

Market and economic comment*

The ongoing US subprime-mortgage crisis saw writedowns from large investment banks and weakening economic data dominate headlines. This prompted flights-to-quality with investors once more seeking the safety of government bonds. Over the quarter, the yield on the 10-year benchmark fell by 43, 17, 24 and 11 basis points (bps) in the US, UK, Europe and Japan respectively. The yield on the interest-rate sensitive two-year benchmark fell further, by 138, 46 and 67bps in the US, UK and Europe respectively, as investors increasingly expected both the US Federal Reserve (Fed) and the Bank of England (BoE) to cut interest rates. In addition, the European Central Bank (ECB) softened its stance.

Although interbank lending rates remained below the peak seen in September, they edged up again, to 6.65% in the case of sterling three-month LIBOR. However, on 12 December, several central banks announced a co-ordinated response intended to calm the markets over the year-end period. The banks injected liquidity, widened the range of allowable collateral and established temporary lending facilities. Sterling three-month LIBOR fell back as low as 5.48% during January, before increasing to 5.74% by the end of February.

The Fed cut US interest rates aggressively during the review period. A 25bps cut on 11 December was followed on 22 January with an emergency 75bps cut, the first intra-meeting cut since September 2001. This was followed with a further 50bps cut at the scheduled meeting on 30 January to leave borrowing costs at 3%, a level last seen in May 2005. At the end of the period, Fed Chairman Bernanke warned economic conditions had become "distinctly less favourable" and "that credit conditions may tighten substantially further".

The BoE cut UK rates by 25bps on 6 December in a widely expected move and delivered a further 25bps cut, to 5.25%, on 7 February. However, the Bank's Quarterly Inflation Report signalled that it does not intend to cut rates as quickly as the market had expected. Governor King said it was "odds-on" that inflation would exceed the 3% limit, driven by rising oil and food prices and exacerbated by sterling's weakness.

In the Eurozone, although growth in the region is expected to slow in 2008, confidence remains more buoyant than in the US or UK and the ECB continued to hold interest rates at 4%. Although the ECB has indicated that the current tightening cycle has ended, high oil and food prices continue to put upward pressure on inflation, already at record highs. ECB President Trichet was keen to point out that interest-rate cuts are not imminent, stating "a number of observers have noted with great attention that I said that there was no call for an increase in rates, but I also said that there was no call for a decrease of rates". Elsewhere, the central banks of Australia, Sweden, Poland, Russia, the Czech Republic and China all increased interest rates during the period.

In currency markets, the US dollar slipped to an all-time low against the euro. With Bernanke suggesting that the US currency's depreciation may be helping to cut the trade deficit, the US dollar also fell to its lowest level in three years versus the yen. Over the period, the US dollar fell by 3.7% against the euro and by 6.7% against the yen. Sterling also fell to a record low against the euro, to £0.7632, a drop of 7.3% over the period.

Performance (% growth)*

	Fund	Sector	Quartile
Year to date	4.1	2.3	3
2007	5.1	4.1	3
2006	-5.4	-3.9	3
2005	5.6	4.3	2
2004	2.3	3.0	3
2003	9.9	7.3	2
2002	7.7	4.2	2
2001	6.0	1.9	1
2000	15.0	5.3	1
1999	-4.4	-3.4	2
1998	5.2	10.4	4
3 months	6.4	4.0	2
6 months	10.1	7.4	2
1 year	8.1	5.5	3
3 years	10.2	7.3	2
5 years	17.4	12.9	2
10 years	58.1	37.3	2

Standardised rolling 12-month performance (% growth)*

	30.12.02	30.12.03	30.12.04	30.12.05	30.12.06
	30.12.03	30.12.04	30.12.05	30.12.06	30.12.07
Fund	9.9	2.3	5.6	-5.4	5.1

Past performance is not a guide to the future. This information is updated on a calendar quarterly basis. Up-to-date information is available on our website www.invescopetpetual.co.uk

Yield (%)*

	29/02/2008	30/11/2007	Difference
Distribution Yield	3.3%	3.6%†	-0.3%

The distribution yield reflects the amounts that may be expected to be distributed over the next twelve months as a percentage of the mid-market price of the fund as at the date shown. It does not include any preliminary charge and investors may be subject to tax on distributions. The distribution yield is also the underlying yield. No yield is guaranteed. † Gross redemption yield.

Duration (years)*

	29/02/2008	30/11/2007	Difference
Duration	4.4	6.1	-1.7
Modified Duration	4.1	5.8	-1.7

Currency exposure (%)*

	29/02/2008	30/11/2007	Difference
Sterling	21.5	12.9	8.6
US dollar	47.8	48.7	-0.9
Euro	19.3	24.4	-5.1
Yen	11.4	13.9	-2.5

Portfolio performance*

The fund rose by 6.4% over the three months to the end of February 2008, outperforming the sector average of 4.0% and placing it in the second quartile of its peer group, the IMA Global Bonds sector. The fund is also ranked in the second quartile over six-months and three-, five- and ten-year periods.

The fund sits in the IMA Global Bond sector, a sector that includes funds that predominately invest in emerging market and high-yield debt, as well as more defensive funds that invest in mainly government bonds. In the current risk adverse environment, government bonds have tended to outperform credit markets in general and high yield in particular. Partially offsetting this, the fund's weighting in the US dollar detracted slightly from its relative performance.

Strategy and outlook*

In terms of strategy, we continued to hold a significant position in cash during the period under review. Although conditions in money markets have improved, throughout most of the period we have tended to favour cash over short-dated bonds. Following the prolonged rally seen in government bonds, we sold out or reduced a number of issues, locking in profits on long-dated US Treasuries and generally trimming longer-dated government bond positions in view of a possible further steepening of the yield curve.

The fund's allocation to corporate bonds, both investment grade and high yield, remains relatively small, although we did marginally increase exposure to them towards the end of the period. The widening of spreads between corporate and government bonds is providing better value and increased opportunities in credit markets. Investors are now being better compensated for taking risk than they have for several years. As a result, we made small additions to investment-grade telecoms as well as to banks following their weakness.

Central banks face a period of trying to balance rising inflation against weakening economic growth. However, the problems seen in credit markets refusing to go away have added a further complication. On balance, central banks are likely to cut rates in order to avoid the risk of the US housing and global credit problems further impacting on economic growth and pushing economies into recession.

The sombre outlook for the US economy from the Fed, as well as a raft of weak US economic data, has prompted a number of investment banks to forecast a US recession, albeit a mild one. However, we feel that a lot of bad news is already priced into government bonds, particularly at the short end. This was evidenced by the two-year US Treasury yielding just 1.50% on 6 March, down by over 150bps year-to-date and down by 3.6% from its peak last summer. We believe that this backs up our view that there is already a considerable amount of poor economic news as well as further Fed easing priced in. Therefore, given that government bond yields have already fallen by such a long way, further significant declines are unlikely in our opinion.

Portfolio breakdown (%)*

	29/02/2008	30/11/2007	Difference
Government Bonds	64.2	66.9	-2.7
UK Government	17.6	11.9	5.7
US Government	16.0	23.0	-7.0
Euro Government	19.4	20.8	-1.4
Japan Government	9.4	9.3	0.1
Government Agency	1.8	1.9	-0.1
Corporate Bonds	18.9	17.4	1.6
Investment-grade corporate	5.4	5.0	0.4
Bank capital	9.5	8.3	1.3
High-yield credit	3.8	3.9	-0.1
Other	0.2	0.2	0.0
Cash	16.9	15.7	1.2

Rating breakdown (%)*

	29/02/2008	30/11/2007	Difference
AAA	52.7	54.5	-1.8
AA	6.0	5.5	0.5
A	16.5	16.8	-0.3
BBB	3.6	3.2	0.4
BB	0.5	1.7	-1.2
B	2.7	1.4	1.3
CCC	0.9	1.0	-0.1
Non-rated (investment grade)	0.2	0.2	0.0
Non-rated (high yields)	0.0	0.0	0.0
Cash	16.9	15.7	1.2

Maturity breakdown (%)*

Years	29/02/2008	30/11/2007	Difference
20+	9.2	21.1	-11.9
16-20	1.4	0.5	0.9
11-15	1.7	4.1	-2.4
7-10	27.7	27.4	0.3
4-6	14.4	8.7	5.7
0-3	28.7	22.5	6.2
Cash	16.9	15.7	1.2

Top 10 holdings (%)*

Issuer	Coupon	Maturity	% of Fund
Japan	¥1.70%	22/3/2010	9.4
UK Treasury	£4.25%	7/3/2011	7.2
UK Treasury	£4.00%	7/3/2009	7.2
US Treasury	US\$2.75%	28/2/2013	4.8
Germany	€3.75%	4/1/2017	3.2
Germany	€3.25%	4/7/2015	3.0
Germany	€3.50%	4/1/2016	2.8
US Treasury	US\$4.125%	15/5/2015	2.5
UK Treasury	£4.00%	7/9/2016	2.3
Germany	€5.25%	4/1/2011	2.1

March 2008 (covering 30 November 2007 to 29 February 2008)

Investment team

Paul Causer: After graduating in Economics from the London School of Economics in 1983, Paul began his career with Asahi Bank in research, before moving to the bank's Treasury department. In 1990 he was given responsibility for managing the bank's multi-currency investment portfolio. Paul joined Invesco Perpetual (formerly Perpetual) in 1994.



Paul Read: Paul graduated in Economics and History from the University of Toronto in 1984 and has an MBA from INSEAD. He began his career with UBS (Securities) Ltd, moving to Merrill Lynch International in 1986. Paul initially worked on bond sales, before moving on to debt trading and working as a director of fixed income trading in Tokyo. Paul joined Invesco Perpetual (formerly Perpetual) in 1995.

Investment process

A top-down review of markets provides an insight into the direction of monetary policy and interest rates, the shape of the yield curve, the policy trends and credit risk. Credit analysis is employed to select individual issuers, focussing on: the quality of management, the extent of gearing, the relationship between net debt and EBITDA, and the relationship between EBITDA and overall financing costs. Emphasis is then placed on the dynamics of these measures. The fund managers consider absolute levels of risk as a key measure.

The team's approach to investment management can be summarised as follows:

- **Active:** we do not track indices and our focus is on absolute risk and return. Our primary performance target is to be top quartile within our peer groups.
- **Flexible and pragmatic;** our approach is informal, iterative, flexible and changes according to market conditions.
- **Market driven:** we exploit opportunities on a short-term as well as a longer-term basis.
- **'All-weather' funds:** our products are designed to be managed through the market cycle.
- **Valuation driven:** we place strong emphasis on assessing value, based on fundamental analysis of potential risk versus potential return.

This approach has shaped an investment process which adheres to the core disciplines of logical thought processes, comprehensive analysis and constant re-questioning of underlying assumptions.

Investment expertise

The Henley-based fixed income team specialise in managing UK retail funds and manage a broad range of assets, including:

- UK government bonds
- Foreign government bonds
- Investment-grade credit
- High-yield credit

The team assets under management (including equity) as at 31 December 2007 totalled £5.3 billion (source: Invesco Perpetual).

Important information

* All data is as at 29/02/08, sourced from Invesco Perpetual unless otherwise stated. Fund and Sector Average performance data is source: Lipper, mid-to-mid, GBE, with net income reinvested. Sector is IMA Global Bonds.

The value of investments and any income will fluctuate (this may partly be the result of exchange-rate fluctuations) and investors may not get back the full amount invested. Past performance is not a guide to future returns.

Where Invesco Perpetual has expressed views and opinions, these may change. There is no guarantee that any securities mentioned will be held in future by the fund. Current tax levels and reliefs may change. Depending on individual circumstances, this may affect investment returns.

The solvency of organisations with whom the fund invests cannot be guaranteed and any difficulty may adversely affect performance.

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