PERSONAL ASSETS TRUST PLC

APRIL 2005 QUARTERLY REPORT No. 36

A REVISIT FOLLOWING A VISIT

On 7 February 2005, Alan Greenspan, the Chairman of the Board of Governors of the US Federal Reserve System, was awarded an honorary Doctorate by the University of Edinburgh. Ian and I were privileged to be there as guests of the University (it was a magnanimous invitation, since my remark in the last Quarterly about Alan Greenspan's being a *"bigger threat to the US economy than Osama bin Laden"* had just been headlined in the Scottish press) and it proved to be a wonderful occasion which we much enjoyed.

Professor Mervyn King, the Governor of the Bank of England, was also there for the award of an honorary degree, and Ian and I were much relieved to see Gordon Brown, the Chancellor of the Exchequer, properly attired in white tie alongside the Governor, in contrast to his eccentric and ill-mannered style of dress at Mansion House dinners. Remembering as I do the shock caused by dear old George *"Tired and Emotional"* Brown's choice of black tie rather than white tie for such events in the 1960s, I can't help wondering if Gordon Brown realises quite how silly he makes himself look by "dressing down" even further than his namesake, in a pompous, stuffy "lounge suit" rather than in the stylish and elegant white tie and tails.)[1]

I am not going to discuss Gordon Brown's recent Budget here. Ian and I differ about him. I think he is a bad Chancellor but a good man. Ian, however, thinks he is not only a bad Chancellor but also (I quote) *"a dangerous zealot capable of returning the UK to pre-1979 socialism"*.

Something that unites the directors of Personal Assets, however, is an affection for *The Spectator* in general and the writings of Mr Christopher Fildes in particular; and Mr Fildes' comments on the Budget could hardly be bettered:

"Another Gordon Brown Budget: how well we know them by now — the thumping delivery, the gabbled numbers, the loopholes closed and opened, so many initiatives, so much complexity, so many popular causes. Old hands have learned to listen for the gaps between the sentences. What has he somehow forgotten to mention? What low ball has he saved up for the small print of an Inland Revenue notice? . . .

"The Chancellor is offering to regulate the regulators and to make the Better Regulation Task Force more regular and, of course, better. Something like a Less Regulation Task Force would be better still, but simplification was never his style . . . It would need a Chancellor who believed, as Lord Lawson did, that taxes should be low, simple and compulsory: in other words, a new one."

Well, we live in hope . . .

ROBED IN MAJESTY

I return, however, to Alan Greenspan, about whom I wrote a great deal in my last Quarterly. Why devote so much attention to him? It would be much more fun to leave the global scene alone and chat about individual companies. They, however, are only the deckchairs, while Alan Greenspan is the Captain of the *Titanic*. He has been steering us ever nearer to the iceberg. Now we are just waiting for the crunching sound.

How things change! As I saw him robed in all his academic majesty I couldn't help my thoughts going right back to 1994, when (believe it or not) I hero-worshipped him. On 5 February of that year, having concluded that the US economy ran the risk of serious overheating, he shocked world markets by pre-emptively tightening monetary policy to slow down over-rapid US economic growth. I was writing a major piece of investment trust research at the time, commenting on the outlook for world markets in the year ahead, and the announcement meant a substantial rewrite. So elated was I by his display of firmness, however, that I didn't care. I was glad to endure this trivial inconvenience, because it showed there was a man in charge of US monetary and interest rate policy who meant business. My relief was palpable:

"The recent raising of US short rates was (to me) a bull sign. It shows that the developed world's fear of inflation is such that the monster is being fought with pre-emptive strikes, not rearguard actions. And that is how things should be. Could we really be entering a golden age of low inflation, low interest rates and steady, undramatic, sustainable growth? The chance is just good enough to be a credible bet."[2]

GREENSPAN "TALKS THE TALK"

In 1994 Alan Greenspan won the confidence of the markets by fitting actions to words. That, however, was more than a decade ago. What has gone wrong since then? Today there is a fashionable expression about having to "walk the walk" as well as "talk the talk". As time went by, Greenspan continued to "talk the talk". Who, for instance, can forget his "irrational exuberance" speech in December 1996, when he said:

"Because monetary policy works with a lag, we need to be forward looking, taking actions to forestall imbalances

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[1] My great-grandfather, a working man turned Scottish Tory MP, followed the then custom by wearing Court Dress (knee-breeches, sword, silver buckles, the lot) when seconding the Loyal Address in the Commons following the King's Speech in 1927. He hugely enjoyed doing so, agreeing with the late Lord (Joe) Gormley that *"nowt's too good for the working class!"*

[2] A good bet too, as it turned out.

that may not be visible for many months . . .

“[H]*ow do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade? And how do we factor that assessment into monetary policy? We . . . should not underestimate or become complacent about the complexity of the interactions of asset markets and the economy.”*

THE “TALK” CONTINUES

He “talked the talk”. But he didn’t “walk the walk”. In the last Quarterly I referred to the series of crises that followed his *“irrational exuberance”* speech. In 1997 we saw the Asian currency crash, followed in 1998 by the Russian bond default and the Long Term Capital Management collapse. By 1999 the world’s central banks were paranoid about Y2K, while in 2000 came the collapse of the Dot.com bubble and, in 2001, the attack on the Twin Towers.

Once a professed believer in the “short, sharp recession”, Greenspan refused to let capitalism take its course. ***Instead, he intervened every time***. So the market never got the chance to clear itself.

And then came his astonishing utterances less than six months ago (19 November 2004). Addressing a conference of bankers in Frankfurt with the US current account deficit running at an annual rate of $664 billion (6% of GDP) he said:

“We see only limited indications that the large US current account deficit is meeting financing resistance. Yet net claims against residents of the United States [in other words, the US trade deficit] *cannot continue to increase for ever in international portfolios at their recent pace.”*

Well, that’s definite enough. Even more telling than the speech itself, however, was Greenspan’s answer to a question afterwards:

“Rising interest rates have been advertised for so long and in so many places that anyone who hasn’t appropriately hedged his position by now, obviously, is desirous of losing money.”

What an extraordinary statement! What on earth can it be but Alan Greenspan’s alibi, to be lodged with his lawyers for the day he needs it? *(“Yeah, I told you wot would happen, di’n’t I, Guv?”)* It sounds good and wise, but how could US investment banks and hedge funds act on it? They are, in aggregate, the market. How could they hedge against themselves?

So, perhaps logically, their reaction was not merely to ignore the advice but to increase their exposure in the belief that if disaster struck, Greenspan would have to lower the Fed Funds rate rather than continue to raise it.

Such is the danger of moral hazard[3] that Greenspan’s gross mismanagement of interest rates has generated.

SHOWDOWN AT THE OK CORRAL

On Wednesday afternoon, 26 October 1881, Wyatt Earp, with his brothers, Morgan and Virgil, strode out with Doc Holliday to meet the outlaws, Ike and Billy Clanton, Tom and Frank McLaury and Billy Claiborne. The OK Corral gunfight lasted no more than 30 seconds, leaving Billy Clanton and the McLaury brothers dead.

The showdown between the Fed and the Wall Streeters (or as Tom Wolfe called them in his novel, *The Bonfire of the Vanities*, the “Masters of the Universe”) cannot be long postponed. It will happen when the Fed Funds rate exceeds the “tipping point” that renders the “carry trade” *(see p. 5)* unprofitable. And the *dénouement,* as at the OK Corral, will likewise take place in no more than 30 seconds.

LOOKING OVER THE HEDGES

Financial market hedges can be as tricky for the unwary as the Grand National ones. Gary North, a market commentator, wrote in December 2004:

“I keep wondering: Who is on the other side of those hedges? Who will have to pony up the money to compensate those who guessed right? If the smart money is hedged (protected), who is the stupid money? How much money do they have to pay off their obligations? In 2003, there were $234 trillion in highly leveraged (unfunded) derivative futures contracts. About 72% in 2003 were interest rate derivatives; about 13% were foreign currency derivatives. The derivative market's growth rate in 2003 was over 33% . . . So, in 2004, the total is probably over $300 trillion. Smart money is hedged against rising rates, says Greenspan. So, there must be stupid money on the other side of each smart-money contract. What happens if 20% of them default? . . . The financial system goes into gridlock. If that happens, the world's economy contracts.”[4]

Like Mr North, I find it hard to believe that there is $300 trillion of stupid money out there waiting to be drawn on. It would take a million Scottish Executives to squander that amount. I don’t, however, see the problem in quite the same way as Mr North does. The many $ trillions of derivatives may exist, but they are something of a red herring (or even, given the huge numbers, a red whale); the great bulk of these derivatives merely offset one another. (Adding together both sides of the balance sheets of all the FTSE 100 companies would give you a nonsensical impression of the size of the UK’s capital stock.)

What is really worrying, is that even after one has done all the necessary netting-off from the total of derivatives outstanding, *there will still be a bit that can’t be offset.* It may be tiny in relation to the $300 trillion, but then the estimated $4 trillion of the total US Treasury market is tiny in relation to the $300 trillion (it’s about 1.3% of it). I share Warren Buffett’s view that derivatives are good when rightly used, but are dangerous when misused. Here’s what he wrote on the subject in the 2003 Annual Report of Berkshire Hathaway. It struck me then, as it strikes me now, as a sensible summing-up of the situation in which world financial markets now find themselves:

“Many people argue that derivatives reduce systemic problems, in that participants who can’t bear certain risks are able to transfer them to stronger hands. These people believe that derivatives act to stabilise the economy, facilitate trade, and eliminate bumps for individual participants. And, on a micro level, what they say is often true. Indeed, at Berkshire, I some-

[3] **Moral hazard.** The risk that a party to a transaction has not entered into the contract in good faith, has provided misleading information about its assets, liabilities or credit capacity, or has an incentive to take unusual risks in a desperate attempt to earn a profit before the contract settles.

[4] http://www.investmentrarities.com/bestofgn.htm

times engage in large-scale derivatives transactions in order to facilitate certain investment strategies.

"Charlie [Munger] *and I believe, however, that the macro picture is dangerous and getting more so. Large amounts of risk, particularly credit risk, have become concentrated in the hands of relatively few derivatives dealers, who in addition trade extensively with one other. The troubles of one could quickly infect the others. On top of that, these dealers are owed huge amounts by non-dealer counterparties. Some of* [these] *. . . are linked in ways that could cause them to contemporaneously run into a problem because of a single event . . . Linkage, when it suddenly surfaces, can trigger serious systemic problems . . .*

"The derivatives genie is now well out of the bottle . . . Central banks and governments have so far found no effective way to control, or even monitor, the risks posed by these contracts . . . ***Derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal."***

This differs greatly from the sanguine view repeatedly put forward by Greenspan at Congressional hearings and elsewhere. Here, almost at random, is an extract from a speech he made to the Futures Industry Association in 1999:

"[Derivatives] *are an increasingly important vehicle for unbundling risks.* [They] *enhance the ability to differentiate risk and allocate it to those investors most able and willing to take it* [and improve] *the ability of the market to engender a set of product and asset prices far more calibrated to the value preferences of consumers than was possible before derivative markets were developed . .*

"I am quite confident that market participants will continue to increase their reliance on derivatives to unbundle risks and thereby enhance the process of wealth creation."

SOME MORE WITNESSES

One thing is clear, anyway. There is a lot of money washing around which is not represented by real earning assets. Don't just take my word for it, however. Here's Bill Bonner of *The Daily Reckoning*, a stimulating "e-newspaper"[5]

"The crime of which Mr Greenspan is guilty is fraud. Putting interest rates at an artificially low level, the Fed chairman intentionally misled Americans. Were it not for [low] *rates and easy lending policies, Americans wouldn't have thought themselves so rich. Their houses wouldn't have gone up so much; they wouldn't have taken out so much equity, because they wouldn't have had any equity to take out. They would have had to spend less, which would have reduced the US current account deficit and diminished household indebtedness. They would also have avoided spending phoney money with Asian and European manufacturers who now might have trouble getting paid."*

So we have a boom fuelled by money being taken out of paper rises in housing equity and spent on buying goods overseas. Now here's what Stephen Roach, Chief Economist at Morgan Stanley, has to say on the subject:

"Lacking in job creation and real wage growth, private sector [US] *real wage and salary disbursements have increased a mere 4% over the first 37 months of this recovery — fully ten percentage points short of the average gains of more than 14% that occurred over the five preceding cyclical upturns. Yet consumers didn't flinch . . . Spurred on by home equity extraction and Bush Administration tax cuts, income-short households pushed the consumption share of US GDP up to a record 71.1% in early 2003 (and still 70.7% in 4Q 2004) — an unprecedented breakout from the 67% norm that had prevailed over the 1975 to 2000 period."*

How's that for scary? A spending boom fuelled not by higher earnings but by raiding housing equity ***and*** by unaffordable tax cuts.

The US has discouraged savings by low interest rates, and fuelled spending by tax cuts which have raised budget deficits. These policies have helped the US avoid a necessary post-bubble recession from 2001 onwards. But it has merely been deferral of a short, sharp correction then for a much worse one in the future. For four years now the USA, prodded by Alan Greenspan, has been stealing from the future to pay for the present. One day the bill will arrive.

GREENSPAN AND OBJECTIVISM

Let me backtrack a little (to use a phrase beloved of Ian when giving presentations). It's nine years, and about half a dozen financial crises, since the *"irrational exuberance"* speech. Why did Alan Greenspan not just let the market clear itself of its excesses? It's worth pausing here to try to understand how he thinks. He is a *devoté* of Professor Ayn Rand and her philosophy of Objectivism. I'm not much of a one for "isms" myself, but what Ayn Rand wrote about free-market capitalism does strike a chord with right-thinking people, such as Ian and I know ourselves to be . . . [6]

She also wrote:

"[Every man] *is an end in himself, not the means to the ends of others. He must exist for his own sake, neither sacrificing himself to others nor sacrificing others to himself. The pursuit of his own rational self-interest and of his own happiness is the highest moral purpose of his life."*

Ian and I disagree about this. I say no Christian (indeed, no believer) could subscribe to such an idea, at least if stated narrowly. Ian, however, maintains that, correctly interpreted, it is *"the 'gold standard' for a successful nation"*, citing Adam Smith's maxim:

"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love."[7]

It is, however, easy to interpret Objectivism as *"what I want, I shall have"* — and thus, *"I don't*

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[5] http://www.dailyreckoning.com/

[6] See the web site http://www.aynrand.org.*"The ideal political-economic system is laissez-faire capitalism. It is a system where men deal with one another, not as victims and executioners, nor as masters and slaves, but as traders, by free, voluntary exchange to mutual benefit. It is a system where no man may obtain any values from others by resorting to physical force, and no man may initiate the use of physical force against others. The government acts only as a policeman that protects man's rights; it uses physical force only in retaliation and only against those who initiate its use, such as criminals or foreign invaders. In a system of full capitalism, there should be (but, historically, has not yet been) a complete separation of state and economics, in the same way and for the same reasons as the separation of state and church."*

I agree with most of this, but part company with her on the separation of state and church . . .

[7] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776, Book I, Chapter II. I would balance this with a quotation from Pope John Paul II's encyclical, *Evangelium Vitæ* (1995): *"Other people are not rivals from whom we must defend ourselves, but brothers and sisters to be supported. They are to be loved for their own sakes, and they enrich us by their very presence."* If I were a philosopher I would set myself the task of trying to synthesise the two, or, at least, of investigating to what extent they could be reconciled.

want a recession, therefore there won't be one". How tempting for Greenspan! As I wrote before, it must be difficult to let events take their course when, uniquely in the world, you *and you alone* have the power to alter that course.

Alan Greenspan recently spoke of the *"imperative to restore fiscal discipline"* lest financial markets rebel against ever-mounting government debt. This is like Wayne Rooney crusading against swearing, coming as it does from one who, said the *Financial Times* for 18 February 2005, *"was complicit in the Bush administration's ruinous tax cuts"* and *"knows that unless matching savings can be found, these tax cuts must not be made permanent"*. It no longer impresses if Greenspan "talks the talk". The tragedy is that it is now too late to "walk the walk". The markets have diverged so far from the path of virtue already that it will take much pain before we return to the straight and narrow.

HIGHER RISK, LESS REWARD

In Quarterly No. 35 I explained why we remained so bearish when most other investors were either cautious or downright bullish.

"Equity valuations [I wrote] *are precariously dependent on the real rates of return available on financial securities. These are grotesquely low."*

Strong words, but (as well as being essential to an understanding of our current investment approach) they describe a simple fact. There has recently been a truly remarkable shift in the attitude of investors to risk and reward, as measured by a huge increase in the amount they are prepared to pay for the same promised returns. Over the last 2½ years the redemption yield on high yield US corporate bonds has ***halved*** from 14% to 7% and the spread on emerging market bond yields over US Treasuries has ***fallen*** from over 10% to under 4%. Over the same period, the yield on US Treasuries was ***unchanged*** at 4.8%. In other words, if one takes US Treasuries as a benchmark, investors seem to be falling over themselves to settle for much, much lower returns than they did before, in exchange for taking on higher risks.

This is analogous to what I argued would happen with hedge funds when these first came into prominence: ***the more money is chasing fixed returns, the smaller the return will be on each dollar invested.*** The remarkable price increases in high yield US corporate bonds and emerging market debt (both appreciating by over 30%) have resulted from the use by US investment banks and hedge funds of ever-increasing amounts of dollar borrowings to benefit from margin spreads on ever-falling yields. So the risk/reward ratio on high-risk fixed interest financial securities has risen dramatically as the risk premium has declined.

The continued extraordinarily low level of real return on US Treasuries and UK Gilts coupled with the evaporation of the risk premium on high risk financial securities has had the effect of making equities as an asset class appear significantly more attractive than in absolute terms they actually are. This is vital to recognise, because one is so accustomed to using the rating of equities relative to fixed interest as a buy or sell signal. If, as we see in today's markets, ***all*** asset classes are much more expensive than they should be, their valuations relative to one another are of much less use as investment indicators. The old bullish cry of *"cheap relative to gilts"* may not have lost its resonance, but it has certainly lost its relevance.

LIFE IN A BESIEGED CITY

Why are the real rates of return available on financial securities in general (not just on equities) so low? Or, in other words, why are all classes of financial securities now so expensive? The world today is like a besieged city in which too much money is chasing too few goods, the result being that the price of the goods is pushed up far beyond what would normally be a fair value. Nor does it really matter what the goods are. If there is a lot of money and a shortage of goods, anything will sell and the normal relationships between the prices of different types of item will be suspended.

The "goods" in the besieged city are financial securities of all kinds. The excess money chasing them is the creation of none other than Greenspan. I don't mean he personally printed it, or explicitly sanctioned its printing. He did, however, create it — by lowering interest rates to unprecedented levels for an unreasonable length of time. In effect, he opened *"Al's Speakeasy"* at the Fed's offices and held a protracted *"Happy Hour"* for the world's borrowers, offering unlimited dollars to the US banking system at an interest rate of 1%, to be reinvested immediately at 4%. Not surprisingly, these unlimited dollars at, effectively, 97 cents each were grabbed and gobbled up — and invested rather more profitably than by just moving up the yield curve.

As a result, the US economy went steaming along merrily, like the memorable scene in the Will Hay film, *Oh! Mr Porter!* when the locomotive had run out of coal and the driver and fireman kept tearing off bits of wood, parts of the train's bodywork and everything else they could find, and shovelling them into the fire to keep the engine going ever faster. Ian compares what has been happening to George Best's statement following his bankruptcy in November 1982, *"I spent a lot of money on booze, birds and fast cars. The rest I just squandered."* The Bible's phrase for it, however, is even more succinct: the Prodigal Son *"wasted his substance with riotous living"*. (Luke 15.13)[8]

A GLOBAL SAVINGS GLUT?

It is only fair to say that Ben Bernanke (a serious contender for Fed Chairman when Greenspan retires in January 2006) has a different explanation for this. He argues that a *"global savings glut"* explains both the wide US trade deficit and low real long-term interest rates worldwide. If true, this would be a satisfying explanation; and the fall in long-term real interest rates is indeed a global phenomenon. So, is there any evidence that a recent shift in overall savings has happened at the global level and driven down real rates of interest across the world?

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[8] A reluctance to seem too gloomy makes me relegate to a footnote the next verse: *"And when he had spent all, there arose a mighty famine in that land; and he began to be in want."*

Well, for the advanced economies as a group, savings rates have been not rising but declining. As Greenspan said in his testimony to Congress on 15 February 2005:

"The sizable gains in consumer spending of recent years have been accompanied by a drop in the personal saving rate to an average of only 1% over 2004, a very low figure relative to the nearly 7% averaged over the previous three decades."

For the world as a whole, however (according to David Miles, chief UK economist at Morgan Stanley), the estimated total level of gross savings world-wide has risen, but only from around 23% at the end of the 1990s to around 24.5% in 2004. Is this enough to drive down real rates by a significant amount?

AN INSUFFICIENT INCREASE

In Mr Miles' view, and ours, it is implausible that such a small increase in savings could by itself have generated a fall in the level of real interest rates as substantial as that implied by the decrease in the level of yields on long dated, inflation-proof bonds. For example, since the end of the 1990s the fall in yields on such bonds in the US and France has been from around 3½% to under 2%. ***That is a huge movement.***[9]

The fall in the yield on long dated UK indexed gilts over this period has been smaller, but is still substantial — from around 2¼% to around 1½%.[10] *(Irredeemable stock yielding 2¼% would have to rise in price by 50% before it yielded 1½%.)* However, moving beyond Mr Miles' time-frame reminds us that between 1982 and 1997 UK indexed gilts yielded, on average, close to 4% — a seismic shift in real rates.

An increase in global savings may have aided the reduction in returns available from financial securities worldwide, but it comes nowhere near to explaining it. We need Greenspan's explosion in the money supply for that. Over the last four years, both the US and the UK have shifted from a 3% annual budget surplus to a 3% annual deficit, thus hosing an annual 1½% of GDP into the economy as new money. Given a typical two times multiplier, this should have produced an extra 3% of annual GDP growth. But the total GDP growth has been running at only 3% over that period in the UK and the US: *so there has been no real intrinsic GDP growth at all!*

To what ought to be Gordon Brown's pre-election embarrassment *(although I see no sign of it)*, this is becoming clearer. Over the last year, according to the Institute of Fiscal Studies, average after-tax income in the UK ***fell*** in real terms by 0.2% — the first decline in any single year since the recession of the early 1990s.[11]

We have been chopping up the train to fire the engine. We have wasted our substance on riotous living. And the day of reckoning, slow to come as it has been, can't be postponed indefinitely.

THE "CARRY TRADE" EFFECT

Long-term real yields have been driven down by US investment banks and hedge funds attracted to the "carry trade", whereby they could borrow overnight at negative real costs (as determined by the Fed Rate) and invest at longer maturities to earn real rates of return (aided by a depreciating dollar). Money for old rope — and a gift from Greenspan, underwritten by the American people.

To quote John Plender (*Financial Times*, 16 February 2005):

"Nearly all big financial institutions have been engaging in so-called carry trades, whereby investors borrow cheaply to invest in assets that yield a margin over borrowing costs. The snag is that, since the Fed started to raise rates last June, the margin has become thinner. To achieve the same profit, people are taking on more leverage and making bigger bets. This makes for more volatile markets of the kind seen since the start of the year. Yet financial institutions continue to set targets for high and increasing revenues and profits that assume the good times spawned by a freakish monetary policy will continue to roll.

"Leverage is not confined to financial institutions. Outstanding US household sector debt of just under $10,000bn in the third quarter of 2004 was at an all-time peak both in absolute terms and relative to gross domestic product . . . The first ground for concern is the phenomenal growth since 1998 in the number of hedge funds and the amount of capital they manage, which has doubled to $1,000bn over the period . . . A second ground for concern is the dramatic growth of derivatives markets and, especially, over-the-counter derivatives in which financial institutions deal with each other directly rather than through public markets

". . . The degree of concentration in these markets is hair-raising. The largest five US banks hold 95% of the total stock of derivatives, while the top 25 hold 99%. JP Morgan Chase alone holds more than half the total stock . . . With so much of the market concentrated in a handful of complex giants, there is a risk that any attempt to reduce their exposure in the face of a shock could magnify rather than diminish the shock. The banks' first line of defence, in the event of trouble, is their capital cushion. Yet it is hard to know what constitutes an adequate cushion when so much financial activity that could pose a systemic threat is outside the banking system, and when the degree of leverage in finance is so hard to gauge."

WHAT DOES THE FUTURE HOLD?

Just because something looks obvious doesn't mean it's wrong. As well as *The Spectator*, I also read the *New Statesman* (unlike Ian, I like a degree of political balance). Patrick Hosking, the *New Statesman*'s City columnist, recalled recently the story of how two economic professors were once walking across a Cambridge court.[12]

"Look," said one, *"there's a tenner lying on the grass." "It can't be,"* said the other. *"Someone would have picked it up by now."*

It seems all too obvious to Ian and me that the present overstretched valuations of financial securities cannot continue indefinitely.

ROBIN ANGUS

[9] Purely for the sake of illustration, an irredeemable bond yielding 3½% would have to rise in price by 75% for it to yield 2%.

[10] Mr Miles argues that long-term interest rates today are effectively at their lowest for 300 years, when the Bank of England was founded in the reign of William III (William II of Scots, if you accept his claim to the throne, which I don't). Real interest rates are currently just under 2%. This compares, says Mr Miles, with an average 5% during the 1980s, 3½% during most of the nineteenth century and 5% when the Bank of England was founded.

[11] Institute of Fiscal Studies, Press Release, 30 March 2005.

[12] Mr Hosking wrote, *"a Cambridge quad"*, but we have courts in Cambridge, not quads.

PERSONAL ASSETS TRUST INVESTMENT PLANS

While the shares of Personal Assets Trust are listed on the London Stock Exchange and so can be bought and sold in the normal way, investors can also buy shares ***free of all commissions and charges*** through the Company's ***Investment Plan***.

Investments in the Company's shares can also be made free of all commissions and charges through the Company's ***ISA*** or through ***PEP and ISA transfers***.

Full details of how to invest in the shares of Personal Assets can be obtained from:

Steven Budge
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10 St Colme Street
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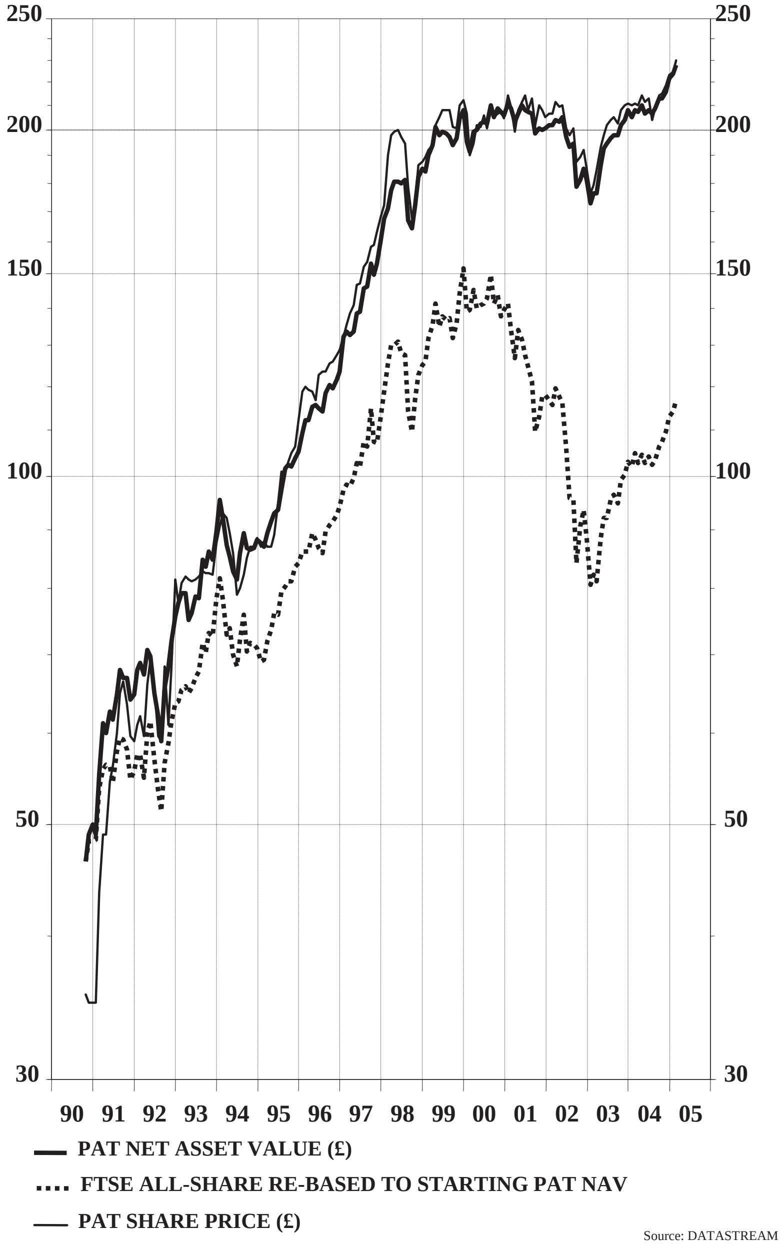
Tel: 0131–225 9995
E-mail: steven.budge@hemscott.net

PORTFOLIO (000's)	31-Mar-05
Royal Bank of Scotland	£9,952
BP	£9,654
HBOS	£8,126
Shell Transport & Trading	£7,458
Barclays Bank	£6,059
GlaxoSmithKline	£4,488
Scottish & Newcastle	£3,776
BT Group	£2,466
British Assets Trust	£1,676
Rentokil Initial	£1,620
Top Ten Equities	**£55,275**
Other Equity Exposure	**£46,221**
Effective Liquidity	**£51,651**
Shareholders' Funds	**£153,147**

PERSONAL ASSETS TRUST PERFORMANCE



% Changes From	31-Oct-90	31-Mar-00	31-Mar-02	31-Mar-04	31-Mar-05
Period	14 Yrs 5m	5 Years	3 Years	1 Year	Values
SHARE PRICE	535.9%	16.1%	6.7%	7.5%	£225.75
NAV PER SHARE	388.0%	13.5%	11.0%	9.3%	£226.63
FTSE ALL-SHARE	147.6%	-21.0%	-3.9%	11.9%	2,457.73
NAV REL TO FTSE A/S	97.1%	43.7%	15.5%	-2.3%	