PERSONAL ASSETS TRUST PLC

JUNE 2017 — QUARTERLY REPORT No. 84

ANNUAL GENERAL MEETING

This year our Annual General Meeting ("AGM") will be held at 12 noon on Thursday 20 July at The Principal Edinburgh (formerly known as the George Hotel), 19-21 George Street, Edinburgh, EH2 2PB. After the AGM there will be a Presentation by Sebastian Lyon, our Investment Adviser, followed by Questions and Answers and a light buffet lunch.

You should have received an invitation to the AGM along with the Quarterly and Annual Report. Alternatively, you can indicate on our website if you would like to attend.

http://www.patplc.co.uk/

TROY LONDON PRESENTATION

This year, as last year, Troy Asset Management Ltd is hosting an investment trust presentation featuring Personal Assets Trust and Troy Income & Growth Trust. The presentation will take place at 2.30 pm (doors open 2.00 pm) on Wednesday 12 July at the Royal Institution of Great Britain, 21 Albemarle Street, Mayfair, London W1S 4BS. To indicate an interest in attending, please contact Troy directly at troy@taml.co.uk

PITY THE PRIVATE INVESTOR

'How can you get your stockbroker' [or, one might suggest, bearing in mind the stories that are to follow, your private banker] '*to make you a small fortune?'*

'Give him a large one, and wait.'

That joke was current at the beginning of my career, back in 1977, and it's probably much older even than that. Bobby White, Chairman of Personal Assets between 1994 and 2009 and himself a former private client stockbroker, liked to quote Woody Allen's even crueller definition:

'A stockbroker is someone who invests your money until it's all gone.'

The perils that can lie in wait for the unwary private investor have been at the forefront of my mind at least since 2002, when I wrote the first of a series of three Quarterlies on the subject (Nos. 27, 28 and 29). But I had been conscious of the problem for a long time before that, and it might not be too much to say that Ian Rushbrook and I consciously created Personal Assets as our own answer to the question of how best private investors should have their money managed. We knew what we wanted for the care of our own money, and formulating the guidelines was a fascinating challenge. But because it was difficult at that time to find anyone who was offering it in exactly the way we required, we decided we should do it for ourselves. Charlotte Brontë's Jane Eyre famously said of Mr Rochester, her ideal husband[1]:

'Reader, I married him.'

Ian and I might equally well have said of our ideal investment trust:

'Reader, we founded it.'

TRUSTS AND PRIVATE INVESTORS

Let's remind ourselves of why investment trusts are especially suitable for private investors.

- Investment trusts offer private investors the benefit of full-time, professional portfolio management, while the direct relationship between the shareholders and the Board of Directors they elect, and whom they can question face to face as closely as they please at General Meetings, ensures maximum accountability.
- Investors managing their portfolios directly or through an adviser can't offset any of their investment management, administration or interest costs against tax. Investment trusts can offset all such costs against tax.
- Higher-rate taxpayers are currently taxed at 20% on all realised capital gains in excess of £11,300 per annum. Such investors managing their portfolio themselves or through professional advisers will therefore sometimes find themselves either paying Capital Gains Tax ("CGT") or being forced to make unsuitable, tax-driven investment decisions. But investment trusts are wholly free of CGT on gains realised within their portfolios and so can buy and sell shares on investment grounds alone.

It's a powerful case, and I wish everyone who might benefit from it was fully aware of it. Why do I say this? Just read on . . .

'LET ME TELL YOU A STORY . . . '

Get your handkerchiefs out, because this is a tear-jerker. I first referred to it in Quarterly No. 29, and it concerns an expatriate couple Ian and I knew at the time. They had retired in the middle 1990s with around US$50 million of capital to invest. On the recommendation of friends prominent in the financial world, they arranged for their money to be managed by a leading Swiss bank. It was not a success. Over a period during which markets in general rose, their $50 million fell in value to $25 million.

Understandably dissatisfied, during the second half of 1999 (just as equity markets worldwide were on the verge of peaking) the couple interviewed a number of the most highly respected private client fund managers in the UK and abroad, grilled them about their views and

[1] I've never been able to understand what my wife sees in Mr Rochester. Needless to say, she regards this as yet further proof of my essential obtuseness and insensitivity.

(you will not be surprised to learn) got the same advice from them all:

'Now is an excellent time to buy equities!'

The sole dissenting voice was Ian's *(the couple had contacted him through friends they had in common).* Ian told them he thought markets were hugely expensive and were riding for a fall. However, Ian wasn't pitching for their business — and anyway, what was one voice among so many, all urging them to buy equities?[2]

The couple therefore transferred their remaining $25 million to another international private bank specialising in managing money for wealthy individuals. Despite this bank's excellent reputation and its sales force's highly polished presentational skills, however, they found that their affairs were in the hands of an eager 25 year old lad who soon started churning their portfolio aggressively. Before long, it was underperforming again — whereupon the eager lad (contrary to the couple's instructions) began throwing their money at US over-the-counter technology stocks.

By now it was the middle of 2000, so readers who recall the TMT boom of that year (Telecoms, Media and Technology) won't be surprised to learn that many of these stocks quickly joined the '90% club' of companies which had lost 90% of their market value from their peak at the start of 2000. All in all, by the year 2003 the couple's $25 million had halved again to around $12.5 million.

This is an appalling story, all the more so because the couple didn't fall into the hands of sharks or scoundrels but had their money managed by blue-chip names of the highest reputation. Of course, anyone who invested in equities at the start of 2000 would have lost money by 2003. But the damage done to the couple's wealth by these high-powered and prestigious private bankers was irreparable.

ALIGNMENT OF INTERESTS

Things have changed since I first told that story, and (much as it grieves the crusty old reactionary in me to say so) most of the changes have been for the better. Greater scrutiny of costs and tighter regulation of and enhanced educational requirements for financial advisers have all played their part. The weaker and less qualified financial advisers have tended to withdraw from the field, and those which are left are much stronger, better informed and more professional.

Yet such damage to wealth still takes place, although sometimes in rather different ways, and is often caused by a business-hungry bank which identifies a likely client and then, in Dr Johnson's cruelly expressive phrase, *'encumbers him with help'*. For instance, an entrepreneur we know well had been convinced by a large investment bank to take out a huge loan in the tens of millions. He didn't know what he was going to do with the money, but he soon realised that part of his hard-earned stake in a public company was now in lien to this bank and that he could find himself a forced seller of his stake in distressed market conditions in order to cover his liability. By taking on this debt he had put at risk part of the value he had created over 30 years. Why? Because debt was cheap, the entrepreneur was perceived as a good risk, and a certain type of banker has traditionally excelled at selling to such people things they don't need and don't even particularly want.

The root problem here was the imperfect alignment of interest between the adviser and the advisee. In the case of Personal Assets, a glance at the Directors' and Investment Adviser's shareholdings reveals that their interests and those of the other shareholders are closely aligned. Private bankers' interests, however, are not always so well aligned with those of their customers. What they seek is to increase their *'share of the customer's wallet'* (an industry expression for their attempts to increase the charges they can levy on customers for more complicated 'products').

KEEP HOLD OF YOUR WALLETS

What can you do to escape such high-grade pickpockets? More than you would think, I'm glad to say, as long as you're prepared to do some homework and use your common sense. When it comes to making investment decisions, I'm a great believer in the merits of common sense, which no investment advice should be allowed to transcend. So I find it a mystery that there are still some private investors who scan the Personal Finance pages of the weekend Press with all the trustful innocence of Homer Simpson, to whom his son Bart once scornfully remarked:

*'You'll buy **anything**!'*

Why do people who usually take such care with their money bungle their biggest financial decision of all by putting their savings in the hands of advisers with whom their interests are not fully aligned and who have an agenda of their own?

I suspect it's for a reason I find both worrying and depressing — that they think of investment as a mysterious and unfriendly world they can't hope to understand, so they just swallow what they read, or are told, in a way they would never dream of doing when making far less important decisions about buying a car or a washing machine. Let's demystify things by asking ourselves some simple questions.

LIFESTYLE CHOICES

Maybe the first question should be:

'Do I want to build capital at all?'

As someone once said:

'Why travel at the back of the 'plane so that your children can travel at the front?'

However, I assume readers of this Quarterly have made the opposite decision. They will possess (or be accumulating) capital they want to preserve and to see grow.

Investment returns come in various forms, however, so one must ask:

'What do I want from my money? Income? Capital growth? Total return?'

You can't have everything. Leaving aside short-term market inefficiencies, the general principle is that the higher the income return you get from an investment, the lower will be the rate of capital growth it produces, and *vice versa.* Common sense will tell you that most high yield investments offer you a real prospect of capital loss.

[2] I'm reminded here of Rhodri Morgan, former First Minister of Wales, who died on 17 May and who once memorably accused the financial services industry of operating on the principle that *'40,000 lemmings can't be wrong'*.

This is why — counter-intuitive although it must have seemed — we asked shareholders to vote to amend the Articles of Association to permit Personal Assets to distribute realised profits as dividend. This has enabled the Board to commit to paying the dividend at the present annual rate of £5.60 for the foreseeable future without scrabbling around for income in a yield-starved world in a way that would inevitably have lowered the quality of the portfolio. We promised that in future years we would use any surplus income to 'repay' the capital so distributed before increasing the dividend. While transfers from reserves in future years can't be ruled out, in the current year the dividend has been fully covered by earnings and we've been able to 'repay' the amount withdrawn from reserves last year.

Risk is for Real

The next question is:

'How much risk can you tolerate?'

Or, putting it bluntly:

'How much of your money can you afford to lose?'

Personal Assets defines 'risk' quite differently from most other global investment trusts and the fund management industry at large.

- The typical definition is likely to be *'volatility of returns relative to an index'*.
- Ours is *'risk of losing money'*.

Given this conservative definition of risk, we usually, although not invariably, prefer our investment portfolio as a whole to have a lower level of risk than that of the FTSE All-Share Index.

How far we've succeeded in managing and minimising risk is shown in the bottom chart on page 10 of the Annual Report. This illustrates how over the past seventeen years Personal Assets has been not only less volatile than UK equities in general but also less volatile than most comparable investment trusts.

What is Diversification?

'Don't put all your eggs in one basket' is good advice, but gives rise to misunderstandings galore. For instance, if mining stocks as an investment class are risky it isn't 'diversification' to hold six of them, any more than it's spreading your risk to place six bets on the same horse in the Grand National.

Similarly, diversification doesn't simply mean holding lots of different shares. It depends on what the shares are. A breakfast of crisps, nuts, chocolate and gin would be 'diversified' in that it would have four different constituents, but only in my undergraduate days would I have thought it a balanced meal.

It can be difficult for a private investor to achieve adequate diversification across companies, sectors and asset classes without great expense and constant vigilance. Why not let investment trusts do it for you? Some would argue that it's better to get a personal service tailored to your own requirements than to be just one investment trust shareholder among thousands. To this I would respond, Why?

After all, what *are* your requirements? Surely, to protect and increase the value of your capital over the long term. Endless buying and selling and paying CGT won't achieve that for you. People sometimes feel that having their money managed by a private bank is the proper and expected *'next step up'* from holding investment trusts or other pooled investment vehicles. But it isn't about what sounds best at the golf club. Because of CGT, it is a paradox that the richer you are, the more advantageous it can be to invest through investment trusts.

Why Control the Discount?

Back in the 1980s I asked a partner in an investment management firm whether he was a 'name' at Lloyds. His reply was succinct.

'I already have unlimited liability as a partner in the firm. Why should I want to have it twice?'

Anyone who holds shares in an investment trust runs the risk of seeing the share price fall. Why run another risk by being exposed to a widening discount as well? Risk and reward are, of course, two sides of the same coin, and some investors like the volatility of the discount and the additional level of possible reward it brings them. I'm more cautious. For instance, suppose that I die suddenly and my executors must realise a sizeable sum quickly to meet inheritance tax or pay legacies. If my money is invested in a trust without a fully functioning discount control mechanism ("DCM"), it's at the mercy of the market twice over. Indeed, Ian Rushbrook died at a time of market turmoil and his death was itself a potentially price-sensitive event for Personal Assets. Had we not had a DCM in place and working satisfactorily, who knows by how much the discount might have widened — and how expensive this would have been for other shareholders who needed to sell shares at that time?

Personal Assets sells at around net asset value because the Directors have decided that it should. If our shares go to a discount we buy them back — in any size, and at any time. If they go to a premium, we create new shares to satisfy demand. This is because the Board believes shareholders should be protected not only from 'discount risk' but also from 'premium risk', which has in the past brought disappointment and financial loss to investors buying into trusts at a premium which has then vanished. As shareholders, we ourselves prefer to avoid both these risks. Judging by the continued demand for our shares, our fellow shareholders agree with us. Since 8 November 1999, *'Discount Freedom Day'*, when trusts were empowered to use capital to buy back shares and hence to control the discount, our number of shares outstanding has risen by more than five times, from 369,121 to 1,979,627.

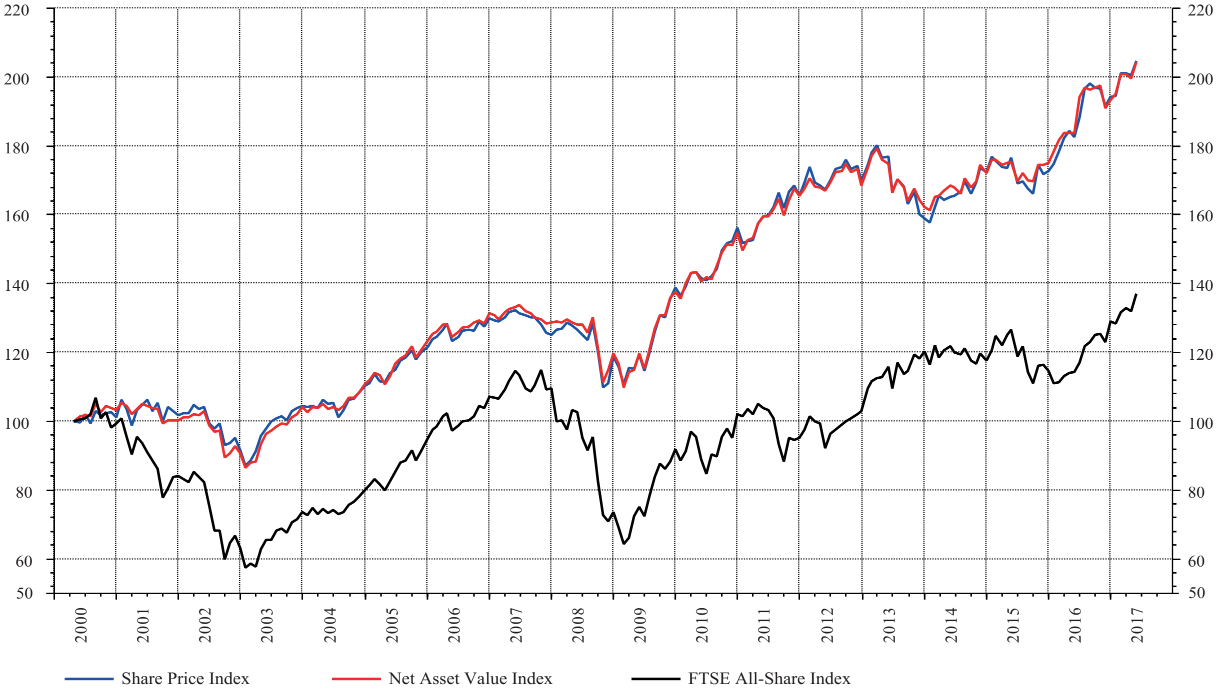
What I've Learned Not To Do

In conclusion, here are five ***Don'ts*** I've learned in 40 years in the market — often painfully, sometimes expensively, but always usefully.

- Don't reinvent the wheel.
- Don't waste time and money doing for yourself what others can do for you more efficiently.
- Don't be tempted by needless duplication.
- Don't buy what someone else thinks you ought to need or want. Decide what you actually *do* need and want, and invest in that.
- Don't buy any financial product without asking exactly what's in it for the people selling it to you.

Robin Angus

Personal Assets Trust Performance



	Value	Percentage Changes				
	31 May 2017	**1 Year**	**3 Years**	**5 Years**	**10 Years**	**30 Apr 2000**
Share Price	£413.80	12.1	24.0	22.5	54.8	104.9
NAV per Share	£408.43	11.3	21.4	22.4	53.5	104.4
FTSE All-Share Index (“Index”)	4,116.08	20.0	12.6	48.8	19.7	37.1
NAV relative to Index		(7.3)	7.8	(17.7)	28.2	49.1

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 May 2017 £’000	Shareholders’ funds %
British American Tobacco	UK	Tobacco	41,096	5.1
Philip Morris	USA	Tobacco	37,182	4.6
Nestlé	Switzerland	Food Producer	31,350	3.9
Microsoft	USA	Software	29,099	3.6
Coca-Cola	USA	Beverages	28,571	3.5
Altria	USA	Tobacco	22,190	2.8
Sage Group	UK	Technology	19,454	2.4
Unilever	UK	Food Producer	16,850	2.1
Colgate Palmolive	USA	Personal Products	16,765	2.1
Berkshire Hathaway	USA	Insurance	16,373	2.0
			258,930	**32.1**

Portfolio Analysis

	Valuation 31 May 2017 £’000	Shareholders’ funds %
Equities	371,799	46.1
US TIPS	151,520	18.8
US T-Bills	5,421	0.7
UK T-Bills	114,981	14.2
UK Index-Linked Gilts	31,726	3.9
Gold Bullion	78,706	9.7
Cash and Cash equivalents	52,948	6.6
Shareholders’ funds	**807,101**	**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