PERSONAL ASSETS TRUST PLC

NOVEMBER 2015 QUARTERLY REPORT No. 78

INVESTMENT ADVISORY FEES

You will have noticed on page 12 of the Interim Report accompanying the Quarterly that we have agreed with Troy Asset Management Limited ("Troy"), our Investment Adviser, amendments to their fee scale for investment advice. Until now the scale has been 0.5% per annum on the first £100 million of shareholders' funds, 0.625% on the next £50 million and 0.75% between £150 million and £500 million, falling thereafter to 0.625% on funds in excess of £500 million. The scale has now been extended to allow for the trust's possible growth in the years to come, so that funds of between £750 million and £1 billion will be charged at a lower rate of 0.55% and funds in excess of £1 billion at the further reduced rate of 0.5%.

This tapering downward of fees is not only in line with what I believe to be best practice in the fund management industry but also reflects the success of our working partnership with Troy over the last six and a half years. When Troy became our Investment Adviser on 3 March 2009, Personal Assets had shareholders' funds of only £151 million. An increase in size to over £500 million at that time seemed a very remote prospect. Since then, however, our net asset value per share ("NAV") has grown from £214.68 to £348.89 (a rise of 62.5%) and the number of shares in issue has risen from 706,706 to 1,731,506 (an increase of 145%), giving shareholders' funds of £604 million at 31 October 2015.

LOWER PERCENTAGE COSTS

Such expansion indicates that Personal Assets is offering a service that investors want, and if this continues it is only fair that (building on what has been the case since we topped £500 million during the year to 30 April 2013) shareholders should enjoy some of the financial benefits of scale.

I'm always wary of the notion that reduction of investment trust running costs, whether absolutely or as a percentage of total assets, is an end in itself. Often in life, although not invariably, you get what you pay for. And a particular *bête noire* of mine recently has been the renaming of what used to be called the Total Expense Ratio ("TER") as Ongoing Charges. In our case this description is misleading, suggesting as it does that Personal Assets is just a fund run by some outside entity that levies charges on us for the privilege. Personal Assets is run not by an outside entity but by its Board, and is subject not to externally imposed charges but to the ordinary costs of running a company, a part of which is the fee we pay to Troy for investment advice.

However, those who pay close attention to trusts' running costs (a perfectly sensible thing to do, as long as it doesn't become an obsession) should be aware that the combination of a fee scale for investment advice tapering downwards for funds in excess of £500 million with the fact that many of our other costs are fixed means that the percentage cost of running Personal Assets will tend to fall if (as has been our experience over the life of the company) it continues to increase in size. Already over the five years between 30 April 2010 and 30 April 2015 our TER (to use the older and more accurate term) has fallen from 1.18% to 0.87% of shareholders' funds, and this reduction would accelerate should the proportion of our shareholders' funds that qualifies for the lower fee rate bands become greater.

DOES SIZE MATTER?

Over Personal Assets' quarter of a century of existence as an independently managed trust its shareholders' funds have grown from less than £7 million at 31 October 1990 to £604 million at 31 October 2015. Perhaps it's unsurprising, therefore, that many shareholders, especially since we crossed the £100 million barrier in the financial year to 30 April 2003 and then the £250 million barrier in the year to 30 April 2011, have asked me whether there is an optimum size for Personal Assets and what the Board will do when we reach it.

My answer has always been the same — there is no optimum size for Personal Assets, and the Board has identified no maximum size either. Unlike some specialist trusts which invest exclusively in smaller companies, particular industry sectors or illiquid and sometimes unlisted securities, our investment policy contains within itself no explicit or implicit size restrictions. What we did with £50 million and have recently been doing with £500 million we believe we could do equally well with £5 billion.

ARE WE MISSING OUT?

But might we not be missing out in less obvious ways because of our size — perhaps by not investing in the specialist sectors or markets to which I've just referred? At the most basic level, the answer is obviously Yes. There are many investment areas to which Personal Assets has no direct exposure, and could not conveniently get it even if we wanted it — for instance, we lack the expertise to invest in emerging markets and are too big to have meaningful stakes in very small listed companies.[1]

Sometimes we are glad of these restrictions. There are lots of stocks

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[1] In Quarterly No. 77 I explained that we do look for opportunities in this market segment, but more at mid caps than small caps. Mid caps are capitalised typically between £600 million and £4 billion, and Troy's focus tends to be on companies at the top of that range.

and sectors I wouldn't touch with the proverbial barge pole. But the possibility is always open to us of investing indirectly in attractive areas through specialist investment trusts or other managed funds. We often did so to good effect in the past, for instance by holding trusts specialising in property, commodities, UK smaller companies and undervalued investment companies, and while we have not done so recently the Board keeps a close eye on possible opportunities.

WHAT ABOUT GEARING?

Personal Assets, therefore, sees no restrictions on the size of the trust and is open to investment in specialist areas. But since I've been speculating in this Quarterly about the running of Personal Assets' portfolio, it may be a good opportunity to deal here with some other questions shareholders commonly ask me about how Personal Assets may develop. One that often comes up is about gearing. Would Personal Assets be prepared to gear, and, if so, to what extent and under what market conditions?

The answer to the first part of the question is Yes, although a very qualified Yes. It's qualified not least because there is a lot of history behind it. I shudder to recall how as a novice in the investment world I thought that for an equity fund all gearing was good, and the more of it the better. This misapprehension stayed with me far longer than it should have done. Twenty or thirty years ago we inhabited what looked likely to be a world of permanently high interest rates by today's standards. Borrowing twenty or thirty year money at a cost in the high single figures looked a steal. Money (it was generally believed) was never likely to get much cheaper than that, and equities would always produce a higher total return than the interest cost of borrowings. It was a green light for investment trusts to borrow as a way of showing confidence in the future as well as of enhancing returns.

History since then has shown how flawed even the most seemingly sensible assumptions can be. Many trusts which geared up in the late 1980s and early 1990s found themselves locked into interest rates that looked increasingly expensive as well as being stuck with prior charges valued far above par and impossible to redeem early except at crippling prices. Partly because of this, it is unlikely in the extreme that Personal Assets will ever borrow money for the long term at a fixed rate, whether in the form of debentures or bank finance.

If we do gear, it will be to exploit short-term opportunities — and it is at least as likely that we will do so using derivatives such as FTSE 100 Futures as it is that we will do so through short-term bank borrowings. We may also, as we have done before, gear through the purchase of securities which are themselves geared. In the 1990s we did this very successfully through investing in fund management companies and investment trust warrants. Few of the latter are left, but other geared securities remain available to us in the market. For instance, at various times over the last twenty years we have invested in general investment trusts selling on high discounts as a way of gearing into a market upturn when NAVs rise and discounts narrow. Trust discounts were until recently at twenty-year lows, which looked to us like a cyclical peak, but as discounts widen we will be on the alert for buying opportunities.

YOUTHFUL MISCONCEPTIONS

Let me pause here for a digression. I've remarked before how easy and obvious the investment game seemed to me when I was starting out in the business nearly forty years ago. Looking back, I again shudder at my *naïveté* and offer thanks to whomsoever is the Christian equivalent of Plutus, the god of wealth[2], for saving me from the ill consequences of my youthful temerity. I have to confess that there was even a time when elaborate financial engineering in the construction of investment trusts fascinated me — until I saw the horrors that resulted from it during the split capital trusts crisis of a decade and a half ago. Fortunately I had by then adopted one of Ian Rushbrook's favourite mantras (which he, in turn, had adopted from the nineteenth century American essayist Henry David Thoreau), *'Simplify! Simplify!'*

Then there was my ill-founded opinion, decades ago, that low interest rates would always be a Good Thing. I supposed then that a low interest rate economy would be by definition efficient and growth-oriented, and I didn't even try to imagine a zero interest rate economy because it would have seemed an absurdity. I never envisaged what, when it actually happened, a zero interest rate world would prove most accurately to resemble — a gigantic, squelching bog, swallowing up everything and giving up nothing.

THINKING THE UNTHINKABLE

Yes, in my callow youth it was only good luck and the kindly vigilance of my superiors that stopped me making a fool of myself. But one lesson I have learned over the years is that, if only as a mental exercise, it is useful to think the unthinkable. For example, at the end of the 1980s, in a piece of investment trust research when I was working with Hamish Buchan at County NatWest, I made two forecasts that proved prescient — that Japan, then as seemingly impregnable as China was until recently, would come to be known as *'the Sick Man of the Pacific Basin'*, and that within ten years an investment trust debenture issued at 6% would be regarded as having been too generously priced.

Neither of these forecasts was based on any special knowledge or insight. I had no particular grounds for supposing that in the coming quarter of a century the Japanese market would never again reach its 1989 heights or that we would find ourselves in, to all intents and purposes, a zero interest rate world. All I can claim is that a willingness to think the unthinkable is a way of preparing oneself for the full range of investment eventualities.

What will the next unthinkable development be? Oil at $150 per barrel? Interest rates in double figures once again? I have no idea. Donald Rumsfeld was memorably mocked for his description of what we

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[2] Perhaps St Gilbert of Caithness, whose account-books were miraculously saved when his enemies set fire to them during his period of office as Archdeacon of my home diocese of Moray in the thirteenth century.

know and don't know, but his words contain much wisdom and are worth repeating here:

'Reports that say that something hasn't happened are always interesting to me, because as we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know. And if one looks throughout the history of our country and other free countries, it is the [last] *category that tend to be the difficult ones.'*

There will always be unknown unknowns; and to derive profit from them, two things are essential — a willingness to think the unthinkable and a willingness to hold cash.

CASH IS THE KEY

As Sebastian Lyon, our Investment Adviser, remarked to me just the other day, our industry hates holding cash, and this is more the case than ever now that it is all but impossible to earn any worthwhile interest on it. But against the received wisdom that holding cash is wrong — it's often regarded by investors and investment managers who should know better as a failure of imagination, a dereliction of duty and a waste of fees — he instanced the successful hedge fund manager Brian Spector, shortly to retire from the $27 billion Baupost Group, who recently wrote:

'One of the most common misconceptions regarding Baupost is that most outsiders think we have generated good risk-adjusted returns despite holding cash. Most insiders, on the other hand, believe we have generated those returns BECAUSE of that cash. Without that cash, it would be impossible to deploy capital when . . . great opportunities become widespread.'

Cash is freedom. Cash is opportunity. Cash is hope. Cash is our friend, and we will never apologise for holding it when we think it right to do so.

WAITING FOR BARGAINS

Personal Assets is long of cash as I write, because we believe that this will be greatly to our advantage when investment bargains start appearing. Earlier this year, in the February Quarterly (No. 75), I surprised at least one shareholder by commenting on how cheerful I felt. I went on to explain:

'Why the cheerfulness? It's because the less encouraging that things become and the less justified today's high asset prices appear, the nearer we come to Personal Assets' next leap forward. We've outperformed UK equities in general over the long term not by stellar stockpicking or by spurts of outperformance in rising markets but by the boring expedient of protecting the value of our shareholders' funds when indices fall.'

The shareholder replied,

'I struggle with the notion that we should be cheerful because we are about to lose less money than other investors!'

Point taken, and our shareholders must be second to none for being not only intelligent but also provocative and witty as well. One of the best bits of my job is contact with shareholders and having them ask interesting questions or make unexpected suggestions (one recent one was for us to have a parallel 'ethical Personal Assets', managed in the same style but excluding certain types of investment). But I still have that feeling of cheerfulness, and (as you will have noted from the Interim Report) Personal Assets' results for the six months to 31 October 2015 are also a modest indicator that things have been going our way. An NAV virtually unchanged against the fall of 7.3% in our comparator, the FTSE All-Share Index, bears witness to Personal Assets' characteristic low volatility and defensive qualities.

Recent times have been frustrating and depressing for investors like ourselves who look for high quality investments at reasonable prices. World financial markets have for years reminded me of an overpriced junk shop in which the same old stock — none of it worth buying — has been gathering dust for ages, while there's no prospect of anything new and exciting coming in. But although we are starved of opportunity at present, we are not starved of hope that opportunities will arise.

What has come over me *(you may by now be asking)*, salivating at the prospect of equities at bargain prices and perhaps even gearing up to buy more of them? Well, that is the natural me. Nothing is further from the truth than to see us as perma-bears. To me, the very idea of being a perma-bear is ghastly — dreary, resigned to being unproductive, and prepared to accept any losses as long as one is proved right intellectually. You might be surprised at how often I look at our portfolio and wish that we could get rid of sizeable chunks of it: the boring bits, like index-linked securities and conventional gilts; the unproductive bits, like cash and treasury bills; and the inert bits, like bars of gold — beautiful to look at if you like that sort of thing (which, as you know, I do), but in practical terms all but useless.

We hold cash, gilts and gold bars as a means to an end, not as an end in themselves. Although over the years I've had to learn what it's like to be an asset manager, I'm an equities man by training and temperament, and for me the natural disposition of an investment trust is to be invested principally in equities — sometimes growth stocks selling on high P/Es, sometimes mature and conservatively run businesses throwing off cash and paying attractive dividends, but equities nonetheless.

LOOKING TO GROWTH

The mention of dividends prompts me to say something about Personal Assets' own intentions as regards its dividend progression. Shareholders will know that we are taking advantage of the ability to distribute capital profits as dividend by undertaking to pay a regular total of £5.60 per annum until such time as we are confident of being able not only to pay but also to sustain the payment of a higher rate of dividend out of earnings. This we believe to be preferable to chasing income by buying poorer quality investments. For equity investors, capital performance and revenue growth often go hand in hand. Over the next few years I'd therefore like Personal Assets to seek both asset and income growth through building up a high quality portfolio of equities, mainly although not exclusively in the UK and the US, offering value for money and growth at a reasonable price, and paying decent dividends that will enable us to rebuild our revenue reserves and act as a springboard for dividend growth.

ROBIN ANGUS

Personal Assets Trust Performance

	Value 31 Oct 2015	Percentage Changes 1 Year	3 Years	5 Years	10 Years
Share Price	£352.60	3.1	0.7	15.0	48.2
NAV per Share	£348.89	2.9	1.2	15.2	47.3
FTSE All-Share Index	3,484.60	(0.5)	15.2	18.7	30.8
NAV relative to FTSE All-Share Index		3.4	(12.2)	(2.9)	12.6

Past performance is not a guide to future performance. The value of investments may go down as well as up and you may not get back the full amount originally invested.

Top 10 Equity Holdings

Company	Country	Sector	Valuation 31 Oct 2015 £'000	Shareholders' funds %
British American Tobacco	UK	Tobacco	30,158	5.0
Philip Morris International	USA	Tobacco	25,787	4.3
Nestlé	Switzerland	Food Producer	23,456	3.9
Coca-Cola	USA	Beverages	22,235	3.7
Microsoft	USA	Software	18,322	3.0
Sage Group	UK	Technology	17,384	2.9
Altria	USA	Tobacco	15,218	2.5
Dr Pepper Snapple Group	USA	Beverages	14,771	2.4
Colgate Palmolive	USA	Personal Products	12,171	2.0
Imperial Oil	Canada	Oil & Gas	11,614	1.9
			191,116	**31.6**

Portfolio Analysis

	Valuation 31 Oct 2015 £'000	Shareholders' funds %
Equities	259,389	43.0
US TIPS	101,643	16.8
UK Index-Linked Gilts	27,965	4.6
Gold Bullion	59,317	9.8
UK Cash and Cash equivalents	149,577	24.8
Overseas Cash and Cash equivalents	5,968	1.0
Shareholders' funds	**603,859**	**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