

# PERSONAL ASSETS TRUST PLC

AUGUST 2010

QUARTERLY REPORT N<sup>o</sup>. 58

## A STIMULATING AGM

Accompanying this Quarterly is a summary of the presentation that our Investment Adviser, Sebastian Lyon of Troy Asset Management, gave at Personal Assets' Annual General Meeting ("AGM"). This took place on 22 July in Edinburgh and was attended by about 100 people.

The AGM seems to get livelier (*in a good way*) every year and, given shareholders' increasing interest, we had allowed an additional half hour for the proceedings. The extra time was amply justified by the very productive question and answer session following Sebastian's presentation, so I thought I would use this Quarterly to report on some points of general interest raised by shareholders during it.

## FTSE 100 FUTURES

Where better to begin than with this hardest of perennials? We began using FTSE 100 Futures in June 2002 and found them to be a simple, straightforward and practical investment tool. We were at pains to explain this from the beginning and in the 2003 Annual Report I carefully wrote:

*'Each time we buy FTSE 100 Futures giving an equity exposure of (say) £10 million, the result is simply that we reduce our effective liquidity by £10 million — nothing more, nothing less. FTSE 100 Futures, as used by Personal Assets, carry no derivative risks whatsoever.'*

I hoped this would suffice. Since then, however, the Futures seem to have been a source of endless puzzlement to many, and no AGM has gone past without anxious questions being asked about them. This is why, given that by the date of this year's AGM we had no exposure at all to FTSE 100 Futures, I fondly hoped that for the first time in eight years we might avoid a question on the subject. Not so. One shareholder asked why we

had *stopped* liking them and *didn't* hold them any more, given that Ian had used them so enthusiastically and profitably!

The reason we don't hold any is *not* that we have decided not to do so in principle or have stopped liking them as a way of investing, but simply because they don't suit our strategy at the moment.

We think of FTSE 100 Futures not as an asset class in their own right but as a practical tool for varying or fine-tuning our exposure to the vitally important asset class represented by UK equities. They are a way of altering the balance of the portfolio between equity exposure and liquidity, making us less vulnerable to sudden market movements while avoiding the extra risk and expense involved in selecting individual stocks to buy or sell. Recently, in particular, they were a good way of participating in the UK stock market's '*dash for trash*' in 2009, since our holding of FTSE 100 Futures gave us exposure to stocks or sectors we would not have wanted to hold directly or for the long term.

We are highly likely to use FTSE 100 Futures again when circumstances make it attractive for us to do so, but we will use them only as what they have always been for us — a means to an end, not an end in themselves.

## GOLD, BEAUTIFUL GOLD!

It was no surprise that several shareholders asked about Personal Assets' holding of gold bullion, despite Sebastian's detailed discussion of it in his presentation. Although I started campaigning for us to hold gold many years ago, both Sebastian and I recognise that it is an unusual holding for an investment trust and that holding gold goes against the grain for many investors, both private and institutional. As long ago

as 1979, when I was an apprentice at Baillie, Gifford & Co and the great gold price boom of 1980-81 was getting under way, I argued in vain that we should buy Kruggerands or some other form of the metal, only to be told by one of the senior partners that while he might consider buying mining shares (which we later did, and I loved dealing in them because they reminded me romantically of favourite boyhood yarns such as *Prester John* and *King Solomon's Mines*), he felt there was '*something sterile*' about gold bullion'.

In one obvious sense, this is true. Although gold has been a store of value since time began and is the only currency that is acceptable anywhere in the world yet cannot ever be printed, it yields no income and, indeed, costs money to hold (*although the cost is minimal*). Shareholders were, therefore, understandably keen to ask about the effect on our revenue account of holding over 10% of our assets in gold and about the possible impact of this on the yield requirement from the rest of the portfolio.

Yes, our holding of gold doesn't help the revenue account, any more than does the unprecedentedly low return we get from holding cash. However, for the time being we see the income cost of holding gold as being a price well worth paying for the sake of risk avoidance and the maximisation of total return.

Furthermore, the restrictions on our earning power are, we believe, only temporary. We do not expect to hold gold for ever. Nor do we expect cash to yield virtually nothing for ever. In the meantime, as a trust aiming to achieve total return we are absolutely determined to avoid lowering the quality of the portfolio simply in order to maintain our dividend objective.

We don't, however, intend to add corporate bonds to the asset classes we invest in, despite one shareholder's suggestion. They are not one of our areas of expertise and because of the length of the lives to maturity of many of these bonds we don't feel that the balance between risk and return is favourable. Moreover, we do not believe in holding investments for no other reason than their yield.

#### **HOW MUCH GOLD? HOW LONG?**

Sometimes shareholders assume that what you hold today, you will hold for ever. This was not so with our FTSE 100 Futures and it is not so with gold. Another shareholder wanted to know if we would be likely to increase our holding in gold beyond the present 11-12%. We pointed out that the stake was originally under 10% and had risen above that level mainly by appreciation, and we added that we would be unlikely to increase it further unless there were a temporary setback in the gold price.

#### **INVESTING IN THE FAR EAST?**

Investing in the Far East is something else we are regularly asked about, and have been ever since I can remember. The first point here is that Personal Assets has got nothing against the Far East, or, indeed, against the BRIC countries which another shareholder asked about (Brazil, Russia, India and China), even though I am rather fond of the quip that Brazil is the country of the future and always will be — something that goes back at least to the 1820s and the first Latin American bond crisis. (*I do have one Brazilian investment — a gold coin of the Emperor Pedro II, whose beard was bushier even than my own; but I bought it for its gold content and its curiosity value rather than for any intrinsic Brazilian-ness.*)

We acknowledge that we are not experts on the Far East or the BRIC countries. We don't pretend to be able to do everything. As we used to say every year in the Report & Accounts in the section headed 'The Board's Policies for Personal Assets':

*'We cannot satisfy all the needs of every shareholder. Personal Assets does not seek to offer one-stop investment shopping for global investors,*

*although we do intend it to supply most of the necessities of life for Sterling-based equity investors. We stick to what we know about and investors who want a stake in specialised investment areas should look for it elsewhere, over and above their shareholdings in Personal Assets.'*

However, we do consciously seek exposure to other economies and countries through the medium of shares listed in London, which applies to other sectors as well.

We were asked if we invested in other investment trusts and we replied that we of course were prepared to and that this was an option which had always been open to us. Collective Assets, which Personal Assets took over in June 2005, specialised in investing in investment trusts and investment management companies and we have always said we may from time to time hold shares in other investment trusts if these look attractive compared to other equities, or if they provided exposure we wanted to areas the attractions of which we felt confident about but in which we lacked expertise.

#### **INVESTING IN PROPERTY?**

On a similar theme, the question was raised as to whether Personal Assets would be likely to hold either direct property or property shares.

Direct property we rule out right away. Unlike some other self-managed investment trusts we do not own even the building from which we operate. Always suspicious of the cult of second-hand bricks and mortar, I am on record as saying (admittedly with tongue in cheek) that if I were Prime Minister of Scotland I would privatise everything except for residential property, which I would nationalise!

Holding shares directly in property companies would also be an unlikely course for us. If we did want to invest in property we would be likely to do so as we have done in the past, through a listed investment trust such as TR Property, in which we had a small holding between 2005 and 2008.

#### **WHAT ABOUT BANKS?**

Given Personal Assets' past exposure to bank shares, we were not

surprised to be asked about our view of the sector at present. This was an easy question to answer. First, we got it wrong in 2008 and should have sold out of the banks much sooner than we did. Secondly, we do not want to invest in banks today because it is still a sick sector. At inflation of between 3% and 5% the banks are struggling to take in money and, as with National Grid, we would probably find ourselves asked to turn capital into income by taking up rights issues.

#### **OTHER EQUITY HOLDINGS**

Questions were raised about the oil sector and BP. We sold BP in time, but for the reasons outlined by Sebastian in his presentation, not because we foresaw the oil spillage in the Gulf of Mexico. As a general principle, however, we worry about companies where business can get tangled up in politics and there is the threat of opportunistic political grandstanding. We were also asked why we had 3% of our assets in Glaxo and we replied that it was a fairly safe, although unadventurous, home for money. It is not a core holding of the Nestlé or Coca Cola sort.

#### **OUR ALLIANCE TRUST HOLDING**

At 30 April 2009 we held 9.6% of our shareholders' funds in the shares of Alliance Trust. We have entirely sold out of our Alliance holding, not too unprofitably but nevertheless with deep frustration and disappointment.

The holding was originally bought by Ian in 2006 as Second Alliance and, after Alliance and Second Alliance merged, was added to considerably by Ian and then by the Board before the appointment of Troy as Investment Adviser. We saw it as an alternative to a FTSE 100 Future which paid us a reasonable level of income while giving us mainstream equity exposure, and we looked to a possible significant uplift in its share price from a narrowing of the discount.

Troy also held a sizeable stake in Alliance Trust and together we did our best to persuade the Alliance Board to do something about the level of the discount. Ian and I were long-term admirers of Alliance and wanted it to do some-

thing similar to what Personal Assets has done in the way of a discount control mechanism. Sebastian felt the same. However, repeated requests to the Alliance Board and meetings with key personnel produced no result and in the end we got fed up and sold. This was a matter of huge regret because Alliance has a wonderful franchise among private investors and would have wonderful growth prospects were it prepared to adopt a discount control mechanism. Since many of those at the AGM were also Alliance shareholders (and, in fact, Alliance is one of my own largest holdings other than Personal Assets) it was at least an opportunity for some frustrations to be aired and shared during and after the meeting.

#### **PENSION 'POISON PILLS'?**

When analysing companies, do we pay attention to the existence of Defined Benefit pension schemes?

The answer couldn't be simpler. You bet we do! It's one of the first things we look at and we are all too well aware of the dangers of exploding pension liabilities — which, for instance, have made BA (in the well-known phrase) 'a pension scheme with wings'.

Although it wasn't raised at the meeting, I think it is also worth mentioning that as a matter of policy Personal Assets itself has no pension scheme and no liabilities for pensions or other benefits. Directors and employees are expected to make their own pension provision, together with health insurance and all similar expenses, from their fees or salaries and there are no hidden costs or benefits whatsoever.

#### **AVOIDING 'TORPEDOES'**

Talk of the banks, BP and defined benefit pension schemes led to discussion about what 'torpedo stocks' there might be in Personal Assets' portfolio today. The quick answer is that we cannot possibly know and that no sane investor would hold something he feared was going to be a torpedo stock!

One shareholder was particularly concerned about tobacco stocks, which we hold for their yield and the exposure they give us to developing economies. In our view,

anti-smoking litigation in developed countries is already in the price of tobacco stocks. There are at present no signs of regulation increasing in the developing countries, but we will naturally keep this under close review.

#### **THE COALITION GOVERNMENT**

What do we think of it, one shareholder wanted to know? Our answer was that it was not perfect, but it was the best government we've got. In our view, it's better (or, at least, less bad) to have ended up with a 'Brokeback Coalition' than a broken-backed Conservative minority administration that probably would not have lasted until the end of the year. Nor could a minority government have implemented what, all in all, was not a bad Budget even by our demandingly 'dry' standards. So we hope for the best.

#### **WHAT KEEPS YOU AWAKE?**

An interesting and unusual question was, 'What keeps you awake at night?' Sebastian's response — I strongly agree — was that inflation had to be our main worry.

*(Deflation is a worry too, in theory, but in practice is politically all but unthinkable.)*

Inflation is notoriously hard to control, and when it gets out of control it destroys everything. Politicians are weak, central bankers are too easily influenced, and the economy may be killed with kindness.

#### **CASH INCOME OPTION**

In Quarterly N<sup>o</sup>. 57 I rather nervously referred to Personal Assets' Cash Income Option within our Investment Plan.

- The Cash Income Option lets investors draw an annual income of £4,000 or more (minimum £1,000 per quarter) from a shareholding in Personal Assets held within the Plan.

- Depending on their own tolerance of risk and view of markets, investors can choose to receive an annual 4%, 7% or 10% of the starting value of their holding as a quarterly cash income from the sale of shares.

- The minimum starting sum depends on the percentage rate of cash income chosen.

Most investors, we argued at the time of the Cash Income Option's launch, would not be liable to pay any tax on their realised cash sums because the Capital Gains Tax ("CGT") threshold was substantial — at the current rate, up to £20,200 per annum of tax-free capital gains for a married couple.

Before the emergency Budget on 22 June, all this was up in the air. However, the worst fears about CGT increases were not realised. The threshold remains at £20,200 for a married couple and the rate for those paying income tax at the higher rate rises from 18% to 28%. Therefore the attractiveness of the Cash Income Option for certain types of investor remains intact and no changes are needed in the way it operates.

#### **A MEMORIAL BUST OF IAN**

It is well known that, as Thomas Gray noted in his *Elegy Written In a Country Churchyard*, no 'storied urn or animated bust' can 'back to its mansion call the fleeting breath'. However, these things can be precious reminders of what has gone before, and the Board was delighted to receive from Dr Frank Rushbrook CBE, Ian's father, the gift of a magnificent bronze bust of Ian, the work of Deirdre Nicholls, the celebrated Scottish sculptress.

It was unveiled at the AGM and will be kept in the Personal Assets Boardroom at 10 St Colme Street, with the exception that it will pre-empt over each AGM in Edinburgh from now on.

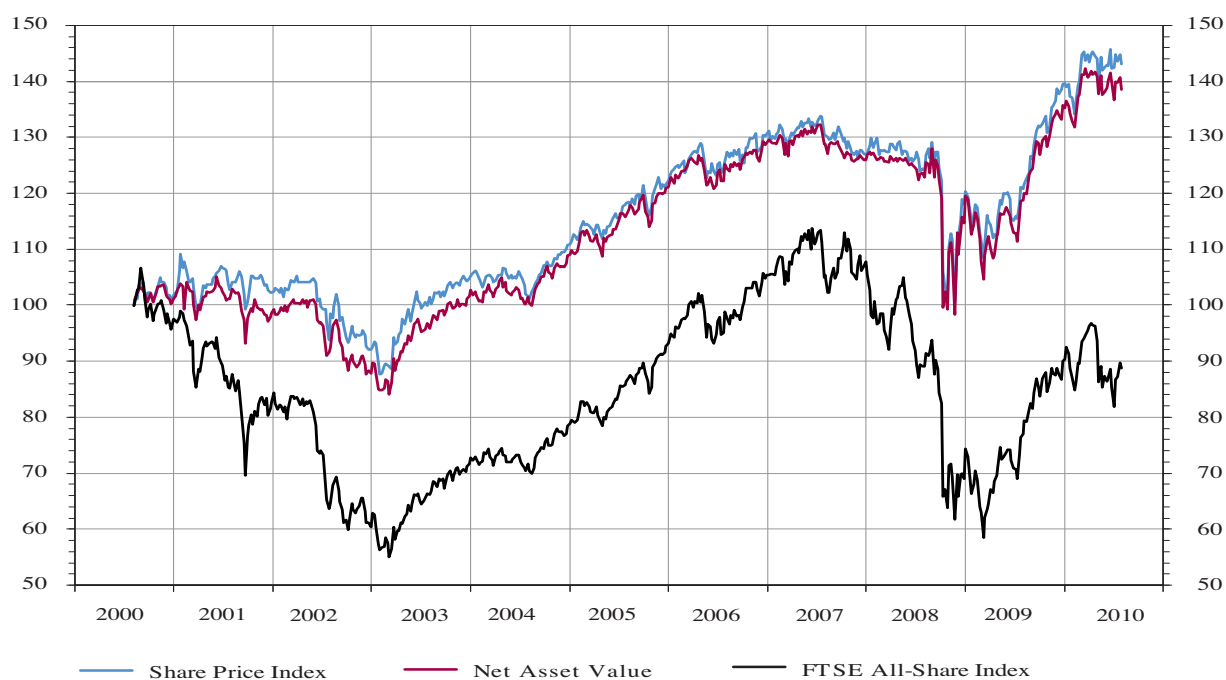
*(Alas, its weight prohibits its being taken to London for the shareholder meeting in January, which is provisionally scheduled for Tuesday 18 January 2011 at a venue yet to be decided on but which will in due course be notified to you on our website.)*

#### **COLLECTED QUARTERLIES**

The book of collected Personal Assets Quarterlies which we are publishing as a tribute to Ian Rushbrook will be available at the same time as the November Quarterly. A request form will appear before then on our website and the book will be available free of charge to shareholders on request.

**ROBIN ANGUS**

## PERSONAL ASSETS TRUST PERFORMANCE



	Value 31 July 2010	1 Year	Percentage Changes		
			3 Years	5 Years	10 Years
Share Price	287.50	18.4	8.9	20.9	43.4
NAV per Share	282.13	16.7	6.9	19.3	39.2
FTSE All-Share Index	2,715.36	15.4	(17.4)	2.7	(11.3)
NAV relative to FTSE All-Share Index	–	1.1	29.4	16.2	56.9

### TOP 10 HOLDINGS

Company	Country	Sector	Valuation 31 July 2010 £'000	Shareholders' funds %
British American Tobacco	UK	Tobacco	13,658	5.8
Nestlé	Switz	Food Producer	11,881	5.1
Coca Cola	USA	Beverages	11,327	4.8
Diageo	UK	Beverages	8,707	3.7
Philip Morris International	USA	Tobacco	7,568	3.2
Vodafone	UK	Telecoms	7,417	3.2
GlaxoSmithKline	UK	Pharmaceuticals	7,221	3.1
Berkshire Hathaway "A"	USA	Insurance	7,166	3.1
Tesco	UK	Food Retailer	6,766	2.9
Johnson & Johnson	USA	Pharmaceuticals	6,470	2.8
			<b>88,181</b>	<b>37.7</b>

### GEOGRAPHIC ANALYSIS

	Valuation 31 July 2010 £'000	Shareholders' funds %
UK equities	64,092	27.3
US equities	45,943	19.6
Swiss equities	11,881	5.1
Australian equities	4,422	1.9
Gold Bullion Securities	27,420	11.7
US Treasury Inflation-Protected Securities	72,428	30.9
Net current assets	8,269	3.5
<b>Shareholders' Funds</b>	<b>234,455</b>	<b>100.0</b>