# PERSONAL ASSETS TRUST PLC

## MARCH 2012 QUARTERLY REPORT No. 64

### MEETING OUR SHAREHOLDERS

Personal Assets is committed to communication with shareholders and we continue to work hard at it, especially given our increase in size in recent years and the large number of new shareholders we have welcomed during that time. The 2012 Annual General Meeting will be held on Thursday 26 July at The Roxburghe Hotel, 38 Charlotte Square, Edinburgh, beginning at 11.30 am. As in previous years, after the formal business of the meeting 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 Annual Report for the year to 30 April 2012 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.

Meanwhile, our London meeting on 24 January proved even more popular than last year's and was attended by over 300 people. A number of interesting topics were raised and in this Quarterly I shall try to give a synopsis of some of the questions and answers, in the form not of a transcription but of a thematic overview, which should help to illustrate how the Board and Investment Adviser work together and will also give shareholders a glimpse of Personal Assets' inner workings.

### POLITICAL AND ECONOMIC

Shareholders at the meeting had both outward and inward political and economic concerns. High on the list was worry about any adverse effects on our portfolio if (or when?) Greece and other countries defaulted on their debt. We have no direct exposure to Greece; and although a Greek default might have an impact on the European businesses of some of the international companies we invest in, the analysts at Troy do not think our portfolio is inadvertently stabling a Trojan horse and are similarly confident about lack of exposure, direct or indirect, to other possible sovereign defaulters.

Nearer home, there was concern about Scottish independence. As it happens, I've often used the analogy of devolution to illustrate the relationship between the Board and the Investment Adviser. Just as Westminster delegates powers to the Scottish Parliament, the Board delegates a series of powers to the Investment Adviser while reserving others to itself.

The difference is that, in our case, the *status quo* works so well that there is no call to change it. The Board and the Investment Adviser work in close and friendly collaboration. There is no conflict, no rivalry and hence no demand for 'devo plus' or 'devo max'.

The Chairman outlined the business-friendly stance so far adopted by Mr Salmond and the SNP, and said that even with full independence (which the Board as a whole thinks unlikely), businesses would not feel any need to flee Scotland. There are no plans yet for wagon-loads of gold to go jolting across the Tweed by the dawn's early light, guarded by Directors riding shotgun and pursued by kilted clansmen, Red revolutionaries or some Scottish hybrid of both.[1]

### INVESTMENT STRATEGY

By investment strategy I mean the broad outlook for markets, currencies and the world economy. Here, prophecy is as difficult as it is about Scottish politics. One shareholder asked us if we were not just muddling through. In a sense, we have no choice but to do so. Managing a portfolio is, as I've written before, like driving a car very slowly through thick fog. However, I was impressed by a recent comment by my old friend Alex Hammond-Chambers, one of the original directors of Personal Assets when it was floated in 1983:

*'Ask yourself why so few fund managers saw the financial crisis coming. The answer is, they weren't looking. Macro risk assessment wasn't part of their style; like the driver of a car who keeps his eye firmly fixed on the few yards ahead of him, he is unable to see an oncoming accident.'*

The Board and the Investment Adviser have to combine the two approaches. What do we see as we look ahead? Many of the factors that affected markets in 2011 will continue in 2012. Governments are still debasing currencies. The likelihood of inflation persists. Despite recent optimistic whispers from the US, economic growth is still likely to disappoint on the downside; and given that 46% of the S&P 500's profits come from overseas, a stronger dollar will hit the stocks with overseas earnings which outperformed last year. In short, the environment remains (to use that most depressing of words) 'challenging' for investors — poor fundamentals being disguised by central policy meddling, including further rounds of QE, or 'quantitative easing', which sounds like a gentle laxative advertised on daytime television but is actually an assisted suicide kit for national currencies. What, for instance, are we to make of this statement?

*'It is now possible to move to a period ahead when inflation will be much closer to the target. It's very hard to know precisely what will happen because all kinds of unexpected events*

[1] Our gold bullion is kept in London anyway, and so will be safe unless the English confiscate it.

*can occur, and we will see a gradual recovery. And that is one which should not lead us to be worried about the size of the balance sheet. I have absolutely no doubt that when the time comes for us to reduce the size of the balance sheet that we will find that a whole lot easier than we did when expanding it.'*

That is what Sir Mervyn King said at a press conference following the Bank of England's February 2012 Inflation Report, and it is like saying that after an orgy of Christmas guzzling it will be easier to shed those few extra pounds than it was to gain them. Perhaps this is what Sir Mervyn and the Bank of England really do think, but I would have expected better from an Aston Villa supporter.

We believe we are in a prolonged secular bear market and have positioned our asset allocation accordingly. Over short periods we may look very wrong, but shareholders will know by now that this is a corollary of our long-term investment style. In 2011 investors tried desperately to capture 'upside', leading to a nasty whipsaw effect. This is why so many active managers and hedge funds underperformed their benchmarks. We are frustrated by the lack of opportunities in stocks we like, but will wait for values to reach attractive levels before taking the plunge. We have not yet seen markets become so cheap as to be compelling and are prepared for two or three years of frustration (in more pessimistic moods I increase this to four or five years).

But what *(one shareholder asked)* of the doom Ian Rushbrook was forecasting for years? Had it happened yet? Few will ever forget the post-9/11 *Private Eye* cover in which an official whispers to the President, *'It's Armageddon, Sir,'* and the President replies, *'Armageddon outahere!'* But could we experience Armageddon without recognising it for what it was? Doom comes in many shapes and sizes. It need not be a single cataclysmic event; and even if it is, it may be nothing like what was expected. In 2000 people predicted the bursting of the technology bubble, not the bank crashes we saw a few years later. Whereas, at the time, the Crash of 1987 was called 'financial meltdown', it's now difficult to spot on a long-term chart; but how many people in 1999 or 2000 would have believed that a dozen years later the FTSE 100 would still not have regained its nominal 1999 peak, to say nothing of the real losses suffered along the way? Futurology is a losers' game. One of my science fiction favourites, Isaac Asimov's *Foundation Trilogy*, a future history of the Galactic Empire from the 1940s and early 1950s, is regarded as a classic of the genre but nowhere mentions computers.

Contrary to what some people believed, Ian Rushbrook and I were never 'perma-bears'. But we did from the late 1990s onward expect the market pendulum to swing — as was historically its wont — all the way from overvalued to undervalued. It never did. For instance, in 2003 it swung from very overvalued to more or less fairly valued and then swept upwards again. The politicians and central bankers, terrified of a depression, have intervened again and again to prevent the market from finding its proper level. If pain is to come, it is more likely to be lasting and chronic than sudden and acute, and is most likely to be inflicted on investment returns by inflation. Some readers like my Latin tags and others loathe them, but the effect of inflation on investment returns is beautifully described by this mediæval adaptation of a phrase from Ovid:

*'Gutta cavat lapidem, non vi, sed sæpe cadendo.'*

'A drop of water hollows out a stone, not by force but by frequently dripping.'

**ASSET CLASSES**

Several shareholders asked about different asset classes, so it may be useful to explain here that the Board considers asset allocation with the help of a matrix which has green *(core investments)*, amber *(unlikely to invest — subject to Board approval)* and red *(not currently permitted)* categories in each geographical or size subsection of the following seven asset classes: Equities; Real Estate; Fixed Interest; Commodities; Currencies; Futures; and Other Asset Classes. It might be said that there is a strategy meeting taking place 24/7 between the Board and the Investment Adviser, maintaining a tradition begun by Ian Rushbrook. We constantly exchange interesting articles and papers and discuss new investment trends and developments by telephone and e-mail. However, the six regular Board meetings each year add discipline to the process and at each Board meeting we review each of the asset classes mentioned and sometimes decide to change the 'colour coding' after discussion between Sebastian and the Board.

One currency that we moved from amber to green some time ago was the Singapore Dollar, and a shareholder at the London meeting wondered if we might look at the Norwegian Krone. Sebastian replied that we could indeed own the Norwegian Krone (it is in the green column for currencies), and Troy had owned it in the past; but, as with all investments, we needed to bear in mind liquidity. From currencies, the questioning moved to index-linked securities. UK Index Linked are expensive by historical standards, but why hold US ones? What sort of yields do they offer? While the yields available in the index-linked market are pretty minimal, what cannot be quantified in the stated yields is the value of the insurance against inflation which they offer.

No meeting of shareholders passes without at least one question about gold, and we were quizzed about both the size of our holding and the reason for the switch from holding gold through an ETF to holding bullion directly. Sebastian confirmed that we were free to increase our holding of gold from its current level — another matrix we consider at every Board meeting is one of minimum and maximum investments in the different types of currencies and securities we hold. As regards the switch from Gold ETF to gold bullion, we investigated transferring from an ETF to physical gold for reasons of security and deliverability and found we could also make a cost saving of 35 basis points (0.35%) by doing so.

What about corporate bonds? At first glance they look tempting in a zero interest rate world where income is difficult to earn and government stocks are ludicrously expensive. However, not only do they often fail to satisfy our criteria for security but also they are frequently very illiquid. Illiquidity in an investment is always a drawback and becomes more of a problem as Personal Assets grows in size. While it is not impossible that we would invest in corporate bonds (in our investment matrix investment grade corporate bonds are categorised amber, so could be bought if the Board gave specific approval), we have not so far done so and would probably be unlikely to do so in the near future.

### Individual Holdings

Our portfolio list, at 21 stocks, is a very short one. Would we hold a greater number of stocks if opportunities arose? On balance we favour a concentrated portfolio but at the moment we have only half our assets invested in equities and in the right circumstances might hold up to 30-40 stocks. Looking at individual holdings, why did we buy Imperial Oil (described at the London meeting as *'Exxon's well-kept secret'*) when we used to hold large integrated companies? We have concerns about integrated oils, which are mostly struggling to replace reserves, and we draw comfort from the location of Imperial's reserves, all found in Canada. As always when a purchase of a new stock is suggested, Troy produced a detailed note on Imperial Oil for the Board to consider. Tobacco stocks also came under the microscope at the meeting, and Sebastian described how BAT had been an outstandingly profitable holding for us over many years.

Questioned about Tesco, Sebastian said that while we recognised the company had its challenges, especially in regard to the trading environment in the UK and the US, we thought that the growth in its other overseas markets would partially offset the shortfall. After a sharp fall in the share price (circa 20%), we did not want to overreact and would be looking to see over the next few months whether management have moved market expectations to a sustainable level of profitability. We are not complacent about the holding but on a prospective dividend yield of 5%, which is more than twice covered, and a price to earnings multiple (on downgraded numbers) of less than 10, much is already discounted in the share price.

### Personal Assets Itself

There are two elements to running an investment trust: managing the portfolio and running the company itself. The latter is, in a special sense, the province of the Board itself although the Investment Adviser can also contribute usefully. At every Board meeting the Board reviews not only the portfolio and the investment outlook but also what might be called internal governance matters like shareholder activity, risk registers, investment plans, the discount and premium control mechanism, the issue and buying back of shares, Association of Investment Companies ("AIC") communications about tax, accounting and other corporate matters, and managing cash and liquidity. Questions about three company-specific areas were raised at the meeting: inflows of new money; the balance between capital and dividends; and the expense ratio.

We have taken in over £100 million of new money during the last year. Could this cause problems in investing? The Chairman referred to the size of the companies we owned and the still relatively small size of Personal Assets. He also pointed out that in operating our discount and premium control mechanism we make money for shareholders through buying in shares at a small discount and issuing them at a small premium, which more than covers the cost of the zero charge investment plans which are such a distinctive feature of Personal Assets.

Would the time ever come when we had to stop issuing shares? The Board keeps the size of the company under review, but it should not be assumed that just because there has been heavy demand for new shares over the last two or three years this will go on for ever. To say that on occasions between 2006 and 2008, when the market was against us, we could scarcely have given new shares away would be an exaggeration; but the number of shares in issue has fallen as well as risen and we have at times made vigorous use of our powers to buy in shares to hold in treasury. It is human nature to assume that a current trend will continue, and extrapolate accordingly; but who can tell what may happen in the future?

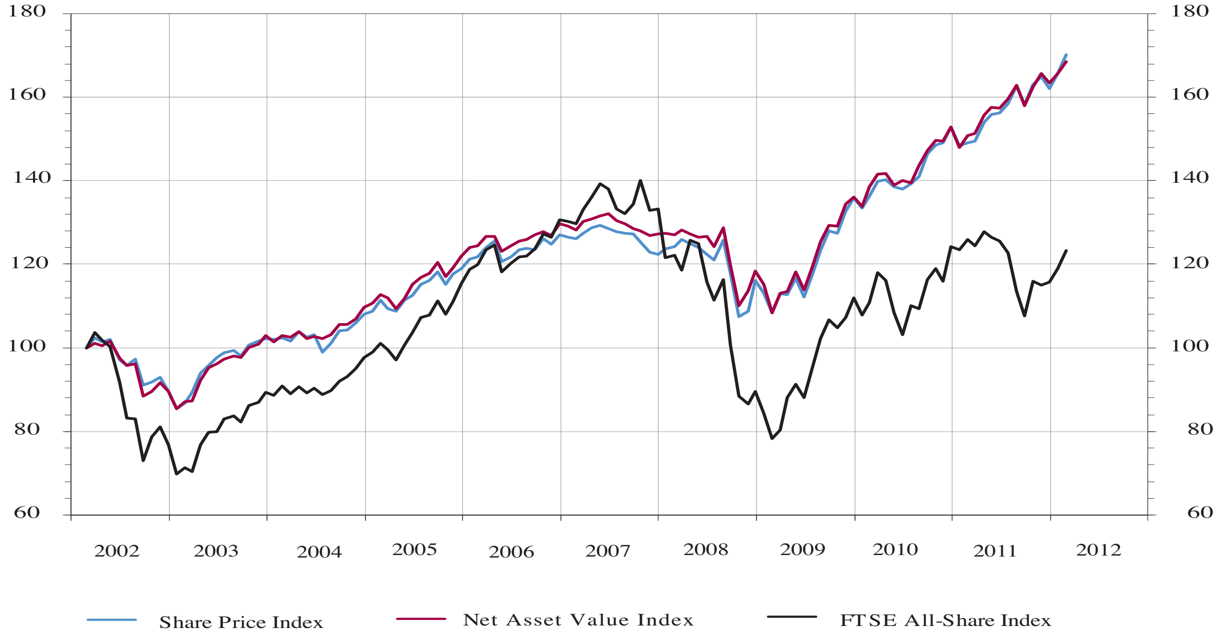
Our transition from being a small trust with huge revenue reserves to being a large trust which has to earn its dividend year by year has raised questions about the balance between capital preservation and income. The Chairman conducted an informal poll at the London meeting, which suggested shareholders gave capital preservation priority over rising dividends. However, there is a balance to be struck and we are giving thought at the moment to whether the Cash Income Option in our Investment Plan, together with a new facility whereby a regular tax free sum could be paid out of ISAs on the same basis, might be more widely publicised at a time when dividend growth is hard to come by.

Can we look to a fall in the expense ratio? Given the terms of the advisory fee, whereby the percentage fee will fall from 0.75% to 0.625% on shareholders' funds over £500 million, together with the fact that many of Personal Assets' other costs are fixed, the total expense ratio will naturally tend to fall if the trust continues to grow.

The Chairman also explained our reasons for setting up our wholly owned company secretarial and administration subsidiary, Personal Assets Trust Administration Company ("PATAC"). Originally created to enable us to guarantee quality of service to shareholders, it is also helping us cut costs to shareholders and reduce our total expense ratio. The Chairman and I sit on the Board of PATAC along with Steven Cowie, Steven Davidson and Steven Budge, and we meet regularly to oversee the running of the business. We now have three clients other than Personal Assets and may reduce our secretarial and administration costs further by taking on others.

**Robin Angus**

## PERSONAL ASSETS TRUST PERFORMANCE




| | Value 29 February 2012 | Percentage Changes 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|
| Share Price | £351.30 | 14.1 | 56.8 | 34.9 | 70.1 |
| NAV per Share | £340.74 | 11.7 | 55.4 | 31.5 | 68.5 |
| FTSE All-Share Index | 3,043.91 | (2.0) | 57.7 | (4.8) | 23.4 |
| NAV relative to FTSE All-Share Index | | 14.0 | (1.5) | 38.1 | 36.5 |

## TOP 10 EQUITY HOLDINGS

| Company | Country | Sector | Valuation 29 February 2012 £'000 | Shareholders' funds % |
|---|---|---|---|---|
| British American Tobacco | UK | Tobacco | 19,777 | 4.3 |
| Microsoft | USA | Software | 18,241 | 4.0 |
| Nestlé | Switz | Food Producer | 14,529 | 3.2 |
| Coca-Cola | USA | Beverages | 14,121 | 3.1 |
| Philip Morris International | USA | Tobacco | 12,770 | 2.8 |
| Diageo | UK | Beverages | 11,817 | 2.6 |
| GlaxoSmithKline | UK | Pharmaceuticals | 10,472 | 2.3 |
| Centrica | UK | Utility | 10,247 | 2.3 |
| Becton Dickinson | USA | Pharmaceuticals | 10,058 | 2.2 |
| Imperial Oil | Can | Oil & Gas | 9,731 | 2.1 |
| | | | **131,763** | **28.9** |

## GEOGRAPHIC ANALYSIS

| | Valuation 29 February 2012 £'000 | Shareholders' funds % |
|---|---|---|
| US equities | 92,850 | 20.4 |
| UK equities | 89,684 | 19.7 |
| Swiss equities | 14,529 | 3.2 |
| Canadian equities | 14,065 | 3.1 |
| Australian equities | 7,882 | 1.7 |
| Gold | 62,811 | 13.8 |
| Government bonds (USA, Singapore and UK) | 159,772 | 35.1 |
| Net current assets | 13,394 | 3.0 |
| **Shareholders' funds** | **454,987** | **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.