PERSONAL ASSETS TRUST PLC

JUNE 2009 **QUARTERLY REPORT No. 53**

A BREAK WITH TRADITION

I have been asked by Robin Angus to write to the shareholders following the appointment of Troy as Investment Adviser to PAT in March (as referred to in the previous Quarterly Nº 52). Filling Ian Rushbrook's shoes is a daunting prospect for any fund manager, but I relish the challenge of building on his track record of looking after shareholders' capital for the past 18 years. Attempting to replicate Robin's beautifully worded Quarterlies, on the other hand, is maybe too much! I have been reading these reports avidly for over ten years as a fellow shareholder. Robin's prose, seasoned with classical references, is something I cannot begin to emulate. Shareholders may be relieved that normal service will be resumed for the next Quarterly.

WILL PAT CHANGE?

I have met a number of shareholders since our appointment to explain how the trust will be managed in the future. The Board and I see this process as one of evolution, not revolution. My investment approach has not been materially different in recent years from Ian's, with a bias towards capital preservation.

I have received a number of questions from shareholders as to how Troy's appointment will affect PAT. The Board and I felt this Quarterly presented a good opportunity to provide the answers to a wider audience.

What is your rôle?

As Investment Adviser to the trust, I will be responsible for day to day stock picking and asset allocation decisions within agreed ranges. Material changes to asset allocation, including the use of gearing or level of liquidity, will be discussed with the Board, and require its approval.

What is the rôle of the PAT Executive?

Robin will continue to be the main point of contact on the Board for shareholders and will write the Quarterlies. My relationship with Robin is very important and one which we both value highly. As was the case with Ian, Robin will be a foil for debate on investment matters. Those who know Robin well, or have read his reports, will be aware of his encyclopaedic knowledge of investment history. This has served the trust well over many years and will continue to do so. From my perspective, it is very helpful to have someone as experienced as Robin to discuss wider investment issues and set those into the context of managing the trust's asset allocation.

Steven Budge will often be the first point of contact for shareholders. He will also continue to manage the buyback and issuance of PAT shares, ensuring the trust's share price continues to trade at or close to net asset value and never at a meaningful discount or premium.

Shareholders may rest assured that, to all intents and purposes, Robin and Steven's rôles are unchanged. While I am based in London, supported by Troy's investment team, I speak to both of them often and I am making regular trips to Edinburgh in addition to Board meetings.

How does your investment approach differ from Ian's?

Not much. I am familiar with PAT's remit to protect and grow shareholders' capital. PAT's investment mandate is very similar to the Trojan Fund, an open ended investment company that I have managed for the past eight years. We will continue to use FTSE futures for asset allocation purposes. One of this trust's great strengths is that it gives its investment manager the ability to shift the portfolio in and out of the market, as well as to pick stocks. This has added significant value for shareholders over the years. The standard practice for investment trusts to be fully invested, and often with permanent structural gearing, has not served investors well for many years. We have no plans to use structural gearing.

The differences between Ian's approach and my own will be at the margin. In more recent years, Ian had focussed on macro market calls and less on 'bottom up' stock picking. I intend to have more of a balance between the two, selecting suitable stocks to hold for the long term. Like Ian, I have demonstrated an enthusiasm for low turnover. When choosing stocks I am keen to invest in strong business franchises that will withstand the difficult economic environment that I envisage for the years to come. Like Ian, my preference is for strong balance sheets and consistent cash flows. I choose to invest in companies that reward their shareholders with sustainable and growing dividends and or have strong asset backing. I will have a preference for managers committed to their businesses via co-ownership and who jealously guard equity capital. The vast number of rights issues in the UK market in recent months tells the tale of management teams who, like Gordon Brown '*failed to mend the roof when the sun was shining*'. Highly cyclical, capital intensive businesses and firms that use sophisticated financial engineering are to be avoided. I am sometimes told that this approach is boring but I do not believe our aim is to offer excitement. In fact such comments give me comfort that we are not involved in the more speculative areas of the market. After the volatility of the past two years, reliability and consistency are to be valued more highly. The protection and growth of people's wealth is not a race.

International diversification may increase somewhat. In the past, PAT held investments in the United States, but we may also selectively invest in European stocks. Overseas holdings will be chosen on a stock specific basis. We will continue with PAT's existing policy of not investing directly in the Far East, including Japan, where we have no expertise.

I have acquired one European stock for PAT to date, Nestlé. The Swiss-based consumer goods company has an outstanding track record of profitable growth and AA+ rated balance sheet. Shareholders have enjoyed increased dividends of 14% per annum over the past five years. Consumer branded goods firms with such characteristics are, in my view, underrated by investors. If inflation returns faster than expected, these businesses will be in a better position to protect real wealth.

I may also, from time to time, invest in other asset classes with the approval of the Board. I have held gold since early 2005 *(for The Trojan Fund)* when the price was $420. Robin hinted in the last Quarterly that I was likely to invest in gold. Since March, I have bought an exposure of gold bullion for PAT (about 9% of net assets). I view this as an alternative to holding part of the portfolio in cash. In a world of currency vulnerability and of historically low interest rates, gold has a rôle to play in protecting real value. It is an insurance policy against declines in other asset classes.

MODUS OPERANDI

We will have strongly held views on the economy and markets and will set the management of PAT, in that context. Unlike many fund managers, PAT will continue to retain a robust, independent investment view. Not for us the perennial cautious optimism or perma bullish views of asset gathering investment companies that are keener to make money ***from*** investors, rather than make money ***for*** them. I believe that when a manager puts his own money at risk he will tend to be less reactive, longer term and more risk averse. Decisions are likely to be more rational and less swayed by short term movements of market sentiment. As a fellow shareholder, my interests are aligned with yours and since my appointment, I have increased my family's holding to 700 shares. It is my intention to increase this in the years ahead.

STILL BEARISH?

In common with Ian and Robin, I have not been shy of expressing the view that we are in a secular bear market that began in the year 2000. Those who believed that the rally from 2003 to 2007 was a new bull market have been found wanting and suffered severe losses in 2008. Ian was right and moved the portfolio correctly to be 100% liquid in early 2008. This action protected PAT's shareholders from most of the collapse in stock markets last year. As markets fell, equity exposure was increased and now stands at about 70%. Huge risks remain, but we accept markets have fallen a long way. As I write, the FTSE 100 Index stands at 4350, down from a peak of 6700 in 2007 and 6950 on the last trading day of 1999. The UK market has fallen 37% (capital return) over almost ten years and by 52% in real terms, adjusting for inflation. Our belief is that the bear market is not over. Nevertheless the current rally may continue for some time and we will endeavour to capture some upside in the knowledge that one final major fall remains the likely outcome.

There remain reasons for caution. We are in uncharted waters economically. Few economies have succeeded in printing money *(euphemistically described as 'Quantitative Easing*') with success. Millions in Zimbabwe will bear witness to the failure of unlimited money creation. The journey chosen may make us all paper millionaires but a great deal poorer in reality.

In the 1980s and 1990s fund managers lived in a stable world of rising equity markets. Investment was a relative game of preferring one stock over another, where good businesses that were well managed performed better over time.

Today, investors' priorities are very different (*or at least they should be*). Knowledge of macro economic factors are critical to value creation and destruction. When the Bank of England and the US Federal Reserve are openly printing money, how do we value UK Gilts and US Treasuries? In the next year (2009/10) the UK's Debt Management Office has forecast net Gilt issuance of £203bn. That is fourteen times the average of the past ten years. Fourteen years' issuance crammed into one. No wonder the Bank of England is buying. What would gilt yields be if they were not? Much higher. At some stage these Gilts must be sold if inflation is to be controlled. The US Treasury numbers are even more eye watering. In the week beginning 22nd June alone, the US will have to sell $104bn of Treasury bonds. Such ever increasing issuance of IOUs shows little intention of repayment…in real terms at least.

One commentator compared the increased power of the Fed to a father rewarding a son with a '*bigger, faster car right after he crashed the family station wagon'*. The laws of supply and demand are being suspended by the authorities and this makes the outcomes unpredictable.

As our Chairman pointed out in PAT's Annual Report, further credit creation is no cure. The financial system is broken. The authorities' attempt to wind back the clock to 2006 will not work. Things cannot return ex-ante. The demise of General Motors and the collapses of AIG Insurance and RBS tell us that high leverage and opaque financial structures are unsustainable. The structured finance boom of recent years was based on the expectation that debt could always be rolled over and would never have to be repaid. The liabilities of AIG and RBS have not disappeared, but merely shifted to their respective governments' balance sheets. According to the IMF, the US and UK debt obligations will reach almost 100% of GDP in a few years time. We have reached levels where debt can thus no longer realistically be paid back. Sovereign default, a prospect inconceivable just a few years ago, can no longer thus be ruled out. The consequences are obvious. Monetary stimulus works by fooling people into believing in money's value, while their central bank cheapens it. Long-dated government bonds are not the investment of choice for anyone other than short-term tactical traders.

THE 'DASH FOR TRASH'

The rally in the market since early March was driven initially by '*short covering*'. Hedge funds had sold stocks in companies with weak balance sheets in the expectation of further share price falls. Favoured targets included consumer cyclical businesses (such as retailers and pub companies) and financials, especially banks and life assurance firms. As the rally continued into April, many more conventional investors chased these sectors, having found they were underperforming the rally. This is why the rally has been referred to as a 'dash for trash'. Investors have been falling over one another to invest in low quality, poorly financed companies in fear of suffering short term underperformance. The reason for this sudden change, from revulsion to enthusiasm, appears to be due to the new market obsession that the economy is past the worst. Green shoot watchers view the economic tea leaves in search of a turn. The data are no longer deteriorating at as fast a rate as in the fourth quarter of 2008 and the first quarter of this year. This is hardly surprising. The world economy fell off a cliff after Lehman Brothers failed in September and some restocking after a collapse in inventories is inevitable.

There is a distinct difference between things getting worse at a slower rate and a full scale 'V' shaped recovery that is now hoped for and discounted into many of the more cyclical parts of the stock market. In fact, while earnings forecasts have been cut and dividends passed, many stocks' valuations have increased by over 50%. The FTSE 250 Index (synonymous with domestic mid-cap UK businesses) has increased in value from a price/earnings ratio of 9 times in the past three months to over 16 times. These companies will require a huge recovery in profits to justify such valuations.

Our preference is to stick with the more liquid 'blue chip' stocks that are able to pay sustainable and growing dividends. The valuations of these companies are only up a fraction since the market lows. If the rally continues, it is likely to broaden out to the stocks that have been left behind. With interest rates so low, stocks paying reliable dividends should begin to perform. If risk aversion replaces the prevailing Panglossian 'V' recovery trade, then defensive stocks will hold up much better.

The reason for our caution is that after a debt driven financial collapse in 2008, a conventional economic recovery is highly unlikely. Certainly its sustainability must be in doubt. What is more likely is a stop, start economy. The steady stable environment labelled the 'Great Moderation' by Ben Bernanke is over and the prospect of increased volatility in the economy as well as the stock market is a more likely outcome. The trading environment is likely to remain unusually challenging for the next couple of years.

While the banking system may appear to be past the worst, huge amounts of further capital will need to be raised. This will prove highly dilutive for existing shareholders. With further bad debts to come in the banking sector, from commercial property and private equity, investors would do well to remember that companies can be both profitable and insolvent.

A BETTER WAY TO INVEST

In a recent seminar James Montier, a strategist at Société Générale, gave fund managers ten recommendations to achieve better long term returns. These were:

1. **Value, value, value** – the price you pay is important.
2. **Be contrarian.**
3. **Be patient** – in line with our own view on low turnover.
4. **Be unconstrained** – do not be conventional. Those who follow the index will not outperform in the long run.
5. **Don't forecast** – anyone investing on the basis of economists or analysts predictions in the past two years is likely to be poorer as a result.
6. **Cycles matter** – be wary of those ruling out 'boom and bust'.
7. **History matters** – Robin would vouch for this one!
8. **Be sceptical** – I have seen many get-rich-quick investments in the past twenty years. Most of them have led to large losses.
9. **Be top down and bottom up** – in 2008, a fund manager running a portfolio taking care to take account of the effects of the credit crisis is likely to have fared much better.
10. **Treat your clients as you would yourself.**

We could not agree more with all of these recommendations - the last one, most of all.

SEBASTIAN LYON

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***, ***ISA*** or ***ISA Transfer***.

The Company also operate a ***Cash Income Plan***, which allows shareholders' to take a capital return of either 4%, 7% or 10% per annum of the value of their plan.

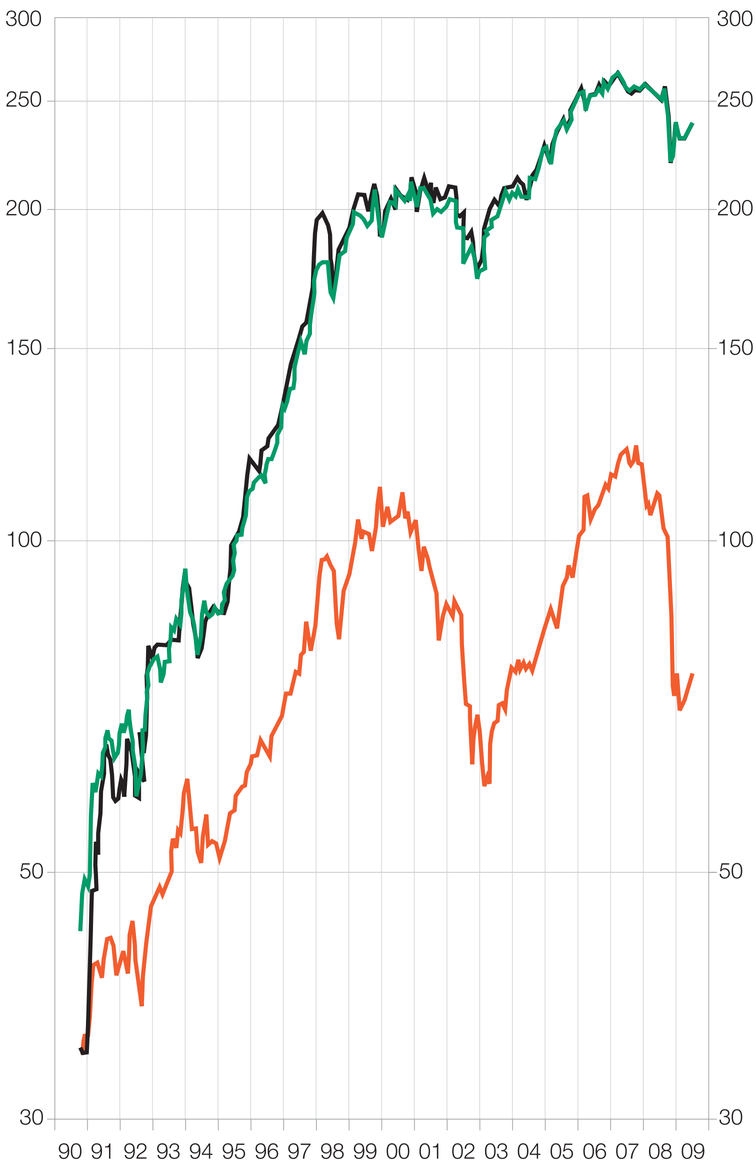
Full details of how to invest in the shares of Personal Assets can be obtained from the Company's website, **www.patplc.co.uk**, or from:

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

Tel: 0131–225 9995
E-mail: steven.budge@patplc.co.uk

Portfolio at 31 May 09	**£'000**
Alliance Trust	15,110
Royal Dutch Shell	13,065
BP	12,258
GlaxoSmithKline	6,773
British American Tobacco	5,908
Philip Morris Int. (US)	4,738
Nestlé	4,501
Centrica	4,296
Tesco	3,828
Newmont Mining (US)	3,788
Top Ten Equities held	**74,265**
Other Equities held	**9,547**
Gold (8.9%)	**16,052**
FTSE 100 Futures held	**40,832**
Liquidity (21.5%)	**38,698**
Shareholders' Funds	**£179,394**

Personal Assets Trust Performance



PAT Share Price (£)
FTSE All-Share re-based to PAT Share Price
PAT Net Asset Value per Share (£)

Source: DATASTREAM

% Changes from	**31-Oct-90**	**31-May-04**	**31-May-06**	**31-May-08**	**31-May-09**
Period	**18 Yrs 3m**	**5 Years**	**3 Years**	**1 Year**	**Values**
Share price	**578.9%**	**13.7%**	**-3.2%**	**-5.9%**	**£241.00**
NAV per share	**415.1%**	**15.7%**	**-3.9%**	**-6.6%**	**£239.19**
FTSE All-Share (FTSE)	**126.9%**	**2.3%**	**-22.8%**	**-26.9%**	**2,252.64**
NAV relative to FTSE	**127.0%**	**13.1%**	**24.5%**	**27.8%**	