PERSONAL ASSETS TRUST PLC

SEPTEMBER 2018 QUARTERLY REPORT No. 89

A MILESTONE REACHED

Personal Assets is 35 years old this month. It was floated on the stock market in September 1983 after Ian Rushbrook and I had spent many absorbing months planning how it might develop.

In March 1981 Index Linked Gilts (or "linkers") had come to the market for the first time and we saw these as our ideal yardstick. We felt that if we could produce low risk returns superior to the assured returns available on linkers, this would be attractive to the kind of cautious investor at whom Personal Assets was aimed.

When Ian died in October 2008 the baton was passed to Sebastian Lyon of Troy Asset Management, whom Ian and I had known well for a decade. He became Investment Adviser in March 2009 and in this Quarterly I aim to explain how he and the Board work together in the running of the Company.

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.

'IT'S ALL ABOUT PERFORMANCE'

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.

'IT'S ALL ABOUT STOCKPICKING'

The fallacies and misconceptions about investment and, more particularly, about investment management are legion, and it's a theme I may well return to in a later Quarterly. But a common fallacy I'd like to dispose of here is that successful investment is all about picking the right stocks and then hanging on to them.

'Don't put all your eggs in one basket,' is a common piece of investment advice, as is *'OK, put all your eggs in one basket, but watch*

the basket.' But neither suggestion tells the whole story. Readers may remember that 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).[1] 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.'*

It's easy to laugh at poor Mr Bancroft. But 'buy and hold' is in fashion just now, and can be dangerous. I often think that if, back in 2000, I had taken a sabbatical and gone on my travels far from the markets (and if, of course, I had never heard of investment trusts), I might have put all my money into two ultimate blue chips of the time, which simply couldn't go wrong: GEC and Royal Bank of Scotland.

Reader, I held both of them — and lost at least some of my money.

And just as business cases can change, cheapness isn't everything either. Stocks can be, and often are, cheap for good reasons. To quote a recent comment by Sebastian:

'There are many companies that we would not buy at any price. Avoiding the dross is more than half the battle when it comes to investment survival. While there may be plenty of superficially tempting opportunities in the stock market, we prefer to remain discerning. Choosing companies with attractive returns on capital, financial strength and earnings growth (usually in that order) is a more effective way to deliver steady returns than bottom-fishing across the stock market's detritus. These lessons have been learned from painful experience.'

WHO DOES THE WRITING?

Now let me deal with a misconception of a different type, that even after the elapse of time still has the power to amuse me. 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.

Such misunderstandings about who has done the writing in work I've produced jointly with colleagues have beset me ever since 1981, when I joined Hamish Buchan as an investment trust analyst at what was then the well-known stockbroking firm of Wood Mackenzie. Because Hamish's name preceded mine on the research and he was recognised as the head of the team, it was often assumed that Hamish wrote the research and I compiled the statistics. In fact, working with the numbers was Hamish's *forte* (I was never more than competent on the statistics side) while Hamish hated writing and was glad to hand it over to me right at the beginning of our working partnership.

Much the same was true of my relationship with Ian Rushbrook. Let me make it clear that Ian had no mean talent with the written word. Perhaps the most vivid passage in Personal Assets' history came from his prescient Managing Director's speech to the 2007 AGM:

'Credit, debt and liquidity have expanded to extraordinary levels and we are certain this expansion must reverse itself. And the catalyst for such a reversal won't be a butterfly fluttering its wings over Peking. It will be a vulture, glutted on sub-prime mortgages, falling from its perch on a skyscraper over Wall Street.'

However, writing was never something he enjoyed and so he was content to leave it to me, although we always discussed the Quarterlies together and on occasion jointly planned them — just as Sebastian and I still do today.

WHO GOVERNS?

Attributing the written word to one person rather than to another is scarcely likely to be of any lasting importance, and in the offices in which I've worked it has usually been nothing more than an excuse for gentle teasing. But another misconception I've encountered quite often over the years *is* potentially more serious, and the approaching tenth anniversary of Sebastian's appointment as Investment Adviser, together with the impending changes in personnel over the next few years the Chairman signalled in the last Annual Report, make this a suitable time to address it.

One analyst who came to visit me shortly after Sebastian's appointment as Investment Adviser startled me by fastening immediately on to the idea that because of what the analyst saw as the potential overlap in our responsibilities Sebastian and I must be engaged at best in a demarcation dispute and at worst in a power struggle. To anyone familiar with the inner workings of Personal Assets such an idea would seem just silly, and I told my interlocutor so. But it has continued to crop up from time to time in conversations with journalists, analysts and shareholders, while ratings agencies also occasionally hint at the potential for a conflict of interest between us. Let me therefore set the record straight once and for all.

There is, in fact, no overlap between Sebastian's and my responsibilities, which have been clear from the beginning of our working relationship and are laid down formally in the relevant agreements. Troy manages the portfolio

[1] *The Money Game*, 'Adam Smith', Random House New York, 1968.

on a day-to-day basis and keeps the Board informed of the decisions while significant shifts in asset allocation are agreed as part of an ongoing dialogue with the Board. The demarcation of responsibilities is clearly set out in the investment advisory agreement which the Board reviews each year.

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 his diocese.

Indeed, I dread to think what a portfolio chosen by a Board of half a dozen highly opinionated individuals might look like. A meeting to review it would all too easily become 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.[2]

What The Board Does Do[3]

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.

As for my own rôle as Executive Director, this developed over the years I worked with Ian Rushbrook and it was formalised in 2002. Like the rest of the Board I don't pick stocks or interfere with buying or selling them, although I'm happy to act as a sounding-board if stocks are being discussed. Instead, in addition to all the usual duties of being an investment trust Director (except for that of sitting on Board Committees, which is left to the non-executive Directors) I try to be the person who knows everything about Personal Assets and its activities: co-ordinating the running of the Company; writing the Quarterlies; overseeing and contributing to the Annual and Interim Reports and other corporate documents; answering queries from shareholders and others; and providing the necessary investment experience for PATAC, our secretarial and administrative subsidiary, in its capacity as the Alternative Investment Fund Manager ("AIFM") to three trusts.

Green, Amber and Red

Now let's look at the details of how responsibilities are allocated.

Under the terms of the contract with the Investment Adviser there are four areas which have been reserved specifically to the Board but as regards which the Board is required to engage in active dialogue with the Investment Adviser:

- the level and form of liquidity within the portfolio;
- asset allocation in the portfolio;
- matters relating to shareholder communication; *and*
- hedging.

In addition to these, three matters are described as having been reserved to the Board alone:

- the Company's gearing levels;
- matters relating to the buying back and issuance of the Company's shares; *and*
- investment in new asset classes.

In practice, however, the Board and the Investment Adviser consult on these matters too, and as regards the first and third of them it would be strange if they did not. (For instance, neither the Board nor the Investment Adviser could decide unilaterally to invest in the Turkish Lira or Argentinian equities!)

As I wrote last time, the Company has no predetermined maximum or minimum levels of exposure to asset classes, currencies or geographic areas but these exposures are reported to, and monitored by, the Board in order to ensure that adequate diversification is achieved.

The resulting matrix is the distillation of years of experience. We set maximum and minimum percentages for each asset class and currency, and operate a 'traffic light' system for investment classes:

- **GREEN** for core investments such as large cap stocks in the UK, US and Europe;
- **AMBER** for areas in which we are unlikely to invest and where doing so would require the Investment Adviser to seek Board approval, such as Japan and corporate bonds; *and*
- **RED** for investments not currently permitted, such as direct property and private equity.

All these parameters are reviewed at each Board Meeting.

Looking Forward

That, I hope, gives a clear picture of how the Board and the Investment Adviser together run Personal Assets. In the next Quarterly I intend to look more closely at the investment process and (as regards equities) at the types of sectors and stocks in which we prefer to invest.

Robin Angus

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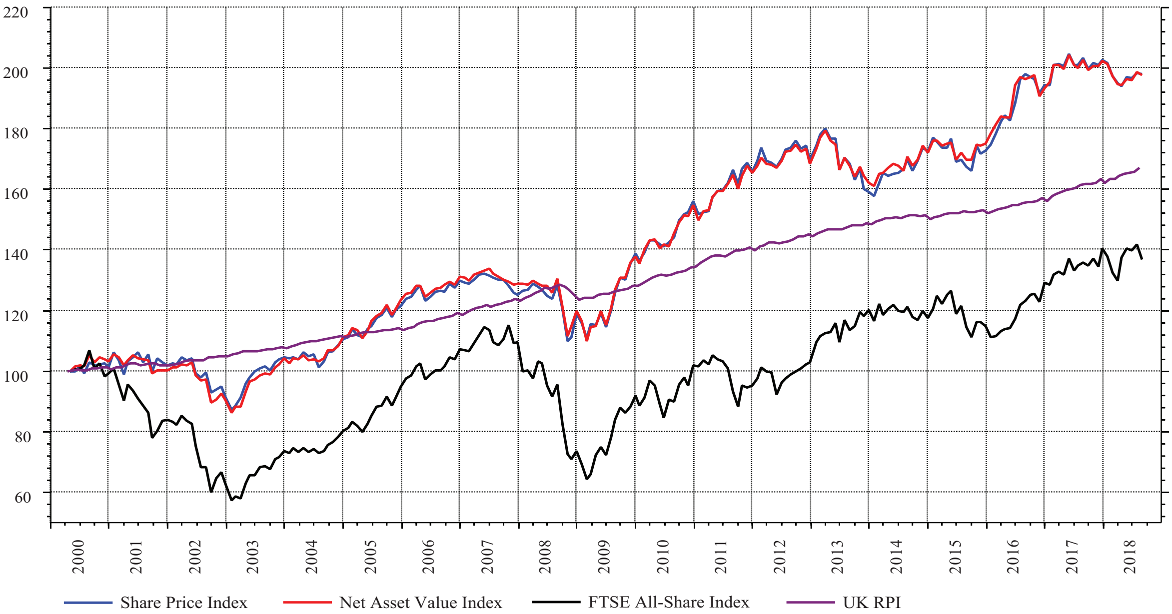
[2] Ian Rushbrook used to refer to the famously argumentative Board of The Independent Investment Company, which was founded in 1924 with three idiosyncratic investment titans as directors — John Maynard Keynes, Thomas Johnstone Carlyle Gifford (the founder of Baillie, Gifford & Co) and Oswald Toynbee 'Foxy' Falk of the stockbrokers Buckmaster & Moore. For a description of this fascinating company (which was no relation to today's much more successful 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.

[3] Anyone interested in my views on investment trust Boards will find them set out in *The Split Capital Investment Trust Crisis*, ed. Andrew T Adams, John Wiley & Sons, 2005, pp. 143-157.

Personal Assets Trust Performance



Source: Thomson Reuters Datastream

Value	Percentage Changes 31 Aug 2018	1 Year	3 Years	5 Years	10 Years	30 Apr 2000
Share Price	£400.00	(2.7)	18.2	17.7	54.1	98.0
NAV per Share	£394.87	(2.5)	16.3	17.8	51.6	97.6
UK RPI	284.20	3.5	9.4	13.2	30.8	67.1
FTSE All-Share Index ("Index")	4,106.14	0.8	19.6	20.4	43.1	36.8
NAV relative to Index		(3.3)	(2.7)	(2.2)	5.9	44.5

Past performance is not a guide to future performance. The value of investments may go down as well as up and you may not get back the full amount originally invested.

Top 10 Equity Holdings

Company	Country	Sector	Valuation 31 Aug 2018 £'000	Shareholders' funds %
Microsoft	USA	Software	33,364	3.7
Coca-Cola	USA	Beverages	27,848	3.1
British American Tobacco	UK	Tobacco	26,051	2.9
Nestlé	Switzerland	Food Producer	25,731	2.9
Unilever	UK	Food Producer	24,696	2.8
Philip Morris	USA	Tobacco	24,032	2.7
Berkshire Hathaway	USA	Insurance	20,697	2.3
Altria	USA	Tobacco	19,856	2.2
American Express	USA	Financial Services	17,989	2.0
Sage Group	UK	Technology	16,076	1.8
			236,340	**26.4**

Portfolio Analysis

	Valuation 31 Aug 2018 £'000	Shareholders' funds %
Equities	339,813	37.9
US TIPS	245,975	27.5
UK T-Bills	180,554	20.1
UK Index-Linked Gilts	31,491	3.5
US Treasuries	37,245	4.2
Gold Bullion	74,322	8.3
Cash and Cash equivalents	(13,320)	(1.5)
Shareholders' funds	**896,080**	**100.0**

Further information on the Trust can be obtained from the Company's website – www.patplc.co.uk or by contacting Steven Budge on 0131 538 6605