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Before reviewing the progress of commodities markets and our funds in July, it would seem prudent to quickly review the events of the last couple of days.

The US credit rating being cut by Standard & Poor's is yet another macro headwind for markets, in what seems to have been a continuing saga of problems that have plagued global growth for the last six months. As a result, it seems likely that there will be a tendency for the media to whip this news into a frenzy, causing consumers, investors and governments to act more conservatively. If there is seen to be a risk of a recession, this tendency can lead to the danger of a self-fulfilling prophecy.

So how does this affect our funds? In terms of collateral, virtually all of our collateral is held in US T-bills with maturities shorter than 6 months. With the new debt ceiling approved, we do not expect the US to default in any short-term debt, but could see a steepening of yield curves which would most likely affect those issues past 10 years in the curve. As such, this will not affect our holdings. We are as conservatively placed as we can be, and still think that the T-bill will be the safe haven of choice in the forthcoming months.

In terms of commodities exposure, we remain fully invested. The downgrade is likely to increase investors' level of defensiveness; commodities have been viewed as a safe-haven relative to other risk assets recently, particularly as gold and precious metals make up around 13-14% of the DJUBS TR Index, so we would expect commodities to outperform other asset classes.

Commodities gained in July, producing a solid performance versus both bonds and equity markets. Improving fundamentals as well as investor buying, reflecting the increasing view that commodities represent something of a safe haven, both contributed to the month's gains. The DJUBS TR Index gained 3.0%, led by precious metals which gained 9.5% and within PGMs silver was the best performer recovering 15%. Continued Sovereign debt issues on both sides of the Atlantic fuelled demand for precious metals as it became evident that the investor world is running low on safe havens. Grains increased 5.4%, partially on a recovery from their oversold state at the end of June. This was further driven by deteriorating weather in North America which threatened the size of the 2011 harvest, not only in wheat but also in corn and to a lesser extent soybeans, in a year where inventories desperately need replenishing. Energy lagged, advancing only 1.7% as weakening global economic growth in OECD countries and continued tightening in emerging market countries weighed on prices.

In this environment, the Threadneedle Enhanced Commodities Fund gained 3.64%, outperforming the DJUBS TR Index by 0.64% over the month. This brings the fund's year to date outperformance to 6.2%, resulting in a year to date absolute performance of 6.5% versus the benchmark which only gained 0.3%. This means that the fund is comfortably exceeding its objective of generating returns over benchmark of 3-6% on an annualized basis.

Outperformance in July was generated from positions in energy, which were overweight gasoline and distillates and underweight US natural gas. The fund was neutrally weighted in crude oil, but positioned largely in Brent oil.

In metals, the fund was overweight lead at the expense of nickel and aluminium, but neutral across that sector, and positioned neutrally also in precious metals.

In agriculture, the fund was underweight grains and oilseeds as well as positioned further back on the curve in new crop months and in softs, it was overweight sugar and underweight cotton.

In livestock, the fund continues to be positioned in feeder cattle rather than live cattle or lean hogs.

On a 12 month horizon, we are bullish commodities, owing to the continued growth of emerging market economies, which are increasing their consumption of resources at a rapid rate and the relative restricted ability to materially increase production across a number of key commodity markets. Additionally, we have recently seen Mexico and Taiwan buy significant sums of gold, and I believe we will continue to see EM central banks buying gold as a diversifier away from US Dollars and Euros in their reserves, particularly as they continue to add foreign currency reserves at a rapid rate.

The Threadneedle Apex Commodities Fund generated a positive 1.65% return after fees in July with contributions from across the portfolio. Our relative value position in gasoline/Brent and short US natural gas started to perform leading to 43bp of gains, while our corn volatility position rebounded as well contributing 17bp. Our long gold and platinum positions added 30bp and overall our resource equities contributed 53bp. Other relative value positions added the balance.

In general, we believe there are short term headwinds for commodities and the markets in general, with a significant risk that Western governments continue to flounder and whip up an overly defensive response from businesses and consumers worldwide. There seems to have been a steady torrent of bad macro news from Europe and the US for the first 7 months of this year, which in my view has been largely self-inflicted. But economic activity continues, and short of another financial disaster, the environment for commodities remains constructive and if we can get to the other side of the macro headwinds, we can return to focusing on market fundamentals.

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