PERSONAL ASSETS TRUST PLC

MAY 2002 **QUARTERLY REPORT No. 25**

A JUBILEE QUARTERLY

This is the 25th Personal Assets Trust Quarterly, making it a sort of Jubilee Quarterly (albeit only a Silver one) to coincide with the Queen's Golden Jubilee year. It is up to shareholders to judge our performance, but if we have carried out our duties half as well as the Queen has carried out hers over the years, we can be more than satisfied. Long may she reign — and may none of us ever forget or take for granted her astonishing example of faithful and selfless service over by far the greater part of the lifetimes of most of us.

We intend later in the year to mark the appearance of the 25th Quarterly by publishing a book bringing all the Quarterlies together and including some other relevant material to put them into context. Publication is scheduled for some time in July and when you receive the 2002 Annual Report & Accounts towards the end of May you will also receive a reply-paid postcard which you can use to request a copy. (The book will be free of charge and will also be post free.) If you received this Quarterly by virtue of being a shareholder in Personal Assets' sister company, Collective Assets, you will receive a similar reply-paid postcard along with the Interim Report.

The book was the suggestion of Hamish Buchan, our newest director *(although I have worked with him even longer than I have worked with Ian!)* and now Deputy Chairman of the Association of Investment Trust Companies (AITC). Always an enthusiast, Hamish looks forward to the book's appearance with unalloyed delight. I wish I did. I have to confess that I rather dread reading back through all the old Quarterlies and finding all sorts of things I had forgotten writing.

There is a wireless programme called *'Just a Minute'*, in which panellists speak for a minute on a given subject without *hesitation, repetition* or *deviation.* There has been a lot of *deviation* (using the word in its more innocent sense) in the Quarterlies. One extreme example of flowery writing even gave rise to a delightful parody by a City friend that has amused the directors of Personal Assets for many years and will be revealed to shareholders for the first time in the forthcoming book.

Much *hesitation*, too, shows in the Quarterlies' publication dates, as the result of my illness (now fully overcome). But their most embarrassing feature may well be *repetition.* I have used them to expound the eternal truths of investment, and the trouble with eternal truths is that they don't change. People just forget them sometimes and so need reminding of them. This I have done!

PAT: THE POSITION TODAY

Writing the 25th Quarterly inevitably gives rise to reflection. How did it all begin? Where have we got to now? Have we stayed true to our initial aims and ideals?

First, some history. Ian became Investment Director of Personal Assets in 1990, a year when its market capitalisation stood as low as £5.5m. Today its market capitalisation, at £93.5m, is seventeen times this level. Its share price is nearly six times and its net asset value per share (NAV) just under four and a half times its 1990 level, compared to just over two and a half times for our benchmark, the FTSE All-Share Index. Reasonable long-term NAV performance and the issue of new shares through our zero-charge Investment Plans have combined to make this expansion possible. Our issued share capital is now virtually three times what it was in 1995 and in December 2001 we became for the first time a constituent of the FTSE All-Share Index. Today, investors in our zero-charge Investment Plans own no less than 45% of our share capital. Of our achievements since 1990, the success of our zero-charge Investment Plans is perhaps the one closest to my heart. It fulfils the hopes I expressed in the 1991 Annual Report & Accounts:

'Personal Assets is an investment trust for private investors. After a thorough policy review the Board has concluded that this aim can best be achieved in the long term by managing Personal Assets as a flexible investment trust specifically for private investors wishing to invest a substantial proportion of their wealth in the company as an alternative to holding directly a diversified equity portfolio or a number of other investment trusts or unit trusts.'

I ended this passage with words that summed up what we hoped Personal Assets would become:

'Our specialisation will be our shareholders.'

PAT: THE 1991 BLUEPRINT

We have, I think, been true to the vision we had for Personal Assets when the company became self-managed in 1990, and this was confirmed recently when Ian dug out a copy of an article about himself that appeared in the Summer 1991 issue of *Investment Trusts* magazine. It described how in 1990 Ian had resigned as Deputy

Chairman of Ivory & Sime to become investment director of Personal Assets, then a small trust which (the article stated) had previously been run as *'a special situations trust to sit comfortably alongside a blue chip portfolio.'*

Today the article makes fascinating reading, showing how the reborn Personal Assets looked to an experienced financial journalist (William Kay) at a time when the concept behind it was new and untested. So I hope I shall be forgiven for quoting the article at some length in what follows.

WHAT INDIVIDUALS WANT

The article began by describing how in the 1980s Personal Assets had been managed as a special situations trust. It went on:

'"I see it as very different today," says Rushbrook. "It is suitable for the wealthy private client" — of which "there happen to be a few in the shareholders' list". Historically, PAT had an appetite for unlisted securities, but it is being weaned off that diet. Instead, it is investing directly in [sizeable UK and US listed equities]*."'*

This was true, but what problems the word 'wealthy' caused when it was used in the article and later on in our Annual Reports! We supposed our shareholders would like it. They didn't. They complained. In fact, the most vociferous complaint about it came from one of the wealthiest people I know.

Can it be that even the rich never think of themselves as 'wealthy'? Perhaps 'wealthy' people are always, by definition, people who have more money than we do. So we dropped 'wealthy' as an adjective, but with regret. It was so much more succinct than the phrase *'who either have a substantial amount of capital or hope to build it out of income'*, which we now use in the Annual Report!

Whether one describes them as wealthy or merely as possessed of a substantial amount of capital, however, we had a clear idea even then of the kind of shareholders we aimed to serve, and of what they were likely to want. To quote Ian from later on in the article:

'"[Our] *shareholders have sterling liabilities . . . therefore prudence would suggest that at least a decent percentage of their assets should also be in sterling. So I don't think one would ever wish to be less than 50% in the UK. Ideally, one would like to split it 60% UK and 40% international, with international investment probably being used more as a way of avoiding risk than to achieve a superior return."'*

This has been Personal Assets' position throughout its life as a self-managed trust. It has never had more than 39% or less than 6% of its shareholders' funds invested in overseas equities, all of it in the USA.

In recent years, the percentage held in US equities tended to fall as the US equity market got *(in our eyes)* ever more overvalued. Personal Assets today has only 6% of its shareholders' funds in US equities. However, our commitment to investing in the USA remains as strong as it was when we started out. I have no doubt that at some time in the future the percentage of our funds invested there will rise again. And when it does, it may well be as a way of avoiding risk, rather than as an attempt to achieve a higher return. Risk-avoidance is a consideration that weighs just as heavily with the Board today as it did in 1991.

A LOW-INFLATION ERA

UK inflation stood at 9.8% in July 1990, the month Ian took over the reins at Personal Assets. Today it may seem like another world, but it didn't seem remarkable at the time. Birds fly, fish swim, inflation is in or near double figures — that had been the UK experience ever since the early 1970s. It had also been the experience of other developed economies, although not so early and not to the same extent. However, Ian in the article successfully predicted falling inflation and the beneficial effect this would have on the P/E ratios of large companies.

He began by explaining why he thought a return to the days of the 'Nifty Fifty' was possible — the 50 blue chip stocks like IBM and Polaroid that in 1972 were trading at between 25 and 75 times earnings, the kind of rating normally accorded to the most speculative growth shares. He commented:

'"They were quality companies growing at perhaps 12% to 15% per annum. Interest rates were around 6% and inflation was below 4%. You could borrow money cheaply and invest at a compound rate of return of 15%."'

'"If you discount at 15% and your cash flow is growing indefinitely at 20%, mathematically you come up with infinity. Therefore there was no limit to the multiple that would be paid for a quality company that would grow . . . at seven or ten points more than inflation."'

An essential tool for an investment manager is a knowledge of history. This was what in 1991 enabled Ian to look to the future and see how circumstances might configure themselves to favour blue chip investment again:

'"If the Germans hold up interest rates [in 1991/92], *Britain must hold up interest rates until inflation is well and truly beaten," he says. Inflation rates can then decline and there will be a combination of low inflation and low interest rates on both sides of the Atlantic. "So we can move back to a period where the big blue chips don't grow any faster than in the past, but the multiples expand very considerably."'*

So during 1990 and early 1991 Ian switched almost entirely out of smaller companies and into larger ones such as BP, BT, BTR and Glaxo, which were Personal Assets' four largest UK holdings at the 30 April 1991 year end.

Three of these companies, BP, BT and Glaxo, we still hold. And we are sometimes asked why we are not still fully invested in major companies of this type, given that low interest rates and low inflation (two of the preconditions just identified for investing in big, high-quality blue chips) are still very much with us.

The melancholy answer is that the most important precondition of all

— the high probability of growth at seven or ten points more than inflation — is no longer there. Find us big blue chips of the highest possible quality that will produce dependable earnings growth of 10% or 12% per annum to infinity (which is what would be needed today, given the level of inflation in the UK and the US) and we will gladly consider buying them. But the earnings outlook in the UK and in the US is pretty depressing just now and will get worse before it gets better. A return to the high earnings growth days of the 'Nifty Fifty' is further away today than it was in 1991.

STOCK-PICKING: A HERESY

In 1990/91 we chose our big blue chip stock purchases with care, but catching the investment tide we felt to be running was far more important than selecting individual stocks. Well, as every schoolboy used to know, the four great heresies of the Christian Church were (in chronological order) Arianism, Apollinarianism, Nestorianism and Monophysitism. *(Yes, I do know what they are. No, I'm not going to define them.)* But the investment world has its heresies too, just as plausible and insidious. One of these heresies is that stock-picking is the true way to success and is therefore the chief task of an investment manager. In the article, therefore, Ian was at pains to explain to the interviewer how the bigger picture came first.

'"I don't think share-picking is investment management," he says. "I think investment management is that whole rounded process of taking a portfolio and making it perform. Share picking is a much lesser part of the art of investment management." You have to be able to pick the shares, Rushbrook says, "but in a reasonably efficient marketplace the price basically, in the short to medium term, is probably about right. It contains all the information the market knows about it."'

Personal Assets has held closely to this approach over the years. Looking at the bigger picture before picking individual stocks stood us in good stead when we moved first into big blue chips (overweighted in banks and oils), then later into fund management companies, and then increasingly into liquidity. Between October 1990, the year when Personal Assets became self-managed, and April 2002 our NAV has outperformed our benchmark, the FTSE All-Share, by 73%. Contrary to popular myth, it is hard to see how such an outperformance could be achieved by stock-picking alone. First you must catch the tide. Then you can pick the stocks.

SELF-MANAGEMENT

Once Ian had outlined to the interviewer his aim of *'doing things with the maximum simplicity'* (I have already quoted in an earlier Quarterly his favourite maxim from Thoreau, *'Simplify! Simplify!'*), he went on to speak of self-management as a way of running an investment trust.

'He believes that stock market games, however seriously played, work better as solo pirouettes than team efforts. "PAT, as a self-managed trust, fits rather nicely with my view of what the best investment management organisation is," he says. "That is, one person who does the research and dealing and so on. In that sense, you've got a total integration of all the activities . . ." His academic training allows Rushbrook to perform the all-singing, all-dancing act with a degree of detachment that fund managers often find difficult to master.'

I am tempted to add that if this is what he really believes, he can write the rest of this Quarterly for himself! The truth of the matter is that over the years Ian has gathered to himself a small group of like-minded, highly committed but very different people, all of whom contribute in important ways (both in the Boardroom and out of it) to the running of Personal Assets. Once discussion is finished, however, every investment decision is ultimately Ian's. Investment management by committee is not for us. Instead, we go for focus, concentration of effort and clear accountability — a way of working that suits us and brings us results.

THE POWER OF PEPS

Readers may have concluded that zero-charge PEPs and ISAs are my King Charles's Head. Whatever I write, I always come back to them. Such plans, however, were part of our earliest thinking:

'Rushbrook is a fan of one of the most successful vehicles in recent years, the Personal Equity Plan. Describing Personal Assets as a "club rather than a restaurant", he says it will look for "ways of delivering to its private-client shareholder base added-value shareholder products such as PEPs in a way that genuinely adds value, as opposed to being simply a profit-margin product for other parties . . . Savings schemes are a total red herring. I think they are obsolesced totally by PEP schemes, if one can get the right costings for PEPs."'

That passage not only contained a striking neologism (the verb 'to obsolesce' used transitively, with the meaning 'to render obsolete') but also clearly foretold the launch of our zero-charge PEPs and Investment Plans, followed by zero-charge ISAs. We faced a major obstacle at first, however. The PEP limit was £6,000, but only £3,000 could be invested even in a fully-qualifying investment trust like Personal Assets. Since we were not equipped to offer PEPs other than one investing just in Personal Assets, all we could offer was a £3,000 PEP that the Chairman gallantly bought, but almost nobody else did.

The 1992 Budget brought the required reform: PEP holders were permitted to invest the full £6,000 in the shares of a qualifying investment trust. This, together with our zero-charge cost structure, gave us the winning formula that resulted in the trebling of our issued share capital between 1995 and today. What more appropriate, then, than that the former Chancellor of the Exchequer who so kindly praised Personal Assets last month in the *Sunday Times* should have been none other than our great 1992 benefactor? Thank you, Lord Lamont of Lerwick!

ROBIN ANGUS

PERSONAL ASSETS INVESTMENT PLANS

While the shares of Personal Assets Trust are listed on the London Stock Exchange and so can be bought and sold in the normal way, investors can also buy shares ***free of all commissions and charges*** through the Company's ***Investment Plan***.

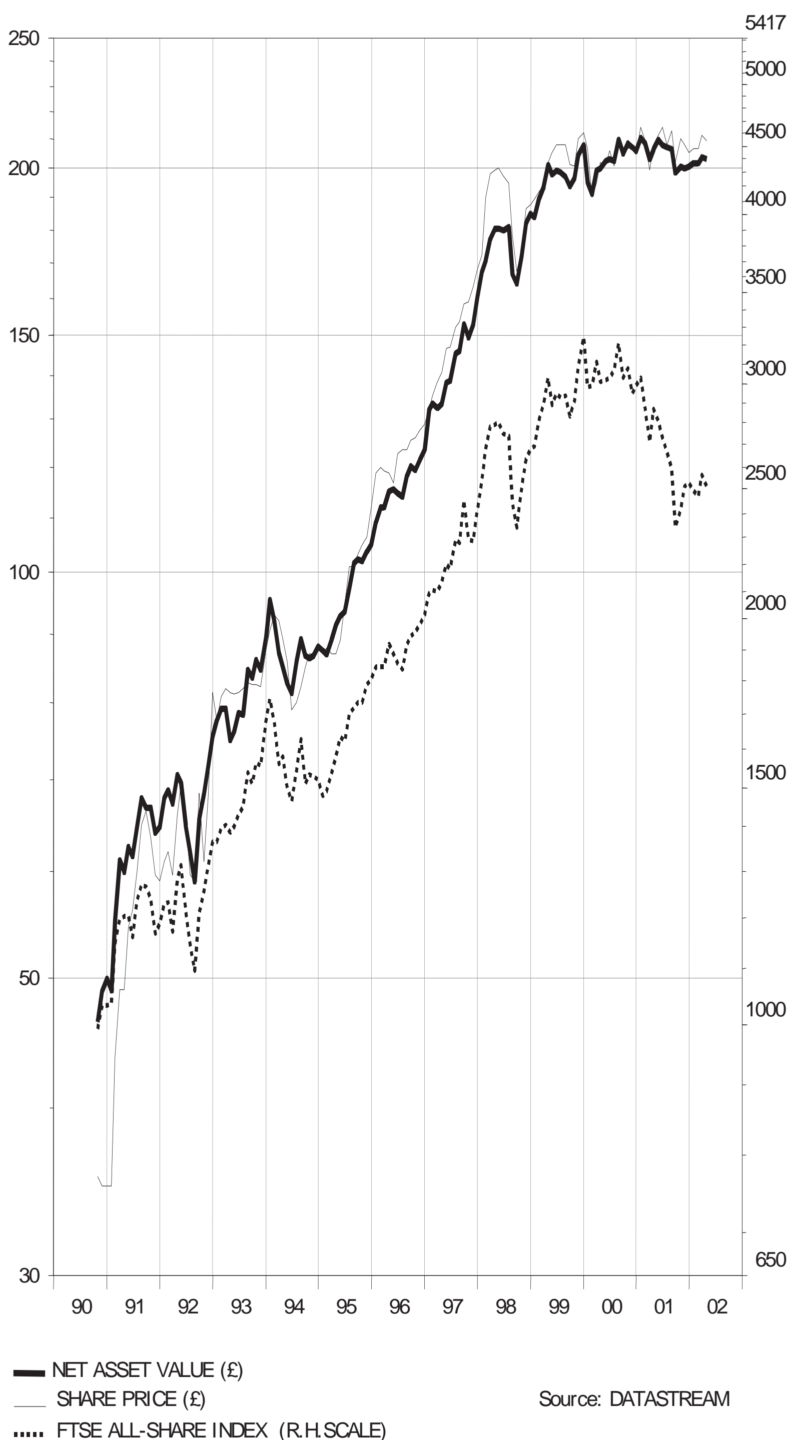
Investments in the Company's shares can also be made free of all commissions and charges through the Company's ***ISA*** or through ***PEP and ISA transfers***.

Details of all these methods of investing in the shares of Personal Assets can be obtained from the Company Secretary at the following address:

Personal Assets Trust PLC
One Charlotte Square
Edinburgh EH2 4DZ

Tel: 0131 465 1000

PORTFOLIO	**30-Apr-02 £'000**
Scottish & Newcastle	£5,150
BP Amoco	£5,094
Royal Bank of Scotland	£4,454
HBOS	£3,786
Shell Transport & Trdg	£2,736
Rentokil Initial	£2,705
Barclays	£2,524
GlaxoSmithKline	£2,490
British Assets Trust	£2,066
BT Group	£1,793
Top Ten Equities	**£32,798**
Other Equities	**£13,370**
Effective Liquidity	**£46,262**
Shareholders' Funds	**£92,430**



% Change Over Period	31-Oct-90 11 1/2 Years	30-Apr-99 3 Years	30-Apr-00 2 Years	30-Apr-01 1 Year	30-Apr-02 Values
SHARE PRICE	**490.1%**	**3.7%**	**3.7%**	**0.5%**	**£209.50**
NET ASSET VALUE	**338.0%**	**1.1%**	**1.8%**	**-1.8%**	**£203.38**
FTSE ALL-SHARE	**153.1%**	**-17.1%**	**-16.3%**	**-12.4%**	**2,512.04**