PERSONAL ASSETS TRUST PLC

JUNE 2006 QUARTERLY REPORT No. 41

PERFORMANCE MEASUREMENT

In Personal Assets' 2005 Annual Report, the Chairman wrote:

'Our liquidity, together with our lack of exposure to smaller stocks, meant that we marginally underperformed our benchmark over the past year. We remain, however, usefully ahead of our preferred measure, a three year rolling average, although we are aware that even this yardstick can have its technical drawbacks and Robin tells me he intends to examine these before long in a Quarterly.'

Well, I'd better get on with it — not least because shareholders are all too well aware that this time we are not *'usefully ahead of our preferred measure, a three year rolling average'* but are lagging embarrassingly behind it.

The results for the three years to 30th April 2006, set out in full in the Annual Report, show our share price up 34%, from £193¾ to £259¼, and our net asset value per share ("NAV") up 38%, from £186.32 to £256.14. While these were record year-end highs, our benchmark, the FTSE All-Share, rose by 63% over the same period and so we underperformed our benchmark by 15.4%, equivalent to a rate of 5.4% annually.

Making significant absolute gains in share price and NAV terms, while at the same time significantly underperforming a strongly rising market, exactly reverses our experience earlier in the decade. Here are some rueful comments the Chairman made at that time, in successive Annual Reports.

- *'Good relative performance does not necessarily buy the groceries.'* ***(2001)***
- *'Fund managers have once again had a year of battling against unrewarding stockmarkets. Our benchmark, the FTSE All-Share Index . . , finished significantly lower than a year ago, down by 12.4%. Against that background, our achievement in broadly maintaining both our net asset value per share (NAV), down just 1.8%, and our share price, up £1, was a satisfactory one,* ***even if shareholders do not feel much richer!****'* ***(2002)***
- *'For the fourth successive year, our benchmark (the FTSE All-Share Index) has fallen in value, this time by a large percentage. Yet again, Personal Assets has outperformed its benchmark — this year by a truly remarkable 22% — while our preferred three year span for measuring our results reveals an astonishing outperformance of no less than 48%.* ***While all too conscious that our shareholders have got no richer over this period****, we are at least glad that (unlike many other investment vehicles) Personal Assets has kept most of their money intact.'* ***(2003)***

So, which is better? To underperform and make money? Or to outperform and lose it?

PERFORMANCE SINCE 1990

Investment management, as I said many years ago in an Annual Report, is a marathon, not a sprint. We have been 'running', in our present form, for 16 years. Let's look at our results for each three-year period since 1990-93.

3-Year Period	NAV vs FTAAS 3 Yrs	NAV vs FTAAS Yrly Ave
2003-2006	-15.4%	-5.4%
2002-2005	14.0%	4.5%
2001-2004	30.2%	9.2%
2000-2003	48.0%	14.0%
1999-2002	21.8%	6.8%
1998-2001	11.7%	3.8%
1997-2000	6.1%	2.0%
1996-1999	10.5%	3.4%
1995-1998	11.4%	3.7%
1994-1997	16.1%	5.1%
1993-1996	11.1%	3.6%
1992-1995	4.9%	1.6%
1991-1994	7.7%	2.5%
1990-1993[1]	-0.4%	-0.1%

[1] April to April. However, Ian did not take over as Investment Director until July 1990 and the Board began measuring the trust's performance in this way only from October 31st 1990.

Since 30th April 1990 our NAV has grown by 352%, from £56.67 to £256.14, and our share price has risen by 556%, from £39½ to £259¼, compared to a 195% rise in our benchmark. Over the 16 years 1990 to 2006 our NAV has outperformed its benchmark at an annual rate of 2.7%.

TWO PERIODS COMPARED

Now let's look at what has happened recently. In his Managing Director's Report, Ian points out the contrast between the last three years and the three years before.

Over the three years to 30th April 2003, ***Personal Assets shareholders got poorer while we nevertheless managed to outperform our benchmark to a startling extent****.*

While our share price fell from £202 to £193¾ over that time, our NAV outperformed the FTSE All-Share by 48.0%, equal to an annual rate of 14.0%.

Over the three years to 30th April 2006, however, ***Personal Assets shareholders got richer but the trust underperformed.***

Our share price rose from £193¾ at 30th April 2003 to £259¼ at 30th April 2006, while our NAV, as stated earlier, underperformed the FTSE All-Share by 15.4%.

How do these periods look when put together? Between 30th April 2000 and 30th April 2006:

- our share price gained 28.3%;
- our NAV was up 28.2%; *and*
- the FTSE All-Share rose 2.4%.

So we outperformed the FTSE All-Share by 25.2% over the six-year period, equivalent to an annual outperformance of 3.8%.

REJECTING '*RENTANINDEX*'

'That's all very well,' you may say. *'But Personal Assets* ***didn't set out to measure itself over rolling six-year periods*** *— however much you wish it had done so!'*

Well, of course it didn't, and it would be fraudulent to pretend otherwise. As an afterword to this Quarterly I'm reproducing *'The Rentanindex Song'*, which I wrote as long ago as 1984 to make fun of the intellectual dishonesty that sometimes characterises performance measurement. But I am ***not*** going to announce here a change in the way we measure the performance of Personal Assets. The goalposts stay where we put them originally. I ***am***, however, going to put on record that I wouldn't have wanted to have moved them anyway, either to a six-year period or to anything else.

This is because I have absolutely no interest in trying to select a period that flatters the performance of Personal Assets.

Why? Because there would be no point in doing so. A lot of my own money is in the trust and its actual value today (which is what matters to me) is a ***fact***, which no amount of tinkering with time-scales could alter. Were Personal Assets some other trust, I might have reason for anxiety lest a spell of underperformance should put my shares to a wide discount to NAV; but this could not happen to us. The Board never allows the shares to go to a discount. So a 'warts and all' presentation of Personal Assets' record is what I want, because any warts it shows are warts on my own face and I need to know how they got there!

A SHAREHOLDER WRITES . . .

If writing these Quarterlies has taught me anything, it is *never to underestimate the alertness of our shareholders and their preparedness to question what they read.*

For example, in Quarterly N°. 39 I compared our price performance since 2000 with that of the ten trusts in our AITC Category (Global Growth) which I thought were most directly comparable to ourselves, narrowing them down to include only those which were over £150m in size and had at least a ten-year record in their present form.[2] I gave in a footnote my reasons for leaving out three trusts which otherwise met these criteria: *British Empire Securities*, which (albeit a superb performer) had a radically different investment approach to us; *Law Debenture*, which also owned and ran a trusteeship business; and *Martin Currie Portfolio* (formerly *Scottish Eastern*), which had undergone major structural changes.

But shareholders of Personal Assets always read the footnotes. Here's what one of them wrote to me after reading Quarterly N°. 39:

'Where I have a wee bit of a grouse is the trusts you chose to benchmark your absolute performance against! Basically you have picked the laggards in the Global Growth sector and whilst you have found reason to reject British Empire Securities, I cannot possibly see the logical comparison between PAT and these leviathans who are basically pseudo FTSE trackers, having an increasingly difficult time due to the recent change from US$ appreciation to $ devaluation. Sorry, but I think you employed "spin" here to put PAT's absolute performance in a better light!'

So I replied to him:

'There's a fundamental point here. Personal Assets is, and is intended to be, a very boring trust. We always saw it as being an alternative to these 'leviathans', rather than as a would-be star, with all the risk that this would involve. It's been nice when we've been at the top of the performance tables, but it's never been a prime objective of ours — our objective being to preserve capital first, and only then to try to make it grow. Personal Assets tries to be a better [generalist] *rather than to compete with the likes of British Empire Securities. Rip Van Winkle might conceivably invest in Personal Assets before vanishing into the Catskills for twenty years, but he certainly wouldn't choose British Empire.*

'This is not, of course, to say that we wouldn't like to be a much better [generalist than the others]. *We are bolder than they are (albeit in a conservative way, being bolder in the defence of our assets), and we also do not, and will not, sell at a discount. But, essentially, such trusts are, and always have been, the ones we have regarded as being our peers.'*

OUR CAUTIOUS AIMS

My correspondent replied, with some surprise, that he had never thought of Personal Assets in that light; and it is strange how the view persists that we are a trust that aims to shoot the lights out, rather than, as we said year after year in our Annual Report,

'to protect and increase the value of shareholders' funds over the long term and to earn as high a total return as possible at a risk not significantly greater than that of investing in our benchmark index, the FTSE All-Share.'

It would be difficult to set out an objective more low-key and boring than that, and if I've tried to get this across once, I've tried a hundred times. It's amusing to see how frequently the word 'boring' has appeared in the Quarterlies, right back to the earliest days.

- *'Just as we have managed PAT in a boring way through the bull market, we shall manage PAT in a boring way through the bear market, when it comes.'* ***(1996)***
- *'Boring isn't necessarily bad. There can be dud companies in wonderful businesses, and excellent companies in boring businesses.'* ***(1995)***
- *'PAT is never going to be the kind of investment trust which tries to roar ahead of the market over every six-month period. If the results we produce bore you to tears most of the time . . . we'll have succeeded in our aim.'* ***(1994)***

And in the first Quarterly of all:

- *'Your directors have too much of their own money invested in this company to want its investment record to be other than boring, predictable and cautiously successful. And you can hold us to that.'* ***(1994)***

BUT WE REALLY <u>DO</u> MEAN IT!

Recently, I've been reading a new study of Sir Oswald Mosley and the Blackshirts.[3] The author tells how Sir Oswald would sometimes give one of his henchmen a stern public dressing-down for making extremist statements, but end with a conspiratorial wink of approval, as if to say, *'You know I have to do this, but just carry on as before.'* How often have I seen that same conspiratorial wink from shareholders after I've described our policy of caution!

Unlike Sir Oswald, however, I really do mean what I say — and I always have done. So, this year,

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[2] These ten trusts, you may remember, were *Alliance, Bankers, Brunner, Electric & General, Foreign & Colonial, Monks, Scottish Investment, Scottish Mortgage, Second Alliance* and *Witan*.

[3] Stephen Dorril, *Blackshirt: Sir Oswald Mosley and British Fascism*, Viking, 2006.

we've changed the relevant wording in the Annual Report to read:

'[Our] *investment policy is to protect and increase (in that order) the value of shareholders' funds over the long term and to earn as high a total return as is compatible with a lower level of volatility than the FTSE All-Share Index.'*

Later on, in *The Board's Policies for Personal Assets*, we state:

'Our aim is to serve the needs (including decisions about gearing and liquidity) of Sterling-based equity investors who share our view that the protection of capital ranks in priority even above pursuing capital growth.'

This is **NOT** a change of policy, merely a change in how our long-standing policy is stated. Yes, we will do our damnedest to produce capital growth in the future, just as we have done in the past. Yes, we hope that we'll again outperform the FTSE All-Share over the longer term — and remember that there's £15.5 million of the directors' own family money riding on this. But it will always be growth second, and protection first.

AN INSTRUCTIVE COMPARISON

Shareholders have often asked me if Personal Assets should be compared to the Independent Investment Trust, of which Max Ward is Managing Director and Douglas McDougall (who first brought me into the investment trust business, nearly 30 years ago, and so has a lot to answer for) is Chairman.

I'm a keen admirer of Independent Investment and I've been a shareholder in it since the very beginning. Not only is it another self-managed trust (as its name suggests) but it is also, like Personal Assets, included in the AITC's Global Growth category. Its performance since launch (October 2000) has been outstanding. Over the last three years, only British Empire Securities of the trusts within the Global Growth category has done better.

But Independent Investment isn't at all like Personal Assets in its investment approach. Here's what is said in its Annual Report for the year to 30th November 2005:

'The Company's objective is to provide good absolute returns over long periods by investing the great majority of its assets in UK and international quoted securities. Most of the Company's portfolio is currently invested in UK equities and this is likely to remain the case for the immediate future. When appropriate, the directors will sanction relatively high levels of gearing and a relatively concentrated portfolio structure. The portfolio is constructed without reference to the composition of any stockmarket index.'

So, unlike Personal Assets, Independent Investment has no benchmark (it seeks absolute returns), at the end of April 2006 it was 16% geared, it had at its year end over 30% in one stock market sub-sector (housebuilders), and it has an implied predisposition in favour of high gearing and 'big bets' when the directors believe these to be appropriate. Indeed, in the section that's headed *'Risks'*, the Annual Report continues with great frankness and honesty:

'The features described above are designed to allow the Company an unusually high degree of freedom to exploit the directors' judgement. To the extent that the directors' judgement is flawed, future results could be unusually poor.'

Independent Investment has done, and is doing, exactly 'what it says on the tin', and it has done so magnificently well; but its investment style and its risk parameters could scarcely be more different from our own. Personal Assets and Independent Investment may be good counterweights to each other, and many investors hold them both; but they are not, and never have been, comparable in the way that, say, two ungeared specialists in Japanese smaller companies might be.

WHAT TIMESCALE TO USE?

Two further comments in Independent Investment's 2005 Annual Report lead me conveniently on to some other aspects of performance measurement.

- *'We believe that no meaningful assessment can be made of investment performance over periods of less than five years.'*
- *'An unexpected result of our progress has been the consistency with which we have produced annual returns that are both positive and superior to those notionally attributable to the FTSE All-Share Index. We regard this as fortuitous and would warn you against expecting it to continue.'*

Their view is that five years is the minimum period over which investment performance can usefully be measured, and they are both responsible and courageous in warning shareholders not to expect uniformly good results.

I now believe that *any* fixed period for measuring performance will produce difficulties; and Ian, who agrees with me on this, has recently been wondering aloud (chiefly to me) if we should adopt the approach favoured by Gordon Brown, who aims to balance the budget over an entire economic cycle. So far, I haven't bitten. As far as I can see, Mr Brown defines the cycle himself — a dangerous thing to allow such a man to do.[4] Here I can't resist quoting an article by Martin Wolf in the *Financial Times* for 22nd March 2006.

'In his heart, Mr Brown remains a man obsessed with quantitative targets for inputs and outputs, rather than a man who has internalised either the role of incentives or the deep uncertainty about the future. No passage from the speech better illustrates these failings than this: "Today the British economy has just 9m highly skilled jobs. By 2020 it will need 14m highly skilled workers. And of 3.4m unskilled jobs today, we will need only 600,000 by 2020." This is Soviet tractor planning at its ludicrous worst. Fifteen years ago, no one imagined the current economic role of the internet, for example. Yet the chancellor now dares to tell us the precise number of highly skilled and unskilled people the economy will "need" 15 years hence. In fact, he has no idea how many skilled people the economy will need . . . by then. Such "plans" are not worth the paper they are written on.'

That's the nonsense you get when you think in terms of 'entire economic cycles'. Remember 'planning', that was once so popular, and George *'Tired and Emotional'* Brown's 1965 National Plan, produced when he was Secretary of State at the short-lived Department of Economic Affairs?[5]

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[4] Now that Mr Greenspan has retired, Mr Brown seems fated to become the Aunt Sally of these Quarterlies; so I suppose I should apologise in advance for giving him too much of what Mrs Thatcher called the 'oxygen of publicity'.

[5] The National Plan was brilliantly demolished by Iain MacLeod, the then Shadow Chancellor, who pointed out that it called for the services of 400,000 men who did not exist.

There are more sinister perils, too.

'There is a danger that . . . the determination of the economic cycle could be seen to be . . . simply in order to comply with the golden rule.' [6]

In other words, the 'cycle' could be defined as being that period of time over which the government was not a net borrower (or over which I, as a fund manager, might have happened to outperform my benchmark), irrespective of what the conditions were at the beginning and the end of it.

The idea of measuring performance over a stock market cycle does have its attractions, however; and (in a sense) it's what I did earlier in the Quarterly, and Ian has done in his Managing Director's Report, when looking at the six-year period 2000-2006. Measuring performance over a stock market cycle could be done only after a certain time-lag, because the highs and lows of stock market cycles are not always immediately recognisable when they occur (!); but it is something Ian and I are currently researching into and I may return to the subject in the next Quarterly. If it worked, it would be a very valuable sort of performance measurement, giving us a greater understanding of the past, which may help us do better in the future.

HOW MUCH IS £1 MILLION?

Here are three questions taken from a Wood Mackenzie Investment Trust Annual I wrote in 1985, my aim being to show that investments valued at the same amount were not worth the same in all circumstances.

- *Is £1 million worth of BT the same kind of investment as £1 million worth of options to buy BT? If not, how can the difference be quantified?*
- *Is £1 million worth of BT the same kind of investment as £1 million worth of a small UK company with a market capitalisation of £10 million? If not, how can the difference be quantified?*
- *Is £1 million worth of BT the same kind of investment as an office block valued at £1 million? If not, how can the difference be quantified?*

Note that each investment has a balance sheet 'value' of £1 million. But is this the whole story?

Consider the ***accuracy of valuation***. The BT shares? No problem there. £1 million of BT would not move the market. So there would be only dealing costs to contend with. The BT options? £1 million would be a fair-sized block. Perhaps more of a problem. The £10 million listed UK company? Dealing at anywhere near the stated price might present grave difficulties, to say nothing of dealing costs. The price obtainable would also be far more likely to be influenced by special circumstances than that of BT. A large block could command a premium — or sell at a discount, depending on market conditions. And the £1 million office block? Who knows what it might really fetch? (Imagine not knowing what even the approximate price of BT might be unless one actually came to sell!)

Next, the ***volatility*** of the £1 million. Here we would need to know the 'beta'[7] of BT and of the small UK listed company before comparing them. And what of the options? Say the price of BT were to fall by 20%. The £1 million of BT shares would then be worth £0.8 million. But the options might be worthless. Yet there they were, in the year end valuation, both at £1 million. As for the property, it stays at £1 million until it is revalued. It may again be valued at £1 million. Or it may be halved or doubled in value at the stroke of a pen, depending on the state of the property market or on purely local factors or on the prejudices or subjective views of the valuer.

Then there is the ***liquidity*** of the £1 million. Say the fund had to realise £1 million in a hurry. No problem with the BT shares. The £1 million worth of options, however, might be harder going. The small unlisted UK company? The sale could take weeks, unless the seller were lucky or didn't mind taking the risk of wrecking the market. And the office block? Again, it could be sold in a day only in exceptional circumstances.

Differences in ***accuracy of valuation***, ***volatility*** and ***liquidity*** — it's hard to imagine investments with less in common. But in a balance sheet they have everything in common. Each is valued at £1 million — no more, and no less.

WHAT DO WE MEASURE?

Here are some further *aperçus* from the same Wood Mackenzie Investment Trust Annual:

- *'Will Spurs beat the Australians in the Test series? Could a racing car win the Derby? Was Beethoven a better musician than Shakespeare? Yes, stupid questions. But no more stupid than some of the questions asked about performance measurement.'* [8]
- *'Performance measurement is not a game. It is not even an academic discipline. It is about real life.'*
- *'A year end portfolio list is a snapshot. And a chronological series of them makes (if it makes anything at all) a cartoon, not a video film.'*
- *'Measuring performance without risk is like measuring height without breadth, or longitude without latitude.'*
- *'Published performance figures show where trusts have arrived at. But they do not show how trusts got there. And six horrible years and one brilliant one can produce the same end result as seven consistently middling ones.'*
- *'Risk is the Great Unknown of performance measurement. We cannot easily distinguish in performance tables between a fund which has achieved a certain level of growth from investing in index-linked gilts, and a fund which has achieved the same level of growth from punting away in cocoa futures, busted bonds and Vancouver-listed oil stocks.'*

I'm painfully aware that I now know much less than I thought I did in 1985, and I also feel much less certain of what *I do* know!

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[6] Treasury Select Committee Report, para. 41, January 2003.

[7] A measure of the sensitivity of an asset to changes in the market, i.e. its market risk. Technically, the correlation of the asset price with the net value of all assets in the market. A beta of 0.5 means that a 1% change in the market index results in a 0.5% change in the value of the assets. *The Handbook of International Financial Terms*, P Moles & N Terry, Oxford 1997.

[8] This comment was the subject of the first public debate I ever had with Ian, when he was managing Atlantic Assets. He objected to another comparison I had made, between Boy George and Zola Budd *(who they? Ed.)*, and so, to prove I ***do*** eventually respond to his criticisms, after 21 years' reflection I have taken it out.

But I'd stand by most of those comments, and here I want also to revisit a distinction I drew then between two types of fund:

• ***Funds designed to achieve internal objectives.*** This category includes funds such as defined benefit company pension schemes and the in-house funds of life assurance companies. While funds like these may have to satisfy actuarial or other internally-set requirements, they do not have to 'sell themselves' in competition with other collective investments.

• ***Funds sold in competition with others.*** This much larger category includes personal pension plans, life assurance schemes, unit trusts and investment trusts.

Into which category does Personal Assets fall? The answer is vital to understanding how we are run.

Personal Assets falls into the category of funds designed to achieve internal objectives.

Personal Assets exists not to attract new buyers, but ***because it is the most appropriate and convenient way for the directors to run their own money.*** If other investors want to join us, we are delighted for them to do so and (as we have made clear since 1990) we will treat them as our partners. But if they want to stop being our partners and to realise their investment in Personal Assets, it does not affect us. Our own money still needs to be managed, and we would carry on managing it exactly as we do now.

HOW DO WE MEASURE IT?

Just as there are these two main types of fund, there are three main approaches to measuring a fund's performance:

• ***Internal.*** Is a fund meeting its internal objectives and succeeding in carrying out its stated policy?

• ***External vs Other Funds.*** How does a fund compare with other funds of a similar type?[9]

• ***External vs Indices.*** How does a fund compare with external benchmarks, such as the FTSE All-Share Index, or the Standard & Poor's Composite Index?

Of these three approaches, Personal Assets has always been focused on the first and the third. We have not, unlike many trusts, placed emphasis on measuring ourselves against a 'peer group', for the reason just mentioned — that we are not aiming to attract new buyers, but are managing our own money.

ABSOLUTE RETURN

This does not mean, however, that Personal Assets is a kind of closet 'absolute return' fund, as some have wondered. Absolute return has become a fashionable concept in recent years, largely because of the growth of hedge funds.[10] Absolute return differs from relative return in being concerned only with the return actually achieved on an asset, not the return relative to a benchmark. Absolute return funds seek positive returns (in other words, seek to make actual money) whether the total market is up or down, while funds measuring themselves against some benchmark index have as their objective that of beating the benchmark, accepting that sometimes, in so doing, they may produce a negative return (or, may, in other words, actually lose money).

What is the fundamental purpose of an investment trust's benchmark? Discussing this with me recently, Ian suggested three main possibilities.

• To enable shareholders to assess how well (or otherwise) they have done and help them determine whether they should hold, sell or buy?

• To enable shareholders (and general commentators like brokers or journalists) to assess the skills and capabilities of the managers of their investment?

• As a general indicator of progress (or otherwise) of value developed over time?

There is something to be said for all of these, but here I should like to concentrate on the third of them — a general indicator of progress. Personal Assets chose the FTSE All-Share as its benchmark because our shareholders are mostly UK residents or expatriates who need to protect the purchasing power of their assets and see it rise along with the standard of living in the UK. Over the long term, investing in the UK equity market is the most widely recognised way for Sterling investors not only to guard against inflation but also to benefit from the UK's economic growth. So the FTSE All-Share serves as a proxy for the growing purchasing power of UK residents, and if we match or exceed it over the long term we should also match or exceed the growth of purchasing power in the country as a whole.

This is what we want to happen with our own money, and we believe it is what our shareholders in general want as well; and our benchmark is a useful tool to help us meet this objective. In seeking to outperform it, we will try also to minimise actual falls in value during market downturns (this is why we are at times prepared to use liquidity to such a major extent); but, unlike an absolute return fund, we cannot hope to avoid such falls altogether without abandoning our basic position as an equity investor.

WHY TOTAL RETURN?

One fun thing about working for 17 years as a trust analyst with Hamish Buchan was fighting with him about total return.

As befitted someone destined to become its Chairman, Hamish believed implicitly in the AITC's preferred methodology of total return, rather than capital only, for measuring investment trust performance.[11] The AITC's *Monthly Information Service* uses only total return when looking at investment trust performance, although it considers trust performance in two ways (share price total return

[9] First, of course, one has to decide which the funds of a similar type actually **are**. Going back to my debate with the shareholder who queried my choices from the AITC Global Growth category, are Alliance or Scottish Investment similar types of fund to Personal Assets? Or are British Empire Securities and Independent Investment? And whatever one decides, one must explain one's choices clearly and unambiguously.

[10] It is revealing that there is no entry for 'absolute return' in *The Handbook of International Financial Terms*, by Moles & Terry, which I quote from elsewhere in the Quarterly, although this was published as recently as 1997.

[11] *'Total return'* assumes the reinvestment of dividends as these are paid or become payable. *'Capital only'* assumes that dividends are not reinvested.

and net asset value total return) and over three periods: one year, five years and ten years.[12]

Why only total return? During all the weary years I spent helping Hamish to produce the AITC's monthly statistics, hearing him yell while I went running up and down innumerable flights of stairs clutching vast bundles of punch-cards with which to feed Wood Mackenzie's huge, state-of-the-art late 1970s mainframe computer, I could never forget that total return on net assets is purely hypothetical. Investment trusts are not allowed to reinvest their earnings in this way and they would lose their investment trust status if they did.

Price total return is, on the face of it, less impractical. Shareholders can, if they wish, reinvest their dividends in the trusts they hold. (I do so myself, in my Personal Assets PEP and ISA.) However, those paying 40% tax (i.e. most of our shareholders) cannot reinvest them in the way total return statistics do; and even then, they will not be able to do so at middle prices and free of commission!

The chief use of total return is, in fact, as a handy tool for making comparisons between very different funds. It gives a fairer way of comparing higher-yielding and lower-yielding trusts. Why, then, does Personal Assets adopt total return as one of its measures for itself in *Objective and Investment Policy* in the Annual Report?

- Since our share price and our NAV are essentially the same and will continue to be so, our price total return is closely akin to our total return on net assets. We are different in this respect from most other trusts, which can see significant divergences between their price and NAV performance.
- We envisage our shareholders as being private individuals, UK residents or expatriates, who may have invested a significant proportion of their net worth in the company. Overwhelmingly, they are higher-rate taxpayers, and therefore they will typically all be in the same tax position as regards the reinvestment of dividends.

[12] It also looks separately at dividend growth over five years.

Total return is therefore a fairer and more useful way of looking at Personal Assets' return than it is for trusts which sell at fluctuating discounts and have a range of private and institutional shareholders liable to tax at different rates.

PAST VS PRESENT

Is the past performance of a fund a guide to its likely future performance? *'No'*, say the Terms & Conditions of most funds; *'up to a point'*, says intuition. It reminds me of Churchill on democracy:

'Many forms of Government have been tried, and will be tried in this world of sin and woe. No one pretends that democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst form of government except all those other forms that have been tried from time to time.'

Past performance isn't much of a guide. But what else might be? It can have its uses, but only as long as we look past the 'how much' to the 'how' and 'why'.

DOES SIZE MATTER?

Is there any relationship between the size of a fund and its performance? Will a small fund tend to outperform a large fund because its range of possible investments is greater? Should large funds forget stock selection and concentrate on the 'macro' level, taking views only on markets, sectors and currencies?

Once again I would like to quote from the latest Annual Report of Independent Investment:

'We are now beginning to feel the constraints of size: the increase in our shareholders' funds from under £60 million at the time of launch to over £140 million at the time of writing has significantly reduced the number of companies in which we can easily build holdings of the size we regard as appropriate. There are now several positions in our portfolio that we consider illiquid and in the case of some of those we would have taken bigger holdings but for the liquidity constraint.'

This is not a problem for Personal Assets, which was below £6 million in size in 1990 and was recently over £190 million. Personal Assets is essentially run as a 'top down' rather than a 'bottom up' fund, and will continue to be so.

RISK VS REWARD

Last, risk — the Great Unknown of performance measurement.

- You are driving along country roads, and during one hour you travel 40 miles, so your speed was 40 mph. But this tells you nothing about the road conditions, or the nature of the weather or the light, or whether you ran out of petrol or got a flat tyre or took a wrong turning, or had a clear run or were stuck behind a caravan. Any or all of these could have influenced your speed, but the bare figure of '40 mph' tells you nothing about any of them (although it may suggest something about the general nature of your journey).
- Two sailors, having left port at the same time on different ships, arrive back at the same time, both fit and well. One, however, has had a calm sea and a prosperous voyage, while the other has been captured by pirates, sold into slavery and then half drowned while escaping. They had the same starting-point and arrived at the same destination, but the way they got there was very different.
- To take Ian's analogy, a man pays a fire insurance premium but his house does not burn down. Nor does the (uninsured) house of his neighbour. Who is better off at the year end? The neighbour. But who is the more prudent investor?

Performance statistics tell us nothing of any of this; and, in particular, they tell us nothing of the risks avoided. They tell us where we got to, not how we got there. Yet in real life we journey on, avoiding risk where we can, facing up to it when we must, and — like Virgil[13] of old — never forgetting what our destination is, or losing hope of reaching it:

Per varios casus,
per tot discrimina rerum
tendimus in Latium;
sedes ubi fata quietas
ostendunt; illic fas
regna resurgere Troiæ.

ROBIN ANGUS

[13] *Thro' various hazards and events, we move*
To Latium and the realms foredoom'd by Jove,
Call'd to the seat (the promise of the skies)
Where Trojan kingdoms once again may rise.'
P Vergilii Maronis *Æneidos*, Liber I, 204-06, translated by John Dryden.

The 'Rentanindex' Song

(I wrote this in 1984 as an introduction to the Statistical Section of that year's Wood Mackenzie Investment Trust Annual. It is, of course, a parody of W S Gilbert's *'I am the very model of a modern Major-General'*, from *The Pirates of Penzance*.)

I am the very model of a trust performance measurer,
I'll dazzle your directors and I'll titillate your treasurer,
The figures that you show me in a manner sad and dutiful
I'll polish by comparison to make them bright and beautiful.
Your equities will outperform, and so will your debenture stocks,
If measured in the way in which I tell you to present your stocks:
Your assets may have tumbled, but no assets ever fell enough
To trail behind the index — if you choose your index well enough.

I recommend my methods with a zeal that's indiscriminate
Whenever you've an awful year you're anxious to eliminate,
Your faulty stock selection may have set your assets slithering,
You've failed to beat the All-Share, and in consequence you're dithering.
Your discount's leaping higher, and investors they are clamouring
To unitise the trust in which they've taken such a hammering,
A bid is in the offing, which could make a jobless gent of you —
A nasty-looking predator has twenty-nine per cent of you.

Forget these horrid nightmares! I shall certainly be sicker than
A parrot, if I cannot find a stock you've risen quicker than:
I've indices galore, and you can see the choice proliferate
By changing round the currencies (for that I charge a stiffer rate).
The simplest-looking markets can be shown in really dotty terms —
Imagine, say, the Nikkei Dow expressed in Polish Zloty terms,
And Jacobson & Ponsbach (that's in Sweden) would be wholly a
Departure from the obvious in Tugrik (that's Mongolia).

There's outperformance waiting! I'll make sure you get your share of it,
For you've been outperforming too, although you're unaware of it.
The Goddess Truth she need not blush (I haven't quite forgotten her),
Your figures may be rotten, but I'll find an index rottener.
Your dreadful US holdings may have driven you to mania —
I'm sure they've outperformed the Tramways Index in Albania,
So don't forget this wise advice — for trust men always treasure it —
'It isn't what you measure, but the way in which you measure it . . . '

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***.

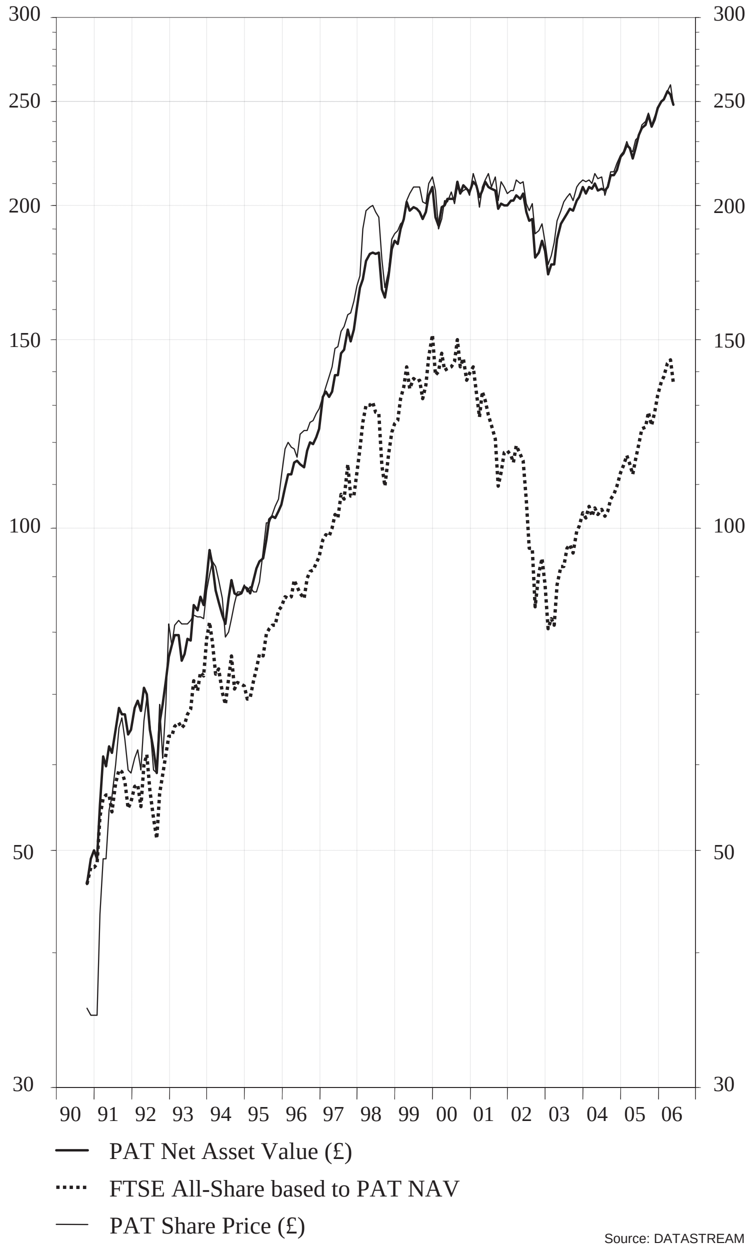
Full details of how to invest in the shares of Personal Assets can be obtained from:

Steven Budge
Personal Assets Trust PLC
10 St Colme Street
Edinburgh EH3 6AA

Tel: 0131–225 9995
E-mail: steven.budge@fandc.com

PORTFOLIO (000's)	31-May-06
BP	14,239
Royal Dutch Shell 'B'	13,198
RBS Group	10,189
HBOS	9,008
GlaxoSmithKline	7,385
Barclays Bank	6,916
BT Group	6,084
Scottish & Newcastle	4,063
Scottish Investment Trust	2,394
British Assets Trust	1,890
Top Ten Equities	**£75,366**
Other Equity Exposure	**£30,646**
Effective Liquidity	**£77,995**
Shareholders' Funds	**£184,007**

PERSONAL ASSETS TRUST PERFORMANCE



% Changes From	31-Oct-90	31-May-01	31-May-03	31-May-05	31-May-06
Period	15 Yrs 7m	5 Years	3 Years	1 Year	Values
SHARE PRICE	601.4%	17.7%	25.8%	8.2%	£249.00
NAV PER SHARE	435.9%	18.4%	29.2%	10.0%	£248.82
FTSE ALL-SHARE	193.8%	3.8%	48.2%	17.5%	2,916.85
NAV REL TO FTSE A/S	82.4%	14.1%	-12.8%	-6.4%	