PERSONAL ASSETS TRUST PLC

MARCH 2011 QUARTERLY REPORT $N^{o.}$ 60

DIRECT SHAREHOLDER LINE

Personal Assets' direct shareholder line is changing from its previous 0131 225 9995 to:

0131 538 6605

Although there will be a short period of transition during which the old number will still operate, please use the new number from now on.

FORTHCOMING AGM

The 2011 Annual General Meeting of Personal Assets Trust PLC will be held on 21 July at The Roxburghe Hotel, 38 Charlotte Square, Edinburgh, beginning at 11.30 am. As last year, after the formal business of the meeting has been concluded there will be a presentation from Sebastian Lyon, our Investment Adviser, followed by a question and answer session. Then a light buffet lunch will be served, over which shareholders will have a further opportunity to question Sebastian and the Directors informally. The AGM is always good fun and a relaxed and enjoyable occasion. We look forward to seeing you there, especially if you were unable to make the London presentation earlier in the year — although there is no reason not to attend both!

The Annual Report for the year to 30 April 2011 will be published in June and you will receive along with it a card to return to us if you would like to come to the AGM. This will be useful in helping us to plan catering numbers.

NO TO A SHARE SPLIT

Our shareholders are our principal intangible assets, and remarkably diverse assets they are. Some are themselves investors with enviable track records and a store of experience that any professional might envy. Indeed, discussing investment matters with them can be more stimulating and productive of fresh insights than many a conventional investment management industry gathering. However, an unavoidable challenge of running an investment trust intended to meet the needs of private investors is that different private investors want different things.

Sometimes this is because of their age or family status, but it also has to do with character and temperament. There are private investors who are risk-averse to the extent that they worry about the solvency and stability of even the largest banks and insurance companies (and who can blame them after the fate of such as Equitable Life, Northern Rock and others in recent years), while others crave excitement and are frustrated by caution, especially when, like a few of them I have encountered in my time, they seem to believe that investment professionals really *do* know what is going to go up by 50% over the next six months but for some strange reason prefer to keep the knowledge secret.

Some private investors want dividends, while others, often for tax reasons, see dividends as an irrelevance and an irritation. Many have their own preferences and prejudices. Some object to banks, others to tobacco shares. Some clamour for holdings in Japan or in emerging markets, others want convertibles, corporate bonds or, frequently, commercial property. Some see gold as the safest investment there is, others as one of the riskiest. In short, as has often been said, you cannot please all of the people all of the time.

In Quarterly $N^{o.}$ 59 I mentioned that the Board was considering two changes to the way Personal Assets does things. The first was the idea of a share split, possibly one that would leave shareholders holding ten shares for every one currently held. We received a lot of letters and e-mails in response to the idea, some passionately in favour, others equally passionately against, some suggesting different ratios of new shares for old, and a good number weighing up the various pros and cons before coming down judiciously on one side or the other. The most notable theme on the *FOR* side was the difficulty experienced by small shareholders in reinvesting dividends, while the argument most commonly advanced *AGAINST* was the distinctiveness of the current share price and what this implied about the nature of the trust.

While both points of view have something to commend them, the letters and e-mails we received worked out at approximately two against a share split for every one in favour. At the London shareholder presentation the Chairman took the opportunity to ask for a show of hands from the 300 or so shareholders present and again the split was roughly one third in favour and two thirds against. We have therefore decided to leave things unchanged for the present, although there would be nothing to prevent our reconsidering it at some future time if shareholders wanted us to do so.

YES TO QUARTERLY DIVIDENDS

The proposal to pay dividends quarterly rather than half-yearly proved much less contentious and, for the reasons outlined in the last Quarterly, we have decided to go ahead with effect from 1 May, the beginning of our next financial year. The first quarterly dividend will be paid in July and payments thereafter will be in October, January and April of each year.

It remains our policy never to cut the dividend rate, so shareholders are able to depend on the next quarterly payment's being at least equal to the previous one. The equivalent of the current rate on a quarterly basis is £1.35, implying a dividend of not less than £5.40 (the same as this year) for the year to 30 April 2012, although, circumstances permitting, we shall hope to do better than that. In effect, we shall now be following the US practice of the 'indicated rate', whereby the forecast annual dividend is four times the most recent quarterly dividend.

INFLATION AND DIVIDENDS

The last dividend paid on the old half-yearly system was declared on 17 March at £2.70 per share and will be paid on 21 April. The £5.40 per share for the year to 30 April 2011 represents an increase of 3.8% over the previous year.

When we decided on the dividend at the Board Meeting on 17 March we were already conscious that it would lag slightly behind the CPI and the RPI, which, on the basis of the latest figures then available (January), were running at 4.0% and 5.1% respectively. When the February figures were announced on 22 March we shared the general dismay at their having risen respectively to 4.4% and 5.5%, and I shall have more to say about inflation later. Meanwhile, as the Chairman wrote in the 2010 Annual Report, our aim is to increase the dividend at a rate higher than the RPI and the CPI not necessarily in each individual year but over rolling three year periods, as we do when measuring capital growth and total return.

BLACK SWAN FATIGUE

A lot has happened in the world since the last Quarterly was written. To use a fashionable phrase, there has been a sequence of *'black swan'* events — extreme and unpredictable occurrences named thus by Nassim Nicholas Taleb in his 2007 book, *The Black Swan: The Impact of the Highly Improbable*. On 26 March 2011 Gillian Tett, US managing editor of the *Financial Times*, wrote:

'[The book] *became a best-seller partly because "black swans" seemed such a novel idea . . . No longer.* [After the 2008 financial crisis] *entire countries such as Iceland, Greece and Ireland imploded in economic turmoil. Natural disasters erupted. And this year there have been revolutions in Egypt and Tunisia, more financial dramas in the Eurozone, war in Libya and, of course, a terrible earthquake, tsunami and nuclear crisis in Japan. Indeed, black swans have suddenly arrived in such a flock that Wall Street traders have invented a grim new phrase:* "black swan fatigue".*'*

I agree. Black swans are fascinating creatures to discuss; but had the 'Arab Spring', the Christchurch earthquake in New Zealand and the Japanese earthquake and tsunami not happened, the world would still be suffering from a major, although less headline-grabbing, problem. Quantitative easing ("QE", and, in its second round, "QEII") isn't working.

LIQUIDITY PREFERENCE

Recently I read on the same day two analyses of this problem from very different sources, which arrived at the same conclusion. The first was by Russell Napier of Credit Lyonnais Securities Asia ("CLSA"), a long-standing friend of Sebastian's and mine, who in 2005 wrote *Anatomy of a Bear: Lessons from Wall Street's Four Great Bottoms* and who really does deserve the overused title of 'investment guru'.

In his recent CLSA survey *'Solid Ground'*, entitled *QEII fails — Sell US Equities,* Russell wrote:

'We felt that the developed world's central banks would be successful in reflating their economies via the creation of more money. [But while] *recent economic data give some encouragement that this reflation is underway, monetary data suggest reasons for serious concern: the economy has accelerated and asset markets have risen, but money has not. This situation cannot persist.'*

Then in the *New Statesman* for 28 March 2011 — it is not true that, as one or two shareholders have unkindly suggested, my reading is restricted to the *Daily Telegraph* and *The Spectator*) — I came across a *critique* by Robert Skidelsky of the Coalition's budgetary policy, entitled *The Osborne Ultimatum*. In it, he wrote:

'There's a big theoretical snag about quantitative easing. Printing money is not the same thing as spending money, and it is the spending, not the printing, of money that will have an impact on the economy. Both the UK and US have had huge expansions in bank money but very mediocre growth in broad money, or bank deposits. The money that is being printed is going into the reserves of the banking system and not being lent out to those that need it most — businesses and households. The process we are seeing is what Keynes called "liquidity preference" *— a strong preference for keeping one's money in cash or near cash, rather than committing it to illiquid investments that might yield a higher rate of return.'*

RICARDO VS KEYNES

Skidelsky sees the current UK situation in terms of a battle of ideas between adherents of two great economists, David Ricardo and John Maynard Keynes. Ricardo is said to have argued that government borrowing was simply deferred taxation — known to some as *'Ricardian equivalence'*. In today's terms, this means that the debts run up by the last government will have to be paid off in the future in the form of taxes, and so people will spend less now in order to prepare for having to stump up later. The Coalition believes that cutting the Budget deficit by reducing spending will remove the need for taxpayers to provide for future higher tax and permit them to spend more now in a way which will create more productive private sector jobs.

According to the Keynesian theory espoused by the Coalition's opponents, the supporters of Ricardo have got things the wrong way round. Far from fear of future taxation delaying recovery by discouraging people from spending, at present it's only the deficit that is keeping the economy alive at all. Since what matters *(they argue)* is the deficit as a share of national income rather than as an absolute sum of money, any policy which gets the economy growing faster will automatically shrink the deficit in percentage terms.

'BIFLATION' EMERGES

Despite the Ricardian approach to spending cuts adopted by the Coalition in the UK, there is a real risk that what we are today experiencing *faute de mieux* is a sort of botched Keynesianism — an attempt on the part of governments and central bankers to stimulate the economy that simply isn't working. Instead, central bank reflationary policies have brought us weaker currencies, rising commodity prices and a phase of what has been called '*biflation'*.

During 'biflation' you get inflation and deflation in different areas of the economy at the same time, and in each case in the very place where you least want it: there is a rise *(inflation)* in the price of commodity-based or earnings-based assets and a simultaneous fall *(deflation)* in the price of debt-based assets. This puts pressure on fixed interest yields and ultimately on equities.

Inflationary pressures are already telling on emerging markets, which have begun to underperform developed markets. A resulting asset allocation shift out of emerging market equities and developed market fixed interest may buoy western markets in the short term, as investors search desperately for some alternative to zero yielding cash; but puffing up the price of paper assets through the use of loose monetary policy only provides a misplaced confidence of perpetual capital gains. Forget Keynes and Ricardo for a moment and turn instead to what the perceptive and too often ignored Austrian economist, Ludwig von Mises, said of asset bubbles:

'In fact, all this amazing wealth is fragile, a castle built on the sands of illusion'.

In the long run it is only retained gains that count. We try never to lose sight of this, and should I ever appear to be doing so you are welcome to sidle up to me and whisper 'Marconi' or 'Royal Bank of Scotland' in my ear . . .

UK INFLATION RISES

Meanwhile, as Mervyn King, the Governor of the Bank of England, has recently warned us, we need to start preparing for a period of high inflation. The British population, he said, must get ready for a sharp fall in the standard of living, as real wages continue to fall. The February figures for both the RPI and the CPI were disconcerting. The last time the monthly increase in the RPI was as high as 5.5% was in July 1991, when the yield on 10-year gilts was 10.2% compared to 3.7% today. If the RPI stays above 5% for long the already sorely tried patience of bond investors will be tested further.

It's all to do with too much money chasing too little value. As investors' confidence grows and memories of the 2008 meltdown gradually fade, today's investing environment combines an increasing volatility with more than a touch of irrational exuberance. Although Russell Napier, whom I quoted earlier, agrees that we are still in a long-term bear market, he believes that in the very short term markets may keep rising as investors are hoodwinked into believing that central bankers have turned the clock back to 2007. Negative real interest rates, a pick-up in Mergers & Acquisitions and a flood of new IPOs (Initial Public Offerings — the flotation of new companies on a stock exchange) will all fool investors into thinking that the monetary ills of the world are over; and so the market merry-go-round may continue to whirl under its own momentum.

This is not our sort of investing. Momentum investing is great fun for sanguine buyers with strong nerves and short memories but does not suit our value-based, qualitative approach. Meanwhile, the old pleasant reassurance of being able to put money on deposit at a decent rate of interest when there was a shortage of attractive investment opportunities is no longer available in our inflation-ridden but zero interest rate world. Once we were paid to wait; now there is a price to pay for liquidity. Who would ever have envisaged that money on deposit would have yielded so little for so long?

WHERE NOW?

The recent outbreak of irrational exuberance will prove to have been an illusion of gigantic proportions when the pressures on western governments' fiscal positions are seen in full relief in 2012. Bond yields will have to rise, and this will choke off the rally in equities by raising the cost of capital. While stock markets in the west may briefly revisit their all time highs (1,576 on the S&P 500 in October 2007 or 3,479 on the FTSE All-Share in June 2007), stocks then may again fall below their lows of earlier in the decade. While central bankers are struggling to encourage credit growth and keep negative real interest rates in place for a sustained period, inflation will be ignored and it will, ultimately, be an inflation scare that will trigger both bond and equity markets to fall sharply. This is the eventuality for which we are preparing ourselves.

A DEFENSIVE PORTFOLIO

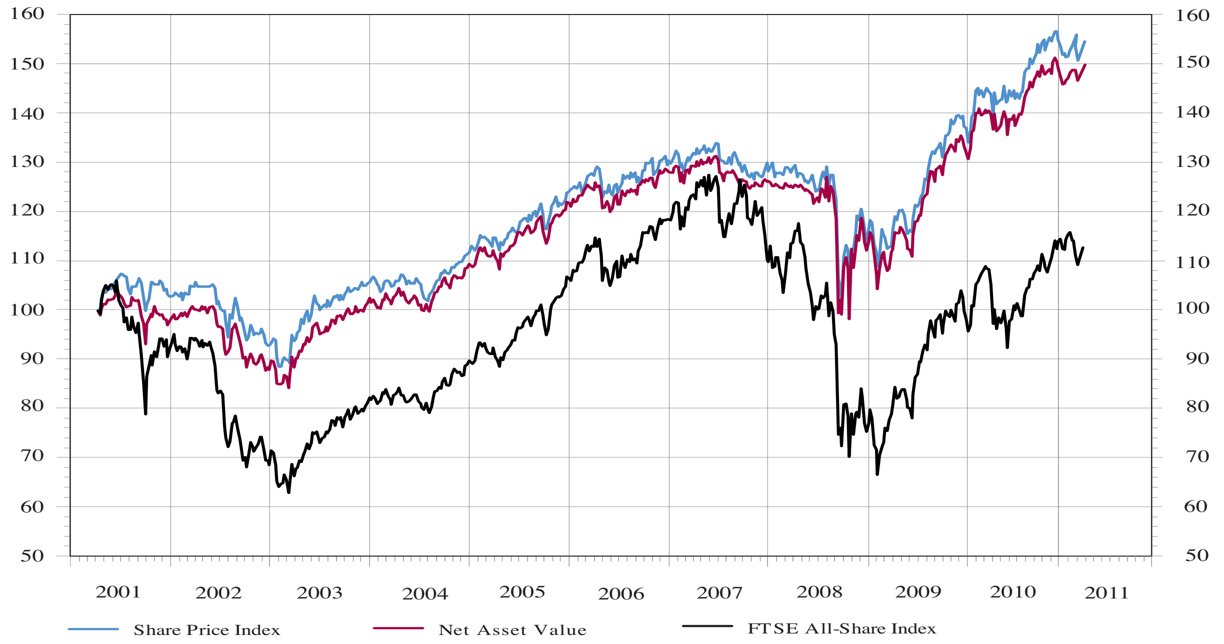
The structure of our portfolio remains defensive and has changed little in recent months. At 31 March we had 50.6% of shareholders' funds in mainly blue chip defensive equities, 27.3% in US Treasury Income Protected Securities (''TIPS''), 14.0% in directly-held gold bullion, 5.4% in gold mining shares and 2.7% in other liquidity.

The balance between equities and liquidity we believe to be about right for now. Any change in the short term may be in the direction of a moderate increase in our holding of gold bullion (money that cannot be printed) as a constituent of our liquidity. Gold currently accounts for about one third of our total liquidity and might rise to up to one half. Within the equity proportion of our portfolio we are continuing to find a few undervalued blue chips offering attractive rates of return and, mindful of the income account, we increased our holdings in **Microsoft**, **Unilever** and **Centrica**.

Also on the income front, a number of our holdings announced robust earnings and dividends recently. **BAT** and **Nestlé** produced dividend increases of 14.8% and 15.6% respectively, while **Centrica**'s payout rose by 11.7%. Nestlé's growth was particularly impressive following the strength of the Swiss Franc in 2010. As regards our two gold mining shares, **Newcrest Mining**'s numbers were encouraging and since **Newmont Mining**'s current earnings estimates are predicated on a low ($1,200/oz) gold price we expect the company to benefit from the current level of the gold price.

ROBIN ANGUS

PERSONAL ASSETS TRUST PERFORMANCE



	Value 31 March 2011	Percentage Changes 1 Year	3 Years	5 Years	10 Years
Share Price	£308.50	6.7	18.6	20.5	54.6
NAV per Share	£306.20	7.0	18.2	19.5	50.3
FTSE All-Share Index	3,067.73	5.4	4.8	0.6	13.1
NAV relative to FTSE All-Share Index	–	1.5	12.8	18.8	32.9

TOP 10 EQUITY HOLDINGS

Company	**Country**	**Sector**	**Valuation 31 March 2011 £'000**	**Shareholders' funds %**
British American Tobacco	UK	Tobacco	15,572	5.3
Nestlé	Switz	Food & Beverages	13,571	4.6
Coca Cola	USA	Beverages	13,326	4.5
Philip Morris International	USA	Tobacco	9,503	3.2
Centrica	UK	Utility	9,446	3.2
Diageo	UK	Beverages	9,320	3.1
GlaxoSmithKline	UK	Pharmaceuticals	8,977	3.0
Tesco	UK	Retail	8,854	3.0
Vodafone	UK	Telecoms	8,801	3.0
Microsoft	USA	Software	8,432	2.8
			105,802	**35.7**

GEOGRAPHIC ANALYSIS

	Valuation 31 March 2011 £'000	**Shareholders' funds %**
UK equities	79,350	26.8
US equities	64,705	21.8
Swiss equities	13,571	4.6
Australian equities	8,181	2.8
Gold Bullion – Physical	41,576	14.0
US Treasury Inflation-Protected Securities	80,849	27.3
Net current assets	7,859	2.7
Shareholders' Funds	**296,091**	**100.0**

Further information on the Trust can be obtained from the Company's website – www.patplc.co.uk or by contacting Steven Budge on 0131 538 6605.