A SHARED JOURNEY

EXTRACTS FROM

PERSONAL ASSETS TRUST QUARTERLY REPORTS 1994-2021

by

ROBIN ANGUS

Per varios casus, per tot discrimina rerum
Tendimus in Latium, sedes ubi fata quietas
Ostendunt; illic fas regna resurgere Troiæ.
Durate, et vosmet rebus servate secundis.

(Through misfortunes of many kinds, through so many critical moments,
We are heading for Latium, the quiet home that the Fates promise.
There it is ordained that the kingdoms of Troy will rise again.
Endure, and keep yourselves safe for better times.)

Virgil, *Æneid* Book 1, lines 204-207

Foreword from the Board of Personal Assets Trust

When Robin Angus died in early May 2022 he had recently completed editing his *Anthology of the Quarterlies* drawing on material which he had written over a period of nearly 40 years.

He entitled this work '*A Shared Journey*' and it was due to be published by PAT this Summer to capture and to stand as a record of Robin's reflections and perspective on his life in the investment world.

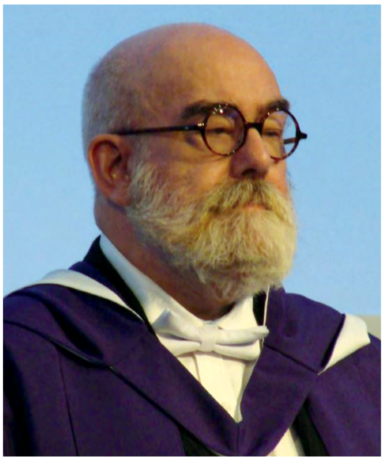
We have now added the Eulogy delivered by The Reverend Allan MacLean of Dochgarroch at Robin's funeral on 24 May 2022 to this publication.

We have done this with the support of Lorna, Robin's widow, to bring to this publication some indication of the rich and complex tapestry of Robin's life beyond the financial world.

We are each fortunate to have known Robin for nearly half a century and it is our privilege to be able to publish this book in celebration and memory of Robin's life.

Hamish Buchan
Director 2001-2020

Iain Ferguson
Director since 2017



Robin Angus

1952 – 2022

Eulogy delivered by the Reverend Allan Maclean of Dochgarroch
at the funeral of Robin Angus on Thursday 26th May 2022
at St Columba's by the Castle, Edinburgh.

In *Private Eye* there is usually a feature titled 'Lookalike', with a letter saying something like: Sir, I noticed a remarkable resemblance between this past leader of a notorious gang of ne'er-do-wells and the present Archbishop. Many years ago I wrote a profile of Robin Angus and had lookalike photographs of him and the novelist Anthony Trollope next to each other, balding head, narrow glasses and fulsome beard. I wondered what Robin would make of this intrusion into an otherwise serious article, and was slightly worried as to what Robin would say. Generous as ever, he said modestly 'I have noticed the similarity myself, but don't tell Lorna'. And, of course, it was not just a physical resemblance; there was something too in Robin, of Trollope's knowledge of and fascination with the church, and church politics, and the subtle ways of the world and people, and indeed finances; as well as their shared magical way with words and language.

Of course, actually, rather than Anthony Trollope, I should have done a look-a-like between Robin and the Ayatollah, and I gather that in financial circles in London, for years Robin was called 'The Ayatollah of Glenfinlas Street'.

A letter was sent last week, from one of Robin's favourite lunch clubs, to its members which said 'it is with sadness that we must inform you of the death of our legendary Grand Makar Robin Angus, or to give his full designation: Chevalier Professor Dr (*Honoris Causa*) Chancellor Robin Angus MA, D.Litt, SSK, MMCM'.

All of which is not bad for a Moray loon; as he said of himself: a boy and a Scot from Forres. The Edinburgh Morayshire Club was one of the dining groups that gave him the greatest pleasure, and which he graced with a memorable and topical poem, always something about his youth in Moray.

Robin's lyrics and poems are indeed legendary, and he had a magic way with words, which he said came from his father and his grandfather. 'Rhymes are not poetry' he said 'they are light verse ...Light verse writing is not an art; it is a knack which with cultivation can become a skill or a craft; without the knack it is impossible'. And it was a knack that Robin cultivated with great success and joy to his audiences. His silvery tongue held people spell-bound, and his way with words and language has led to many a memorable quote. Who can forget that he wrote: 'If God had given the Ten Commandments to civil servants, rather than to Moses, the Bible would still be at an initial drafting stage.' or 'As time is short, let us begin with an event in the <u>very</u> recent past, by Scottish standards at least, in the year 1694.'

For a time he wrote parodies of Christmas carols and Gilbert and Sullivan too;

Once in Royal David's city became:
'Once in Scotland's Royal City,'
Weary brokers toiled by night.
and
I am the very model of a roving Scots ambassador.

There were limericks too, but there was also a serious side to his rhyming, not only among the band of poets, called the Monks of St Giles, to which Robin belonged, but more seriously still, when Robin was the Secretary of the Speculative Society, he wrote the Minutes in iambic pentameters, and they lie in the Minute Books alongside those written (not in verse unfortunately) by Sir Walter Scott and others.

Now I need to declare an interest, as Robin said that, apart from school friends, I am his oldest friend. I first met him in Moray, where we were both ordinands in the Episcopal Church over fifty years ago; but really my earliest memory is when he came over from Cambridge, or probably down from St Andrews, to Oxford; it was some sort of Anglo-Catholic rally. Robin was not good at balance, bicycling was quite beyond him, but I urged him to try a tricycle that someone had brought. 'The balance is quite different,' I said, but for Robin it made no difference, as he careered off across St Giles, straight at St John's, then back across, towards (appropriately) Pusey House. Robin knew nothing of brakes, or, I was going to say, bells, but he knew plenty about them in church, and when they should be rung.

When it was time to leave Cambridge, there seemed to be one of three ways forward. One was to be an academic and his professor said 'Robin is definitely the brightest and possibly the nicest student I have ever had'. One was to be ordained, but Robin decided to follow his father's example as an absolutely committed layman; and the other was to enter the financial world, as the professor said 'Scots seem to be quite good at managing money'; but when asked at the interview 'what do you know about the investment management world', Robin is supposed to have said 'I gather you have good lunches, and have g and t before lunch; and I am very partial to a g and t'.

His career in finance is well-known; as an investment analyst he went from Baillie Gifford, to Wood Mackenzie, and then helped set up Personal Assets Trust. Not only was he very astute and successful but his reports were legendary. The cream of the earliest ones were printed in 1992 in *Haec Olim* and now the more recent Personal Assets Trust quarterlies, which were compulsory reading for all followers of the investment company sector, have been recently edited by Robin and are soon to be published too.

When Personal Assets Trust was founded, I, thinking that it was some sort of early bitcoin, said I might buy some. Robin explained there was a minimum sum involved, 250 he said, and I thought he meant 250 thousand pounds and said it was a bit beyond me. He often chided me at my stupidity and how much that £250 would be worth now.

Robin never wished to move out of the financial world, but he did say in one report: ‘Only two things could possibly tempt the author [ie Robin] away from trusts: a bishopric in the Scottish Episcopal Church, or a safe SNP seat’, and then commented: ‘Neither of these is, at present, likely to be offered to him’.

The article I wrote with the look-alikes was partly concerned with how Robin’s committed faith influenced his field of work. He said that the right use of money was positively Christian, seen in the ability it allows for the work of Christ, and furthermore in the display of generosity. He said it is a challenge for Christians and for the Church, to care for those who are suffering, not least those caught up in the backwash of global problems. Robin was a member of the Commission, set up by the Church of Scotland, concerned with Finances and Ethics, and he was for many years a financial advisor to the Roman Catholic Church in Scotland. It was for this work that he was given the rare honour of being made a Knight of St Sylvester, by the Pope. Robin was an Honorary Professor at Heriot-Watt University, where he regularly gave lectures including some on financial ethics. For this he was given his honorary doctorate.

Bullying was something Robin could not bear, and I think that his generosity in so many fields came not just from his faith, but also as a counter to the unhappiness he suffered at school. He was made miserable at school until the 6th form, when he began to be respected for who he was, as a person, and he began to make friends. He did not like the way the Government bullied people (for example in trying to stop people smoking, or insisting on wearing seat belts in cars; two of his bugbears), or the way the University bullied the Speculative Society, or how some clergy bullied their congregation, or how Westminster bullied Scotland. Maybe his politics stemmed from this.

His interests included Liturgies, King Charles 1st, and Jacobitism. He delighted in reminding people that in the 18th century the Scottish Episcopal Church was ‘the SNP at prayer’. He belonged to many societies, often of a Royal Martyr or Jacobite tinge, and was himself the Chancellor of the Memorial Merit of Charles the Martyr, a sort of Order of Chivalry.

He also subscribed to many of their periodicals and magazines, which piled up behind the front door of his home, and as for books, he kept Cornerstone bookshop afloat with his purchases. I have a friend who is a literary editor of a London paper, and who years ago made a resolution that with each new book coming into the house, one had to go out. I am told that I myself do not keep to this rule, but Robin most certainly did not. His books were his treasure chest, always revealing something new, however often they were re-read, and Robin re-read many of his books.

I have left until now Robin's personal life, and it is no coincidence that Lorna chose for this service not only the hymns from their wedding, but also the picture of their wedding for the back cover of the Order of Service; it was the happiest day of Robin's life, and for the next 45 years, he was never content unless he slept at home; and he and Lorna shared humour and love, and shared his many and numerous friends, who became Lorna's friends too. Most of his friends he never lost touch with. Lorna was the stay of his life.

With no children, Robin was a sitting duck as a godfather; and he was generous and kind to them to a fault. If Robin's home in Colinton and his office in town were stuffed with books, so too is the file of letters (all with the Queen's head stuck on up-side down – a Jacobite trait like passing the claret over a glass of water) that he sent to my son Hector; The letters are about his beliefs, his interests, his holidays; and above all there are his poems. In the style of Hilaire Belloc and titled 'The Bad Child's Book of Chiefs, or some lesser known byways of Highland History', sometimes called 'A Good Godfather's book of bad poems for a future chief'. Robin did a series. They are full of his interests, with many subtleties and with lots of footnotes to explain the terms often decrying the Campbells, and promoting bishops and their vestments. Here are two examples: 'For myself I always imagined that the Dracula family was related to the Campbells, given they are all bloodsuckers' (Don't forget that Robin's dear wife Lorna was a Campbell from Campbeltown) and another foot note said 'Ca-b-ll, [ie Campbell] censored as a word unfit for the eyes of clergymen, young children and persons of the female sex'. Of one poem he said 'I think there is something in it to annoy all sorts and conditions of men, which you will find as you grow older makes for amusement in life'.

So we come to Robin's life of faith. He said it was built on the foundations that he was taught by his mentor and the rector of his youth, George Sessford, who became Bishop of Moray. Robin said he was constantly finding new insights and encouragement both in theology and in his thought, but they never departed from the rock on which his faith was built. He said that romanticism was a spring to his spiritual life. And for exactly 25 years he has been a member here, at St Columba's by the Castle, a congregation dedicated to social action, a community with whom he worshipped Sunday by Sunday, even day by day. He said 'I am proud of my own kirk. St Columba's was founded specifically to defend King Charles's Liturgy, and tradition, at a time when the Episcopal Church grew sleek and respectable, ashamed of its Scottishness, sighing for the fleshpots of Canterbury'.

The Old Testament reading was chosen because it talks of a time to be born and a time to die, and it really was the time for Robin. Frail from his childhood, failing health had become a burden, his interests were diminishing, and the lock-down had not been propitious, cooped up at home. The reading ends 'Whatever is – has already been, and what will be – has been before; and God will call the past to account.' And I can not think of a better or more fitting person, or advocate for the past, than Robin to explain to God, with humility and humour, 'what has been before'.

To

Douglas McDougall

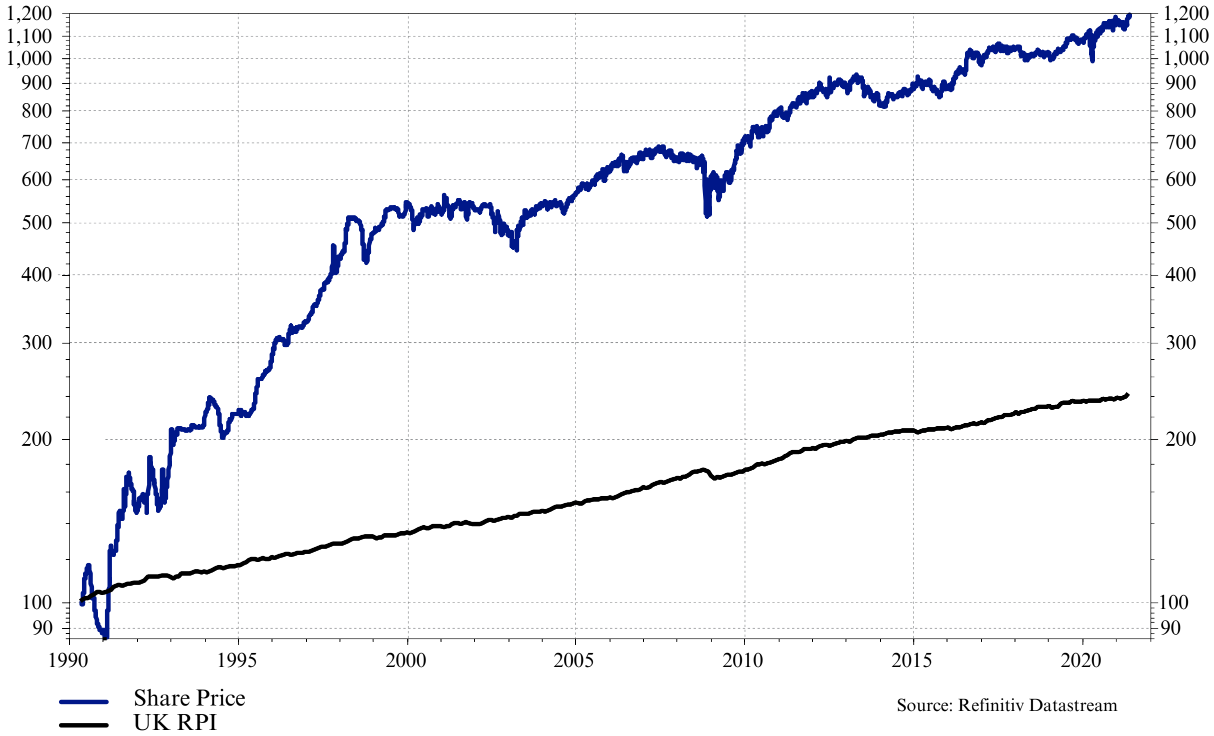
Il miglior fabbro

Investment
Trusts.
High

Contents

Record of Growth 1990-2021

(From Annual Report to 30 April 2021, updated to 31 October 2021)



Introducing the "PAT Proposition"

- **The preservation of capital in real terms as our first priority**
- **PAT's conscious positioning as a core part of an individual's portfolio**
- **Abolition of the discount/premium risk**
- **Genuine liquidity at all times through the discount control mechanism**

You're never too old to learn. When planning this anthology in autumn 2021 in consultation with the Directors of Personal Assets Trust ("PAT") I was struck by their emphasis on setting out at an early stage what they called the "*PAT proposition*". To an antediluvian relic like me this suggested only either an unwanted approach in a singles bar or a get-rich-quick scheme whispered in one's ear by a pencil-moustached spiv like Private Walker in *Dad's Army*. However, a search on the internet soon informed me that in today's world a *"proposition"* in this context meant *"a statement that articulates the product's features, uses and differentiators while taking into account the customers' problems, wants and needs"*.

My internet search went on to state that a *"proposition"* in this sense was *"the North Star metric for product messaging"*. More puzzlement. But the internet came to my rescue again. A "*metric*" (it informed me) simply means "*a standard of measurement*" and a *"North Star metric"* is *"the key measure of success for the product team in a company. It defines the relationship between the customer problems that the product team is trying to solve and the revenue that the business aims to generate by doing so."*

In this sense, the "PAT proposition" is a useful phrase; and it immediately takes me back to PAT's origins in the early 1980s, when Ian Rushbrook (then of the fund managers Ivory & Sime) and I (from the stockbrokers Wood Mackenzie) used to meet regularly for Sunday lunches – I after church, he after several hours of work in the office – to discuss our hopes and ambitions for the world of investment in general and the needs and wants of individual investors in particular. Both of us had at the beginning of our careers fallen in love with the concept of investment trusts. We liked their purity, their single-minded dedication to the interests of those who invested in them and their direct accountability to their shareholders. But there was a problem. There were hundreds of investment trusts on offer, some of them characterless and others with weird and wonderful capital structures and/or investment policies. Some existing trusts we were for various reasons happy to invest in ourselves as part of our wider investment portfolios. But none of them, it seemed, offered exactly what we wanted as a core investment.

Ian and I therefore consciously created PAT as our own answer to the question of how we wanted to have our money managed. Formulating the guidelines was a fascinating challenge. But because it was difficult at that time to find anyone who was offering it in exactly the way we required, we decided that the simplest thing was to do it for ourselves. Charlotte Brontë's Jane Eyre famously said of Mr Rochester, her ideal husband:

'Reader, I married him.'

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

'Reader, we founded it.'

What follows is to a large extent based on what I wrote in Quarterly N°. 50 in August 2008, the last of the series into which Ian Rushbrook had a direct input (his untimely death took place two months later). That it still stands the test of time 13 years later is a testament to the way in which PAT has remained true to the vision Ian and I had over 30 years ago and which Sebastian Lyon and his colleagues at Troy Asset Management have inherited and shared.

What were the guiding principles Ian and I adopted in running PAT and which have been followed ever since? While bearing in mind the sometimes contrived nature of such lists (which I fear is something of a theme throughout this anthology!), I'll highlight ten of these, not necessarily in order of priority):

1. *Serving the shareholders*
2. *Eliminating the discount*
3. *Communications*
4. *Acceptable performance*
5. *Investing for the long term*
6. *Avoiding specialisation*
7. *Free to be unfashionable*
8. *Using liquidity/gearing*
9. *Rejecting 'incentive' fees*
10. *The rôle of the Board*

1. Serving the shareholders

Unfashionably, the Board sees its principal duty as being to serve the shareholders, not (as is nowadays mandated under company law) to serve the Company. We relate to individual people, not to a faceless entity, and what we wrote in the Report & Accounts for 1991, the first year in which PAT was independently managed, still holds good:

'Our Annual Reports have consistently stressed that PAT is an investment trust for private investors. After a thorough policy review carried out during the year just past, the Board has concluded that this aim can best be achieved in the long term by managing PAT as a flexible investment trust specifically for private investors wishing to invest a substantial proportion of their wealth in the Company as an alternative to holding a diversified equity portfolio or a number of other investment trusts or unit trusts. In other words, "our specialisation will be our shareholders".'

In effect, the Directors ever since then have run PAT for people like themselves, believing that (as indeed seems to be the case) what suits them may suit others.

2. Eliminating the discount

There are two main kinds of risk for an investment trust – portfolio risk and discount (or rating) risk. As regards the latter, we have taken action to eliminate the share price discount to NAV for all time: a state of affairs PAT first achieved in April 1995 but which after 8 November

1999 (Discount Freedom Day) we were in a position to guarantee. Before then, trusts had been permitted to buy in their own shares for cancellation only by using revenue reserves (usually tiny in relation to a trust's share capital, and in any case generally used for smoothing dividend payments). On Discount Freedom Day, however, an amendment to the rules became effective permitting an investment company to distribute realised capital profits by way of redemption or purchase of its own shares.

Investment trust Boards have often seemed curiously unenthusiastic about eliminating the discount. For instance, it was startling to read the Chairman of Alliance Trust, when referring to share buybacks and the discount a few years ago, commenting:

'Having considered the arguments [for using buyback powers] *we have chosen not to do so. Instead we have continued to invest in the development of our financial services . . . '*

As an example of a non sequitur, this would be hard to beat. Boards have decided, wrongly, that the benefits of a low or non-existent discount accrue principally to the sellers. In fact the overwhelming benefit is to continuing shareholders, and to new shareholders for whom there is no risk of a discount arising in the future. It is the ultimate safeguard of shareholder value; if PAT's long-term performance were to prove unsatisfactory, shareholders at least have the certainty that they will be able to exit at any time at a price close to NAV – in other words, without incurring any additional discount caused by poor performance.

3. Communications

By 'communications' I don't mean ever-longer Annual Reports filled with ever more irrelevant detail. Regulators, legislators and specialists in corporate governance seem not to recognise that there can be such a thing as information overload, or that, as the celebrated science fiction writer Robert A Heinlein wrote:

'The best place to hide a needle is in a stack of needles.'

From the vantage point of 2021 I have no hesitation in saying that Annual Reports are in this respect now far less useful to private investors than they were 30 years ago. Their volume and opacity is bamboozling. In the first ever Quarterly in 1994 we set out what are still our own views on communication.

'We regard our shareholders as our partners and one of our aims is to foster and strengthen this feeling of partnership . . . We aim to develop [the Quarterlies] . . . *as our shareholders wish, and find most useful. We hope that they will provide a means for shareholders to get to know us better and to understand more fully how we think and work when managing your money and ours.'*

4. Acceptable performance

To write of 'acceptable' performance suggests what the poet John Dryden described as being to 'damn with faint praise'. But faint praise is better than blunt condemnation. To individual investors, what does 'acceptable performance' actually mean? Investment trust managers' actions have generally been dictated by institutional definitions of what performance should be and how it should be sought. All too often, trusts have chosen indexation or quasi-indexation, picked unduly risky and/or narrow specialisations (whether temporary or permanent), or adopted potentially disastrous capital structures – all so that they can 'do something different' for the institutions.

Since we run PAT for ourselves, we view absolute performance as being more important than relative performance against benchmarks and we measure performance in terms of the share price. Two main constituents go to make up acceptable share price performance for us. The first is decent long-term NAV performance compared to that of UK equities in general. The second, as noted earlier, is the very important one of the elimination of discount risk.

Words from our Annual Report & Accounts for the year to 30 April 1991 are still relevant today:

'The object of portfolio management is not "to invest in good companies" or "to back management". It is to make money from buying shares for their eventual resale in the long term after a share price performance which exceeds that of a comparable index. Probably the best general investment advice is that given by Warren Buffett, America's most successful investment manager. It is summarised in two rules. The first rule is not to make mistakes. The second rule is not to forget the first rule.'

After over 30 years of running PAT we would add a third constituent of performance, which we use from time to time as a means of enhancing the two I mentioned earlier. This is the use on appropriate occasions of liquidity or gearing (*see later*).

5. Investing for the long term

To an institution buying an investment trust, the performance horizon is often short term and relative performance is frequently an end in itself. In particular, institutions want to determine their overall level of liquidity and thus expect trusts to be fully invested in their specialist areas. The performance horizon of the kind of private investor PAT serves, however, is much longer; year-on-year performance, while perhaps of passing interest, is of little relevance. This is why we have been in the habit of showing performance not only over one and three years but over five years, ten years and since PAT became self-managed in 1990.

Some general comments about how PAT is likely to perform in various types of market environment may be helpful here.

In bull markets PAT will tend to become more and more liquid, our relative performance worsening with each increase in liquidity. Conversely, in a bear market we will become increasingly invested in equities, again underperforming the FTSE All-Share Index.

Given that bull and bear markets can persist for many years, what will ultimately prove to have been profitable liquidity and gearing management of the type just described may create the paradox that for much of the time, PAT will underperform the FTSE All-Share Index. Only at points of inflection (i.e. significant shifts in market values when bull turns to bear or *vice versa*) will accumulated underperformance from our liquidity and gearing management burst into blossom as outperformance. PAT's relative performance is likely to be inconsistent and is potentially volatile, while in contrast PAT's absolute performance will be more consistent. We believe such consistency to be in keeping with shareholders' needs and wishes.

6. Avoiding specialisation

Why limit yourself if you don't need to? Given that we run PAT as we want our own money to be run, we have no wish to tie our future to one 'far away country of which we know nothing', or to one market sector or one class of security, or to accept the lack of that all-important attribute of any investment portfolio, its liquidity (in other words, the speed with which it can be realised if the need arises). We can't satisfy the requirements of every shareholder and we have never tried to do so. We stick to what we know; and investors who want a stake in specialised investment areas should look for it elsewhere, over and above their shareholdings in PAT.

7. Free to be unfashionable

This is a corollary of avoiding specialisation, but there is more to it. We have had our times of underperformance and have sometimes felt that Kipling's *If* was written especially for us:

'If you can keep your head when all about you
  Are losing theirs and blaming it on you,
If you can trust yourself when all men doubt you,
  But make allowance for their doubting too.'

Fundamentally, short-term criticism doesn't matter to us. We are managing our own money as we think fit, not trying to keep up with competitors or attract new business, and fashion doesn't influence us in our task.

8. Using liquidity/gearing

We view liquidity and gearing as essential investment tools for protecting and growing shareholders' funds over the long term.

We believe in the active use of gearing and liquidity in investment management. When markets look particularly attractive and we want to increase our equity exposure to more than 100% of shareholders' funds we will do so in a flexible way, typically by buying derivatives such as FTSE 100 Futures. When we believe markets to be overvalued, we may either hold part of our resources in cash or short-term fixed-interest securities or sell FTSE 100 Futures to reduce our equity exposure. PAT is well known for its successful use of liquidity over the years and we have found it invaluable as a dependable way of protecting shareholders' capital.

In exceptional circumstances our equity exposure could be as high as 150% or our liquidity as high as 133% of shareholders' funds.

[Note: Since that was originally written, the Board has reduced the maximum permitted liquidity to 100% of shareholders' funds. The maximum permitted gearing will not exceed 50% of shareholders' funds. These limits would not be exceeded without shareholder approval.]

9. Rejecting 'incentive' fees

A paper by Grant Thornton, the accountants, claimed some years ago that over 45% of mainstream investment trusts had some element of manager remuneration linked to 'performance' and that the incidence of this had grown rapidly in the preceding years. However, they noted that it was far from clear that this is to shareholders' advantage, since incentives 'can be a one-way option enhancing the return to managers' and 'in themselves they do not make managers perform better'.

I agree with this analysis. We believe incentive fees for investment managers to be counterproductive. Firstly, no manager ever tries to underperform. To attempt to motivate them through incentives merely to do their jobs is therefore *naïf* as well as wasteful of shareholders' money. Second, incentive fees for investment managers gratuitously increase stress when calm and reflection are required. Third, incentives tempt managers to target their own bonuses rather than pursue the trust's best interests; underperforming managers will all too often react by ramping up the investment risks they take.

Since 1990 PAT has by deliberate choice had the simplest of fee structures – a tapered percentage of shareholders' funds, so that the fee paid can fall as well as rise and is unaffected by any gearing the trust might take out.

The fee payable to PAT's Investment Manager, Troy Asset Management, is based on the Company's shareholders' funds and is: 0.65% on the first £750 million; 0.55% between £750 million and £1 billion; and 0.5% thereafter, payable quarterly in arrears. The overall percentage fee rate will therefore tend to fall should PAT's shareholders' funds rise.

Some managers charge fees on gross assets, which is an incentive for the managers to gear up and take excessive risks. We have always set our face against this, which we believe to imperil the interests of shareholders, and we levy fees only on net assets (i.e. shareholders' funds).

10. The rôle of the Board

A final key ingredient of PAT's success (although it might as well have ranked first in the list) has been its old-fashionedly stable and committed Board.

The Board of a trust catering specifically for private individuals is of vital importance because it acts on behalf of shareholders as the guardian of their interests and as the guarantor of continuity. As the then Chairman of PAT, Bobby White, wrote in 2003:

'Another significant event during the year was the publication of the "Higgs Report" on non-executive directors. Among its remarkable conclusions was one which suggested that a Board would be the stronger if it were constantly changing and its members hardly knew each other. Another proposed the appointment of a senior non-executive director as a rival to the Chairman. You will not be surprised to read that your Board does not believe this is how PAT should be run.'

The Board has throughout PAT's history had a more than ordinary financial commitment to the trust and hence community of interest with its shareholders. This is what we intended when we started running PAT in 1990 and is how we shall continue in the future.

Footnote: A Word of Warning and Explanation

In 2011 we produced a book entitled *'60 Not Out': Personal Assets Trust Quarterlies 2002-2011*, which *inter alia* reprinted Quarterlies N°. 26-60 in full. In an introduction to the book I wrote the passage which follows. It seems to me worth reprinting here as a way of setting in context what is written in the present book, where a few inconsistencies and contradictions may still be found to remain.

"These Personal Assets Quarterlies were written between October 2002 and March 2011. That is a long time in the investment world, so not only is there a fair amount of repetition but also there are doubtless many contradictions to be found in the body of the text, as well as comments that would make me cringe as I saw how inaccurate or misguided they were. I shall, however, leave you to find these for yourselves; and, when you have found them, please be kind and do not contact me and tell me about them. Remember that the Quarterlies were not written as a continuous narrative but were a series of individual responses to events, written at the time the events had just occurred or were still occurring. There's an old Jewish saying that 'the Torah interprets the Torah', and an old Christian one that 'the Bible interprets the Bible'. Despite all the inconsistencies and contradictions, I hope that 'the Quarterlies will interpret the Quarterlies' and that, through all those inconsistencies and contradictions, a unity of spirit and purpose will still be evident."

A Shareholder Writes . . .

Some Shareholders Write . . .

(What follows is a succession of extracts from letters I received from shareholders between 1994 and 2003, together with extracts from what I wrote in reply.)

There are hundreds of investment trusts out there. How on earth am I going to be able to choose suitable ones?

Yes, there are hundreds of investment trusts. Some of them, notably in the split capital trust sub-sector, have weird and wonderful capital structures and/or investment policies. I'm not suggesting you invest in trusts like those. I look chiefly at the biggest dozen or so trusts that can combine a flexible investment policy with a reasonable and growing dividend (if this is important to you) and low total management costs.

In the past I tended to agree with you about the suitability of investment trusts for most investors. But now I am having second thoughts. For example, in the period 30 April to 30 November 2002 Foreign & Colonial fell 30% and Witan fell 29% while the FTSE fell 20%.

You are by no means the only person to have drawn my attention to the rotten performance of the big generalists over the last few months. The first thing I would say is that, while I do recognise the poor performance of the big generalists recently, the seven-month period you quote is a very short time.

Big generalists have been underperforming for three main reasons. The first is that, unlike Personal Assets, they have typically been fully invested in equities, which generally have been falling in price.

Second, some of them have even been positively geared, which exaggerated the effect of the market fall on their net asset values ("NAVs").

Third, discounts have widened significantly (which also usually happens when markets fall) and this has further depressed such trusts' share price performance.

How has Personal Assets managed to escape this 'discount trap' into which other trusts have fallen?

It's simple. Personal Assets sells at around NAV because the Directors have decided that it should. If our shares ever go to a discount we buy them back – in any size, at any time. If they go to a premium, we create new shares to satisfy demand. Furthermore, the Board believes that shareholders dislike not only 'discount risk' but also 'premium risk', which has in the past brought severe disappointment to investors buying into trusts which, although often very good in themselves, were selling at a premium to NAV which has then vanished. As shareholders we ourselves prefer to avoid both these risks. Judging by the continued demand for Personal Assets shares, our fellow shareholders seem to agree with us. In April 1995 we had 152,187 shares in issue. Now we have over 537,000, an increase of more than three and a half times. *[By 30 April 2021 we had 3,232,929 shares in issue, or over 21 times the April 1995 total.]*

But if 'discount risk' is such a bad thing, why do other big diversified trusts not do as Personal Assets does and eliminate it also?

Ask their Boards! In theory, there's no reason why they shouldn't. In practice, there are three main reasons. Firstly, their managers are often afraid that buying back shares would shrink the trusts' size and so reduce the managers' fees. Second, geared trusts would become even more highly geared as their equity base shrank while their gearing stayed fixed (although this could be neutralised by an increase in liquidity).

Third, large percentages of the big diversified trusts are still held by institutions which are sometimes reluctant to sell their shares in the market at a discount to be bought in for cancellation, preferring to wait and see if they can get NAV at some future date through a hostile bid or through some sort of restructuring scheme. Personal Assets has been lucky in that from the very beginning we have chiefly had only what might be called ‘natural’ shareholders – private shareholders who genuinely wanted to be invested in the trust. Most other trusts are less lucky and still have to contend with an historical ‘overhang’ of sometimes discontented institutional shareholders.

Personal Assets’ use of liquidity has benefited shareholders greatly. Why have other general investment trusts stayed so heavily invested in equities over the last three years?

I think there are three main reasons for this. Firstly, most general investment trusts are still held heavily by institutional investors. These often don’t like investment trusts to go liquid. They prefer to make their own decisions about liquidity and they regard their trust shareholdings simply as an alternative to holding equities directly. If they find they are holding cash or bonds at one remove through an investment trust, this annoys them because it distorts their own asset allocation calculations.

Second, trust managers are human. Because they are paid to be equity investors, they are terrified not to be fully invested in equities. To go liquid is to break step with their rivals. Needless to say, the Board of Personal Assets believes that sometimes one has to be bold and break step. But never under-rate how hard this is for equity managers. Like a GP prescribing alternative therapies, if it goes wrong there will be serious trouble. It can feel much safer just to risk making the same mistake as everyone else, even if one is pretty sure it will be a mistake.

This brings me on to the third reason, which might be called ‘The Curse of Relativity’. Many investment managers have been trained to think in terms of relative, not absolute, returns. This is how they are measured by their peers, the Press and performance consultants. For a portfolio to fall in value by 15% when the market falls 20% is therefore a triumph, but for it to rise by 15% when the market rises 20% is a disaster – even though the ‘triumph’ will involve the shareholder losing £15 in every £100 and the ‘disaster’ means she has gained £15! The problem is that shareholders, in my experience, are interested in absolute as well as relative performance. This is why Personal Assets places such emphasis on protecting, as well as increasing, shareholders’ capital.

Do you agree that the big general trusts look risky just now?

Well, to echo the late Professor Joad of *The Brains Trust* in the 1940s, it all depends on what you mean by ‘risky’! If there were to be another 1,000-point fall in the FTSE 100 Share *[which stood at just over 4,000 when I wrote this particular reply to a shareholder]* they would almost certainly do much worse in the short term than the market in general. I therefore wouldn’t buy them in the hope of capturing some short-term outperformance. But I rarely would buy anything in the hope of capturing short-term outperformance. I’m hopeless at that sort of investment. If today I were giving some money to a new godchild as a christening present, the capital to be kept intact until the godchild came of age, I should not hesitate to put the money in a big general trust. The ups and downs of NAV performance and the vagaries of the discount will have washed out by then, and that is what I mean by long-term investing.

A reason for the big generalists’ recent poor performance is the silly trend of the trust industry to become quasi-trackers and do so in some instances with aggressive gearing. I would be interested in your comments on this.

It’s hard to imagine a worse recipe for portfolio performance than to be a quasi-tracker with aggressive gearing over a three-year period during which the UK market, as measured by the FTSE 100, fell from just under 7,000 to just under 3,700! Like you, I find it infuriating when Managers’ Reports blame ‘gearing’ for under-performance, as if their gearing were some sort of unlucky accident beyond their control. Who made them gear in the first place? To borrow a phrase used by Scots schoolchildren as a lame excuse for their misdemeanours, there can be nowadays a sense of 'a big boy geared up my trust and ran away' about Managers' Reports. And why didn't they hedge the gearing later? Even if trusts do have a geared balance sheet, this doesn't mean they must at all times have a geared portfolio. One can neutralise gearing by holding gilts or other fixed interest securities, or by selling FTSE 100 Futures.

However, don't fall into the trap of supposing that gearing is always a bad thing. Ten years ago, people fell into the opposite trap of thinking it was always a good thing. Neither is true. Gearing is an investment tool which it is appropriate to use at some times but not at others, and which can be a good servant but a bad master.

Surely managers should be involved in the decision on the trust's debt position and, therefore, must also share the responsibility for underperformance during their management? Is it right that management fees are tied to gross assets?

Managers are usually heavily involved in deciding on a trust's debt position and so must bear much of the responsibility for gearing-induced underperformance during the period of their management. As for management fees tied to gross assets, they are a disgrace. Indeed, I strongly attacked them in print some time ago in the two articles on split capital trusts I wrote with Dr Andrew Adams of the University of Edinburgh (published in *Professional Investor*). They can all too easily induce greedy or unscrupulous managers to put their own interests ahead of those of the shareholders. In my opinion they were a prime cause of the recent split capital trust scandal and I should like to see them outlawed. No self-respecting manager should accept them and no self-respecting Board should permit them.

You can never be certain that the tax treatment for trusts will remain as kind as is currently the case. In the mid 1970s investment trusts were taxed twice on all gains, once within the confines of the portfolio and again in the hands of each investor.

I do indeed remember how in the mid 1970s trusts were subject to internal Capital Gains Tax (albeit at 15%, half the personal rate) on gains realised within their portfolios. As an apprentice fund manager at Baillie, Gifford & Co I was then much involved in the annual flurry of bed-and-breakfasting, and transferring overseas holdings between dollar loan and dollar premium accounts.

There is no guarantee that those bad old times will not return. From the point of view of private investors, Mr Brown has proved to be a thoroughly unsympathetic and unhelpful Chancellor (witness his plundering of the pension funds). He could turn nasty on investment trust taxation too. Furthermore, I have for some time been afraid that the split capital trust scandals could lead to a lot of unwelcome new regulation of investment trusts – regulation that would benefit nobody, would have done nothing to prevent the split capital *débâcle* itself, would make life difficult for responsible trust Boards and managers, and would serve only to appease the Financial Services Authority ("FSA") and other highly-paid busybodies in what has sadly become the City's latest growth industry. I hate regulation. Common sense and *'caveat emptor'* served investors well in the past. I fail to see why they shouldn't be enough for the future. We must look to the Association of Investment Trust Companies ("AITC") *[now the Association of Investment Companies ("AIC")]*, our trade body, to defend the investment trust industry vigorously against the empire-building of unaccountable government agencies and the publicity-motivated posturing of supercilious Treasury Select Committees.

It is too extreme a view to suggest investors simply hold investment trusts and no other types of investment. The key rule of investment is never to have all your eggs in one basket . . . one should never have just commitment to investment trusts.

What I actually wrote was considerably more nuanced, and was as follows:

'Even the private investor with many millions to invest is in my view best served by a portfolio of half a dozen good general investment trusts.'

I stand by that. Firstly, it is clear that it's very much a personal opinion rather than some kind of *ex cathedra* pronouncement which I would have no authority to make even if I wanted to. I am a partisan of investment trusts and anyone who knows anything about me or my writings knows that. Second, there are always exceptions and qualifications to everything. So I might happily differentiate, for instance, between someone's core portfolio (which could be in half a dozen investment trusts) and a range of other investments held as 'insurance', as deliberate diversifications, or just for 'fun'.

You say, 'half a dozen good investment trusts would satisfy all my investment needs'. But I have spread myself a little wider and have found this stimulating.

I'm delighted to hear it. There's no contradiction between our positions. Half a dozen good investment trusts would indeed satisfy all my investment needs, just as water would satisfy all my drinking needs and bread and vitamin pills all my eating needs – but I might get a bit bored!

This is why I often suggest that people keep aside up to 10% of their money for fun, so that they can gamble a little bit, speculate on the odd hot tip and thus find it exciting to turn to the City pages every morning. There is more to life than just one's 'needs', and so I'm glad you've found interest, excitement and (I hope) profit in pursuing a wider-ranging investment policy.

I would argue that a private individual's portfolio could perfectly well be made up of carefully-chosen individual equities.

Yes it could; and at its best such a portfolio would be very suitable. I have no doubt that any of a number of excellent private client stockbrokers known to me could construct a first-class one. But I have all too often seen such portfolios not at their best. Some of them have been costly dogs' breakfasts that made me ashamed of the financial industry.

This is why I have come to the conclusion that half a dozen general investment trusts would be a reliable choice for most people. It is not the only choice, but it would be a sound and dependable one and would be less likely to cause worry and uncertainty than most of the other options available. To stress the advantages of investment trusts, however, is not to damn all other ways of investing. I rejoice that Personal Assets' relationship with good private client stockbrokers has been of the happiest. Long may it continue so.

Quarterly N^o. 28 (February 2003)

Why Not 100% Liquid?

A shareholder wrote to ask why we didn't take our bearish stance to its logical conclusion. Why, she asked, are you only 40% liquid, not 50%, 60% or even 100%?

I replied that investing in equities was about looking for potential reward and balancing against this the risk required to gain it. Markets invariably offer, at any time, some risk and some potential reward. This will fit somewhere on the overall risk and reward spectrum, which runs from high reward/very little risk (at the end of 1974, for instance, when prices were so depressed that there was not much risk in investing) to high risk/very little reward (in early 2000, for example). At present, we believe that our 40% liquidity strikes an appropriate risk/reward balance.

But there are times when it might be logical for us to be 100% liquid. We don't need to be 100% certain of a market fall, because the worst that can happen to a fund that is 100% liquid is that its NAV rises only by the return on its fixed interest investments less its costs of management. No-one ever went bust from too much liquidity, whereas fixed gearing of 40% from 1972 would have bankrupted a fund by December 1974.

Quarterly N^o. 42 (September 2006)

Why the Abject Performance?

'I am a holder of your shares. Despite the strong performance of the market during the last year, your performance has been abject. What are you going to do about it?'

That was quite an e-mail to have received less than a fortnight before Personal Assets' Annual General Meeting and it concentrated the mind wonderfully as I prepared to meet the shareholders.

My answer won't come as a surprise to you. It was that we would do nothing beyond what we were doing already. We would stick to our guns and refuse to be deflected from pursuing our long term strategy by short term underperformance. I pointed out that in frothy and volatile markets like these it is usual for us to underperform the FTSE All-Share, sometimes very substantially so, and that it would be a surprise not only to ourselves but also to many of our shareholders if we didn't. This, I continued, was because, as a matter of principle, we don't invest in what we believe to be severely overpriced assets which carry a risk of serious and perhaps permanent capital loss.

What's more, we don't invest on a one-year view, or anything like it. We may not think in centuries, as the Vatican is supposed to do, but we do think in decades. Consistency over the long term is what matters to us, and it's impossible to overemphasise that Sebastian Lyon and the Board are not just hired hands, managing money for other people. It is our own money that is at stake. This is the key to everything we do. If the shares of Personal Assets fall in value, so does our own net worth – and, ultimately, our future financial security and that of our families is put at risk.

Quarterly No. 69 (August 2013)

Why Not Take More Risks?

One shareholder responded to comments I had made about short-termism by posing another question. While accepting the general principles underlying our investment policy, he was curious as to why a cautious, low risk investment approach should lead to underperformance in buoyant markets.

In response I cited two reasons. The first was that when markets are buoyant the likelihood is that we will not be fully invested in equities, because at such times we will think them too dear and too risky. Therefore, if equities across world markets rise by, say, 20% and only half of our shareholders' funds is invested in equities, our NAV would (other things being equal, which they never are) rise by only 10% and we would underperform the global equity market. The corollary of this is that if equities across world markets fall by 20% and only half of our shareholders' funds is invested in equities, our NAV would fall by only 10% and so we would outperform the global equity market.

The second reason I gave as to why a cautious, low risk investment approach leads to underperformance in buoyant markets was that, as a rule (although not invariably), in buoyant markets the pace is set by riskier, more volatile shares whereas the shares we like to own tend to be less risky and less volatile than average. Therefore even the shares we do hold will tend to rise by less than average, or (of course) fall by less than average if the market starts declining.

In the unlikely event that the next question hasn't occurred to you (I continued), I'm going to take the (market) bull by the horns and ask it myself. When equity markets are buoyant, why on earth don't we hold riskier shares (and more of them) on a short term basis, perhaps using borrowed funds to invest in additional equities as some trusts do, to make hay while the sun shines before reverting to type and becoming conservative and cautious investors again when the market stops being buoyant and starts to fall?

This is a question we are often asked by shareholders and others who sympathise with our investment approach but are puzzled as to why we can't capture a bit of short-term performance as well. It is a question I, too, used to ask during my impatient younger days back in the late 1970s and early 1980s. How easy it looked, to run with the market for short-term gains while still sticking to our long-term principles! And how inexplicably mulish and stick-in-the-mud were my superiors, who refused to do what to me, in those days, seemed so obvious. The inconvenient truth I learned painfully over subsequent years is that while it is not too hard to tell when equity markets are undervalued or overvalued, it's virtually impossible to tell when a buoyant market will stop rising and start falling – just as it's virtually impossible to tell when a depressed market will stop falling (or stagnating) and start rising.

Quarterly N^o. 69 (August 2013)

Are We Too Rich to Care?

Life in the investment trust world is full of surprises. I had always thought that the Directors' shareholdings in Personal Assets would be seen as reassuring, so I was startled when a shareholder unhappy with our recent performance wrote to complain that the Directors and the Investment Adviser were obviously too rich to care about what happened to their own invested capital.

In my limited acquaintance with the super-rich, indifference to the fate of their invested capital is not prominent among their characteristics. And when I remember that my own initial stake in Personal Assets some thirty years ago was the equivalent of 50 of today's shares, I think not of thirty years of smug indifference to investment outcomes but of thirty years of hard work as well as hard saving. The financial fate of the Directors depends to a large extent on Personal Assets' performance. This is not a guarantee of success, but it is a guarantee of diligence, application and attention to detail.

Quarterly N^o. 74 (November 2014)

Justifying Fees

A shareholder recently wrote to me to complain that the fee paid by Personal Assets for investment advice seemed quite a lot to him, given what he described as 'so little movement in the composition of the fund'.

I replied that the thudding sound he might just have heard was that of me beating my head against a brick wall. Again and again throughout my working life I've encountered the view that the more transactions a fund makes, the more deserving the fund managers are of their fees. People often complain to me about our lack of portfolio activity. One academic economist with whom I sometimes have lunch greets me each time with, 'Have you done your one transaction this year?', as if all I did in the office for the rest of the time was surf YouTube.

But is the amount of work done by a fund manager best measured by the number of trades that have taken place within the fund? Emphatically not. Leaving aside the fact that dealing costs money and that this over time can cause significant erosion of capital, a high volume of portfolio changes can be as much an admission of failure as evidence of thoughtfulness and care. If the investment outlook hasn't changed, why change the portfolio you have structured specifically to benefit from that very outlook and to guard against the dangers it presents?

It takes at least as much work to run Personal Assets' portfolio as it would to run a straightforward stock-picking fund. We think about the stocks we hold just as much as do the managers of such funds, and we have the added dimension of having to think strategically about sectors, markets, currencies and commodities. Furthermore, while our positions in equities may not change as much as would positions in more actively managed equity-only funds, Personal Assets is not an equity-only fund and there is a lot of work and skill involved in managing our index-linked holdings and our holdings of the very short-dated (a couple of months at most) UK and US Treasuries we buy in preference to bank deposits for reasons of security, to say nothing of our currency hedges.

Quarterly N^o. 87 (February 2018)

Alan Greenspan and Gordon Brown

The Great Pensions Robbery

'I remember when I was a child, being taken to the celebrated Barnum's Circus, which contained an exhibition of freaks and monstrosities. The exhibit on the programme I most desired to see was the one described as "The Boneless Wonder". My parents judged that that spectacle would be too demoralising and revolting for my youthful eyes. I have waited fifty years to see The Boneless Wonder – sitting on the Treasury Bench.'

Those are Churchill's words about the sadly underrated Ramsay Macdonald. Who else could have put it so unforgettably? But even during its first term of office the administration headed by Blair the Boneless Wonder proved it could turn round and bite – the teeth on this occasion being those of the Chancellor of the Exchequer. For larceny on a grand scale it would be hard to surpass 'new' Labour's Great Pension Fund Robbery of 1999, which fully justified our pre-election fears. To borrow words originally used by Lady Mary Wortley Montagu to describe the satirist Alexander Pope, Gordon Brown soon found a way in which he could:

'like a polished razor keen,
Wound with a touch that's scarcely felt or seen.'

It was so simple. All the Chancellor had to do was abolish Advance Corporation Tax ("ACT"), which he did as from 6 April 1999. This meant that the notional 20% of tax that had already been paid on dividends was no longer reclaimable. 20% of your dividends doesn't sound much. Even the resulting 20% off the annual dividend income accruing to pension funds (since pension funds could no longer reclaim ACT) sounds bearable. But it was much worse than that. Wise investors recognise that the value of equities is the discounted present value of the future dividend stream from them. So when the Chancellor abolished the tax credit on dividends he stole from investors up to 20% of the value of the UK equity market.

Introduction to 1997 in Personal Assets Trust Quarterlies, The 1990s and Beyond

The East Is *(in the)* Red

Personal Assets has never invested in Japan. Since our working relationship began in the early 1980s, Ian Rushbrook and I have been profoundly bearish of Japanese equities. Writing in the late 1980s I compared them to Dutch tulip bulbs in the seventeenth century as examples of investment assets inflated in price beyond all reason.

Yet today, in 1998, Ian and I believe that Japan is the key to what may happen in major world stock markets over the next couple of years. To explain why, I shall begin with a comparison I made a decade ago, in February 1988, when writing about the inter-relationship between the US and Japanese economies.

'At the root of the world's problems is the imbalance between the US and Japan. The world could be compared to a village dominated by a rich but extravagant squire (the US) spending above his means and obtaining both goods and cash advances from the thrifty village shopkeeper (Japan). And about such a village there would be two alarming features.

'Firstly, the squire would be in the power of the moneylender – and, equally, the moneylender would be in the power of the squire. (If I owe you £1,000, I am in your power. If I owe you £1,000,000, you are in MY power – a simple fact of life.) And, second, the prosperity of everyone in the village (the other countries in the world) would depend on the continuing working relationship between the moneylender and the squire. Between them, they would dominate the village's economy.'

As far as it went, the simile was not a bad one – although I forgot to mention the highly significant fact that the going concern valuation of the shopkeeper's shop kept on being ramped up skyward whenever possible buyers came to look at it, making him feel extraordinarily well-off and confident.

So, ten years later, in 1998, what is happening in the global village?

'Squire' and 'Shopkeeper'

Well, up at the manor house the champagne-corks are popping. The estate buzzes with activity, the home farm is more productive than ever and the squire has been taking on so many extra servants that new ones are hard to find.

What is more, buyers keep on coming to look round the estate, offering prices for it which seem to get higher every day.

Indeed, Dr Greenspan, the estate factor, has two main worries. Firstly, he believes that good servants are in such short supply that their wages are bound to rise, which will be bad for the estate as a whole. Second, he fears that the squire (and his family, dazzled by the apparent rise in the value of their inheritance) will succumb to the temptation to overspend.

Down in the village, however, the shopkeeper is in trouble. Over the years his takings have been excellent, but now he seems to have reached the limit of what he can sell, whether to the squire or to the other villagers. New goods overflow his shelves and no-one wants to buy them.

Spending a lot of money on renovating his shop has done little to help trade. Indeed, recently many of the villagers down Bangkok Alley and Jakarta Lane have lost their jobs. This means they have much less to spend and may find it difficult to repay the money the shopkeeper lent them during the good times.

All the shopkeeper can do, unless he wants to see his business shrink and some of his staff get laid off, is keep lending money to the squire. This buoys up his apparent profits, because the squire pays a good rate of interest – far better than the shopkeeper could earn by investing still more money in trying once more to renovate and restock his shop.

However, the finances of the shopkeeper's business are in a mess. Not only are his accounts muddled (which they always have been, but it didn't seem to matter so much when he was making money hand over fist), but also he owes money for renovations and to his suppliers. This he knows all too well, although to the outside world his business still seems to be spinning off lots of spare cash for re-investment.

If he is to save himself from bankruptcy, he will soon have to bring himself to accept that his finances are in confusion, stop declaring such large profits, and discontinue lending more and more money to the squire. But if he does so, what will happen to him? What will happen to the squire? And what will happen to the other villagers, who depend so much on the economic health of squire and shopkeeper alike?

A Choked-Up Economy

Similes are useful only up to a point. Let's spell out what is actually happening. The people of Japan are saving too much while at the same time the government and big Japanese companies are reinvesting large sums of money unproductively and wastefully.

Japanese individuals thus have a huge and growing pile of savings, much of which has been finding its way into US Treasuries because interest rates in Japan are so low and the Yen is so weak. Japan's public and corporate debt, however, is much higher than most outsiders realise.

Japan's savings mountain stands at some \$10 trillion. Its declared public debt of around \$4.5 trillion is already high, at 100% of GDP. Some analysts believe, however, that adding in the debts of the government's Fiscal Investment & Loan Programme, or Zaito, together with Japan's huge unfunded public sector pension obligations, could take the true figure as high as \$11 trillion. Furthermore, many big public companies in Japan have debt equal to about four times their equity, compared to the US average of around one and a half times.

There is therefore in Japan a serious mis-match between its high private sector savings rate and its mounting public and corporate indebtedness. One would normally expect the banks to help resolve this by attracting money from savers to channel into corporate lending. The banks, however, are frightened to lend at home for fear of adding to their already souring loan portfolios and so are unhelpfully steering their funds into the safer haven of the US.

Quarterly No. 14 (May 1998)

The Great Interventionist

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, Dr 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 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.'*

He certainly '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 dotcom bubble and, in 2001, the attack on the Twin Towers.

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

Quarterly No. 36 (April 2005)

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 Dr Greenspan. I don't mean that 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% which borrowers could immediately reinvest 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 Rushbrook 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 is even more succinct, when it says that the Prodigal Son:

"Wasted his substance with riotous living". (Luke 15.13)

Quarterly №. 36 (April 2005)

The 1997 Tax Credit Theft

A shareholder wrote to us with a question it earlier took the *Financial Times* and the Institute of Actuaries quite some time to resolve, and which leads me here to return to what in 2002 I called The Great Pensions Robbery *(see later)*.

'In 2003 you were comparing dividend yields with historic averages and coming to the conclusion that the market was highly valued . . . You appear not to have taken into account the fact that the historic averages included dividends which were declared as gross amounts, whereas since 1998 dividends are declared in net terms. This makes a big difference to conclusions concerning market value.'

In fact, it makes no difference at all. The removal of the ACT tax credit in 1997 was not some fiscal technicality that left the underlying value of equities unaltered. Instead, it was a breathtaking imposition that reduced the yield from equities to the largest investors in the UK equity market by 20%.

In plain words, it was a straightforward theft by Gordon Brown of up to 20% of the value of the stock market – a typical act of smug perfidy on the part of a Chancellor of the Exchequer who already shames two of his most famous predecessors by combining the sanctimoniousness of Gladstone with the duplicity of Lloyd George.

The comparability of dividend yields before and after the removal of the ACT tax credit is of fundamental importance to the valuation of equities. While it is true that for basic and higher rate taxpayers the changes made no difference to their after-tax dividend returns, this is a red herring. Tax-paying private individuals, before and after 1997, bought equities for their after-tax returns rather than on published gross yields which they could not receive and so were not of relevance to them. Gordon Brown's tax theft from gross funds so crippled equity market values that it is essential to include the ACT tax credit in the dividend yield prior to 1997, to maintain comparability with current stated yields. Before 1997, gross dividends were net to gross investors (in other words, the stated gross dividend was what they actually received). Today, all they receive is the actual stated (net) dividend – a simple confiscation of value.

Quarterly №. 38 (September 2005)

Six Years of Cheap Money

In Ian Rushbrook's speech at our July 2006 AGM he pointed out that global interest rates had been unusually low for an unusually long time, so that the world's central banks would have to move faster to raise interest rates. Moreover, global inflationary pressures were already rising, so leaving economies vulnerable to any unforeseen (and unforeseeable) market crises.

At the root of the problem was Alan Greenspan, the Chairman of the US Federal Reserve. What is the chief task of any central banker? It is, surely, to fine-tune a country's economy by using monetary policy and the central bank rate to moderate excessive growth and mitigate economic slowdown. Yet after the attack on the Twin Towers in 2001, Dr Greenspan did what US drag-racers used to do. He added nitroglycerine to the fuel, which makes it possible to get to 200 mph in under six seconds, but doesn't do a lot for the engine!

Over the two years from September 2001 he cut the Fed rate from 6.5% to an amazing 1% and then kept it there for a further year, so applying a blowtorch to a case of US economic frostbite and, while resolving the problem in the short term, causing potentially enormous long term financial damage to the world.

Quarterly Nº 44 (March 2007)

A Lost Sherlock Holmes Story

Now to a lost Sherlock Holmes story: *'The Case of the Frightened Auditor'*, or, *'The Case of the Dog that Didn't Bark'*.

'Great Scott, Holmes!' cried Dr Watson. 'How did you know that the Big Issue seller on the corner of Baker Street was a Chartered Accountant?'

'Elementary, my dear Watson. You know my methods. His suit was expensive but frayed, his faithful hound was chewing on a faded list of Arthur Andersen partners, and the pseudonym on his seller's badge was "N Ron".'

'Upon my soul, Holmes! You excel yourself. But what can be the meaning of the sinister coded message that he chalked up on the wall behind him?'

'PWC/KPMG/DTT/EY, beware!'

'The letters make no sense. Can they refer to our old adversary, Professor Moriarty?'

'I think not, Watson. The letters encrypt the names of the "Big Four" accountants, the partners of which are terrified of becoming as destitute as our Big Issue seller. As for Professor Moriarty, he long ago changed his name to "Dr Greenspan" and became Chairman of the Fed…'

In 2001, the accounting profession got a wake-up call. Arthur Andersen and many of its partners were ruined by the firm's attempts to help ease Enron through escape hatches in accounting principles when preparing its accounts, leading to a $66 billion collapse in the market value of Enron shares. The remaining 'Big Four', terrified of the same fate, will therefore now resist any attempts by its clients, regulators, other government agencies or the Fed to 'go easy' this time round in marking to market their clients' exotic investments under FAS 157.2.

Quarterly Nº 48 (February 2008)

'But – *Bolivia?*'

What sort of world are we living in, when Bolivia can borrow for ten years at a mere 4.75% and Indonesia at 3.3%?

An over-eager appetite for risk, a lack of discrimination in investing, and compression of yields into an unhelpfully narrow range are not new. Indeed, like most things in the financial markets, they tend to come in cycles. In the late nineteenth century an unfriendly critic wrote of the Scottish investment trust industry:

'The Scots, of all people in the world, are supposed to be best able to take care of themselves and their money. Whenever an honest penny can be earned, they will not be far to seek. And yet it has come to this with them, that they will face almost any risk for the sake of the difference between 4% at home and 4½% across the Atlantic.'

Between that time and this, the principles – lack of discrimination by investors and the compression of yields – remain the same, although there are differences in the detail. 4% at home? Those were the days. And 'across the Atlantic' is one thing, but – *Bolivia*?

Quarterly Nº 67 (March 2013)

A World Without Yield

It might be said that in a world without interest rates and with ever dwindling yields on traditional income-paying securities, both the bond and equity markets have become gigantic machines converting capital into income.

I say this because if I want income, I have to buy a bond or an equity share that produces it; and in today's markets I will almost certainly have to pay more for a stream of income than it is objectively worth. Therefore, I am exchanging pounds of capital I already possess for fewer pounds of income than I would have got in the past or might get in the future. In other words, because I need a particular kind of return categorised as 'income', I have to deploy my capital inefficiently. This problem, and the whole question of the too rigid division between capital and income in the minds of most investors, lies at the heart of the recent reassessment of Personal Assets' dividend policy.

Many of the ways of converting capital into income are obvious. I can buy investments which are wasting assets, such as annuities, bonds selling at above par, or mines coming towards the end of their productive lives (which were quite common investments when I first followed gold shares in the late 1970s). Or I can buy high-yielding investments which, although not wasting assets *per se*, have some of the same characteristics – say, shares in mature companies returning capital to their shareholders by overdistributing *via* dividends and/or share buybacks. But another way has appeared – quality stocks which offered a mix of income and capital growth but are now too dear to offer an adequate margin of safety.

Stocks in the last of these categories have moved from being what are known as 'GARP' stocks (Growth At a Reasonable Price) to what I would call 'GAWP' stocks (Growth At the Wrong Price), at the price of which one can only gawp while studiously refraining from buying. If I buy growth at the wrong price – for instance, by buying a stock on a yield of 3% when, in my opinion, it would be fairly valued on a yield of 4% – I am turning capital into income as surely as if I were to buy a gilt selling at above par, with the difference that I can't even amortise the implicit premium on the equity, although I can amortise the actual premium on the gilt.

Some may object and say value shouldn't be looked at in this way – that the same stock may at different times be dear when it yields 4% and cheap when it yields 3%, depending on the level of the market. This I deny. While it is true that sometimes the particular characteristics of an investment may be worth more to me than they are to you, this is because you and I may have different needs and wishes, and has nothing to do with the level of the market. Pope Benedict XVI during his reign spoke and wrote much about 'the tyranny of relativity'. Whether or not this is true of faith and morals, it is certainly true of investment, in which there are absolute truths and absolute values, and where relative market judgements are often more misleading than useful.

Quarterly Nº. 67 (March 2013)

QE and *Game of Thrones*

Has quantitative easing ("QE") impeded economic recovery? In a sort of *Game of Thrones* fantasy-land in which the magic fire of QE will hatch the dragons' eggs of growth, the Bank of England has tried to stoke up the economy with £375 billion of newly-minted money, or around 25% of UK GDP. Where has the money gone?

Even now, despite a modest economic recovery, you don't see much of it in higher real output, or in higher employment, or in higher real incomes – average real pay, according to the TUC late last year, has fallen by 7½% since 2008. How can you get strong and sustainable growth if real wages have fallen by such an unprecedented amount – not to mention zero yields on savings and slashed pension annuity rates, both of which have reduced real spending power across the economy as a whole?

Driving down yields on government bonds was expected to encourage investors, beginning with the banks, to seek out productive new investments offering higher returns. But they didn't. They used the cheap money to bid up the price of existing assets, like bonds, equities and property, just as I fear will inevitably happen with Mr Osborne's 'Help to Buy' scheme.

Quarterly Nº. 71 (February 2014)

Negative Interest Rates

The world has turned topsy-turvy and negative interest rates are straight out of *Alice in Wonderland*. We expect to be paid for lending, just as we expect to be paid for working. It's part of the natural order of things. We don't expect to have to pay people to use our money for their own profit.

True, there have been times when, in reality if not in appearance, we've had to pay to be allowed to lend. Much of the 1970s, the decade in which I entered the world of investment trusts, saw high nominal interest rates but even higher inflation. This meant that real interest rates were negative. For instance, at the end of 1974 the Bank of England's Minimum Lending Rate ("MLR") was 11½%. If you had lent someone £100 for twelve months at that rate, you'd have got £111.50 back before tax. But given that the Retail Price Index at the end of December 1975 was up by 24.9% year on year, your £111.50 would by then have been worth a mere £89.27 in December 1974 terms and lending the money for a year would have cost you £10.73, plus the income tax on your interest.

That would have been painful enough, but now we're being asked not only to pay to lend but also to be seen to do so. We are starting to experience a world of negative nominal interest rates – something we'd previously thought of only as a weird anomaly in a particular time and place, like Switzerland in 1979. But such weirdness is rapidly becoming an everyday state of affairs.

Quarterly N^{o.} 75 (February 2015)

What Moves the Market?

'In his first week as Prime Minister Mr Corbyn is scheduled to have talks in Washington with President Trump and in Paris with President Le Pen before flying to Dublin to try to settle the details of Ireland's humiliating €13 billion bail-out of the UK, which is to be funded by Apple's EU imposed tax settlement. The terms of the Irish loan include a commitment by the UK to join the lengthening list of countries introducing capital controls . . . '

Well, it seems that anything can happen nowadays. Brexit took me by surprise. Like most people, I had expected the Remainers to win. But Lord Melbourne's observation on the passage of the Catholic Emancipation Act in 1829 shows how history can repeat itself:

'What all the wise men promised has not happened, and what all the damned fools said would happen has come to pass.'

Was Michael Gove on to something when he suggested that the British people had had enough of experts? Distrust of *bien-pensants* and the *cognoscenti* may be one of our national traits. (Note that we have had to borrow the words from foreign languages, since no English terms properly express their meaning.) And Lord Salisbury, as eminent and as quotable a Prime Minister as Lord Melbourne, had arrived at the same conclusion when he wrote in 1877:

'No lesson seems to be so deeply inculcated by the experience of life as that you should never trust experts. If you believe doctors, nothing is wholesome: if you believe the theologians, nothing is innocent: if you believe the soldiers, nothing is safe. They all require their strong wine diluted by a very large admixture of . . . common sense.'

In short, Michael Gove, Lord Melbourne and Lord Salisbury agree in pointing out that John Bull can be unpredictable when he wants to be. And if I was unprepared for Brexit, I was even less prepared for all the political shenanigans that followed – weeks of ever more sensational headlines suggesting that not only the Conservatives but also Labour and perhaps the British political party system itself would implode.

Fortunately, such shenanigans need not much concern us. Most people would be surprised if they knew by how little the stock market is affected by purely political news. Elections come and elections go, but it's the economy, and the markets which reflect it, that go on for ever. With a few notable and mostly tax-related exceptions like Gordon Brown's short-sighted and disastrous raid on the pension funds in 1997, the damage even the most meddlesome of politicians can do is blessedly limited.

One of the reasons I came into the business was curiosity about what moved the market. Again and again I would hear or read in the daily stock market reports that shares in London had (say) fallen because of riots in Ecuador or risen because of peace talks in Yemen. I found such explanations unconvincing at the time, and I soon discovered that they seldom came anywhere close to the truth. They were just well-meant attempts to explain complicated happenings in the context of the day's news headlines.

In my time I've seen the stock market compared to anything from a mettlesome stallion to a hyperactive child. How might we personify it today? Given all its unpredictability and capriciousness, perhaps as Boris Johnson. Certainly his namesake, Edward Crosby Johnson II, founder of Fidelity Investments, summed things up accurately half a century ago when he described the market as 'endlessly fascinating, endlessly complex, always changing, always mystifying'.

Quarterly N^o. 81 (September 2016)

Bin Ends

Ian's loathing of Gordon Brown was such that in Quarterly N^o. 40 it led him to ruin one of my most cherished literary flourishes. I had referred to the preposterous figure of Trimalchio in Petronius Arbiter's *Satyricon* as 'a sort of combination of Billy Bunter, Michael Barrymore and Silvio Berlusconi'. Though I say it myself, this was a pretty good description. Ian, however, on this occasion completely missed the point and browbeat me into substituting the name of Gordon Brown for that of Silvio Berlusconi. I still regret this, since not only was Gordon Brown as unlike Trimalchio as it is possible for anyone to be, but also Silvio Berlusconi succeeded in clinging to the headlines more successfully and for longer than either Gordon Brown or Michael Barrymore.

Introduction to '60 Not Out', a book of collected Quarterlies N^o. 26-60, pub. 2011

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).

Quarterly N^o. 36 (April 2005)

You will be relieved to hear that Alan Greenspan and Gordon Brown are getting a rest in this Quarterly. However, I can't resist quoting in a footnote the perfect song for Gordon Brown to sing when he takes over from Tony Blair:

'The last man nearly ruined this place,
He didn't know what to do with it;
If you think this country's bad off now –
Just wait till I get through with it!
The country's taxes must be fixed,
And I know what to do with it;
If you think you're paying too much now –
Just wait till I get through with it!'

The Marx Brothers, *Duck Soup* (1933)

Quarterly N^o. 37 (May 2005)

I cannot understand the awe and esteem in which some people hold Gordon Brown. However good, sincere and well-meaning he may be (and I genuinely believe that he is all these things) he has proved himself to be maddeningly obtuse and a slave to complexity and obfuscation, although this is disguised by his *persona* as a canny Scottish bank manager from one of the early, cosy episodes of *Dr Finlay's Casebook*. (I sometimes wonder how Mr Brown would have got on had he been exactly the same man in every way, but had spoken Estuary English rather than had an educated Scots accent.)

It is a telling comment on Mr Brown's way of doing things that *Tolley's Tax Guide*, 4,555 pages long in 1997, has now more than doubled in size to weigh in at 9,806 pages. As for his self-advertised 'prudence', he is in fiscal terms about as prudent as Imelda Marcos in a shoe shop. He is a kind of reincarnation of Mrs Vivian Nicholson of Castleford in Yorkshire, who in 1961 won the football pools and then famously announced that she and her husband, Keith, were going to:

'Spend! Spend! Spend!'

Quarterly N°. 45 (May 2007)

The words 'responsible', 'borrowing' and 'Gordon Brown' do not, in our view, fit well together.

Quarterly N°. 51 (December 2008)

Also questioned was Personal Assets' lack of exposure to emerging markets and to the so-called 'BRIC' countries (Brazil, Russia, India, China). The Chairman mentioned the latest acronym, 'MINT' (Mexico, Indonesia, Nigeria, Turkey), and noted that the economies, currencies and stock market performance of those countries had deteriorated since the acronym was first coined. Personal Assets, he promised, would never be 'all things to all people'.

Speaking for myself, I expect such acronyms to proliferate. Might we see 'GAMBLE' (Gambia, Albania, Moldova, Burundi, Laos, Eritrea) and 'LOTTERY' (Lesotho, Oman, Togo, Tonga, Ecuador, Rwanda, Yemen)? Personal Assets' equity investments will continue to be in the developed markets we know and where we benefit from management access, higher standards of law and accountancy, political stability and generally better corporate governance.

Quarterly N°. 71 (February 2014)

What has happened? It's very simple, really. If nobody wants to borrow money, nobody will pay money for the privilege and so the price of money will remain low. Today we're in a world still awash with money but sadly short of growth.

Quarterly N°. 75 (February 2015)

We find ourselves stuck in a barren wasteland which promises us either very low or negative returns in the future. Oscar Wilde famously described a cynic as someone who knows the price of everything and the value of nothing. I wonder if today's definition of a cynic, at least in the world of investment, might be someone who knows the value of everything and therefore can't believe the prices?

Quarterly N°. 75 (February 2015)

I had an ill-founded opinion, decades ago, that low interest rates would always be a Good Thing. I supposed then that a low interest rate economy would be by definition efficient and growth-oriented, and I didn't even try to imagine a zero interest rate economy because it would have seemed an absurdity. I never envisaged what, when it actually happened, a zero interest rate world would prove most accurately to resemble – a gigantic, squelching bog like the Grimpen Mire in *The Hound of the Baskervilles*, swallowing up everything and giving up nothing.

Quarterly N°. 78 (November 2015)

Capital Gains Tax

A Particularly Nasty Tax

Which Prime Minister penned the following plea to which Chancellor of the Exchequer?

'I am sure there should be something in the nature of a capital gains tax. This may not be a good tax technically and it might not bring in much revenue if Stock Exchange prices become steadier. But that would not matter in itself. The tax would show our intention to be politically just, and would be a form of insurance that all sections of the community would have to play their part.'

Clement Attlee to Hugh Dalton? Or Harold Wilson to Denis ('tax the rich until the pips squeak') Healey? No, it was Sir Anthony Eden to Richard Austen ('Rab') Butler, in September 1955.

Earlier, Eden had noted in his diary,

'Cabinet [discussion] *on economic situation went well, but was disappointed to find how little* [Rab Butler] *was able to suggest in the way of action in respect of capital gains or dividends to balance the demands he is making on others. I have no sympathy for* [Sir Charles] *Clore and his ilk and would like to hit them hard.'*

Eden's proposal came to nothing, but the idea stayed on the table and was acted on seven years later by Harold Macmillan as Prime Minister and Selwyn Lloyd as his Chancellor of the Exchequer. Macmillan had all the charm and guile of a rascally Venetian Doge; principle was not his strong point. Compared to him, David Cameron was (as Carlyle dubbed Robespierre) a 'sea-green incorruptible'. As for Selwyn Lloyd, although his career ended well as Speaker of the House of Commons he was a hapless figure, described by Rab Butler as 'far from first class, and was lucky to get where he did' – Foreign Secretary at the time of Suez and then, as Chancellor, the author of the 'Pay Pause' in 1961. He introduced the first Capital Gains Tax ("CGT") as part of his deflationary 1962 Budget. To quote Harold Macmillan's biographer:

'The most striking measure was the introduction, by a Conservative government, of Capital Gains Tax (Macmillan would have preferred calling it 'Tax on Short-Term Speculative Profits'), which has stuck ever since.'

Short-term capital gains (defined as gains made and realised within six months) were to be taxed at the same rate as income tax and, if applicable, surtax. Income tax was 8s 3d in the pound (41¼%) at the standard rate. Surtax was chargeable on incomes above £2,000, rising through nine different rates from 10% up to 50% on income of £15,000 and over, thereby giving a total top rate of 91¼%.

This tax on short-term 'speculative' gains had been mooted as part of Selwyn Lloyd's July 1961 package of panic measures. Later, it moved up the agenda as a way of bribing the trade unions, who had been made to suffer Lloyd's 'Pay Pause'. The Chairman of the Stock Exchange having protested in vain, Lord Cromer, the Governor of the Bank of England, wrote a prophetic letter to Lloyd in December 1961, arguing that what was intended merely as a tax on speculation would inevitably become a much wider tax on all capital gains.

'I deplore, as much as you do, the spivish sort of society which has been created in this country as the result of the excessively high rate of income and surtax. It is because of this excessively high personal taxation that such a high premium has been put on . . . speculation . . . What you are now suggesting will merely aggravate further without removing the cause which stimulates recourse to this form of defence against Government oppression. What is even worse is that you are creating a precedent that future Governments will quote when they extend your measures to all capital gains, as they inevitably will. I would question whether you realise the degree of disillusionment and bitterness that during the long years of Conservative rule no real move has been made to reward effort and discourage mere opportunism.'

Lord Cromer was right, as James Callaghan's 1965 Budget showed. This, among other unpleasant reforms, did indeed impose CGT on all capital gains.

We seem to be stuck for the foreseeable future with this wretched tax. What is wrong with it? I have already mentioned its complexity, and it will be seen from the arguments Eden, Macmillan, etc, used in its favour that it began life not only as an interventionist experiment in social and economic engineering but also as a sort of 'social justice' or 'envy' tax, to convince the trade unions that 'the rich' were bearing their share of the nation's burdens. (Bearing them, of course, in addition to the existing 91¼% top rate of income tax and surtax combined, which was apparently not enough.)

However, there is much more to object to about CGT than that.

- It is unjust.
- It distorts the allocation of savings and investment.
- It yields little and, while paid by few, affects many people.
- It encourages individuals to speculate on rising house prices.

CGT Is Unjust

There is a fallacy in the minds of many people that income and capital are two distinct *'pots'* which bear no relationship to each other. Income is earned, whereas capital is either inherited ('theft from the people', as some socialists would say) or acquired by luck, deviousness or fraud. This, of course, is pernicious nonsense. Most people's capital is accumulated wholly or mainly out of their income, and this income has already been taxed.

CGT is double taxation, like Inheritance Tax ("IHT") and tax on investment income. If I were devising a new tax system (as Chancellor of an independent Scotland, say), I would decree that once income had passed through the 'toll-gate' of Income Tax, any of its subsequent fruits, whether as investment income or capital gain, would be outside the tax net.

CGT Distorts Investment

If one set out to devise a tax that would encourage maximum inefficiency in the use of wealth while discouraging individuals from investing in equities, a more effective one than CGT could scarcely be imagined.

Let's suppose that I have a holding worth £100,000 in a company I now regard as being less well managed than it should be, and therefore no longer the best home for my savings. The instinctive, and best, response would be to sell it. But suppose that I, being a long-term, supportive investor, have held it for ten years and have made a taxable gain on it of £50,000. Now, the complexity of CGT is fiendish. Never content to leave well alone, Gordon Brown as from 5 April 1998 replaced indexation with Taper Relief. This means that the percentage of a gain charged at 40% declines over time. After an initial three year holding period during which a realised gain is taxed at 40% on 100% of the gain, the tax payable falls to 40% on 60% of the gain after ten years. Thus I would be liable to pay £12,000 of CGT on my shares (£50,000 multiplied by 60%, taxed at 40%).

Do I resign myself to stumping up this £12,000? Human nature being what it is, it's more likely that I'll make the right tax decision but the wrong investment decision. I'll hang on to the shares and see them underperform. Because of CGT, private individuals cannot sell and reinvest efficiently; they miss out on the fruits of their thrift; and over the long term they are increasingly deterred from investing in equities at all.

CGT Yields Little

CGT is even less important as a percentage of the UK's tax receipts than the similarly unpopular IHT. In 2005/06, out of a total tax 'take' of £398 billion, CGT brought in £3.0 billion compared to IHT's £3.3 billion.

How many people actually pay CGT? The most recent figures from HM Revenue & Customs cover tax year 2003/04, during which 28.5 million people paid Income Tax and only 160,000, or 5.6% of Income Tax payers, paid CGT. (The number paying IHT was lower still, at 30,000.)

If the proceeds from CGT, and the numbers paying it, are laughably small, why do I argue that it affects very large numbers of people? It is because it acts as a formidable deterrent to otherwise desirable investment activity. Hundreds of thousands of people, I believe, are hampered by CGT in this way – many, many more than actually pay the tax.

CGT Distorts House Prices

The way people now accumulate capital is all too often not by investing in equities, but by borrowing as much as possible to buy bigger and more expensive houses. Lenders are shovelling fuel on the flames. Abbey National today offers mortgages of five times salary. The mortgage lending arm of Morgan Stanley lends up to seven times. Ever-rising house prices are an insidious evil. A nation is no better off in aggregate from the doubling of the paper value of its housing stock. This only impoverishes those who are unfortunate enough to have to borrow ever greater amounts to acquire somewhere to live. When gains made on the sale of one's principal residence were exempted from tax, it was never envisaged that people would use their main residence as an investment vehicle. Yet this is exactly what has happened.

It cannot be healthy for the economic future of the UK, or for the financial future of millions of people, to be so bound up with highly leveraged second-hand bricks and mortar. The best solution would be to abolish CGT altogether. As I wrote earlier, it would cost a mere £3 billion, out of some £400 billion. The reward would be a saner housing market and much greater efficiency for private individuals in planning their future – something that should please a wise Chancellor. So, in a Cameron government, might George Osborne consider it? You may recall his inspiring declaration of Conservative principles last month:

'To those who still want us to make up-front tax cuts now, we say: we will not back down.'

I am not holding my breath.

[Note: CGT rates have changed considerably since this was written, but the basic problems remain.]

Quarterly No. 43 (November 2006)

Codifying the Rules

Ten Rules for Investment

Judging by the number of books sold on the subject and the number of column inches devoted to investment guidelines and 'do's and don'ts' in the weekend papers and in financial magazines, everybody must be looking for investment rules.

I'm not surprised. Rules are wonderful things. They save you from thinking and they absolve you from blame. 'I was only obeying orders' may cut little ice at a war crimes trial, but in the realm of investment it is much more comforting to be able to blame someone else – the framer of those investment rules – when things go wrong and the expected profits do not materialise.

Well, the lovers of ready-made investment rules are about to get their chance. Or perhaps not. You see, Ian Rushbrook was recently asked by a well-known financial journalist and author to reveal his investment secrets – the rules he followed when managing money.

At first Ian denied that he had any such rules or secrets, being sceptical of things suggestive of 'black boxes' and believing that investment principles could not be codified. Later, however, he relented sufficiently to set down ten basic rules for equity investment and asked me to write them up for him.

To begin with I was tempted to call these 'Ian's Ten Commandments', but on reflection I decided not to do so. This is because they are not commandments, just observations – distillations from experience.

Nor, by the way, need there have been ten of them. The number ten just has a neatness and familiarity which tends to make one's mind work in that way. Otherwise there could as easily have been 11 or 13.

And if Ian's investment rules are 'laws', they are laws only in the descriptive, not the prescriptive, sense. The distinction is a vital one. Prescriptive laws are laid down by someone for others to obey, which is why they are also called 'command laws'. An example might be the speed limit on motorways. This is 70 mph because Parliament has so decided. But there is nothing sacred about the 70 mph figure. Parliament is at liberty to change it to 60 mph or 80 mph, or even to do away with speed limits altogether.

Descriptive laws are quite different. They explain how things work in the natural world. An obvious example is the Law of Gravity. This 'law' cannot be disobeyed. Nor can it be repealed or modified or replaced. It is not really a 'law' at all. It is just a description of how things are.

The ten 'laws' which follow are therefore not really laws. They are more a set of descriptions of how things are – or rather, of how things tend to be. And the ten laws, or rules, were very much a quick, off-the-cuff response on Ian's part. As he himself said to the author who approached him,

'There are no rules – just obvious guidelines that are difficult to remember when talking to a persuasive broker. And even guidelines are made to be broken!'

The Rules Explained

1. Only invest in companies with growth in revenues per share and avoid companies that 'grow' by acquisition.

The Chairmen and Chief Executives of companies often see the growth of their empire as being a virtue in itself.

So did Napoleon and Hitler.

Mere growth in size is of no benefit to shareholders. What is of importance to them is not the total value of a company, but the value of each of the company's shares. And the value of the shares is determined not by the size of the company as a whole but by revenues, earnings and dividends per share, and their rate of growth. Unless a measure of corporate growth has the words 'per share' attached to it, use it with caution.

2. Avoid highly geared companies like the plague – debt is crippling to management flexibility and corporate growth.

This is counter-intuitive. Equity investors are always inclined to believe that gearing is good, and the more gearing the better. Yet the financial scrap-heap is littered with companies which borrowed too much and came unstuck.

In running a company, the interests of the shareholders should always be paramount. But if a company is highly geared, this cannot be the case. The interests of the creditors will be paramount. And it isn't good to rank second in a Board's order of priorities.

3. Only invest in companies with an attractive return on total capital employed as opposed to simply a high return on equity, achieved through the use of debt.

What is equity? It can be a factory or a portfolio of securities, an idea or a roomful of people. It depends on the nature of the business.

Return on equity ("ROE") by itself, therefore, doesn't necessarily mean very much. Indeed, I've known companies with negative equity, their total capital employed being less than their borrowings. This of course – assuming the company makes any profit at all – produces an infinite ROE.

Return on total capital employed gives a much better measure of the intrinsic profitability of a business than does ROE.

4. The market does 95% of the work for you – your problem is not to duplicate research but to identify errors of logic in company valuations.

Of the most frightful 'dogs' the stock market offered when I was a young investment management apprentice, perhaps the doggiest of all were the banks. In the high-inflation 1970s and early 1980s they were a byword for unattractiveness as investments. Yet over the last five years the banks have rocketed in price and our investments in them have made millions for shareholders.

This was not because the major broking analysts were not analysing them properly. It was because most investors had failed to spot how attractive the banks had become in the new, low-inflation environment.

As regular readers of these Quarterlies will know, Ian and I are sceptical about the idea of macroeconomic 'new paradigms'. However, sometimes 'new paradigms' for individual companies and sectors really can emerge. Helping to spot them is an important part of a fund manager's job.

[Oh dear. As we later discovered to our cost, banks can turn very sour too . . .]

5. Against the market at any point in time, that which looks statistically cheap is probably dear and vice versa. This is caused by insiders driving share prices in the short term.

This could be summed up as:

'Generally speaking, the market knows more than you do.'

It could also be summed up as:

'There is usually a good reason for apparent anomalies.'

These are important insights. So the wise fund manager examines every apparent anomaly in stock market pricing very closely indeed, to discover the reason for it. Very, very occasionally there will not be a reason for it, or the reason will be inadequate. Then, and only then, the anomaly becomes an opportunity.

6. Only invest in companies where you would be prepared to work for the chief executive.

There is a problem here. I really can't imagine Ian being prepared to work for anyone – let alone the type of person likely to be chief executive of a company!

In saying this, however, Ian was envisaging himself as a young man, keen to make his way in life. Did the chief executive come across (in person or from coverage in the media) as someone such a young man would gladly follow? Could he or she articulate a sound strategy? Had he or she the charisma to imbue the company with a sense of purpose and excitement?

7. If you don't understand the product or service – don't invest in the company.

This would have served me well over the last year or eighteen months, since it would have debarred me from investing in any internet or technology companies!

It would seem to be such common sense that it hardly needs saying. But remember that at the time of the South Sea Bubble in 1720 a company was successfully promoted 'For an Undertaking which shall in due time be revealed' – and remember also that human nature does not change.

8. Working full-time in investment you will probably see only two to three outstanding investment opportunities in a year – be prepared to wait for them.

In D H Lawrence's short story *The Rocking Horse Winner* a boy who rides a haunted rocking horse can sometimes see which horse will win a real race the next day. One insight makes the story an investment classic. When the boy feels under intolerable pressure to spot a winner (the family fortunes need restoring) he finds himself unable to 'know' which horse will win, and if he bets on this inadequate basis (a helpful gardener places his bets for him) he loses his money. Only when the boy really *'knows'* – when he feels absolutely sure – does he win. This is a useful model for a fund manager to follow.

(That the boy eventually dies after foreseeing the result which will bring him his greatest *coup* need not discourage us.)

9. Minimise portfolio turnover.

This rule supplements the previous one.

'If there is nothing worth doing, it's worth doing nothing.'

Turnover costs money, dissipates effort and hampers independent thought. Young or insecure fund managers easily fall into the habit of ingratiating themselves with the brokers who 'phone daily with 'helpful' suggestions. Surely such attention needs rewarding? And of course those cherished tickets to Wimbledon or Twickenham go to the most profitable clients, rather than to the wisest ones.

Keeping stockbrokers happy is not a priority for shareholders. Good performance and minimising portfolio risk are what matter.

10. Entertain your broker at your expense rather than his – this will improve his advice dramatically.

At lunch or dinner, the host has the upper hand. It is much easier to refuse someone something while he is swilling your brandy than while you are swilling his. And if what you refuse is a dubious underwriting or just a not particularly interesting share tip, your shareholders benefit.

A fund manager who is entertained to lunch or dinner often feels duty bound to pay for it by placing an order. But we can afford our own lunches, so we prefer to keep investment objectivity by paying for them ourselves.

Quarterly No. 22 (August 2001)

Ten Common Misconceptions

It's time for another investment 'ten'. There are some great investment misconceptions and ten of them are listed here. Some you'll have seen mentioned in past Quarterlies, but all of them bear repetition.

1. The point of investing is to beat an index.

If you spent all your time reading investment company reports you might be forgiven for thinking that the point of investing was to beat an index. Nearly every investment fund has a benchmark or comparator (even Personal Assets, although we'd be happy not to) and funds' own reports often focus on performance relative to their benchmark.

But to quote Bobby White, formerly Chairman of Personal Assets:

'Good relative performance does not necessarily buy the groceries.'

If a fund sets out to preserve the value of capital and then, if possible, to make it grow, an investor would have every excuse for being as sick as the proverbial parrot if the All-Share fell by 30% and the fund's net asset value fell by only 25%. It should have been able to protect its shareholders' funds better than that even from the investment equivalent of Hurricane Irma.

The all-important criterion for judging the performance of an investment fund is whether it does what it says on the tin. Read the writing on the tin first, and if it accords with what you're aiming for, then that's a reason for buying it. Thereafter, judge it on the extent to which it keeps its promises.

Even good performance in the absolute (as opposed to against a benchmark) doesn't excuse everything. If I entrusted some of my 'sacred savings' to an investment adviser who promised to invest it conservatively but instead put it on a horse which romped home at 50-1 in the 3.30 at Chepstow, I might buy her a case of champagne to celebrate but I'd still give her the sack as my financial adviser, because she hadn't done what she had promised. Never forget that a result by itself tells us nothing about how it was achieved. It might have been through careful, steady investment or wild, reckless plunges. As well as knowing where we are we also must understand how we got there.

2. The point of investing is to beat your competitors.

The second of my great investment lies is closely related to the first. The competitive spirit is in all of us, and we easily fall into the language of sport (indeed, I've just done so). My toes still curl when I remember how, nearly 30 years ago, I hypothesised in an investment trust annual about a 'Management Olympics' for investment managers. So forget all those metaphors about races. If an investment fund does what it says on the tin, that's what matters. If it delivers more than it promises, then that's fine – but not if the fund, in attempting to over-deliver, takes more risks than it said it would.

3. The point of investing is to make your money grow as much as possible.

No, it isn't. Risk comes into it too. Every investor has a different degree of tolerance of risk, and a level of risk which one investor would be happy to accept would be much too great for another.

To investors who value stability and try to reduce worry to a minimum, Personal Assets offers low price volatility. Every year in our Report & Accounts we show a chart of share price performance against share price volatility. This shows investors not only how our share price has performed, but also how smooth a ride it has been. We may not be among the trusts which travel the farthest, but we do (we believe) offer a less bumpy ride.

4. Total return is the only fair way of measuring performance.

Total return is one valid way of measuring performance, but it's less useful to private investors than to institutional investors. Private investors are not homogeneous. They have very different aims, tolerances of risk and tax positions. Therefore the total return I get from a particular investment may be different from the total return you receive from exactly the same investment, or which I would receive if I held the investment in an ISA.

Let's say I hold the investment in an ISA because I want to accumulate capital by reinvesting dividends free of tax. Total return in those circumstances is a useful measure. But suppose that I hold an investment because I want to live off the income from it without touching the capital. Total return is of no interest to me then. What I want to know is how big, safe and fast-growing the stream of dividends is. Total return would be the universally best measure of performance only if all investors held their investments for exactly the same reasons. But they don't.

5. Past performance is no guide to the future.

To adapt the old chestnut, there are three great lies in life: the cheque is in the post;

I'm from the Government and I'm here to help you; and past performance is no guide to the future. A moment's thought shows you how silly the last statement is. Were it true, we could abolish examinations, CVs, references and almost every other means of distinguishing among the options open to us.

Past performance is not a perfect guide to the future, but it's the only one we've got and it can give us useful information. Do we want to invest in small companies? Then we go for proven small company managers. Do we want yield? Then we go for income managers with good track records. And so on.

6. The unforgivable risk for an equity investor is to be out of the market.

While there are circumstances in which this is true (fund managers who promise to be fully invested in equities at all times have a fiduciary duty to keep that promise), equity fund managers not compelled to be 100% in equities at all times can and should use their discretion. This is what they are paid for, and they shouldn't hide behind a non-existent policy restriction.

7. To hold cash is an admission of failure.

Our industry hates holding cash, especially now that it's all but impossible to earn any interest on it. It's regarded as a failure of imagination and a waste of the fees investors are paying. But at times it's right to hold cash, for without it we couldn't do what we hope eventually to be able to do – buy bargains when these at last appear. We hold cash not only to reduce risk but also to ensure that it'll be there when we need it.

8. Never be forced to pay CGT.

A major advantage of investment trust status is that investment trusts are exempt from Capital Gains Tax ("CGT") on gains realised within their portfolios. This is more tax-efficient than if a private investor managed the same portfolio in the same way. (Gains realised on the disposal of investment trust shares are of course subject to CGT at the normal rate.)

While CGT may not be as grim a levy as it was between 1988 and 2008, when a higher rate taxpayer was liable to pay it at the rate of 40%, even paying it at the current rate of 20% for higher rate taxpayers still goes against the grain. Sometimes, however, it's better to pay it and sacrifice a portion of your capital gain in order to secure the rest. Purely tax-driven investment decisions are best avoided.

9. Gold, being sterile, is not a proper investment.

Ian Rushbrook would never hold gold, for this very reason. And he wasn't alone. Lots of able investment managers I have known held the same view, even if a few of them may have accumulated Krugerrands on the sly. Yes, gold is sterile. It pays no dividends but costs money to keep safe, and – in short – it's easy to see why it's been called a 'barbarous relic'.

But we don't see it that way. Gold can do a job for us, and as long as it does we're prepared to hold it.

10. Capital is capital, and income is income, and never the twain shall meet.

Is this a great investment misconception? You'd think that someone who regularly questions the usefulness of the total return approach to measuring investment performance would deplore any blurring of the lines between capital and income.

Far from it. Sometimes it makes good sense. As a recent example, we began drawing on realised capital profits to maintain the level of our dividend. Our reason for so doing is that it's more conservative to realise a small portion of high quality investment profit than to switch into lower quality, higher-yielding stocks. Counter-intuitive though it may be, sometimes being prepared to dip into capital for living expenses rather than reduce the quality of the portfolio can be what true total return investing means.

Quarterly N°. 85 (September 2017)

‘Καὶ ἦν ἤδη ἐγγὺς ἡλίου δυσμῶν’

Fear not. There has been no computer malfunction. The quotation is from the original Greek of Plato’s *Phædo*, the dialogue in which he describes the death of Socrates, and may be translated as ‘and the sun was already beginning to set’. As a schoolboy I thought the words so haunting and beautiful that I vowed to quote them if ever I had to write a letter of farewell. This Quarterly is not exactly a farewell, and my colleagues and friends assure me that my sun need not set for some time to come. But although my classical quotations, while delighting some, infuriate others, I hope that on this occasion even readers in the latter category will forgive me for keeping the vow I made to myself over half a century ago.

Learning from Experience

What follows is yet another investment ‘ten’ – some insights into the process of investment which I’ve gained in the course of my working life. Acquiring them has been at times fun and at other times painful, but I hope they may be useful to those who come after me. I’ve attempted similar such lists of insights in Quarterlies before, but they were written from the point of view of someone involved in the investment management process and attempting to choose among individual companies in Personal Assets’ universe. Here, however, I write purely as a private investor who invests mainly in investment trusts, and outline what I believe are the principles private investors would be well advised to adopt as regards their invested capital.

NOT the Ten Commandments

As I’ve said before, it’s hard to resist adopting the artificial neatness of ten numbered points,. But those which follow are not commandments in any sense. They are observations, hints and suggestions, nothing more.

1. Investment is not a hobby or a game. It’s grim reality.

Let me emphasise one thing above all others. While there is nothing wrong with having a flutter on a share you fancy with money you can afford to lose, and while those investors who are able to afford it will sometimes quite rightly set aside, say, up to 5% or 10% of their total capital for ‘a bit of fun’, investing is not a game or hobby, whatever the sporting metaphors beloved of investment commentators may lead you to suppose. It is grim reality. Lose at golf or drop out of a race and you may feel disappointed. Make the wrong investment decisions and lose some of what have aptly been called your ‘sacred savings’, and you may find yourself permanently poorer and your life choices will be fewer and less enjoyable.

2. Decide on your own definition of risk.

Lots of wealth managers and other investment advisers assign risk ratings to the funds they recommend. But there is no industry-wide consistency. What wealth managers Middling & Co call medium risk, their competitors Rash & Racy Ltd may consider low risk and Mess[rs] Scrooge McCanny high risk. What is an investor to make of it all?

My answer is that investors should decide on their own definition of risk, based on their financial aims and commitments, and rate potential investments accordingly. I know exactly what I mean by risk, and you’ll find the definition on page 6 of the 2020 Report & Accounts:

‘Our definition of “risk” is fundamentally different from that commonly used by other global investment trusts and the industry at large (ours being “risk of losing money” rather than “volatility of returns relative to an index”).’

3. Begin by setting out your objectives. Why, and to what end, are you investing?

Do you want to accumulate a pension pot large enough to live off in comfort? Lend a hand with grandchildren’s school fees?

Amass capital to leave to future generations? Or do you want to do more cannily out of savings what those selling equity release plans keep urging us to do with some of the equity in our houses – make home improvements, have special holidays or help your cash-strapped adult children?

4. The desired outcome should determine the investment method and timescale adopted.

People interested in investment often look at stocks, shares and investment funds through the wrong end of the telescope. They surf the internet and read the weekend papers and the investment magazines, identify investments that look attractive and then commit some of their 'sacred savings' to them. This is like going into a supermarket and filling your shopping trolley with miscellaneous items that take your fancy, overlooking the necessity for buying things you really need and have put on your list.

There's seldom any point in buying sober blue chips in the hope of making a quick turn, or buying so-called 'recovery stocks' (which all too often don't recover) and locking them away for 40 years. The first thing for investors to decide is what they want the outcome of their life of investing to be.

5. Find a manager you trust.

This is one of the hardest lessons to learn. Lots of people trusted Neil Woodford, and there was a huge amount of supporting evidence for their trust. But perhaps they didn't spot that Neil Woodford himself had changed and was doing things in a different way.

You can never take a manager's views for granted. Now that even Warren Buffett has started buying the gold shares he once despised, anything can happen.

Again and again we keep being reminded that 'past performance is not a guide to future performance'. Here, as I've done before, I want to issue a warning against what can sometimes be unduly cautious and even unhelpful advice from those who run and regulate the investment industry. Past performance is usually the only objective evidence we have. How can you judge managers without looking at their past record and giving consideration to how they coped with past crises and exploited past opportunities? Their record is their CV. Nobody would appoint someone to a job without studying one of those very carefully. Choosing a fund manager to look after some of your 'sacred savings' is no different.

6. Time permitting, READ. My preference is for journals like *The Economist* and the weekend *Financial Times*, rather than periodicals concentrating mainly on individual stocks.

On my first day as an investment apprentice at Baillie Gifford in October 1977 I was presented with a pile of books to read from the company library, including classics such as, *The Money Game* by 'Adam Smith'; *Do You Sincerely Want To Be Rich*, Charles Raw's examination of Bernie Cornfeld and Investors Overseas Services; and J K Galbraith's *The Great Crash*.

I was immediately hooked and I've been devouring investment books and journalism ever since. (Others would doubtless add webcasts and podcasts, but despite urgings from my colleagues I haven't got there yet.) It's rather like learning a new language or reading books on travel – it gives access to a whole new world in which you rapidly learn to feel at ease.

There's a wider aspect to this, too. So much has changed in the world in which we operate. One of the first things we turned to in the *Financial Times* in the 1970s was the column 'Men and Matters'. No-one would think of calling it that now. During my apprentice years oil was king and I enjoyed following oil companies. Today's reluctance to invest in fossil fuels never even remotely occurred to me then. Times change and we change with them. Indeed, sometimes we even help to bring about the changes ourselves.

It's vital for investors to keep abreast of social and other changes which may affect markets. Whatever one's political views or prejudices may be, such changes are objective facts and have to be incorporated into investors' thinking. For instance, there was a time not so long ago when I might have written off ESG (Environmental, Social and Governance) investing as a fad. How wrong I would have been. As Sebastian Lyon, our Investment Manager, wrote in his Troy Investment Report 65, ESG is here to stay and will be increasingly influential on investment decisions. Evidence also suggests that it, like gender diversity on Boards and within companies, can have a favourable impact on performance.

7. Use your common sense.

You can subcontract many things to an investment manager or adviser, but the one thing you must never subcontract is your common sense. I believe it's up to individuals to learn by experience, and as regards advertising and promotion I'm what might be called a 'full disclosure libertarian' – tell the customers everything, then leave them to make up their own minds.

There's no excuse for swallowing uncritically everything you read in the papers about potential investments. Nor is there any excuse for leaving common sense outside the broker's or IFA's door when seeking investment advice. As my father used to say to me in my boyhood days:

'God gave you a brain. Use it.'

Do you believe everything someone selling a car or a new kitchen tells you, if it seems contrary to common sense? Of course not. Why do it, if you're investing? And does it seem common sense to put all your 'life savings' (that tear-jerker of a phrase so beloved of the media) into one dubious investment?

Something curious seems to afflict people who are otherwise intelligent and sensible when they are exposed to the high pressure selling of investments. I don't know how many of you remember the Barlow Clowes affair in 1988, but around 18,000 customers, on the recommendation of intermediaries, invested their money in what was essentially a 'bond-washing' operation in which UK gilts were bought and sold in order to create tax advantages. I won't go into the scheme's investment flaws here, but perhaps it was the prominently displayed link with UK gilts that led investors to believe their money had been invested risk-free.

This caused me to write:

'Tell those eager buyers that water can go uphill, and they'd have laughed at you. Tell them you had a perpetual motion machine, and they'd have laughed at you. Tell them they could invest in gilts, pay a hefty management fee and still get a yield higher than that on the gilts themselves, and they chorused, 'Where do we sign?'

Yes, Peter Clowes, the malefactor-in-chief of the whole enterprise, should have been ashamed of himself for devising a fraudulent product that grew into a Ponzi scheme and he richly deserved the ten-year prison sentence he was given, although to the fury of his victims he served less than half of it. (Three years later, he was imprisoned again for the more downmarket crime of fraudulently claiming Jobseeker's Allowance.) But a few, at least, of the customers should have been ashamed of themselves for falling for it, and the intermediaries who sold it to them should have been ashamed of themselves for recommending it.

Lastly, learn from your mistakes. They can teach you a great deal – more, sometimes, than you can learn from your successes. Remember Marconi? Yes, I held it in one of those fortunately long forgotten investment products called a Single Company PEP, and failed to follow it as closely as I should have done because I remembered the cash mountain of GEC and was dazzled by the glamour of Marconi's name. And there was Royal Bank of Scotland, which I invested in because I worked for it after it took over NatWest and I got shares in it in exchange for my NatWest holding. I then participated in its Save As You Earn Scheme and bought yet more shares. Eventually I sold them for what I thought a rotten price, but after more than a decade it's never managed to climb back to anywhere near that price again. This taught me that even when you think it's too late to sell, it ain't necessarily so.

8. True and false diversification.

It is a truth universally acknowledged that diversification is a Good Thing. Spread the risk, and you diminish the risk. But the reverse may also be true. Spread the chances of reward, and you may diminish the reward. The ultimate diversified portfolio of UK listed stocks would be an index fund like the FTSE All-Share, and I've remarked earlier on the flaws of an investment in the All-Share.

This applies primarily to the underlying portfolio of stocks. The investor who invests mainly through investment trusts will usually be more interested in diversification by manager, which brings me back to the point about finding managers one can trust.

Beware of investing with lots of managers all doing more or less the same thing. The disappointing record of value investing might be a warning over the last few years.

9. Indices are a potentially harmful distraction.

I'm glad to say that Personal Assets is not, and never has been, in the business of trying to match or beat an index. Its aim for the last 30 years has been much more basic than that. It is to preserve and, if possible, increase the purchasing power of its shareholders' funds per share. For example, over the ten years to 30 April 2020 our share price rose by 4.1% per annum compound, whereas the FTSE All-Share over that period compounded at only 1.3%. Had Personal Assets merely matched the FTSE All-Share over that period our share price at 30 April 2020 would have been £329 rather than the £433 it reached in reality.

(Another change in today's investment world is that compound interest at yields of 1% or below is no longer the sure path to riches that once it was. But compounding still works its magic when a well-run company that's mindful of its shareholders' interests reinvests its growing profits.)

Indices are often skewed and unhelpful. They aim to measure how a market moves in its totality, even if there are some stocks and sectors included in that market that investors like ourselves either can't buy for reasons of illiquidity or wouldn't touch with the proverbial barge pole. I couldn't care less whether the money I originally invested in Personal Assets has beaten, matched or lagged an index. That wasn't my reason for investing in it. What I care about is that my money is as far as is humanly possible no more at risk than it was previously and has the same or greater purchasing power that it had at the time when I invested it.

Learn from those older and more experienced than yourself. When someone made an arcane observation about the economy or the market, Bobby White, Chairman of Personal Assets 1994-2009, would often comment dryly:

What's that got to do with the price of fish?'

I might ask a similar question about my invested capital. Will it buy me as much, or more, of the necessities (and pleasures) of life as it did before? If it does, my investment will have been a success. If it doesn't, there are, to say the least of it, questions the Board and investment manager must answer.

When a trust Director or Chairman says to me 'it's all about performance', a little bit of me dies inside. It's as inadequate as an approach to investment as using latitude without longitude would be as an approach to navigation. What it's 'all about' is performance *in the context of the degree of risk accepted in pursuing it*.

Veteran readers of these Quarterlies may remember that (like a surprisingly large number of shareholders in Personal Assets) I'm a long term holder of Scottish Mortgage. It's done me extremely well over the years and I'm more than grateful to James Anderson, Tom Slater and their colleagues, but sometimes it's been at the cost of some heart-stopping temporary dips. So be it. I know what I bought, I know why I continued to hold it and I'm fully aware of why I hold it still.

10. Total return is what counts – as an approach to investing, rather than measuring performance.

At the heart of common sense investing is an understanding of total return – the fairest, truest and most helpful way of making the most of one's sacred savings. Here readers may pause with disbelief, because I've often been dismissive of total return as a way of measuring a trust's performance compared to its peer group. But this is not the kind of total return I'm concerned with here. Performance tables shed little light on a trust's real progress, and while peer groups may be useful when discussing the performance of geographical or sector specialist trusts, trusts comparable to Personal Assets are few and far between and I prefer to think of it as being in a peer group of only one.

What I mean by the total return approach to investing is a recognition that capital and income are not irreconcilable opposites but are complementary elements or aspects of an investor's pool of useable assets. At different stages of life investors regard the pool differently. During early to middle adulthood the emphasis will be on accumulating capital by saving out of income, reinvesting dividends and accepting a degree of capital risk on the investment pool itself. As investors near retirement their appetite for capital risk is likely to diminish, and after retirement investors may decide that the time has come to start drawing on their capital.

Don't kill the goose that lays the golden eggs. Enjoy the eggs, while taking great care of the goose.

Quarterly No. 96 (September 2020)

Corporate Governance

Regulatory Irrelevancies

I believe private investors in the UK are often badly served, not only by those who manage their money but also sometimes even by the very regulators who are supposed to be trying to help them. To reassure my colleagues, I must make it plain that this and the next three paragraphs express only my own views, not those of the Board. But while people nowadays press for disclosure of everything down to the name of the office cat, I fear that the authorities' well-meant attempts to help private investors by greater disclosure may only confuse them further. Take, for example, some of what we must now include in the documentation for our ISAs and Investment Plans. It isn't that we've anything to hide. It's just that some of what is asked for is as impossible to answer as the old trick question, 'Have you stopped beating your wife yet?' For instance, how can we answer the compulsory question, 'What are the charges for?' in our ISA documentation when there are no charges?

I don't suppose many of our shareholders read a magazine called *Viz*, but sometimes copies of it drift into business offices along with the *Sun, Private Eye* or the *Church Times*. (Well, I read the *Church Times* in the office sometimes.) *Viz* features a cartoon character called 'Roger Irrelevant', who, if asked a question, replies with lots of impressive gobbledegook that is totally beside the point. Roger Irrelevant could easily be the Government's retail savings 'Tsar', responsible for a 'crackdown' on non-disclosure and for 'implementing a raft of tough new policies' on investor protection. (How's that for Blairspeak?) What else can account for the odd requests with which we have to comply? Since, for instance, Personal Assets offers only a £7,000 ISA invested in the trust's own shares, why does Roger Irrelevant make us spell out the following?

'An ISA can have three components: stocks and shares, cash, and life assurance. ISAs can be either "maxi" or "mini". The principal difference between them is that a "maxi" ISA allows you to subscribe up to the annual limit with a single manager, whereas you may subscribe to a "mini" ISA for each component with different managers. If you subscribe to a "mini" ISA you will not be able to open a "maxi" ISA for the same tax year. If you subscribe to a "maxi" ISA you will not be able to open another ISA (whether "maxi" or "mini") in the same tax year, although you may open a TESSA-only ISA from the proceeds of a matured TESSA.'

While all this is true as general information, it is utterly irrelevant to the Personal Assets ISA. Why, therefore, must it clutter up our ISA documentation? And on another matter, to do with Roger Irrelevant's assumption that everyone is a money-launderer unless proven innocent, a shareholder recently wrote to ask why we were being 'so bloody bureaucratic' in insisting that his wife could not open an ISA with a cheque drawn on his bank account. I telephoned him to say that I was entirely on his side and it made my blood boil too, but we had no choice. As far as Roger Irrelevant was concerned we had to assume that his wife was a criminal unless she convinced us otherwise.

Introduction to 1999 in Personal Assets Trust Quarterlies, The 1990s and Beyond

Why Reporting is Slower

Comparing our 1991 Annual Report with that for the year ended 30 April 2005, the first thing to notice is a big difference in size: the 1991 Report runs to only 24 pages, compared to 38 in 2005. Trees die that corporate governance may flourish. (Our Report is still concise as these things go. Foreign & Colonial's Annual Report for the year ended 31 December 2004 has 124 pages.)

A greater size, alas! means slower reporting. It was with some pride that the Chairman wrote in 1991:

'Timely information is of particular interest to private investors and you will see that we are publishing this Annual Report much earlier than is usual for an investment trust.

In future years we would hope to improve on this still further.'

Some hope. The authorities keep giving us more to do, so it takes ever more time both for us to compile the figures and for the auditors to audit them. In 1991 the Balance Sheet was signed on 17 May; in 2005 it was not signed until 23 May. There were five Notes to the Accounts in 1991 on just over two pages, compared to 20 on nine pages in 2005. The third page of Notes to the Accounts in 1991 also contained the Report of the Auditors, telling you everything you needed to know in six crisp lines. (We mischievously reproduced this in our 2003 Annual Report.) However, the cumbersome 2005 Directors' Responsibility Statement and Independent Auditors' Report (the very name is longer!), which weighs in at 973 words compared to 1991's 73, is full of new information you never suspected, like:

'The Directors are responsible for preparing the Annual Report, including the financial statements which are required to be prepared in accordance with applicable United Kingdom law and accounting standards.'

Well, what do you know?! I bet you thought the Annual Report was prepared by Heart of Midlothian Football Club in accordance with the laws of Outer Mongolia. I'm glad that's been cleared up.

Quarterly N^{o.} 39 (November 2005)

Annual Reports Expand

In times of boom or of recession, one thing can always be relied upon to grow – the amount of verbiage required by officialdom.

I am not prepared to sit counting up all the words in the 1991 Annual Report, the first that Ian Rushbrook and I compiled after Personal Assets became self-managed, so you will have to accept my assurance that it was a good deal briefer than the 1999 Annual Report, the earliest for which I can count the words electronically. But in the 1999 Annual Report there were 6,725 words, whereas in this year's Annual Report there are 21,872. That is nothing like 15,000 extra words of useful information. It is 15,000 extra words mostly of caveat, qualification, statement of the obvious and covering of the rear end.

If I had a criminal mind, I think I should find it much easier to conceal something in one of the Annual Reports of today than in one from 20 years ago, if only because Annual Reports then were short and succinct enough for shareholders to be able to read every word, whereas nowadays one gets utterly lost in the tangled thickets of Corporate Governance and Risk Management. Take this amazing revelation on page 43:

'The fair value of equity and other financial securities held in the Company's portfolio fluctuates with changes in market prices. Prices are themselves affected by movements in currencies and interest rates and by other financial issues including the market perception of future risks.'

Gosh! Isn't life full of surprises! Whoever would have thought it? Surely share prices depend on the Signs of the Zodiac or the phases of the moon?

I would like to show large tracts of the Annual Report in the smallest possible readable font size, perhaps like this:

I would like to show large tracts of the Annual Report in the smallest possible readable font size, perhaps like this.

This would show my contempt for it. Alas! I don't think I would be allowed to get away with it.

Quarterly N^{o.} 57 (June 2010)

'Fund Management Speak'

It is all too easy to lapse into the vacuities of 'fund management speak', a language with which readers of fund management advertisements and Annual Reports will be painfully familiar. Fund managers often extol their 'carefully selected portfolio of high quality stocks', but what does this actually mean? Except in the short-lived circumstances of a 'dash for trash', would any fund manager admit to having a carelessly selected portfolio of low quality stocks?

Politeness, lazy thinking and the need to emulate *Private Eye*'s fictional journalist 'Phil Space' cause people to say or write meaningless things. For a time, a company I worked for had a 'mission statement' printed on a little card which its employees were supposed to carry around as an inspiration for their daily work. I did so, but rather than using it as the company had intended I produced it every time I had to make a speech in public and read it out loud in order to ridicule it. One way of demonstrating how fatuous it was, was to put all its statements into the negative. 'We believe in recruiting people of excellence' or 'we believe in giving a first class service to our clients' may sound good, but 'we don't believe in recruiting people of excellence' or 'we don't believe in giving a first class service to our clients' sound so silly as to make one wonder if the original statements were worth making at all.

Quarterly N$^{o.}$ 61 (June 2011)

Platitudinous Verbiage

Recent developments in company reporting have failed to cheer me. My particular *bête noire* is the excruciating but mandatory note 13 on Financial Instruments, which I've only once seen surpassed as a series of statements of the obvious. This was in a book written by a former Professor of English at the University of St Andrews which had become something of a cult classic among his students when I was an undergraduate there. He had been a keen officer in the Royal Naval Volunteer Reserve and the book was entitled *A Glossary of Shakespeare's Sea and Naval Terms including Gunnery*. It contained definitions such as, 'sea: the continuous body of salt water that covers the greater part of the earth's surface' and 'water: the liquid of which seas, lakes, rivers are composed'.

Compared to this valuable information, one could almost welcome such platitudinous verbiage as I quoted earlier:

'The fair value of equity and other financial securities held in the Company's portfolio fluctuates with changes in market prices. Prices are themselves affected by movements in currencies and interest rates and by other financial issues including the market perception of future risks.'

Just as it is very easy to explain the self-explanatory and say at great length what should go without saying, it is very easy to add things and expand things but much harder to prune or discard things. Sometimes, too, the original reason for including something can be forgotten, as in the story of Catherine the Great of Russia (1729-96) and the first snowdrop that appeared in the gardens of her palace at St Petersburg. It so delighted her that she ordered a guard to be posted there to protect it from being plucked. Legend has it that by the time of the Russian Revolution in 1917 a guard was still posted day and night at that spot, although no-one could remember why.

Quarterly N$^{o.}$ 76 (June 2015)

Bin Ends

There are always going to be some knaves and fools on the Boards of public companies. Jabez Balfour, Clarence Hatry and Lord Kylsant have their heirs in every generation, just as do those weak fellow-directors who either connived at or failed to spot their malfeasances. These were once, however, regarded as being the exceptions. Now, in keeping with the brave new world of Blair and Blunkett, the principle is the same as it is in everything from money-laundering to airport security – guilty until proven innocent.

Quarterly N$^{o.}$ 33 (May 2004)

One of the Higgs Review's odder recommendations is that directors who have served on a Board for more than nine years from the date of their first election should cease to be considered as 'independent'. Mr Higgs' experience of life must differ from mine. There's someone I've worked closely with for 27 years, three times as long as Higgs' limit. Is she in my pocket?

No fear. I'm married to her, and she is my most unsparing critic. No fault of mine goes unnoted.

Quarterly No. 33 (May 2004)

Corporate governance by a multiplicity of committees, each spying on the next, brings to my mind the frantic scene of backstage mayhem in the Marx Brothers' *A Night at the Opera* where Herr Gottlieb is mistaken for Groucho and hit on the head with a frying pan by a detective, who is simultaneously hit on the head with another frying pan by Harpo – brilliant slapstick, but unhelpful as a model for corporate governance.

Quarterly No. 33 (May 2004)

I leave the last word on corporate governance to a man whose memory I treasure and who knew more than most about how companies (and countries) are run, Sir Denis Thatcher:

'I'm not very bright, you know. I just read the papers before the Board meeting, and the others usually don't. And I can add up.'

Quarterly No. 33 (May 2004)

Corporate governance is a fashionable topic these days. It suits the Blairite mood. More and more the *bien-pensants* of the City see it as an end in itself, the rights and wrongs of which are as self-evidently objective and immutable as the laws of physics. It is a pontificators' paradise for the political and financial chattering classes and a fertile breeding-ground for committees. Yet corporate governance surely should be only a means to an end – to ensure the best possible deal for shareholders. Everything proposed in the name of better corporate governance should be judged by whether it will put shareholders in a more favourable position than before.

Extract from Draft Paper
on Corporate Governance, 2006

And now, from the people who gave you such idiocies as straight bananas and the metric system, comes the EU's proposed AIFM Directive. Too blinkered or obtuse to recognise that the alleged problem was largely of their own making, the politicians are now determined to cover their own *derrières* in future by introducing 'one size fits all' legislation to regulate all investment companies regardless of their assets, domicile, size or venue for trading their shares.

Quarterly No. 55 (November 2009)

It is a staple of comedy shows such as *Yes, Minister* that when someone is asked an awkward question in an interview he replies through gritted teeth, 'I'm glad you asked me that.' This can also apply to AGMs.

Quarterly No. 62 (August 2011)

Annual Reports nowadays are drowning in a tsunami of well-meant verbiage. Recently a senior audit practitioner visited us to describe the glories of modern reporting. I told her that, despite the undoubtedly good intentions behind nearly four decades of tinkering, Annual Reports were less informative and useful to shareholders today than they were when I entered the investment trust world in 1977; and when she asked if she could quote me, I gave my permission with delight. Some sections of Annual Reports are now reminiscent of nothing so much as the scene in the Marx Brothers' *A Night at the Opera* in which Groucho, as Otis P Driftwood, tells Chico, as Fiorello:

'The first part of the party of the first part shall be known in this contract as the first part of the party of the first part shall be known in this contract – look, why should we quarrel about a thing like this? We'll take it right out, eh?'

Quarterly No. 74 (November 2014)

Discount and Premium Control

Discount Freedom Day

This year marks an important anniversary for Personal Assets. We have not sold at other than a nominal discount for ten years now – since the spring of 1995.

Between then and 1999 this was thanks to continuing healthy demand for new shares. Then came the magic date itself – 8 November 1999: Discount Freedom Day. Before 8 November 1999 investment companies had been permitted to buy in their own shares for cancellation, but only by using revenue reserves. This, however, was never popular. Revenue reserves are usually tiny in relation to a trust's share capital but, given the preference of many private investors for income, they are invaluable for smoothing dividends. Later, the custom grew up of resorting to the Courts to have certain reserves reclassified as distributable, so they could be used to buy back shares. We ourselves did this in April 1999. On Discount Freedom Day, however, an amendment to the rules relating to investment companies as set out in the Companies Act 1985 became effective, permitting an investment company to distribute realised capital profits by way of redemption or purchase of its own shares in accordance with section 160 or section 162 of the Companies Act 1985 without losing investment company status. This was the best thing to happen to the trust sector since 1979/80, when exchange controls were abandoned and CGT within trusts' portfolios abolished in the first year of Mrs Thatcher's rule.

Thus far, however, the new powers have not been fully exploited. Most trusts which have taken buy-back powers have used them only to buy in shares at as big a discount as possible, to increase the NAV per share. This is laudable enough, but misses the main point. The new powers do not just allow trusts to make enhancements to their NAV by buying back shares at a discount.

They make it possible to abolish the discount itself, and to ensure that the trust thereafter sells consistently at close to NAV.

John Bunyan's *The Pilgrim's Progress* (another investment classic which was not intended by its author to be one) recounts the sorry fate of 'The Man in the Iron Cage':

'[The Interpreter] *took* [Christian] *by the hand . . . and led him into a very dark room, where there sat a man in an iron cage. Now the man, to look on, seemed very sad; he sat with his eyes looking down to the ground, his hands folded together, and he sighed as if he would break his heart. Then said Christian, What means this? . . .*

'MAN: I am now a man of despair, and am shut up in it, as in this iron cage. I cannot get out; . . . I cannot!'

Observe here that there is no reason why the man can't escape if he chooses. His cage is merely the cage of his own despair. He is convinced, however, that he is a prisoner; and in this he is like the Boards of most investment trusts today, who believe they can do nothing about the discount while ignoring the clear evidence that it is in their power to get rid of it. I therefore cannot say it too strongly: in the investment trust sector of today, discounts are voluntary.

Quarterly No. 37 (May 2005)

Outlawing the Discount

'We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America . . .'

The US Constitution is rather more famous a document than the Articles of Association of Personal Assets Trust but the two do have certain things in common: both of them set out arrangements for the governance of a corporate entity and both of them enshrine strongly held beliefs and principles. Here I want to discuss one particular belief which we hold so strongly that it is reflected in a proposed change to our Articles of Association.

It is the belief that for investment trusts the discount is voluntary.

The proposed change to the Articles commits the Directors to ensuring that the shares of Personal Assets continue to sell at close to net asset value ("NAV"). Previously, the commitment to keep our share price close to NAV was at the discretion of the Board, which – in theory, at least, although for the present Board ever to have done so would have been inconceivable – could at some future date have reneged on it. If the proposed amendment to the Articles be accepted by shareholders, however, the policy will from then on be able to be changed only by shareholders voting at a General Meeting. Directors are often reluctant to bind their successors. This, however, is exactly what we wish to do. The power to alter our 'no discount' policy will accordingly cease to be the Board's and will belong directly to you, the shareholders.

Some years ago I began a speech at a Securities Institute debate in Edinburgh on the subject of investment trusts with these words:

'The discount is voluntary'

I still recall the gasps of disbelief they evoked. Yet, as so often happens on this particular issue, I won the debate but – perplexingly – made no converts. Ian Rushbrook and I are constantly astonished that after years of having our advice eagerly sought by directors and managers of both new and existing trusts, and having given them detailed explanations of how our 'no discount' strategy works in practice, and having witnessed their enthusiastic nods of acquiescence as we did so, not one other investment trust has seen fit to follow in our footsteps.

As the young might say nowadays, what's not to understand? Were it an untried strategy, this lack of imitators might be understandable; but our strategy has been proved to work. It has enjoyed thirteen years of unbroken success and has consistently done what it was meant to do through periods of sometimes sharply rising and falling markets and through spells of both outperformance and underperformance by Personal Assets itself. There is no mystery about it and it involves neither rocket science nor some attribute peculiar to Personal Assets. We have done nothing that any other investment trust with a straightforward capital structure and a reasonably liquid investment portfolio could not also do, and the number of such trusts is very large. Yet people still often speak of abolishing the discount on investment trusts as if it were an unattainable dream.

Quarterly No. 49 (June 2008)

Financial Engineering

OPM + (2 + 20) = MH

What on earth is this? It lacks the elegance of Einstein's $E = MC^2$, but for financial markets it could prove far more important. It is *Rushbrook's Law of Hedge Fund Manager Behaviour*. OPM is 'Other People's Money'. (2 + 20) is the characteristic structure of a hedge fund's management charges – 2% per annum of gross funds, and 20% of profits. MH is 'Moral Hazard', where the manager of a fund has an incentive to take risks with investors' funds in an effort to achieve returns that should never have been promised.

Here is an extreme, but not unreasonable, example of it in practice.

- A hedge fund is launched in March 2005, raising $100 million.
- It borrows $900 million in Yen at an interest rate of 0.25% and converts them to Dollars at 105.3 ¥/$.
- It puts its total $1,000 million on deposit for two years at 5%. Since the borrowing cost of the $900 million is only 0.25%, the fund grows to $1,097 million.
- The Yen falls to ¥118.0 against the Dollar. The liability of the $900 million of borrowed Yen falls to $803 million. The fund, originally $100 million, is now $294 million.
- The manager's fees total $73 million. The investors profit by $121 million. All are delighted.

But if the Yen rises to ¥92.51/$, the managers retain their fees but the investors are wiped out. 'Moral Hazard' in action!

Quarterly N°. 44 (March 2007)

Bin Ends

Financial engineering is very tempting. I often wonder how many complicated corporate schemes are brought forward not because they do the job best, but simply to prove that they can be done. These I call the Sinclair C5s of the financial world. Remember that little electric car? An ingenious idea. The trouble was that it didn't actually serve any real purpose, so nobody bought it.

Quarterly N°. 4 (May 1995)

I distrust investment trust warrants issues. They're fairy gold. Journalists who enthuse about 'free warrants' don't know what they're talking about. Warrants are never 'free'. They're like alcohol, apparently a stimulant but in fact a depressant – at least on the ordinary shares, once the warrants have been issued

Quarterly N°. 4 (May 1995)

In 1995 we carried out an opinion poll using our shareholders as a focus group. The subject was warrants. These were fashionable at the time. Markets were rising, so warrants always went up in price. Shareholders who received them loved them and they were popularly believed to be something for nothing. Should Personal Assets join the party? Warrants would enhance shareholder value. A 'package' of five ordinary shares and one warrant would undoubtedly sell for more than five ordinary shares on their own. Furthermore, they would increase shareholder choice. Instead of only one way to invest in PAT, there would be two ways – through the ordinary shares and through the warrants.

However, in the words of that great investment trust analyst Oscar Hammerstein II in *The Sound of Music* (my wife recently went to a 'singalong' performance of this film, dressed as a goatherd), *'Nothing comes from nothing: nothing ever could.'* Wise words, which sum up warrants nicely. True, a kind of value is created from nothing – time value. But this is realised only if the warrants are sold, and it is paid for later in the form of dilution of equity. And if the warrants are kept, the time value wastes away, like a clock running down, and the shareholders are left no better off than when they started. As it turned out, our shareholders (a shrewd bunch) were not enthused by the warrants idea. As Quarterly N°. 5 relates, a goodly number of them wrote to tell me so and I was glad to be able to report that they had reached the same conclusion as the Board.

Introduction to 1997 in Personal Assets Trust Quarterlies, The 1990s and Beyond

Share buybacks are another way for companies to reward shareholders, and they have become increasingly popular and widespread in recent years. Our preference, however, continues to be for dividends. While share buybacks can have merits, management have often bought back shares at too high a price in good times and then stepped back at the very time when they could have created the most value by buying back shares at low prices. It is notable that many share buyback programmes ground to a halt in 2008, just as markets plummeted.

Quarterly N^o. 61 (June 2011)

For those old enough to remember Steve McQueen and Faye Dunaway in the 1969 film *The Thomas Crown Affair*, the 'barbell' trust structures of 2002/3 irresistibly recalled the song *The Windmills Of Your Mind*:

'Like a circle in a spiral, like a wheel within a wheel… '

This understandably tempted me to suggest a new verse beginning:

'Like a hurdle on a hurdle, like a fee within a fee… '

I used this in an article I wrote at the time for *Professional Investor* on 'barbell' trusts, but the editors evidently thought it too frivolous and cut it out.

Quarterly N^o. 88 (June 2018)

Fund Management as a Business

What about this Proposition?

How would you like to invest in a business with the following characteristics? It needs no working capital. It begins each year with a flow of income which is more or less guaranteed. Its charging rate for the work it does bears no relationship to its running costs. And it tends to attract the brightest and most able people. Seems attractive, doesn't it! What can it be? It almost sounds like becoming an MP, except that the bit about attracting 'the brightest and most able people' might knock that idea on the head.

In fact, through being a shareholder in Personal Assets you have already invested very substantially in such a business. It is the business of fund management, which has been one of our most profitable investment 'themes' in recent years.

Quarterly N^o. 11 (February 1997)

Good Fundamentals

Let us look a little more closely at the attractions of fund management as a business to invest in. While the fundamentals of the business are not the whole story, they are a good place to start. Several of its characteristics are highly appealing from the investor's point of view.

- Fund management needs no working capital. There is no 'stock' and no 'work in progress' to be financed. No expensive equipment need be bought (computers and the like can be leased and paid for out of profits, just as office space can be rented with no capital outlay). No money has to be tied up in the business, except for whatever balances the regulatory authority may demand. Of course this would make fund management companies anathema to a 'value investor' fixated on book value, since a fund management company will often have a relatively low book value. I learned to distrust pure book-value-based investing in 1980, however, when a fund I then helped to manage had a holding in a company with a book value in the region of 212p per share while its share price was suspended at 8p. The trouble was that the book value was represented by specialist steel mills, and in the depths of a recession like that of 1980 it would have been impossible even to give them away. Book value is a delusion unless the assets are realisable at their carrying value in the accounts. All too often they are not.
- A fund management company starts each year with a flow of income which is more or less guaranteed. A manufacturing company can be hit by an unforeseen fall in demand for its products, leaving it burdened with unsold stock which it has to finance and a workforce which it has to pay, or make redundant at a high cost. This cannot happen to a fund management company. Markets may rise or fall during the year, affecting its stream of fee income (which is usually charged on a percentage basis). It may lose accounts or gain them. But broadly speaking it will know at the start of any year roughly what it can expect to earn in fees during the course of that year; and the longer term the contracts on which it manages funds, the more stable its stream of fee income will be.
- A fund management company's charging rate bears no relationship to its running costs. It costs nearly twice as much to make 2,000 widgets as it does to make 1,000. There are some economies of scale, but where labour and (especially) materials are concerned these economies of scale will be limited. Hence, a doubling of business volume might do little more than double the earnings of Widgets PLC. It would, however, be different for a fund management company. It costs virtually the same to manage £2,000 million as it does to manage £1,000 million. It need take no more people, no more computers, no more office space and only a little more paper. There may, of course, be some need to recruit more staff if more clients who need visited are taken on. But the incremental costs of managing twice as much money should be only a small percentage of the existing cost base. By contrast to Widgets

PLC, therefore, a doubling of business volume and hence in fee income for a fund management company might (costs having increased only slightly) triple or even quadruple profits. Of course, it is not always as simple as this. People love to spend. People love to empire-build. But if a fund management company is tightly run, nearly all of an increase in fee income should go directly to the bottom line.

- Fund management tends to attract the brightest and most able people. Sometimes, of course, this can be a mixed blessing. Exceptionally bright and able people can be a thorough nuisance to work with. However, fund management does attract people who are unusually able, intelligent, committed, motivated and anxious to succeed. Rewards come earlier than almost anywhere else; the rewards are higher than almost anywhere else; and people are prepared to work incredibly hard to earn them. There are no restrictive practices or haggling over working hours in the best-run fund management companies. Almost uniquely, management and workforce have such an identity of interest as to make the distinction meaningless.

(As diligent readers of the financial Press will know, the besetting problem of fund management companies is, of course, the *prima donna*. However, *prima donnas* are rarely as important as they themselves believe. You lose some, you gain some; and meanwhile the supply of equally gifted understudies is almost limitless.)

Quarterly N°. 12 (July 1997)

Managing Unlisteds

Even today there are still some investment commentators who appear to believe that 'unlisted' is a synonym for 'fast-growing' and 'exciting'. This is very wrong. Unlisted investments are riskier than listed ones. Managing them makes rearing children or breeding racehorses seem restful. They are more likely than listed companies to fail to achieve their promise, to require additional transfusions of capital, or to go bankrupt. They are by definition very difficult to value accurately, and they are often highly illiquid. In John Buchan's novel *The Island of Sheep* Richard Hannay's wife Mary laments to their friend Sir Archie Roylance her teenage son's experience with hawks:

'If you want to live with death, Archie, keep hawks. They perish at the slightest provocation. Hang themselves, or have apoplexy, or a clot, or something, or they get lost and catch their jesses in a tree and die of starvation. I'm always being heartbroken by Peter John coming in with a sad face in the morning to tell me that another bird is dead.'

This might well be the tale of an unlucky investor in unlisteds. With such investments it's the presence of a market listing, not its absence, which should be seen as a safeguard and as an advantage.

Quarterly N°. 12 (July 1997)

An Alluring Business

There are long term and short term reasons for investing in investment management companies. The long term reason is that the investment management business is fundamentally an extremely attractive one. Take the example of a fund management firm which merely manages to achieve an investment performance no worse than average and does no more than hold on to its existing clients. Even so, its earnings (and hence its share price) should over the long term grow at the same rate as the return from equity markets in general, assuming that it is adequately run and keeps its costs under control.

Investment management companies can also present good short term buying opportunities. If markets rise they can be used to provide gearing, although they are usually companies to avoid when markets fall. Furthermore, because the underlying business is so profitable, it can happen that companies which have fallen from favour can recover unusually quickly and rewardingly.

Quarterly N°. 31 (December 2003)

Gold

Gold, Beautiful Gold

Given the recent Press coverage of the subject, it was no surprise that at the 2010 AGM 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 about to get under way, I argued in vain that we should buy Krugerrands or some other form of the metal, only to be told by one of the senior partners that while he might consider buying gold mining shares – which we later did, and I loved dealing in them because they reminded me romantically of some of my favourite boyhood yarns like John Buchan's *Prester John* and H Rider Haggard's *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 immemorial 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 in our case 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 penalty 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 (and hence our likely future returns) 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 don't believe in holding long-term investments for no other reason than their yield.

Sometimes shareholders assume that what you hold today, you will hold for ever. This was not so with our FTSE 100 Futures and it certainly 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.

Quarterly N^o. 58 (August 2010)

The Attractions of Gold

Personal Assets (I said at a presentation to investors) uses gold as a tool, a means to an end, in helping us keep our capital safe. Let's therefore get gold in perspective.

- Objectively considered, gold is about the worst investment it's possible to imagine. You can't eat it. You can't drink it. You can't smoke it. You can't plant it. You can't make it into anything very useful. It pays you no dividends and earns you no interest. Indeed, it costs you money to store and insure it.

- What's more, gold can be very volatile and very risky. Between its $800/oz peak in 1980 and Gordon Brown's masterly sale of our gold reserves at $275/oz twenty years later, it proved a rotten long-term investment as well as a terrifying short-term one.

Yet gold is unique. Wherever you went to in the world at pretty well whatever known period of history, you would have been able to pay your way with a pocketful of small denomination gold coins. Think of ten sovereigns (which I actually took to the presentation as a visual aid and to jingle at the other speakers). A century ago, ten quid would have been a week's income for a comfortably off person. Today, ten sovereigns, now worth around £2,750, would still be a week's income for a comfortably off person.

Let's be honest. If Nick Clegg pushes the nuclear button, the Third World War starts and we have to flee to the desert or the mountains, what would we rather take with us? A bundle of banknotes? Some share certificates? Or those ten gold sovereigns?

Quarterly Nº 63 (December 2011)

Liquidity, not a Commodity

Sometimes people talk about our holding of gold as if we regarded it as a commodity. We don't. To us it is liquidity and we hold it because we don't see an end to central banks' monkeying around with fiat money (money issued by sovereign states). Gold doesn't default or impair, and now that negative real interest rates have morphed into negative nominal interest rates, holding gold has no opportunity cost when compared to cash deposits. We believe that when faith in central bankers is put to the test, people will return to gold as they lose faith in sovereign money.

Quarterly Nº 77 (September 2015)

Bitcoin

Some shareholders have asked me for my views on Bitcoin. Insofar as they are printable, they are as follows.

Bitcoins are gold without thousands of years of history, without beauty, and without utility as a portable store of value. I would rank Bitcoins below Co-op milk tokens and along with banknotes printed using a John Bull printing outfit. All they have is 'conspiracy value'. If people stopped 'mining' them, hoarding them, speculating in them and puffing them up in the Press, they would be worthless.

I'm sticking to gold.

Unpublished Internal Note, 2020

Bin End

Gold is a risky investment and in normal circumstances it might well not be a natural long term holding for Personal Assets. However, in certain circumstances (such as at present) I believe it to be the right one and I am glad that it is now part of Personal Assets' armoury of investment choices.

I was true to my instincts when I wrote in 2003 in a verse for *The Spectator*:

My dour Scotch fingers itch today for gold,
Which wise men bought while Brown the Braggart sold.
Sought for its shine and splendour, hue and 'heft',
Loved by the Right, and hated by the Left,
Outlasting Midas, Mill and Maynard Keynes,
Since gold's for glamour, grace and (maybe) gains,
I've sovereigns, shimmering in my northern lair,
That shine as bright as Boris Johnson's hair . . .

Introduction to '60 Not Out', a book of collected Quarterlies Nº 26-60, pub. 2011

Inflation

A Swindle and a Cheat

Inflation, once it takes hold, is a cruel conjuring trick. It causes the price of shares to rise and their value to fall. It is subversive not only of the economy and of financial markets but also of social stability, because it weakens and may even break the link between the money we use as a means of exchange and the underlying real wealth which money represents. In practice, however, inflation is popular because it increases the paper value of our assets while reducing the real burden of our debts. It also leads to high interest rates, which savers like because they fail to realise that the interest they are getting is, in fact, a repayment of their own capital which is subject to Income Tax. Inflation distorts balance-sheets and leads businesses to make wrong investment decisions, while the feeling of fullness it creates in our wallets is as illusory as that which a Chinese takeaway creates in our stomachs.

Contrary to what some foolish and glib-tongued politicians would have us believe, it is difficult for there to be an 'acceptable level' of inflation, if only for the reason that inflation is never stable. It feeds on itself. Inflation by its very nature creates yet more inflation. In short, inflation is a swindle and a cheat – an hallucinogenic drug which should be fought as single-mindedly as any other cause of debilitating addiction.

Quarterly No. 8 (June 1996)

People Love Inflation

'The ideal rate of inflation, if you want to maximise growth and employment, is between 5% and 10% I think that's about right.'

So claimed Denis Healey, the former Labour Chancellor of the Exchequer, in an interview published in the 8 November 1996 issue of the *New Statesman*. (Being broad-minded, I read the *New Statesman* every week along with The *Spectator* after I have given my attention first to the *Church Times* and The *Economist*, in that order.) Those words, coming as they do from an elder statesman generally supposed to be on Labour's right wing, are not encouraging. At first glance they may look reasonable. Inflation of 5% or 10% sounds mild and innocuous, doesn't it? At an inflation rate of 5%, however, money halves in value in 14 years. At a rate of 10% it halves its value in seven years. Does that sound 'about right' to you? It certainly doesn't sound all right to me.

The trouble is, of course, that Denis Healey is speaking for Middle Britain and (although they are often unwilling to acknowledge it openly) the inhabitants of Middle Britain love inflation. Borrowers love it because their overdrafts and mortgages melt away in its friendly warmth, leaving them less and less encumbered with debt. A £10,000 mortgage taken out in March 1974, when Denis Healey became Chancellor, would represent a debt burden of only £1,691 in 1996 money. Wage-earners love it because it leads to large compensatory increases in pay. A 10% pay rise is something well worth celebrating in the eyes of most people compared to the measly 2% or 3% of today. And savers love it because it leads to high interest rates on their savings.

Interest rates have been a special grievance in Middle Britain of late. There are many people who bitterly resent the 4% or 5% they now receive, fondly recalling the 10% they used to get before the decline of inflation damped down their 'feel-good factor'. It makes them feel bitter towards the Government in the same way as a young diabetic child feels bitter towards its parents for depriving it of the sweets which might kill. Neither the child nor the saver understands the nature of the disease.

Given inflation's popularity, acting responsibly on it cannot be fun for politicians. I have little hesitation in claiming that if inflation were suddenly back within Denis Healey's 5% to 10% range, with interest rates and pay rises to match, the Conservatives would win a General Election tomorrow.

Yes, everyone loves inflation, deluded fools that they are. Consider the real position of borrowers, wage-earners and savers in inflationary times.

- **Borrowers.** At first sight, they of all people are the ones who seem to gain most from inflation; and of course they do benefit in a significant way as the falling value of money reduces their burden of debt. There is, however, an indirect penalty they pay. They lose a sense of what wealth means. They borrow money to invest in 'real assets' (usually second-hand bricks and mortar) which they can see rising in value over the years while the value of the borrowed money falls. So by Pavlovian conditioning they come to believe that bricks and mortar are wealth. I well remember otherwise intelligent investment professionals in the City in the 1980s disdaining equity shares and instead moving ever higher up the housing ladder with the aid of ever bigger mortgages, supposing this to be the only sure way of accumulating capital. I predicted a slump in property values and they laughed at me. They also laughed when I said that if I were Prime Minister I would privatise everything except housing, which I would nationalise. They failed to realise that I proposed this policy only half in jest, the huge stock of capital tied up idle in houses being (in my opinion) a shocking waste and a handicap to economic growth.
- **Wage-Earners.** Who is better off – someone who gets a 10% pay rise when inflation is 12%, or someone who gets a 3% pay rise when inflation is 2%? The answer is obvious. The latter gets a real pay increase while the former has had in real terms a year-on-year pay cut. Who, however, feels better off? Again the answer is obvious. The person getting a 10% pay increase feels flush with extra buying power. The fact that the extra buying power is an illusion is overshadowed by the excitement of getting a four-figure pay rise. Big numbers are much more fun than small ones. The extra £5 notes one gets as part of one's pay rise look just the same as they did last year, even if they buy less than they bought then. How much nicer a thick bundle of them feels, therefore, than a thinner one! (When I was last in Italy I took with me £500 worth of Italian banknotes, so that I could be a Lire millionaire. It felt much more exciting than my original £500 did.)
- **Savers.** Here is where inflation makes me really angry. Savers are swindled monstrously by inflation – and they love it. Suppose I have £10,000 on deposit 'earning' me 10% interest at a time when inflation is also 10%. I get a cheque at the end of the year for interest of £1,000 and I go off and spend it. Not bad, eh? So much more fun than the mingy £400 or so I have been getting now that inflation is low. But wait a minute. How much paper money do I need to add to my savings to maintain the purchasing power they had when I first put them on deposit? Quite right. I need £1,000. So in fact I have spent £1,000 of my own capital under the illusion that it was interest I had earned; and to add insult to injury I will probably have had to pay tax on it as well.

How to Pay Tax Twice

People often compare inflation to a binge. In the short term, they're right. Inflation makes us feel flush with cash and we guzzle up consumables accordingly. In the long term, however, inflation has effects more like those of a crash diet – a wasting away of the healthy muscle tissue of one's savings. Year after year, 'interest' is paid which is really a return of capital; and year after year the purchasing power of one's capital shrinks, even though the number of pounds on deposit in the bank or building society remains the same. Inflation is financial anorexia, which kills our savings without our noticing it.

Its ghoulish task is made even less welcome by the fact that the 'interest' we receive is classed by the tax authorities as 'income' even though in fact it is merely a return of part of the purchasing-power of our capital. So our savings, accumulated usually out of our taxed income, are taxed a second time when they are returned to us as 'interest'.

Remember my £10,000 on which I received 'interest' of £1,000 (which in fact was the amount I would have needed to add to my capital just to maintain its purchasing power)? Assuming it was subject to tax at the 40% rate, I would have kept only £600 of it and I would have given the Government £400. Even had I been prudent and refused to spend the £600, adding it to my capital instead, I should still have had £400 worth of the purchasing power I possessed the previous year confiscated by the Government for no good reason. It would be just as if the Government had raided my bank account and withdrawn a sum of money from my already-taxed savings without so much as a by-your-leave.

The Peril of Inflation

Double taxation, however, is far from being the worst of inflation's effects. Inflation is ultimately more destructive of society than drugs, crime or Communism, because it destroys faith in the means of exchange within a society. Of course its debilitating effects are not obvious at first. Things feel better with a little of it. Think of gin (which as a lifelong churchman I frequently do, because the High Church party in the Church of England and the Scottish Episcopal Church exists on it). A large gin perks me up. A second large gin perks me up even more. I feel wonderful after half a dozen. And after a dozen, when I am being picked up off the pavement, I am so happy that I don't even worry about being mistaken for a Conservative MP. The next morning, however, is another story.

I can already guess what is in your minds as you read this. If gin is a good thing in moderation but a bad thing in excess, is not the same true of inflation? Does not a little of what we fancy do us good? Yes, it often does. A little inflation is useful because it acts as a lubricant within the economy. It also enables industries to rationalise themselves. Wage cuts in industries which are contracting or dying are usually not politically acceptable. Reducing the cost of employing workers by allowing real wages to fall while nominal wages stay the same or rise slightly is, however, acceptable – or, at least, can be got away with more easily. Mild inflation, therefore, can aid economic efficiency.

The trouble is, however, that it is very difficult to keep inflation at a steady rate. Inflation tends to have a momentum of its own. It will trend upwards or downwards. I might concede the merit of inflation at, say, 2% or 3% per annum as long as it stayed at that level. Sadly, it almost never does. Most of us will remember the inflationary horrors of the middle 1970s, when inflation reached a year-on-year rate of 26.9% in August 1975. Then inflation rose again in the late 1980s, reaching a peak of 10.9% in September 1990. Getting it choked out of the system caused one of the worst recessions in living memory. Once inflation gets out of control, it is desperately hard to get it back under control once more.

For this reason, I worry when I hear talk about the attractions of having a little bit of inflation. Before 1993-94 the last time inflation was below 3% for 24 months in a row was 1958-61. That is a very long time ago; and within 12 months of breaking through the 3% barrier in 1961 it had reached 5.7%. In March 1988 Nigel Lawson tried to avoid the risk that the Crash of 1987 would induce an economic slump by bringing in a relaxed Budget. Inflation then was running at 3.5%. It did not return to that level until November 1992. If we are to have 'a little bit of inflation' without seeing it run away from us we will therefore need a Chancellor even cleverer than Nigel Lawson. That seems an unlikely prospect.

Are We in a New Era?

The picture is not all gloom, however. Monetary authorities throughout the world are taking inflation much more seriously than they did. One of the most significant events in recent history took place in February 1994, when Dr Greenspan raised US interest rates in anticipation of rising inflation, rather than in response to it. At the time all my friends in the City were plunged in misery as markets dived. But I find it difficult to remember anything in the financial world which has pleased me more.

Since then, equity markets have soared, bond markets have stagnated and inflation has come to be regarded in most developed countries as Public Enemy Number One. In the UK Mr Clarke talks of 'prudence' in a way which sits ill with his suede shoes and blokey demeanour. Meanwhile, on the Labour benches Mr Brown strives to outdo the driest of Conservatives with the stern fiscal rectitude he adopts in his public utterances. No-one, except perhaps for Denis Healey, seems to have a good word for inflation as an acceptable price to pay for economic expansion and full employment. So when all the political great and good agree, is it possible that we are moving once again into a low-inflation era?

If so, we could be in for interesting times. Consider what might happen if inflation remained for a number of years at a level of less than (say) 3% and people eventually started to believe that this, rather than inflation of 5% or 10%, was the natural state of affairs.

- The attraction of bonds would rise. In the UK they are unpopular as investments because their value has been so uncertain in an inflationary environment. Only on rare occasions during my adult lifetime has there been a real return available from gilts. In Germany, however, where since the Second World War money has been sounder than it has been here, holding bonds is much more popular than holding equities. It is therefore not surprising that a much higher percentage of the business sector in Germany than in the UK is financed by debt capital than by equity. (There are many fewer listed companies in Germany now than there were in the 1930s.) In the UK investors have accepted the risk of holding equities because the risk of holding bonds has been greater. If people were to trust money again, however, the safe returns available from bonds would look much more enticing.

- Does this mean that equities would lose their allure? Far from it. True, if people really became convinced that inflation had been beaten, equities would be put in the shade for a while as the price of bonds rocketed. Yields of 8% or more on fixed interest securities would not last for long if people became convinced that inflation would be at around the 2% to 3% level for the foreseeable future, and the price of gilts could rise by anything up to 50%. Thereafter, however, bond prices would stabilise and equities would come back into their own. Companies would get used to operating in the new environment. Long-term debt would be easier to raise at attractive interest rates because lenders would feel more confident. High interest rates deter companies from borrowing, because they do not fully recognise how the inflation which has brought about the high interest rates will erode the capital burden of their debt. History shows that in times past low interest rates have brought about more highly geared and hence more profitable companies. This, I believe, would happen again and it would enhance the returns available from equities.

- Perhaps best of all, it would take a long time for people to recognise that things really had changed. We always expect trends to go on for ever. In the 1950s, 1960s and 1970s we were ruled by politicians who grew up during the slump of the 1930s. Thus another slump was what they most feared; and this caused them to underestimate the dangers of inflation. They were operating two or three decades behind the times. Now we are all conscious of the dangers of inflation and will probably continue

> to be so for many years to come. As a result, we may be in a sound-money environment for quite a long time before we recognise it for what it is. So for those who realise sooner than others that the trend really has changed, there could be rich investment pickings, first in the gilts market and then in the equity market.

Do I Believe It?

What a glowing picture I have painted of a world nearly free of inflation, in which people trust the value of money again and make investment choices accordingly! Do I believe my own rhetoric? No, I don't. Or at least, I am prepared to concede the possibility but I am very far from being convinced. The sad truth is that democracy and sound money are not compatible except by the exercise of almost superhuman vigilance and self-denial on the part of elected governments.

In the days before democracy (universal suffrage didn't arrive in the UK until 1928), the purchasing power of Sterling was broadly the same in the early 1930s as it was in the 1660s. Why? Because until the rise of trade union power and the extension of the vote to everyone there could be something approaching a free market in wages. Now, however, actual cuts in wages, salaries, pensions and benefits of the kind we last saw in the early 1930s would be politically impossible. The voters and the trade unions would not stand for it, even if the politicians were brave enough to try it. The consequence of this is that the value of money can no longer move in cycles as once it did. We cannot have inflation of 5% or 10% for a year or two, knowing that we will soon have deflation of 5% or 10% to correct it (the purchasing power of Sterling was indeed broadly the same in the early 1930s as it was in the 1660s, but there were large and frequent fluctuations between those dates). Politicians would never dare to leave unaltered the economic circumstances which might bring about such deflation. All that is open to governments nowadays is therefore to keep as low as possible the inflation which will inevitably exist.

This, however, is not a good way to get re-elected. Dampening down the economy is not a vote-winner. I accordingly fear that, politicians being only human, there will always be a tendency for human nature to have its way. For this reason I view the dying days of this government and the strong likelihood (although by no means certainty) of a Labour government next time with some nervousness. The temptation for the Conservatives to manufacture a 'feel-good factor' and for Labour to relax spending restraints naturally uncongenial to them will be great. Lead us not into temptation; but deliver us from evil.

Quarterly N^o. 9 (November 1996)

Why Not a Bit of Deflation?

We now know that Mr Mervyn King, the Governor of the Bank of England, at the Bank's policy committee meeting on 6 August voted to increase the UK's QE ceiling to £200 billion rather than the £175 billion eventually agreed on. So what? It's only money. Nobody's actually going to have to pick up the bill for it, right?

Sometimes Mess^rs Bernanke, King and their ilk seem like pushers of a miracle drug that can defer hangovers for ever. (We've had 'club drugs' such as Ecstasy and GHB, so why not QE?) The trouble is that we get hangovers for a good reason. If we didn't get them, we might keep on drinking and drinking until we poisoned ourselves. For hangovers, read deflation. Everyone is terrified of deflation and regards it as an absolute no-no: actual cuts in wages, salaries, pensions and benefits of the kind we last saw in the early 1930s would (it is believed) be politically impossible today. Yet sometimes I feel heretical and ask myself what would be wrong with a bit of deflation. This is why I was both surprised and pleased earlier this year when Paul Johnson reminisced in *The Spectator* about the historian A J P Taylor's alternative view of the 1930s:

'A J P Taylor liked to talk about the Great Depression of the Thirties. "It was all right for some, such as myself," he said, with satisfaction. "With a nice, safe job as a university don, I was sitting pretty. Prices were stable or going down. Don't let anyone tell you deflation is a bad thing. It's a jolly good thing for the middle classes with salaried jobs and savings. Life was good to us. Empty roads. You often had a railway carriage to yourself. You didn't have to book a hotel room. Or a restaurant. Everyone glad to see you – service with a smile. You could buy a three-bedroom house for £600, new. If it hadn't been for the rise of Hitler, I'd say it was the best time of my life, personally."'

Contrary to popular belief, I am not old enough to remember the 1930s personally. I do, however, remember what my family used to say about them and it bore out A J P Taylor's recollections pretty accurately. Since the 1930s, savers have been punished at the expense of borrowers, the profligate have been pampered and the grasshopper has triumphed over the ant. How pleasant it is to dream that some day things might change…

Quarterly No. 54 (September 2009)

1955 vs 2005

(This is an extract from a much longer paper on inflation I was working on in 2006 but never finished. The background to it was that I was considering the pros and cons of investing in the 50-year Inflation Linked ("IL") Stock that was issued in September 2005. The contrasts between 1955 and 2005 were illuminating and sometimes amusing. The same, however, would today doubtless be as true of the contrasts between 2005 and 2021.)

1955 vs 2005: Prices

This brings me to another major risk involved in holding a 50-year IL gilt. By September 2055, when the IL 50-year gilt will be due for repayment, I expect there will still be an RPI and inflation will still be a topic of conversation. But there will also be the vital consideration that might be called, *'How Life Itself can Change over Half a Century'*.

At first glance it seems easy to find out what inflation has done since 1955. Taking January 1987 as 100, the RPI at the end of December 1955 was 11.3 and by the end of December 2005 it was 193.3. In other words, £1 in 1955 had the purchasing power of £17.11 by December 2005, or (looking at it the other way round) £1 in December 2005 had the purchasing power of 14^{d} (around 6p) in December 1955. This couldn't be simpler, you might think; and it can be lots of fun translating today's prices into those of 1955 or *vice versa* using these figures.

The trouble is that the more you do it, the more misleading you find that it is. (You discover the same thing when the 'modern equivalents' of prices and incomes given in the introductions to biographies and histories fail to ring true.) It's not just that the pound sterling buys less and less with the passing years, but that *within* this general loss of purchasing power it buys proportionately less of some things than of others (and sometimes it even buys more of things, like calculators and most electrical goods). In addition, new things to spend our pounds on keep appearing, while the different employments by which we earn those pounds become relatively more or less remunerative.

Let's look at a couple of examples. In 1955 the price of a bottle of ordinary blended Scotch whisky was 38s 6^{d}, or £1.92. Apply to this the 17.1 times multiplier that I mentioned earlier, and you get whisky at £32.83 a bottle. What nonsense! It costs only a third of that amount at the beginning of 2006. Indeed, it has become so much cheaper, relatively speaking, that we need not wonder why 'binge drinking' is within the financial reach of modern youth. While there's good news for drinkers, however, it's not good news for smokers, since a standard packet of 20 cigarettes at 3/6^{d} (17½p) in 1955 would today cost not the £3 or so that the RPI-derived multiplier would lead you to expect, but £5 or more.

Of course, in 1955 I wasn't drinking whisky and smoking cigarettes. I was only three years old. But in a few years – in 1960, let's say – I would be starting to buy comics, and it's interesting to look at the prices of these. The *Beano*, a favourite comic of mine, cost 2^d in 1960. According to the RPI, 2^d then would be $2/10^d$ today, or around 14p in what I still call 'the new money'. What does the *Beano* cost now? No less than 75p, or more than five times what the RPI would lead me to suppose. *Fifteen bob for a comic!* True, it has more pages now than it did then, but it's the same item.

What else has changed since the days when chicken was a luxury and beef was cheap; a postage stamp cost $2½^d$, or 18p, compared to the 29p it actually costs now; receipts had to be validated by putting a twopenny stamp on them; there was still Stamp Duty at 2^d a time on cheques; furniture and the more expensive kinds of clothing were priced in guineas; and cars were priced 'ex works'? (What was the use, it seemed to me as a boy, of a car without its 'works' – which I imagined to be its engine, etc?) There was, of course, much less 'choice' for consumers in the 1950s. But I'm of the opinion that, *pace* Mrs Thatcher, many people either aren't much interested in choice or even dislike it.

One major change in lifestyle taking place in the 1950s, however, was that Hire Purchase was coming into fashion (how old do you now have to be to remember the phrase, *'buying something on the never-never'*?), bringing new and expensive consumer goods within the reach of the masses. Looking at advertisements from the early and middle 1950s recaptures some of the excitement of these new consumer goods, as well as reminding us of how amazingly expensive they were then relative to comparable items today. You could have bought a Pye 'Continental' 21-inch TV for 95 gns, for instance (about £1,700 now, according to the RPI), or the cheapest Frigidaire 'Family' refrigerator for 66 gns, or $£10/8/0^d$ down and 24 monthly payments of 57/- each, totalling $£78/16/0^d$ (around £1,350 in today's terms, a lot of money for a very small fridge) while the largest in the Frigidaire 'Family' range of refrigerators cost 166 gns, or nearly £3,000.

It was a time when, to quote Harold Macmillan, *'Most of our people have never had it so good.'* There was a famous *Spectator* cartoon after his 1959 General Election victory showing 'Supermac' at the head of the cabinet table, around which there sat washing-machines, refrigerators, television sets, etc, and addressing them in words to the effect of, *'Well, gentlemen, I think we fought a successful campaign.'*

1955 vs 2005: Incomes

Starting at the top, in 1955 the Lord High Chancellor of Great Britain got £12,000, or £204,000 in 2005 terms. This has held its value almost exactly, the Lord Chancellor's salary now being £202,000. Compared to him, however, the Archbishop of Canterbury should move from Lambeth Palace to Carey Street. His £7,500 in 1955, or £128,000, has become a mere £60,000 today. Moving down the social scale, the average wage for an adult male worker in 1955 was $£10/17/5^d$ for a 49-hour week, or £565 annually. Today this would correspond to £186 a week, or £9,672 per annum, compared to the actual national average earnings for adult males of £31,515 at April 2005. Whatever the RPI suggests, no-one who earned £565 per annum in 1955 and was getting a gross £9,672 now would regard this as having preserved the purchasing power of his 1955 income.

Extract from Draft Paper on Inflation, 2006

Beer vs Education

L P Hartley in his novel *The Go-Between* famously wrote, *'The past is another country. They do things differently there.'* I lived in that other country once, and so did you. Nostalgia may not be what it used to be, but I still can't resist it. In September 1970, when I started drinking legally in pubs *(note the careful phrasing)*, light beer cost $1/10^d$ a pint and heavy beer 2/-. The 2006 equivalent of 2/- in September 1970 is, officially, £1.02.

Today it would be a miracle to get a pint of beer for that, even at a Happy Hour in J D Wetherspoon's. The reverse, however, is true of spirits. A bottle of spirits cost 44/6^{d} in 1970. It certainly doesn't cost £23 now, the ratio of spirits to beer prices having altered radically in favour of the hard stuff. Indeed, for the price of a bottle of spirits at an off-licence in 1970 you could have bought 22 pints of beer in a pub. Nowadays you could buy only about five pints.

Beer was always important to students, but I'm told that much more important to many parental budgets nowadays are school fees. I didn't attend a fee-paying school myself. I had no need to. Forres Academy, an ancient seat of learning with pre-Reformation origins and a Latin motto ('Jehovah tu mihi Deus quid deest' – *'Jehovah, Thou art my God: what do I lack?'* – now unfortunately replaced in the interest of modernity) at which generation upon generation of my forebears were educated, was the state school serving my home town and its surrounding area. Looking back, I can't praise it too highly. In addition to its many other advantages (such as a healthy and stimulating social mix) it was of such academic excellence that I've enjoyed ever since being able to correct the classical quotations of Wykehamists. Boarding at Winchester itself, however, cost £537 per annum in 1964-65, the year in which I started at secondary school. Accordingly, the RPI would suggest fees today of £7,279 per annum. I therefore turned to the 2006 edition of *Whitaker's Almanack* to see what they might actually be. £7,170 was the figure I spotted. Remarkably accurate, I thought, until I saw that this was per term, and that the annual equivalent would therefore be £21,510.

This being the case, I would have imagined that David Cameron would have been on to a winner in expanding the grammar school sector in England and Wales again to cater for those wanting an academic education for their children but unwilling or (more likely) unable to pay such hefty sums for it. Since he has refused to do so, I wait without too much suspense to see whether he will send his own children to the state comprehensives he obviously thinks good enough for the populace in general.

Our Own Private RPI

The truth of the matter is that we all have our own personal inflation rates. Age, marital status, family size, the need (or not) to commute to work, sporting and leisure interests, and expectations of travel and holidays all make a difference. The stated inflation rate in the UK, as measured by the RPI to January 2006, is 2.4%. Ask yourself if that represents the change in your own cost of living over the last year. It's unlikely, I would suggest — especially if you moved house, or if you have expensive children at school or university, or grandchildren to help educate, or care home costs to meet for elderly relatives. Each of us uses a different mix of goods and services, and the prices of these goods and services move *relative to one another*, not just uniformly in line with an index.

Extract from Draft Paper on Inflation, 2006

Bin Ends

Who remembers inflation? People of my age grew up with it. Now I can even be a bore about it. Half a crown for pocket money? 2½^{d} to send a postcard or an unsealed letter? 6^{d} for a bar of chocolate and 1/- as the minimum deposit in the local Savings Bank? Yes, I remember it well – and I can also remember inflation of nearly 27% in 1975 and the disastrous effects of a rise in the mortgage rate from 8% to 17% in 1978, the year after we had bought our first house with the help of a variable rate mortgage.

Introduction to 1996 in Personal Assets Trust Quarterlies, The 1990s and Beyond

Inflation is not dead, only resting.

Quarterly N$^{o.}$ 77 (September 2015)

Insights from History and Literature

Thomas Mann's Insight

I can promise you that once we are convinced beyond all doubt that an investment opportunity exists which no-one else in the market seems to have spotted, we will act boldly. But such opportunities do not occur every day, or even every year, and they cannot be manufactured – even (or perhaps especially) when they seem to be needed most.

There is a good illustration of this in what I believe to be one of the best books about investment ever written (although this would probably not have been the author's primary intention) – Thomas Mann's great German novel *Buddenbrooks*. It is based on Mann's own family history (his father was a grain merchant and a Senator of the self-governing Hanseatic city of Lübeck) and chronicles three generations of a great merchant house in that city. The scene which always remains in my mind is the one in which Senator Thomas Buddenbrook, the proprietor of the firm in the third generation, afraid to admit to himself his own lack of business acumen but painfully aware of the way in which the business has declined relative to its competitors, determines in its centenary year to restore its fortunes through a glittering *coup* involving the advance cash purchase of a harvest of rye in Mecklenburg.

The day of the centenary of the House of Buddenbrook dawns, and all the ships along the quays are flying their flags in the firm's honour. As Senator Buddenbrook receives the plaudits of his employees and his fellow-merchants he is handed a telegram informing him that the harvest of rye has been destroyed by a sudden brief hailstorm. His *coup* has failed, and the firm has been seriously crippled as a result.

What did Senator Buddenbrook do wrong? Two things. Firstly, he panicked and acted on impulse. The House of Buddenbrook was slipping down the performance tables, and so he lost his nerve. He hunted around desperately for a masterstroke to catapult the firm back up the performance tables again. But desperate investors make bad decisions. Only losers who keep their nerve can become winners again. Second, what he had thought was an enticing opportunity was in fact a gamble. He was correct in thinking that the rye was cheap, and that he could make a big profit out of it by buying it in advance. But he could not possibly have known that it would not be destroyed by hail or by some other weather hazard before he took delivery of it, and he should have thought of this. The taking on of an uncontrollable risk was what made his advance cash purchase of the rye a gamble.

With the fate of Senator Buddenbrook in mind, we will give you two pledges. Firstly, if Personal Assets slips down the performance tables (as it doubtless will from time to time) we shall keep our nerve. We will not try to make up the lost ground impulsively. We will be patient and we will work our way back up again over time. Second, we will never take on risks which we know to be beyond our control. There is a world of a difference between a gamble and an opportunity. There are always gambles around, but opportunities cannot be called into existence on demand. As long as Ian Rushbrook and I are in business together we shall try to seize opportunities, but we will never gamble.

Quarterly №. 3 (March 1995)

Knowledge and its Limitations

OK, then. The market is going to fall eventually, and it will probably take the form of a nosedive rather than a 'correction'. The October 1997 anniversary of the last Crash passed with no more than a wobble, but the mood still reminds me of 1987 – lots of nervous stumbles and spurts while the newspapers print articles explaining why it is different this time. It is never different this time. As Edwin Lefevre wrote in 1923 in his classic *Reminiscences of a Stock Operator:*

'There is nothing new on Wall Street. Everything that has happened before will happen again.'

Therefore why not go for broke and sell out of equities altogether, buying back when they are cheap once more?

To begin with, I am a rotten prophet. Ask me where the UK market will be in 50 years' time and I could make a fair stab at it. Ask me where it will be in 50 weeks, or 50 days, and I stand about as much chance of being right as Mystic Meg does of winning the Lottery. For instance, everyone remembers the Crash of 1987. I foresaw it. I turned very bearish in October and I argued vehemently at a Personal Assets Board meeting that we should increase our liquidity massively in anticipation of it. I lost the argument and it was lucky for everyone that I did. You see, I turned bearish in October *1986*. Over the next 12 months the UK market rose by a further 50%. (It is often forgotten that calendar 1987 was an up year for the UK market.)

Of course, I was absolutely right. I knew there would be a Crash; I said there would be a Crash; and in due course there was a Crash. Much good it did me. It was useless knowledge. I should have remembered another of my favourite investment textbooks, John Buchan's *The Gap in the Curtain*. Unlike *Reminiscences of a Stock Operator*, but like most of my favourite investment textbooks, it was never intended to be one and it was written as a novel. Yet it contains flashes of insight lacking in all but a handful of the academic tomes emanating from business schools, or the more popularly-written books of the *'How to Make a Killing on the Stock Market'* type, which must be a waste of money because if their authors really knew how to make a killing on the stock market they would not be writing books but would be busy – *errm* – making a killing on the stock market.

In *The Gap in the Curtain*, five guests at a country house take part in an experiment in which each of them is able to glimpse for a moment the newspaper headlines for the day exactly one year later. In each case the information gained, although accurate, proves useless or misleading. Of particular interest in our case is the experience of the financier, Arnold Tavanger, who spots a headline to the effect that there is to be a world merger of all the producers of a rare mineral and tries to capitalise on this cleverly. He fails, and at the end of Buchan's account Tavanger is made to say:

'I saw the announcement of the world merger . . . I knew with perfect certainty that one thing was going to happen. If I hadn't known it . . . I would have been content to take my profit . . . As it is, that infernal atom of accurate knowledge has cost me twenty thousand. But it was worth it . . . for I have learned one thing which I shall never forget, and which I commend to your notice. Our ignorance of the future has been wisely ordained of Heaven. For unless man were to be like God and know everything, it is better that he should know nothing. If he knows one fact only, instead of profiting by it he will assuredly land in the soup.'

Quarterly N°. 13 (February 1998)

The Board from Hell

'On Friday, the 21st June, the Board of the South Central Pacific and Mexican Railway sat in its own room behind the Exchange, as was the Board's custom every Friday. On this occasion all the members were there, as it had been understood that the chairman was to make a special statement . . . The Board always met at three, and had generally been dissolved at a quarter past three. Lord Alfred and Mr Cohenlupe sat at the chairman's right and left hand. Paul Montague generally sat immediately below, with Miles Grendall opposite to him, but on this occasion the young lord and the young baronet took the next places. It was a nice little family party, the great chairman with his two aspiring sons-in-law, his two particular friends, the social friend, Lord Alfred, and the commercial friend, Mr Cohenlupe, and Miles, who was Lord Alfred's son. It would have been complete in its friendliness, but for Paul Montague, who had lately made himself disagreeable to Mr Melmotte . . .

'It was understood that Mr Melmotte was to make a statement. Lord Nidderdale and Sir Felix had conceived that this was to be done as it were out of the great man's heart, of his own wish, so that something of the condition of the company might be made known to the directors of the company. But this was not perhaps exactly the truth. Paul Montague had insisted on giving vent to certain doubts at the last meeting but one, and, having made himself very disagreeable indeed, had forced this trouble on the great chairman . . . What nuisance can be so great to a man busied with immense affairs, as to have to explain or to attempt to explain small details to men incapable of understanding them? But Montague had stood to his guns. He had not intended, he said, to dispute the commercial success of the company. But he felt very strongly, and he thought that his brother directors should feel as strongly, that it was necessary that they should know more than they did know. Lord Alfred had declared that he did not in the least agree with his brother director. 'If anybody don't understand, it's his own fault,' said Mr Cohenlupe . . . '

Anthony Trollope, *The Way We Live Now,* Chapter XXXVII, The Board-Room

There you have it: from the corporate governance point of view, the Board from Hell. Even the most casual reader will be able to spot many things wrong with the conduct of the Board of the South Central Pacific and Mexican Railway. Although it did at least meet weekly (rather than quarterly, as seems increasingly to be the case with investment trust Boards), it was not usual for all its members to attend *('on this occasion all the members were there')*. The meetings were short, lasting generally for a quarter of an hour. Of the directors, two were close friends of the Chairman and two others were seeking the hand of his daughter in marriage. The Company Secretary (a singularly ineffective one, as Trollope later makes clear) was the son of one of the directors. Lord Nidderdale and Sir Felix Carbury, Miss Melmotte's two hopeful suitors, evidently knew little of the Company's affairs and were content to receive such morsels of information as might fall from the Chairman's lips.

For his part, the Chairman was brusque, secretive and intimidating, while Paul Montague, the 'rebel' director, obviously felt that his fellow directors were not as well informed as they should be. However, Lord Alfred (portrayed earlier in the novel as a financially embarrassed nonentity interested only in playing whist) did not agree, while Mr Cohenlupe (an MP, so no doubt used to voting as he was told and not asking questions) blamed Paul Montague himself, not the Chairman, for his lack of understanding.

Although *The Way We Live Now* was written 130 years ago, the account of the Board meeting has a familiar ring. It highlights the importance, when legislating for corporate governance, of understanding human nature and working within the limits it imposes. Most of us in the business world have known company directors like Lord Nidderdale or Sir Felix Carbury, out of their depth and living off their own past reputations or (as in this case) the reputations of their forebears. We may also have encountered from time to time a *'Miles, who was Lord Alfred's son'* or a selfish and cynical Cohenlupe, while a few of us have perhaps known or encountered a Melmotte and may even have found ourselves, or seen others find themselves, in the painful position of a Paul Montague.

Most of us, too, will recognise the temptations that beset the members of the Board of the South Central Pacific and Mexican Railway: temptations not to go out on a limb; not to betray one's ignorance; not to question success too closely; not to make a fuss; not to bother busy and important people, especially brusque ones; not to make life difficult for one's friends; and not to put at risk one's own prospects or the prospects of one's children. These are all subtle temptations, not dramatic ones. They are especially potent when one is in any case unsure of one's ground and is quite prepared to admit that one may be wrong. They are temptations which beset the weak rather than the wicked, and all of us have our weak spots. As temptations, in short, they are very human.

From Draft of Article on Corporate Governance, 2004

Are We Obstinately Blind?

At times, when people have been trying to persuade us that equities are cheap, I've wondered if they've inwardly been comparing us to those maddening and pig-headed creatures, the Dwarfs in C S Lewis's *The Last Battle*, the final book in his *Chronicles of Narnia*. Towards the end of the book, the forces of evil having been defeated, the humans and the talking beasts of Narnia are rejoicing – all except the Dwarfs. These sad and surly creatures sit on sweet-scented grass in glorious spring sunshine, but (having once been fooled) they are so determined not to be fooled again that they've convinced themselves they are still imprisoned in a dark, smelly stable. Lucy, the little girl who is High Queen of Narnia, is upset that they seem so miserable and so she picks violets for them.

'She leaned across and held the fresh, damp flowers to his nose. But she had to jump back quickly in order to avoid a blow from his hard little fist. "None of that!" he shouted. "How dare you! What do you mean by shoving a lot of filthy stable-litter in my face?"'

Even Aslan the Lion, the Christ-figure of the tale, tries to give the Dwarfs delicious food and drink, but they see only slops and rubbish. They refuse to trust anyone or anything, vowing repeatedly:

'Well, at any rate there's no humbug here. We haven't let anyone take us in. The Dwarfs are for the Dwarfs.'

Has the Personal Assets Board been as obstinately blind as the Dwarfs?

Quarterly N^o. 44 (March 2007)

A Prophetic Play

A few years ago the National Theatre put on a revival of Harley Granville Barker's perceptive 1905 play *The Voysey Inheritance*, which gripped me powerfully when I first saw it as a teenager. It tells of how one day the senior partner of Voysey & Son, an apparently prosperous firm of solicitors, reveals to his horrified heir that the firm has in reality been insolvent for years. Capital held in trust for clients has been devoured to maintain the Voysey family's high-spending lifestyle, while the clients have been kept happy with what appeared to be continuing interest payments on their now vanished or misappropriated capital. When his father dies, the son is left with the choice of continuing the fraud or coming clean with the clients, leaving them hopelessly impoverished and the Voysey family itself bankrupt.

The play is, in effect, a microcosm of today's world – apparent prosperity built on a morass of debt, *legerdemain* and panicky short-term expedients.

Quarterly N^o. 62 (August 2011)

Foxes and Hedgehogs

The philosopher Sir Isaiah Berlin may not be a familiar figure in the workaday world of money management (Sir Winston Churchill, when issuing a luncheon invitation, famously confused him with the songwriter Irving Berlin) but his best-known insight has a lot of relevance to investment. Taking up a reference by the Greek poet Archilochus, he divided thinkers and writers into two categories – the fox, which knows many small things, and the hedgehog, which knows one great thing.

This can apply to portfolio managers too. The 'foxes' are the ones who buy a little of this and a little of that, to get exposure to a wide variety of areas. What fascinates them is the investing process, and they love diversifying, spreading their risk and making lots of bets, at least some of which are certain to come right. They energetically top-slice or top up portfolio investments and are never creatively idle. Indeed, they don't recognise the concept of creative idleness.

Doing nothing makes them feel guilty, and they feel that any activity is better than none.

'Hedgehogs', on the other hand, are clear as to their objective and are single-minded in pursuing it. There is a bit of the 'fox' and of the 'hedgehog' in all of us, but I like to think of Personal Assets as being managed in a 'hedgehog' fashion, all our efforts being directed not towards 'beating an index' or 'outperforming our peer group' as if we were engaged in playing some sort of game, but rather towards protecting and increasing (in that order) the value of shareholders' funds per share over the long term, which shareholders voted overwhelmingly to approve as our investment objective.

Quarterly N^o. 80 (June 2016)

'We're Off to See the Wizard'

To the best of my knowledge no-one has so far identified L Frank Baum's *The Wizard of Oz* as one of the world's great investment classics. But something in the way the Wizard is portrayed – as someone who is seemingly all-powerful and all-knowing, but is in fact a rather pathetic confidence trickster from, of all the unlikely places, Omaha, Nebraska – makes me think of the horrors that can ensue when the least reputable kind of investment manager confronts the least well-prepared kind of investment client.

(I'm relieved to say that *The Wizard of Oz* was written long before Warren Buffett, who runs Berkshire Hathaway, one of our US holdings, made Omaha, Nebraska, famous as a centre of successful portfolio investment.)

Many readers will remember the notorious Bernie Madoff investment scandal of a decade ago, when some 4,800 investors made a paper loss reported as being $64.8 billion. The scene in December 2008 when Madoff told his two sons he was 'finished', that he had 'absolutely nothing' left and that his investment fund was 'just one big lie' and 'basically, a giant Ponzi scheme' is irresistibly reminiscent of the Wizard's confession to Dorothy, the Cowardly Lion, the Scarecrow and the Tin Man:

'I have fooled everyone so long that I thought I should never be found out.'

Beware, then, of any investment managers who make claims of predictable and satisfactory returns irrespective of circumstances. Good investment managers are not omni-competent wizards and they do not operate in isolation from the unpredictable adverse factors that affect everyone else. Instead, they are more like mountain guides – learning constantly, experienced in what can go right and what can go wrong, capable of avoiding mishaps, minimising harm and finding new routes, but still fallible and able to be caught out.

Similarly, good investment clients are prepared to ask questions and, if they don't understand something, are prepared to say so. Many people – especially men, according to those who write about psychology – hate to confess that they don't know things. But it's better to look ignorant, get sensible answers and make wise decisions than look savvy and make expensive mistakes.

Quarterly N^o. 91 (February 2019)

Trusts and the Caucus-Race

(Fans of Lewis Carroll will note that I have considerably abbreviated the account of the Caucus-race for reasons of space)

They say that lovers of sausages should never watch them being made. I feel rather the same about year-end trust performance tables, with which I once had a great deal to do. When I worked for Wood Mackenzie during the 1980s and 1990s we were employed to produce for newspapers and investment magazines various year-end trust performance rankings and awards. These grew in number with the passing years, adding more and more sub-classes and types of specialisation. The result was that the exercise came to resemble the Caucus-race in *Alice in Wonderland:*

'What I was going to say,' said the Dodo, 'was, that the best thing would be a Caucus-race.'

'What is a Caucus-race?' said Alice. 'Why,' said the Dodo, 'the best way to explain it is to do it.' First it marked out a race-course, in a sort of circle, and then all the party were placed along the course, here and there. There was no 'One, two, three, and away,' but they began running when they liked, and left off when they liked, so that it was not easy to know when the race was over. However, when they had been running half an hour or so, the Dodo suddenly called out 'The race is over!' and they all crowded round, panting, and asking, 'Who has won?'

This question the Dodo could not answer without a great deal of thought. At last the Dodo said, 'Everybody has won, and all must have prizes.'

The curious thing is that there is probably more value in measuring trust performance by a Caucus-race than by a league table. Why should I compare Personal Assets to the FTSE All-Share? I don't want to have the same level of risk as the All-Share, and I don't want my capital to be as volatile. And I definitely don't want whoever manages my money to treat the stocks in the All-Share as a list of suggested investments. The Caucus-race approach recognises that trusts do different things over different time periods, and are more concerned with trying to achieve their own stated objectives than with competing against each other. I remember from schooldays a verse by the great American sports writer Henry Grantland Rice which went:

'For when the One Great Scorer comes
To mark against your name,
He writes – not that you won or lost –
But HOW you played the Game.'

Stripped of any sentimental overtones, it conveys a great truth: what matters is how you play the game – or, in modern idiom, how well you deliver what it says on the tin.

I try to avoid *clichés*. You won't find me using words such as 'robust' or 'vibrant' without inverted commas to mark them out as what they are, and you will never catch me using 'raft' when I mean simply 'a large number'. But one *cliché* I welcome is the one I used in the previous paragraph: 'It does what it says on the tin.' This delightful expression cuts right through sloppy vagueness and prevarication to provide a simple and infallible test.

Quarterly No. 92 (June 2019)

A Forecaster's Nightmare

Science fiction fans of a certain age may recall Isaac Asimov's celebrated *Foundation Trilogy*, set in the far future in the declining days of the First Galactic Empire. The galaxy's greatest analyst and forecaster, a mathematician called Hari Seldon, has spent his life developing a theory of 'psychohistory', which can predict the future of large populations. Seldon foresees the imminent collapse of the Empire and a dark age of 30,000 years before a Second Empire can arise. Although the momentum behind the fall of the First Empire is too great to be stopped, Seldon devises a plan (known as the Seldon Plan) whereby the interregnum between the two empires is limited to just a thousand years.

To implement his plan, Seldon creates the Foundation – two groups of scientists and engineers at opposite ends of the galaxy – to preserve the spirit of science and civilisation and be the cornerstones of the new Galactic Empire. But Seldon predicts that various crises will occur during the thousand years in which the Second Empire will be evolving. Should the leaders of the Foundation make the wrong decision regarding any of these crises, the Foundation may fall.

At each crisis, a Time Vault opens on the planet Terminus and a hologram of Seldon (now deceased) explains the crisis's significance to the Foundation. This happens four times, and on each occasion Seldon, speaking by means of the hologram, correctly describes the nature of the crisis and the steps that must be taken by the leaders of the Foundation to resolve it. But the leaders judge the fifth crisis has come when an external threat arises in the form of a mysterious being known only as the Mule. He is a mutant and possesses the ability to sense and manipulate the emotions of others. He uses this ability to take over the planets bordering the Foundation, and has them wage war against it.

As the Mule advances, the Foundation's leaders assume that Seldon will have predicted this attack and that his next hologram appearance will, as before, tell them how to defeat it. To their horror, however, Seldon predicts a civil war (which does not happen), not the rise of the Mule (of whom he makes no mention). The hologram then goes blank as Terminus suffers a power failure in an attack by the Mule, and the Foundation falls.

Yet there is hope. As one of the leaders of the Foundation puts it to a colleague:

'When Seldon fails us, our prop disappears and we've been leaning on it so long, our muscles are atrophied to where we can't stand without it . . .

'And you see a way out?

'No, but there must be one. Maybe Seldon made no provision for the Mule. Maybe he didn't guarantee our victory. But, then, neither did he guarantee defeat. He's just out of the game and we're on our own.'

And so it is with COVID-19. The unthinkable has happened. Black swans do exist. Our compasses no longer work. Our maps stop just where we need them to continue. Many business models hitherto invincible now face existential challenges. The rug has been firmly pulled from beneath investors' feet and prior assumptions are invalid.

Quarterly No. 95 (July 2020)

Bin Ends

The famous old maxim, 'First, do no harm', is one which counsels against such rash reactions. It should be engraved on the heart (or wallet) of anyone who manages money.

Quarterly No. 91 (February 2019)

Fund managers often feel that some action is necessary because of the terms of their investment mandate. But to quote the wise words of Warren Buffett:

'The trick is, when there's nothing to do, do nothing.'

Quarterly No. 91 (February 2019)

Investor Psychology

The Time Illusion

Every time shareholders or financial advisers come in to the office I know that sooner or later the inevitable question will be asked:

'How long do you think it will be before the market starts rising?'

Here I want to make an observation about investors' psychology (an interesting subject, about which one never stops learning).

Over the last couple of years of equity prices in the doldrums I have been startled to realise that, when looking at markets, investors both professional and private seem to think predominantly in terms of periods of time – will it be three months, six months or a year until the next market rally?

In real life it doesn't work that way. Stuck in a motorway tailback, your first thought may be to ask, 'How much longer will I be stuck here? Half an hour? An hour?' But a moment's thought will show that it isn't really a question of time. You'll stop being stuck not once a predetermined amount of time has gone past, but once the blockage obstructing the traffic has been cleared – which may take five minutes or five hours, depending on the nature and severity of the blockage and the amount of effort required to clear it. Five minutes may be more than enough; five hours might be very quick work indeed.

What is the blockage obstructing markets at the moment and preventing them from rising until it is cleared away? It is the substantial overvaluation of equities that I wrote about in the last Quarterly and which still persists. Equities continue to be far too expensive just now and markets cannot begin a sustained upward movement until equities are attractively valued once more.

(I choose the words 'a sustained upward movement' with care, because there are sure to be lots of little rises – and falls too, some of which may not be so little – before that sustained upward movement arrives.)

Quarterly No. 24 (March 2002)

A Tale of Two Trusts

An old friend of mine with a fondness for investment trusts comes to see me for coffee every so often and to pour out her miseries and regrets. This might seem an odd thing for her to do, because she's done rather well from her investments over the years (she's also one of the most intelligent people I know), but she suffers from what might be called 'chronic comparisonitis' – a common condition among investors, and a side effect of the otherwise praiseworthy practice of portfolio diversification.

She has two main investment trust holdings. One is Personal Assets, and the other is a large and well-regarded Scottish generalist. As is only to be expected, her two trusts never perform exactly in line with each other. They have different investment philosophies and aim to fulfil complementary needs. Personal Assets has its cautious, low-risk approach to investment while the other trust is managed more conventionally and sits somewhere in the middle of the risk spectrum.

Alas! As soon as you hold more than one investment, one of them is an underperformer. Your portfolio has become a league table. Accordingly, always in my friend's mind is the nagging thought that if only she had invested entirely in the trust which has recently performed better, she herself would be better off. She is one of those investors who tends to see things not in terms of risk avoided, but rather of opportunity missed and price appreciation foregone. Diversification of risk is a principle designed to bring peace of mind. In my friend's case, however, it seems to bring mainly vexation and stress.

Nearly 40 years in the investment business have taught me that there is a surprising number of investors who, despite paying lip service to the importance of diversification and minimising risk, worry scarcely at all about risk except during actual market collapses, when it is impossible to ignore it. Instead, they worry that they aren't making as much money as they might, or that other investors may be doing better than they are.

Opportunity lost, not danger avoided, is what is generally uppermost in their minds.

That's why it's so important not to become fixated on the 'league table' approach to performance. If Wisden ranked cricketers only by the number of runs they scored and ignored everything else, the results would doubtless be eye-catching but they would be very misleading. Likewise, it wouldn't make much sense to say that Gordon Banks or Neville Southall were rotten footballers because they never scored goals. They were goalkeepers, and it wasn't their job to score goals.

Quarterly N°. 72 (June 2014)

Introducing 'Relativititis'

Quarterly N°. 72, published in June 2014, described an ailment called 'chronic comparisonitis'. Sufferers from it forget that an investment portfolio is – or, at least, should be – a structured entity in its own right, possessing various qualities intended to complement one another. Instead, they see a portfolio as a league table of unrelated investments, and spend their time wishing that they had invested all their money in whichever shares happened to be topping the table when last they looked. Diversification of risk by holding a spread of investments is a sound principle designed to bring peace of mind. But to the unfortunate sufferer from 'chronic comparisonitis' it all too often brings vexation and regret.

Related to 'chronic comparisonitis' is 'relativititis'. Thinkers such as Richard Hoggart, the cultural historian, and Pope Benedict XVI have described what they perceive as the modern loss of belief in moral absolutes as 'the tyranny of relativism'. From the point of view of an investor, its meaning can be expanded to encompass the loss of a sense of absolute value. Confronted by a set of unattractive options, sufferers can feel tyrannised into choosing the least unattractive of them rather than judging them in terms of absolute attractiveness or lack of it and, if none of them appeals, not choosing any of them.

Investment managers can easily get caught in this 'relativititis' trap. When shareholders are clamouring for action and the market keeps on soaring skywards, any investment looks better than none. But that is when some of the worst investment mistakes are made. How many fund managers plunged into technology, media and telecommunications stocks in early 2000, when their run was coming to an end but their names simply had to appear in a published portfolio list? Probably about as many as piled heavily into 'Nifty Fifty' stocks on Wall Street in the early 1970s, just as those stocks were embarking on a decade or more of underperformance. How much better it would have been to have kept the cash for use when there really were unmissable bargains around.

Some investment funds, of course, don't have a choice in the matter. They are designed to be fully invested. In particular, geographic or sector specialists set out to be subcontractors within their specialist areas, leaving decisions about liquidity to the trust's shareholders themselves. But Personal Assets isn't like that. For all practical purposes it is a private investor writ large. Of course, we couldn't stop institutions holding our shares even if we wanted to. But the Board and the Investment Adviser together run the portfolio not for any particular class of institutional investor but as if we were managing our own personal capital – which, of course, is exactly what we're doing.

Personal Assets' aims and objectives are those of the Directors and the Investment Adviser, who want to protect and increase (in that order) the value of their investment over the long term. Although sometimes we can learn from what other investment trusts are doing, we don't have to worry about comparing ourselves to them all the time, because we don't think of them as competitors. We are interested in absolutes, not relatives. As one commentator wrote recently, Personal Assets 'marches to the beat of its own drum'.

Just as we don't have to match or mirror the composition of an index or measure ourselves against one, we don't have to be fully invested if we don't think it right to be so. As in the case of all private investors managing their own money, nothing prevents us from structuring our portfolio exactly the way we want it. We're immune from 'relativititis'. It is the antithesis of the way we operate. We buy investments because we believe them to be attractive in their own right, not because we think they're the best of a bad lot. We aren't obliged to hold stocks of any particular size or in any particular sector. If we want to, we can use liquidity or gearing – and if the portfolio composition we think best at any given time means holding a large amount of cash, so be it.

Quarterly N°. 73 (August 2014)

The Meaning of 'Performance'

What do we mean by 'performance', and how do we measure it? One of the most frustrating things I've encountered during my nearly 40 years of involvement with the investment management industry is what I call the 'portfolio manager as blinkered idiot' theory.

As long ago as 1995, in Quarterly N°. 3, I was lamenting how Ian Rushbrook and I were constantly being asked questions such as: 'Personal Assets is a diversified trust, so why don't you invest in the Far East?'

(I went on to explain that for 'Far East' you could equally well read 'emerging markets', or 'unlisteds', or 'small companies', or 'property', or just about any other asset class you cared to mention.)

The implication always seemed to be that we were living in a world overflowing with profit opportunities which should be as readily apparent to the onlooker as they were tempting to the investor – a veritable magic orchard full of low-hanging fruit crying out to be plucked – and that it could only be masochistic bloody-mindedness that was stopping Ian and me from piling up our basket with these obvious succulent delights.

Quarterly N°. 80 (June 2016)

Bin Ends

I once upon a time had a schoolmaster who, uncharacteristically, decided to take up gardening and planted some potatoes. They did not thrive, because every week he kept digging them up to see how much they had grown. Many investment managers are like this. They do not give their investments time to come to fruition. Indeed, they are often not intended to come to fruition. They are bought in the hope of making a short-term turn, or to provide some extra degree of 'diversification'.

Quarterly N°. 10 (November 1996)

Just because something looks obvious doesn't mean it's wrong. Patrick Hosking, the *New Statesman*'s City columnist, recalled recently the story of how two economics professors were once walking across a Cambridge court. (Mr Hosking actually wrote, 'a Cambridge quad', but we have courts in Cambridge, not quads.)

'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.'

Quarterly N°. 36 (April 2005)

In the days when a referendum on Scottish independence seemed about as likely as the Bank of Scotland going bust, I used to tease my English friends who lived in Scotland that when the day of freedom dawned, all their assets would be expropriated in return for Kingdom of Scotland 2% Irredeemable Stock. How far-fetched I imagined this to be! But in last year's bond markets such a stock might well have gone to a premium and my departing English friends would have been laughing all the way to the airport.

Today they are laughing all the way to the Zoopla website, to see how much they are making in the housing market, thanks to nice Mr Osborne and his 'Help to Buy' scheme. The British feel so thoroughly at home with rising house prices that every few years they stop seeing it as a bubble and begin to think of it as part of the natural order of things. Which it isn't.

Quarterly N^{o.} 70 (November 2013)

Performance Measurement

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 folk always treasure it —
'It isn't what you measure, but the way in which you measure it . . . '

How to Measure Performance

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?
- ***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 (to a lesser extent) on the third. We have not, unlike many trusts, emphasised 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.

This does not mean, however, that Personal Assets is a kind of closet 'absolute return' fund. Absolute return has become a fashionable concept in recent years, largely because of the growth of hedge funds. 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, they 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? There are 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 originally chose the FTSE All-Share as a 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. The FTSE All-Share therefore 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 nearly two decades 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. 'Total return' assumes the reinvestment of dividends as these are paid or become payable. 'Capital only' assumes that dividends are not reinvested.

Why 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 and late 1970s state-of-the-art 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. 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 the section headed 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.

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 it can have its uses, as long as we look past the *'how much'* to the *'how'* and *'why'*.

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 average 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.

- A woman pays a fire insurance premium but her house does not burn down. Nor does the (uninsured) house of her 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 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.'

Virgil, Æneid, I, 204-06

(Through misfortunes of many kinds,
through so many critical moments,
We are heading for Latium,
the quiet home that the Fates promise.
There it is ordained that
the kingdoms of Troy will rise again.)

Quarterly N°. 41 (June 2006)

'You Picked the Laggards . . . '

If I've learned anything from writing these Quarterlies, 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 (then) 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.

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

(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 from ours; Law Debenture, which also owned and ran a trusteeship business; and Martin Currie Portfolio (formerly Scottish Eastern), which had undergone major structural change.)

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 Personal Assets 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 Personal Assets' absolute performance in a better light!'

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 those 'leviathans', rather than as a would-be star, with all the risk that this would involve. It's been nice when we've topped 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.'*

My correspondent replied, with some surprise, that he had never thought of Personal Assets in that light; and it's strange how the erroneous view persists that we are a trust that aims to shoot the lights out.

Quarterly №. 41 (June 2006)

Turning to Total Return

The Chairman mentions in his Statement the apparently increasing emphasis in the Report & Accounts on total return. He is enthusiastic about the concept of total return. I am less so, and he and I have been debating this for thirty years without yet coming to a common mind on the subject. Both of us agree that total return is the standard way of measuring long term return in the investment world in general. It is what the investing institutions recognise, it is what most investment funds use as their headline return figure and it is the AIC's preferred method of performance measurement. But is it useful to individual investors in real life? I'm not sure.

Speaking for myself, I focus on the movement in my share price over the years and the growth in my dividend over the same period. I think of them differently, and combining them doesn't help me.

Some people see an essential unreality in total return calculations in that most real-life investors in shares don't reinvest their dividends. Oddly enough, I don't fall into this category. My wife and I do reinvest most of ours, from our shares in the Personal Assets ISA and Investment Plan, but I still don't think in terms of the total return from those shares, whereas others, I know, do think of it in that way.

Judging by the thirty years of bickering between the Chairman and myself over this, I don't think there's any right or wrong answer. Since different ways of looking at things are useful for different purposes, it seems appropriate to introduce total return calculations to the Annual Report while keeping the capital and dividend growth ones too, thus giving the Chairman, me and the rest of the shareholders the best of both worlds.

Quarterly №. 57 (June 2010)

The Past *Can* be a Guide

A shareholder once asked me why, given the incessant repetition in investment documentation of the mantra that 'past performance is no guide to the future', the Investment Adviser's presentation was full of material relating to the past.

As it happens, I disagree with conventional wisdom on this point. Past performance can indeed be a guide to the future, although neither an infallible nor a universally applicable one. Every political pundit, stock analyst and racing tipster acts on the belief that the past can guide us, and 'horses for courses' is here applicable metaphorically as well as literally. I can make a fair stab at predicting how Personal Assets will do in both absolute and relative terms in different types of market. In 2013-14 I would have got it wrong, but long term holders will vouch for the essential predictability of our returns most of the time, as well as the predictability of the returns from other trusts which have a consistent investment approach. Investment management is hard enough without ignoring the lessons the past can teach us – and when history is forgotten, people make mistakes.

Quarterly №. 77 (September 2015)

Bin Ends

I am not a fan of the use of the CPI in preference to the RPI as a measure of inflation. To quote a recent statement from

Unison, the public sector workers union, which has obviously wised up to Mr Brown:

'The idea of inflation that doesn't count housing or energy or seasonal food costs might be fine for statisticians and mythical people who don't live anywhere, don't eat anything and don't have to spend money on gas or electricity.'

Bearing in mind the omission of Council Tax from the CPI, one suspects that this is a pretty accurate description of how the government visualises pensioners and others on fixed incomes.

Quarterly Nº. 49 (June 2008)

What Ian Rushbrook and I originally planned in 1983 was to take as our benchmark 'the assured returns available from index-linked gilts'. We didn't do so because at the time we were told it lacked credibility – it would be too easy to beat. But I often wish we had stuck to our guns. Relative performance doesn't interest us and if we were starting again we probably wouldn't have a comparator.

Quarterly Nº. 88 (June 2018)

There are pieces of analysis left over from my early days that I can now read only with toe-curling embarrassment. One of these is to be found in the Wood Mackenzie Investment Trust Annual 1985. It described in great detail the possible ways of measuring investment performance, some well established and some I had just invented. I've confessed before how in describing how performance measurement might develop I even speculated about the possibility of devising a 'Management Olympics' ranking all trusts by Overall Factor and all management groups by Management Group Overall Factor (don't ask).

At the time, I was proud of what I believed to be innovative thinking. Now it seems to me that I was trying to reduce the art of Rembrandt or Van Gogh to 'painting by numbers'.

Quarterly Nº. 92 (June 2019)

Why measure performance over ten years, not nine years or 11 years? Having been brought up in a world in which there were 20 shillings to the pound, eight furlongs to a mile and 5½ yards to one rod, pole or perch, I learned fractions long before decimals and I have no great loyalty to systems of measurement based on the number ten.

Quarterly Nº. 92 (June 2019)

Private Investors and their Problems

Private Investors

This is the last in a series of three Personal Assets Quarterlies dealing with the problems facing the private investor. In Quarterly N$^{o.}$ 27 I set the scene for the discussion and argued that in my opinion private investors, even those with millions to invest, were usually best served by a portfolio of half a dozen good general investment trusts. In Quarterly N$^{o.}$ 28 I responded to some queries raised by shareholders. My aim in Quarterly N$^{o.}$ 29 is to draw the various threads together and bring my argument to a conclusion.

Here the 'Question & Answer' ("Q&A") format suggests itself. This can sometimes be exasperating for the reader, as in lots of those new-style, supposedly more 'user-friendly' official documents in which a Q&A sets out patronising and unhelpful answers which nobody can understand to questions which nobody would ever ask. In writing this Quarterly, however, I have had no such problems. I know only too well the questions people are asking, because they write and tell me; and I know what kind of answers they need, because they soon let me know when my answers don't satisfy them.

Accordingly, what follows is not a report of an actual conversation, but it could have easily have been so. It is an imaginary dialogue between a shareholder and myself, an amalgam of conversations and correspondence I have had over the last six months.

What's the problem? There are lots of well-recognised ways for private investors to invest their money in the stock market.

Our Chairman, Bobby White, (who is not only himself a retired stockbroker but also someone who gave his name to a large and well-respected private client broking firm) has a favourite saying:

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

Ian Rushbrook claims that this could be extended to investment managers as well. The common thread? Always too much pressure to 'do something', resulting in too much buying and selling.

Perhaps the simplest fact of life for a private investor is that buying and selling can (literally) cost you a fortune. It makes no difference whether you manage your portfolio yourself or pay an adviser to do it on your behalf. Active portfolio management always means buying and selling. Thanks especially to Capital Gains Tax (and despite the steep market falls of the last three years, most long-established portfolios are still heavily pregnant with capital gains), this costs the private investor money.

There are lots of good independent financial advisers (or wealth managers, or whatever you want to call them) in the market place, as well as some bad ones. All of them, however, will involve you in doing what buying and holding a range of generalist investment trusts never will – paying CGT year after year. This guarantees that active management, whether by yourself or by an adviser, will be cost-ineffective.

It's better to spend your money on a lawyer or accountant who will find the best tax structure for your finances as a whole, than on paying tax that (if you invested through investment trusts and held on to them) you wouldn't have to pay.

You don't seem to be very keen on people having their money managed directly for them by professional financial advisers.

I wouldn't want to put it quite like that. It would be far too sweeping. The trouble is, however, that entrusting your money even to the best-known and most prestigious of personal financial advisers can be a gamble – and I've tended to meet the losers.

Here's a horror story for you. Ian Rushbrook and I know an expatriate couple who at their retirement some years ago had around US$50 million of capital to invest. On the recommendation of friends prominent in the financial world, they arranged for their money to be managed by a leading Swiss bank. It was not a success. Over a period during which markets in general rose, their \$50 million fell in value to \$25 million.

Understandably dissatisfied, during the second half of 1999 (just as equity markets worldwide were on the verge of peaking) the couple interviewed some of the most highly respected private client fund managers in the UK and abroad and grilled them about their views. Needless to say, they got the same enthusiastic advice from all of them:

'Now is an excellent time to buy equities!'

The only dissenting voice was Ian's (they had contacted him through friends they had in common). Ian told them he thought markets were hugely expensive and riding for a fall. However, Ian was not pitching for their business – and anyway, what was one voice among so many, all urging them to buy equities?

So they transferred their remaining \$25 million to an international bank specialising in managing money for wealthy individuals. Despite this bank's excellent reputation and impressive presentation skills, however, they found that their affairs were in the hands of an eager 25 year old lad who soon started churning their portfolio aggressively. Before long, it was under-performing again – whereupon the eager lad (contrary to the couple's instructions) began investing their money heavily in US over the-counter technology stocks.

By now it was the middle of the year 2000, so readers will not be surprised to learn that many of these technology stocks quickly joined the '90% club' of companies which had lost 90% of their market value from their peak at the start of 2000. All in all, by this year the couple's \$25 million had halved again to around \$12.5 million.

This is an appalling story, all the more so because the couple did not fall into the hands of sharks or scoundrels but had their money managed by blue-chip names of the highest reputation. Of course, pretty well anyone who invested in equities at the start of 2000 would have lost money by 2003. But the damage done to the couple's wealth by these high-powered, prestigious private client fund managers was far worse than would have resulted from investing in a few 'boring' diversified trusts.

Despite such hard cases, surely it's better to get a personal service tailored to your own requirements than to be just one investment trust shareholder among thousands?

Why? After all, what are your requirements? Surely, to protect and increase the value of your capital over the long term. Endless costly buying and selling and paying Capital Gains Tax won't achieve that, irrespective of how bright the managers are. And why should placing your £100,000, £1 million or even £10 million with a wealth manager buy you a better service than a £1,000 million investment trust will get from its own dedicated team of professional managers?

In my experience, people often feel that having their money managed by a wealth manager is the proper and expected next step up from holding investment trusts or other pooled investment vehicles. They think that the only appropriate kind of investment management for people in their position is something with a designer label. But it shouldn't be a matter of what sounds best at the golf club. It is a paradox that the richer you are, the less logical it is (because of the impact of CGT) to use discretionary fund management and the more advantageous it is to invest through investment trusts.

You talk a lot about 'generalist' trusts. But depending on your definition, the term could cover anything from well over a hundred trusts to a mere dozen or so.

This question has already cropped up several times in my postbag, so I'll quote from what I recently wrote to one shareholder.

'To put it in a nutshell, the kind of trust I mean has probably been around for the best part of a century, will have a market capitalisation of at least a quarter of a billion and may well be managed in Scotland or at least have Scottish links. But I don't want to make

exclusive claims for such trusts. I invest in trusts of that kind because of the kind of person I am, the kind of place I live, the kind of training I've had and the kind of people I know . . . I suppose ultimately one feels happiest investing in what one personally knows, likes and trusts.'

I must stress that there are trusts I would happily buy that don't meet all these criteria. There are many trusts which would be at home in an individual investor's portfolio like my own – notably our fellow independently-managed trusts Alliance and Second Alliance, the Dundee-based standard-bearers of the private investor market.

Can't you get the same effect from holding a range of geographical specialists as from holding some diversified trusts?

Yes, but it's a lot more work. You have to be a fund manager yourself, deciding what markets and currencies to be in. Then you must monitor the portfolio carefully, making sure it reflects your preferred mix of markets and currencies at any given time. Even though I've spent my entire working life in the investment business, I still don't feel competent to do that for myself singlehandedly. I'm sure that this feeling is shared by many private investors who know just enough about investment to be conscious of how little they actually *do* know!

How can you guarantee that the Boards and managers of general trusts will behave sensibly and not, for instance, get gearing or liquidity badly wrong?

You can't. All you can reasonably expect is that, while they may get it badly wrong, they don't get it so disastrously wrong that the trust is crippled for the future. The only way to hedge the risk (and it's very far from perfect, since investment managers always tend to hunt as a pack) is to spread your investment over several trusts. This is why I always speak of investing in half a dozen, rather than just one or two.

Please note, however, how much greater the risk is from gearing and liquidity than it is from individual stocks. Individual stocks are eye-catching but usually irrelevant. To take the worst possible case, occasionally a major company does go bust. If this happens, an investment trust which holds the stock may lose 2% or 3% of its assets. Even if a trust's top holding goes bust, a loss of 5% or so would be regrettable but hardly catastrophic.

You and others endlessly talk about 'investing for the long term'. But I never know what is meant by long-term investment.

How long is 'long term'? How long is a piece of string?! It's an expression that can easily be used as a cop-out in the investment management world. As the Red Queen in *Alice in Wonderland* said, it can mean *'what I want it to mean, nothing more, nothing less'*. The trouble is that 'long term' genuinely does mean different things to different people in different situations. For instance, a market-maker might think of it as 48 hours. On the other hand, when asked for his opinion of the effect of the French Revolution, Chou En-lai (the Chinese Premier under Mao Tse-tung) famously remarked:

'It is too soon to tell.'

You should therefore decide what 'long term' means to you and choose managers who employ the same timescale.

How important are management and other costs?

Not very. Not enough for management costs to be the main factor in making your investment decisions, anyway. There are lots of commentators on the investment trust industry who get very uptight about management fees. However, it seems to me that they often allow a kind of moral outrage to overcome their investment judgement. Sometimes this moral outrage is unjustified; sometimes it is simply irrelevant. Look, for example, at Jean-Pierre Garnier's much-criticised £5m a year and possible £22m severance package at GlaxoSmithKline. In the context of Glaxo SmithKline's £80bn market capitalisation it is of no economic importance to shareholders. But if M. Garnier really is the best value-adding manager for the job and they lose him as a result of quibbling over his pay, shareholders will have done themselves economic damage.

As with the Boardroom 'fat cats' who today evoke so much indiscriminate sneering, some apparently high fee rates may be worth every penny while some cheaper-looking ones would still be dear at half the price. (*'The labourer is worthy of his hire.'* Luke 10.7) What is important is value for money, and that (rather than fees and expenses in absolute) is what I look for in an investment trust.

You would sing the praises of investment trusts, though, wouldn't you? You work for one yourself.

Yes, I do indeed work for an investment trust. But I don't praise investment trusts just because I work for one. I work for one because I have deliberately chosen to do so in preference to any other area of the investment world. This is because I think investment trusts are the best. Of course, in practice they can fall short of the best; and however excellent the investment trust structure may be in theory, this is no guarantee against failure or misuse. But we think that well-run investment trusts are still unbeatable as investment vehicles for private investors.

OK. Summarise the case for us.

- Investment trusts offer private investors the benefit of full-time, professional portfolio management, while the direct relationship between the shareholders and the Board of Directors they elect ensures maximum accountability.
- Investors managing their portfolios directly or through an adviser can't offset any of their investment management, administration or interest costs against tax. Investment trusts can offset all such costs against tax.
- Higher-rate taxpayers are currently taxed at 40% on all realised capital gains in excess of £7,900 per annum. Such investors managing their portfolio themselves or through professional advisers will therefore find themselves either paying CGT or being forced to make unsuitable, tax-driven investment decisions. Investment trusts are wholly free of CGT on gains realised within their portfolios and so can buy and sell shares on investment grounds alone.

Ever heard of Victor Kiam? No, I hadn't, either – but then I haven't shaved for over 30 years, so it's understandable. An American entrepreneur, he was famous for his TV advertising slogan for Remington Razors, of which he was Chairman and part owner:

'I liked the shaver so much, I bought the company.'

Ian Rushbrook liked the story because this is what he did too. He liked investment trusts so much, he decided to manage a major part of his own money through Personal Assets, the trust he and I together created.

Both Ian and I love investment trusts. Neither of us would ever want to do anything else. Indeed, such are our feelings that for words to express them we can only turn to Sir Winston Churchill himself:

'My tastes are simple. I am easily satisfied by the best.'

Quarterly N^o. 29 (May 2003)

(Here I can't resist quoting Homer's words from the *Iliad, 'αἰὲν ἀριστεύειν καὶ ὑπείροχον ἔμμεναι ἄλλων' ('always to be best, and to be distinguished above the rest')*. From this comes 'αἰὲν ἀριστεύειν', the motto of the University of St Andrews – words which inspired me through the four happy years I spent there.)

Money Laundering

We live in suspicious times. A few months ago I wanted to make my wife a joint signatory of a bank account I have been using since 1970. The account is held at the same branch of the same bank that four consecutive generations of my family have banked with ever since the year 1900, when Queen Victoria was on the throne. Given this long history, and given that I have been married to my wife for 28 years and she is a blameless character (or a better actress than I suppose), and especially since she herself has been an individual customer of the same bank, also since 1970, I imagined that to get her name added to my chequebooks would be the merest formality and would be done merely on my say-so. Far from it. It came as an unpleasant surprise when *inter alia* the bank demanded to see her passport, no less. Of course, it is not the bank's fault. They didn't make the rules. But it sticks in my throat that the government seems to regard us all as money-launderers until proven innocent. This is not what British justice is meant to be about (although I suppose it is easier work for the authorities than making the streets safe or catching burglars).

And there was worse to come. I found that I had to prove not only my wife's existence but also my own. The bank with which my family had banked for over a century still wasn't sure if I existed or not. They therefore demanded proof, and it had to be a particular kind of proof. I don't have a driving licence, because I can't drive and have no intention of doing so, and I don't have a passport because I don't travel abroad. I therefore found myself producing no fewer than 36 pieces of identification (including various items of correspondence from the bank itself and even a returned cheque signed by my great grandfather in 1910), pleading abjectly with the bank staff to admit that I was who I said I was. They eventually conceded this, but it was a maddening and bitter struggle.

I therefore could not sympathise more with those shareholders who have been caught out by all those infuriating official requirements to supply utility bills and goodness knows what else when taking out Personal Assets ISAs for the first time; and since I know from letters and 'phone calls that some shareholders think the Board of Personal Assets itself, rather than the government, is being deliberately obstructive and bloody-minded about this, I want to put the record straight. The Board dislikes these patronising and impertinent requirements every bit as much as you do; and it makes us angry when, for example, new shareholders attempting to take out an ISA lose the chance to have an ISA in that tax year simply because they forgot to send in a utility bill with their application or didn't even know they were supposed to do so.

Even those taking out their first Personal Assets ISA who have remembered to send in their utility bills, *etc, etc*, have sometimes fallen victim to the requirement for a 'cooling off period', which means that you cannot have your money invested for a period of seven days after you have sent in your cheque. A 'cooling off period' is undoubtedly appropriate for investment products that are actively sold to inexperienced investors who may, after 'signing up' in the enthusiasm of the moment, find themselves wondering later on whether they have made the right decision. Anyone subscribing for a Personal Assets ISA, however, in the view of the Board knows what he or she is doing and freely takes the initiative to apply.

Extract from Draft Paper
on Corporate Governance, 2006

[Note: While preparing this anthology I had occasion to transfer a modest sum of money from my account with one bank to my account with another. This took over an hour of inquisitorial and patronising third-degree interrogation during which I seemed to be suspected of being a fraudster, a money launderer, a Colombian drug baron, a sufferer from dementia and a tiresome child all at once, rather than an old fellow merely trying to access what was rightfully his. I would close the account, only I suspect that all other banks would nowadays be just as bad.]

Bin End

A cautious investor at the end of the last century always had the comfort of knowing you couldn't go wrong by putting all your money into one-decision blue chips like GEC or Royal Bank of Scotland.

Quarterly N^o. 63 (December 2011)

Random Reflections

Investors' Expectations

'That trust of yours is going nowhere,' the Chairman's sister (a shareholder) said to him recently.

Well, no one could accuse her of mincing her words. If, however, the Chairman's word is law (and in all good investment trusts it is), the Chairman's sister's words must at least merit respectful consideration. What, therefore, did she mean by her comment?

What she meant was something very simple, very straightforward and very obvious: over the last year or eighteen months there has not been much of an increase in Personal Assets' share price.

She was right, of course, and we shall come on to the reasons for the lack of movement in the share price later. What is interesting as a starting-point, however, is her assumption that there *ought* to have been movement in the share price – in other words, that if there is little upward share price movement over a year or eighteen months, a company somehow isn't doing very well or is letting its shareholders down.

The question this raises is a fascinating one. What do people expect from their investments, and over what time scale do they expect it? It's a question I have thought about a great deal over the years, but I've been thinking about it even more carefully during the last few days because a 13-year-old nephew of mine has just been issued with 250 shares in Bradford & Bingley. He knows I am involved in the investment world, so he has been asking me to tell him how the price of the shares will move over the next few weeks in order that he can decide whether to keep them or sell them.

(This is an important decision for him, because if he sells them he can buy a PlayStation with the proceeds.)

Those Bradford & Bingley shares are casting a cloud over my spirits as Christmas approaches. Not only my nephew but also his parents and his aunt (my wife) are baffled that I cannot predict for him what will happen to the share price over the next couple of weeks. What's the good of having an investment professional in the family (they mutter to themselves) if he can't even tell you a simple thing like that?

Neither he nor the rest of the family – let alone the barbers, taxi-drivers, members of the clergy and others who solicit my advice in the course of providing me with their professional services – can be made to see that it isn't simple. They just cannot be made to realise that predicting movements in equity markets (let alone movements in individual share prices) over all but the very long term is pretty well impossible.

Quarterly Nº 20 (December 2000)

Hutber's Law

One of the greatest advances in business wisdom during my lifetime must surely be Hutber's Law, which owes its name to Patrick Hutber, the late and much lamented City Editor of the *Sunday Telegraph*:

'Improvement means deterioration.'

Hutber's Law applies to virtually everything I can think of, from 'chip-and-PIN' cards, the railways and the educational system to the introduction of decimal currency, the abandonment of Imperial units of measurement and the near-destruction of the House of Lords.

In the words attributed to one of our greatest Prime Ministers, the 3rd Marquess of Salisbury:

'All change is for the worse, so let us have as little change as possible.'

Whatever Messrs Cameron and Davis may say, the best political manifesto ever produced in Britain was, I maintain, that issued in 1715 on behalf of the Church Party (as the Tories then called themselves) by Francis Atterbury, Bishop of Rochester. It had just 60 words and consisted entirely of a list of negatives:

'No new war, no new taxes; no attempt against the Church; no repeal of the conditions upon

which the crown was settled upon the King; no foreigners in employment; no standing army; no Long Parliament; no restraint of the liberty of the press; no insulting the memory of the Queen. TOTAL: No alteration of the Constitution in Church and State.'

Quarterly Nº. 39 (November 2005)

Milton Friedman's Death

Some people change the way we think. Milton Friedman was one of them. His life was spent trying to persuade politicians to replace the word 'fair' (a concept that exists only in the eye of the beneficiary) with the word 'free' (which distils the independent judgement of a great multitude of individuals throughout the marketplace).

In his 1980 TV series *Free to Choose,* Friedman extolled the *laissez-faire* policy of Sir John Cowperthwaite, Hong Kong's Financial Secretary 1961-72. A Scot (what else?) educated at St Andrews and Cambridge (where better?), Sir John declared in his first speech as Financial Secretary:

'In the long run, the aggregate of decisions of individual businessmen, exercising individual judgment in a free economy, even if often mistaken, is less likely to do harm than the centralised decisions of a government, and certainly the harm is likely to be counteracted faster.'

Sir John's legacy is enormous. On his appointment, the earnings of the average Hong Kong resident were about a quarter of those of a UK resident, but by the early 1990s average incomes in Hong Kong were higher than in the UK. This is what Scots can achieve at their best. For what they can do at their worst, one today need look no further than 11 Downing Street; but, as Quarterly Nº. 43 says of Capital Gains Tax, not all the worst taxes were devised by Gordon Brown.

Quarterly Nº. 42 (September 2006)

Strange Beliefs

People sometimes believe the oddest things. I'm not referring here to 'fake news' and all the weird and wonderful tales circulated on social media about everyone from the Pope and Donald Trump to the casts of *Love Island* or *Celebrity Big Brother*, but to the straightforward misconceptions that take hold about everyday matters. Here's one example. Recently a shareholder wrote to share with me his fears that an outside predator might launch a bid for Personal Assets. I was able to reply that, while bids have taken place in the investment trust sector and will probably continue to do so as long as trusts exist, the idea that this might happen to Personal Assets worried me not in the slightest.

Why would anyone want to bid for us? The usual justification for taking over an investment trust is to acquire cheap assets. This would indeed be worrying for the Board if Personal Assets' shares sold at a material discount, but they haven't done so since Discount Freedom Day in November 1999 and will never do so again. While buying £1 of assets for 90p makes good sense, buying the very same assets at 102p plus costs would make no sense at all.

It's true that sometimes an investment trust will be bid for not so much to acquire cheap assets as to put an indifferently managed pool of assets to better use. This, however, would again typically be mirrored in the existence of a discount and the mutterings of shareholder discontent, neither of which apply to Personal Assets today. I'm not one for making rash statements, but taking all these things together I feel I can say with confidence that Personal Assets is about as bid-proof as an investment trust can be.

Another common misconception concerns what an investment trust should aim to be doing for its shareholders. A very eminent trust Chairman once remarked to me, as if it were blindingly obvious:

'It's all about performance.'

Up to a point he was right, but there's a lot more to performance than how much you can get the net asset value per share ("NAV") to rise, which was what the trust Chairman had been talking about. The success or failure of an investment trust is no more limited to its NAV performance than the choice of a car has to do only with the speed at which it can be driven. While a Bugatti Chiron or a Lamborghini Aventador may go faster than other cars, they wouldn't be the obvious choice for the school run or pottering about town, to say nothing of their petrol consumption or the cost of insuring them.

Similarly, there are lots of things other than straightforward NAV performance that potential buyers of shares in an investment trust may want to consider:

- How much risk is being taken to achieve the NAV performance?
- Is possible extra performance a fair exchange for any extra risk?
- How volatile have the returns historically been? Does the share price properly reflect the NAV, or is there a persistent discount (or premium)?
- How great is the yield and how safe is the dividend?
- How hard is the portfolio being ridden to earn this dividend?
- How efficiently is the company run in terms of its Ongoing Charges Ratio ("OCR")?
- Does the way the company is managed meet the buyer's requirements on Environmental, Social and Governance ("ESG") matters, or on equality and diversity?

There are many other criteria I could mention here, but these should be sufficient to demonstrate that, while NAV performance pure and simple is a large part of the story, it's by no means all of it.

Quarterly N° 89 (September 2018)

Bin Ends

The accusation from one shareholder that our photographs had put his wife off her breakfast has hit home, and the dilemma remains one of which we are painfully aware.

Quarterly N° 1 (August 1994)

No flatulent and nauseating 'Mission Statement' will ever ooze from this address.

Quarterly N° 2 (November 1994)

National Westminster Bank can scarcely be called a glamour stock, but it was seriously undervalued and its management seems to have learned caution and common sense from the mistakes of the past.

[Yes, this seemed to be true – in 1995!]

Quarterly N° 6 (November 1995)

I don't expect that many shareholders have been poring over the *minutiæ* of our net asset value performance during a period in which our share price has risen from £87 at our 30th April 1995 year end to £120 at the time of writing. That's an increase of 38%, nearly twice as great as the rise in our NAV. Like being kissed in the dark, one feels inclined to say:

'Mmm, nice. But who's . . . errm . . . actually DOING it?'

Quarterly N° 7 (February 1996)

One of the silliest proverbs I was taught as a boy was:

'Take care of the pennies and the pounds will take care of themselves.'

Like all sceptical schoolchildren, I soon noticed that most such proverbs were contradicted by another equally famous one, for instance 'Many hands make light work' *vs* 'Too many cooks spoil the broth'. So here I offer as a riposte to the proverb I first quoted:

'Penny wise, pound foolish.'

Experience shows that the best hope of protecting one's capital in bad times or of making serious money over the long term lies in catching investment tides. Tides, not ripples, make performance.

Quarterly Nº. 30 (September 2003)

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.

Quarterly Nº. 36 (April 2005)

I was amused to read the recent leaked comments of the Hungarian Prime Minister, Ferenc Gyurcsány [as Glenda Slagg of *Private Eye* would have said, *crazy name, crazy guy!!!!!*] to the effect that he had to thank '*divine providence, the abundance of cash in the world economy and hundreds of tricks'* for keeping the Hungarian economy afloat. This has not been true of Hungary alone.

Quarterly Nº. 42 (September 2006)

Is Mr Cameron passionately wooing the British electorate as once Leonardo DiCaprio wooed Kate Winslet, unaware that he, too, is on board the *Titanic*? Or does he know all too well the dire nature of the impending impact, but is afraid to shatter the romantic illusion? In either case, the Conservatives are not to be envied.

Quarterly Nº. 56 (April 2010)

Regular readers of these Quarterlies will know that I am not a lover of change. My instincts are those of C S Lewis as expressed in *The Voyage of the Dawn Treader*, one of the *Chronicles of Narnia*:

'That would be putting the clock back,' gasped the Governor. 'Have you no idea of progress, of development?' 'I have seen them both in an egg,' said Caspian. 'We call it GOING BAD in Narnia.'

Quarterly Nº. 57 (June 2010)

Personal Assets' investment in gold has been very headline-grabbing. You may even have imagined (I told the audience at an investment presentation) that I'd be some sort of American-style survivalist, with my rifles and my cases of baked beans and my Sarah Palin Hunting Calendar.

Imagine my surprise and delight when Sebastian Lyon and his colleagues at Troy took the hint and presented me a week later with my very own Sarah Palin Calendar as an early Christmas present.

Quarterly Nº. 63 (December 2011)

We're no survivalists. Neither are we perma-bears, revelling in gloom. Nor is our investment outlook a stopped clock, right twice a day but wrong all the rest of the time. We're pragmatists, tackling a particular set of problems that face us as investors. All investment decisions should be pragmatic rather than ideological.

Quarterly Nº. 63 (December 2011)

The environment remains (to use that most depressing of words) 'challenging' for investors – poor fundamentals being disguised by central policy meddling, including further rounds of QE, or 'quantitative easing', which sounds like a gentle laxative advertised on daytime television but is actually an assisted suicide kit for national currencies.

Quarterly Nº. 64 (March 2012)

Many startling events have taken place in the financial markets since I began following them as a schoolboy in the 1960s, but it still came as a shock earlier this month to see 3½% War Loan at par. War Loan has been a joke. At one point during the 1970s its yield, 18.7%, equalled its price, which was £18.70 per £100 nominal of stock. In 1932, its coupon was reduced from 5% to 3½% and 'or after' was added to its maturity date of 1952 to make it redeemable at the government's option. Since 1952, or indeed since 1932, it has been a rotten investment in terms of the erosion of the value of both capital and interest by inflation. But at least it has reached its nominal value again.

[It was subsequently redeemed at par in March 2015.]

Quarterly Nº. 65 (June 2012)

There is growing pessimism about savings prospects. For the first time, young people expect to be less well off than their parents; and as regards capital, older investors are asking not so much ‘how can I make this grow?’ as ‘how can I make this last?’

Quarterly N^o. 65 (June 2012)

My first impressions of the work of a Board came from the popular 1960s TV boardroom drama *The Power Game*. Fortunately for the Directors’ blood pressure and the shareholders’ peace of mind, the Board Meetings of Personal Assets were nothing like that.

Quarterly N^o. 68 (June 2013)

Come what may, we shall guard our stake money and remain, like Camp Coffee, Merchiston Castle School and the Royal Canadian Navy, *‘Ready, aye ready!’*

Quarterly N^o. 68 (June 2013)

Polaroid was a good example of a stock that was first a beneficiary and then a victim of technological change.

Quarterly N^o. 77 (September 2015)

World financial markets have for years reminded me of an overpriced junk shop in which the same old stock, none of it worth buying, has been gathering dust for ages, while there’s no prospect of anything new and exciting coming in.

Quarterly N^o. 78 (November 2015)

Here in Britain, demagoguery of the extremer sort has never really caught on – partly because of our first-past-the-post voting system, partly because we have a Head of State who is above and outside politics, and partly, I like to think, because of our national sense of humour. The 1930s cry of ‘Hail Mosley!’ sounds just as ridiculous to today’s inhabitants of these islands as doubtless did the ‘Hail O’Duffy!’ salute of General Eoin O’Duffy’s contemporary Irish Blueshirts.

Quarterly N^o. 82 (November 2016)

A further challenge we face today is that of pension provision. Following two decades of tinkering by doubtless well-meaning Chancellors of the Exchequer, the pace of interference has accelerated. Have things gone too far? Will making possible the premature raiding of pension pots by savers who are already inadequately provided for mean that overstretched sixty-somethings will find themselves with no alternative but to drive their newly-acquired red Lamborghinis to the Post Office to pick up their basic state pension? How much will people now in their 20s and 30s need to live on when they reach pension age, and how are they going to build up the necessary capital sums to escape being the ‘squeezed centenarians’ of the later twenty-first century?

Quarterly N^o. 82 (November 2016)

President Trump has proved that it is possible for a politician to be even more entertaining than Boris Johnson. Imagine if history had permitted a summit meeting between Mr Trump and Russia’s Boris Yeltsin! And recently President Trump seemed to mistake a Swedish television competition to pick the performer to represent Sweden in the Eurovision Song Contest for a terrorist outrage. (Followers of the Eurovision Song Contest may consider the misapprehension understandable.) As for the investment opportunities that the new President may bring, a godson of mine once held units in an investment vehicle called the Rupert Fund, named after Rupert the Bear, through which people were able to invest on their children’s behalf. (The fund is now known as the Invesco Perpetual Children’s Fund.) In response to President Trump’s election I’m thinking of starting the Nellie the Elephant Fund, through which you can invest in construction companies on the US-Mexican border. Its advertising jingle will be:

> *‘Off we go with a trumpetty Trump,*
> *Trump, Trump, Trump.’*

If you find the concept interesting, give me a ring. But it’ll be a trunk call.

Quarterly N^o. 83 (March 2017)

If I worked for Unilever I would be fed up seeing my company characterised in the media by photos of jars of Marmite, sales of which are worth a mere £28 million annually compared to Unilever's 2016 turnover of £43 billion. There's much more to Unilever than the yeast-flavoured spread you either love or love to hate, and we are happy holders of the shares.

Quarterly Nº. 83 (March 2017)

Mistakes can be worth their weight in gold if you make them early enough in your career.

Quarterly Nº. 91 (February 2019)

These are bewildering days. By the time you read this, Jacob Rees-Mogg may be commissioning an extension to 10 Downing Street to accommodate his growing family, Mrs May may have retreated to the House of Lords or taken Holy Orders in the Church of England, Boris Johnson may be wowing them on Strictly Come Dancing and Jeremy Corbyn may be President-elect of Venezuela.

Quarterly Nº. 91 (February 2019)

The 2008 Crash and After

2006 : The US Housing Market

The US mortgage market is enormous. Outstanding US home mortgages total approximately $8.5 trillion. This is a huge sum, almost twice the size of the entire US Treasury market of $4.3 trillion.

New mortgages are created by the 'thrifts', savings & loans ("S&Ls"), insurance companies, banks and other similar financial intermediaries, and are financed by them in the first instance through short-term borrowings. In normal times around one third of new mortgages are retained by the originators and two thirds are securitised into mortgage-backed securities ("MBSs") through government agencies – Fannie Mae (The Federal National Mortgage Association), Freddie Mac (The Federal Home Loan Mortgage Corporation) or Ginnie Mae (The Government National Mortgage Association), or by substantial banking entities. These guarantee the payment of interest and principal, effectively producing an instrument as credit-worthy as the ten-year Treasury bond.

The MBS market, some $5.6 trillion, dwarfs the US dollar holdings of foreign central banks.

US homeowners are entitled to repay their mortgages at any time without capital penalty. The standard 30-year US mortgage is normally priced at a 1.5-2% interest rate premium to the yield on the ten-year Treasury note. This covers the servicing costs of the mortgage originators and rewards Fannie Mae (say) for guaranteeing the payment of interest and principal on the underlying mortgages (a total of around 50 basis points), together with meeting the implicit cost of providing a 'put' at par to the mortgagor.

An MBS based on standard 30-year mortgages has an expected duration of around ten years: the principal amount of a 30-year repayment mortgage would, other things being equal, be outstanding for an average 15 years, but experience shows that early repayments (such as home moves, refinancings, deaths of homeowners, etc), typically lower a mortgage's average duration by around five years.

As mortgage costs fell from 8% in 2000 to under 6%, the probability that borrowers would refinance and repay their old mortgages increased. (In fact, not to have done so would have been nothing less than financial lunacy.) Moreover, at a time of rapid house price rises fuelled by the easy availability of cheap money, refinancing homeowners took on new mortgages for larger amounts than the loans that they paid off, thus realising as spending money some of the accumulated equity in their homes.

Such a tidal wave of refinancings, at a much earlier date than would normally have been expected, inevitably shortened the duration of MBS instruments and presented investors in them with a problem. To keep the duration of their portfolios steady as interest rates fell, MBS investors found themselves having either to buy longer-dated Treasury bonds or to enter into interest rate contracts with a similar effect, so pushing long bond rates lower still.

This is where it gets really interesting. As in a detective story in which Professor Moriarty taunts Holmes and Watson with a cryptic clue to the solution, Dr Greenspan in September 2005 published a research paper (only his second during his tenure at the Fed): *'Estimates of Home Mortgage Originations, Repayment, and Debt'*.

No-one could have written it but Dr Greenspan. From 1997, when the Department of Housing and Urban Development discontinued its quarterly gross mortgage flow system, there had been no systematic attempt to disaggregate the net change in outstanding home mortgage debt into its constituent gross flows. However, using the resources and researchers available to him at the Fed, Dr Greenspan achieved this in his paper, with astonishing results. The enormous level of refinancing of mortgages it reveals, offers (in our view) the first plausible explanation of how the Required

Rate of Return (RRR) on financial securities worldwide could have been driven below 2% – just as it chillingly suggests what could happen once things start going into reverse.

Here are the figures. To get them in proportion, remember some other ones: an approximate $0.25 trillion per annum increase in corporate savings; the estimated $0.1 trillion increase in OPEC's reserves since 2001; and China's 2005 trade surplus of $0.1 trillion.

- During the 1990s, repayments of US mortgages averaged around $0.7 trillion annually.
- Repayments more than doubled to $1.7 trillion in 2001.
- They were just under $2.2 trillion in 2002.
- In 2003, repayments reached an astounding $3.4 trillion.
- Repayments have continued at an annual rate of around $2 trillion for 2004 and 2005.
- Mortgage repayments between 2001 and 2005 thus totalled $11.3 trillion. (This, remember, is almost equal to a full year's US GDP.)

Here, at last, we have the 'unified theory' we have been looking for: the weight of money from unprecedentedly huge and bunched-together early mortgage repayments, dwarfing those Asian central bank holdings, net corporate savings, Chinese trade surpluses and recycled petrodollars, and pressing on the long end of the US Treasuries market for five years, driving yields down remorselessly. And Dr Greenspan is well placed to explain it, because he caused it, deluging the economy with unlimited free money, like the entertaining Latin author Petronius Arbiter's Trimalchio on his self-designed monument:

'in tribunali sedentem prætextatum . . . et nummos in publico de sacculo effundentem'

('sitting in official robes on his official seat, pouring out money in abundance from a bag')

Gaius Petronius Arbiter, *Satyricon*

Quarterly N^o. 40 (February 2006)

2007: Could This Be It?

August was exciting. At first the market weakness was reminiscent of last summer's tumble, when the FTSE 100 reached 6,106 on 9 May but then fell as low as 5,507 on 14 June (a 10% correction of the type so often forecast by market analysts). This time, however, the movements have been bigger. The FTSE 100's highest 2007 level was 6,732 on 15 June, less than 200 points below its all-time high of 6,930 on 30 December 1999; but on 16 August it fell to 5,859, or 13.0% below its year's high. So we started to wonder — COULD THIS BE IT AT LAST?

The rollercoaster continued. On 20 August, in an amazing scramble into government paper at almost any price, the yield on the one month US Treasury Bill fell 1.6 percentage points to 1.34%, while the yield on three month T-Bills fell 1.2 percentage points to 2.51%, a sharper fall even than during the October 1987 crash. Yet within a day or so all was calm. Then we saw Sentinel, the money market managers, accused of fraud by the SEC; KKR Financial trying to raise $500 million in an emergency rights issue while its executives agreed to find $100 million themselves if it failed; the government of Saxony selling the state bank, Sachsen LB, which may have accumulated $80 billion of risky assets through a set of Irish funds kept off balance sheet (you couldn't make it up); HBOS intervening to fund Grampian, its $37 billion conduit; and Barclays drawing on the Bank of England's emergency lending fund for two weeks running. Bad news has kept on breaking, yet equity markets have remained almost perky.

Quarterly N^o. 46 (September 2007)

2007: What Kind of Crisis?

What kind of crisis faces world central bankers today?

- A ***temporary credit crunch*** (i.e. a lack of short-term funding thanks to lenders' doubts about borrowers' creditworthiness)?
- A ***liquidity problem*** (with investors being unable to sell assets to meet margin calls)?
- ***A solvency crisis*** (if assets have to be sold to meet debts, investors would be bankrupt)?

We believe that, as far as many financial vehicles are concerned, it is a solvency crisis. According to Axel Weber, the President of the Bundesbank, the only difference between a classic banking crisis and the current turmoil is that the institutions most affected are not regulated banks but conduits and structured investment vehicles ("SIVs" or "SIV-lites"). But while a classic run on banks can be resolved when banks are basically sound, many SIVs are in fact insolvent ('leaky SIVs'?) and sponsoring banks are now being forced to assume direct funding requirements on to their balance sheets.

They brought this on themselves. As in the split trust *débâcle*, investment banks enticed investors to invest in high yield products and created the products for them to invest in. Investment banks drove the hedge fund industry, acting as prime brokers and even carrying out the marketing. They created the entire conduit, SIV and SIV-lite sector so as to generate fees through off-balance sheet lending; and, joy of joys, the system developed the derivatives market and such exotica as Collateralised Debt Obligations ("CDOs").

The investment banks which securitised these loans, sliced them up into CDOs with inappropriately high credit ratings and sold them to investors in search of high yield probably had no idea of the risks they were taking; but given the toxic nature of the securities sold to the innocents (if institutions can be so described), the investment banks will find that their liabilities and duties didn't end with the sale of their services and products.

Quarterly N°. 46 (September 2007)

2007: Dr Bernanke's Catch-22

One has to feel for Dr Bernanke – he has to deal with the mess left by Dr Greenspan. While the Fed did tighten money between 2004 and 2006 by a series of ¼% rate rises from 1% to 5¼%, the effects were foiled by creative Wall Street financing. Aggressive lenders offset this tightening by 'teaser rates' for house buyers who couldn't afford the inevitable higher reset rates.

But the sudden collapse of credit availability means that the whole of the Fed's 2004-6 tightening is taking effect now, coupled to an increase in credit spreads. Dr Bernanke is in a Catch-22 situation – a paradox, described in Joseph Heller's famous novel, whereby one is a victim regardless of the choice one makes. Yossarian, a US bombardier in World War II, recognising the increasingly suicidal nature of the missions he has to fly, seeks to be grounded. However, the only basis for a pilot's being grounded is if he is insane; and a pilot seeking to be grounded is obviously sane and so must fly.

Consider Dr Bernanke's dilemma. He would be crazy to cut the Fed rate and sane if he didn't – but if he's sane he has to cut the Fed rate! Being sane, he wants to avoid replacing the 'Greenspan put' with a 'Bernanke put', as would happen if he cut the rate. But to avoid major upheaval (which is a sane aim) he must cut the rate to fulfil the unanimous expectations of financial markets (which would be insane, because it would both increase moral hazard and be a step towards renewed inflation).

(Here, 'moral hazard' means that if the central bank or the government bails out lending institutions when they get into trouble, the lenders may come to believe that they can take on high and profitable risks without having to bear the losses if things turn sour. As for inflation, most people enjoy a bit of inflation and would welcome it. All their problems get inflated away.)

Quarterly N°. 46 (September 2007)

2007: We go 100% Liquid

On 18 September, following Alan Greenspan's reported claim that US house price percentage declines would probably be in double digits – almost guaranteeing a US recession – and in the conviction that huge worldwide sales of assets would sooner or later have to occur in order to repay debt and de-leverage the global financial system, we announced that we had gone 100% liquid.

Such a liquidity decision is virtually unprecedented for a mainstream UK investment trust, and it indicates the gravity with which we view the current situation. How big do we see the problem as being? Let's go back to July, when Charles 'Chuck' Prince, then still the Chairman and CEO of Citigroup, uttered these astonishing words in an interview with the *Financial Times*:

'When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing.'

Not any more, they're not. The party was over even by July, when Chuck Prince was still enthusiastically shaking his booty (a modern expression for dancing, I understand). The scale of the inevitable hangover, however, was not yet apparent to all. Ben Bernanke, Chairman of the Fed, forecast in July that sub-prime-related losses would be between $50 billion and $100 billion. Even then, according to Jan Hatzius, Chief US Economist at Goldman Sachs, Bernanke's numbers seemed quite optimistic. Now, Hatzius believes, 'it is clear to most observers that they are far too low' and his early November back-of-the-envelope calculation of US home foreclosure related losses was as high as $400 billion for financial companies. Such a shock, he argues, could force the US banking system to cut lending by $2 trillion (equal to 15% of US GDP), causing a major recession.

These numbers sound bad enough, but they may prove to be only a fraction of the eventual total. Here Donald Rumsfeld's words, regarded as *naïf* at the time, are in fact both perceptive and profound:

'There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we know we don't know. But there are also unknown unknowns. There are things we don't know we don't know.'

This is alarmingly true; and, to quote Al Jolson:

'You ain't heard nothin' yet . . . '

Quarterly No. 47 (November 2007)

2008: Nightmare on Wall St

What is going on? Think of Groucho Marx as Otis B Driftwood in *A Night at the Opera*.

'Signor Lasparri comes from a very famous family. His mother was a well-known bass singer. His father was the first man to stuff spaghetti with bicarbonate of soda, thus causing and curing indigestion at the same time.'

Since 9/11, the Fed has kept on pumping vast amounts of cheap money (or spaghetti) into the economy as a 'cure' for the much-dreaded forthcoming recession. But these continued helpings of spaghetti, far from being a cure, are what created the problem in the first place. The US financial system is now like a bloated hedge fund, the Fed being prepared to lend to the system however much money it demands at ever lower interest rates, irrespective of the damage this will ultimately cause. Signor Lasparri's father would have agreed with Walter Bagehot, famous mid-19th century editor of *The Economist*, on the duty of central banks. This was not to bail out unwise lenders, but to lend unlimited amounts to *bona fide* financial institutions at a penal rate. The Fed is now at serious risk of being in dereliction of its twin charges: to maintain stable prices and sustainable long term employment.

As Ian Rushbrook said in his speech at Personal Assets' 2007 AGM:

'The catalyst [for a market fall] *won't be a butterfly fluttering its wings over Peking. It'll be a vulture, glutted on sub-prime mortgages, falling from its perch on a skyscraper over Wall St.'*

Quarterly №. 48 (February 2008)

2009 : Alphabet Soup

Is the recession nearly over? It all depends on the shape it takes. V? Or U? Or W? Or L? Or even K?

- A V-shaped recession sees a quick upturn from the bottom and a speedy return to growth. This is what most economists think we will see, perhaps because it is what they want to see, the wish becoming father to the thought.
- A U-shaped recession bumps along the bottom for a while before recovery begins. This is the shape moderate pessimists expect.
- Gloomier forecasters look for a W-shaped, or double-bottomed, recession; while at present we may be staggering up from one bottom, another one awaits us.
- The most pessimistic possibility of all is the L-shaped recession (one which develops into a depression because, like an 'L', it plunges down but doesn't turn up), or its relative the 'ski jump' recession (also known as the 'Armenian K' from the shape of the letter K in the Armenian alphabet – trust me!), where a short term stimulus causes an up-tick that eventually leads to a sharper drop.

Where do I stand? Somewhere between a W and an Armenian K. But at the moment my impression of the world of finance and economics is of the bland leading the bland. President Obama has reappointed 'Helicopter Ben' (so called from his 2002 advocacy of a 'helicopter drop' of money into the economy to fight deflation) to a second term as Chairman of the Fed. On 25 August Stephen Roach of the *Financial Times* wrote:

'[this is] *as if a doctor guilty of malpractice* [were] *being given credit for inventing a miracle cure.*'

Since taking over as Fed Chairman, Dr Bernanke has followed Dr Greenspan in adopting as his theme tune:

'I'm for ever blowing bubbles,
Pretty bubbles in the air,
They fly so high, nearly reach the sky,
Then, like my dreams,
They fade and die . . . '

The trouble is that Dr Bernanke's bubbles, like Dr Greenspan's, do not 'fade and die'. Instead, they burst and splatter their mess all over us. Dr Bernanke has been a great advocate and practitioner of 'quantitative easing' ("QE"), a phrase which bears the same relationship to 'printing money' as 'terminological inexactitude' does to 'lie'. It is a dishonest name for a dishonest activity. Indeed, some have even called it state sponsored theft. It has temporarily made the financial markets drunk on hopes of an economic recovery, but I can't see how such a recovery can possibly be anything other than faltering, fragile and fraudulent.

Quarterly №. 54 (September 2009)

2010: A Chill Wind

I find it odd that people seem so unconcerned about the economic outlook. The skies are leaden, the wind is chill, but life goes on as before. Perhaps, as T S Eliot said:

'Mankind cannot accept too much reality'.

Economists and politicians seem content to sing along with Blanche DuBois of Tennessee Williams' *A Streetcar Named Desire* the sentimental 1930s hit, *'It's Only a Paper Moon'*:

'It's a Barnum and Bailey world,
Just as phony as it can be,
But it wouldn't be make-believe
If you believed in me.'

Unlike Blanche DuBois, we are not going to be able to depend on *'the kindness of strangers'* to rescue us from our misery. Even the most eminent among us do, however, share her capacity for self-deception. I shan't subject you to yet another diatribe against D^rs^. Greenspan and Bernanke, but I do notice that Dr Greenspan has just written a paper for the US think-tank, the Brookings Institution, in which, in a conscious echo of Dr Bernanke's 'global savings glut', he argues that central bankers were innocent and impotent bystanders in a global macro-economic shift.

Quarterly N^o.^ 56 (April 2010)

2016: QE Hasn't Worked

The near demise of interest rates is a moral issue. Lenders should be entitled to a fair return on money which they allow others to use, and the government and central banks are preventing it. This cannot be good for the long-term health of the economy, which depends on the efficient and appropriate use of capital.

Where have we gone wrong? The financial crisis of 2007-8 was so grave that co-ordinated remedial action by governments and central banks was probably unavoidable. But in Quantitative Easing ("QE") governments and central banks managed to come up with a cure that was worse than the disease.

QE was meant to stimulate the real economy. The idea was that the purchase of bonds by central banks from the clearing banks which held them would give the clearing banks more free cash to lend to productive enterprises, thus fostering economic growth. But it didn't work. The clearing banks collected the cash from the sale of bonds they held but then sat on it, increasing the money supply but slowing down its velocity of circulation. One might say that, as a cure for economic stagnation, central bankers acting as doctors to the economy prescribed more money in circulation – 'money pills' – but alas! the clearing banks collected the pills from the chemist and stockpiled them uselessly in the bathroom cabinet (the bank vaults), where they remain to this day.

Maybe QE was useful at the very beginning, when the world's financial system seemed on the brink of collapse. But other than that, it hasn't worked and it won't work.

Even more worrying has been a bubble in bonds. By buying them in huge quantities (£375 billion so far in the UK with up to £60 million more to come, and a total of $8.7 trillion worldwide since 2008) central banks have forced bond prices up and bond yields down – in both cases, to unprecedented and ridiculous levels.

Central banks are now glutted with bonds, while elsewhere there is a bond famine. Pension funds, prisoners of actuarial assumptions, struggle to compete with central banks in the bond market and are bidding for bonds at any price, rather than a price approaching historical fair value. The long-term risks of this are frightening. It used to be said that compound interest was the world's greatest discovery. Now it is only a beautiful memory.

Quarterly N^o.^ 81 (September 2016)

Bin Ends

How much is the current $2 trillion of subprime mortgages worth? Until now, it has been valued by the lenders on the basis cruelly described by Bob Janjuah (Global Head of Credit Strategy, Royal Bank of Scotland) as 'mark-to-make-believe'.

Quarterly N^o.^ 47 (November 2007)

Readers of *Private Eye* may recall the post-9/11 cover that showed an adviser whispering to President Bush, 'It's Armageddon, sir,' and Bush replying, 'Armageddon outahere.' Well, if going 100% liquid is 'geddon outahere', we have reacted like George Bush.

Quarterly N^o.^ 47 (November 2007)

The Nature of Investment

Winning the Losers' Game

Ian Rushbrook and I first became friends in the early 1980s, long before we started working together on Personal Assets, and we would then meet regularly to exchange our thoughts about investment and to find escape from the pressures of investment conformism by 'saying the unsayable' to each other. From the point of view of both investment managers and stockbrokers, one of these 'unsayable' things was that too much investment activity is death to performance. Ian and I believe this strongly, however, and we've got two reasons for it.

The first is very simple. Buying and selling shares costs money. Given that our aim is to preserve and, if possible, increase Personal Assets' net asset value per share over the long term, it's bad enough that you have to pay the Board to manage your money for you. This handicaps you (and ourselves, as shareholders) relative to the market from the beginning, since the market bears no management costs. But it would make matters even worse if we then churned the portfolio at a great rate, suffering as we did so market-makers' spreads and stockbrokers' commissions on every deal, because the market suffers no dealing costs either.

Of course, we would churn away with a clear conscience if we knew we could add value to the portfolio relative to the market each time we did so. But please send for the men in the white coats if ever you catch us making this claim. If an investor believes that he (or she) is much cleverer than the market, he's certifiable. If he believes that he's a little cleverer than the market, he's probably deluding himself. But if he believes that he's no cleverer than the market and he admits it, he'll commit your money to the market only when the long-term odds of success look overwhelmingly favourable. And the Directors (I'm glad to say) belong in this last category.

So much for the first reason. The second was well summed up in a seminal article written by Charles D Ellis in 1975 and entitled *The Losers' Game*. By this title, of course, Ellis meant investment management, and he began by making the obvious point I've just made – since managed funds suffer dealing expenses and management costs while the market (as represented by an index) doesn't, the sum of investors who make up the market must therefore inevitably underperform the market itself.

That's bad enough, but it gets worse. Ellis went on to advise investors:

'Don't do anything, because when you try to do something, it is on average a mistake.'

This sounds too depressing to be true, but in fact it isn't. It *is* true, and knowing the truth is always useful – however depressing it may be.

Firstly, note the careful wording, 'on average'. Ellis doesn't maintain that it's impossible to beat the market, just that it's extremely difficult to do so. We agree. And now think of the last time you played golf or bridge. If you're a golfer, you lose more matches through your bad strokes than you win through your brilliant ones. That's because golf, in Ellis's terminology, is a Losers' Game. Quoting the great Scottish-American golfer Tommy Armour, Ellis writes:

'The way to win is by making fewer bad shots.'

Similarly, the way to do well at bridge is not to outbid your opponents every time. Instead, you aim to outbid them only if you know you can make the contract.

In managing a portfolio, we're playing bridge (or golf) against all the participants in the stock market. Hence the important truth contained in Ellis's central thesis, that the way to be a successful investor is to avoid mistakes. The more decisions you make as an investor, the more chances you have of making wrong ones. If you must act, follow the golfing rule:

'Play the shot you've got the greatest chance of playing well.'

And leaving aside sporting metaphors (which, as the least sports-minded member of the Board, I'm always glad to do), Ellis also counsels:

'Almost all of the information in the investment management business is oriented towards purchase decisions . . . [But] *concentrate on selling instead. Almost all of the really big trouble that you're going to experience in the next year is in your portfolio right now; if you could reduce some of those really big problems, you might come out the winner in the Losers' Game.'*

Quarterly N$^{o.}$ 1 (August 1994)

Sprints and Marathons

Some years ago in a Personal Assets Annual Report I wrote:

'Investment management is a marathon, not a sprint.'

I was wrong, because a marathon is run towards a finishing-line, and since the Directors have no intention of bringing forward a Resolution to wind up Personal Assets at any time in the foreseeable future, we have no finishing-line.

To make a racing comparison, the investor is the punter, the market is the bookie, and on average the bookie wins.

There *can* at times be ways of guarding ourselves against undue risk while positioning ourselves to reap unusual rewards – and if we can do so, we will.

Of course, I'm well aware that such a strategy, when set down in general terms like this, reads unhappily like King Lear's pathetic cry:

'I will do such things – what they are yet I know not – but they shall be the terrors of the earth.'

Nor should you suppose that we have some glittering *coup* up our sleeves, to startle and delight you before Christmas.

Quarterly N$^{o.}$ 2 (November 1994)

Unnecessary Diversification

Then there was the affair of Dow Chemical, which earned me the first praise I ever received in the investment world. Newly taken on as an apprentice in an investment management firm in 1977, I was put to work examining a series of Annual Reports of companies my firm had invested in, together with the notes and comments thereupon by my more seasoned colleagues. One of them which caught my eye was Dow Chemical, which had been bought at around $55 and was by that time languishing in the low $20s. The recommendation by one of my colleagues which had led to its purchase was along the lines of,

'This is a gap in our portfolio.'

My rather tart rejoinder was:

'Yes, but it was not a gap we needed to fill.'

This was described by my partner-in-charge as 'a very perceptive comment', and my pleasure and pride at the compliment may be judged from the fact that it remains clear in my mind after nearly twenty years. Buying Dow Chemical certainly diversified our portfolio, but only in the same way as the skills of the Scottish Rugby XV would be diversified if I were selected to play for it instead of Gavin Hastings. As a 'diversification', Dow Chemical added nothing. Instead, it detracted from our performance and it also represented an opportunity cost insofar as it tied up money which might have been better used elsewhere.

Quarterly N$^{o.}$ 3 (March 1995)

Common Temptations

To 'do something' is a great temptation in itself and requires self-control to resist. Doing something is a lot more fun than not doing something. Selling old investments and buying new ones creates a buzz of excitement in the investment manager's mind. Activity is its own adrenalin. And it is even sweeter afterwards. Who doesn't know the feeling of contentment after a long day's gardening, with barrowloads of slaughtered weeds and rows of newly-planted bulbs to show for it? (I don't, but my wife tells me it is very satisfying.) Certainly it is far more soothing to the soul than the infinite tedium of waiting patiently for the green shoots to appear and the roses to grow. Yet the green shoots will not appear if they are grubbed up prematurely and the roses will wither if they are pruned and watered to death.

And there is the 'stockbroker factor'. Institutional stockbrokers can seem delightful people, who can be the most attentive of friends. In this they are like shopkeepers, who welcome browsers and will gladly pass the time of day with them as long as they are confident that money will eventually tinkle into their tills. But except in rare cases, the relationship is a commercial one. Friendship is bought, as are the accompanying invitations to Wimbledon or to the Savoy. No orders to buy and sell, and the relationship shrivels. Since we all like to be liked, and most of us enjoy being asked to a good dinner, what could be easier than to keep friendship alive through placing copious orders at shareholders' expense, enjoying at the same time the delicious camaraderie of a shared punt in the market?

Quarterly N^{o.} 4 (May 1995)

Keynesian Investment

For many years the name of John Maynard Keynes caused apoplexy among right-wing economists because in their view he was the symbol of all that had gone wrong with society and the economy during the period from the Second World War to the election of Mrs Thatcher. This was as silly as it was unfair. All too often people attacked what they thought Keynes had said, rather than what he actually did say. Moreover, the problems of the 1970s, when the Keynesian economic consensus broke down, were quite different from those about which Keynes wrote in the 1920s and 1930s; and had he been writing in the 1970s he would doubtless have suggested very different remedies.

However, it is not Keynes the economist who interests me here but Keynes the investor; and anyone who during the unpropitious years between 1930 and 1936 was able to increase his own net worth from £8,000 to £500,000 must have views worth studying about the process of investment. Not all of Keynes' techniques would suit Personal Assets. Keynes was a renowned speculator in commodities and on one famous occasion was allegedly forced to consider filling King's College Chapel with wheat he had bought. Leaving aside commodity speculation, however, Keynes' three maxims laid down in his 1938 *Post Mortem* on investment policy, written for King's College, Cambridge (of which he was Bursar), have much in common with the Personal Assets Board's own investment beliefs.

I believe now (Keynes wrote) that successful investment depends on three principles:

- A careful selection of a few investments (or a few types of investment) having regard to their cheapness in relation to their probable actual and potential intrinsic value over a period of years ahead and in relation to alternative investments at the time.
- A steadfast holding of these in fairly large units through thick and thin, perhaps for several years, until either they have fulfilled their promise or it is evident that they were purchased on a mistake.
- A balanced investment position, namely a variety of risks in spite of individual holdings being large, and if possible opposed risks (for example, a holding of gold shares among other equities, since they are likely to move in opposite directions when there are general fluctuations).

As Keynes himself wrote in 1934,

'As time goes on, I get more and more convinced that the right method in investment is to put fairly large sums into enterprises which one thinks one knows something

about and in the management of which one thoroughly believes. It is a mistake to think that one limits one's risk by spreading too much among enterprises about which one knows little and has no reason for special confidence.'

Quarterly Nº 10 (November 1996)

Forecasts are for Fools

If you turn to the back page of this Quarterly you will find a list of Personal Assets' ten largest equity investments at 31 October 2000. From these, let's take the top five UK holdings: Scottish & Newcastle; Royal Bank of Scotland; BP Amoco; British Telecom; and Glaxo Wellcome.

It would be difficult to find five bluer blue chips than those. *[What a shaming example of famous last words . . . !]* Needless to say, we believe them to be good, sound, dependable long-term investments and the five of them together accounted for just under 20% of our shareholders' funds at 31 October.

How much variation has there been in the prices of these high-quality blue-chip shares over the twelve months to 31 October 2000 – a period during which the FTSE All-Share rose by 6%? The difference between the FTSE All-Share's highest and lowest points during the twelve months was 13%, its high point having been 3,265.95 on 4 September and its low point 2,852.60 on 17 April. (By comparison, Personal Assets' high point was £213 on 7 December 1999 and its low point £190 on 28 February 2000, a variation of 11%.) The companies we are speaking of are not small-caps, speculative stocks or dotcoms. So might the average variation in the prices of these stocks be lower than the market (and Personal Assets), at around 10%? Or could it be a bit higher, at 15% or 20%?

Here are the differences between the lowest share prices of the five companies and their highest share prices.

Scottish & Newcastle 41%
(High 569p, Low 342p)

Royal Bank of Scotland 58%
(High 1,547p, Low 647p)

BP Amoco 34%
(High 671p, Low 445p)

British Telecom 55%
(High 1,513p, Low 680p)

Glaxo Wellcome 30%
(High 2,068p, Low 1,440p)

What does this tell us? It doesn't tell us that these stocks are specially volatile, or are in trouble in any way. Such wide price movements are common among FTSE 100 stocks. It does, however, remind us that the variations in the prices of even the biggest blue chip shares during a fairly quiet period for the UK market as a whole can be astonishingly high. Predictability isn't in it.

Quarterly Nº 20 (December 2000)

Prediction or Gambling?

As for the assumption that investment professionals can accurately predict day-to-day or week to-week movements in share prices, this has been not only the bane of my life but also a grave social handicap for a quarter of a century.

Those not involved in investment seem to think that asking what their shares will open at tomorrow morning is as simple a question for me to answer as asking me directions to the railway station. (I refuse to write 'train station', as is the regrettable modern habit.) Yet I have never known anyone in the investment world who could tell me with any degree of accuracy better than 50% whether the UK market would open up or down the next day – and 50% accuracy, of course, is what you would get from tossing a coin.

I remember this fallibility of the professionals with fondness, because one day back in the late 1970s some important news had been announced which would obviously have a major influence on how the market opened the next day. One of the senior investment managers at my firm was confident that the market would open higher. I guessed it would open lower and bet him £1 (big money to me, in those days) that it would do so. It did. He paid up and I bought a box of small cigars with my winnings.

The senior investment manager in question is now responsible for the management of many billions of investment trust and pension fund money. His record is superb and his knowledge and judgement beyond reproach. Yet so simple a question as how the market would open the next morning defeated him – just as it would defeat any investment manager today.

Remembering this, instead of the unwarranted assumptions of investment professionals' omniscience of the Chairman's sister and my nephew, I shall give you an assumption of my own – one of which I am sufficiently confident to describe it as a rule.

In most areas of life, the accuracy of one's predictions diminishes as the scale of time increases. As far as the performance of the stock market is concerned, the opposite is the case.

In other words, if you want to know what the UK equity market will do over the next 50 years, I'd be happy to have a stab at telling you and I would be reasonably confident about my answer.

If, however, you want to know how it will open tomorrow morning, don't even ask.

Quarterly No. 20 (December 2000)

The Merits of Doing Nothing

Readers may recall that the starting point for the December 2000 Quarterly was the Chairman's sister's observation that Personal Assets was 'going nowhere'. The Chairman's sister earned her 15 minutes of fame and several shareholders later wrote to say that they found the Quarterly helpful. This time my theme is a related one – not that Personal Assets has been 'going nowhere', but that it has been 'doing nothing'.

By 'doing nothing' I don't just mean keeping a percentage of our assets liquid. I mean making very few changes to the portfolio at all, whether by buying or selling.

How easy that sounds, doesn't it? So the first thing to make clear is that doing nothing is very, very difficult indeed. Just ask Mr Blair. If anything happens to disturb the smooth surface of public affairs, be it a rail crash or an outbreak of foot-and-mouth disease, the Press, the politicians and the chattering classes all clamour for action. They want the government to 'do something'.

Do what, exactly? Well, it doesn't really matter, does it? Action, to most people, is not only an end in itself but also a virtue in itself and an instinctive response when under pressure. And I have to admit that when it comes to action for its own sake, I am (at least in non-financial matters) as bad as anyone. My wife always complains:

'Your trouble is that when you're annoyed or something goes wrong, you always want to DO something – and you always end up by making things worse.'

As usual, she's quite right, and although I'm not sure I'd like to entrust her with a portfolio of equities, the remark just quoted shows that she has inadvertently arrived at one of the most important insights needed by an investment manager. Fortunately for our financial security as a couple, it's one I've followed throughout my working life.

Quarterly No. 21 (May 2001)

Constructive Idleness

During my time as an investment trust analyst in a firm of stockbrokers I was sitting one afternoon reading a US investment magazine – whether it was *Forbes, Fortune* or *Business Week* I cannot now remember. A colleague stopped by my desk to chat – an occupational hazard in the wretched open plan office in which I was then forced to work – and snorted in a sarcastic way:

'Well! It's easily seen some people haven't got much work to do!'

What my colleague failed to realise was that I was busily at work, getting the insights and background I needed to generate ideas – which was actually what I was being paid for. To him, it didn't look like work and so it wasn't work. And it is sadly true that in the open plan offices of today the need to create the appearance of work can all too easily lead to time-wasting, short termism and the absence of real thought. If Personal Assets were a large investment management company staffed by lots of eager young fund managers bustling around in an open plan office, I dread to think what would have happened to us over the last two and a half years of markets 'going nowhere'. Much lower liquidity, much higher turnover and much poorer performance, I dare say – but then I wouldn't have stayed to find out.

Quarterly Nº. 21 (May 2001)

'May' does not equal 'Will'

The idea of a portfolio manager 'doing nothing' is very difficult for most people to understand. It seems to defy both experience and common sense. Puzzled shareholders can therefore scarcely be blamed for asking, as they sometimes do:

'Is there nothing – not one single stock out of the whole UK and US equity markets – that you think is worth investing in? Nothing that might produce a total return even fractionally higher than cash over the next three years (that being the period over which you have chosen to be measured)?'

Well, of course, the answer is that there will be many such investments. Lots of stocks may produce a total return higher than cash on a three year view. The problem is that 'may' does not equal 'will'. And the difference between those two little words amounts to a very large 'wealth warning' indeed.

Quarterly Nº. 21 (May 2001)

Opportunity *vs* Risk

In September 2002 I got a letter from a shareholder who wrote as follows:

'Did not Personal Assets miss a great opportunity to obtain (and tuck away) a big asset gain at the time of the Technology, Media and Telecom ("TMT") boom/ relatively short bull market? Was it not obvious that the market had gone mad with huge gains day by day? So Mr Angus stayed out of it. Probably the biggest money making opportunity to come our way for many years – perhaps ever again?'

This is a harsh accusation, so it is worth looking carefully at my correspondent's argument, which is really *Opportunity* vs *Risk* – do we have more to gain or to lose from a course of action where the possibility both of gain and of loss is clear?

My correspondent wrote:

'Was it not obvious that the market had gone mad with huge gains day by day?'

Yes indeed, which is exactly why we stayed out of the TMT boom. But what my correspondent thinks (and it is easy to understand his frustration) is that Personal Assets – even though the Board was fully aware that the market had, indeed, 'gone mad' – should nevertheless still deliberately have gone into that mad market, bought TMT stocks, held them as they rocketed, and then sold out before they fell.

My correspondent wrote that he himself had successfully done so. I don't doubt it. He comes across as an intelligent investor. However, while I have known plenty of intelligent investors who have gone into a risky market, got their timing right and made large profits, I can honestly say that I have never known (or even heard of) anyone with the consistent ability to time such market forays with a degree of certainty sufficient to satisfy a Board of Directors responsible for running large amounts of other people's money and large amounts of their own money as well.

Yes, it would be exciting to try, but that isn't an argument for trying it. Oscar Wilde famously described the activities that led to his trial as 'feasting with panthers' – exciting, perhaps, but much good it did him. I have a feeling that trying to ride the TMT boom while escaping unscathed might have been similarly exciting, and similarly disastrous.

I am a cautious soul and I have too much to lose. If Personal Assets misses out on a potential gain, I can live with it. But if it gambles heavily and loses, then (however big the hoped-for gain might have been) I will be in trouble financially. That is not a risk I am prepared to accept.

There will always be opportunities ahead – often when one least expects them. This is why I'll give the last word to Jimmy Gammell, the first Chairman of Personal Assets:

'Every generation has believed that the real money was only to be made in the generation just past – and every generation has been wrong.'

Quarterly N^o. 24 (March 2002)

Those FTSE 100 Futures . . .

These days *[this was written in 2003]* we manage our exposure to the UK equity market partly through the use of FTSE 100 Futures. The questions we get asked about these suggest they can be difficult even for experienced investors to understand. Following the AGM, I think it worth trying to correct the commonest misapprehension about them, encapsulated in the familiar question:

'Are FTSE 100 Futures a kind of traded option?'

No, they are not a kind of traded option, although many people seem to think they are. At the AGM, for instance, we were asked questions such as:

'How much do you pay for each FTSE 100 Futures contract?'

'Is there loss of time value over the life of the future?'

'Could you lose the lot if you buy a 4,000 future but the FTSE 100 goes to 3,800?'

FTSE 100 Futures just don't work like this. They are contracts we enter into, not securities we buy. Instead, we put up money as margin (10% of our exposure through the Future) and earn interest on it, which in practical terms has the same result as keeping the money on deposit. Nor can there be any loss of time value, because (unlike an option or a warrant) there is no time value to lose. And we could not possibly 'lose the lot' on Futures. They are not an all-or-nothing bet that a certain index level will be reached. They are, instead, a way of obtaining exposure to the market over a certain period (which can then be rolled over repeatedly at no extra cost) without actually investing money in individual stocks. I really can't do better here than reiterate what we wrote in the Annual Report:

'We have been using FTSE 100 Futures contracts as a way of reducing our liquidity in response to falling markets (making us less vulnerable to a sudden market recovery) while avoiding the extra risk and expense involved in selecting individual stocks . . . 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.'

Quarterly N^o. 30 (September 2003)

Looking Back to the 1990s

What sort of a game are we playing? It's a long game, that's for sure. As I said, we try not to make mistakes. From 30 April 2000 to 30 April 2013 may be a lengthy period, but it's still, as the Chairman admitted, an arbitrary one; so let's set those years in the context of Personal Assets' 23-year-long history as a self-managed trust.

If we look back to 30 April 1990, when Ian Rushbrook and the Board took over the running of the trust and Personal Assets as we know it today came into existence, we can detect over our first decade a pattern of performance which, while it is in some ways not dissimilar to that of 2000-13, also contains significant differences which repay careful study. Both the similarities and the differences are of vital importance in understanding what it is that drove Ian Rushbrook and what today drives the Board and Sebastian Lyon, the Investment Adviser.

The 1990s were another world as far as investment was concerned. Over our ten financial years between 30 April 1990 and 30 April 2000 not only did the All-Share rise in eight of them and fall in only two, but even those falls were marginal: in the year to 30 April 1995 the All-Share dipped by just 0.1% and in the year to 30 April 2000 it fell by only 0.9%.

Not to have made money during the 1990s would have been quite an achievement even for permabears of the kind we are so often wrongly accused of being. While the long bull market of the 1990s may have climbed a wall of worry as all bull markets do – Dr Greenspan and 'irrational exuberance' in 1996, the 1997 Asian currency crash, and then the Russian bond default and the collapse of Long Term Capital Management in 1998 – it did so very successfully.

Over the decade the All-Share rose by 187.8%, a stunning result. Personal Assets, however, did even better, its NAV rising by 252.6% from £56.67 (adjusted for the 1for-100 share consolidation in 1993) to £199.80. Not unsurprisingly given our aversion to risk, we outperformed the All-Share in each of the two years in which it fell and we underperformed it in three of the eight years in which it rose; but our pattern of underperforming the All-Share in up years did not hold good consistently throughout the decade, and that was just as well.

What happened? What was different about the 1990s? The answer is that investment conditions were different. In those days Ian and I were able to be bulls not just in theoretical terms but in practical terms too and we were able to find opportunities for profit which had a far more favourable risk/reward ratio than the ones we saw on offer from 2000 onward.

At least during the first half of the decade, equities were often cheap and were seldom, if ever, priced at higher than their fair value. Accordingly, Personal Assets was not only fully invested in equities until the early months of 1996, but also geared to the rising market until as late as 1998 through our holdings of investment trust warrants and shares in a basket of investment management companies – a form of gearing which we believed was more effective and less risky for us than using borrowed funds would have been. This, together with our success in anticipating the market shift from smaller stocks to large blue chips, was what enabled us to outperform even the heady bull market of the 1990s.

Having gained an advantage over our comparator (and hence over the UK market in general) during the 1990s, our next task was to hold on to it during the very different investment environment that was to follow – one in which stocks were very seldom cheap and were often overpriced, and where disasters waiting to happen (the dotcom bubble, sub-prime mortgages and the banking crisis, to name but three of them) were more common than opportunities waiting to be exploited. But despite bloopers like staying with bank shares for too long in 2008, we not only held on to our advantage but managed to increase it.

Quarterly N^o. 68 (June 2013)

The Merits of Cash

Cash, considered as an investment, is perhaps more controversial even than gold. To hold it in any quantity is seen as the ultimate bankruptcy of imagination and failure of nerve, provoking the dreaded question from those who suffer from 'relativititis', 'Surely there must be *something* worth buying?' And this is particularly so today, when wealth managers and investors alike query paying fees to money managers to hold cash when interest rates are zero. They fail to see what Personal Assets has proved several times in its history – that holding cash can add value. And they also fail to see that, rather than its being a cowardly cop-out, holding cash takes considerable courage. I see no reason to change what I wrote about it in Quarterly N^o. 69:

'Cash is the most criticised of all investments. Wealth managers and private client stockbrokers are reluctant to hold any cash for clients, particularly in a zero interest rate world. But the virtue of cash is seriously underrated at present, just as it was in 2007 and 1999. In the longer term (i.e. on a ten year view) cash is almost certain to lose a significant amount of its value in real terms, but so too may equities, while conventional bonds are a bear market waiting to happen. Cash has an important rôle as a diversifier in today's highly correlated, low return world. It should not be a permanent holding, but it is dry powder to deploy when value once again presents itself.'

Quarterly N^o. 73 (August 2014)

Thinking the Unthinkable

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

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

What will the next unthinkable development be? Oil at $150 per barrel? Interest rates in double figures once again? I have no idea. Donald Rumsfeld was memorably mocked for his description of what we know and don't know, but his words (which I have already quoted in Quarterly N^o. 47) contain much wisdom and are worth repeating here:

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

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

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

Quarterly N^o. 78 (November 2015)

What about Gearing?

I shudder to recall how as a novice in the investment world I thought that for an equity fund all gearing was good, and the more of it the better. This misapprehension stayed with me far longer than it should have done. Twenty or thirty years ago we inhabited what looked likely to be a world of permanently high interest rates by today's standards. Borrowing twenty or thirty year money at a cost in the high single figures looked a steal.

Money (it was generally believed) was never likely to get much cheaper than that, and equities would always produce a higher total return than the interest cost of borrowings. It was a green light for investment trusts to borrow as a way of showing confidence in the future as well as of enhancing returns.

History since then has shown how flawed even the most seemingly sensible assumptions can be. Many trusts which geared up in the late 1980s and early 1990s found themselves locked into interest rates that looked increasingly expensive as well as being stuck with prior charges valued far above par and impossible to redeem early except at crippling prices.

Quarterly N°. 78 (November 2015)

The Money Game

One of my favourite books about investment is *The Money Game*, by 'Adam Smith' (the pseudonym of the talented and perceptive US economic commentator and journalist George J W Goodman). Its Chapter Nine, Mr Smith Admits His Biases, is the culmination of the first (and arguably most important) section of the book. In it, Smith writes:

'One of my biases is so strong that I have to mention it immediately, because it runs counter to an idea that is very common, i.e., that if you buy good stocks and put them away, in the long run you can't go wrong. Well, as Keynes once remarked, "In the long run we are all dead."'

Smith then introduces us to a certain Mr Bancroft, whose belief was that the best strategy for a conservative, long-term investor (like we all are, since very few of us will admit to being a short-term spiv) is 'locking up [stocks] and putting [them] away'. And Mr Bancroft chose his stocks carefully.

'[But where] *Mr Bancroft erred was in the locking up and putting away, for by the time his descendants managed to get their fingers on the portfolio, Mr Bancroft's Southern Zinc, Gold Belt Mining, Carrell Company of New Hampshire and American Alarm Clock Company were all worth 0, and in fact, so was the estate.*'

Quarterly N°. 89 (September 2018)

'Know Thyself'

In my earliest days as an investment management trainee I thought that investment management was all about choosing individual stocks, and I overdosed on stock ideas like a child in a sweetshop. The Standard & Poor's Stock Guide was endlessly fascinating – a box of delights into which I would dip not only when I was at work but also when travelling to the office, or soaking in the bath, or at nights when I couldn't sleep. And the arrival of the latest batch of Extel cards did the same for the UK market, although at that time UK stocks didn't fascinate me as much as US stocks did.

Then there were sector stockpicking services like Keefe, Bruyette & Woods on US regional banks and J S Herold's 'Appraised Worth' estimates for the smaller oil stocks. With these services to hand I would pester my superiors with pæans of praise for such obscure discoveries as WellTech, a small oil service company from which (lacking any money to invest in the company itself) I in 1978 made £1 by successfully betting one of the partners I worked for that it would be taken over within the year.

All this was fun and stimulating in the extreme, but gradually I came to see that if the choice of investments were left to me alone, my stock-fixated approach would produce a portfolio as unsatisfying as a main meal consisting entirely of *canapés*. Further experience taught me that there were two main ways of approaching the construction of a portfolio – 'top down' and 'bottom up'. Both have their uses, but as my career progressed 'top down' came to strike more of a chord with me. And then there was 'growth' versus 'value', together with shades between the two such as 'GARP' ("Growth At a Reasonable Price"). In this respect, Troy see themselves as qualitative investors with a keen eye on value.

Γνῶθι σεαυτόν, as the Greek oracle of Delphi said – 'know thyself' – is advice every investment manager should follow. Knowing one's own temperament and biases is vital to success, so it was useful to me to discover that I was by temperament a 'top down' investor and that I had a bias towards value rather than growth. Losing some of my money (what Jimmy Gammell, the first Chairman of Personal Assets, used to describe as one's 'grubstake') hurt me more than did a failure to win high returns.

Quarterly N^{o.} 90 (December 2018)

The Problem with 'Triggers'

Lots of people assume that having 'trigger levels' for purchases and sales is an integral part of fund management. As it happens, however, the practice of setting trigger levels for buying and selling is a particular bugbear of mine.

This is because an index level, a dividend yield or a price/earnings ratio has no absolute value intrinsic to itself. Exactly the same index level, P/E or yield can be screamingly cheap at one quarter's end and staggeringly expensive at the next as a consequence of changes in the economic, financial or political situation.

Investors who have fixed a buying target at 1,000 points below the current level of the FTSE 100 and are prepared to act on it come what may could secure a bargain if the FTSE 100 fell by that amount and the fundamentals remained unaltered, but they would be taking a serious risk if Mr Corbyn had become Prime Minister the previous day and Mr McDonnell was already at work on his emergency Budget. Just as circumstances alter cases, so they should alter targets. This is why targets, if you insist on having them, are better seen as reminders to stop and think, rather than for knee-jerk action.

Quarterly N^{o.} 91 (February 2019)

Risks to Watch Out For

Managing a fund is more than just managing a portfolio of investments, and very markedly so in the case of an investment trust, which is not only a fund but also a listed company. Some types of risk are common to all or most funds. Others are very rare, but (if they do occur) can cause major problems – for instance, those in a category not otherwise featured here which we might call Historical Risk.

(For an example of this, take what happened to Fleming American Investment Trust. In 1997 the trust had a lawsuit slapped on it by the US Environmental Protection Agency. In Fleming American's case the damage in question was the contamination of a lake with creosote between the years 1887 and 1891. This had been the fault of one of the companies Fleming American now held, even though the damage had taken place decades before Fleming American had even been launched. The prospect of paying a court full of US lawyers for months on end led to the board's understandable decision to put a stop to the uncertainly by settling to the tune of several million dollars.)

The list of risk categories which follows may seem unduly long, but all have at one time or other been raised with me by at least one shareholder or interested investor.

1. Performance Risk.
2. Structural Risk.
3. Gearing Risk.
4. Rating Risk.
5. Regulatory Risk.
6. Supervisory Risk.
7. Management Risk.
8. Policy Change Risk.
9. ESG Risk.
10. Realisation Risk.

1. PERFORMANCE RISK

The Nature of the Risk. As Maria von Trapp sings to the children in *The Sound of Music*:

'Let's start at the very beginning, A very good place to start.'

Every investment fund has performance risk. It is commonly seen as 'risk of underperforming a benchmark', but to us it is 'risk of failure to do what it says on the tin'.

How We Guard Against It. We have a clearly-stated policy against which every Board decision and every action the Investment Adviser takes is measured. To quote Kipling's *Kim*, it is our *'ne varietur'* – our guideline and our requirement which will never change.

2. STRUCTURAL RISK

The Nature of the Risk. Are there aspects of a fund's structure that could hinder performance? Closed-endedness not balanced by a discount and premium control mechanism ("DCM") is the most obvious, but others are gearing, a fixed life, or the existence of other classes of capital. Woodford Equity Income's problem was that under the Open-Ended Investment Company Regulations 2001 it could invest only 10% of its portfolio in unlisteds, and for various reasons (e.g. a fall in net assets while the valuation of the unlisteds remained the same) the fund exceeded this limit.

How We Guard Against It. Personal Assets has the simplest possible structure for an investment trust, consisting only of Ordinary shares. It is not geared, has no fixed life, holds no unlisteds, and operates a DCM to ensure its shares always trade close to NAV, thus eliminating discount and premium risk.

3. GEARING RISK

The Nature of the Risk. Gearing is a good servant but a bad master. A reducing pool of assets but the same amount of gearing means that the gearing percentage increases, taking one of the levers of power away from Boards and managers.

How We Guard Against It. We have never borrowed money for investment. We were geared in the 1990s, but our geared exposure to markets came from holding investment trust warrants and the shares of investment management companies. It is possible that at some time in the future we may use short-term borrowings, but it is much more likely that we would use equity index futures.

4. RATING RISK

The Nature of the Risk. This risk is peculiar to closed-ended funds. Personal Assets, while not an open-ended fund in the usual sense, both creates new shares to satisfy demand and buys back shares when demand is exceeded by supply.

Over the 15 months to 31 July 2019 we issued 305,354 shares for a consideration of £124 million. Had we not done this, a large premium might have emerged. Why, then, don't we just 'let the premium rip'? Sometimes, too, people talk as if Personal Assets owned an orchard full of low-hanging fruit which the Board inexplicably fails to pick. Why should we not at least be a little greedier and go for one or two extra percentage points on the new shares we issue?

Doing either of these superficially attractive things would in fact break faith with our shareholders. Buyers of new shares are often also existing holders through investment plans. Seeking a bigger increment to NAV through issuing stock at a higher premium would be merely one hand taking from the other. As regards 'letting rip', for a short-term benefit you would destroy performance in the long term, there being no way to achieve a decent return if you have a double-figure premium that will naturally trend back to zero – that is, NAV.

How We Guard Against It. We ensure our shares always trade at close to NAV through a combination of share buybacks at a small discount and the issue of new or Treasury shares at a small premium when demand exceeds supply. We are, we believe, unique in the trust sector in that this policy is enshrined in our Articles of Association and could be changed only by a vote by the shareholders themselves in a General Meeting.

5. REGULATORY RISK

The Nature of the Risk. AIFMD, FATCA, MiFID II – such strings of initials suggest codes waiting to be cracked at Bletchley Park. Some, like FATCA (the US Foreign Account Tax Compliance Act), were imposed from outside, while others, like AIFMD (Alternative Investment Fund Managers Directive), are imposed by the EU.

How We Guard Against It. While the AIC does sterling work in this area, it is not to be expected that leaving the EU (assuming we are actually permitted to do so) will be accompanied by a bonfire of regulations. On the contrary, in the wake of the Woodford problems we would expect regulation to increase. A sizeable slice of every Board meeting will therefore still of necessity be taken up with scrutinising these risks and making sure we're in the clear.

6. SUPERVISORY RISK

The Nature of the Risk. Is there appropriate oversight of the Investment Manager or Adviser?

How We Guard Against It. Independent Boards are one of the greatest advantages possessed by investment trusts. Their job is not to run the trust on a day-to-day and stock-by-stock basis, but, like the sovereign in Bagehot's definition, to make use of their right 'to be consulted, to encourage and to warn', and they know, too, that there are proper occasions for each of these.

Are independent Boards effective? The gentle inquiry, 'Are you quite sure that's a good idea?' from The Queen would be more chilling than any explosion of rage from President Trump. Quite apart from my rôle at Personal Assets, long experience of the sector has taught me that the same is true of advice behind the scenes from a good Board.

It is the responsibly of the Directors individually and of the Board as a whole to make sure that Personal Assets is run properly, and risk of all kinds has risen higher up the Board's agenda in recent years. Twice a year the Board considers the comprehensive Risk Registers we keep, and these are constantly updated as new risks are identified.

7. MANAGEMENT RISK

The Nature of the Risk. Fund management is a people business, and as in all people businesses the people concerned don't always do what you want them to. They lose focus, or retire, or move to other firms, and this can cause problems for the funds they leave behind.

How We Guard Against It. In 2009 the Board drew up the Investment Advisory agreement to the effect that should the Investment Adviser undergo a change of control or a change in its corporate structure which might reasonably be expected to be materially prejudicial to our interests, or should Sebastian Lyon cease to be a full-time executive of the Investment Adviser, Personal Assets has the right unilaterally to terminate the agreement. Since then, ten years of harmonious working together have done much to produce the Personal Assets we know today, and Sebastian's personal holding of over 15,000 shares shows the strength of his commitment to the trust.

We also make sure that we stick to our knitting and avoid the example of an investment manager whose trust we once invested in. A value investor, he had after initial success been underperforming for several years while growth was king. Over lunch one day he told us that he was still a value investor but now needed to be a momentum investor at the same time. We never discovered if he could have pulled off this remarkable feat because we sold the shares that afternoon and the trust itself quietly expired a short while thereafter.

8. POLICY CHANGE RISK

The Nature of the Risk. This is when a trust either puts proposals to shareholders for a change of investment policy or, on attaining a pre-set winding-up date, produces proposals which don't suit all its shareholders. Once upon a time (the early 1980s, to be exact) there was a trust which changed its investment policy from being a global generalist to being an industry specialist. In the short term, however, the change was not a success, because of a sudden unforeseen deterioration in the fundamentals of the chosen industry. At the first AGM after the policy change a disgruntled shareholder accordingly scrawled on his voting card the NAV at the year end, the (much higher) NAV at the previous year end and the comment:

'You must be a shower of bloody idiots.'

I also once had a personal holding in a trust nearing its winding-up date. The continuation proposals I had expected didn't materialise and I was faced with either a roll-over into a fund I didn't want, or a substantial capital gains tax bill. Only the coincidence of my having capital losses on hand sufficient to offset the gain prevented the wind-up from penalising me financially.

How We Guard Against It. *Τα πάντα ῥεῖ, μηδέποτε κατά τ'αυτό μένειν*, as the Greek philosopher Heraclitus reputedly said – 'all is in flux, nothing stays still'. Investment styles and specialisations come and go, but capital preservation never goes out of fashion. A trust's reason for changing its policy will usually be that it hopes the change will improve the trust's rating, but in our case the DCM keeps the share price steady at around NAV. We therefore have no intention of changing our policy, and since we doesn't have a fixed life we never need to have a continuation vote. Just like Personal Assets itself, our investment policy is here to stay.

9. ESG RISK

The Nature of the Risk. Investors are increasingly conscious of Environmental, Social and Governance ("ESG") risk, which has moved from being a minority interest to its current place in the mainstream of investment decision-making. As the importance of ESG factors has increased in the eyes of regulators and consumers, as well as investors, so the potential financial impact of these factors, both positive and negative, has increased.

How We Guard Against It. For Personal Assets' portfolio, the Investment Adviser does not exclude companies from its investment universe purely on ESG grounds. Rather, analysis of environmental, social and governance risks is integrated into the research and decision-making process. This entails consideration of both the negative risks and the opportunities for companies that are on the front foot as regards these issues. Engagement with the management teams and boards of the companies we own continues to be a critical part of the Adviser's investment process. The Adviser votes all proxies of shares owned and engages with management teams on material issues. It is essential that we keep abreast of how this landscape is evolving and the Board will continue to require that the Adviser provides updates on how ESG is integrated in response to the changing nature of the risks.

10. REALISATION RISK

The Nature of the Risk. The Woodford affair has reminded us that this is one of the gravest risks facing investment funds. Is there a danger that the managers will have to disturb investments before they have had the chance to mature, in order to repay departing investors or meet other demands for cash? The first forced asset sale on record is in the Bible (Genesis 25, 28-34), where Esau, faint from lack of food, found himself having to sell his birthright for a mess of pottage – a famously poor bargain which acts as a warning for all generations to come when assets have to be disturbed prematurely for cash.

It was as long ago as March 1995, in Quarterly N^o. 3, that I described Thomas Mann's great novel *Buddenbrooks* as an investment classic. It chronicles the rise and fall of a merchant house in the north German city of Lübeck, and how Senator Thomas Buddenbrook, the third of his line, failed disastrously as he tried to live up to the example of his father and grandfather. What I didn't mention then was how the story ends, with the forced sale of the business for well below its true value – a reminder of how serious and sad 'realisation risk' can be.

'The liquidation of the business . . . took a most deplorable course . . . The pending business was disposed of on hurried and unfavourable terms. One precipitate and disadvantageous sale followed another . . . and so the losses piled up. Thomas Buddenbrook had left, on paper, an estate of [650,000] marks. A year after the will was opened it had become . . . clear that there was no question of such a sum.'

The last straw was when the family house was sold for a disappointing sum and replaced by a small villa for which the executors paid too high a price. Those who think house property is a one-way bet should read *Buddenbrooks* and weep.

How We Guard Against It. Losses through realisation risk can be severe. They would, however, be much less of a danger for Personal Assets because our equity portfolio is made up of the bluest of blue chips. While these are not impervious to large swings in value such as BAT experienced in 2018, if the likes of Microsoft or Unilever were, like Burford Capital, to fall by 65% in a day it would surely be Armageddon and we would have more to worry about than Personal Assets' share price. In his presentation at the Annual General Meeting, Sebastian Lyon reassuringly demonstrated how in normal circumstances some 95% by value of Personal Assets' shareholders' funds could be realised within a single day. Even in abnormal markets Personal Assets would be better placed than many trusts in terms of liquidity.

Quarterly N^o. 93 (September 2019)

What does it say on the Tin?

Earlier this year I had to complete, for what I hope will be the last time, the two mandatory annual online tests for investment professionals about Data Protection and Anti-Money Laundering. The format of a large proportion of these tests consisted of asking you to choose the correct answer from among a series of options. To use the same format here, the following have been suggested to me at various times by shareholders and fund managers alike as they attempt to answer the question, 'What is an investment trust's job?':

- To outperform its benchmark?
- To outperform its peer group?
- To grow in size as much as possible?
- To win awards?

The answer is, of course, none of these. A trust's job is very simple – in the modern phrase, it is 'to do what it says on the tin'.

But as one who has seen many trusts come to the market with fashionable specialisations only to come badly unstuck once the wheel of fashion turns against them, I would add this: an investment policy should be a support, never a straitjacket. Take care that what it says on the tin is something you are confident you can deliver.

Quarterly N^o. 95 (July 2020)

Bin Ends

In the world of investment, as everywhere else, Ovid's maxim still holds sway:

'Res age, tutus eris.'

('Keep busy and you'll be safe'.)

Quarterly N^o. 1 (August 1994)

I owe to the ever-stimulating Mr Christopher Fildes, in a recent issue of *The Spectator*, the timely reminder of Walter Bagehot's words that there is nothing so difficult about money as to justify impenetrable writing, and nothing so solemn as to exclude jokes.

Quarterly N^o. 2 (November 1994)

The confession that I am a compulsive market-watcher may seem odd, since I never tire of saying how much I pride myself on Personal Assets' detachment from short-term market froth. But there is no contradiction here. Detachment need not mean ignorance. An ostrich with its head in the sand may be detached, but it is not the sort of detachment I should wish to emulate. The most productive time to stand back from the market and be 'different' from it is when one is thoroughly familiar with it – just as I sometimes feel I can bend the rules to good effect when writing or speaking English, because I know it so well, but would not be able to do the same thing in French. You can bend the rules only if you know the rules. You can get things into proportion only if you know what they are meant to look like in the first place.

Introduction to 2002 in Personal Assets Trust Quarterlies, The 1990s and Beyond

Why does Personal Assets sometimes hold general trusts which offer us no apparent extra portfolio diversification? The answer is that they were bought as another way of getting exposure to equity markets – like holding direct equities or using futures, but at a discount we believed would narrow. Examples are Scottish Investment, British Assets and Foreign & Colonial (all sold at a good profit) and our current holding in Alliance Trust. We also hold trusts to exploit opportunities in geographical or industrial areas we don't have the expertise to invest in directly. Examples here have been TR Property and City Natural Resources. We'll continue to use trusts in this way if opportunities arise.

Quarterly No. 46 (September 2007)

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. (This is a view that goes back at least to the 1820s and the first Latin American bond crisis.)

Quarterly No. 58 (August 2010)

When choosing companies to which to commit our irreplaceable long term capital, we take care to look for strong balance sheets, preferably with no debt. This provides both flexibility and resilience for management. In running a company, the interests of the shareholders should always be paramount. But if a company is highly geared, this cannot be the case. The interests of the creditors – notably the company's bankers or bondholders – will of necessity be paramount. We do not ever want to rank other than first in a Board's order of priorities.

Quarterly No. 61 (June 2011)

There are many books about inspirational tycoons or entrepreneurs who have created and built up great companies; but I have sometimes thought of commissioning one entitled 'Company Destroyers', about people who have come in (or been brought in) from outside to take charge of great companies that were doing a perfectly good job for their shareholders, and proceeded to wreck them. It would be a big book, and a very sad one.

Quarterly No. 61 (June 2011)

Capital discipline is essential to avoiding mistakes in stock picking. The arrogance of company bosses can be overwhelming. I don't just mean arrogance about pay and bonuses, but the misuse of company resources for vaulting ambition and self-aggrandisement.

We can all recall past corporate follies and disasters which have led to permanent capital loss for shareholders. It has often been overpayment for acquisitions, either using equity or debt, that had led to value destruction. Only yesterday I received an e-mail from a friend, lamenting how the company he works for (in which, I'm glad to say, Personal Assets does not hold shares) had bought a lot of other companies in 2007-8, at the peak of the market, and had not only paid too much for goodwill but also had bought various businesses that were peripheral to its core strategy. The result? Massive write-downs, major sell-offs and a share price that had declined by nearly 85%. The story is an all too familiar one. More often than not, investors celebrate mergers in haste but repent at leisure

Quarterly N^o. 61 (June 2011)

Glamour and excitement are not necessarily positive in the world of investment. Plenty of thrilling start-ups or fashionable 'concept' stocks have come a cropper over the years while blue chips have powered quietly but satisfyingly ahead. It still causes me amusement to remember how in the mid 1980s a bullish colleague of mine took out what was called an 'Aggressive Growth PEP' with a starting investment of £2,400. It promised the moon and the stars. After a number of years he cashed it in and found it had 'grown' to be worth around £2,000.

Quarterly N^o. 61 (June 2011)

Twitter went from $26 to $50 on its first day of dealings. Resurgent interest in US stocks has paved the way for 192 companies to raise $51.8 billion from new stock offerings, putting the market on track to rival the sums raised by US companies at the height of the 2000 dotcom bubble. In a recent speech on quantitative easing ("QE") I remarked that the motto of the USA was *'In God We Trust'*, not *'I'm For Ever Blowing Bubbles'*.

Quarterly N^o. 70 (November 2013)

Every portfolio tells a story – and if it doesn't, it should do. A portfolio is greater than the sum of its parts. It is an organic whole – not just a basket of individual ingredients but a blend of those ingredients to produce something with a life of its own. It is structured to be able to capitalise on foreseen opportunities and protect against foreseen shocks, but also to have the resilience to respond to the unforeseen. If people ask me what we expect to happen in the next few months, I usually point them to our portfolio and tell them that this is their answer.

Quarterly N^o. 72 (June 2014)

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

Quarterly N^o. 78 (November 2015)

I'm always wary of the notion that reduction of investment trust running costs, whether absolutely or as a percentage of total assets, is an end in itself. Often in life, although not invariably, you get what you pay for.

Quarterly N^o. 78 (November 2015)

Throughout my career I've taken pride in working in a sector which is accountable to those it seeks to serve and which actively encourages them to engage with Boards, managers and fellow shareholders and stakeholders. They have a perfect right even to send rude letters or ask rude questions (and I've had a few of both in my time), because they own the company and are my employers as well as (I like to think) my partners. And remembering as I do from my student days the agitation in the 1970s to disinvest from Barclays, I'm not surprised to see the renewed emphasis on 'voting for causes'. Whether you are a dyed-in-the-wool climate change denier or a dedicated supporter of Extinction Rebellion, this heightened consciousness will affect you.

Quarterly N^o. 94 (November 2019)

The Nature of Personal Assets

A New Venture for Us

In the 1994 Annual Report we wrote:

'We regard our shareholders as our partners and one of our aims is to foster and strengthen this feeling of partnership. To that end we shall from now on be sending you informal Quarterly Reports in March and August, in addition to the Annual Report in May and the Interim Report in November.'

Like the contents of a magazine, the contents of each issue will, we hope, be a surprise. But we also hope that when you have put down the Quarterly you will say:

'Well, at least ***that*** *was worth reading.'*

If you don't, we trust you will let us know, and give us your reasons!

Quarterly N° 1 (August 1994)

Personal Assets' Structure

Personal Assets is an investment trust. Why do we keep it as such, since all the Directors and probably many of the shareholders have portfolios big enough to manage directly, and we could easily join together to liquidate the company? The answer is very straightforward – it's for reasons of hard-nosed financial advantage. Directly-managed portfolios are subject to Capital Gains Tax ("CGT") on realised capital gains. The portfolios of investment trusts are not. Furthermore, individuals can't borrow money and offset the costs against their tax bills. Investment trusts can. If, therefore, we liquidated Personal Assets and devoted exactly the same amount of time and skill to our own portfolios as we do to Personal Assets at present, we'd be significantly worse off, because we can do things through Personal Assets that we can't do as individuals.

Quarterly N° 2 (November1994)

'Why Don't You. . . ?'

'Personal Assets is a diversified trust, so why don't you invest in the Far East?'

I've mentioned before how Ian and I are always being asked questions like this, and for 'Far East', you can read 'emerging markets', or 'unlisteds', or 'property', or any other asset class you like. The asset class itself is not important. The importance of such questions lies in the two implicit assumptions being made by the questioners: that all 'diversification' is good and the more diversification the better; and/or that we are missing outstanding profit opportunities which are there for the taking.

The truth is very different. Take diversification. Not all diversification is good. Sometimes it can be pointless, and sometimes it can be positively harmful. Mix blue and yellow together and you get green, but if you stir in every other colour in the paintbox you get a muddy brown. Back every horse in every race, and only the bookie wins. There is a purpose in diversification only if it serves either to reduce risk or to enhance the possibility of reward.

Quarterly N° 3 (March 1995)

Demand brings Expansion

Personal Assets has since 1995 succeeded in doing what conventional wisdom said was impossible. It has increased its size through the creation of new shares at a premium to NAV without making an issue of 'C' shares or indulging in any other type of share placing. On 31 October 1990 Personal Assets had (adjusting for the consolidation in January 1993) 149,313 shares in issue and a market capitalisation of £5.3 million. By 30 April 1995, the last year end at which Personal Assets' shares were selling at a discount, there were 152,187 shares in issue at a price of £87, giving a market capitalisation of £13.2 million. (A small number of new shares had from time to time been issued at a premium during 1993 and 1994.)

As I write, at the close of business on 3 December 1999, there are 355,920 shares in issue at a price of £212.50, giving Personal Assets a market capitalisation of £75.6 million. The NAV per share is £207.03, so the shares are selling at a premium of 2.5%. Since 30 April 1995 Personal Assets has more than doubled its number of shares in issue, creating 203,733 new shares compared to the 152,187 outstanding at the beginning of the period.

[As of 30 April 2021 there were 3,232,929 shares in issue at a price of £471, giving Personal Assets a market capitalisation of £1.5 billion. The NAV per share is £465.19, so the shares are selling at a premium of 1.2%. Since 30 April 1995 Personal Assets has increased 21-fold its number of shares in issue, creating 3,080,742 new shares compared to the 152,187 outstanding at the beginning of the period.]

Quarterly №. 18 (December 1999)

Shareholders come First

In our 1991 Annual Report, the first to be published after Personal Assets became self-managed in 1990, we made our priorities clear by stating, 'Our specialisation is our shareholders'. If I didn't regard all 'mission statements' as pompous garbage, that might serve as ours. In each subsequent Annual Report we have stressed that Personal Assets is run for one specific reason – to meet the requirements of individual investors who want to commit a significant proportion of their capital to an investment trust. We aim to protect and increase the value of shareholders' funds over the long term and to achieve as high a total return on shareholders' funds as possible given our dislike of a level of risk significantly greater than that of investing in *[what was then]* our benchmark, the FTSE All-Share.

In this we have the advantage of being free from the policy restrictions of specialist trusts and the complicated capital structures of some more recent trusts. Furthermore, because Personal Assets is almost entirely held by individual investors it does not have to take account of the differing and at times conflicting objectives of investing institutions. Personal Assets is run not by an investment management firm but by its Board, and the Directors run Personal Assets for people like themselves.

Accountability to our shareholders is at the heart of everything we do. For many Boards, shareholder criticism is no more than 30 lashes with a feather duster. Not for us. Criticism from our shareholders is criticism from our partners. This is not to say that we always agree with it (!), but we do always take it seriously.

Quarterly №. 26 (October 2002)

Troy Asset Management

Full information about Troy Asset Management Limited is given in today's Press Release, including the fact that Troy was named after Lord Weinstock's 1979 Derby winner rather than the topless towers of Ilium. (I was a little disappointed when I learned this, given the opportunities I might have had for quoting from the *Æneid*, but I'm sure shareholders will be greatly relieved.)

I should just like to add that for me the appointment of Troy as Investment Adviser to Personal Assets is a coming together of friends. Sebastian Lyon, Chief Executive of Troy, has been a significant private shareholder in Personal Assets since 1999. He first came to know of Ian Rushbrook and Personal Assets through Jonathan Davis's book *Money Makers* (1998) and thereafter kept in regular touch with Ian and me over the years, visiting us in Edinburgh, meeting the rest of the Board at the AGM and taking part in many a fascinating discussion about investment (including joining me in teasing Ian about his refusal ever to entertain the idea of investing in gold). I look forward eagerly to working with Sebastian and despite the current economic storms I am full of hope and confidence as regards the future of Personal Assets.

Quarterly №. 52 (March 2009)

A Dash for Trash

'Sell in May and go away,
Come back on St Leger Day.'

There may be something in the old saying. In 2005 Barclays Capital worked out that between 1964 and 2004 the average return from buying the London index at the beginning of October and selling at the end of May was just over 7% whereas the average return from buying at the end of May and selling at the beginning of October was –2%. Although the old adage proved significantly wrong in 2005 and modestly so in 2006, it was modestly right in 2007 and very right in 2008, when between the end of May and the beginning of October 2008 the FTSE 100 fell by 18%, from 6,054 to 4,960.

This year the FTSE 100 ended May at 4,418. While we have not reached St Leger Day yet (12 September at Doncaster) the odds against a return to that level by then are much higher than the *ante post* 11/4 against currently offered on the joint favourites, Age of Aquarius and Kite Wood.

[In the 2009 St Leger, the bookies would have been pleased that Kite Wood came second and Age of Aquarius was pulled before the start. Mastery won at 14/1. Meanwhile, on 9 September 2009 the FTSE 100 closed at 5004.30 – the first time it had closed at over 5,000 since 28 September 2008.]

But this is a liquidity driven rally – a 'dash for trash' – which is likely to go into sharp retreat at the first sniff of bad news or expectations unfulfilled. While many investors, terrified of short term underperformance, have piled into poorly financed, low quality companies, we have focused on liquid blue chips that can pay sustainable and growing dividends. The valuations of such stocks have risen only a fraction since the recent rally began; yet, when interest rates are so low, shares paying a reliable income should begin to perform.

Some say it is 'dangerous' to be in cash just now because of the risk of missing out. We look at things differently. To us, 'danger' means 'the danger of actually losing money', not failing to grab the last halfpenny in an overvalued equity market which might turn and tumble at any time. We don't have a coat of arms; but if we ever did it would be difficult to think of a better motto for us than *'Quod tuum tene'* – or, in English, 'Hang on to what is your own'.

Quarterly N$^{o.}$ 54 (September 2009)

Should We Split the Shares?

Our shareholders are our principal intangible assets, and remarkably diverse assets they are. Some are themselves investors with enviable track records and a store of experience that any professional might envy. Indeed, discussing investment matters with them can be more stimulating and productive of fresh insights than many a conventional investment management industry gathering. However, an unavoidable challenge of running an investment trust intended to meet the needs of private investors is that different private investors want different things.

Sometimes this is because of their age or family status, but it also has to do with character and temperament. There are private investors who are risk-averse to the extent that they worry about the solvency and stability of even the largest banks and insurance companies (and who can blame them after the fate of such as Equitable Life, Northern Rock and others in recent years?), while others crave excitement and are frustrated by caution, especially when, like a few of them I have encountered in my time, they seem to believe that investment professionals really do know what is going to go up by 50% over the next six months but for some strange reason prefer to keep the knowledge secret.

Some private investors want dividends, while others, often for tax reasons, see dividends as an irrelevance or even as an irritation. Many have their own preferences and prejudices. Some object to banks, others to tobacco shares. Some clamour for holdings in Japan or in emerging markets, others want convertibles, corporate bonds or, frequently, commercial property. Some see gold as the safest investment there is, others as one of the riskiest. In short, as has often been said, you cannot please all of the people all of the time.

In Quarterly N° 59 I mentioned that the Board was considering the idea of a share split, possibly one that would leave shareholders holding ten shares for every one currently held. We received a lot of letters and e-mails in response to the idea, some passionately in favour, others equally passionately against, some suggesting different ratios of new shares for old, and a good number weighing up the various pros and cons before coming down judiciously on one side or the other. The most notable theme on the *For* side was the difficulty experienced by small shareholders in reinvesting dividends, while the argument most commonly advanced *Against* was the distinctiveness of the current share price and what this implied about the nature of the trust.

While both points of view have something to commend them, the letters and e-mails we received worked out at approximately two against a share split for every one in favour. At the London shareholder presentation the Chairman took the opportunity to ask for a show of hands from the 300 or so shareholders present and again the split was roughly one third in favour and two thirds against. We have therefore decided to leave things unchanged for the present, although there would be nothing to prevent our reconsidering it at some future time if shareholders wanted us to do so.

Quarterly N° 60 (March 2011)

How Troy Chooses Equities

Now to stock selection, which remains important despite our 'top down' approach. Here are some guidelines Troy, and hence Personal Assets, follow:

- Invest only in companies with growth in revenues per share. We avoid companies that 'grow' by acquisition. Mere growth in size is of no benefit to us. What matters is not the total value of a company, but the value of each of the company's shares. And the value of the shares is determined not by the size of the company as a whole but by revenues, earnings and dividends per share, and their rate of growth.
- Avoid highly geared companies like the plague. It is important that businesses are self-financing. Debt is crippling to management flexibility and corporate growth. The financial scrap-heap is littered with companies which borrowed too much and came unstuck. As I've often said, in running a company the interests of shareholders should always be paramount. But if a company is highly geared, this cannot be the case: the interests of the creditors will be paramount. Who wants to rank second, third or fourth in a Board's order of priorities?
- Make sure managers act like owners. It is vital that the managers of businesses understand how value is created – not by issuing equity but by jealously guarding it. We prefer to see genuine share ownership by Boards (as we practice at Personal Assets itself) instead of the 'heads I win, tails you lose' self-issuance of share options.
- Invest in companies with high total return on capital employed.
- Avoid cyclical businesses, especially those with high capital intensity. Recovery situations offer borrowed performance. While investors may make money in the short term, someone else will give it back eventually, as and when the economic cycle turns down again. These companies tend to gobble up cash and will turn to shareholders time and again for more. We want to invest in companies that pay us to own them, not *vice versa*.
- Don't ignore history. Many analysts and investors focus far too much on the next

quarter, or the coming year. Equities are long duration assets. When we buy stocks we consider the outlook for the next decade or more and ask if the business will remain resilient. Financial performance over the previous ten years is a more important indicator than short term earnings forecasts. The track record shows both how growth has been financed and how shareholders were rewarded by dividends or buybacks.

- That which looks statistically cheap is probably dear and *vice versa*. Cheap stocks are usually cheap for a reason. The market can sniff out low quality earnings and will value them accordingly. A low P/E tells you more about the quality of the business than its worth. Great stocks are rarely cheap but they can sometimes be discovered selling at reasonable value, which is when we look to buy them. We are patient. Opportunities will present themselves and, when they do, we make them count by buying percentage holdings, not fractions.

Quarterly Nº. 69 (August 2013)

La Mission Haut-Brion '68

In January 2003 I was invited to a New Year's colloquium of fund managers to give my views on the investment outlook for the coming year, and since Personal Assets had successfully predicted the market's fall from its 2000 heights I was greeted with reverence and awe. At the corresponding event in 2004 my views were listened to with respect, in 2005 they were greeted with polite derision and in 2006 I wasn't even invited. The patience of some of our shareholders had worn very thin by 2007 and Ian and I had to make it our daily discipline to stiffen the sinews and summon up the blood before going about our business in public.

Despite that, it never occurred to us during those difficult years to diverge from what we believed to be the right course by adopting a more media-friendly policy. Confronted by extravagant praise or contemptuous derision, we treat those two impostors just the same. That's rather like where we are now. We know an upturn in performance will come and we're poised to make the most of it; but we can't pretend that the waiting is fun. It hasn't yet exactly driven me to drink, but it has made me meditate on parallels to Personal Assets in the world of wine. In my student days, the Dean of my college was a claret-loving clergyman of the type that was once the glory of the Church of England. He taught me many things; but none was so valuable as that certain highly regarded Bordeaux *châteaux* have a habit of producing good wines in 'off' years. Proof of this was a toothsome La Mission Haut-Brion 1968 with which he plied us on a College Retreat. I wouldn't want to press the analogy too far – La Mission Haut-Brion makes even better wines in good years – but there is something of this 'off year' quality about Personal Assets. We are a trust that (relatively, at least) tends to do well in such years.

The alcoholic analogy might even be taken a little further. Personal Assets might be compared to a rather reserved guest at a party who is very far from being a party animal. We pace our drinking, so that as the party hots up we look dull, awkward and out of things. But because of this, we don't get drawn into doing the silly things some people do when parties are at their wildest – and we don't have a hangover the next day. Boring, I know. But it has its advantages.

Quarterly Nº. 73 (August 2014)

Our 1993 Share Consolidation

One of the most distinctive features of Personal Assets is its 'heavy' (i.e. high) share price. It dates from January 1993, when we had a 1 for 100 share consolidation that increased our then share price from 77p to £77. Personal Assets had come to the market in September 1983 through a 1-for-30 rights issue by Atlantic Assets, another investment trust managed by our then managers, Ivory & Sime. The result had been that many small shareholders in Atlantic Assets had found themselves with minuscule holdings of Personal Assets, sometimes worth only a few pounds – scarcely worth holding, yet disproportionately expensive to sell.

One shareholder complained that as a consequence of taking up their rights in the rights issue his three daughters each held eight shares in Personal Assets, worth around £6 per daughter and paying dividends of around 13p – less than the cost of the stamp used to post the dividend cheque. Selling the shares would have cost more than the sale proceeds, so the shareholder unsurprisingly urged us to act. The Board decided on a 1-for-100 consolidation in which all holders of fewer than 100 shares (worth up to £77 on the old basis) would receive cash at close to NAV. This reduced the number of shareholders by around two-thirds, which not only meant significant economies in printing and postage but also, and more importantly for the future, sent out a message that Personal Assets was an idiosyncratic vehicle that wasn't intended as an investment for the smallest shareholders.

Quarterly N°. 74 (November 2014)

Frustrated Bulls

Following the publication of Quarterly N°. 80 a shareholder of many years' standing wrote to me:

'It would seem to me that [in the Board's opinion] the time will never be right for Personal Assets to buy a substantial amount of equities. When equities have low multiples you wouldn't be prepared to take the risk. You would always be behind the game in a rising market. You make money in a falling market, but you are still hedging your bets. You have to take risks. There are always risks in life. If you are not prepared to take risks you shouldn't invest in the stock market.'

I can see why he wrote this. Since Personal Assets became independently managed we have never been 100% invested in equities pure and simple. We have, however, in times past been significantly more fully invested than it may have seemed, through investing in highly geared investment trust warrants and investment management companies and, later, by using FTSE 100 Futures.

Sebastian and I have often said that we are frustrated bulls and look forward to being fully invested in equities, or even geared. We mean it. Oh yes, we mean it. We do indeed. And we accept that an equity investor has to take risks. Be assured that when the time is right, we'll do so. The shareholder I mentioned (he knows who he is) can hold us to account if we don't.

Quarterly N°. 81 (September 2016)

Stella Artois & Patek Philippe

I've often said that a holding in Personal Assets is designed not just to allow you to sleep but actually to send you to sleep. Sometimes I get asked about our 'heavy' (i.e. high) share price by shareholders or, more often, outsiders who find it puzzling, and I reply that we prefer this to a stock split because it says something about Personal Assets and those who hold it.

It's rather along the lines of the old advertisement for Stella Artois:

'Personal Assets shares – reassuringly expensive'.

I wish I'd thought of that first. But even more to the point is what I think would be the most appropriate slogan if we were ever to advertise (which we've never done). It's borrowed from the well-known Patek Philippe watch advertisement:

'You never actually own a Personal Assets share, you merely look after it for the next generation.'

Quarterly N°. 83 (March 2017)

'Crambe Repetita'

I sometimes receive the accusation that the Quarterlies contain too much repetition of the kind referred to by the Latin poet

Juvenal as *'crambe repetita'*: 'twice cooked cabbage', or, in the Scots phrase, 'cauld kail het again'. Such a diet may be filling, but a delight to the palate it is not. Yet, like the inescapable In-Flight Safety Demonstration on aeroplanes, it is there for a reason. Frequent flyers may bury themselves behind their copies of the *Financial Times*, but to others the safety demonstration will be fresh and new, and occasionally it may even be a matter of life and death.

Writing these Quarterlies is not like writing the chapters of a book. They are more like a journal or a periodical. A book need only state a point of view or describe a methodology once, but a periodical must go over old ground (with or without a new slant) from time to time because its readership will have changed, and the number of Personal Assets shareholders is constantly increasing.

Quarterly Nº 90 (December 2018)

Bin Ends

Dr E M 'Coroner' Grace, brother of the great Dr W G Grace, is said to have had a scotch and soda carried out to him at the wicket each time he scored 50 runs during an innings. On reaching Quarterly Nº 50 I feel entitled to the same.

Quarterly Nº 50 (August 2008)

Emerging markets are usually higher risk and are not an asset class in which we have expertise. Investors wanting direct exposure to them would in our view be better served by using other trusts specialising in these markets. We do, however, have a useful degree of indirect exposure to developing countries through our holdings of companies like BAT, Nestlé and Unilever.

Quarterly Nº 71 (February 2014)

Here's a question for all investors:

'How much risk can you tolerate?'

Or, putting it more bluntly:

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

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

The typical definition is likely to be 'volatility of returns relative to an index'.

Ours is 'risk of losing money'.

Quarterly Nº 84 (June 2017)

One shareholder accused me a few years ago of writing these Quarterlies for 'a coterie of over-educated sycophants'. OK, fair enough. You can't please everyone, and what delights one reader may exasperate another. (The Latin tags I sometimes introduce are especially noteworthy here.) But the same shareholder went on to say how much better the Quarterlies had been back in the days when Ian Rushbrook wrote them. The trouble with this is that (with the exception of two one-pagers when I was unwell in 1998) Ian never actually *did* write them. Some of the thoughts may have been Ian's, but the words were all mine.

Quarterly Nº 89 (September 2018)

Our choice of stocks is reminiscent of Dr Primrose's not very gallant description of his wife's attributes in Oliver Goldsmith's *The Vicar of Wakefield*, where he wrote that he:

'. . . chose my wife as she did her wedding gown, not for a fine glossy surface, but such qualities as would wear well.'

Quarterly Nº 90 (December 2018)

New shareholders need to know all the traditions of what has been called the 'family atmosphere' (or DNA) of Personal Assets. All families have their traditions, shared memories, remembered triumphs and cautionary tales, and Personal Assets is no different.

Quarterly Nº 90 (December 2018)

The Problem of the Dividend

The Dividend Dilemma

In a recent note for the Board on our revenue shortfall compared to the sum required to maintain the dividend at the current rate, I said we were faced with three choices: increasing the portfolio yield; cutting the dividend; or taking powers to use capital reserves.

- Increasing the yield on the portfolio is something many Boards in a similar position have chosen to do. We believe, however, that at this stage in the investment cycle it would almost inevitably lower the quality of the portfolio and, as a result, risk lowering the total return.
- Cutting the dividend might seem the cleanest approach, and thanks to our discount and premium control mechanism it would have no adverse effect on the share price. However, we are conscious of the value placed by some shareholders (often long-standing ones) on our unbroken record of paying either an increased or a maintained dividend ever since 1990. Is there any way that this can be preserved without imperilling our prospects of protecting and increasing (in that order) the value of shareholders' funds per share over the long term?
- In 2012, changes to the law made it possible for trusts to seek authority from shareholders to distribute realised capital profits as dividend, and many trusts have taken advantage of the new rules. We were clear from the beginning that this would be a less bad option in terms of protecting and increasing shareholders' funds per share than 'buying' income by acquiring equities we would not otherwise choose to own. But could we reconcile ourselves to the principle of distributing capital as dividend?

At first we rejected the idea of distributing capital profits in this way. But two considerations have now persuaded us to seek shareholders' permission to do so.

- By paying dividends partly out of revenue reserves we are already, in a certain fashion, distributing capital. Extending the principle to paying out an element of capital profits as dividend would be a genuine total return solution to the dividend problem – paying out a percentage of the total return from a high quality portfolio, rather than reducing the quality of the portfolio in order to maintain the dividend from higher income receipts.
- Compared to net asset value per share ("NAV"), the sums involved are tiny. Constant earnings per share of £4.21 and a maintained dividend of £5.60 would exhaust our revenue reserves in 2016 and in 2017 necessitate a transfer of £1.39 per share from capital. A shareholder liable to pay tax at the top rate of 45% would suffer extra tax of £0.42 per share (30.56% of £1.39, or 27.5% of the grossed-up amount of £1.54) compared to what she would have to pay if we distributed as dividend only our earnings of £4.21. Compared to net assets of £351.89 per share at 31 January 2015, this would cost her less than 0.12% of NAV.

This is the justification for our intended solution of the problem of the dividend, which is to draw on realised capital profits to maintain the dividend at the present level of £5.60 per annum.

Quarterly N°. 75 (February 2015)

Dividends and Total Return

The recent change to the Articles of Association permitting the payment of dividends out of realised capital profits solves once and for all a problem which had recently been taking up an increasing amount of the Board's attention – namely, that of how to keep faith with income-conscious shareholders by maintaining the dividend at the current rate without disadvantaging shareholders of all kinds, income-conscious or not, by restricting our investment flexibility or lowering the quality of the portfolio and hence putting at risk capital protection and capital growth.

Once we had set aside any preconceptions about what had looked like the unbridgeable distinction between capital and income (something the Chairman and I have been campaigning about for many years), the answer was plain. We had already established our willingness to distribute capital by being prepared to pay dividends partly out of revenue reserves. Extending the principle to paying out a small element of capital profits as dividend has provided us with a genuine total return solution to the dividend dilemma.

It does in a small way what the Cash Withdrawal Option in our Investment Plan used to do on a larger scale – paying out a percentage of the total return from a high quality portfolio rather than reducing the quality of the portfolio by buying into higher-yielding stocks in order to maintain the dividend from higher income receipts. We can now maintain our annual dividend payment rate of £5.60 per share for the foreseeable future, and shareholders for whom it is a significant factor in their annual budgeting can rely on it continuing to be paid regularly from now on. But to answer worries that such distribution of capital profits will harm our chances of protecting shareholders' funds in the longer term, we have made it clear that we intend to draw on capital profits only to maintain the dividend at the present £5.60 per annum, not to increase it.

Quarterly N^{o.} 76 (June 2015)

Bin Ends

Rubbish is rubbish, whatever it yields.

Quarterly No. 5 (October 1995)

Leaving aside short-term market inefficiencies, the general principle is that the higher the income return you get from an investment, the lower will be the rate of capital growth it produces, and *vice versa*. Common sense will tell you that most high yield investments threaten you with a real prospect of capital loss.

This is why – counter-intuitive although it must have seemed – we asked shareholders to vote to amend the Articles of Association to permit Personal Assets to distribute realised profits as dividend. This has enabled the Board to commit to paying the dividend at the present annual rate of £5.60 for the foreseeable future without resorting to an expedient all of us would have dreaded – that of being forced to scrabble around for income in a yield-starved world in a way that would inevitably have lowered the quality of the portfolio.

Quarterly No. 84 (June 2017)

The greatest danger for a trust which pays a dividend is what the Chairman calls 'allowing the dividend "tail" to wag the capital "dog".' All too often, a trust anxious to maintain or increase its dividend will resort to lowering the quality of its portfolio in order to squeeze from it a higher yield. This we will never do. Nor would we need to, now we have the freedom to distribute realised capital profit as dividend. I can't emphasise too strongly that this was in fact the most conservative option available to us.

Quarterly No. 88 (June 2018)

The Rôle of the Board

What The Board *Doesn't* Do

One thing that is almost universally true of investment trust Boards (the Board of Personal Assets here being no exception) is that they are not involved in stock selection. It's not their job, any more than it is the job of the Board of a football club to pick the squad for each match or of a Bishop to pick the hymns for every Sunday service in every church in her diocese.

Indeed, I dread to think what a portfolio chosen by a Board of half a dozen highly intelligent but also highly opinionated individuals might look like. A meeting to review it might be a cross between the voting at the Eurovision Song Contest and picking teams in a school playground. The Board naturally has a watching brief to ensure that stock selection remains consistent with the trust's investment approach as articulated over the years. But the danger of stock selection *per se* by the directors would be that the Board might function like an international football team, full of *prima donnas* unable to work productively together.

Ian Rushbrook in this context used to refer to the famously argumentative Board of The Independent Investment Company, which was founded in 1924 with three idiosyncratic investment titans as its directors – John Maynard Keynes, Thomas Johnstone Carlyle Gifford (the founder of Baillie, Gifford & Co) and Oswald Toynbee 'Foxy' Falk of the stockbrokers Buckmaster & Moore. For a description of this fascinating company (which was no relation to today's The Independent Investment Trust, chaired by Douglas McDougall and managed by Max Ward), see Nigel Edward Morecroft, *The Origins of Asset Management from 1700 to 1966: Towering Investors*, Palgrave Studies in the History of Finance, 2017, pp. 194-203.

Quarterly N$^{o.}$ 89 (September 2018)

What The Board *Does* Do

With all investment trusts, there is a distinction to be drawn between running the company (the responsibility of the Board) and running the portfolio (the responsibility of the Investment Manager or Investment Adviser). Walter Bagehot, the journalist who was the Editor-in-Chief of *The Economist* 1860-77, famously wrote that a constitutional monarch had three rights: to be consulted; to encourage; and to warn. As I've written elsewhere, this neatly sums up the rôle of an investment trust director as regards the running of the portfolio.

A less obvious area where the Board of an investment trust comes into its own is where the trust runs into a sticky patch such as Personal Assets suffered in 2014, when we suffered in investment terms a 'perfect storm' as our NAV actually fell when our comparator rose. In such circumstances the Board's job is first and foremost to support and encourage the Investment Adviser.

Quarterly N$^{o.}$ 89 (September 2018)

Thoughts on Investment Management

What *is* a Share Price?

The obvious answer to this question is:

'Why, of course, the number of pence – or pounds, in the case of Personal Assets – people are prepared to pay for a share!'

Quite so. But why give anything at all for a share? A share in, say, ICI is a piece of paper which entitles its owner to a tiny fraction of that company. So what? Who wants a tiny fraction of a factory or a warehouse? ('Look, dear, those are MY bricks – on the bottom left-hand corner beside the door of the manager's office!') You can't even turn up, hand over the share certificate and get in exchange a Bunsen burner, a few pipettes and a sack of sodium chlorate. No – a share in an operating company is by itself actually quite useless.

It has value only because, in addition to entitling its owner to a tiny fraction of everything a company owns should the company be acquired by a bidder, it also entitles its owner to a tiny fraction of all the profits the company makes. In other words, it is capable of producing income – either present income (paid as dividends) or deferred income (profits which are reinvested in the business in the hope of making more profits which, in turn, are available to be paid as dividends).

What, then, is a share in a company worth – in other words, what should a share price be? The answer is simple. Even if the company is going to be bid for (see below), it is worth the present value of the future stream of income it is expected to produce for its owner.

This is nothing more than the specific application of a general law – that an asset other than a recognised means of exchange (such as banknotes, or wampum or cowrie-shells in earlier times) is an asset only if it fulfils one or more of three criteria:

- It is capable of producing income (income value).
- It has a present or a future practical use (utility value).
- It is the object of a conspiracy (conspiracy value).

Assets which have primarily a conspiracy value (gold, jewels, Japanese shares, art, antiques and the like) need not detain us long. A Van Gogh is worth $35m only because somebody has paid $35m for it and others would pay a similar amount if they got the chance. But if people came to think that, rather than being a masterwork, a Van Gogh was a rubbishy daub idly slapped on canvas by a self-mutilated moron, it would be worth only a few pence as scrap. The $35m 'value' is underwritten solely by a public 'conspiracy' to admire Van Gogh.

Nor need assets with a utility value detain us. These are things like baked beans, steel, sugar and pork bellies. They are worth money only because we can either use them ourselves or sell them on to people who need them.

Assets with an income value are what interest us most as investors. These are houses capable of being let, goods for hire, fixed interest securities of all kinds – and, of course, ordinary shares. These assets are worth what the income they will produce in the future is worth to a buyer today.

This applies also in the case of bids. Why? Because assets producing income of £1x under the management of Bloggs & Co may produce income of £2x under new management, and therefore deserve a correspondingly higher value in the market place – although it would be idle to deny that a degree of conspiracy value sometimes creeps in as well.

Problems with valuation which obscure this basic law stem mostly from situations in which assets which have one kind of value temporarily acquire another kind of value. For instance, tulip bulbs primarily have a utility value. But in seventeenth-century Holland they briefly acquired a fantastic conspiracy value. Gold also has essentially only a utility value. But it has had, in addition, a high conspiracy value since records began. (Perhaps the Good God Herself in Her

Wisdom started the conspiracy. But that is another matter.)

And houses, which essentially have either an income value or a utility value, have also enjoyed from time to time a high conspiracy value – as in London and the rest of south-east England during the later 1980s.

Now, of these three types of value, income value is the most enduring. A conspiracy value vanishes when somebody blows the whistle on it. A utility value vanishes when somebody eats the sugar or spills the beans. But income value remains as long as the income is there, accruing for or being paid out to its owner. This is why ordinary shares as an asset class are a good investment.

'Come Off It . . .'

. . . I hear you say at this point. And certainly what I've just written looks, at first glance, like a load of old rubbish. What about growth companies, which pay minimal dividends but enjoy high prices for their shares in the market? And what about Warren Buffett, 'Mr Investment' himself, whose company, Berkshire Hathaway, has never paid a dividend in its entire existence? Well, the answer is that there are two kinds of income – actual income (dividends) and deferred income (retained earnings). Mature companies pay out a high percentage of their earnings as dividends. Growth companies retain most of their earnings to finance further growth. The question is, which is the more valuable to an investor in total return terms? Dividends? Retained earnings? Or a bit of both?

Common sense says that retained earnings are better. £1 retained by a company I invest in is worth at least £1. But when paid out as a dividend, it is worth only 75p in cash to a higher-rate taxpayer. Why, then, should I feel pleased if the company turns itself into a machine which takes my £1 notes and gives me 75p in exchange every time? But of course it isn't as simple as that. Whatever may be true of growth companies or of Berkshire Hathaway (which, remember, is an operating company rather than just an investment fund), experience shows that the market doesn't like non-specialist investment trusts which pay no dividends. The capital shares of split-capital trusts are a case in point. High taxpayers should love them, because they roll up capital gains tax-free on their behalf. And institutions which pay no tax but which invest for total return (like pension funds) should find them just as attractive as high-yielding shares, since to them it should not matter how they earn their returns, whether as income or as capital gain. Yet the capital shares of split-capital trusts frequently sell at discounts even to theoretical net present value, while income shares often sell at a premium.

One reason for this is, of course, that a bird in the hand is worth two in the bush. I can spend the dividends I get, or stuff them in a sock under the bed if I want. But unrealised capital gains can melt away if markets fall or the managers of the trust are incompetent..

Quarterly N°. 5 (October 1995)

The Nature of Value

Let's think about value for a moment. I'll begin by recalling the news reports during the 1987 stock market Crash, when it seemed that reporters were vying with one another to freeze our blood with tales of how many billions of pounds had been 'lost'. One silly man appeared on television claiming that he had lost overnight all his savings for his retirement. I'm still puzzled as to how he managed to do this, unless he'd punted the entire amount in futures and options. A number of more intelligent-looking investors, however, still claimed to have 'lost' 25% or 30% of their savings.

I held very few shares in those days, but I did hold some, and my wife, understandably perturbed by what she read in the papers and saw on television, asked me how much we had lost in the Crash. I was able to answer with what I believed to be perfect truth,

'Nothing. Not a penny.'

Why did I say this, when the prices of the shares I held had fallen substantially? Well, I held the same number of shares after the Crash as I held before it. None of them looked likely to cut their dividends, so the tangible money return I earned from them was going to be unchanged. And since I had no intention of selling any of my shares their market price was a matter of indifference to me.

Instead, I was confident that the long-term value of my investments, consisting of the earnings from the businesses in which my shares enabled me to participate, was unaffected by the Crash. So I lost nothing in the Crash. I would have lost money only if for some reason I had had no option but to sell my shares immediately after the Crash took place. Doubtless a handful of extremely unlucky investors found themselves in this position but they must have been few in number, because it is very seldom that one absolutely has no choice but to dispose of one's portfolio on a given day.

Quarterly No. 8 (June 1996)

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 building 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 percentage of the share capital could command a premium – or sell at a discount, depending on market conditions. And the £1 million office building? 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' 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 building? 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.

Quarterly N$^{o.}$ 41 (June 2006)

Bin Ends

Much damage is done to portfolio performance through falling in love with businesses. It is not the primary rôle of an investment manager to share the joys and sorrows of the managers of businesses and to defend them loyally while the stock price plummets.

Quarterly N$^{o.}$ 6 (November 1995)

I once knew an extraordinarily successful investor in Japanese shares who picked stocks by looking at their financial data in a stock guide printed in Japanese. He couldn't understand a word of the text, so he focused entirely on the figures. Then, when he had found a company he liked the look of, he would call a broker and ask what its name was and what it did. This was maybe rather an extreme approach, but it did have the merit of concentrating the mind.

Quarterly N$^{o.}$ 6 (November 1995)

The 'efficient market' hypothesis so beloved of academics is, in my opinion, a load of old rubbish and no-one who has been an investor even for five minutes could possibly give it credence.

Quarterly N$^{o.}$ 6 (November 1995)

I almost made an embarrassing mistake there. I was about to call Philip Morris 'a long-standing favourite stock of ours'. And so it is, in a sense, because we've held it for a long time and we've continued to be believers in its investment merits. But in a more fundamental sense we do not have 'favourite stocks' and we never will. To fall in love with stocks to the extent that we're too fond of them to sell them when they've done their work for us is to let sentiment master judgement. Philip Morris doesn't love us, so why should we cramp our style by vowing everlasting fidelity to it? To the investment manager, even the best of companies is just a means to an end.

Quarterly N$^{o.}$ 7 (February 1996)

If Mozart or Rembrandt were alive today, I'm sure they would become accountants. They would look around for the best way to use their inborn creativity and the choice of career would be obvious. I'm not an accountant myself, but I've spent quite a lot of time working on Church accounts and I always used to make sure that they showed a loss for the year, to scare people into giving more. Of course I did it perfectly legitimately and in accordance with the rules of accounting. Why lie, when there are so many ways to tell the truth?

Quarterly N$^{o.}$ 8 (June 1996)

The price at which one buys something, be it an index, a share or any other investment, is of vital importance. Even the best stock in the world won't produce acceptable returns if it has been bought at too high a price, because it is the purchase price that is the unchanging denominator that determines the eventual returns, however much the numerators (dividend received, eventual resale price) may change.

Quarterly N$^{o.}$ 61 (June 2011)

The problem is not a shortage of funds to invest, but a shortage of sufficiently attractive returns to be earned on funds invested. If only they were allowed to do so, market forces would sort things out. The ubiquitous TV advertisements for payday loans remind us that there is no shortage of credit at a price; and it is not that Spain cannot borrow money, but that Spain has to pay 7% to do so. As Ian Rushbrook was fond of pointing out in another context, there was no risk of 'the oil running out', as environmentalists claimed. The risk was that oil at its present price would run out. If the price is right, there will always be oil – and credit – to be found.

Quarterly N$^{o.}$ 65 (June 2012)

'Don't put all your eggs in one basket' is good advice, but gives rise to misunderstandings galore. For instance, if mining stocks as an investment class are risky it isn't really 'diversification' to hold six similar ones – not much more, anyway, than it would be spreading risk to place six bets on the same horse in the Grand National. Likewise, diversification doesn't simply mean holding lots of different shares. It depends on what the shares are. A breakfast of crisps, nuts, chocolate and gin would be 'diversified' in that it would have four different constituents, but only in my undergraduate days would I have thought it a balanced meal.

Quarterly N^o. 84 (June 2017)

Never forget how hard it is to recoup stock market losses. If an investment or an index falls by half (50%), it has to double (i.e. go up by 100%) to get back to where it started. That's a lot to ask, and sadly sometimes causes investors to shoulder increasing risk in an attempt to recover lost capital.

Quarterly N^o. 85 (September 2017)

Never underestimate the usefulness of cash as an asset class to hold at appropriate times, such as when nothing in particular across the spectrum of possible investments looks worth buying. Holding cash is not an admission of failure. It's better to hold cash than lose money on investments acquired just for the sake of buying something. Some fund managers, however, are not good at holding cash because cash burns holes in their pockets and they can't wait to invest it.

Quarterly N^o. 88 (June 2018)

I can't emphasise enough that we used FTSE 100 Futures a decade or so ago for essentially conservative reasons. When might we turn to them again? Perhaps when we want to ride on the back of a swiftly rising market spurred on by the kind of stocks we don't want to hold directly (the sort of markets which are described as a 'dash for trash'). Or we might, in racing parlance, want to lay off a bet when we don't want to sell stocks we hold but do want to reduce our exposure to equities.

Quarterly N^o. 88 (June 2018)

We think in Sterling, because most of our shareholders are UK residents or expatriates whose personal liabilities are denominated mainly in that currency. Their need to match their long-term liabilities with Sterling assets means it is prudent for our portfolio to have a high Sterling content.

Sometimes, therefore, prudence will also dictate that we should use currency hedging to protect the Sterling value of a portion of our foreign investments, and this we have often done, as disclosed in successive Annual Reports.

Quarterly N^o. 88 (June 2018)

I'm sometimes asked why we don't make use of long-term debt. At current rates, isn't it a no-brainer? No, because it can prove risky in unforeseen ways. Many trusts borrowed when it seemed a no-brainer in the 1980s, and lived to regret it when interest rates fell from levels that looked low by historical standards to minuscule levels that made long-term debt excruciatingly expensive to repay early.

Quarterly N^o. 88 (June 2018)

Thoughts on Stock Markets

Is Market Timing Possible?

In all my years in the investment business I've never met anyone who has any real insight into what is called 'market timing'. Anyone can say that the UK market is overvalued. That is not the point. The point is to say when the over-valuation will be corrected. This is like predicting when an overstretched rubber band is going to snap.

It has taken me most of my adult life so far to understand that 'market timing' is (probably) impossible. When I came into the investment business in 1977 I thought I knew everything there was to know about making money. The mystery to me was that everyone else was so stupid and slow. I was Mastermind, they were the Teletubbies. Nothing could be simpler than managing an equity portfolio. Sell when the market is high, buy back when the market is low, and make a killing every time.

I lectured one of the senior partners to this effect and got nowhere. His response was baffling. How did I know at any given moment that the market was high or low? And how would it help me if I did? What a foolish man he is, thought I. Timid, or just obtuse?

Now I see clearly that he was right. Yes, it is possible to say that the market is 'high' or 'low', if you mean that it is higher or lower than it has been at some other time. This is not, however, the same as saying that it is 'high' or 'low' in any useful sense. 50°F is higher than 40°F, but it is not hot. Are we any better off if we can say that the market is objectively 'high' or 'low' based on yields, P/E ratios or some other statistic? Not really. You can't stop a heatwave by pointing out that temperatures are higher than average for the time of year – just as, when storms set in, it pays to heed the words of Louis MacNeice:

'The glass is falling hour by hour,
The glass will fall for ever,
But if you break the bloody glass
You won't hold up the weather.'

Quarterly N^o. 13 (February 1998)

A Sense of Perspective

In investment, a long memory helps. So I am constantly astonished to find that the thinking of most investors, even of my own age or older, is determined almost entirely by what has happened during the last decade – or even, it can seem, during the last month.

This is unfortunate and unhelpful, because the last ten years in the UK and US equity markets have seen a lot of rapid movement, mostly upwards. As a result, rapid movement, mostly upwards, is what investors now expect. A sharp market fall they can easily cope with, but the problem is that they expect a corresponding sharp rise in a matter of months to compensate for it.

Markets, however, have not always been like that. I have followed them since the early 1960s, when I was a precocious schoolboy. The ICI bid for Courtaulds, the rise and fall of John Bloom's Rolls Razor, the GEC bids for AEI and English Electric, the collapse of Cyril Lord's carpet empire and the dizzy roller-coaster ride of Poseidon – I remember them all.

If, therefore, I have gained nothing else, I have at least gained patience and a sense of perspective.

Quarterly N^o. 22 (August 2001)

What Lies Ahead?

For a long time now, share prices in the USA have been floating on a sea of cheap money. Since 11 September, additional money has come in torrents. Today, however, I have a vision of Dr Greenspan as an agitated zookeeper, repeatedly trying to hose down a dead elephant in the hope it will wake up. The dead elephant is the US economy, and, at one remove, the US equity market.

Of course, the elephant is not dead, only resting. That is where the metaphor (as is the way with metaphors) parts company with reality. One day the elephant will rise up again to trumpet exuberantly the start of a new bull market. I long for that day. But I don't think it is coming yet awhile.

Quarterly Nº. 23 (November 2001)

Mistaken Assumptions

I recall in the ghastliest days of the 1970s a trade union leader commenting:

'It is unacceptable today that anyone should earn less than the national average wage.'

Self-evidently daft, as I hope you'll agree – but plenty of people who should know better still appear to believe a good fund manager can reasonably be expected to outperform all the time. They are usually the same people who seem to think I could make them any sum of money without risk over any given period of time, if only I would be co-operative enough to tell them how.

Take a recent visit from a successful and obviously intelligent potential shareholder who wanted a discussion about Personal Assets in particular and financial markets in general. We were discussing the state of the financial markets, and what my visitor could neither accept nor comprehend was my refusal to give him a timescale. He kept insisting:

'When will the next bull market begin? Come on, now. Give me an idea. Three months? Six months? A year?'

As I listened to him it struck me, as often before in such situations, that people actually seem to think we keep information from them on purpose, perhaps to tease them. If only it were so! How should I know when the next bull market will begin? How on earth would anybody know? Many years ago, grappling with the problem of forecasting short term market movements, I wrote (with what I'm sure was an audible sigh):

'A trend is a trend until it stops.'

I was surprised later when a friend told me he had quoted this aphorism in his MBA thesis. But alas! investors do often follow momentum rather than fundamentals, like a nervous traveller who jumps on a train which is about to leave, not daring to pause and find out its destination in case he misses it.

Identifying the start of a bull market isn't to do with time. It's to do with value. Bull markets do not begin after a fixed amount of time has elapsed since the last one. They begin only once equities, following a long period of disappointment and loss of hope, have got so screamingly cheap that it should be impossible to resist buying them.

Quarterly Nº. 32 (February 2004)

Preparing to be Bullish

In February 1991, when I worked with Hamish Buchan in the investment trust team at the stockbrokers County NatWest WoodMac, the market was gloomy. We were in the middle of the First Gulf War. There were tensions in what are now the Baltic States and it seemed that what was then the USSR might implode into violence and chaos. The UK was sliding into a particularly nasty recession and there was little confidence in John Major's government. 'Black Wednesday' was still to come and Norman Lamont's famous 'green shoots' were a long way from sprouting. Perhaps surprisingly, however, in my *Investment Trust Review of 1990* I found myself writing thus:

'The world is in a hell of a mess. We have never written a piece of trust research against so depressing a global background. Nor shall we pontificate (here, at least) about the state of the economy or the market. All we shall say is that cleverer people than we are seem to be making very gloomy noises. It will therefore surprise our clients if we say that this will be a cheerful Review with a clear message: START BUYING.'

How did I justify this? I did so by suggesting ten rules *[Oh dear! Yet another 'ten rules'!]* for common sense investors.

1. Markets go up when lots of people want to buy.
2. Markets go down when lots of people want to sell.

3. Markets also go down when few people actually want to sell, but nobody very much wants to buy, either.
4. It is unlikely that anyone buying OR selling knows much more about what's really going to happen in politics or the economy than you do.
5. It is therefore safe to back your own common sense judgements without fear, since common sense is an attribute which investors tend to forget they possess.
6. Always buy shares which offer intrinsically good value.
7. This means that you should usually buy on an actual, or at least a potential, yield basis.
8. Always buy too early. Market timing is unreliable as a technique. It will, of course, work well for you if you can manage to get it right more often than not. But you almost certainly won't.
9. Very clever people will tell you that there can be exceptions to these rules. When they are telling you this so insistently and so persuasively that you start to believe what they say, remember Rule 10.
10. There aren't.

[As it proved, the FTSE All-Share Index rose by 15.1% in calendar 1991, 14.8% in 1992 and 23.3% in 1993 . . .]

Quarterly N^{o.} 51 (December 2008)

A Debate about Regulation

'Was the recent banking crisis caused by insufficient regulation of financial markets?'

That was the topic for the 2009 Annual Debate of the Centre for Financial Markets Research at the University of Edinburgh Business School last month and, as a longstanding sceptic about regulation in all its forms, I was delighted to be asked to make the case that the problem had not been insufficient regulation but the very opposite – that there had been too much government interference, not least from central bankers who were in constant terror of alienating the politicians who kept them in their jobs.

Interference by the authorities, including well-meant but counter-productive regulation, is an ever-present menace not just to our lives in general but to the investment trust sector in particular. In my speech, therefore, I was at pains to explode the myth that the banking crisis was caused by governments' benign neglect rather than by their malign meddling. To do so, I first looked back at what happened before and during the crisis and then tried to ascertain whether more regulation could have cured it.

The Credit Cycle Rules, OK

Readers of these Quarterlies will not be surprised by my speech's starting point – that the root cause of the banking crisis had been a clash between an irresistible force (Alan Greenspan) and an immovable object (the credit cycle). According to the Austrian School of economics, credit cycles are the inevitable consequence of the adoption by central banks of policies which cause interest rates to remain too low for too long, resulting in excessive credit creation, speculative bubbles and lowered savings. Low interest rates stimulate more and more borrowing from the banking system, which causes an expansion of the money supply leading to a credit-fuelled boom during which the funds created by all this artificially stimulated borrowing seek out ever-diminishing investment opportunities, causing capital resources to be misallocated into areas that would not attract investment at all if the money supply had remained stable.

(The Austrian School of economic thought, for which, as shareholders may know, Sebastian and I have a *tendresse*, emphasises the spontaneous organising power of the price mechanism or price system. It holds that the complexity of human behaviour makes mathematical modelling of the evolving market extremely difficult and advocates a *laissez faire* approach to the economy, the strict enforcement of voluntary contractual agreements between economic agents and the subjection of commercial transactions to the smallest possible imposition of coercive forces (in particular, the smallest possible amount of government intervention). The Austrian School derives its name from its predominantly Austrian founders, including Ludwig von Mises. Its best known representative is probably Friedrich von Hayek. In 1975 Mrs Thatcher, on a visit to the Conservative Research Department, famously interrupted a speech advocating a 'middle way' by holding up a copy of Hayek's *The Constitution of Liberty* (others say it was his *The Road to Serfdom*) and announcing sternly, 'This is what we believe!')

Thirteen Years of Madness

So far, so familiar. That was the banking crisis in a nutshell. But the process should have been brought to an end long before it actually was, when it became clear even to central bankers that exponential credit creation could not be sustained. Then the money supply should have contracted sharply as the market 'cleared', causing resources to be reallocated to more efficient uses. In May 2002 Ian Rushbrook wrote about how Alan Greenspan had been intent on propping up the equity market and postponing the inevitable reckoning. He concluded:

'[One] *of the strengths of the capitalist system is its ability to rid itself of excess. Dr Greenspan should have trusted capitalism.'*

But he never did. In December 1996 he famously criticised the 'irrational exuberance' of markets. He was quite right to do so. But what happened then? A series of annual crises turned the former arch libertarian, gold bug and disciple of Ayn Rand into the Great Interventionist. As is well known, 1997 saw a major Asian currency crash followed in 1998 by the Russian bond default and the collapse of Long Term Capital Management. By 1999 the world's central banks were getting paranoid about Y2K (remember it?), succeeded in 2000 by the dotcom bubble and in 2001 by the attack on the Twin Towers. Dr Greenspan intervened every time. Then, over the 2½ years that followed the Twin Towers, he reduced the Fed rate from 6½% to a crazily irresponsible 1%.

To deny the inconvenient truth that the central bankers were responsible for the banking crisis is like saying that, while producing *pâté de foie gras* may be immoral, the moral fault rests with the geese for allowing themselves to be force fed. The market never got the chance to clear itself. We never suffered the necessary pain. As Ian Rushbrook wrote in July 2006:

'In a Faustian bargain to avoid the recession he dreaded but knew was inevitable, Dr Greenspan created worldwide a deadly debt mountain the enormity of which will only be revealed over the next three years.'

Those three years are now up and we can see how right Ian was.

Spiking the Punchbowl

William McChesney Martin, the Chairman of the Federal Reserve from 1951 to 1970, famously said that the job of a good central banker was to take away the punchbowl just as the party got going. So what did Dr Greenspan do? He spiked the punchbowl with industrial alcohol and poured it down the throats of the drunken partygoers. The Federal Reserve? You'd have thought it was the Bullingdon Club.

And Dr Greenspan knew exactly what he was doing. Everyone now knows about the disaster of sub-prime mortgages, but as early as September 2005 Dr Greenspan, as Fed Chairman, published a major research paper quantifying what was happening in the US mortgage market. Mortgage refinancing at crazily low rates of interest went hand in hand with the ever lower real rates of return that were available on financial securities, and yet governments still consciously continued to pursue economic policies that, while apparently producing ever greater levels of GDP, required both government and consumers to borrow ever-greater amounts of money to forestall economic collapse.

Recessions are Good for You

Well, we've seen the bursting of the mother of all bubbles, but the bubble-blowing goes on. 'Quantitative easing' has been joined by fiscal tinkering such as 'cash for clunkers', a bizarre circular process which saw the government print money for people to spend on new cars so that General Motors could get cash to start repaying its debt to the government. Any benefits from such tinkering last only while the tinkering continues, but the distortions to the economy remain. The cumulative result of these distortions may be not the bringing back to health of an ailing giant but the creation of a Frankenstein's monster.

Rather than turning the Fed into a gigantic speakeasy over the last decade, Dr Greenspan, Dr Bernanke and the politicians should have followed the excellent advice of Andrew W Mellon, Secretary to the Treasury from 1921 to 1932, and welcomed recession:

'It will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up the wrecks from less competent people.'

The plain fact of the matter, however politically incorrect it may be to say so, is that we need recessions. It has been cowardly, irresponsible and stupid of central bankers and their political masters to keep on artificially avoiding them. Recessions are good for you – just as hangovers are good for you (they remind you not to keep on drinking until you damage your health) and pain is good for you (it tells you when things are going wrong in your body, so that you can do something about it).

Regulation is Bad for You

Now to regulation. I've already said that recessions are good for you. By contrast, although sometimes it can be a necessary evil, regulation is bad for you. It is destructive of true morality because it creates an atmosphere in which anything is deemed permissible unless there is a law against it. Instead of cultivating a moral sense, people accordingly find themselves adopting a 'within the rules' or 'find a loophole' mentality. But as the world's greatest authority on business ethics, St Paul the Apostle, so wisely wrote in his Second Epistle to the Corinthians, Chapter 3, verse 6:

'The letter killeth, but the spirit giveth life.'

As St Paul might have predicted, the letter of regulation has all but killed the spirit of financial morality. Of plenty of things recently, both bankers and MPs have been saying, 'It was within the rules.' It may well have been within the rules. But that didn't stop it being wrong. Once, people would have known this by instinct. Now it seems that they no longer do. It is a tragedy that we now demand thousands of pages of rules and millions of miles of taped conversations, all to replace three little words: *Dictum Meum Pactum* – 'My Word Is My Bond'.

Personal Responsibility

Two other words have also been forgotten today: *Caveat Emptor* – 'Let the Buyer Beware'. I've complained before about those people who lost what the media always call 'their life savings' with Barlow Clowes. Tell them that water could go uphill, or that you had a perpetual motion machine, and they'd have laughed at you. Tell them you could invest in gilts, pay a hefty management fee and still get a yield higher than the gilts themselves, and they chorused, 'Where do we sign?'

Their equivalent this time were the 'ninja' borrowers (*n*o *i*ncome, *n*o *j*obs or *a*ssets) who took out borrowings they knew they could never repay. The whole thing was the single greatest act of corporate irresponsibility since the commissioning of the Edinburgh tram system. It was irresponsible of the banks to lend them the money; it was irresponsible of the borrowers themselves to borrow it; it was irresponsible of the bankers again to slice up the mortgages and confuse investors with fancy packaging; it was irresponsible of those investors to buy what they didn't understand; but most of all it was irresponsible of central banks to keep interest rates so low for so long.

Quarterly N^o. 55 (November 2009)

The 'Brexit Bounce'

What of the 'Brexit Boom' or 'Brexit Bounce' which, after weeks of gloomy predictions of financial meltdown if we voted to leave the EU, saw the FTSE 100 Index rise by 9.5% between 23 June and its post-Brexit peak on 15 August? It would be nice to think this was because voting to leave the EU had instantaneously unleashed within Britain a new dynamism, a new entrepreneurial spirit and a new drive to succeed. Well, perhaps. But even if it has done, we won't see the evidence for a few years yet. In the short term, the explanation for the recent stock market bounce is very simple and has nothing to do with the (as yet) unknown terms on which Brexit will eventually take place: 'It's the currency, stupid!'

Floating exchange rates mean that today we don't need old-style devaluations like Harold Wilson's 'pound in your pocket' exercise of 1967. But a short, sharp fall in the currency, in whatever way it comes about, acts as a short-term tonic. It makes exports cheaper to foreigners and hence more competitive, and makes imports dearer in the home market and hence less tempting. This is what caused the recent market upsurge, and as we get used to the lower exchange rate for Sterling the tonic effect will wear off.

What of the longer-term outlook? Recently I came across the maxim, 'Never trust a forecast with a decimal point' – in other words, beware the false precision that the Chairman calls 'spurious accuracy'. (It applies to performance statistics too.) Long-term forecasts of Brexit's effect on the economy are not just inaccurate. They are worse than inaccurate. They are useless and hence dangerous. I can't say at this stage whether leaving the EU will make us better off or worse off once the full consequences of exiting are clear. It might go either way. In the long run, however, I have no doubt that the UK economy will manage to survive whatever Brexit throws at it.

Quarterly N^o. 81 (September 2016)

Turning-Points in Markets

Just as there can be sea-changes in the political mood, so there can be such turning points in the mood of the financial markets, sometimes linked to politics and sometimes not. It is for these that we need to be on the lookout.

I've lived through at least three of the most memorable of them. My earliest stock exchange recollections are of the long bull market in equities which ran from the beginning of the 1950s until the oil shock of 1973, when the first great mood change took place and we suffered the ghastly 1974 market crash, followed by talk of the formation of private armies and the possible collapse of civil society. The lesson? Nothing dominates the market, or sets its mood, for ever. Like a spotlight in a prisoner-of war camp, the focus constantly shifts. The private armies of the mid 1970s are as forgotten today as the threats of nuclear war which gave rise to the 1980 election joke, 'What's flat and glows in the dark?' 'Teheran, five minutes after Ronald Reagan gains office.'

After a few years of sideways markets during which I learned my trade at Baillie Gifford from investors like Max Ward and Douglas McDougall, another seismic mood change took place in around 1982, when investors became convinced that Thatcherism was here to stay and a further long bull market began. This came to an end in 2000 (the so-called 'Crash of 1987' is now difficult to spot on a long term chart and 1987 in its entirety was an up year for the UK market) and we embarked on a complex period of market ups and downs until the third great mood change, at the time of the banking crisis in 2008. The lesson? Things do come in cycles, but not necessarily nice neat ones that are predictable in length or in severity.

One thing these changes had in common is that they occurred at times when the prevailing market mood, whether of optimism or of weary resignation, had come to feel so entrenched that anything else was inconceivable. Ian Rushbrook, the founder of Personal Assets, was fond of saying that change at such times would come only when the market as a whole had ceased to believe that change was possible. History proved him right, and I believe the future will too.

Quarterly Nº 82 (November 2016)

The Perils of Forecasting

Let me be a spoilsport here and prick the brave balloon of economic and market forecasting. Much of the forecasting we encounter – whether it comes from banks, broking houses, think tanks, the academic world or the Bank of England, and irrespective of how dense and complicated is the algebra in which it is dressed up – is not new or original, but at bottom consists of extrapolating present trends.

Forecasts produced by this method are usually either useless or downright misleading. You know the kind of thing: if present trends continue, within half a century Germany will be a country with a Muslim majority while the Church of England will be extinct and everyone living in Britain will be clinically obese. This is good for headlines in the *Daily Express* and *Daily Mail*, but not much else.

And if the extrapolation of present trends is of little use, so, too, is much of what is somewhat optimistically called the 'science' of futurology. This, too, is inescapably in thrall to today's trends. For instance, I've mentioned before that the science fiction author Isaac Asimov was also an academic scientist and a world renowned populariser of scientific research. However, his famous *Foundation* trilogy, written in the 1940s and published between 1951 and 1953, purports to describe the future history of the galaxy over tens of thousands of years but contains no mention of computers. Similarly, when we were busy with our Filofaxes and Betamax video recorders in the early 1980s few of us conceived of the Internet. Henry Ford had the last word on innovation when he allegedly said that, *'If I had asked people what they wanted, they would have said* [not automobiles but] *faster horses.'*

Quarterly Nº 82 (November 2016)

Two Useful German Words

Languages are not my strong point. I've never yet been able to discover the French for *'entrepreneur'* or the German for *'angst'*. But you don't have to speak a language fluently to marvel at some of its gems. It isn't often one says 'the Germans have a word for it', but there are two German words which I have always found useful when discussing the world of investment.

- **Verschlimmbesserung.** Here's something that has dogged me (and I daresay you as well) all through life in areas ranging from public transport to computer design. It's a word used to describe specific instances of Hutber's Law, quoted in an earlier Quarterly: 'improvement means deterioration'; and it means an attempted improvement that will only make things worse. The antidote to this stern and sonorous Teutonic term is a pithy American saying attributed to T Bert Lance, the Director of the Office of Management and Budget in President Carter's 1977 administration:

  'If it ain't broke, don't fix it.'

  We are never tempted to fix what ain't broke – or if we are, we steel ourselves not to.

- **Zugzwang.** Any chess player (or any footballer) will be familiar with this. It's a situation found in chess and other games wherein players are put at a disadvantage because they must make a move when they would infinitely prefer not to. The fact that players are compelled to move means that their position will become significantly weaker as a result, because every move it is possible for them to make will only worsen their position. This can happen to investment managers who have highly specific active mandates, but it can never happen to us. If we can't see anything we want to do which we are confident would benefit us, we don't have to do anything.

Quarterly Nº 91 (February 2019)

Bin Ends

There are only two kinds of equity investors – those who know that they can't predict the market, and those who don't know that they can't predict the market.

Quarterly Nº 7 (February 1996)

Bear markets can have as many false bottoms as a drug smuggler's luggage. Fund managers old enough to have lived through a couple of market cycles will tell you that trying to catch a rapidly rising market can be like trying to snare a flock of birds in flight.

Quarterly Nº 26 (October 2002)

While I'm on the subject of investment management, I can't resist querying the common belief, so frequently expressed when talking to investment trust investors and directors:

'It's all about picking the right stocks.'

Stock selection is very difficult. In my youth a seasoned fund manager quoted to me a maxim of the legendary Sir George Williamson, advocate in Aberdeen and Chairman in the 1950s of the now sadly departed Scottish Northern Investment Trust.

'If you get 5 out of 10 right, you're good. If you get 6 out of 10 right, you're brilliant. And if you say you get 7 out of 10 right, you're a bloody liar!'

My only criticism of Sir George would be that 6 out of 10 right would be more than brilliant. It would be well nigh incredible.

Quarterly Nº 32 (February 2004)

Every year I attend a reunion Christmas Lunch with some of my old friends and colleagues from Wood Mackenzie (later, NatWest Securities). On each occasion, all 20 or so of us submit our predictions of the level of the FTSE 100 in 12 months' time. All of us are seasoned market observers and practitioners and we each have at least 30 years' investing experience. Every year, our forecasts show a range of several thousand points, the highest sometimes being twice the lowest, and there is virtually never any discernible pattern to them.

Quarterly Nº 59 (December 2010)

On 29 January 2016 Haruhiko Kuroda, Governor of the Bank of Japan – Kamikaze Kuroda, as he has been dubbed – surprised world markets and set the Nikkei (temporarily) skyrocketing by cutting Japanese interest rates to a negative 0.1%.

I used to visualise the Japanese market as lying gasping in an oxygen tent – the oxygen being quantitative easing. These days, markets increasingly remind me of TV hospital dramas in which anxious medics use defibrillators to deliver electric shocks to patients' chests in a desperate attempt to revive them.

Quarterly Nº 79 (February 2016)