

PERSONAL ASSETS TRUST PLC

MAY 2007

QUARTERLY REPORT No. 45

'THINGS CAN ONLY GET BETTER'?

Ten years ago, when New Labour took power in May 1997, Ian and I didn't believe a word of that sickening song. We were pretty sure that things were not going to get better. Instead, we expected them to get worse. As Ian wrote in the 1997 Annual Report:

'The rationale for [our] increase in liquidity [during 1996-97] was the high probability of a Labour Government within the year. Having worked in the 1970s with income tax of 83% on earnings and tax at 98% on so-called "unearned" income I still have a morbid fear of champagne socialists, even if they recycle themselves as "New Labour". Can we ever be certain that we will never again hear another Denis Healey (a supposed "moderate") sneering that he will "squeeze the rich until the pips squeak"? My strong suspicion remains that the incoming Labour government's necessary but undeclared source of higher tax revenues will be the corporate sector, through an increased corporation tax rate and a partial, if not full, removal of the ACT tax credit on dividends . . . Financing promised reforms in education, health care and law and order will prove an intractable problem . . .'

OUR PROPHECIES FULFILLED

As it turned out, Ian's prophecies were pretty close to the mark. Financing New Labour's reforms in education and health care has swallowed up gigantic and unprecedented sums of taxpayers' money¹ but there has been pathetically little to show for it all in the shape of better services. As for ACT, the outcome was even worse than we expected. We were hit with not the partial but the full removal of the ACT tax credit on dividends. I can't think of a more malicious or crassly stupid act by any Chancellor of the Exchequer,

¹ As I write this, we have not yet reached Tax Freedom Day, which now falls on 1st June, five days later than when Mr Brown took office.

although the blame must be shared with Norman Lamont, who in 1993 reduced the tax credit from 25% to 20% and thus established a precedent that Mr Brown was only too keen to exploit. I'm glad that at last, during the May 2007 election campaigns, Mr Brown started to be pilloried for his plunder of the pension funds. His own pension is safe, of course, as are those of Labour's natural (and growing!) constituency, the public service workers; but the pensions of others have suffered a blow as crippling as it was underhand.

Mr Brown is also responsible for some less well publicised changes which have caused harm. The Pensions Regulator has been instructed to judge a pension fund as being underfunded if too high a proportion of its assets is held in equities, thus forcing pension funds to sell equity holdings and buy large quantities of gilts instead. These gilts have inevitably been bought at high prices; by 2006, buying by pension funds had forced long gilt yields down to 50-year lows. Now, however, gilt yields have started to rise and are likely to rise further, resulting in inevitable capital losses for the pension funds, while at the same time the pension funds have been unable to hold as much in equities as they would otherwise have wanted because this would have made them (in Mr Brown's definition) 'underfunded'.²

As a footnote to this dreary tale, it needs to be said that it is not only

² I am sorry to say, however, that the root of the problem here was Nigel Lawson's monkeying around with pension fund surpluses in his 1986 Budget. To quote the 2005 Turner Report:

'Indeed not only did contributions fall but they were required to fall by deliberate government policy ... the Finance Act of 1986 ... required pension funds to identify whether ... they had a surplus of 5% or more, and to take action to remove the surplus within five years, or else lose some part of their tax exempt status.'

pensions that have been ravaged during Mr Brown's decade in office. It seems that a spendthrift Chancellor makes a spendthrift nation. The savings ratio has collapsed from 9.7% of income in the spring of 1997 to 3.7% today. It is very hard to see how a long term pensions and savings crisis can be avoided.

HOW DID THE MARKET DO?

As we contemplate a decade of broken promises and an economy in a far worse position than in 1997 we have to recognise that superficially the stock market has done not too badly during the Brown era. Over the decade, the total return per annum on the FTSE All-Share Index ("FTSE") averaged 7.5%. This, however, is before inflation and tax on dividends. After inflation and tax the return falls to 3.9%, and the sustainability of even this lower rate of return is heavily dependent on the FTSE's being at present 'appropriately priced'. As you will see from Ian's Managing Director's Report in the Annual Report, we believe the market currently to be 45% overvalued. Should the market adjust from this level, as we believe that at some time it must, the total return per annum for the Brown years would prove itself to have been precisely NIL.

'SPEND! SPEND! SPEND!'

I cannot understand the awe and esteem in which some people hold Gordon Brown. He has proved himself to be unintelligent and obtuse,³ a natural 'big government' man and a slave to complexity and obfuscation, although this is disguised by his *persona* as a canny Scottish bank manager from one of the early, cosy episodes of *Dr*

³ Does anyone else remember Jilted John's eponymous 1978 hit with its refrain, 'Gordon is a moron, Gordon is a moron'? I find myself humming it more and more often these days.

Finlay's Casebook.⁴ It is a telling comment on Mr Brown's way of doing things that *Tolley's Tax Guide*, 4,555 pages long in 1997, has now more than doubled in size to weigh in at 9,806 pages.

Mr Brown is also extraordinarily rude and graceless when carrying out the duties of his high office. He turns up to the Lord Mayor's Banquet at the Mansion House in a crumpled lounge suit rather than the expected attire. Such childish inverted snobbery is unbelievably pig-headed, pompous, arrogant and inappropriate. He insults both his hosts and his fellow guests, and he insults the people of Great Britain, whom he represents, and the Queen, whose minister he is. What would Mr Brown think if he were holding his first Cabinet meeting as Prime Minister and Alastair Darling turned up in a shell-suit and baseball cap?

As for his self-advertised 'prudence', he is in fiscal terms about as prudent as Imelda Marcos in a shoe shop. He is a kind of reincarnation of Mrs Vivian Nicholson of Castleford in Yorkshire, who in 1961 won the football pools and then announced that she and her husband, Keith, were going to 'Spend! Spend! Spend!'

It beggars belief that a man should have spent so many billions of pounds on such apparently deserving causes with so little to show for it. (Remember the £22.5 billion raised by 3G mobile 'phone licences in 2000? Whatever became of that, I wonder!) Mr Brown is a perfect illustration of the truism that you can't solve problems by throwing money at them. He is a child of socialism and of 1960s and 1970s 'big government'; and as the son of a Church minister he evidently believes, with Ecclesiastes 10:19, that 'money answereth all things'.

Yet there is no real opposition from the Conservatives, who have just announced another dispiriting U-turn. 'Dave' Cameron from 'Slough Comprehensive' tells us that Grammar Schools are too

⁴ I sometimes wonder how Mr Brown would have got on had he been exactly the same in every way, but had spoken Estuary English rather than had an educated Scots accent.

good for bright children from modest backgrounds and that a Conservative government will instead continue Labour's failed state sector social engineering experiment of huge, flashy comprehensives full of expensively but inappropriately dressed 'hoodies' indulging in gang warfare in the intervals of studying for A Levels in Leisure, Fashion and Beckham Studies. There is something of Churchill about 'Dave' — but, alas! only insofar as he brings to mind Churchill's celebrated description of Ramsay Macdonald:

*'I remember when I was a child, being taken to the celebrated Barnum's Circus, which contained an exhibition of freaks and monstrosities, but the exhibit on the program which I most desired to see was the one described as "The Boneless Wonder". My parents judged that the spectacle would be too demoralizing and revolting for my youthful eye and I have waited fifty years, to see The Boneless Wonder sitting on the Treasury Bench.'*⁵

INFLATION AND INTEREST RATES

Perhaps it is ironic that the policy decision for which Mr Brown, as Chancellor, received almost universal praise was that of surrendering his power to set interest rates. Making the Bank of England independent and giving freedom to the Monetary Policy Committee ("MPC") to set interest rates as it saw fit proved highly successful. Surrendering power, however, accords ill with what Lord Turnbull has described as the 'sheer Stalinist ruthlessness' of Mr Brown's personality. Interest rates depend on the inflation rate target, which is set for the MPC by Mr Brown. When Labour took office in 1997 the RPI was 2.6%. Now it is 4.5%. Mr Brown manipulates inflation to suit his own ends. Here is a comment from James Ferguson in *Money Week* for 18th May 2007:

'As always with Brown, there was the small print. The MPC's decision wasn't entirely free — they had to keep inflation within a narrow band.'

⁵ I'm reminded, too, of Enoch Powell's aside to the Monday Club on 20th April 1985. 'If you think the Conservative Party would kill its own grandmother for votes you are wrong. In fact, the Conservatives would kill the old girl and eat her afterwards.' Quoted in Simon Heffer, *Like the Roman: The Life of Enoch Powell*, Weidenfeld & Nicolson, 1998, p. 890.

Fair enough, you might think. But as soon as inflation got too high and interest-rate rises threatened, the Chancellor arbitrarily switched the measure used from the Retail Price Index (today at 4.5%), which had got us through 50 years without a hitch⁶, to the much lower Consumer Price Index (now at 2.8%). Meanwhile, the Office of National Statistics (ONS) has allowed itself to be bullied into using all sorts of tricks to deliberately lower (sic) the reported rate of inflation. There's 'hedonics'⁷, where if a product is assumed to be better quality (like a computer having more memory) then its price rise is actually recorded as a price drop. Worse is 'substitution', where an increase in the price of chicken is ignored if beef prices stay flat, because households are assumed to have substituted beef for chicken⁸. Yet even with these efforts, CPI is now way above the Bank's 2% target.'

Mr Brown is very consciously a Scot; and I must say that were I an Englishman I would be pretty fed up with the UK's current constitutional arrangements. I would resent having policies affecting me in important areas decided by Scots MPs while such matters in Scotland were decided by another Parliament. As for Mr Brown's being able to be Prime Minister although he has no responsibility for huge swathes of policy in the part of the country he represents, I think I should be more fed up still. When Northern Ireland had its own Parliament but still sent MPs to Westminster it would have been thought inconceivable for one of those MPs to have held senior ministerial office at all, let alone to have been Prime Minister.⁹

⁶ Not only Mr Brown creates new indices. For instance, the Tax and Prices Index (TPI) was brought in by Mrs Thatcher's first government as a measure of the increase that workers needed to maintain their living standards after prices and tax changes had been taken into account. It was a rather more useful index than the CPI.

⁷ See Quarterly N^o. 39.

⁸ This year being the 150th anniversary of the Indian Mutiny, when much trouble was caused by the alleged use of pork and beef fat for greasing cartridges. I would be interested to know the views of the Hindu, Muslim and Jewish communities on 'substitution' of this kind.

⁹ As an old-fashioned monarchist I am also irritated that people speak of Mr Brown as if he had already been chosen as the next Prime Minister. Choosing a Prime Minister is the prerogative not of a political party or of the House of Commons, but of the Queen. Rather than sending for Mr Brown, she could send for Mr Cameron, or for Sir Menzies Campbell, or even for me. Indeed, I rather wish she would.

'DARK BROWN STUFF'

Those who were brought up on *The Beano* at the end of the 1950s will remember frequent scenes in which Dennis the Menace or the Bash Street Kids were cornered by an irate farmer holding over their heads a huge pitchfork laden with steaming ordure, which was euphemistically referred to as 'dark brown stuff'. This seems an apt phrase with which to describe Mr Brown's various machinations and their manifold ill effects on the economy and on the UK's financial health. Have you noticed, for instance, that the UK achieved something astonishing this year? We have heard endlessly about sclerotic, overtaxed Germany; yet our public spending ratio overtook Germany's for the first time in living memory. The figures were 45.3% versus 45.1%. We seem ominously close to the tipping-point, after which we will be stuck in a high-spending morass with little prospect of real growth.

To quote Allister Heath in *The Spectator* for 12th May 2007:

'All the main English-speaking economies have grown faster than the UK since 1997, including not only the US and Ireland but also New Zealand, Australia and Canada . . . Other economies that have grown faster than Britain include Luxembourg, Greece, Iceland, Spain and Finland — as well as all the emerging economic giants, of course, led by China and India. While Britain has done better than basket-case economies such as Japan, Germany and France, it has been left behind by all its genuine, 21st-century competitors.'

However, the UK has seen striking growth in one area during the Brown years. The number of those employed in the public sector has risen by 0.9 million, to 7.0 million. This is 24% of the total workforce of 29.1 million, but it is even more depressing and sinister to relate that 37% of the increase in employment during the Brown years has been in the public sector. Is it any wonder that many, ourselves included, look at the expansion of the public sector and the ever-increasing percentage of GDP gobbled up by tax, and fear the recrudescence of a dependency culture and a society which knows nothing save handouts and

benefits? Indeed, the Stalinist approach to the public sector favoured by Mr Brown is matched only by the Stalinist inefficiency of his administration. The child tax credit fiasco, in which at least £5.7 billion has been overpaid over three years (some put the figure as high as £9 billion, if fraud is included), most of which will never be recovered, would do credit to any Five Year Plan or Collectivisation Scheme for sheer muddle and waste.

In 1997, Labour inherited a golden economic legacy that even Mr Brown has found difficult to squander completely; and few recognise that the comparison between the widely mocked Conservative government of 1992-97 and the Labour years thereafter does Mr Brown no favours. Much is made by Mr Brown's admirers (predominantly cronies, courtiers and deluded academics) of the UK's 59 consecutive quarters of economic growth. Yet the first 20 of these were under the Conservatives, and the Office for National Statistics tells us that the average quarterly growth rate was 0.77% during the Conservative quarters and 0.69% under the Labour ones. Hardly a huge margin, but enough to dispel the notion that Labour took over a basket case economy.

And where has this growth come from? Indeed, has it been real growth at all? As I wrote in September 2005, in *Quarterly* No. 38:

'Since 2001 the USA and the UK have moved from a 3% annual budget surplus to a 3% annual deficit . . . injecting an annual 1½% of GDP into the economy as new money. This, given a typical 2x multiplier, should have produced an extra 3% of annual GDP growth; but total GDP growth has been only 3% annually over that period in the UK and the US, so there has been no real GDP growth at all.'

What a fraud. It is like taking out a bank loan and calling it a pay rise. Huge personal and public borrowings, ballooning house prices — Mr Brown, and not some past Tory, has been the true 'load-samoney' Chancellor.

DROWNING IN DEBT

I've started on the subject of debt, so I'll finish. Here we enter an area of mystery. A report by the

Centre for Policy Studies ("CPS") in November 2006¹⁰ claimed that Britain's National Debt was *three times higher than the Government admitted* — £1.3 trillion, higher than Britain's GDP and equivalent to £53,000 for every household in the UK.

The CPS claimed that the official Treasury figure of £487 billion for the National Debt wrongly excludes the cost of public sector pensions liabilities, the hidden costs of Labour's Private Finance Initiative ("PFI") contracts and debts incurred by Network Rail. When these are taken into account, says the CPS, the total is £1,340 billion, or 103.5% of GDP. According to the CPS, the extra costs include funding public sector pensions to the tune of £720 billion, together with a further £90 billion for local government pensions. The hidden costs of PFI, which the government uses to deliver hospitals, schools and roads, are stated as being £25 billion, while Network Rail's debts are £18 billion. Mr Newmark and Mr Hammond said their figure could be even higher because their estimate for public sector pensions is conservative. The Government's own figure for these liabilities is £460 billion, which is excluded from national debt figures. But some studies say the bill could be as high as £1,025 billion.

The Government (claims the CPS) is also wildly understating the impact of PFI, under which private companies raise the finance for public projects and run them on the government's behalf. The firms are paid for their work over two decades or more. But critics claim that PFI is merely an elaborate way of keeping huge public spending commitments off the public books by claiming they belong to the private sector.

These are not my figures, dreamed up in order to taunt Mr Brown. They are the CPS's figures. And I find them scary. As Prime Minister, Mr Brown is obviously 'unfit for purpose'.

ROBIN ANGUS

¹⁰ Brooks Newmark MP and Stephen Hammond MP, *Simply Red*, Centre for Policy Studies, 27th November 2006, £5.

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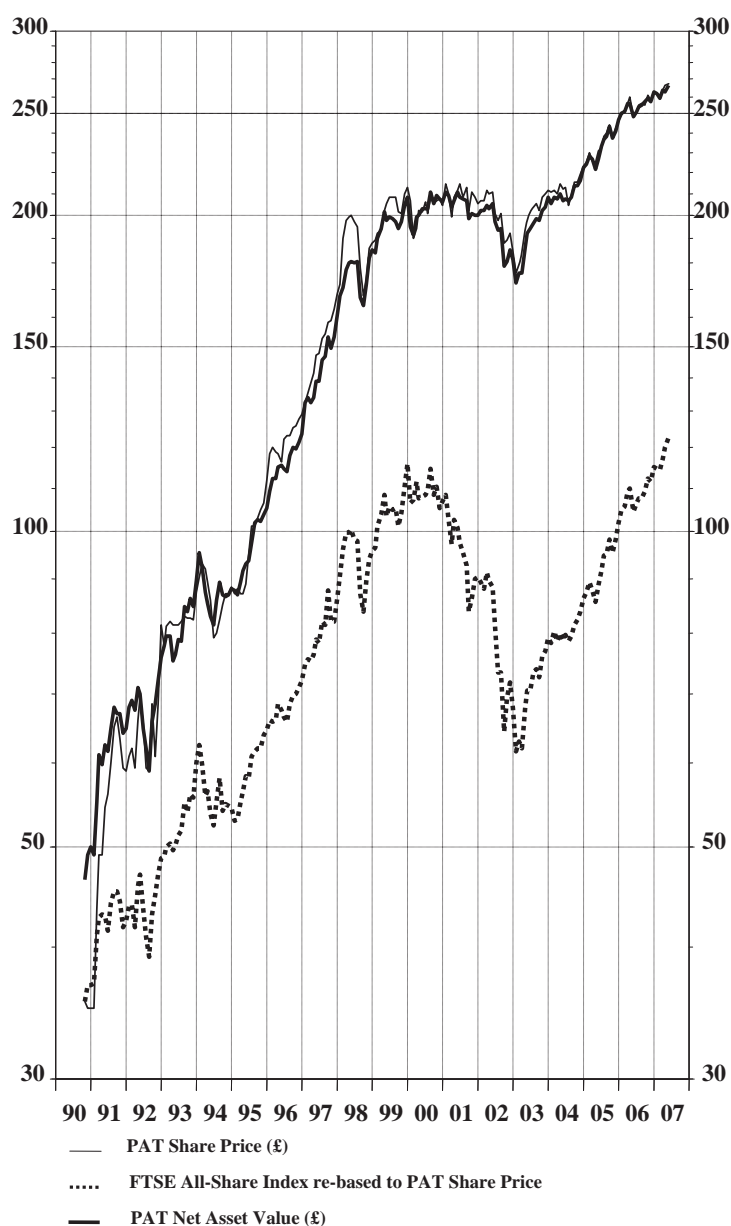
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PORTFOLIO (000's)	30-Apr-07
RBS Group	£13,896
Royal Dutch Shell 'B'	£13,837
BP	£13,572
HBOS	£11,902
GlaxoSmithKline	£9,412
Barclays Bank	£8,724
BT Group	£8,223
Scottish & Newcastle	£5,055
Alliance Trust	£4,830
Rentokil Initial	£1,738
Top Ten Equities	£91,189
Other Equities	£3,672
Effective Liquidity 50.7%	£97,555
Shareholders' Funds	£192,416

**PERSONAL ASSETS TRUST
PERFORMANCE**



Source: DATASTREAM

% Changes from	31-Oct-90	30-Apr-02	30-Apr-04	30-Apr-06	30-Apr-07
Period	16 Yrs 6m	5 Years	3 Years	1 Year	Values
Share price	649.3%	27.0%	24.0%	2.6%	£266.00
NAV per share	470.0%	30.2%	25.9%	3.3%	£264.70
FTSE All-Share (FTSE)	238.0%	33.6%	50.0%	9.2%	3,355.60
NAV relative to FTSE	68.6%	-2.6%	-16.0%	-5.3%	