PERSONAL ASSETS TRUST PLC

JUNE 2008 QUARTERLY REPORT No. 49

OUTLAWING THE DISCOUNT

'We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America . . .'

The US Constitution is rather more famous a document than the Articles of Association of Personal Assets Trust but the two do have certain things in common: both of them set out arrangements for the governance of a corporate entity and both of them enshrine strongly held beliefs and principles. Here I want to discuss one particular belief which we hold so strongly that it is reflected in a proposed change to our Articles of Association.[1]

It is the belief that for investment trusts the discount is voluntary.

The proposed change to the Articles commits the Directors to ensuring that the shares of Personal Assets continue to sell at close to net asset value ("NAV"). Previously, the commitment to keep our share price close to NAV was at the discretion of the Board, which — in theory, at least, although for the present Board ever to do so would be inconceivable — could at some future date have reneged on it. If the proposed amendment to the Articles be accepted by shareholders, however, the policy will from then on be able to be changed only by shareholders voting at a General Meeting. Directors are often reluctant to bind their successors. This, however, is exactly what we wish to do. The power to alter our *'no discount'* policy will accordingly cease to be the Board's and will belong directly to you, the shareholders.

'VOX CLAMANTIS IN DESERTO'

The words are from St Jerome's Vulgate translation of the Gospel according to St Mark, chapter 1, verse 3: *'The voice of one crying in the wilderness.'* As far as investment trust discounts are concerned, I know only too well what must have been in St Mark's mind as he wrote those words. Sometimes it seems that in articulating the belief that for investment trusts the discount is voluntary I might as well be saying that the earth is flat or that Mr Brown is the greatest British Prime Minister since Sir Robert Walpole. Some years ago I began a speech at a Securities Institute debate in Edinburgh on the subject of investment trusts with these very words:

'THE DISCOUNT IS VOLUNTARY.'

I still recall the gasps of disbelief they evoked. Yet, as so often happens on this particular issue, I won the debate but made no converts. Ian and I are constantly astonished that after years of having our advice eagerly sought by directors and managers of both new and existing trusts, and having given them detailed explanations of how our *'no discount'* strategy works in practice, and having witnessed their enthusiastic nods of acquiescence as we did so, not one other investment trust has seen fit to follow in our footsteps.

As the young might say nowadays, what's not to understand? Were it an untried strategy, this lack of imitators might be understandable; but our strategy has been proved to work. It has enjoyed thirteen years of unbroken success and has consistently done what it was meant to do through periods of sometimes sharply rising and falling markets and through spells of both outperformance and underperformance by Personal Assets itself. There is no mystery about it and it involves neither rocket science nor some attribute peculiar to Personal Assets. We have done nothing that any other investment trust with a straightforward capital structure and a reasonably liquid investment portfolio could not also do, and the number of such trusts is very large. Yet people still often speak of abolishing the discount on investment trusts as if it were an unattainable dream.

BROKEN PROMISES

Ian and I are, frankly, baffled by this. So it is a relief to be able to report that we are not the only ones to be questioning the received wisdom of the investment trust sector about discounts and how to eliminate them.

In the Summer 2008 edition of the magazine *Investment Trusts* there appeared an article by Fiona Hamilton aptly headed 'Broken Promises'. It tackled the subject of discount control and share buybacks and it began with some surprisingly forceful words.

'A generation ago the whole City observed the Stock Exchange motto, "Dictum meum Pactum" ("My Word is my Bond"). *An individual's personal as well as his business dealings were considered relevant to his reputation, so that even such an impersonal transgression as being caught travelling first class on a third class ticket could lead to disgrace. Many still adhere to the same moral code, but not, some are now saying, certain investment trust directors. Having persuaded investors to support new issues or restructurings with the promise that their trust's share price would be kept to a specified maximum discount to NAV, they have allowed it to widen much further.'*

The article, a thoroughly researched and comprehensive one, goes on to give various examples of investment trusts which have

[1] For this and other proposed changes to the Articles of Association, see the Annual Report.

made promises to their shareholders about controlling the discount but have failed to keep them. Mentioning names here would be invidious[2], but one trust was cited as having a 17% discount compared to a recent commitment to a discount ceiling of 7.5% — a ceiling which, according to the article, *'it has now quietly abandoned'*.

Another trust with a commitment to a discount no higher than 5% was recently allowed by its Board to sell at a discount of over 20%, this shocking state of affairs being explained away by its management in the words that the commitment was *'to be over the long term and subject to normal market conditions, and conditions have not been normal'*.

Market conditions that have *'not been normal'* have never stopped us keeping our promise not to allow the shares to go to a discount. Why should they stop others? The words just quoted read more like an excuse than an explanation.

The article cites so many examples of trusts which have either broken their word or watered down their commitments to such an extent as to make them meaningless, that to continue the catalogue here would be depressing in the extreme. I will, however, mention one more trust singled out for criticism in the article. This trust was launched in December 2003 and committed itself then to keeping the discount *'within a few points of NAV'* through regular issuance and buying. Until April 2007 it traded at between a premium and a discount of 5%. Since then, however, its discount has widened to 16.5% and yet nothing has been done about it. Its manager is quoted as saying:

'It's a matter of tactics and time scale. Is there a discount? Yes. Are we comfortable with it? No. What are we going to do? Time will tell.'

Rather than keeping shareholders properly informed about the Board's intentions, the manager seems almost to be taunting them.

'BIG BROTHER KNOWS BEST'?

There is an arrogance about such an attitude on the part of trust Boards and managers that makes me think of all those patronising announcements so typical of modern life, beginning, *'For your own comfort and safety . . . '*

I know perfectly well what makes for my own comfort and safety, thank you very much, and it is usually the reverse of what the announcements are telling me; the *'comfort and safety'* being so solicitously referred to is in fact seldom mine, but is that of those making the announcements.

When promises have been made and firm commitments have been given, Boards should not then treat shareholders as if they were schoolchildren, or a herd of mute, cowed passengers penned miserably in Terminal Five. Presumably the shareholders of these trusts bought the shares in the expectation that the Board's promises about controlling the level of the discount would be fulfilled. They have every reason to be angry if promises are not kept, and the trust sector as a whole is harmed when promises seem not to be worth the paper on which they are written and Boards give the impression that their word is not to be trusted.

SHAREHOLDERS KNOW BEST

Our belief is that shareholders know best and that they are entitled to get what they want and what they have been promised. I'm glad to say that the *Investment Trusts* article recognises what we are committed to doing:

'Personal Assets is arguably the greatest proof that buybacks can work. It has kept its discount to minimal levels for over a decade and has issued new shares to prevent a premium developing when demand outstrips supply. As proof that this lack of volatility can be appealing, its issued capital has increased steadily since buybacks began.'

This is true, as the figures confirm. It is as long ago as April 1995 that Personal Assets last sold at more than a nominal discount to NAV. At that time there were 152,187 shares in issue, whereas by our 30 April 2008 year end the number of shares in issue had increased nearly fivefold, to 733,051. So much for the idea that buying back shares to eliminate the discount inevitably means that a trust will shrink to an unsustainably small size. We believe, in fact, that the truth is the exact opposite: if shareholders are secure in the knowledge that their shares will never be allowed to go to a discount to NAV, they will be encouraged not to sell their existing shares but to buy more.

Although our *'no discount'* policy has facilitated a two way traffic in the shares of Personal Assets (which is exactly as it should be, because the policy is intended to meet shareholders' requirements — sometimes shareholders need to realise their shares and they want to do so without suffering the effects of the discount) the preponderance of new shares issued over existing shares bought back must mean that we are doing something right. As the Chairman notes in his Statement this year:

'We are pleased to report that at the year end we had more shares in issue than a year ago, investors having subscribed some £1.6 million of new capital. On the face of it, this is surprising in a year during which the FTSE All-Share fell by 7.6% and pessimism about markets was widespread. Our high liquidity in dangerous times does not fully explain this, since investors can always hold cash directly. I believe, rather, that the fundamental reasons are that shareholders are confident we will continue to "do what it says on the tin" and ensure that no appreciable discount arises on our shares and that they prefer that Personal Assets' managers should determine when the liquidity should be reinvested in equities, rather than having to take that decision themselves.'

Assuming that the proposed change to the Articles is passed, shareholders will have the added confidence that the decision to continue the *'no discount'* policy will be theirs and no-one else's.

MAKING ENDS MEET

Personal Assets increased its dividend for the year by 12.2%, well ahead of the 4.2% rate of inflation as measured by the Retail Prices Index ("RPI"). We continue to use the RPI as our measure of inflation because we would insult neither our shareholders' intelligence

---

[2] You can find them in the magazine itself, which I can highly recommend to all followers of the sector and which is available from *Investment Trusts* Subscription Dept, FREEPOST SEA 5480, Sittingbourne, ME9 8BR, or see website: www.investment-trusts-magazine.co.uk.

nor their wallets by measuring the growth of our dividend against that of the Consumer Prices Index ("CPI"), which omits Council Tax and mortgage interest payments, or against the even more restricted benchmark cynically described as *'core inflation'*, which omits those non-essentials, energy and food.

To quote a recent statement from Unison, the public sector workers union, which has obviously wised up to Mr Brown:

'The idea of inflation that doesn't count housing or energy or seasonal food costs might be fine for statisticians and mythical people who don't live anywhere, don't eat anything and don't have to spend money on gas or electricity.'

Bearing in mind the omission of Council Tax from the CPI, one suspects that this is a pretty accurate description of how the government visualises pensioners and others on fixed incomes.

Since 1997, when the Labour party took office, the RPI has risen by 37% whereas our dividend has exactly doubled. In other words, whereas *'the pound in your pocket'* today would have only the purchasing power that 63p had in 1997 the real purchasing power of Personal Assets' annual dividend has risen by 46%. Furthermore, our commitment to keep increasing the dividend in real terms year after year remains intact.

In Quarterly N^o. 34 (September 2004) I looked at Personal Assets' dividend progress since it became self-managed in 1990. I'll update the figures here. Over the last 18 years Personal Assets' NAV per share has risen by 354% and its dividend by 360%, bearing out the truth of the old investment maxim that over the longer term dividend growth and capital growth go hand in hand. Our 360% growth in dividend compares with dividend growth of just 110% on the FTSE All-Share over the same period and a rise of 71% in the RPI, so the rate of increase has been both sizeable in itself and far ahead of the obvious benchmarks.

Speaking as a shareholder, too, it's pleasing to see that the Personal Assets shares my wife and I bought in the summer of 1990 at an average price of around £44, and which yielded only 2.3% when we bought them, now yield a prospective 10.7% on their book cost. In addition, during the time we've held them we've received dividends amounting to £48.27½ per share, which is more than we originally paid for them.

THE CASH INCOME OPTION

I have to admit, however, that Personal Assets (prospective yield 1.83% on a price of £255.50 and a current dividend rate of £4.70) is not a high yielding trust and is never likely to be. This is why during the year to 30 April 2005 we introduced the Cash Income Option ("CIO") to our Investment Plan. The CIO offers investors (who may be either new or existing Personal Assets shareholders) a cash income from realising a percentage of the total return from a holding in Personal Assets — a total return, we believe, that is higher in quality, and therefore more sustainable, than that available from high-yielding equities.

Using the CIO is as straightforward as using the other options in our Investment Plan; like them, too, it is zero-charge. The CIO lets investors draw an annual income of £4,000 or more (minimum £1,000 per quarter) from a shareholding in Personal Assets held within the Plan. Depending on their own tolerance of risk and view of markets, investors can choose to receive an annual 4%, 7% or 10% of the starting value of their holding as a quarterly cash income from the sale of shares. The minimum starting sum depends on the percentage rate of cash income chosen.

THEY SAID IT WOULDN'T WORK

As with our *'no discount'* policy, some sceptics said that the CIO would never work in practice. Again, we have succeeded in proving the sceptics wrong.

- They said that the shares would go to a discount if the market fell or if Personal Assets underperformed, causing the CIO to eat up capital by increasing the number of shares that had to be sold to provide the same sum in income. During the period in which the CIO has been in operation Personal Assets did indeed underperform for a time and markets did indeed fall. Yet our discount control mechanism continued to work effectively and no discount appeared.
- They said that even if Personal Assets shares didn't go to a discount and didn't underperform, their NAV would still fall in a falling market and cause users of the CIO to *'eat the seed corn'*. Again, this didn't happen. The share price of Personal Assets has been remarkably stable in a falling market because the NAV has been remarkably stable. Thanks to our high liquidity it has hardly moved at all and so the falls in the market have not necessitated the selling of a greater number of shares to realise a cash income than would have been the case had the market stayed steady. This is the result, in practice, of our stated objective of protecting and increasing ***(in that order)*** the value of shareholders' funds over the long term.

CASH FLOW AND THE DIVIDEND

The CIO has operated in good times and bad and has worked effectively. This year we have corrected what we had identified as being a small defect in its workings. The CIO until this year made cash payments at the end of March, June, September and December. However, this pattern of cash payments gave rise to an inefficiency regarding reinvestment of dividends. Under the terms of the CIO, dividends received on shares held within it were reinvested in April and October in additional Personal Assets shares, while shares then had to be sold two months later, in June and December, to realise cash to make the quarterly distributions.

We have corrected this inefficiency by altering the terms of the CIO so that cash payments will be made at the end of April, July, October and January in each year, thereby avoiding the necessity for any reinvestment of dividends. This, we believe, makes the CIO even more efficient and *'fit for purpose'* than it was before and we are grateful to the holders of the CIO with whom we worked in arriving at this improvement to its functioning.

ROBIN ANGUS

Personal Assets Trust 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 ***ISA transfers***.

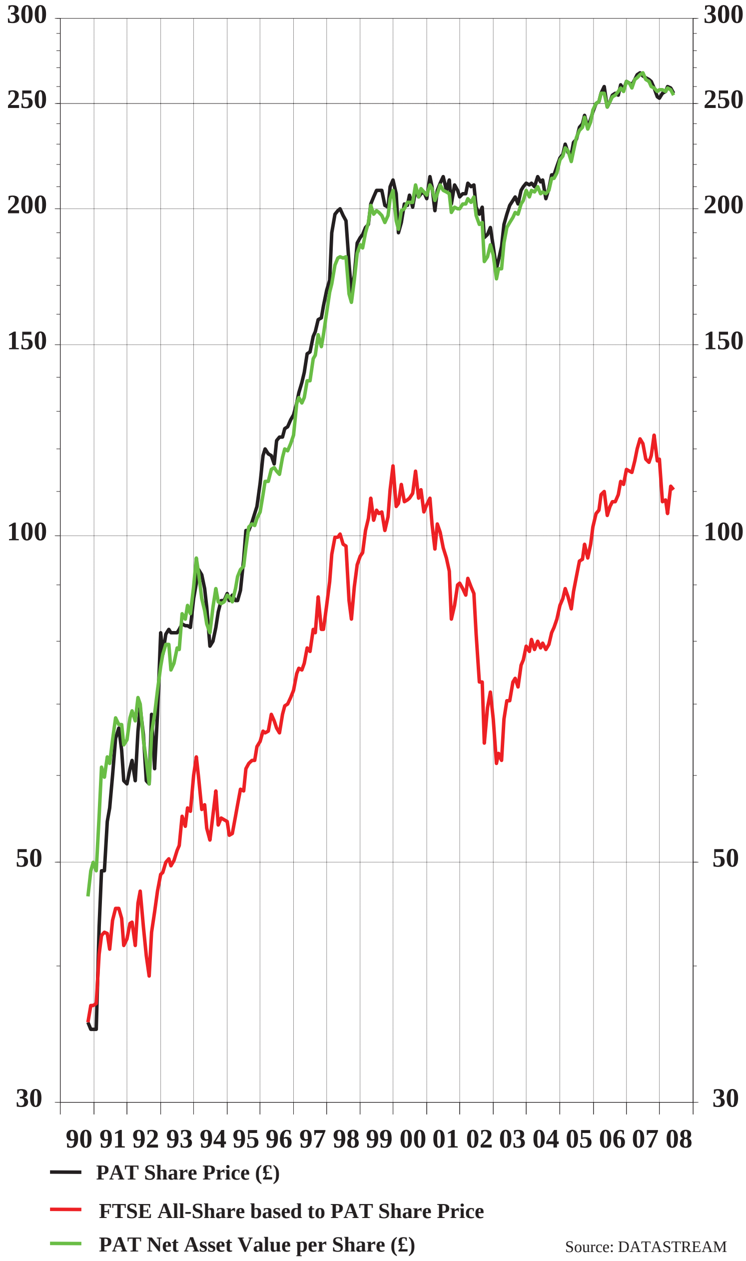
Full details of how to invest in the shares of Personal Assets can be obtained from:

Steven Budge
Personal Assets Trust PLC
10 St Colme Street
Edinburgh EH3 6AA

Tel: 0131–225 9995
E-mail: steven@personalassetstrust.com

PORTFOLIO (000's)	**31-May-08**
Royal Dutch Shell 'B'	£16,419
BP	£14,586
GlaxoSmithKline	£7,238
BT Group	£5,772
HBOS	£4,397
Alliance Trust	£4,391
Royal Bank of Scotland	£3,680
Barclays	£2,979
Philip Morris Int. (US)	£1,942
Dover Corp. (US)	£1,366
Top Ten Equities	**£62,770**
Other Equities held	**£8,644**
FTSE 100 Future sold	**-£73,396**
Liquidity	**£189,270**
Shareholders' Funds	**£187,288**

Personal Assets Trust Performance



% Changes from	31-Oct-90	31-May-03	31-May-05	31-May-07	31-May-08
Period	17 Yrs 7m	5 Years	3 Years	1 Year	Values
Share price	621.1%	29.3%	11.2%	-4.2%	£256.00
NAV per share	451.3%	32.9%	13.1%	-3.8%	£256.00
FTSE All-Share (FTSE)	210.5%	56.6%	24.1%	-10.4%	3,082.26
NAV relative to FTSE	77.6%	-15.1%	-8.9%	7.3%	