

PERSONAL ASSETS TRUST PLC

APRIL 2010

QUARTERLY REPORT No. 56

HIGHER LIMIT ON ISAS

Let's begin with a bit of good news to brighten up what will be, on the whole, a fairly cautious Quarterly. From the point of view of those holding shares in Personal Assets the two most noteworthy features of last month's Budget, if such a non-event can be dignified with that name, were that the rate of Capital Gains Tax was (to widespread relief) kept unaltered at 18% while Individual Savings Accounts ("ISAs") will in future years be index-linked from their new upper limit of £10,200.

If you invest in a Personal Assets ISA by direct debit, please note that, in keeping with our practice of accepting only the maximum amount permissible each year, the lump sum investment for a Personal Assets ISA will be £10,200 and the rate of monthly direct debit will be £850 per month. If you want to increase your direct debit, please in the first instance contact the Administrators, Halifax Share Dealing Limited, on the following telephone number:

0845 850 0181

A GENERAL ELECTION LOOMS

Otherwise, the Budget was a dull affair of 'candle-ends and cheese-parings' (to borrow Gladstone's phrase) delivered in the language of Walter Mitty. Forecasts that were a little less appallingly bad than expected were dressed up as good news, such as that government borrowing this year is expected to be £167 billion rather than £178 billion.¹ Public sector net debt is expected to be 54% of GDP this year and 75% in 2014/15 — mere piffle in the wind, according to Mr Darling.

¹ One commentator tellingly compared this to an obese man saying he was going to deal with his weight problem by putting on weight less quickly than he did before.

As a Budget it was nothing more than a stopgap, best described in words spoken by Dr Johnson in another context:

'Sir, that is the blundering economy of a narrow understanding. It is stopping one hole in a sieve.'

The financial markets are all too aware, however, that there will have to be a *real* Budget one of these days, that either the axe will drip with blood or debt will crush us for a generation, and that we are on the brink of a General Election which in theory will decide which of those it will be but in practice may end up by solving nothing. Don't write off Labour yet. I find it all too easy to imagine the re-election of Mr Brown on the basis of 'the devil you know' and a general sense that Mess^{rs}. Cameron and Osborne are untested lightweights. Who can forget 1992, when it seemed that everyone was thoroughly fed up with the Conservatives and that a Labour victory was a racing certainty but Mr Major took to his soapbox and gained for his party an unexpected and mostly rather uncomfortable five years in office — not so much a new lease of life as a stay of execution?

The nervousness of the markets has been increased by speculation about the possibility of a 'hung Parliament' — a possibility that I suspect has been talked up because it gives the pundits more to pontificate about. In practice, the Westminster voting system makes 'hung Parliaments' unlikely. In the last century we have seen them only in 1922, 1923 and 1929 (when at the start of each election campaign it seemed that any of the three main parties might form the next government) and 1974 (when a very close-fought election between the Conservatives and Labour was complicated by a Liberal revival, an upsurge in Scottish and

Welsh Nationalism and the removal of the Conservative whip from the Ulster Unionists). What I fear more than a 'hung Parliament' is a failure by both main parties to appreciate the seriousness of the debt crisis we face and to take the unpopular action necessary to tackle it.

Here I am in total agreement with Sebastian Lyon, our Investment Adviser, who recently wrote in an investment report for Troy Asset Management:

'In contrast to 1979, the electorate may not yet be ready for radical change. What seems to be required is another cathartic moment for politicians and the electorate to recognise the seriousness of the problem. In the late Seventies it was the humiliation of calling in the IMF and the 'Winter of Discontent' which forced the issue. Margaret Thatcher was elected with a clear mandate for short term pain, which would ultimately lead to long term gain. Voters today have yet to reach this conclusion because much of the danger is not visible and the huge deficit has not yet impacted their everyday lives. As with an iceberg, most of the threat is out of sight.'

The idea of the iceberg is worryingly apt. Is Mr Cameron passionately wooing the British electorate as Leonardo DiCaprio wooed Kate Winslet, unaware that he, too, is on board the *Titanic*? Or does he know all too well the dire nature of the impending impact, but is afraid to shatter the romantic illusion? In either case, the Conservatives are not to be envied.

'SLASHER' OSBORNE?

*'Alas, regardless of their doom,
The little victims play!
No sense have they of ills to come,
Nor care beyond to-day:
Yet see how all around 'em wait
The ministers of human fate,
And black Misfortune's baleful train!'*

Thomas Gray's *Ode on a Distant Prospect of Eton College* was penned long before the arrival of

'Dave' Cameron at that establishment; but in the circumstances of today I still can't help thinking of Mess^{rs}. Cameron and Osborne as helpless little victims. That is why I was bemused to read in the *New Statesman* for 8 March an article by Professor David Blanchflower about Mr Osborne's Mais Lecture, delivered on 25 February at the Cass Business School. Professor Blanchflower was the resident 'dove' on the Bank of England's Monetary Policy Committee until his term of office ended last year and is this year to address the AIC Directors' Conference; and his article was headed, *'Why Slasher Osborne Scares Me'*.

I had not thought of Mr Osborne in this way before. 'Slasher' Osborne seems as unlikely a nickname for him as 'Capability' Brown would be for the Prime Minister. Looking at his lecture, I could find nothing in it that would scare anyone. It seemed timid and feeble compared to the enormity of the problem presented by the state of the public finances. *'Like being savaged by a dead sheep'* is the description that springs cruelly to mind. But Professor Blanchflower betrayed his political and economic assumptions by ending his article with the words:

'There was nothing in Slasher's speech to suggest he had any credible plans to raise growth, lower unemployment or increase the incomes of ordinary working people.'

This is where Professor Blanchflower and I differ. It should not, in my opinion, be expected of a Chancellor that he should do any of those things. His job is to create and maintain the conditions under which those things may happen of themselves. Unfortunately, I expect that those who agree with Professor Blanchflower's implied belief in governmental activism or even (to use a term favoured in the 1960s and 1970s) *dirigisme* are in the majority. I'm not sure if I'm cheered or depressed by the view attributed to Alexander Fraser Tytler, Lord Woodhouselee, the eighteenth-century Scottish judge, which Sebastian and I have recently been pondering:

'A democracy is always temporary in nature; it simply cannot exist as a

permanent form of government. A democracy will continue to exist up until the time that voters discover that they can vote themselves generous gifts from the public treasury. From that moment on, the majority always votes for the candidates who promise the most benefits from the public treasury, with the result that every democracy will finally collapse because of loose fiscal policy, which is always followed by a dictatorship.'

Were I not so committed to Personal Assets, I should be tempted to apply for the job.

WE'RE IN A PHONEY WORLD

I find it odd that people seem so unconcerned about the economic outlook. The skies are leaden, the wind is chill, but life goes on as before. Perhaps, as T S Eliot said, *'mankind cannot accept too much reality'*. Economists and politicians seem content to sing along with Blanche DuBois of Tennessee Williams' *A Streetcar Named Desire* the sentimental 1930s hit, *'It's Only a Paper Moon'*:

*'It's a Barnum and Bailey world,
Just as phony as it can be,
But it wouldn't be make-believe
If you believed in me.'*

Unlike Blanche DuBois, we are not going to be able to depend on *'the kindness of strangers'* to rescue us from our misery. Even the most eminent among us do, however, share her capacity for self-deception. I shan't subject you to yet another diatribe against Mess^{rs}. Greenspan and Bernanke, but I do notice that Mr Greenspan has just written a paper for the US think-tank, the Brookings Institution, in which, in a conscious echo of Mr Bernanke's 'global savings glut' (see *Quarterlies 36 and 40 for our disagreement with this idea*) he argues that central bankers were innocent and impotent bystanders in a global macro-economic shift.

His argument in defence of this astonishing self-whitewash is that, thanks to the end of the cold war and to reform in China, hundreds of millions of workers were absorbed into the global economy over a fairly short time. As GDP growth in emerging economies soared, their consumption could not keep up with rapidly rising income and savings rose. The rise in global saving relative to investment created a global decline in

long-term rates, which became decoupled from the short-term rates that central bankers control.

So that's all right, then. The 'Greenspan Put' and the explosion of credit in the US and elsewhere in the developed world had nothing to do with it and it was all the fault of the thrifty Chinese (who have just reported their first monthly trade deficit in six years, but that's another matter). Even though the circumstances could scarcely be more different, I'm reminded of the words of Senator Abraham Ribicoff to Mayor Daley at the 1968 Democratic Convention in Chicago, when violence exploded on the streets:

'How hard it is, how hard it is to accept the truth, when we know the problems facing our nation.'

How hard it is, indeed. Greenspan and Bernanke printed the money. Mervyn King joined in. We are just the poor saps who are having to honour it.

THE MUSHROOMING STATE

Across the developed world, policy makers have over the past year been attempting to resuscitate the global economy by transferring the huge credit boom from the private sector to the state. Central bankers have slashed interest rates to unprecedented levels while adopting what might euphemistically be called an 'unconventional' approach to improving banks' profitability *via* the printing of lots and lots of nice crisp new banknotes. Meanwhile, governments have engaged in a huge orgy of borrowing to keep national economies from grinding to a halt. The UK has seen government spending as a percentage of GDP increase from 36% in 1999 to 48% last year (*which is almost approaching Scotland's unenviable level of over 50%*) and public sector employment has risen by almost a million in the ten years to 2009; in 2009 alone, as the private sector was hit by 900,000 redundancies, the public sector added 300,000 jobs. UK public sector debt is expected to rise to over 80% of GDP in the next three years.

Nor is the problem confined to these shores. While the UK will spend almost 30% more than it

will receive in tax revenue in 2010, the US is more profligate still, spending almost 40% more than its tax take. Again to quote Sebastian:

'No one in their right mind would spend 40% more than they receive in annual income year after year but politicians are unprepared to take the bad tasting medicine required because the benefits will not be seen on their watch. The virtues of prudence have been well and truly abandoned. While we may hope for the best as investors, we should prepare for a loss of faith in government bond markets, which will result in a much higher cost of capital. Government bonds, traditionally low risk assets, look anything but safe.'

MONEY CHEAP, MARKETS DEAR

Well, that's what you would expect, isn't it? Lots of cheap money drives asset prices up. However, it isn't happening in the wider economy. Considering the aggressive nature of the economic stimulus combined with a 25% devaluation of sterling since the summer of 2008 and the lowest interest rates since Dutch William, that alien, grim-faced Calvinist, developed the concept of the National Debt in the 1690s to pay for his unpopular foreign wars (*does this sound familiar?*), the UK economy is still growing at an anæmic rate, having been able to manage growth of only 0.4% in the fourth quarter of 2009. Back in February 2002, following a series of 11 cuts in interest rates in calendar 2001 that brought the Fed Funds rate from 6.50% to 1.75%, I wrote that Mr Greenspan was behaving like an agitated zookeeper repeatedly trying to hose down a dead elephant in the hope it would wake up. The hose was the supply of cheap money and the dead elephant was the US economy. The only thing that prevents me from extending the simile to Mr Darling and the UK economy today is that, in today's world of political correctness, London Zoo no longer keeps elephants.

The outlook therefore calls for caution, to say the least of it; but at the time of writing there is a P/E of 18 times on the FTSE All-Share and a yield of around 3.1%. This is far too dear. We do not believe that the rally in equities,

which began in March 2009 and which, a year ago, we argued could reach 5400 on the FTSE 100, can be sustained much further — all the more so because that FTSE level has now been surpassed by a significant margin.

Yet complacency remains high, as indicated by the Chicago Board Options Exchange Volatility Index, or VIX (commonly known as the 'Fear' Index), which is close to a three year low. As investors have become more optimistic and have been prepared to accord ever higher valuations for stocks, we have grown ever more distrustful of a rally driven by liquidity resulting from the unprecedented financial distortion caused by 'free' printed money. As referred to earlier, we are indeed in a '*phoney world*' of zero interest rates and quantitative easing which has led to distorted prices of a number of asset classes including bonds, equities and property. In particular, the pressure on sterling is likely to increase over the next few years and ultimately the dollar will also come under pressure for the same reasons of weak fiscal positions and a growing lack of credibility attaching to sovereign debt, of which Greece's well publicised problems are a lead indicator.

CHANGES TO THE PORTFOLIO

*I bring you naught for your comfort,
Naught for your desire,
Save that the sky grows darker yet,
And the sea rises higher.'*

G K Chesterton's words sum up our feelings pretty accurately. So how does one invest when one is struggling through the Slough of Despond among crowds of excited clubbers who seem to be tripping on '*miaow-miaow*'? The structure of the portfolio is shown on the back page of the Quarterly. Our equity exposure at 31 March 2010 was 66.1%. Of this, 53.4% was in direct equities: 30.1% in the UK; 16.6% in the US; 5.5% in Switzerland; and 1.2% in Australia (the two last because we want to hold Nestlé and Newcrest Mining, not for exposure to Switzerland or Australia as such). Exposure to the UK market through FTSE 100 Futures adds a further 12.7%.

We have been inclined to decrease Personal Assets' equity exposure,

primarily *via* our holding in FTSE 100 Futures. The individual stocks we hold give us exposure to defensive, cash generative businesses which should steer us through the very difficult economic conditions we expect for some time to come. While most of these companies are domiciled in the UK, their revenues and profits are generated outside the country.

We maintain our holding, currently 9.3%, of gold bullion — money that cannot be printed.

A SUCCESSFUL EGM

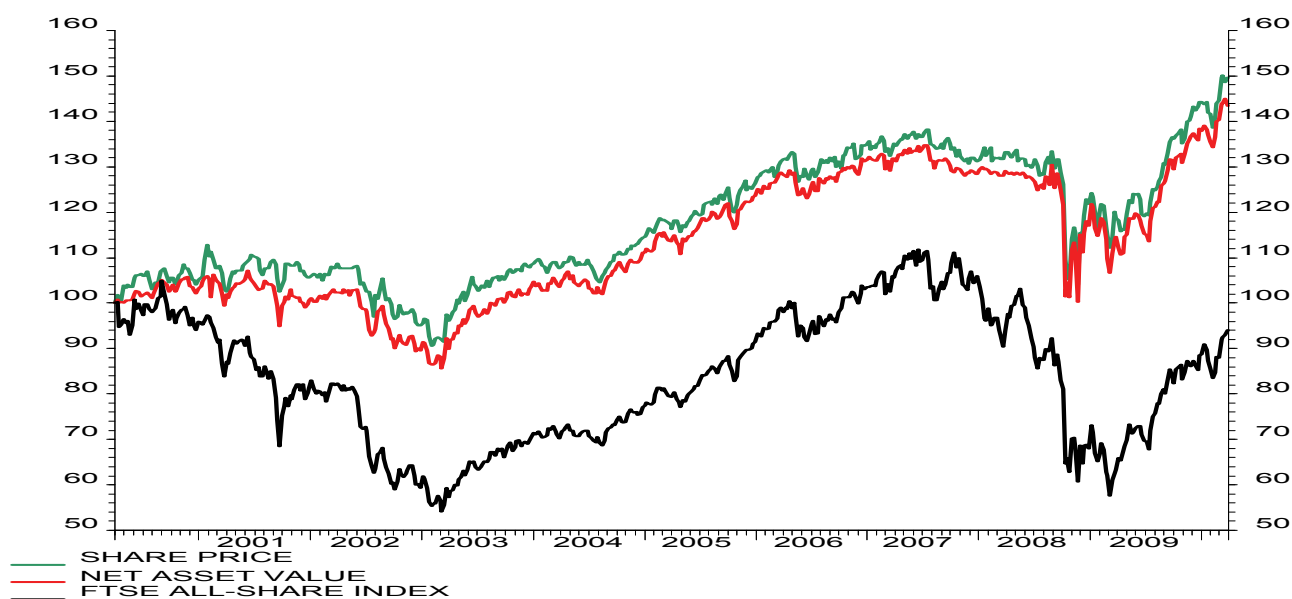
I'm glad to say that at the Extraordinary General Meeting held on 31 March the resolutions to renew the Company's authority to issue new shares were passed with overwhelming majorities. Before the meeting, however, one shareholder wrote to me as follows:

'I am a simple man with a simple mind and see things in simple terms. I have had a lump sum investment in PAT for many years and am depending on its growth as part of my savings plan for retirement. Performance has not been spectacular but one could claim that we have been spared the worst of the turbulence over past months. If further shares are issued then this must have the effect of diluting the value of my shareholding compared with maintaining the status quo . . . I intend therefore to vote against the resolution(s) . . .'

I'm glad to say that I was able to get him to change his mind by explaining that issuing further shares would actually enhance, rather than dilute, the value of his shareholding compared with maintaining the *status quo*, because any new shares would be issued at a small premium to net asset value. I was, however, a little concerned that he would even contemplate the idea that our performance might ever be '*spectacular*'. So I plead with you now — if Personal Assets' performance is ever '*spectacular*' in a rising market because we seem to be taking the kind of risks that could result in the loss of irreplaceable capital, write to me, complain to me, come and camp outside 10 St Colme Street and make my life a misery, until the Board returns to its senses. We are not in the business of trying to be '*spectacular*'.

ROBIN ANGUS

PERSONAL ASSETS TRUST PERFORMANCE



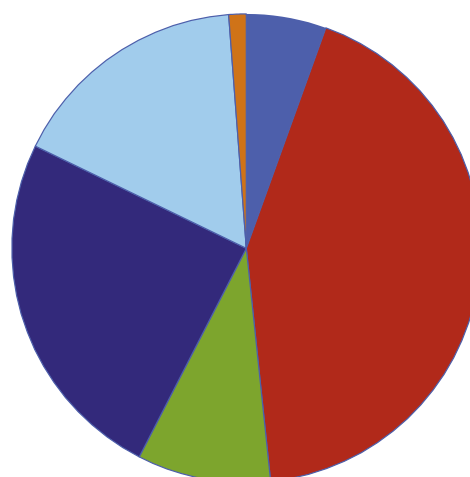
% Changes from	31-Mar-00					31-Mar-10
	Period	10 Years	5 Years	3 Years	1 Year	Values
Share price		48.6%	28.0%	9.9%	23.8%	£289.00
NAV per share		43.3%	26.3%	8.6%	25.1%	£286.16
FTSE All-Share (FTSE)		-6.4%	18.4%	-11.4%	46.7%	2,910.19
NAV relative to FTSE		53.2%	6.6%	22.6%	-14.7%	

PORTFOLIO 31-MAR-10

£ '000

Royal Dutch Shell	14,157
Nestlé (Switzerland)	12,772
British American Tobacco	11,696
Coca Cola (US)	11,675
Diageo	8,691
GlaxoSmithKline	8,219
Berkshire Hathaway (US)	7,708
Tesco	7,539
Philip Morris Intl (US)	6,162
Sage Group	5,523
Top Ten Equities	94,142
Other Equities held	30,248
FTSE 100 Futures held	29,529
Gold Bullion	21,520
Liquidity	57,337
Shareholders' Funds	232,776

GEOGRAPHIC BREAKDOWN



Switzerland (5.5%)	UK inc Futures (42.8%)
Gold (9.2%)	Liquidity (24.6%)
US (16.6%)	Australia (1.2%)

Further information on the Trust can be obtained from the Company's website – www.patplc.co.uk or by contacting Steven Budge on 0131 225 9995.