from thirteen semi annual or annual reports.

Lastly on our record, against the background now of a complete stock market cycle (the table above "hides" the down turns) – really the only period over which, objectively, you can form an opinion as to investment performance – it is gratifying to contemplate again the return being well ahead of the level of risk we have taken with our unit holders' money (again, also see note 3 below). This "cake and eat it" situation, is additionally pleasing to record, as we expect to do better in bear markets than bull conditions and the latter prevailed for much of the seven years.

Investment activities

In the year we were again uncharacteristically active and, predominantly, we favoured equities as they became available at prices that made sense : for example, Dr Pepper in soft drinks in the US (principally), American Express (in travellers cheques and debit cards) and Proctor and Gamble (in consumer goods) and we were increasingly enthusiastic about some of our existing holdings, such that we added to them (Brambles, Diageo and BP); we also benefitted from the possible takeover of Cadbury by Kraft foods.

As we fished on the bottom, we did buy one or two securities which worked out less well – for example Northgate in van hire. Meanwhile, the outcome of the Lloyds takeover of HBOS leads us directly to contradict what we said about it a year ago: we are now *not* comfortable with our holding in it since - as all poor investments do in the end - it is throwing up one unwelcome decision after another and has destroyed all but hope value, such that we now see it as having an end date on it (otherwise you are investing in a start up with a poor track record).

It is no compensation, to consider our other bank holdings which are doing well, or to smile at the amusing comment from one Lloyds shareholder: “if it wasn’t for bad luck, I wouldn’t have had any luck at all”; more encouragingly, our mistakes have been few and far between so far.

It is therefore pleasing that, despite one or two unwise moves, we did quite well with our equity portfolio in the year - we played our hand reasonably wisely (particularly moving from bonds to equities) - and we added some great businesses (and one or two funds as well) to our list, so that our collection now looks increasingly well-placed.

Outlook

We said a year ago that equities “are now set to deliver acceptable returns once again” and that proved accurate and we also remarked that “the stock market…is likely to move higher well before the economy or sentiment demonstrably improve...the outlook is currently attractive” and that also turned out to be right (although in both cases we had no insight as to *when* those statements might be proved correct); in March, we noted the beginning of the end of the gilt bubble, and although it has certainly not burst, they have advanced no further since then.

As ever, we do not (nor does anyone) have the faintest idea where general business or the stock market are going to go in the next year or two (fortunately for our investors we do not need to form a view), but we are nonetheless seeing some signs of a retreat from volatility and such developments (positive or negative) rarely reverse quickly; in this environment, we will do our best to capture as much of the available returns, without compromising security.

Equities are now the place to be and therefore, within the framework of our mandate, we will be looking increasingly to them to provide our returns and so most of our time is now spent looking at them rather than bonds; a year or so ago, we also worked hard in fixed income markets, but the great opportunities there (like SEGRO bonds) are now largely exhausted and unlikely to return any time soon.

Finally, we would remind our investors to keep expectations to a sensible level and that all securities markets are two way streets.

We look forward to reporting the interim performance in the spring, while more about our *value investing* philosophy and the current fund prices and performance are on our website. As ever, we close by thanking Marlborough who, as managers and registrars, do a first-class job on the housekeeping and Barlow Andrews likewise with the audit; both houses, provide us with a standard to try to emulate.

Graham Englefield
Robert Bogle
Graham Shaw
04.11.09
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Notes

1. Statistical source: the benchmark figures we quote in the table above are derived from statistics recorded in the Financial Times newspaper (and all are calculated on a *mid-to-mid* price basis, with net income reinvested); the MFM Hathaway Fund, equally, shows performance based on the mid-price of *accumulation* units, so that all figures in the tables are on the same footing. Movements in the price of an *accumulation* unit, provide a complete record, since accrued income is included alongside capital performance.

2. “Equities” means company shares and the FTSE All Share Index (what we generally mean by “the stockmarket”) records the experience of a commitment to almost all quoted companies; “Gilts” means UK government bonds, while the FTSE All Stocks Index is an average of all those in issue and so we use that to prepare the bond part of the benchmark. The FTSE 100 Index covers just the largest quoted companies (the “blue chips” or “large capitalisation” or “large cap” stocks), but we use the first two indices (as to 70:30) in calculating our benchmark.

3. The benchmark is intended as a rough guide to how well the portfolio has been invested over any period (particularly the allocation between bonds and equities) and it reflects how a typical conservative private investor’s portfolio might be constructed; one reason why it is only an indicator though, is that it is impliedly continually rebalanced to 70:30 each day (as statistically it must be). Our most meaningful goal then, long term, is to get the same or a better return than equities (the toughest test long term), while taking materially less risk than them over a market cycle (so a bare minimum acceptable performance would be to match that return which the amount (and type) of equities which we have actually held would have produced (and that is approximately +49% so far)).

4. The cumulative figures in the last line of the tables very accurately show the *total return* from 25.11.02 to 01.10.09; any apparent discrepancy, from a simple aggregation of annual and semi-annual statistics (either here or in previous reports), is explained by rounding each year in preparing the discrete statistics.

5. Any references to “year” (or, for example, “2002/2008”) in the tables or the text, is to the fund year – October 1st to September 30th, except for 2002/03 (shown in previous reports – but contained in aggregate numbers here), which is for the period 25th November 2002 to 30th September 2003. The actual valuation dates for the unit trust (and therefore the comparative indices/benchmark) may, in some years, vary by a day or so from these dates, but we are consistent in using the same dates in subsequent periods.