PERSONAL ASSETS TRUST PLC

SEPTEMBER 2009 QUARTERLY REPORT No. 54

THANK YOU, BOBBY!

At the end of our July 2009 AGM Bobby White retired as Chairman after nearly fifteen years in office during which our share price rose from £87 to £234½, our annual dividend rate from £2 per share to £5 and our market capitalisation from £13 million to £176 million. Bobby's long experience of private client stockbroking was invaluable to the Board as a guide to the needs of individual investors and his instincts as a stockpicker were useful as a counterpoint to Ian's more top-down investment approach. His humour and lightness of touch contributed greatly to the smooth running of Personal Assets, so that his dissection of Ian's and my investment thinking at our regular Monday evening meetings was something to look forward to rather than dread and his occasional callings to order of overly discursive or argumentative Board meetings were always well received and willingly obeyed.

After Ian's death in October 2008 Bobby was a tower of strength to us all, co-ordinating the running of the company on a day to day basis while guiding our search for a new Investment Adviser. During his Chairmanship he has been not just a valued colleague but a personal friend. We look forward to keeping in close touch with him during his well-earned retirement.

WELCOMING A NEW CHAIRMAN

Hamish Buchan, who takes over as Chairman after having served as a non-executive director since 2001, scarcely needs further introduction. A top-rated investment trust analyst for many years and a past Chairman of the Association of Investment Companies, he might almost be described *(especially if I wanted to tease him)* as 'Mr Investment Trust'. Hamish and I began working together at Wood Mackenzie in 1981 and after our first ten shared years there a humorous well-wisher sent us an anniversary card addressed to 'the Odd Couple'. Like Jack Lemmon and Walter Matthau in the film, we have had our occasional minor disagreements; but it has been a happy and fruitful partnership and in having had the opportunity to work so closely for so long with two such men as Hamish and Ian I am gratefully aware that I have been the luckiest of mortals.

WELCOMING NEW DIRECTORS

Following the AGM we also welcomed two new directors. Stuart Paul joined Stewart Ivory (subsequently First State Investments) as an investment analyst in 1994 and is now First State's Joint Managing Partner with special responsibility for Asia Pacific and Global Emerging Markets. Frank Rushbrook, who is Ian Rushbrook's son and has Personal Assets in his bloodstream, is currently an Associate Director of F & C Management with special responsibility for European Small Cap stocks.

Already I sense a question forming in some shareholders' minds. Does this mean that we are about to start diversifying into Emerging Markets or European Small Caps? To save you the trouble of asking, the answer is 'certainly not'. Our policy remains as Sebastian Lyon, our Investment Adviser, described it in Quarterly N$^{o.}$ 53:

'International diversification may increase somewhat. In the past, PAT held investments in the United States, but we may also invest selectively in European stocks. Overseas holdings will be chosen on a stock specific basis. We will continue with PAT's existing policy of not investing in the Far East, including Japan.'

Stuart and Frank will, however, broaden the Board's discussions through enabling us to draw on their wide experience of global equity markets, while they share the deep commitment of the Board and the Investment Adviser to investment trusts and to Personal Assets' own distinctive philosophy. We look forward keenly to working with them.

WELCOMING NEW INVESTORS

After these eventful few months we don't just have a new Chairman and two new Directors; we have some new shareholders as well, and they deserve a welcome too. At the end of February 2009, just before Troy Asset Management took over as our new Investment Adviser, Personal Assets had a total of 750,876 shares in issue. Of these, 44,170 shares had been bought in at various times by the Company at a small discount to net asset value and were held in Treasury for re-sale, giving us a net total of 706,706 shares outstanding. As I write (9 September) all the shares we held in Treasury at the end of February had been sold at a small premium, either to new investors or to existing investors who wanted to increase their holdings. In addition, we have issued since then a further 18,333 new shares, giving us 769,209 shares in issue — an 8.8% increase in the net total at 28 February and just over five times the 152,187 shares outstanding before our 'no discount' policy first took effect in April 1995.

Our market capitalisation as of 9 September was therefore £197 million, its highest ever. This has raised a question in the mind of at least one shareholder, who wrote to me that he was concerned that following Ian Rushbrook's death the 'personal' would not be as evident in Personal Assets and that the Board might be tempted to concentrate more on the trust's size than on its performance. This is most certainly not the case. The Board's emphasis remains on performance (first the safeguarding of our capital and then seeking to make it grow); and while we are, of course, encouraged when new shareholders like what we do and seek to join us, size is not an objective. The Directors, and Sebastian, our Investment Adviser (who is a committed long term shareholder), remain focused on the share price and will always be so.

A PAT MEETING IN LONDON?

Little did I think that one day I'd find myself writing those words. Ian and I were never fond of travelling and the last time I can recall our making a trip together south of the Border was in 1994. All our Board meetings since the company was floated in 1983 have taken place in Edinburgh and, as befits a company registered in Scotland, so have all our AGMs. In our early years it didn't greatly matter where our meetings were held. We were a very small company and far fewer people came to our AGMs than do now — a couple of dozen at most. The meetings were brief and formal in those days, with no report from the Managing Director or Investment Adviser. However, in recent years the AGM has developed into a much more widely attended forum for presentations, questions and discussion. This year, for the first time, we held the AGM at an outside venue rather than at our registered office and we had an attendance of around 100.

While the AGM will continue to be held in Edinburgh, the Board feels that it might be useful to shareholders living south of the Trent to have an annual meeting in London as well, at which the Chairman and other Board members would be present and Sebastian would give a presentation and then answer questions. Our current thinking is that this should be held in January (the provisional date is Wednesday 20th) and that it should take the form of a presentation beginning at noon followed by a light buffet lunch. On our website we have a facility allowing you to indicate whether such a meeting would be of interest to you. This would be helpful because it would give us an idea of likely numbers.

http://www.patplc.co.uk/

RECESSION'S ALPHABET SOUP

Is the recession nearly over? It all depends on the shape it takes. V? Or U? Or W? Or L? Or even K?

- A V-shaped recession sees a quick upturn from the bottom and a speedy return to growth. This is what most economists think we will see, perhaps because it is what they want to see, the wish becoming father to the thought.
- A U-shaped recession bumps along the bottom for a while before recovery begins. This is the shape moderate pessimists expect.
- Gloomier forecasters look for a W-shaped, or double-bottomed, recession; while at present we may be staggering up from one bottom, another one awaits us.
- The most pessimistic possibility of all is the L-shaped recession (one which develops into a depression because, like an 'L', it plunges down but doesn't turn up), or its relative the 'ski jump' recession *(also known as the 'Armenian K' from the shape of the letter K in the Armenian alphabet — trust me!)*, where a short term stimulus causes an up-tick that eventually leads to a sharper drop.

Where do I stand? Somewhere between a W and an Armenian K. At the moment, however, my impression of the world of finance and economics is of the bland leading the bland. President Obama has reappointed 'Helicopter Ben' (so called from his 2002 advocacy of a 'helicopter drop' of money into the economy to fight deflation) to a second term as Chairman of the Fed. On 25 August Stephen Roach of the *Financial Times* wrote:

'[this is] *as if a doctor guilty of malpractice* [were] *being given credit for inventing a miracle cure.'*

Despite this, Mr Bernanke now seems to be competing with Mr Gordon Brown for the title of Saviour of the World. Does he deserve the accolade? Well, here he is on the US economy:

'Our forecast is for moderate but positive growth going into next year. We think that by the spring, early next year, that as these credit problems resolve and, as we hope, the housing market begins to find a bottom, that the broader resiliency of the economy, which we are seeing in other areas outside of housing, will take control and will help the economy recover to a more reasonable growth pace.'

That sounds quite reasonable, doesn't it — moderately hopeful, but not going over the top. The problem is that Mr Bernanke said it on ***8 November 2007***. Did he really believe it, even at the time? It recalls the Prophet Isaiah's condemnation of people who:

'say to the seers, See not; and to the prophets, Prophesy not unto us right things, speak unto us smooth things.'

Meanwhile Ian, an aficionado of Lewis Carroll, would have found it all too reminiscent of the Bellman in *The Hunting of the Snark:*

'What I tell you three times is true.'

MORE BUBBLE TROUBLE

Mr Bernanke got it wrong from the start. As we pointed out as early as April 2005, in Quarterly No. 36, his theory that the runaway train of asset prices in the USA was powered by a 'global savings glut' was simply untenable. Thrifty Asians did not cause the US housing bubble or deliberately cash in equity and pump up domestic US borrowing in order to fuel consumption. However, it was more convenient for Mr Bernanke to have someone outside the USA to blame than it was for him to admit that US lenders, borrowers, consumers and regulators were all conniving together in a guilty and gluttonous orgy of having their cake and eating it.

Since taking over as Fed Chairman, Mr Bernanke has followed Mr Greenspan in adopting as his theme tune:

'I'm for ever blowing bubbles,
Pretty bubbles in the air,
They fly so high, nearly reach the sky,
Then, like my dreams,
They fade and die . . . '

The trouble is that Mr Bernanke's bubbles, like Mr Greenspan's, do not *'fade and die'*. Instead, they burst and splatter their mess all over us. Mr Bernanke has been a great advocate and practitioner of 'quantitative easing' ("QE"), a phrase which bears the same relationship to 'printing money' as 'terminological inexactitude' does to 'lie'. It is a dishonest name for a dishonest activity. Indeed, some have even called it state sponsored theft. It has temporarily made the financial markets drunk on hopes of an economic recovery, but I can't see how such a recovery can possibly be anything other than faltering, fragile and fraudulent.

US consumers, like those in the UK, are of necessity only in the early stages of an unprecedentedly massive retrenchment exercise as they struggle to reduce personal debt and build up retirement savings while sweating under the burden of the extra taxation that will be required to service the huge additional borrowings that their governments have undertaken.

- The USA's gross national debt was just under $10 trillion at the end of 2008, or 70% of GDP, compared to $5.6 trillion and 58% at the end of 2000. Current estimates are for over $18 trillion at the end of 2014, or 100% of forecast GDP.
- In the UK the national debt, which stood at £350 billion when Labour took office in 1997, is forecast to quadruple to £1.4 trillion in 2014 even assuming that growth resumes this year.

The UK government's borrowing binge has even driven Mr David Cameron, the Leader of the Opposition, to make the statement on 18 August that the government was running the risk of not being able to meet its obligations. When someone who may soon take office as Prime Minister feels it right to say something as astonishing as this, we should all be worried.

Why not a bit of Deflation?

We now know that Mr Mervyn King, the Governor of the Bank of England, at the Bank's policy committee meeting on 6 August voted to increase the UK's QE ceiling to £200 billion rather than the £175 billion eventually agreed on. So what? It's only money. Nobody's actually going to have to pick up the bill for it, right?

Sometimes Mess[rs] Bernanke, King and their ilk seem like pushers of a miracle drug that can defer hangovers for ever. (We've had 'club drugs' such as Ecstasy and GHB, so why not QE?) The trouble is that we get hangovers for a good reason. If we didn't get them, we might keep on drinking and drinking until we poisoned ourselves. For hangovers, read deflation. Everyone is terrified of deflation and regards it as an absolute no-no: actual cuts in wages, salaries, pensions and benefits of the kind we last saw in the early 1930s would (it is believed) be politically impossible today. Yet sometimes I feel heretical and ask myself what would be wrong with a bit of deflation. This is why I was both surprised and pleased earlier this year when Paul Johnson reminisced in *The Spectator* about the historian A J P Taylor's alternative view of the 1930s:

'A J P Taylor liked to talk about the Great Depression of the Thirties. "It was all right for some, such as myself," he said, with satisfaction. "With a nice, safe job as a university don, I was sitting pretty. Prices were stable or going down. Don't let anyone tell you deflation is a bad thing. It's a jolly good thing for the middle classes with salaried jobs and savings. Life was good to us. Empty roads. You often had a railway carriage to yourself. You didn't have to book a hotel room. Or a restaurant. Everyone glad to see you — service with a smile. You could buy a three-bedroom house for £600, new. If it hadn't been for the rise of Hitler, I'd say it was the best time of my life, personally."'

Contrary to popular belief, I am not old enough to remember the 1930s personally. I do, however, remember what my family used to say about them and it bore out A J P Taylor's recollections pretty accurately. Since the 1930s, savers have been punished at the expense of borrowers, the profligate have been pampered and the grasshopper has triumphed over the ant. How pleasant it is to dream that some day things might change . . .

Don't Trust This Rally

'Sell in May and go away,
Come back on St Leger Day.'

There may be something in the old saying. In 2005 Barclays Capital worked out that between 1964 and 2004 the average return from buying the London index at the beginning of October and selling at the end of May was just over 7% whereas the average return from buying at the end of May and selling at the beginning of October was –2%. Although the old adage proved significantly wrong in 2005 and modestly so in 2006, it was modestly right in 2007 and very right in 2008, when between the end of May and the beginning of October 2008 the FTSE 100 fell by 18%, from 6,054 to 4,960.

This year the FTSE 100 ended May at 4,418. While we have not reached St Leger Day yet (12 September at Doncaster) the odds against a return to that level by then are much higher than the ante post 11/4 against currently offered on the joint favourites, Age of Aquarius and Kite Wood. But this is a liquidity driven rally — a *'dash for trash'* — which is likely to go into sharp retreat at the first sniff of bad news or expectations unfulfilled. While many investors, terrified of short term underperformance, have piled into poorly financed, low quality companies, we have focused on liquid blue chips that can pay sustainable and growing dividends. The valuations of such stocks have risen only a fraction since the recent rally began; yet, when interest rates are so low, shares paying a reliable income should begin to perform.

At our 30 April 2009 year end, when the FTSE 100 was at 4,244, we were 70% exposed to equities. This rose to 77% over the summer but at the beginning of September we trimmed it back to 70% again. A yield of 3.4% and a P/E of 17 times on the FTSE All-Share might suit a stable, growing economy and a serene financial outlook; but today they look, at best, deeply uninspiring and our next move is likely to be a further increase in liquidity. This, however, we will achieve not by reducing the long term holdings in direct equities we have been building up in recent months but by selling FTSE 100 futures. Some say it is 'dangerous' to be in cash just now because of the risk of missing out. We look at things differently. To us, 'danger' means actually losing money, not failing to grab the last halfpenny in an overvalued equity market which might turn and tumble at any time. We don't have a coat of arms; but if we ever did it would be difficult to think of a better motto for us than, *'Quod tuum tene'* — or, in its English version, *'What we have, we hold'*.

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***, ***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:

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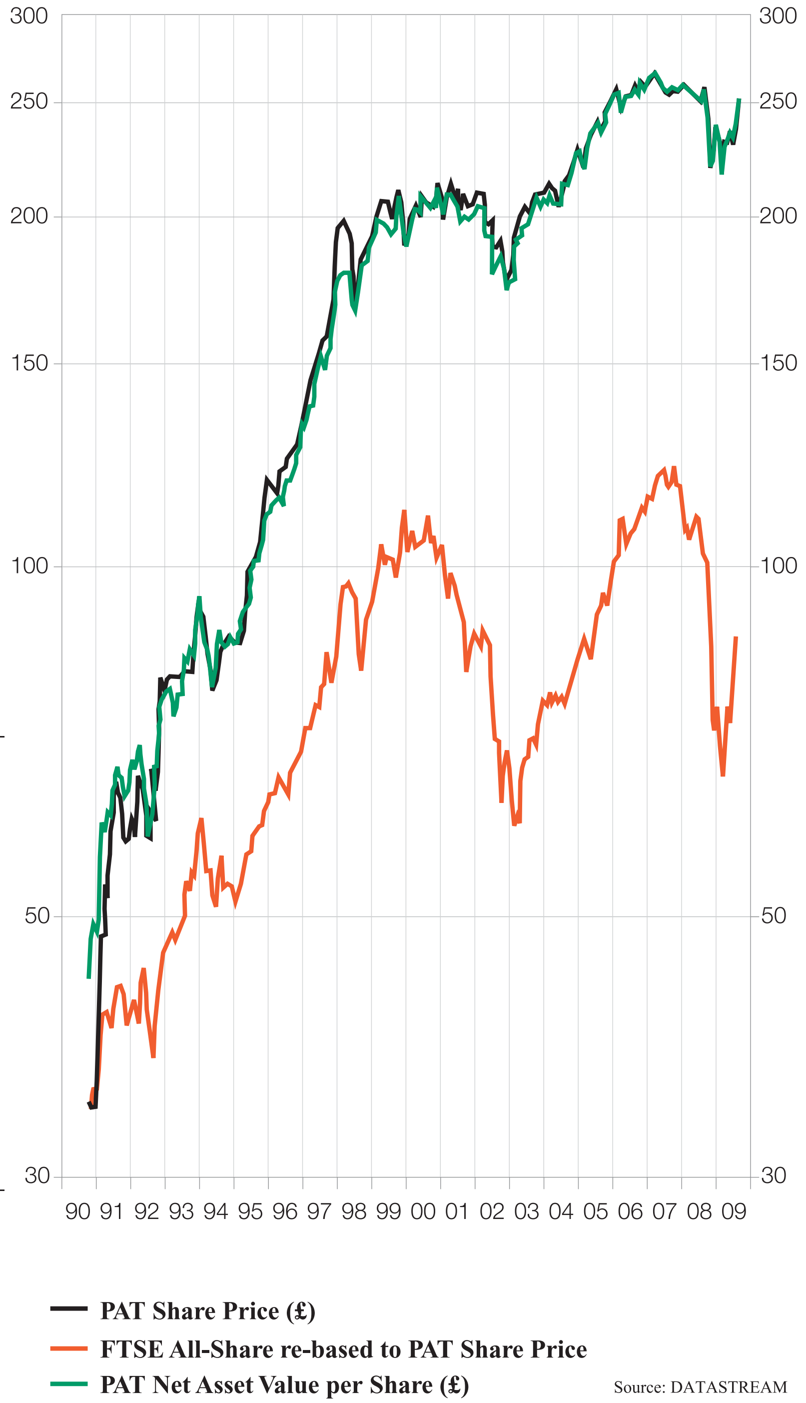
Personal Assets Trust PLC
10 St Colme Street
Edinburgh EH3 6AA

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

Portfolio at 31August 09	**£'000**
Alliance Trust	14,179
Royal Dutch Shell	13,057
BP	12,768
Nestlé	8,920
GlaxoSmithKline	7,820
British American Tobacco	6,559
Diageo	5,592
Philip Morris Intl (US)	5,026
Berkshire Hathaway (US)	4,909
Tesco	4,687
Top Ten Equities held	**83,517**
Other Equities held	**19,607**
FTSE 100 Futures held	**45,742**
Gold (8.4%)	**16,362**
Liquidity (14.8%)	**28,796**
Shareholders' Funds	**194,024**

Personal Assets Trust Performance



Source: DATASTREAM

% Changes from	31-Oct-90	31-Aug-04	31-Aug-06	31-Aug-08	31-Aug-09
Period	**18 Yrs 10m**	**5 Years**	**3 Years**	**1 Year**	**Values**
Share price	**616.9%**	**21.9%**	**-0.5%**	**-1.9%**	**£254.50**
NAV per share	**446.2%**	**21.6%**	**-0.5%**	**-2.6%**	**£253.62**
FTSE All-Share (FTSE)	**153.9%**	**13.8%**	**-16.2%**	**-12.1%**	**2,520.66**
NAV relative to FTSE	**115.1%**	**6.8%**	**18.7%**	**10.8%**	

PERSONAL ASSETS TRUST PLC

INVESTMENT ADVISER'S PRESENTATION TO THE JULY 2009 AGM

A SHAREHOLDER WRITES . . .

Like you, I am a shareholder in PAT. Over the ten years I have been an investor in the company, while many have lost money in the dot.com bust and the credit crisis, PAT has served its shareholders well. Ian Rushbrook, who was both a friend and an exemplar to me, had many strengths; and not the least of these was that he was prepared to be different.

There are two main ways to manage money. The more common of these is the high risk/high reward approach. Ian's approach was different. He believed that in falling markets one's first task was to preserve one's capital and that in rising markets one's task was to capture as much as possible of the upside without taking undue risks and unthinkingly following fashion. This is the approach I believe to be best for private investors who have made or have inherited wealth and who want to keep it.

CHOICES THAT ENDED IN TEARS

Keeping wealth is not as easy as it sounds, however. In 2003 Robin wrote in Quarterly N°. 29 about an expatriate couple who on their retirement had entrusted $50 million of capital to be managed by a leading Swiss bank. Over a period during which markets in general rose, their $50 million fell in value to $25 million. Dissatisfied, the couple during the second half of 1999 (just as world equity markets were peaking) sought the views of some of the most respected private client fund managers in the UK and overseas. They got the same advice from all of them: *'Now is an excellent time to buy equities!'*

The only dissenting voice was Ian's. He told them markets were hugely expensive and riding for a fall. However, Ian was not pitching for their business and so they transferred their remaining $25 million to an international bank specialising in managing money for wealthy individuals. Then they found, however, that their affairs were in the hands of a 25 year old youth who churned their portfolio aggressively. Soon it was underperforming again, whereupon the youth (contrary to the couple's instructions) began punting their money heavily into small US technology stocks. In a short time many of these joined the '90% club' of companies which had lost 90% of their market value from their peak at the start of 2000 and by 2003 the couple's $25 million had halved again to $12½ million.

I can cap this, however, with the tale of an entrepreneur who distrusted banks and decided on 'do it yourself' fund management as a day trader. He began with $5 million. Eight years later he put what was left on deposit: $500,000.

Both these two options, therefore — giving it to professionals and doing it yourself — ended in tears.

SO WHAT DO WE DO?

PAT is an antidote to both these flawed approaches. It is a unique vehicle for prudent private investors who seek first to safeguard their irreplaceable capital and only then, if possible, to make it grow in real terms. PAT's approach is based on capital preservation, sensible asset allocation (using FTSE 100 futures for strategic moves) and picking high quality stocks for our core equity portfolio. To quote one PAT investor:

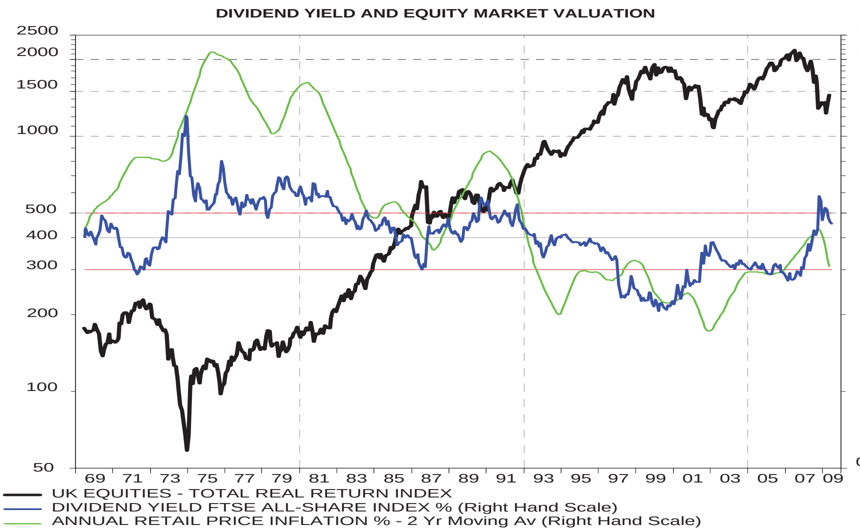
'The trust is not here to shoot the lights out.'

To protect wealth first, and only then to grow it, is a demanding mandate. It is necessary to be patient, to recognise that you won't perform over every period and to remember some golden rules:

- Be detached from the day-to-day market sizzle and spin. You are investing for the long term.
- Invest in sustainable business franchises and in companies with strong business positions.
- Look for growing dividends.
- Avoid recovery stocks and so-called 'turnaround situations'.
- Don't overpay for hope or be seduced by fashion.
- Avoid permanent capital loss.

CHART 1: MARKET HISTORY

The first of my two charts *(see below)* is an updated version of Ian's chart for the AGM in 2004 and shows the total real return on the FTSE All Share *vs* the dividend and rolling two-year inflation.



In 1999 the dividend on the FTSE All-Share was 2%. By 2004 it was 3.5%, but this in Ian's view still didn't represent good value. The FTSE 100 then stood at 4,500 and, in defiance of logic, the rally continued while the credit boom began; but 2007-9 has seen a steep market fall, from 6,750 to its present level *[16 July]* of 4,300, and the dividend yield is around 4.5% after a series of savage dividend cuts from banks and others.

CHART 2: WHERE DO WE GO?

At this level and on this yield basis the market seems to us now to be fair to good value and we have been becoming more enthusiastic about equities. Chart 2 *(below)* shows how critically important is the impact of the starting valuation of the market on long term equity returns. In 1998 Ian correctly identified that stocks were very overvalued and he positioned PAT accordingly. The market P/E was then 24 times and the market duly produced a negative return over ten years. 1998 proved the worst year since 1968 in which to have bought and held the equity market on a ten year view. 1999 looks likely to prove as bad, or even worse. In contrast, the best year to have bought the equity market on a ten year view would have been 1974, when the market was selling on six times earnings.

Today it is difficult to work out exactly where the market stands in rating terms because of the recent swingeing dividend cuts and the collapse in profits. Our best guess is that the market today *[16 July]* is selling on between nine and eleven times earnings. Taking history as our guide we might therefore reasonably expect real returns of 10-13% per annum from equities over the next ten years — but there can be no certainty of this.

WHAT ARE THE RISKS?

Despite our greater enthusiasm for equities we believe there are still good reasons remaining why we should not be fully invested. From Chart 1 *(overleaf)*, we can see all too clearly that inflation is a key variable which helps determine equity valuations. Deflation is also a risk, and we have no recent experience of this in the UK.

If inflation makes a serious comeback the market will be sure to fall further. Today we are in uncharted waters from an economic and market perspective. Interest rates are at their lowest for 300 years. This renders negligible the return from cash and impels one to look for an alternative, but the options available inevitably involve acceptance of more risk. Both bonds and equities currently yield substantially more than cash but remain vulnerable to a rise in inflation — and in the long run inflation destroys wealth.

To our consternation, the Federal Reserve and the Bank of England are openly, blatantly and unapologetically printing money. We may not have reached Zimbabwe status yet, but the risks the Fed and the Bank are running are huge and the temptations faced by the governments they represent are no less overwhelming. The UK and the US have a debt problem which is out of control. Some have called this 'a bull market in government' — in other words, even if consumers do succeed in reducing their indebtedness, governments will find themselves having to issue more and more debt to bridge budget deficits and to service the huge increases in government borrowings we have already witnessed. Meanwhile, even if no further horrors emerge it will take years to repair the banks' balance sheets, which governments have in effect underwritten.

For the US Dollar and for Sterling the demand is both finite and uncertain. However, the supply is unlimited — and, hence, the currency is compromised. We therefore *(and to Robin's unconcealed delight after many years of campaigning)* believe it to be prudent to hold some of our shareholders' funds in gold — the global currency which cannot be printed, the supply of which is finite, and which is independent of the world financial system.

WHERE PAT STANDS TODAY

The secular bear market which began in 2000 is not over. Whatever some optimists may predict, we are not seeing the beginnings of a new bull market. The odds are that stocks will move lower again; and we cannot rule out the possibility that there may be one last horror to come. This influences our thinking about current investment strategy; Ian was right in that whereas individual stocks can be risky, the biggest single risk is that of policy error and at the moment our predilection is to err on the side of caution.

How may the portfolio develop? None of us is seeking to change the core characteristics of PAT. During the selection process I explained to the Board that I envisaged 'evolution, not revolution'. From now on I would expect our liquidity (except in the most exceptional circumstances) to range from 0% to 50%. We will have a long term equity core consisting of shares in strongly financed companies that are able to pass on rising costs, e.g. Nestlé, Tesco, Shell and BAT; and our preference is for stocks paying high and stable dividends which can grow in real terms. In addition to this equity core we will use FTSE 100 futures for short term strategic moves. I am firmly committed to PAT; I have already added to my personal shareholding; and I look forward to doing so again in the years to come.

SEBASTIAN LYON