PERSONAL ASSETS TRUST PLC

OCTOBER 2002 **QUARTERLY REPORT No. 26**

'THE BLUE BIBLE'

'We regard our shareholders as our partners and one of our aims is to foster and strengthen this feeling of partnership.' (Quarterly No. 1)

Our Quarterlies reflect the importance we give to communicating with shareholders and we have recently republished the first 25 of them in a book entitled *Personal Assets Trust Quarterlies: The 1990s and Beyond.* One recipient, however, immediately christened the volume *'The Blue Bible'* — a name we have adopted with delight. It contains not only the reprinted Quarterlies but also a lot of new material, some from early Annual Reports but most of it published here for the first time.

So the book, despite its official title, is not just a compilation of old Quarterlies. It is, in effect, the history of Personal Assets from 1990 onwards. If, like Ian and me, you believe the future lies in the past, forget Nostradamus and read how we managed to achieve our milestone 100% outperformance of the FTSE All-Share *(see later)*.

A book of around 100,000 words can't be read at a sitting, and isn't meant to be. So I suggest that as a start you read the Author's Preface and Barry Riley's Foreword. Thereafter, just enjoy yourself — but on no account miss the 'Spoof Quarterly' on page 131!

Shareholders who requested copies should by now have received them. Any who missed the announcement can get a copy by writing to the Company Secretary at the address on the back page of this Quarterly. (Like our PEPs, ISAs and Investment Plans, the book is 'zero-charge' — *i.e. free*!)

A MILESTONE FOR PAT

Perhaps the ultimate milestone in the history of Personal Assets was achieved at the end of August this year. By a remarkable coincidence, the *'Blue Bible'* has been published at the very time when we have succeeded in outperforming our benchmark, the FTSE All-Share Index, by more than 100% since Ian took over as Investment Director in 1990.

Between 31 October 1990, the first reporting date after Ian's appointment, and 31 August 2002 the FTSE All-Share rose by 106%. Personal Assets' net asset value per share (NAV) rose by 319% over the same period and its share price rose by 466%, outperforming the FTSE All-Share by 103% and 175% respectively. In other words, since Personal Assets became a self-managed investment trust in 1990 the FTSE All-Share has little more than doubled whereas Personal Assets' NAV has more than quadrupled and our share price, which in 1990 stood at a discount to NAV of more than 25%, has risen by over 5½ times. Throwing modesty to the winds, we call this no mean achievement. It is rare for general investment trusts to be able even to *match* the FTSE All-Share over any considerable period of time, never mind outperform it by more than 100% over 12 years.

What is our secret? There isn't one, really. Apart from the simple investment principles we list year after year in our Annual Report — stable investing for the long term; avoiding high turnover; making our investment decisions count by not dissipating our efforts; diversifying internationally to reduce risk; and sticking to what we know about — I would say that the key to our success so far has been that we put our shareholders first. To quote a remark of Ian's from when I first knew him in the early 1980s, *'The shareholder is God.'* This is not quite how I would choose to express it as a churchman, but I do nevertheless agree wholeheartedly with the underlying sentiment!

SHAREHOLDERS COME FIRST

In our 1991 Annual Report, the first to be published after Personal Assets became self-managed, we made our priorities clear by stating, *'Our specialisation is our shareholders'*. If I didn't regard all 'mission statements' as pompous garbage, that could be our one. In each subsequent Annual Report we have stressed that Personal Assets is run for one specific reason — to meet the requirements of individual investors who want to commit a significant proportion of their capital to an investment trust. We aim to protect and increase the value of shareholders' funds over the long term and to achieve as high a total return on shareholders' funds as possible given our dislike of a level of risk significantly greater than that of investing in our benchmark, the FTSE All-Share.

In this we have the advantage of being free from the policy restrictions of specialist trusts and the complicated capital structures of some more recent trusts. Furthermore, because Personal Assets is almost entirely held by individual investors it does not have to take account of the differing and at times conflicting objectives of investing institutions. Personal Assets is run not by an investment management firm but by its Board and the directors run Personal Assets for people like themselves.

Accountability to our shareholders is at the heart of everything we do. For many Boards, shareholder criticism is no more than 30 lashes with a feather duster. Not for us. Criticism from our shareholders is criticism from our partners. This is not to say that we always agree with it (!), but we do always take it seriously. Unlike some investment trusts, too, we are free to concentrate 100% on our shareholders' needs. Trusts run by investment management groups are sometimes subject to opposing 'pulls' from their shareholders on the one hand and their management group on the other. We believe, as we hope do our shareholders also, that to be self-managed is a major advantage for any investment trust, particularly when the directors are prepared to exercise their personal judgement and to be accountable to shareholders for those decisions.

Shareholders and Board

Let me stay for a moment on the subject of the relationship between the shareholders and the Board. *'All your directors look around the same age,'* said a shareholder who telephoned the Company Secretary after receiving the 2002 Annual Report. Well, some of us might feel justified in taking offence at this — notably Gordon Neilly, still a mere lad of 41. But what about me? Shareholders who depend on the Annual Report will not have an up-to-date idea of how I look. We do not waste your money on fripperies, so the same photograph of me has appeared every year since 1994. I look even older these days. Ian makes cruel (and frequent) reference to my elderly appearance, calling me *'the only man I know who looks old enough to be his own father'*. Yet I have only just turned 50, more than a decade younger than Ian and the Chairman, and it is one of life's ironies that they both look so much younger and fitter than I do.

The shareholder, however, had a point. He himself was in his 50s and he felt that a Board consisting mostly of men in their 50s and 60s would have the same concerns and expectations as he did. So he felt Personal Assets was a suitable investment for him, preservation of capital naturally being the first concern of a man nearing retirement. However, although he also wanted to recommend Personal Assets to his children, he feared that they (aged around 30) might not find it so attractive. Preservation of capital was not top of the agenda for them. They wanted to build up capital and make it grow. What did Personal Assets offer them? Was it just a club for the late middle aged?

The first point that struck me was that the shareholder's age did not prevent *him* from having a clear idea of what the next generation would want — and the same is true of the directors. Some of us have children in their 20s or early 30s, setting out on their careers and in some cases getting married and starting families of their own. We know their needs and ambitions well. (In Ian's own family there are three generations of Personal Assets shareholders.)

Serving Young and Old

But behind these personal details lies the important principle set out clearly in our Annual Report:

'The Board envisages that a typical Personal Assets shareholder will either have a substantial amount of capital or hope to build it out of income. Investing in Personal Assets gives such shareholders an alternative to managing a significant proportion of their own investment portfolio (whether directly or through professional advisers), although the Company does not offer global investment coverage and Personal Assets should not be the only shareholding of any investor who wants this.'

In other words, Personal Assets explicitly sets out to cater for both the older generation, who *'have a substantial amount of capital'*, and the younger generation, who don't yet have much capital but *'hope to build it out of income'*. I myself was once a member of this younger generation. Being a cautious soul, I built up my capital during my 30s and 40s not through dabbling in risky or adventurous investment schemes but through investment trust PEPs, ISAs, savings schemes or investment plans — regularly buying shares in sound, diversified investment trusts and never selling them. It wasn't glamorous and it didn't look at all exciting. But it worked for me and it is what I invariably recommend to people in that position who ask for advice.

Private Investors' Needs

This leads me on to one of my hobby-horses — the poor treatment too often received by private investors from those who are paid (and paid well!) to advise them. In the *'Blue Bible'* (*Personal Assets Trust Quarterlies: The 1990s and Beyond)* I wrote as follows:

'I meet many people who have a six-figure (or seven- or eight-figure) sum managed by a financial adviser — perhaps a firm of stockbrokers, an investment management house or a wealth management company. I am often horrified by the inappropriate investment management "services" these investors get. Far too many holdings? Far too much buying and selling? Slavish obedience to a "black box"? Belated pursuit of fashionable sectors when no profits are left to be made and a fall is just round the corner? I've seen them all.

'Such "services", seldom cheap, would be dear at any price. So even the private investor with many millions to invest is in my view best served by a portfolio of half a dozen good general investment trusts. Professional management, a spread of investments, no transactions (so no broking costs) and freedom from Capital Gains Tax within the portfolio, all at a reasonable price. It's what I do for myself — and it's what I'd still do if I had ten or even a hundred times as much money.'

It is indeed. However many millions I had, half a dozen good general investment trusts would satisfy all my investment needs. The suitability of such trusts for the private investor is a subject very close to my heart, and one on which I shall have a lot more to say. In the next Quarterly I

shall look more closely at the position (or predicament) of private investors — the serious flaws in the advice they are typically given by financial advisers and the advantages they gain from having their funds managed efficiently and effectively through investment trusts. However, the subject requires a whole Quarterly to itself *(it may even need two, since it is so important)* and I still have to update you on the topical subject of Personal Assets' liquidity.

UPDATE ON OUR LIQUIDITY

Shareholders have recently been asking us about Personal Assets' liquidity position, which at our 30 April 2002 year end stood at 50%. Markets have had a roller-coaster ride since then. So did we just hold on to our liquidity as markets fell and then, when they began rising again and our liquidity was no longer working to our advantage, console ourselves that at least we were making money on our 50% of shareholders' funds still invested in equities? Not quite. Following July's very sharp market falls we felt it prudent to reduce our liquidity while retaining maximum flexibility. We did so by using FTSE 100 Futures.

Long-standing shareholders will know that the use of futures by Personal Assets as an investment tool has been envisaged almost since Ian became Investment Director. A statement to this effect was first made eight years ago, in the Report & Accounts for the year ended 30 April 1994, and has been highlighted in the Report & Accounts every year since. Nor has it just been a theoretical possibility, since in past years we have used derivatives profitably on several occasions.

What made us decide in July to use FTSE 100 Futures rather than either invest more money directly in equities or hold on to our existing level of liquidity? Well, as you may imagine, during the July market plunge our feelings were becoming more and more like those of Nanki-Poo in *The Mikado*, when he spoke of *'modified rapture'*. On the one hand, the slide seemed to be gathering pace and we were starting to think that if it continued equity markets might bottom out at a point at which we would want to be fully invested again. A last great market sell-off, creating an irresistible buying opportunity, is what we have been waiting for.

Share prices had become so volatile, however, that we feared a sudden market upsurge *before* we could prudently re-invest our liquidity for the longer term. Re-investing liquidity is not as easy as it sounds. Choosing the right shares is only part of it. Other questions have to be faced. Is this a true market bottom, or another false one? Bear markets can have as many false bottoms as a drug-smuggler's luggage. What if the market *does* bottom out, only to leap by 25% in a week as everyone fights to buy stock and no-one can get it at anything like the price they are prepared to pay because no-one wants to sell and the last thing the market-makers are prepared to do is go short? Fund managers old enough to have lived through a couple of market cycles *(there are now very few of us around, believe me!)* will tell you that trying to catch a rapidly rising market can be like trying to snare a flock of birds in flight.

LIQUIDITY AND RISK

So what should we do? For five years or more our liquidity had guarded us against the dangers of the bear market. But by July we knew we also had to avoid missing out on the sudden leap by which bear markets are typically followed. Having spent five or six years waiting for the boat, we had no wish to miss it — especially since this particular boat may sail only once every decade or so.

We knew that as the stock market kept falling its long-term risk profile kept altering. So we decided it made sense to alter the profile of our own risk protection as the market fell, putting progressively *less* stress on guarding against a further decline and correspondingly *more* emphasis on protecting ourselves against the risk of missing out on a sudden major market rise. Do that successfully, and we could concentrate on long-term stock selection once the first indiscriminate leap in share prices had taken place. Miss the market turn, however, and no amount of careful stock selection could recover the lost ground.

The obvious thing for us to do in such circumstances was to use FTSE 100 Futures as a way of reducing our liquidity without actually buying shares. Being cautious by nature, we decided to do it in stages. Our total liquidity before starting the exercise was around £51m. On 23 and 24 July we took out futures which in effect decreased our liquidity from £51m to £31m, or from 59% to 36% of shareholders' funds, and we decided that each time the market fell another 5% we would reduce our liquidity by a further £10m through buying more futures. This meant that if the market dipped to 3,200 we would in effect be fully invested, and if it got as low as 2,750 we would actually have positive gearing of 30%.

FUTURES IN THE FUTURE

That's the story so far. At the end of July the market stopped falling, so the bottoming out and the leap upwards were deferred yet again. We closed out our September futures, realising a useful net profit of £1m, and took out an equivalent number of December ones. This gives us effective liquidity of 39% (October 14).

By reducing our liquidity we are hedging our bets. This is because *not* hedging our bets at this stage would be playing for unacceptably high stakes. The FTSE 100, remember, is *already* well over 3,000 points down from its high. This dwarfs any likely further fall from now on, even though we still expect the market to go lower before it starts a sustained recovery and during October so far it has duly started weakening again. So we would rather forego a percentage of the possible benefits from a further fall than risk missing out on what may, when it comes, be a major rise (even a relatively modest 1,000 point rally from here would mean a gain of nearly 25% on the FTSE 100).

We can hardly wait!

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***.

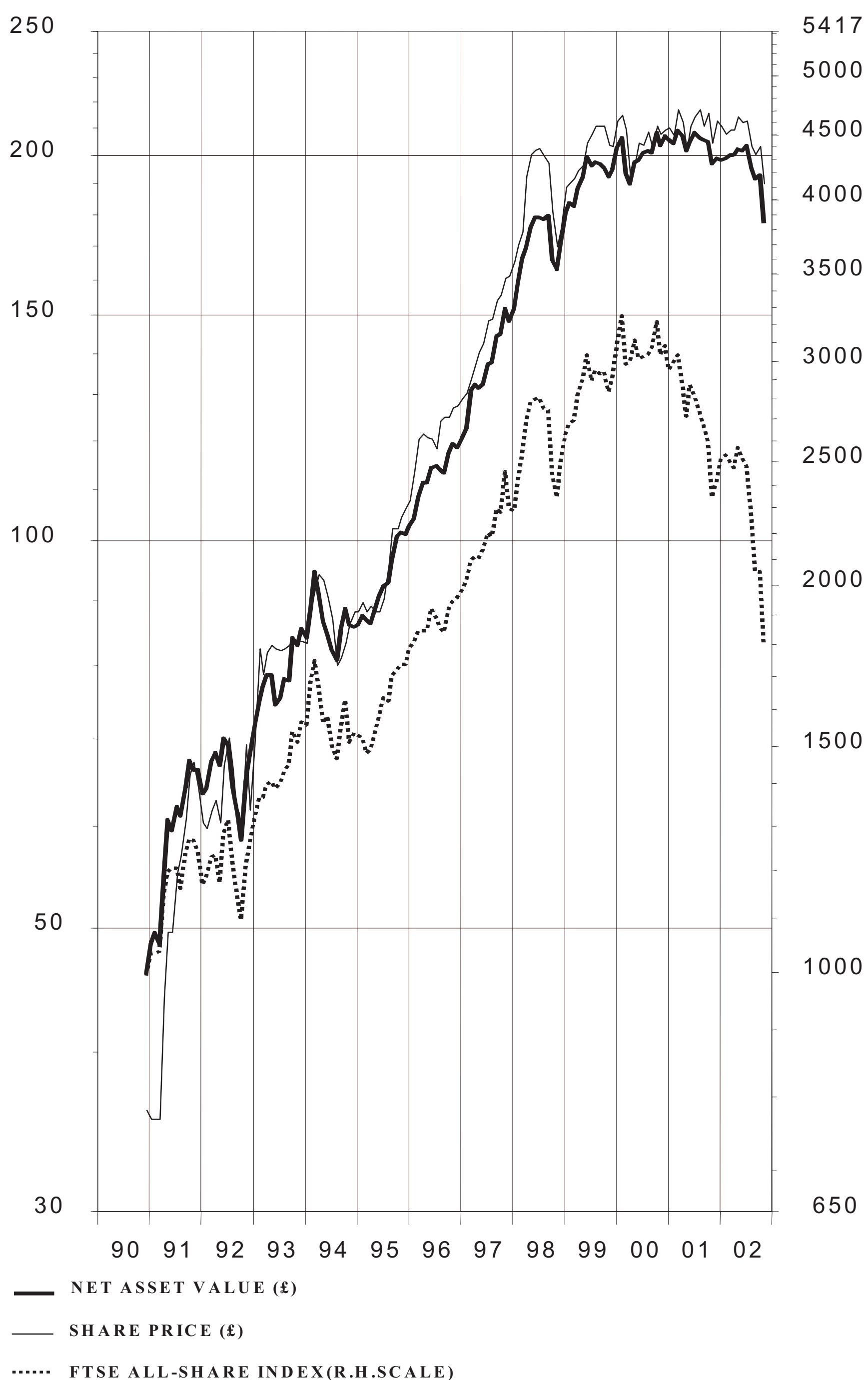
Investments in the Company's shares can also be made free of all commissions and charges through the Company's ***ISA*** or through ***PEP and ISA transfers***.

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-Sep-02 £'000**
Scottish & Newcastle	£4,592
BP	£3,698
Royal Bank of Scotland	£2,716
HBOS	£2,673
Shell Transport & Trdg	£2,122
Rentokil Initial	£2,083
GlaxoSmithKline	£1,845
Barclays	£1,560
British Assets Trust	£1,354
Foreign & Colonial IT	£1,202
Top Ten Equities	**£23,845**
Other Equity Exposure	**£30,635**
Effective Liquidity	**£33,238**
Shareholders' Funds	**£87,718**



% Change Over Period	31-Oct-90 11 11/12 Years	30-Apr-00 2 5/12 Years	30-Apr-01 1 5/12 Years	30-Apr-02 5 Months	30-Sep-02 Actual
SHARE PRICE	429.6%	-6.9%	-9.8%	-10.3%	£188.00
NET ASSET VALUE	285.1%	-10.5%	-13.6%	-12.1%	£178.81
FTSE ALL-SHARE	81.5%	-40.0%	-37.2%	-28.3%	1,801.48