NCB

October - December 04
Issue 2

Invest In Yourself

Asset Allocation - Not just an afterthought

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WEALTH MANAGEMENT

A QUARTERLY PERSPECTIVE FROM NCB

ASSET ALLOCATION – NOT JUST AN AFTERTHOUGHT

I have absolutely no idea where the old cliché 'Don't put all your eggs in one basket' came from, but it's certainly been around a very very long time... And it's hardly survived as long as it has, without there being more than a grain of truth to it.

Anyway, this simple cliché explains most (but not all) of what asset allocation is all about. It is essentially the process of dividing the capital in a portfolio across a range of different asset classes like equities, fixed interest, property and cash. It is, however, not just simply a matter of diversification, (although diversification, in itself, does reduce risk and is a very important part of it). The theory behind asset allocation develops the simple concept of diversification further, by analysing the historic risk (ie. volatility) and return profiles of different asset classes, and examining how these assets can be combined in a single portfolio to provide a particular level of future return with the least amount of risk. It's obviously not quite as good as owning your own crystal ball, but if you're lucky enough to have one of these, you don't have to worry about things like asset allocation!

The only circumstances where an investor could legitimately avoid looking at asset allocation is where they have absolutely no concern at all about risk. In those circumstances, they could simply load up on whatever asset class they fancied the most, and simply take their chances. However, since most investors actually do care quite a lot about risk, and want to make sure that they have enough money available to meet their long term goals, this cavalier approach really isn't good enough.

Essentially, an asset allocation process is about the very first thing we engage in when faced with a new client who wants us to manage money for them. It is not a secondary consideration or afterthought. It is the single most important job in constructing any investment portfolio.

Coming up with a suitable asset mix for a particular client is unfortunately not an exact science. But whether you adopt a very detailed mathematical approach (which can be done) or you simply make sound judgments based on experience, the asset allocation job absolutely needs to be done.

Done sensibly, with an experienced investment advisor, this process will ensure that a portfolio is constructed with the right blend of assets and with appropriate risk/ reward characteristics. Done without due consideration, the portfolio is almost doomed to underachieve from the outset, and no amount of skillful stock picking, bond or fund selection or even personal genius, is likely to compensate for the structural flaws.

A number of international studies have shown that asset allocation can be responsible for over 90% of portfolios longer term investment performance, with other factors such as market timing and individual stock selection coming in a very distant second and third place.

So what is the key message to private investors? It's very simple. If the most sophisticated brightest money managers in the world take asset allocation seriously, then you should too! And remember, its not a job that is done once at the outset and never done again. This is a very common mistake. It really needs to be done again and again during the life of the portfolio. Not only do the prospects for different asset classes change, investors change too!

Greg Dilger – Head of NCB Wealth Management.

JOE HANRAHAN - HEAD OF PERSONAL FINANCIAL SERVICES

INVEST IN YOURSELF AND NOT THE TAX MAN!

As we approach October 31st, many self-employed people will be focussing their attention on the payment of final tax due for 2003 and will be making a payment of preliminary tax for 2004. Ouch! We can all think of more worthy causes to contribute to.

For starters who better to contribute to than yourself and your family!

October 31st is very significant for the self-employed because it represents the last opportunity to reduce the final tax due for 2003 and, at the same time, reduce the amount of preliminary tax due for 2004 by means of a Pension Contribution. And, with the arrival of Approved Retirement Funds (ARFs), the fact is that any pension contribution made in this way not only reduces tax, but can be kept in retirement as a nest egg to be used and passed on to family as needs be.

Pension planning, therefore, is now an integral part of tax planning, wealth management, investment management and estate planning. This often maligned activity is now one of the most effective ways for self employed people to build up a significant capital sum.

Clearly, the tax reasons for making pension fund contributions are very compelling as the example below demonstrates. Frequently, however, clients tell us that they can't afford to make pension contributions or that they use their available funds to invest outside this structure because of a perceived lack of control over the investment decision making process. Both of these assertions generally don't hold water.

Saving tax, building up a fund in a tax free environment whilst at the same time controlling your own fund's destiny is now becoming an extremely popular and rewarding way to plan for retirement. Take the example below:

Self-Employed Accountant aged 53

Net Profit €100,000* (Max Pension €30,000 (30%) (Tax Relief 42%)

Tax Liability €32,900

Preliminary tax paid in 2003 of €20,000

No Pension		**With Pension**	
2003 Final Tax	€32,900	2003 Final Tax	€32,900
(Less 2003 Preliminary Tax)	(€20,000)	(Less tax relief @42% x €30,000)	(€12,600)
		Revised Final tax liability 2003	€20,300
		(Less 2003 Preliminary Tax)	(€20,000)
2004 Preliminary Tax		2004 Preliminary Tax	
(100% of '03 Final tax)	€32,900	(100% of '03 Final tax)	€20,300
Pension Contribution	Nil	Pension Contribution	€30,000
Total Outlay Oct '04	**€45,800**	**Total Outlay Oct '04**	**€50,600**

*Earnings after expenses/capital allowances

The net cost of a contribution of €30,000 to a personal pension fund is €4,800. At retirement, 25% of whatever this contribution accumulates to can be taken out of the fund tax free and the balance can be kept either as cash (taxable) used to buy an income or an Approved Retirement Fund. In addition, the older you get the greater the scope you have to claim tax relief on your contributions. A self employed person can always contribute up to 15% of their income (up to a cap of €254,000) for tax relief purposes. This rises to 30% for those who are 50 or over.

The taxman gets less, you get more!

And it gets better. Investors in pension funds also enjoy the very significant benefit of not being liable to income tax or capital gains tax on any securities/assets held within the pension structure. Returns, therefore, compound over the full life of the investment and potentially add to the final fund value which can be taken at retirement.

So why do many investors choose to ignore this when making their investments? Why do they not avail of the enormous benefits now available?

Unlike executives and directors operating through a 'company' and capable of setting up their own bespoke Small Self Administered Pensions (SSAPs), self employed investors don't have this option and feel that they are reduced to investing solely in the range of pooled funds offered through the main domestic life companies.

Feedback suggests that for many self employed clients, the perceived lack of control over how their money is invested is one of the principal drawbacks. Moreover, predicting future investment performance from historic results has been a less than rewarding strategy.

In a recent survey of fund managers' performance, many managers who were in the top quartile of performers in the period 1/12/97 to 1/12/2000 were at the back of the pack in the following three year period;

Predicting future performance from historic results

Top Quartile	29%
2nd Quartile	13%
3rd Quartile	37%
Bottom Quartile	21%

Source: Standard & Poors Micropal

Over 58% of managers performed below median demonstrating that the odds are firmly stacked against top quartile managers consistently repeating the feat!

So, following last year's best performer has, in the past, undermined the confidence and willingness of some investors to make further contributions. This is one of the most frequent reasons we get from clients who don't bother to make use of pension entitlements.

Apart from the tax reliefs available, critical to the ultimate 'pot' available at retirement is the performance of the contributions over the life of the investment. So, is there any way for self employed investors in pension funds to retain control of those investments and to retain responsibility for their own destiny? The answer is a resounding 'Yes'.

The stockbroking response to this dilemma are called 'Self Directed pension funds' and they allow for almost complete control and discretion by the investor over what assets he or she wishes to include in a pension fund.

Self Directed uses the combination of an Insurance company (to provide the pension wrapper) and a stockbroker (to provide access to various investment instruments and to help with ongoing investment advice). The graph overleaf illustrates this perfectly.

The key to Self Directed is the control and flexibility of both contributions and investment timing. How many investors have made contributions to their pensions at a tax deadline only to discover that it was a poor time to invest in markets?

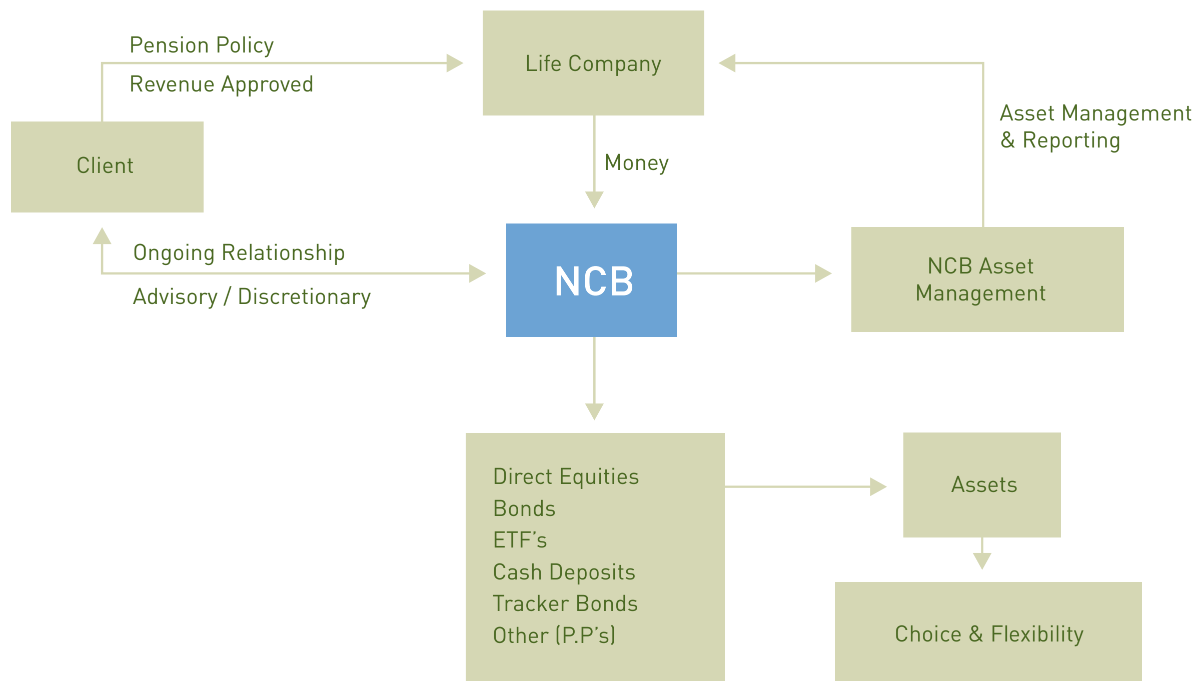
This is where Self Directed, with its access to a specific portfolio manager, daily research and information, quarterly valuations and a wide range of investments to choose from has begun to resonate with our clients.

Self Directed allows investors the latitude to determine what strategy best suits them and, ultimately, what pension fund they generate to keep at retirement. You can, for instance, be fully invested in equities or, alternatively, fully invested in cash. You have the freedom to be wherever YOU want to be.

A wonderful combination of tax relief, tax free investing, control and flexibility over investment decisions and the added pleasure of knowing that you have invested in yourself and not the tax man!!

For more information on personal pensions or retirement planning call Joe on 01 611 5611 or email joe.hanrahan@ncb.ie

How a Self Directed Pension works



Breaking News

Syndicated Property Funds

NCB has access to a range of syndicated blue chip commercial property investment opportunities in the UK and other select European locations. These investment opportunities are geared and are suitable for personal, company and pension fund investors.

Section 50 Student Accomodation

NCB still have access to a few units in River Walk the section 50 student accommodation scheme in Waterford. River Walk is a new development of 193 apartments specially designed for students and 99% of the purchase price (excluding the fit out cost) can be used to offset Irish rental income. River Walk will be completed in 2005 so investors will be able to claim allowances from 2005 and on.

New ETFs

The launch of the UK's first sterling bond and FTSE 250 ETFs by Barclays Global Investors (BGI) earlier this year has increased the range of markets that investors can now access cost effectively.

Airtricity does it again

There is further good news for investors in Airtricity. Last week Airtricity won two European awards at the Euromoney/Ernst & Young annual awards.

The first one was for the 'European Entrepreneurial Developer of the Year' and the second was for the 'European Green Electricity Supplier of the Year'.

For further details on the above call Killian on 01 611 5611
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NIGEL POYNTON - DIRECTOR, NCB WEALTH MANAGEMENT

DIVIDENDS – NOT TO BE UNDERESTIMATED!

Many investors are first attracted to the stockmarket by the potential for capital gains rather than dividend income. However, investing in equities with an emphasis on income is enjoying a resurgence in popularity as the volatile equity markets that we have witnessed over the past few years have increased the attractiveness of companies with dividend yields.

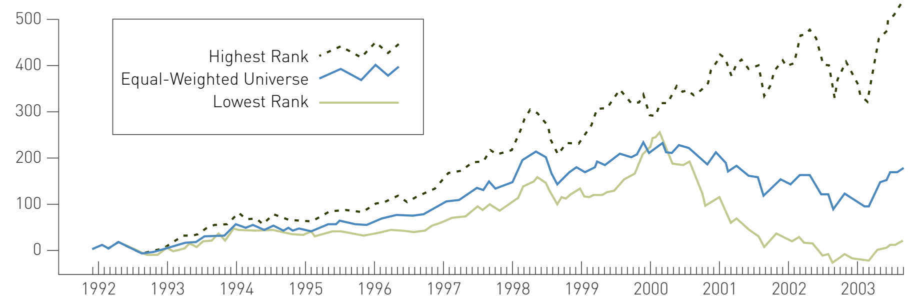
In this article we shall show that investing in high yielding stocks is a very valid strategy over the long term and we believe that intelligent stock picking is key to superior performance. Simply selecting stocks on the basis of an apparently high dividend yield is not enough.

It is worth noting at this point that investing in equities for dividends rather than just capital growth is not a new strategy but has been a long tradition in the investment management industry. America's very first mutual fund, the Massachusetts Investors Trust, launched in 1924 by MFS Investment Management, made the provision of a reasonable income one of its key objectives. And equity income investing now accounts for a significant proportion of fund management activity in the most developed countries.

As can be seen from the chart below selecting high yielding stocks is a strategy that has been successful over the long term.

A high yield strategy has quite clearly outperformed since 1992 and what is interesting to note is that this period included the technology bubble of the late 1990s, where low-yielding stocks (and indeed stocks paying no dividends at all) outperformed their more traditional dividend paying counterparts. In spite of this, the high yield strategy has outperformed over the long term.

Numerous studies have also been completed that corroborate the view that dividends account for a large proportion of the total return (ie. capital growth plus income) available from equities. One such study undertaken by the London Business School[1] showed that £100 invested in UK equities in 1900 would have risen to about £16000 by 2000 if dividends were spent but nearly £1,700,000 if the dividends had been reinvested. Clearly reinvesting dividends is crucial to the return you can expect from equities.



Universe DJ Stoxx 600 Dividend Yield Cumulative Performance (Source: Smith Barney)

Given these facts you could be forgiven for thinking that investors could ever doubt the importance of dividends, whether as an income producing investment in its own right, or for re-investment into the stockmarket. Yet you only need to look back to the period 1998–2000 when many investors were seduced away from reliable dividend producing stocks into 'new economy' and technology related stocks that offered the prospect large capital gains. In this environment, income investing fell deeply out of favour.

The investment cycle we currently find ourselves in is characterised by more conservative expectations of the total returns that can be anticipated from equity-based investments. Instead of the high double-digit returns experienced in the 1990s, we feel that investors should expect more modest returns in the region of 8–9% per annum over the next five to ten years.

Also, the general market consensus that interest rates are likely to remain at relatively low levels for the foreseeable future means that yields available from core fixed-income and money market investments are currently not particularly attractive. Therefore it is reasonable to assume that if this scenario is proved correct, the importance of income as a percentage of the total market return could become more and more important. On the other hand, should equity values remain broadly flat, or indeed fall, the income could also help make up for disappointing capital performance.

Elsewhere a recent Citigroup research report[2] has come up with a number of interesting conclusions from a study of income-based strategies for the European-centric equity investor (including UK). They also estimate that dividend income accounted for just under half of the total return from the UK equity market over the past seven years.

Citigroup also address the fact that whilst investors appear to be getting excited at the prospect of US equities delivering close to a 2% dividend yield, Irish, European and UK equities already deliver considerably higher yields – 2.6%, 3.2% and 3.6% respectively. Therefore global investors should place a greater emphasis on Irish, European and UK markets as they search for income. This viewpoint would also sit comfortably with NCB's overall investment strategy, which remains largely underweight US equities.

Interestingly Citigroup conclude that investors who wish to tilt their portfolios towards an income theme should look at those European sectors that tend to exhibit high yield characteristics and therefore should overweight sectors such as Banks, Insurance, Telecoms and Utilties; and underweight sectors such as Media, Tech, Pharma and Food & Beverages.

European Sectors – Current Dividend Yield

Yield >3.20%	
Utilities	4.69%
Banks	4.07%
Energy	3.48%
Insurance	3.40%
Financial Services	3.30%
Yield <2.50%	
Cyclical Goods & Services	2.39%
Healthcare	2.18%
Media	2.05%
Technology	1.23%

Source: Smith Barney

Another interesting statistic is that approx 20% of European stocks yield more than 10 year German bonds or UK gilts (ie. greater than 4.0% & 4.8% respectively) and with so many stocks, equity investors would have to have a bearish view in order not to be at least looking at some of these stocks (see table below).

European Large Cap Stocks Yielding More Than Bunds / UK Gilts

Stock	Current DY
Enel	9.37
United Utilities	8.49
Lloyds TSB	8.41
Telecom Italia Mobile	6.05
ABN Amro	5.85
Scottish & Newcastle	5.72
Electrabel	5.68
Scottish Power	5.51
Alliance & Leicester	5.41
Fortis	5.37
Scottish & Southern Engy	5.37
Unicredito Italiano	5.30
Legal & General	5.28
BT Group	5.25
Banche Popolari Unite	5.17
Electrolux B	5.14
Sainsbury (J)	5.08
ING Groep	5.06
British American Tobacco	5.01
Old Mutual	5.00
Endesa	4.94
Aegon	4.85
UPM-Kymmene	4.82
San Paolo Imi	4.81
Nordea Bank	4.70
Suez	4.70
Danske Bank	4.58
Akzo Nobel	4.57
RAS	4.57
ENI	4.53
DaimlerChrysler	4.44
Telecom Italia	4.44
Allied Irish Banks	4.41
Royal Dutch Petroleum	4.40
Sandvik	4.37
Iberdrola	4.35
Santander Central Hisp	4.33
SEB A	4.29
KPN	4.26
ForeningsSparbanken	4.23
Dexia	4.12
BBV Argentaria	4.10
Stora Enso R	4.10

Source: Smith Barney

As pointed out earlier in this article, simply selecting stocks on the basis of an apparently high dividend yield will not work. In fact, a high yield should often be treated with caution, as it could point to corporate distress or doubts over the ability of a company to honour its dividend payments. A strategy where high yielding stocks are screened based on the following key ratios makes a lot of sense.

- Historical Dividend Yield
- Forecast Dividend Yield
- Dividend Growth Rate
- Dividend Cover

To demonstrate that solely relying on dividend yield calculations to select stocks may not necessarily lead to outperformance, you only need to look back at investors who had bought telecommunications stocks in the late 1990s, without looking at the industry fundamentals and the subsequent impact that these had on valuation levels. Most investors who undertook this simplified approach underperformed both the market and telecommunications sector significantly.

To the end of the 1990s the telecommunications industry was largely concentrating on the future growth prospects that could be driven by the expansion of 'third generation' (3G) services, and the subsequent billions of euros spent acquiring licences to offer 3G services built up enormous amounts of debt which in many cases became too large to handle.

Quite rationally, financial analysts became concerned about the levels of the debt within the industry and these telecom stocks subsequently performed very poorly. Consequently, attention turned to the raising of fresh capital to restore stretched balance sheets and a number of these recapitalised companies became some of the market's best performers.

The key point to note is that, in this instance, focusing purely on dividend yield at the expense of analysing companies and their valuation would have been a poor investment strategy. We maintain our belief that high yield investing is a compelling investment strategy for the long term. However, we urge investors to look at fundamentals and valuation whilst accessing their investment decisions.

Finally it is important to know that whilst an investment strategy focused on dividends has delivered above average returns over the past decade there will very likely be periods when such a strategy shall underperform the broader market. However, we firmly believe that if this approach is 'fine tuned' and followed in a disciplined manner, it should produce satisfactory results.

Selected Irish Company Dividend Yields

Company	Yield
Viridian	5.6
Readymix	4.5
Allied Irish Banks	4.4
Greencore	4.4
Irish Life/Permanent	4.3
Bank of Ireland	4.2
Abbey	3.6
Fyffes	3.5

Source: NCB

References:

1 Triumph of the Optimists:
101 Years of Global Investment Returns - Dimson, Marsh & Staunton - London Business School - 2001.

2 Citigroup - Pan-Europe - Income focus - August 2004.

For more information on dividend investment call Nigel on 01 611 5611 or email nigel.poynton@ncb.ie

KILLIAN NOLAN - BUSINESS DEVELOPMENT MANAGER, NCB WEALTH MANAGEMENT

GUARANTEED FUNDS – STILL WORTH CONSIDERING

Actively managed, diversified investment funds with capital guarantees are emerging as a popular alternative to tracker bonds and with profit funds. Investors not only benefit from the returns achieved in a diversified, actively managed portfolio but they have the security in the knowledge that their original capital is secure.

NCB has recently analysed the full spectrum of funds available for risk averse investors and we feel that no individual fund appears to offer the flexibility and growth potential of the Hibernian Guarenteed Fund.

The Hibernian Guaranteed Fund combines a portfolio of high yield equities, Euro–zone bonds, Irish and/or UK commercial property with a five year 100% capital guarantee. The fund will start off with 1/3 invested in each sector, but Hibernian will actively manage this portfolio and can alter their weightings within the individual sectors.

Investment in the Hibernian Guaranteed Fund is a 5-year investment but investors can access their capital at any time or take an income of up to 6% per annum. It is also possible to switch over to the full range of funds available under the Hibernian Spectrum Bond (64 in Total).

Past performance figures cannot guarantee the future returns of a fund but it is always an interesting guideline as to how a fund has performed in alternative market conditions.

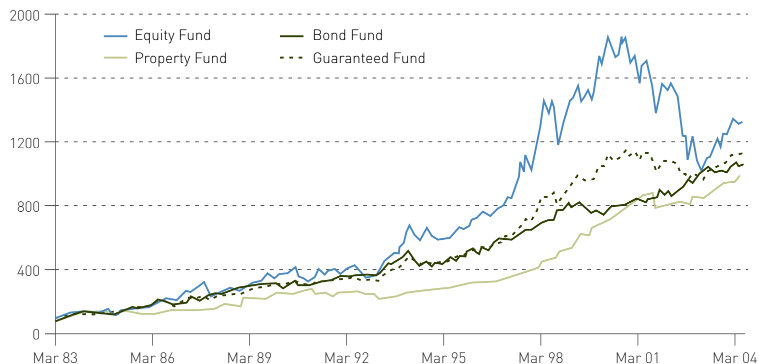
If you look at the attached graph you will see the performance of the 3 underlying funds that combine to make the guaranteed fund, over the past 21 years.

Asset Class	Annualised Gross Return over 21 years
Equity Fund	12.40%
Bond Fund	11.20%
Property Fund	10.80%
Guaranteed Fund	11.50%

Source Hibernian Life and Pension

If you are looking for capital security, a diversified portfolio that will be actively managed and may need an income or access to your original investment NCB recommends the Hibernian Guaranteed Fund.

For more information on Hibernian or any 'pooled funds' call Killian on 01 611 5611 or email killian.nolan@ncb.ie



Source Hibernian Life and Pension

EDDIE CLARKE - DIRECTOR, NCB WEALTH MANAGEMENT

CFDs – MAGIC OR MENACE?

Contracts for difference (CFDs) have certainly caught the interest of experienced private clients. Only relatively recently available to individual investors, they offer an innovative, cost effective and transparent, means of executing leveraged short term trading strategies.

In simple terms, a CFD is an agreement between an investor and a CFD provider/broker to pay the difference between the opening and closing price of an underlying security, typically a share or index, allowing the investor to profit or suffer a loss without ever actually owning the stock.

Gearing / Leverage

The powerful benefits of gearing have not been lost on the Irish property investor over the last decade, where a combination of a rising market prices along with leverage (debt) has produced amazing returns on capital. CFDs now provide experienced investors access to gearing for stock market trades in a systematic way and so effectively acts as an alternative credit provider to the traditional lenders. CFD funding is provided at a margin of 1% above benchmark Euro, Sterling and US Dollar cost of funds. So typically, with gearing available of the order of 5 to 10 times an investor can put on a trade of say €500,000 for an initial cash outlay of €100,000 (i.e. only 20% of the principal is required at the outset).

Cost Savings

By definition an investor never actually owns the share in a trade he/she is not liable for stamp duty. This consequently removes a meaningful upfront cost for short-term traders. Stamp duty stands at 0.5% of purchases of UK registered companies and 1% on Irish registered companies.

Short Selling Shares

Apart from gearing and stamp duty savings another feature of CFD trading is the ability to sell shares you do not own. This opens up the way for investors to profit from a falling as well as a rising market/stock.

Transparency

The prices at which securities are bought and sold through CFDs reflect those prices available in the underlying market.

So as you can see, CFDs can afford you pretty well all of the benefits of buying shares but without some of the associated costs. They are ideally suited to executing short-term trading strategies to capture available opportunities and act as a complement to rather than a replacement of, a well diversified investment portfolio. So what kind of successful strategies are we seeing and what issues should be borne in mind when deciding whether or not to invest via CFDs?

Going Long

Simply buying shares through a CFD and using gearing to magnify gains or losses. We've seen this strategy employed with great effect where investors have bought exposure to shares with relatively low volatility but with modest albeit upward price momentum. A recent illustration of this strategy where constant upward revision of earning forecasts in Tesco plc along with the positive effects of gearing has shown investors a handsome return with what they perceived to be a very tolerable level of risk.

Dividend Plays

The holder of a share through a CFD will be credited with a net dividend on the day the underlying share goes ex dividend. In theory, the underlying share price should adjust to take account of this, in practice where shares have good momentum behind them, they can continue to push ahead, leaving the investor with the benefit of the dividend and the possibility of a capital gain. We've again seen this strategy reap excellent rewards for investors in relatively lowly rated Irish and UK financials stocks with significant dividend yields. Whats more, we find many investors continue to have innate comfort investing in leading Irish and UK financial stocks and are consequently prepared to tolerate the increased risk that gearing brings with it.

Going Short

CFDs now provide a means for investors to speculate that a share (or indeed a market index or commodity) will fall back from its current level. We've recently seen clients take the view that the high price to earning multiples on which the NASDAQ index trades, is unsustainable and due for a downward correction. This is a very valid view, and a CFD is an ideal way to actually make that bet.

There are a myriad of other potential strategies including 'Defensive shorts' which allow investors the opportunity to lock in short term gains on shares they believe have good long term prospects but have possibly gone too far in the short term. A client may also not wish to incur a large capital gains tax liability by selling a long standing holding.

Pairs Trades

Pairs Trades are another potential and more sophisticated strategy where an investor might, for example, go long one stock and short another in the same sector to reduce sector specific or market risk and take a strong view of the relative merits of one company over another.

So if CFDs can offer a lot more benefits and opportunities, what are the potential pitfalls?

Over Gearing

There can be an obvious temptation for an investor with limited resources to typically take an initial sum of €50,000 (called margin) and gear that up 5 to 10 times via CFD so as to purchase stock to the value of say €250,000. However, the investor is now exposed to the full outstanding value of the underlying trade and liable to lose a great deal more money than the initial stake or 'margin'. A simple rule of thumb is that if you can't readily liquidate assets to broadly take up the full outstanding position, then you are probably over geared. For this reason, we feel CFDs are really only appropriate for experienced investors. They are NOT a mechanism to allow investors to trade dangerously beyond their means.

The Crossover

Investors should be conscious of the fact that as time moves on the cost of funding eventually out weighs the benefit of cost savings afforded by not having had to pay stamp duty in the first place. This comparison is of course only valid based on the assumption that a client could and would otherwise settle a trade from his own cash resources rather than using another form of credit (ie. a loan from a bank).

So magic or menace, you decide! But for all their benefits, they are, after all, simply another means of executing a trade. The most important starting point always was and always will be a well conceived and smart idea. Nothing ever replaces a good idea!

For more information on CFDs, trading or stockbroking call Eddie on 01 611 5611 or email eddie.clarke@ncb.ie

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