

Newsletter & Quarterly Attribution Analysis

Threadneedle (Lux) Enhanced Commodities Fund

Information for Investment Professionals

April 2012

Threadneedle (Lux) Enhanced Commodities Fund

Portfolio characteristics

Fund Description	Threadneedle (Lux) Enhanced Commodities Fund (TECF) is an actively managed long-only commodities fund that uses derivatives to gain exposure to commodity indices or sub-indices composed of futures contracts on physical commodities.
Fund Managers	David Donora and Nicolas Robin
Benchmark Index	DJUBSCI TR
Target Return	Benchmark plus 3-6% per annum
Risk Budget	Expected tracking error up to 6%
Launch Date	29 June 2010 (fully invested C.O.B. 30 June 2010)

Highlights

- Commodity markets corrected in March after a strong performance recorded in the first two months of the year

- Correction led by Energy Sector

- Energy excluding natural gas held up well in March, driven by positive performance in Brent crude oil and refined products

*as at 31/03/2012

Total AUM

US\$: 555.0m

Institutional share class ISINs

US\$: LU0515769775

EUR-hedged:
LU0515769932GBP-hedged:
LU0515770435

Retail share class ISINs

US\$ (AU):
LU515768298EUR-hedged (AEH):
LU515768454GBP-hedged (AGH):
LU515768884

Overview

Commodity markets corrected in March after the strong performance recorded in the first two months of the year. The Dow Jones UBS Commodities Index fell by 4.1% for the month, led by losses in natural gas and the metals complex. In natural gas, the weakness exhibited by the March contract expiry at the end of February was confirmed by a dismal performance in March. Prices fell by more than 20% for the month as the production cuts announced by Encana, Conoco and Chesapeake failed to produce more than a brief short covering. Energy excluding natural gas held up well in March, driven by positive performance in Brent crude oil and refined products.

Enhanced Commodities Performance to 31 March 2012

	1 month	3 months	Year To Date	1 year	Since launch (cumulative)	Since launch (annualised)
TECF (Gross)	-1.77%	6.23%	6.23%	-4.43%	35.96%	19.19%
TECF (Net)	-1.89%	5.84%	5.84%	-5.87%	32.39%	17.39%
DJUBSCI TR	-4.14%	0.87%	0.87%	-16.29%	13.00%	7.23%
Relative*	2.47%	5.31%	5.31%	14.17%	20.32%	11.15%

Source: Morningstar. Net performance based on Institutional share class USD, Global Close prices, unadjusted income reinvested. Gross performance based on Global Close prices, unadjusted income reinvested, and the TER (Total Expense Ratio). *TECF Fund Gross v DJUBSCI TR. Please note the relative return shown is the geometric relative.

Performance analysis - key elements of relative return

The fund outperformed its benchmark, continuing the strong relative performance recorded for the last three months. Relative performance was driven by gains in the energy complex, with small positive contributions in base metals and livestock and small negative contributions in grains and softs.

In energy, the underperformance of US natural gas relative to the rest of the sector allowed us to generate 2.5% of outperformance. We had maintained our large overweights in refined products on the expectation that emerging markets demand would continue to support the complex while refinery closures were likely to take their toll in the Atlantic Basin's physical market incrementally as we moved into the summer driving season. Gasoline spot markets started to improve seasonally with US inventories beginning their seasonal decrease driven by refining maintenance in the US market. As a result, we saw a sharp increase in backwardation in the US gasoline market during March, a move that we had anticipated and expect to continue as we get closer to the US driving season. Performance across other sectors was close to flat in March, although we generated a small outperformance in base metals, driven by our underweight in aluminium.

Activity

With weather effects subdued and the injection season starting in mid-March this year, natural gas inventories are now 50% above long-term averages and at historical highs for this time of the year. There have been anecdotal reports of some US natural gas storage facilities, especially in the producing region, triggering interruption clauses in interruptible storage contracts. This suggests that storage capacity is already constrained. Such interruptions usually occur at the end of the injection season. Ultimately, we expect that the downward pressure on the market will be maintained by lack of available storage, and have therefore maintained our large underweight in US natural gas.

Elsewhere, we have closed our underweight in copper tactically. In softs, we continue to carry no position in coffee and cotton as we see further downside potential in both markets. In grains, we continue to prefer the soybean complex and high protein wheat over wheat and corn.

Outlook

Going forward, our conviction trades in the energy sector remain unchanged. We continue to believe that oil based energy will be driven by the supply-side and geopolitical tensions in the Middle East over the coming months. We still carry our largest overweights in refined products and have seen our position in US gasoline benefit from a material tightening in the US physical markets. Conversely, we expect that US natural gas will continue to weaken on storage concerns, as we entered the injection season with inventories at all-time highs for this time of the year.

Weights and attribution – 31 March 2012

	Fund weight (%) as at 31 March	Fund contribution (%) for the month
Commodity		
Aluminum	0.00%	0.00%
Copper	7.66%	-0.09%
Lead	0.00%	0.00%
Nickel	7.23%	-0.59%
Zinc	3.18%	-0.19%
Brent Crude Oil	10.57%	0.04%
Gas Oil	6.94%	0.04%
Heating Oil	3.44%	-0.02%
Natural Gas	0.81%	-0.21%
RBOB	10.93%	0.14%
WTI Crude Oil	2.85%	-0.11%
Corn	5.57%	-0.47%
Soybean Oil	4.51%	0.05%
Soybean	8.96%	0.46%
Wheat	4.26%	0.15%
Feeder Cattle DJUBS	3.53%	-0.29%
Feeder Cattle GSCI	2.16%	-0.18%
Lean Hogs	0.00%	0.00%
Live Cattle	0.00%	0.00%
Gold	10.01%	-0.23%
Silver	3.11%	-0.20%
Coffee	0.00%	-0.04%
Cotton	0.00%	0.00%
Sugar	4.10%	-0.10%
Sectors		
Base Metals	18.07%	-0.88%
Energy	35.55%	-0.12%
Grains	23.48%	0.19%
Livestocks	5.69%	-0.47%
Precious Metals	13.12%	-0.43%
Soft	4.10%	-0.14%

Source: Threadneedle as at 31 March 2012

Performance Attribution Analysis – YTD 2012

	Returns			Contributions			Attribution		
	Port. Total Return	Bench. Total Return	Variation In Total Return	Port. Contribution To Return	Bench. Contribution To Return	Variation in Contribution To Return	Geometric Allocation Effect	Geometric Selection Effect	Geometric Total Effect
Base Metals									-0.54
Aluminum	-	-3.26	-	0.09	0.07	0.03	0.07	-0.03	0.04
Copper	10.75	11.11	-0.36	0.50	0.74	-0.24	-0.16	-0.01	-0.17
Lead	-	--	-	0.26	--	0.26	0.05	--	0.05
Nickel	-5.00	-5.22	0.22	-0.29	-0.14	-0.14	-0.27	0.01	-0.26
Zinc	-5.56	7.73	-13.29	-0.20	0.19	-0.39	-0.17	-0.03	-0.20
Energy									5.71
Brent Crude Oil	15.21	8.78	6.43	1.00	0.49	0.51	0.53	0.02	0.55
Crude Oil	3.57	3.05	0.53	0.34	0.37	-0.03	-0.13	0.01	-0.12
GasOil	10.36	--	10.36	0.48	--	0.48	0.53	--	0.53
Heating Oil	11.73	10.83	0.90	0.77	0.39	0.37	0.19	0.03	0.23
Natural Gas	-27.58	-36.96	9.38	-0.62	-3.78	3.16	3.13	0.20	3.33
RBOB	18.28	19.43	-1.15	1.84	0.65	1.19	1.21	-0.11	1.10
Grains									-0.28
Corn	-7.76	-1.11	-6.65	-0.52	-0.12	-0.39	-0.03	-0.42	-0.39
Soybean	14.19	15.37	-1.18	1.10	1.06	0.04	0.12	-0.09	0.03
Soybean Oil	4.30	4.34	-0.05	0.20	0.16	0.04	0.06	-0.00	0.06
Wheat	2.24	-0.01	2.25	0.12	0.06	0.06	-0.05	0.08	0.03
Livestocks									0.18
Feeder Cattle	-2.34	--	-2.34	-0.12	--	-0.12	-0.18	--	-0.18
Lean Hogs	--	-4.52	4.52	--	-0.10	0.10	0.12	--	0.12
Live Cattle	-1.52	-5.63	4.12	-0.00	-0.20	0.19	0.23	--	0.23
Precious Metals									-0.02
Gold	7.26	6.35	0.91	0.80	0.76	0.04	-0.06	0.05	-0.01
Silver	16.21	16.15	0.06	0.50	0.48	0.01	-0.01	0.00	-0.01
Soft									0.25
Coffee	-	-20.44	-	-0.16	-0.52	0.36	0.37	-0.01	0.36
Cotton	--	0.35	-0.35	--	-0.01	0.01	0.03	--	0.03
Sugar	4.74	9.81	-5.07	0.20	0.35	-0.15	0.06	-0.21	-0.14
[Collateral & Cash]									0.09
[Collateral & Cash]	-	--	-	0.01	--	0.01	0.09	--	0.09
Total	6.30	0.88	5.42	6.30	0.88	5.42	5.91	-0.51	5.37
Unit Price Timing	-0.07	0.00	-	-	-	-	-	-	-
Total	6.22	0.89	5.33	-	-	-	-	-	5.29

Source: Factset. Past performance is not necessarily an indicator to future performance. Returns are calculated daily using global close valuations and cash flows and are chain linked for longer time periods. Performance includes gross re-invested income and is gross of fees. Attribution is calculated daily using geometric measurement. Data from 31 Dec 2011 to 31 March 2012 (in USD) Benchmark is DJ UBS Commodity Index from 31 Dec 2011 to 31 March 2012 (in USD)

Attribution Analysis YTD Q1 2012 Sector breakdown:

Energy +5.71%

The outperformance in the sector was driven by a relative value position held between natural gas +3.33% and RBOB gasoline +1.10%, which contributed a total of +4.43% for the quarter. The US gasoline market continued to drive the sector higher by rallying nearly 18.61% on the quarter on the back of more refinery closures in the US affecting both the US Northeast and the Gulf of Mexico. We also held a large overweight in distillates which generated +0.76% of outperformance.

While products strength continued to dominate the oil complex, US Natural Gas continued to be affected by rising inventories relative to averages and mild temperatures in the US market. By the end of March, US Natural Gas inventories were running more than 50% over long term averages, leading to a fall of nearly 40% of the Natural Gas index since the start of the year in spite of announced production cuts by key players. In crude oil, we continue to prefer Brent over WTI and were slightly underweight the crude oil market during the quarter generating +0.43% of outperformance.

Base metals -0.54%

After rallying strongly in January, the base metals complex corrected during the quarter as growth prospects for China were downgraded and negative sentiment regarding the Eurozone continued to dominate. We maintained a large overweight in Nickel, a large underweight in Aluminium and smaller underweight in Copper. We generated slight positive contributions in Aluminium and Lead, and small negative contribution in Copper, Nickel and Zinc.

Precious metals -0.02%

We were essentially market weight in across the Precious Metals complex throughout the first quarter of this year, and generated a slightly negative relative performance of -0.02%.

Grains -0.28%

The grains complex was volatile during the quarter. After an initial sell off during the index rebalancing window, the market recovered

nicely during the quarter led by the Soybeans complex. We have been slightly overweight in the sector for most of the quarter. We continue to prefer high protein wheats over Chicago Wheat and have had a small overweight in the Soybean complex. In Corn, we have been affected by a flattening of the forward curve towards the end of the quarter which cost about -0.39%. We continue to expect that the old crop/new crop spread will weaken as we move into the index roll window.

Softs +0.25%

We increased our underweight positions in Cotton and Coffee during the quarter and maintained a small overweight in Sugar and generated an outperformance of +0.25% in the sector. In Coffee, we generated +0.36% of relative performance as the market continued to liquidate. We generated a small underperformance in the Sugar market -0.14% and a slight positive performance in Cotton +0.03%.

Livestock +0.18%

We continue to favour Feeder Cattle over Lean Hogs and Live Cattle during the quarter. This relative value position continued to deliver positive relative returns +0.18%.

Key risks

Market Risk: The value of investments can fall as well as rise and investors might not get back the sum originally invested, especially if investments are not held for the long term. **Currency Risk:** Where investments are made in assets that are denominated in foreign currency, changes in exchange rates may affect the value of the investments. **Political and Financial Risk:** The fund invests in markets where economic and political risk can be significant and where governance and regulation may not be well developed. These factors can affect liquidity, settlement and asset values. **Liquidity Risk:** The fund invests in assets that are not always readily saleable without suffering a discount to fair value. The portfolio may have to lower the selling price, sell other investments or forego another, more appealing investment opportunity. **Volatility Risk:** The fund may exhibit significant price volatility. **Basic Risk:** The fund invests in commodity derivatives rather than physical commodities. Therefore, changes in the prices of the underlying commodities will not be mirrored exactly in the fund price.

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The Portfolio invests in commodity indices comprised of futures contracts on physical commodities in certain sectors. As these futures contracts approach expiration, they are replaced by contracts that have a later expiration. Depending on the prevailing prices in the underlying market, this could positively or negatively impact the portfolio. Commodity prices may change unpredictably, affecting the index and the level of the index and the value of the Portfolio in unforeseeable ways. The portfolio invests in single commodity indexes which may be particularly susceptible to fluctuation and may fluctuate rapidly based on numerous factors. The commodities underlying the Index components may be produced in a limited number of countries and may be controlled by a small number of producers, political, economic and supply related events in such countries could have a disproportionate impact on the prices of such commodities and the value of the index.

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