PERSONAL ASSETS TRUST PLC

JUNE 2011 QUARTERLY REPORT No. 61

'60 NOT OUT'

As a tribute to Ian Rushbrook we have just published *'60 Not Out — Personal Assets Trust Quarterlies 2002-2011'*, which not only contains Quarterlies Nos. 26-60 but also has as its centrepiece Ian's own Investment Reports from Personal Assets' Annual Reports for the years between 2000 and 2008, showing our response to the financial crisis as it developed. The book is available to shareholders free on application and a request form for it is included along with the Quarterly and the Annual Report.

FRUSTRATED BULLS

'As frustrated bulls we are excited about the prospect of becoming a stock picking trust once more.'

Sebastian Lyon, our Investment Adviser, makes this statement on page 5 of this year's Annual Report and he does so with the encouragement of the Board, which looks forward to being able to return to Personal Assets' roots in this way after several years during which we had little choice but to concentrate on the 'macro' investment picture.

Of course, the 'macro' will always be of prime importance. Even during the early and mid 1990s Personal Assets was never *only* a stock picking trust. But while concentrating on the 'micro' can mean failing to see the wood for the trees, there can be an equal and opposite danger of missing out on stock opportunities by failing to see the trees for the wood. As we used to express it each year in the Annual Report in words that strove for the balance we felt to be essential:

'In managing Personal Assets we concentrate on decisions that will have an appreciable effect on our net asset value per share. First in order of importance come decisions about the attractiveness or otherwise (relative to cash) of the markets in which we invest and about the sectors we favour within equity markets. Stock selection complements these decisions.'

In this Quarterly I shall try to describe the *'Personal Assets style'* of stock selection adopted by Ian and still pursued by Sebastian and the Board today. I want to do so because otherwise it is all too easy to lapse into the vacuities of *'fund management speak'*, a language with which readers of fund management advertisements and Annual Reports will be painfully familiar. Fund managers often extol their *'carefully selected portfolio of high quality stocks'*, but what does this actually mean? Except in the short-lived circumstances of a *'dash for trash'*, would any fund manager admit to having a carelessly selected portfolio of low quality stocks?

Politeness, lazy thinking and the urge to emulate *Private Eye*'s fictional journalist 'Phil Space' cause people to say or write meaningless things. For a time, a company I worked for had a *'mission statement'* printed on a little card which its employees were supposed to carry around as an inspiration for their daily work. I did so, but rather than using it as the company had intended I produced it at every opportunity and read it out loud in order to ridicule it. One way of demonstrating how fatuous it was, was to put all its statements into the negative. *'We believe in recruiting people of excellence'* or *'we believe in giving a first class service to our clients'* may sound good, but *'we do not believe in recruiting people of excellence'* or *'we do not believe in giving a first class service to our clients'* sound so silly as to make one wonder if the original statements were worth making at all.

WHAT SORT OF STOCKS?

The kind of stocks we choose for our equity portfolio is determined by the job we want them to do for us. This, in turn, is determined by what Personal Assets' objectives are. In summary, Personal Assets aims to:

- Protect wealth.
- If possible, increase it.
- Pay a worthwhile dividend.
- Grow dividends in real terms.

To achieve these objectives we look for stocks which fulfil certain criteria — not all of which are applicable to every stock, but which together make up our 'wants list' for the equity portfolio as a whole:

- Strong balance sheets
- Putting shareholders first
- Capital discipline
- Dividend discipline
- Paying the right price
- Value before glamour
- Long term holdings
- Decent sized holdings
- True diversification

STRONG BALANCE SHEETS

It is important to begin with this because it is in some respects counter-intuitive, at least to the enthusiastic beginner in the world of investment. When choosing companies to which to commit our irreplaceable long term capital, we take care to look for strong balance sheets, preferably with no debt. This provides both flexibility and resilience for management. In running a company, the interests of the shareholders should always be paramount. But if a company is highly geared, this cannot be the case. The interests of the creditors — notably the company's bankers or bondholders — will of necessity be paramount. We do not ever want to rank other than first in a Board's order of priorities.

Of course, inexperienced equity investors are always inclined to believe that gearing is good, and more gearing is better. As a young apprentice fund manager I thought the idea of gearing, or leverage, intoxicating in its possibilities. Even as an investment trust analyst I argued during the early part of my career for trusts to take on more in the way of long term balance sheet gearing — something I blush to remember today, because over the years my views have changed. It astonishes me now that in my earnest youthful theoretical advocacy of the virtues of gearing I failed to make the connexion with how my family's own century-old business had collapsed in the 1960s through borrowings, as interest rates rose while the business declined; and the financial scrap-heap is littered with companies which borrowed too much and came unstuck.

PUTTING SHAREHOLDERS FIRST

Much nonsense has been talked and written about 'company culture' and my earlier recollection of the '*mission statement*' card shows it at its silliest. Yet company culture *is* important — for instance, Greggs, one of our UK holdings, still has a definite 'family' feel despite its remarkable record of growth — and commitment to shareholders is something we believe should be in the DNA of any company we invest in.

Of course, not all those companies which are committed to their shareholders get it right. The well-meaning do not always succeed. But it is, at least, a start. And the perils caused by its absence are great. Companies can lose touch with the people who own them and become mere personal fiefdoms of the people who run them. At worst — and the worst *does* sometimes happen — they can even be made to resemble occupied countries to be plundered in the interests of outsiders. There are many books about inspirational tycoons or entrepreneurs who have created and built up great companies; but I have sometimes thought of writing one entitled '*Company Destroyers*', about people who have come in (or been brought in) from outside to take charge of great companies that were doing a perfectly good job for their shareholders, and proceeded to wreck them. It would be a big book, and a very sad one.

In the quest to avoid losing touch with shareholders and their rightful expectations, companies and their Boards require two kinds of discipline — *capital discipline* and *dividend discipline*.

CAPITAL DISCIPLINE

Capital discipline is essential to avoiding mistakes in stock picking. The arrogance of company bosses can be overwhelming. I don't just mean arrogance about pay and bonuses, but the misuse of company resources for vaulting ambition and self-aggrandisement.

We can all recall past corporate follies and disasters which have led to permanent capital loss for shareholders. It has often been overpayment for acquisitions, either using equity or debt, that had led to value destruction. Only yesterday I received an e-mail from a friend, lamenting how the company he works for (in which, I'm glad to say, Personal Assets does *not* hold shares) had bought a lot of other companies in 2007-8, at the peak of the market, and had not only paid too much for goodwill but also had bought various businesses that were peripheral to its core strategy. The result? Massive write-downs, major sell-offs and a share price that had declined by nearly 85%. The story is an all too familiar one.

This is why we avoid companies that grow aggressively by acquisition. More often than not, investors celebrate mergers in haste but repent at leisure. Mere growth in size is of no benefit to shareholders. What is of importance to them is not the total value of a company, but the value of each of the company's shares. And the value of the shares is determined not by the size of the company as a whole but by revenues, earnings and dividends ***per share***, and their rates of growth.

DIVIDEND DISCIPLINE

We obviously like to receive dividends for their own sake, so that we can pass them on to our shareholders in the form of a secure and growing income stream. But there is more to our liking for companies with a good dividend-paying track record than that. Again, it is what it tells us about a company's ethos and priorities. We believe that, as part of an essential commitment on the part of any company to reward its shareholders, having to pay dividends is a valuable discipline. We take care to look at dividend track records — often over decades, not merely a few years. The longer the track record, the more likely it is to be ingrained in the culture. Dividends like those from British American Tobacco highlight the strength and staying power of consistent returns, so often missed by the *CNBC*-watching generation with holding periods for stocks which are a fraction of that preferred by Personal Assets. One of the attractions, to us, of Coca-Cola is its no fewer than 49 years of uninterrupted growth in its dividend.

Share buybacks are another way for companies to reward shareholders, and they have become increasingly popular and widespread in recent years. Our preference, however, continues to be for dividends. While share buybacks have merits, management have often bought back shares expensively in good times and then stepped back at the very time when they could have created the most value by buying back shares at low prices. It is notable that many share buyback programmes ground to a halt in 2008, just as markets plummeted. Nestlé, one of our core holdings, was a welcome exception, having returned a third of its market capitalisation to shareholders over the past five years in dividends and share buybacks.

PAYING THE RIGHT PRICE

People laughed at me in December 1989 when I said the Nikkei Dow, at over 39,000, was too high. Over the ensuing two decades there have been times when it would have been right to invest in Japanese equities and times when it would have been wrong, but an investment in the Nikkei Dow index at that level would *never* have been right because it has never got back to that level again. Again, people laughed at me in December 1999, exactly a decade later, when I said that the FTSE 100, at 6,939, was too high. Again, there have been times since then when it would have been right to invest in UK equities and times when it would have been wrong, but an investment in the FTSE 100 at that level would *never* have been right because it has never got back to that level again.

The price at which one buys something — be it an index, a share or any other investment — is of vital importance. Even the best stock in the world won't produce acceptable returns if it has been bought at too high a price, because it is the purchase price that is the unchanging denominator that determines the eventual returns, however much the numerators (dividend received, eventual resale price) may change.

This was true in the dot.com boom of a decade ago, just as it was in the days of the 'Nifty Fifty' in the early 1970s — the 'one decision' US growth stocks everybody had to own. Of these, Coca-Cola, Johnson & Johnson and Philip Morris have gone from strength to strength and are among our core holdings; but whatever happened to Xerox and Polaroid? It has even, dare I say it, applied to the gold price too. In 1980, after the price of gold had dropped from $800 per ounce to $500, I remember suggesting to someone that it might be a good time to buy. What a rotten decision that would have been — a quarter of a century of frustration and disappointment.

Patience is also necessary. To buy a share you like, when everybody else is buying it too and the price never seems to come within your target range, is horribly tempting. One starts to think about those stocks all of us can recall from various stages in our careers (BTR is one I particularly remember from my days as a young fund manager and Hanson Trust is another) which it would *always* have been right to buy. Until, of course, it wasn't.

VALUE BEFORE GLAMOUR

The world is not always a glamorous place. People have to wash and eat and drink and do all sorts of mundane things, and they have to pay money to do them. Could anything be more unglamorous, at first glance, than the likes of Johnson & Johnson, or Colgate Palmolive, or Unilever, or Coca-Cola, or Nestlé? Yet they are among the world's best-run businesses and are committed to continuing to do what they have done successfully for so long — delivering value for shareholders.

Likewise, glamour and excitement are not necessarily positive in the world of investment. Plenty of thrilling start-ups or fashionable 'concept' stocks have come a cropper over the years while the blue chips just referred to have powered quietly but satisfyingly ahead. It still causes me amusement to remember how in the mid 1980s a bullish colleague of mine took out an 'Aggressive Growth PEP' with a starting investment of £2,400. It promised the moon and the stars. After a number of years he cashed it in and it had 'grown' to be worth around £2,000 . . .

LONG TERM HOLDINGS

Turnover costs money, dissipates effort and hampers independent thought. Young or insecure fund managers easily fall into the habit of ingratiating themselves with the brokers who 'phone daily with 'helpful' suggestions. Surely such attention needs rewarding?

No. Keeping stockbrokers happy is not a priority for shareholders and is certainly not something on which Sebastian sets store or to which he devotes his time. Good performance and minimising portfolio risk are what matters.

DECENT SIZED HOLDINGS

There are not so many good companies around that one can afford the luxury of having small holdings in lots and lots of them. When I began in the fund management business it was not uncommon for a diversified investment trust to have holdings in 500 different stocks. This was a waste of time, of effort and of opportunity. Instead, I shall repeat here what we used to write each year in the Annual Report:

'Because of our belief in decisions that "make a difference", our preferred practice (although there will always be exceptions to this) is not to buy a quantity of securities worth less than 2% of shareholders' funds at the time the investment is made, or to use derivatives to reduce or increase our equity exposure by less than a similar amount.'

TRUE DIVERSIFICATION

Diversification is often misunderstood. It doesn't just mean holding a lot of stocks rather than a small number of them. To take an obvious example, if we sold our holding of gold bullion and replaced it by an equal quantity of gold in the form of Britannias, Maple Leaves, American Eagles, Krugerrands, etc, that would not be diversification. Similarly, not all diversification, even if it genuinely does spread risk, is good or useful.

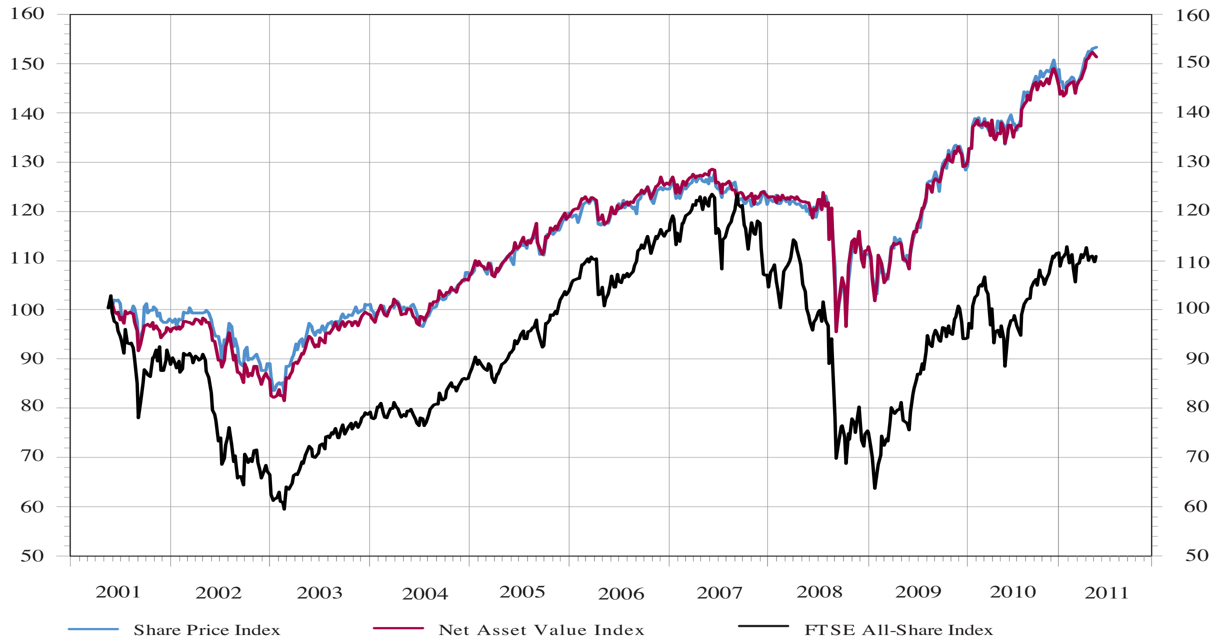
The first professional compliment I ever received was in 1977, from Douglas MacDougall, my old boss, friend and mentor at Baillie Gifford, who first brought me into the investment trust business. He had set me to examine some company reports which analysts in the firm had written up over the previous year. One of these was for a company called Dow Chemical, which our in-house analyst said would fill a gap in our stock coverage. I remarked that it was indeed a gap, but not one we needed to fill. This, Douglas told me, was *'a very perceptive comment'*. I still glow with pride today.

MAKING A START

We have made a start on building a portfolio of stocks, but it is early days. We are very confident that, as the secular bear market comes to an end, opportunities will present themselves to add to our existing holdings as well as enabling us to invest in businesses with similar merits. This process cannot be rushed. We are determined not to overpay for stocks that we feel are likely to be cheaper in the years ahead. 'Micro' stock pickers tend to outperform a rising market but lose disproportionately in subsequent falls, while top-down investors lag in rising markets but hold up well in times of trouble. As private investors stewarding what are aptly called 'sacred savings', we owe it to ourselves to continue to be patient until there is more certainty both about valuations and about the outlook.

ROBIN ANGUS

PERSONAL ASSETS TRUST PERFORMANCE



	Value 31 May 2011	1 Year	Percentage Changes 3 Years	5 Years	10 Years
Share Price	£322.00	12.5	25.8	29.3	52.3
NAV per Share	£318.62	13.4	24.5	28.1	51.6
FTSE All-Share Index	3,121.07	16.8	1.3	7.0	11.0
NAV relative to FTSE All-Share Index	–	(2.9)	22.9	19.7	36.6

TOP 10 EQUITY HOLDINGS

Company	Country	Sector	Valuation 31 May 2011 £'000	Shareholders' funds %
British American Tobacco	UK	Tobacco	16,938	5.3
Nestlé	Switz	Food Producer	14,742	4.6
Coca-Cola	USA	Beverages	13,076	4.1
Diageo	UK	Beverages	10,169	3.2
Philip Morris International	USA	Tobacco	10,120	3.2
GlaxoSmithKline	UK	Pharmaceuticals	9,962	3.1
Tesco	UK	Food Retailer	9,726	3.0
Centrica	UK	Utility	9,237	2.9
Johnson & Johnson	USA	Pharmaceuticals	9,140	2.8
Vodafone	UK	Telecoms	8,425	2.6
			111,535	**34.8**

GEOGRAPHIC ANALYSIS

	Valuation 31 May 2011 £'000	Shareholders' funds %
UK equities	83,546	26.0
US equities	65,661	20.5
Swiss equities	14,742	4.6
Australian equities	8,188	2.5
Gold	43,233	13.5
US Treasury Inflation Protected Securities	81,141	25.3
Singapore Treasury Bills	12,787	4.0
Net current assets	11,602	3.6
Shareholders' funds	**320,900**	**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.