PERSONAL ASSETS TRUST PLC

AUGUST 2008 — QUARTERLY REPORT No. 50

REACHING A LANDMARK

Dr E M 'Coroner' Grace, brother of the great Dr W G Grace, is said to have had a scotch and soda carried out to him at the wicket each time he scored 50 runs during an innings.[1] On reaching Quarterly Nº 50 I feel entitled to the same. The first Personal Assets Quarterly appeared 14 years ago, in August 1994. On 31 July 1994 our net asset value ("NAV") was £85.79, our share price £80 and our discount 6.7% — we didn't succeed in eliminating the discount *(for which, see later)* until April 1995.

As the back page of this Quarterly shows, our NAV on 31 July 2008 was £251.27, our share price £250 and our discount a nominal 0.5%. Our NAV and share price were 293% and 313% respectively of their 31 July 1994 levels, compared to 178% for our benchmark, the FTSE All-Share Index.

Over that period our dividend per share has grown from £1.95 to a current rate of £4.70, being 241% of its 31 July 1994 level compared to the corresponding figures for the RPI and the aggregate dividend on the FTSE All-Share of 150% and 195% respectively.

Veteran shareholders will recall that in 2002, when we reached Quarterly Nº 25, we decided to re-issue them in book form with an introduction and commentary. This we expect to do again later in the year. Whether we do so just for Quarterlies Nºs 26-50 or for the entire series of Nºs 1-50 remains to be decided: no copies of the first volume are left, although I see one is for sale second hand on the internet and a recent attempt to sell an autographed example on eBay ended in failure.

REAFFIRMING OUR PRINCIPLES

Accompanying this Quarterly is an edited and updated version of Ian's speech to the Annual General Meeting on 17 July. This, together with the information on the back page, will bring you up to date with Personal Assets' current position and our view of world financial markets. So Ian and I felt it would be a good idea to use this *'landmark'* Quarterly to reaffirm the fundamental principles in accordance with which we run Personal Assets.

Is this just *'vain repetition'*, as St Matthew's Gospel says? No. It surprises us how sometimes the message fails to get through. One long-standing shareholder wrote recently to ask if Personal Assets had a policy about controlling the discount, for instance, and despite all the evidence to the contrary in Annual Reports and Quarterlies I find that quite a few shareholders assume we have all our liquidity sitting as cash in a bank or building society. I have also lost count of how often people have asked me when we intend to move into Europe, Japan, China or India, or into unlisteds, commodities, gold bullion, private equity or hedge funds — in short, whatever happens to be in fashion at the time.

So forgive me, please, if everything that follows is well known to you. In self-defence I'll quote some words of Sir John Templeton, who died last month at the age of 95 and will be much missed. In 1953 he wrote in a memorandum to his colleagues,

'Each of us should keep in mind the strong psychological effect of repetition. Pointing out a good performance record once does not have nearly the effect as pointing out the same record four or five times.'

Perceptive words from a great man, and they apply to more than just performance figures; so I have no hesitation in taking his advice.[2]

THE TEN COMMANDMENTS

What are our guiding principles in running Personal Assets? While bearing in mind the sometimes contrived nature of such lists, I'll highlight ten of these (not necessarily in order of priority):

1. ***Serving the shareholders***
2. ***Eliminating the discount***
3. ***Communications***
4. ***Acceptable performance***
5. ***Investing long term***
6. ***Avoiding specialisation***
7. ***Free to be unfashionable***
8. ***Using liquidity/gearing***
9. ***Rejecting 'incentive' fees***
10. ***The rôle of the Board***

In this Quarterly I shall examine them in turn and indicate how each of them influences the management of Personal Assets.

1. SERVING THE SHAREHOLDERS

Unfashionably, the Board sees its principal duty as being to serve the shareholders, not (as is nowadays mandated under company law) to serve the Company. What we wrote in the Report & Accounts for 1991 still holds good:

'Our Annual Reports have consistently stressed that Personal Assets is an investment trust for private investors. After a thorough policy review carried out during the year just past,

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[1] I can't now find the reference for this story. If one particular cricket-mad shareholder who often contacts me *(he knows who he is!)* can supply it, I'd be grateful. Since 'E M' reputedly scored 10,025 runs in first class matches and no fewer than 76,760 runs in total throughout his career, which continued until he was 67, he probably hit a good many fifties and got to consume a good deal of scotch and soda.

[2] According to Jonathan Davis in the *Financial Times* for July 20 2008, Sir John also said in June 2003 that his major concern was the emerging 'bubble' in real estate. *'In most nations in the world, real estate prices are way above the cost of reproducing the building, and that's dangerous. This is a very big bubble because the amount of money in real estate is several times as big as it is in stocks.'* He thought a good subject for research would be *'what governments would do when real estate prices go down 50%,'* which he was sure would lead to some money-making opportunities once the bubble burst.

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 a diversified equity portfolio or a number of other investment trusts or unit trusts. In other words, ***"our specialisation will be our shareholders"****.'*

In effect, the Board since then has run Personal Assets for people like themselves, believing that (as indeed seems to be the case) what suits us may suit others. Ian became Investment Director in 1990, when our market capitalisation stood at just £5.5 million. Today our market capitalisation is 35 times this, or £190 million, although had it moved in line with our benchmark, the FTSE All-Share, it would stand at not much over £13 million; and in December 2001 we became a constituent of the FTSE All-Share Index.

This expansion has resulted from a combination of acceptable NAV performance, communication with and service to shareholders and the issue of new shares through our zero-charge Investment Plan, funded by the Company because we believe it to be an important benefit to shareholders both for its own sake and as a mechanism for eliminating the discount. All of these reasons for expansion I shall touch on later in the Quarterly.

2. ELIMINATING THE DISCOUNT

By this we mean elimination of the share price discount to NAV for all time: a state of affairs we first achieved in April 1995 but which after 8 November 1999 (***'Discount Freedom Day'***) we were in a position to guarantee. Before then, trusts had been permitted to buy in their own shares for cancellation only by using revenue reserves (usually tiny in relation to a trust's share capital). On Discount Freedom Day, however, an amendment to the rules became effective permitting an investment company to distribute its capital profits by way of redemption or purchase of its own shares.

Trust Boards often seem curiously unenthusiastic about eliminating the discount. For instance, it was startling to read the Chairman of Alliance Trust, when referring to share buybacks and the discount in her last Statement, commenting:

'Having considered the arguments [for using buyback powers] *we have chosen not to do so. Instead we have continued to invest in the development of our financial services . . . '*

As an example of a *non sequitur*, this would be hard to beat. Boards have decided, wrongly, that the benefits of a low or non-existent discount accrue principally to the sellers. In fact the overwhelming benefit is to continuing shareholders, and to new shareholders for whom there is no risk of a future discount. It is the ultimate safeguard of shareholder value; if our long-term performance proved unsatisfactory, shareholders have the certainty that they will be able to exit at any time at a price close to NAV — in other words, without incurring any additional discount caused by poor performance.

3. COMMUNICATIONS

Well, this is what the Quarterlies are all about. By 'communications' I don't mean ever-longer Annual Reports filled with ever more irrelevant detail. Regulators, legislators and specialists in corporate governance seem not to recognise that there can be such a thing as information overload, or that, as the great science fiction writer Robert A Heinlein wrote:

'The best place to hide a needle is in a stack of needles.'

Annual Reports are now far less useful to private investors than they were 20 years ago. Their volume and opacity is bamboozling. It would be cruel to make a comparison here with the utterances of Dr Rowan Williams, the present Archbishop of Canterbury, but today he might find his true vocation as a successor to Hampel and Higgs. In contrast, in the first ever Quarterly we set out what are still our own views on communication.

'We regard our shareholders as our partners and one of our aims is to foster and strengthen this feeling of partnership . . . We aim to develop [the Quarterlies] . . . *as our shareholders wish, and find most useful. We hope that they will provide a means for shareholders to get to know us better and to understand more fully how we think and work when managing your money and ours.'*

4. ACCEPTABLE PERFORMANCE

To individual investors, what does *'acceptable performance'* actually mean? Investment trust managers' actions have generally been dictated by institutional definitions of what performance should be and how it should be sought. All too often, trusts have chosen indexation or quasi-indexation, picked unduly risky and/or narrow specialisations (whether temporary or permanent), or adopted potentially disastrous capital structures — all so that they can *'do something different'* for the institutions.

Since we run Personal Assets for ourselves, we view absolute performance as being more important than relative performance against benchmarks and we measure performance in terms of the share price. Two main constituents go to make up acceptable share price performance for us. The first is decent long-term NAV performance above that of UK equities in general. The second, as noted earlier, is the very important one of the elimination of discount risk.

Words from our Annual Report & Accounts for the year to 30 April 1991 (the first Report & Accounts after Ian became Investment Director) are still relevant today:

'The object of portfolio management is not "to invest in good companies" or "to back management". It is to make money from buying shares for their eventual resale in the long term after a share price performance which exceeds that of a comparable index. Probably the best general investment advice is that given by Warren Buffett, America's most successful investment manager. It is summarised in two rules. The first rule is not to make mistakes. The second rule is not to forget the first rule.'

After nearly 20 years of running Personal Assets, we would add a third constituent of performance, which we use from time to time as a means of enhancing the two I mentioned earlier. This is the use on appropriate occasions of liquidity or gearing *(see later)*.

5. INVESTING LONG TERM

To an institution buying an investment trust, the performance horizon is often short term and relative performance is often an end in itself. In particular, institutions want to determine their overall level of liquidity and thus expect trusts to be fully invested in their specialist areas. The performance horizon of the kind of private investor Personal Assets serves, however, is much longer; year-on-year performance, while of interest, is of little relevance.

For this reason, the Board decided in 1991 to measure our NAV performance against our benchmark over rolling three-year periods. This was an attempt to avoid the short-termism of measuring results against our benchmark on purely an annual basis. However, given that our investment objective is 'to protect' and 'to grow' shareholders' funds, it fails to deliver a full understanding of the success or failure of investment performance.

In bull market conditions Personal Assets will tend to become more and more liquid, our performance worsening with each increase in liquidity. Conversely, in a bear market we will become increasingly invested in equities and eventually geared, again underperforming our benchmark.

Given that bull and bear markets can persist for many years, what will ultimately prove to have been profitable liquidity and gearing management of the type just described may create the paradox that ***for much of the time, Personal Assets will underperform its benchmark***. Only at points of inflection (i.e. significant shifts in market values when bull turns to bear or *vice versa*) will accumulated underperformance from our liquidity and gearing management bear fruit as outperformance.

6. Avoiding Specialisation

Given that we run Personal Assets as we want our own money to be run, we have no wish to tie our future to one *'far away country of which we know nothing'*, or to one market sector or one class of security, or to accept the lack of that all-important attribute of any investment portfolio, its liquidity (in other words, the speed with which it can be realised if the need arises). We cannot satisfy the requirements of every shareholder. We stick to what we know; and investors who want a stake in specialised investment areas should look for it elsewhere, over and above their shareholdings in Personal Assets.

7. Free to be Unfashionable

This is a corollary of avoiding specialisation, but there is more to it. We have had our times of underperformance and recently have sometimes felt that Kipling's *If* was written specially for us:

"If you can keep your head when all about you
Are losing theirs and blaming it on you,
If you can trust yourself when all men doubt you,
But make allowance for their doubting too."

Fundamentally, however, short-term criticism doesn't matter to us. We are managing our own money as we think fit, not trying to keep up with competitors or attract new business, and fashion doesn't influence us in our task.

8. Using Liquidity/Gearing

We view liquidity and gearing as fundamental investment tools in protecting and growing shareholders funds over the long-term.

We believe in the active use of gearing and liquidity in investment management. When markets look particularly attractive and we want to increase our equity exposure to more than 100% of shareholders' funds we will do so in a flexible way, typically by buying derivatives such as FTSE 100 Futures. When we believe markets to be overvalued, we may either hold part of our resources in cash or short-term fixed-interest securities or sell FTSE 100 Futures to reduce our equity exposure.

In exceptional circumstances our equity exposure could be as high as 150% or our liquidity as high as 133% of shareholders' funds.

9. Rejecting 'Incentive' Fees

An August 2008 paper by Grant Thornton, the accountants, claims that over 45% of mainstream investment trusts have some element of manager remuneration linked to 'performance' and that the incidence of this has grown rapidly in the last 15 years. However, they note that it is far from clear that this is to shareholders' advantage, since incentives *'can be a one-way option enhancing the return to managers'* and *'in themselves they do not make managers perform better'*.

I agree with this analysis. We believe incentive fees for investment managers to be counterproductive. Firstly, no manager ever tries to underperform. To try to motivate them through incentives to do their jobs is *naïf*. Second, incentive fees for investment managers gratuitously increase stress when calm and reflection is required. Third, incentives tempt managers to target their own bonuses rather than pursue the trust's best interests; underperforming managers will usually react by ramping up the investment risks they take.

Since 1990 Personal Assets has by deliberate choice had the simplest of fee structures — a flat percentage of shareholders' funds, so that the fee paid can fall as well as rise and is unaffected by any gearing the trust might take out.

10. The Rôle of the Board

A final key ingredient of Personal Assets' success (although it might as well have ranked first in the list) has been its old-fashionedly stable and committed Board.

The Board of a trust catering specifically for private individuals is of vital importance because it acts on behalf of shareholders as the guardian of their interests and as the guarantor of continuity. As the Chairman wrote in 2003,

'Another significant event during the year was the publication of the "Higgs Report" on non-executive directors. Among its remarkable conclusions was one which suggested that a Board would be the stronger if it were constantly changing and its members hardly knew each other. Another proposed the appointment of a senior non-executive director as a rival to the Chairman. You will not be surprised to read that your Board does not believe this is how Personal Assets should be run.'

Given that Ian and his family own shares in Personal Assets worth £14.3 million and the other Directors and their families own shares worth a further £1.5 million, the Board has a more than ordinary commitment to the trust and community of interest with its shareholders. This is what we intended when we started running Personal Assets in 1990 and is how we shall continue in the future.

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***.

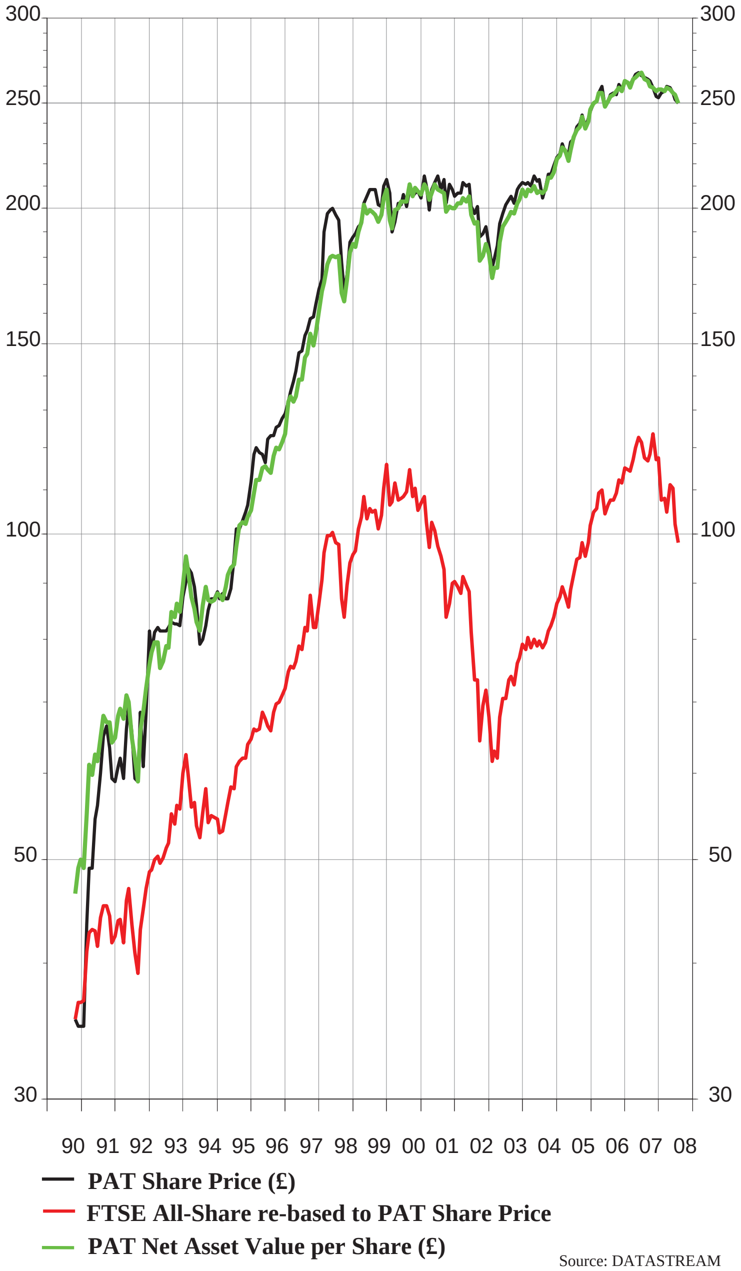
Full details of how to invest in the shares of Personal Assets can be obtained from:

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-Jul-08**
Royal Dutch Shell 'B'	£13,900
BP	£12,504
GlaxoSmithKline	£7,644
Royal Bank of Scotland	£5,117
BT Group	£4,519
Alliance Trust	£4,004
HBOS	£3,193
Barclays	£2,687
Philip Morris Int. (US)	£1,903
Dover Corp. (US)	£1,251
Top Ten Equities	**£56,722**
Other Equities held	**£7,117**
FTSE 100 Futures held	**£74,434**
Liquidity (25.3%)	**£46,772**
Shareholders' Funds	**£185,045**

Personal Assets Trust Performance



Source: DATASTREAM

% Changes from	31-Oct-90	31-Jul-03	31-Jul-05	31-Jul-07	31-Jul-08
Period	**17 Yrs 9m**	**5 Years**	**3 Years**	**1 Year**	**Values**
Share price	**604.2%**	**22.5%**	**5.2%**	**-5.3%**	**£250.00**
NAV per share	**441.1%**	**27.8%**	**6.3%**	**-4.8%**	**£251.27**
FTSE All-Share (FTSE)	**177.0%**	**34.4%**	**3.9%**	**-16.4%**	**2,749.21**
NAV relative to FTSE	**95.4%**	**-4.9%**	**2.2%**	**13.9%**	