PERSONAL ASSETS TRUST PLC

NOVEMBER 2013 QUARTERLY REPORT No. 70

PERFORMANCE AND OUTLOOK

Sebastian and I have given a full analysis of our recent investment performance and present investment stance in the Interim Report after the Key Features, the performance charts and the portfolio information. This concentration on investment performance and outlook in the Interim Report gives me the opportunity to discuss in the Quarterly a number of other matters that currently concern us:

- Buying back shares and how this fits in with our discount and premium control policy.
- The possible implications of a stabilisation or contraction in Personal Assets' issued share capital.
- The misunderstandings that, despite all our best efforts over the years, still surround Personal Assets' investment policy and our investment aims and approach.
- The risk involved in our exposure to US Treasury securities.

BUYING BACK SHARES

During the last week of October we took the opportunity of buying back a small quantity of shares at a slight discount to net asset value ("NAV"). This was our first share buyback since 2009. One sharp-eyed shareholder spotted the announcement and e-mailed me to ask if the repurchase signalled a change in our approach. I replied that, on the contrary, buying back shares in the market was a normal part of our discount and premium control policy, but one which for a long time we had lacked the chance of putting into practice in a way that would bring about an uplift in NAV for continuing shareholders.

Over the last four years all the pressure has been on the buy side and we have been regular issuers of new shares at a small premium to NAV. Prior to that, however, we were quite often able to buy back shares selling in the market at a small discount. This was particularly so during 2007 and 2008, when our contrarian stance and our underperformance compared to the FTSE All-Share Index made us unpopular *(does this sound familiar?)*, and then, in October 2008, there was the uncertainty caused by Ian Rushbrook's sudden death.

Eliminating the small overhang of shares in the market at the end of October by buying them in to hold in treasury for eventual resale kept Personal Assets trading at around NAV and is something we will do again whenever a similar overhang presents itself, although we also had the opportunity to issue new shares at a small premium at the beginning of November.

DISCOUNT PREVENTION

Given that we have not sold at a discount since 1995 and have since 1999 been able to guarantee that our shares would always sell at around NAV, I was surprised to get an e-mail recently from a shareholder complaining that as a result of our recent poor performance:

> *'People are selling up wholesale, and investors who hope for a reasonable return and . . . have an investment choice will continue to sell, to the further detriment of the share price.'*

While acknowledging the recent poor performance and the resulting numerical preponderance of sellers over buyers, I wrote to reassure the shareholder that such selling was not, and could not be, *'to the further detriment of the share price'*. The selling, I explained, had no effect whatsoever on the share price, which was determined solely by the NAV. That is because of our strictly and consistently exercised discount and premium control policy, which means that shares in Personal Assets have sold at close to NAV consistently since 1999 and will continue to do so.

Alas! Subsequent correspondence failed to get the point across to the shareholder concerned and in that particular case I had to admit defeat. Let me therefore reiterate the position here, so that there can be no mistake about it:

- *In the case of most investment trusts, the share price performance is affected by movement in two things: the NAV itself, and the supply of and/or demand for the shares. The latter is what determines the discount or premium to NAV. However, Personal Assets' shares do not sell at either a significant discount or a significant premium and never will, so the share price performance is affected ONLY by movement in the NAV.*

USES OF DISCOUNT CONTROL

Why is this a good thing? Surely it would be more fun to let the shares go to a sizeable premium from time to time — or, indeed, to a sizeable discount, so that they could be bought on the cheap? To demonstrate the benefits of a discount and premium control policy, compare what usually happens with investment trusts in general to what happens with Personal Assets.

In the case of most trusts, excess demand will tend to push shares to a premium while excess supply (from investors wishing to sell) will push shares to a discount. The result is exaggerated price movements in both directions. If the trust is doing well, demand will tend to increase, whereas if it is doing badly demand will fall and selling pressure will start to grow.

None of this happens to Personal Assets. But isn't it a missed opportunity during times when the shares are in fashion and without the discount and premium control policy they might otherwise go to a premium — a pleasure shareholders in other trusts sometimes enjoy, but we never do? In the short term it may indeed seem like a lost opportunity, but in the longer term it would be thoroughly undesirable. Buying at a premium shares which may go to a discount is disastrous for the returns you can expect to earn from them. Making up a loss of value caused by a change in rating from a 10% premium to a 10% discount is very hard indeed.

And now imagine what might have happened during Personal Assets' recent period of poor performance. The fall in the share price (which was in line with NAV) has been disappointing enough, but without the discount control policy our NAV underperformance might also have caused a discount to appear and then widen — no great problem if one has no intention of selling, but an irrecoverable loss of 10% or 20% of irreplaceable capital if for some unavoidable reason one has to realise one's holding.

Results of Stabilisation

It seems that, for the time being, Personal Assets' issued share capital is stabilising and may even start to contract. What effects may this have on the trust's operations?

- There may be a reduction in the trust's size. In theory, this would necessitate repeated alterations to the portfolio to ensure that (if this was what we wanted) the percentages in stocks and asset classes remained the same. However, as long term investors we neither sell nor buy stocks in a mechanical way, irrespective of their market valuations at the time.
- The 'ongoing charges' ratio (formerly known as the total expense ratio, or "TER") may edge up. However, any effect would be slight. The TER for the year to 30 April 2013 was 0.89% and we calculate that even if shareholders' funds (which were £593 million at 30 April 2013) fell to £400 million and stayed there for a full year, the TER would rise by only four basis points, to no more than 0.93%.
- At the moment we are distributing as dividend more than we earn, and so if we had fewer shares in issue there would be less need to dip into revenue reserves to make up the difference. This would not transform our revenue reserves, but would be useful at the margin.

Misunderstandings Persist

Returning to the central theme of our investment performance, there is no denying that we are still going through an unpropitious period for Personal Assets and no immediate end is in sight. There is, however, something I feel I must say here. Yes, shareholders have every right to criticise us if we don't fulfil our promises, or if we do badly something we have clearly set out as part of our investment policy. But it's frustrating to be criticised, as has sometimes happened of late, for not doing what we have never undertaken to do.

As an example, Personal Assets was upbraided recently for not being like Fidelity Special Values or Scottish Mortgage. But why would anyone suppose us to be like either of those trusts? They are bottom-up stock pickers, one concentrating on the UK and the other investing globally in strong businesses with above-average returns and aiming to achieve a greater return than the FTSE All-World Index. Our investment policy of protecting and increasing *(in that order)* the value of shareholders' funds per share over the long term guides us just as firmly as would a policy of restricting ourselves to a type of company or a geographical area.

I accept that our investment policy of seeking to avoid actual loss rather than outperform an index or a peer group in relative terms is unusual within the trust industry, but that is what we do, and is, we must presume, why investors buy our shares. The tin is so clearly labelled that I can't help being mystified when some investors expect us to do something else altogether.

We are also not interested in short term performance. A shareholder asked me rather crossly:

'Do you intend to carry on with your investment policies unchanged, regardless of global market changes?'

My answer, which the shareholder probably found annoying but was the only one I could give with any degree of honesty, was:

'In a word, yes. That is what we think is right for us, and we shall continue to do it.'

We don't alter long-term policies carefully designed to meet long-term objectives, to suit short-term conditions that may change at any time. We no more think of doing so than Fidelity Special Values would switch to Japan if UK small companies had a bad patch, or Scottish Mortgage would invest in gold and index tracker funds if its equity portfolio proved disappointing. In particular, we see a significant risk at the moment that if we did become more fully invested, or moved into riskier assets (courses sometimes urged on us), we would be likely to lose money. Remember our investment policy, overwhelmingly approved by shareholders in December 2012:

'Our definition of "risk" is fundamentally different from that commonly used by other global growth investment trusts and the industry at large (ours being "risk of losing money" rather than "volatility of returns relative to an index").'

Staying Wary of Bubbles

Twitter went from $26 to $50 on its first day of dealings. Resurgent interest in US stocks has paved the way for 192 companies to raise $51.8 billion from new stock offerings, putting the market on track to rival the sums raised by US companies at the height of the 2000 dotcom bubble. In a recent speech on quantitative easing ("QE") I remarked that the motto of the USA was *'In God We Trust'*, not *'I'm For Ever Blowing Bubbles'*.

But is not this (you may ask) the boring moan of the kind of pessimist who has forecast thirteen out of the last four market corrections? In particular, where today is the inflation so often warned against? Since QE began in 2009, the UK CPI has risen at an annual rate of 3 to 4%, easing to 2.2% over the last twelve months. This is not good, but is scarcely Armageddon.

There are other kinds of inflation, however. Think of the huge quantities of ever more highly-sought-after and highly-priced paper assets which self-destructed in the US housing bubble, or the technology bubble, or the Japanese asset price bubble of the 1980s.

Since QE began, we've seen something of this in the gilt market. Although it has since risen, the yield on UK 10-year gilts fell below 1½% in the summer of 2012. In the days when a referendum on Scottish independence seemed about as likely as the Bank of Scotland going bust, I used to tease my English friends who lived in Scotland that when the day of freedom dawned, all their assets would be expropriated in return for Kingdom of Scotland 2% Irredeemable Stock. How far-fetched I imagined this to be! But in last year's bond markets such a stock might well have gone to a premium and my departing English friends would have been laughing all the way to the airport.

Today they are laughing all the way to the Zoopla website, to see how much they are making in the housing market, thanks to nice Mr Osborne and his *"Help to Buy"* scheme. The British feel so thoroughly at home with rising house prices that every few years they stop seeing it as a bubble and begin to think of it as part of the natural order of things. Which it isn't.

Keeping the Stake Money

In Quarterly N$^{o.}$ 68 I wrote that we underperformed the All-Share in NAV terms in seven out of thirteen financial years between 30 April 2000 and 30 April 2013, whereas we outperformed it in only six. I went on to point out that we never underperformed the market when it had a down year during the period. The six financial years in which we outperformed the All-Share were the only six years in which it fell.

In this way we preserved our all-important stake money. And each time we held on to our stake money when the market fell, we had it ready when the market began to rise. That is why our style, so uninspiring at first glance, has produced long-term results better *(probably)* and less volatile *(certainly)* than would a string of years of outperformance marred by a couple of disastrous ones.

Our lower volatility is clear from the chart headed *Share Price and NAV in £ versus FTSE All-Share Index* in the Interim Report. Over the ten years to 31 October 2013 our NAV (and hence our share price) and the All-Share rose by approximately the same amount, but we got there with notably *(and satisfyingly)* fewer ups and downs than the All-Share did.

Strategic Use of Liquidity

One of the ways we achieved our past spells of outperformance was through the size of the strategic moves we made when we were confident the time was right. An example is our use of liquidity. Some think Personal Assets is always liquid and therefore always likely to underperform. However, an examination of our liquidity management during the difficult financial year between 30 April 2008 and 2009 gives the lie to this.

We started the financial year with liquidity of 100%. This level remained until the end of May, but by the end of June our liquidity had halved, to around 50%. Thereafter, we used liquidity aggressively, its month end levels between 31 July 2008 and 30 April 2009 varying between 13% and 44%. This was bold by any standards and it produced results: while we lost money in NAV terms, the FTSE All-Share lost more — 29.3% compared to our 10.3%, meaning that we outperformed the All-Share by 26.9%.

It is no surprise that our liquidity level tends to be high when markets are high, and low when markets are low. When markets are high, we want to be light of stocks in order to minimise the risk of loss when the market falls; when markets are bombed out, we want to invest our liquidity in underpriced assets we think will rise.

It may be argued that our major moves in liquidity in 2008 and 2009 were achieved by using futures rather than by stock investing. But futures were a means, not an end. We didn't go from 100% liquidity to (at one stage, within a month) 5% because we were using futures; we used futures because we wanted to go quickly from 100% liquidity to 5%. And just as we used them before, it remains open to us to use futures again if they seem the most suitable option at some time in the future.

US Treasuries

One question I am asked increasingly often by shareholders concerns the risks of holding US Treasury securities. Here is a typical query:

'I have a modest holding in Personal Assets via my ISA. Following the recent débâcle in the USA with likely ongoing severe political problems and on top of this the imminent end of quantitive easing I am getting a bit concerned about Personal Assets' holding of US Treasuries. Can you tell me please how the directors see the situation viz the holding of US Treasury stock?'

I replied that our holdings were in US Treasury Inflation Protected Securities ("TIPS") and that we held them for defensive reasons, as a hedge against inflation. Yes, the situation in the USA has been worrying, and sentiment in the markets has been dominated by fears of an end to QE. However, if we can't ultimately trust US Treasuries there is not much, if anything, in the way of shares and securities that we *can* trust. As regards the 'fiscal cliff', I expect that there will be embarrassing expedient after embarrassing expedient, with disaster endlessly postponed for the simple reason that the Republicans will not dare to shut the country down, however much they may deplore the gap between expenditure and income.

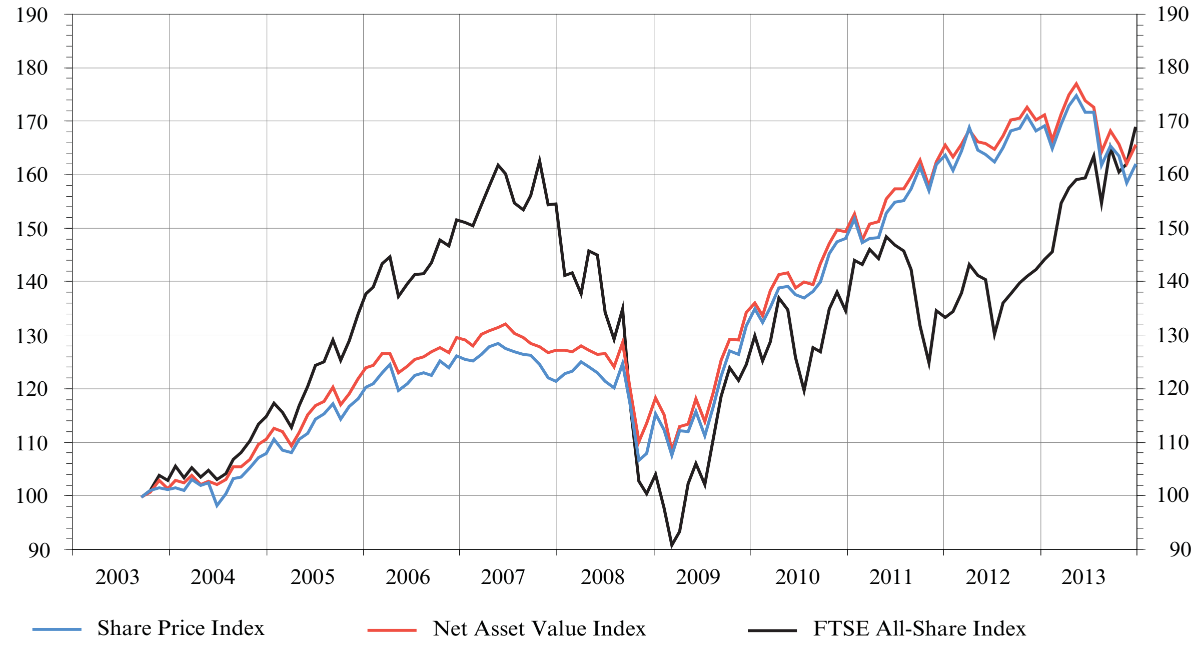
Our 'Pillars' Still Stand

Our portfolio retains its four 'pillars': blue chip equities; index linked bonds; gold bullion (including gold mining shares); and cash.

- Many of our **blue chip equities** are fully priced at the moment, but we are hoping for opportunities to add to our existing holdings (perhaps when 'tapering' at last appears and momentum fades) as well as being prepared to add new ones, such as Dr Pepper Snapple.
- **Index-linked bonds** served us well up until early 2013. Since then, they have been dragged down by the bond market rout. If in future inflation expectations drove up bond yields, index-linked should begin to perform again.
- Recent weakness in the price of **gold** has also affected our short term performance but we hold it as long term portfolio insurance.
- As I wrote in Quarterly N$^{o.}$ 69, **cash** is the most criticised of all investments. But its virtues are seriously underrated at present, just as in 2007 and 1999. While it is not meant to be a permanent holding, it is dry powder for us to use when value once again presents itself.

Robin Angus

Personal Assets Trust Performance



	Value 31 Oct 2013	1 Year	Percentage Changes 3 Years	5 Years	10 Years
Share Price	£336.60	(3.8)	9.7	51.6	61.8
NAV per Share	£334.75	(2.9)	10.5	50.3	65.4
FTSE All-Share Index	3,585.32	18.6	22.1	64.2	68.7
NAV relative to FTSE All-Share Index		(18.1)	(9.5)	(8.5)	(2.0)

Top 10 Equity Holdings

Company	Country	Sector	Valuation 31 Oct 2013 £'000	Shareholders' funds %
British American Tobacco	UK	Tobacco	24.241	4.1
Nestlé	Switz	Food Producer	21.305	3.6
Imperial Oil	Canada	Oil & Gas	17,787	3.0
Microsoft	USA	Software	17.344	3.0
Glaxo SmithKline	UK	Pharmaceuticals	16,923	2.9
Coca-Cola	USA	Beverages	15,891	2.7
Becton Dickinson	USA	Pharmaceuticals	14,749	2.5
Philip Morris International	USA	Tobacco	13,517	2.3
Sage Group	UK	Technology	13,459	2.3
Altria	USA	Tobacco	12.003	2.1
			167,219	**28.5**

Portfolio Analysis

	Valuation 31 Oct 2013 £'000	Shareholders' funds %
USA equities	113,684	19.5
UK equities	74,343	12.7
Swiss equities	21,305	3.7
Canadian equities	21,280	3.6
Australian equities	3,884	0.7
Gold	66,126	11.3
Government bonds (USA, Singapore and UK)	234,306	40.1
Net current assets	48,754	8.4
Shareholders' funds	**583,682**	**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