PERSONAL ASSETS TRUST PLC

FEBRUARY 2019 QUARTERLY REPORT No. 91

THE QUEST FOR CERTAINTY

Life is full of mysteries, and one I can never quite fathom is why so many people who ask me about the outlook for Personal Assets give the impression of thinking I know a lot of things I'm not telling them. For instance, some weeks ago I had a meeting with an experienced investor I know well. Our discussion was interesting and constructive, but it got bogged down at one stage when the investor kept pressing me to tell him the level of the FTSE 100 Index at which Personal Assets would be prepared to make a major strategic move into UK equities. It was obvious that he thought I (or, rather, Sebastian Lyon, our Investment Adviser) had a figure in mind which, for some reason, I wasn't prepared to tell him. But in fact there is no such figure. That's not the way Personal Assets' investment approach works.

What I have to guard against in discussions like that is *not* the giving away of information which in any event doesn't exist, but the danger of inadvertently misleading questioners by casually mentioning some figure which they will then wrongly remember as having been a forecast. I sometimes worry that if in a spirit of mischief I were to pluck figures out of the air and say that the FTSE 100 would be *(let's say)* 6,000 in six months' time and 8,000 six months later, or that Personal Assets would buy the UK market on a yield of 5.0% and sell it on a yield of 3.0%, my questioners would eagerly scribble the figures down and leave with a smile on their lips, a song in their hearts and a buying or selling order underlined on their *'to do'* list.

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.

'WE'RE OFF TO SEE THE WIZARD'

To the best of my knowledge noone 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[1] — 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.

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.[2] 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 omnicompetent 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. Better to look ignorant, get sensible answers and make wise decisions than look savvy and well-informed and make expensive mistakes.

TWO TYPES OF CONFLICT

Rather than being clear-eyed and confident in the possession of what they know to be certainties, fund managers can feel that, in Matthew Arnold's words, they are:

> *'on a darkling plain . . .*
> *Where ignorant armies clash by night.'*

[1] 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.

[2] On 27 September 2009 the Securities Investor Protection Corporation trustee estimated actual losses to investors of $18 billion.

Two types of clash can especially bedevil fund managers. First, there is the inevitable conflict between the human instinct to seek for certainty and the knowledge, acquired through experience, that things can and do go wrong or work out differently from what was expected. The surest and safest way to cope with the desire for certainty is to accept that certainty is something not given to mortals and, instead, work hard at improving the odds in favour of the success of the action you propose to take. The first step towards managing risk is to accept that the risk exists.

There is conflict also between the knowledge that things can and do go wrong and the urge to improve matters by *doing* something. It's a natural reflex, but 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. Thomas Alva Edison is reputed to have said that genius is 1% inspiration and 99% perspiration. I would say that fund management (at least as Personal Assets practises it) should be more like 1% buying and selling activity and 99% patience.

Fund managers often feel that some action is necessary because of the terms of their investment mandate. But to quote Warren Buffett, whom I mentioned earlier:

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

Personal Assets' investment policy is framed so that it never compels us to do anything we don't want to. We are relieved to be able to say that neither Verschlimmbesserung nor Zugzwang *(see below)* hold any terrors for us.

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.

HOLD ON TO WHAT YOU HAVE

My occasional quotations from Latin authors in these Quarterlies are literary Marmite. Some readers love them, others loathe them. But here I want to quote some words of Quintus Ennius (239-169 BC), one of the earliest of the great Roman writers, who wrote of the dictator Quintus Fabius Maximus Cunctator ('Delayer'), who saved Rome by steadily refusing to be drawn into open battle with Hannibal during the Second Punic War:

'Unus homo nobis cunctando
restituit rem.
Nœnum rumores ponebat
ante salutem.' [3]

Most of us dream of being Hannibal or Napoleon rather than Fabius or Kutuzov, the Fabius-like Russian general who fought Napoleon in 1812, but Fabius and Kutuzov were the ones who ultimately triumphed. As I wrote a year ago in Quarterly N^{o.} 87, both of them refused to be panicked into acting despite immense pressure to do so, instead husbanding their strength until the time was right for confrontation and victory. Doing nothing needed huge bravery when politicians, rulers and even the generals on their own side were clamouring for action, and it is no different for fund managers. Brilliant failure may be exciting to read about in the history books, but it spells disaster for one's financial planning and — worse — can destroy one's irreplaceable capital.

IRREPLACEABLE CAPITAL

There was a time when to write of *'irreplaceable capital'*, or *'sacred savings'*, would have struck me as over the top and somewhat pompous. It doesn't now. It's an obvious truth and sheer common sense. Money lost is desperately hard to regain. It's not the first time I've pointed out in one of these Quarterlies that a fall of 50% in the amount of one's capital cannot be recouped by a 50% rise in what remains. It has to *double* before you're even back to where you started, and that is a very tall order for any fund manager, let alone a cautious and canny one.

Mistakes can be worth their weight in gold if you make them early enough in your career. But never forget that what has taken 40 years to build up may be irreparably damaged in as many months, or even weeks or days. More than four decades of observing what can go right or go wrong in the world of investment has taught me the dangers of following the herd, or extrapolating present trends into the future, or being overawed by reputations, or failing to notice changes taking place in companies or sectors I thought I knew well. And if at times I whisper to myself *'Marconi'* or *'Royal Bank of Scotland'*, it's for a painful reason.

WHAT HAS BEEN HAPPENING?

These are bewildering days. By the time you read this, Jacob Rees-Mogg may be commissioning an

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[3] 'One man, by delaying, restored the Roman state to us. He valued safety more than the applause of the mob.'

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. Let's therefore take a look at what has been happening in financial markets over the last 12 months or so.

- 2017 was a year of remarkable stability in markets, so it wasn't surprising that 2018 opened with the optimism deriving from synchronised global economic growth and President Trump's tax reforms, which provided what Sebastian in an investment report called a *'sugar rush'* of fiscal stimulus.
- This *'blue sky outlook'*, Sebastian went on to say, *'seduced retail investors who had taken the best part of a decade to recover their confidence from the deleterious effects of the financial crisis.'*
- Rising markets had been sustained by governments pumping money into the system, while the markets themselves followed the example of the frenetic cartoon character Wile E Coyote by maxing out on share buybacks and M&A (mergers & acquisitions).
- But, like all cartoon fans, we knew the moment would inevitably come when Wile E Coyote looks down and sees that the cliff he's been running on is no longer underneath him and he is about to plummet into a bottomless canyon.
- 2018, as President Trump would say, differed bigly. It was marked by the pattering sound of falling dominos *'thick as autumnal leaves that strew the brooks in Vallombrosa'*[4]: first there was Bitcoin, then Emerging Markets, then UK equities and then US equities.
- Markets became more and more agitated as the year progressed, swinging widely; and investors grew anxious about the possible effects of tightening monetary conditions.
- And as so often happens, a bull market that had run its course kept coming back for repeated encores, each less convincing than the last.

Look At The Bigger Picture

Finally, a word about how we are placed now and what I think may happen as the year progresses. Be aware, however, that it's important to start with the bigger picture. Because individual stocks are so fascinating to follow and discuss, the real news about our portfolio is sometimes overlooked or fails to make the impact it should.

I could easily write an informative Quarterly by going through our list of equity holdings at 31 January 2019, explaining *(say)* why we had 3.3% of our shareholders' funds in Microsoft or 2.4% in Unilever. And I could please those who complain about our holdings of tobacco shares by pointing out that they now amount to just 4.9% of shareholders' funds compared to 8.2% at 30 April 2018 and 12.6% at our 2017 year end — although part of this was due to share price falls, and the reductions that we did make were for financial rather than ethical reasons.

Such a Quarterly, however, would describe only a third of Personal Assets' portfolio and so could give quite a wrong impression of where we are. It is far more important to note that we were 66.7% liquid at 31 January 2019 and that this had increased from 61.6% since our 30 April 2018 year end and 54.3% since 30 April 2017. Our equity percentage, at 33.3%, was the lowest it had been since Troy was appointed our Investment Adviser in March 2009. Strategic decisions of this kind are much more influential in determining performance than the progress of individual stocks.

Where We Are Today

When people ask me what we expect for the next year or two I point them to our portfolio, since it is our invariable practice to put our money where our mouth is. What is our portfolio telling investors now?

The section entitled *Key Features* on page 1 of the Annual Report lists ten categories of investment, but (as I wrote in Quarterly Nº 80 in June 2016) for all practical purposes it makes sense to amalgamate some of them to give what, with a nod to Lawrence of Arabia, I've described as our Four Pillars of Wisdom:

- Equities (33.3% of funds)
- Cash and equivalents (27.5%)
- Index-Linked (30.4%)
- Gold Bullion (8.8%)

Gold bullion has been dull in recent years but has gained a little ground recently. It remains an insurance policy against a loss of faith in central bankers — and is significantly cheaper than portfolio insurance using derivatives.

Our equity holdings — 16.6% of shareholders' funds in the USA, 10.3% in the UK and 6.4% elsewhere — are a core of value which I wouldn't expect to shrink much further, although I don't envisage large-scale early additions either. While I look forward to when our equity portfolio is in percentage terms at least twice (and perhaps even three times, in ideal circumstances) what it is today, the time has not yet come.

Wherever I look among companies in the developed world, I've for the last two or three years been overwhelmed by overstretched balance sheets, anæmic economic growth, overdistributed earnings, too many share buybacks in the recent past, and vulnerable dividends. Yes, there is quality around, and we hold some of it. But none of it is cheap, most of it is too dear to add to, and a lot of it is too expensive even to hold with safety.

Meanwhile, we continue to store up lots of dry powder in the form of cash and treasury bills; and our index-linked bonds remain our ballast in stormy seas and a source of additional buying power when the longed-for moment arrives. Far from seeking to avoid risk altogether, we are eager to take it — but only when the time is right. Let me end with what Sebastian wrote last month in an investment report:

'Amid the general market gloom, there is good reason for Troy to be optimistic. Our asset allocation has been cautious for some time and we are prepared to shift it more positively . . . We head into 2019 with the most conservative positioning for a decade. Normalisation will be painful but I would expect to head into 2020 more fully invested, if value presents itself.'

Robin Angus

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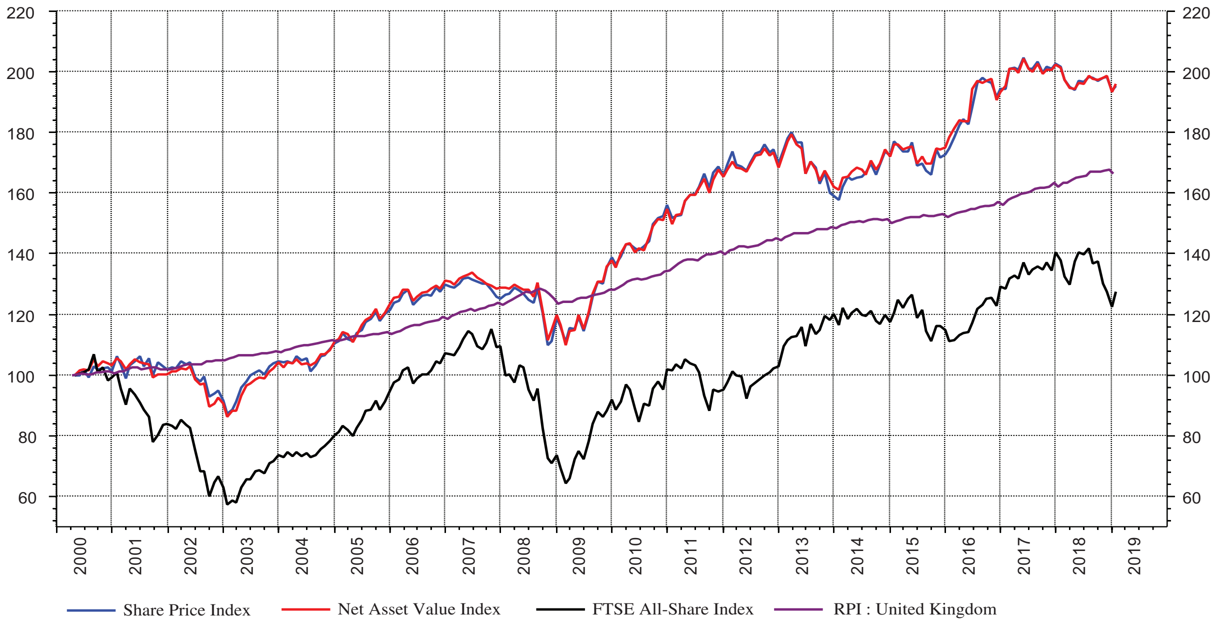
[4] From Milton's *Paradise Lost*. Perhaps markets in 2019 will be such that the last decade will come to seem a 'Paradise Lost' indeed.

Personal Assets Trust Performance



Source: Thomson Reuters Datastream

Value	**Percentage Changes 31 Jan 2019**	**1 Year**	**3 Years**	**5 Years**	**10 Years**	**30 Apr 2000**
Share Price	£394.50	(3.2)	11.8	23.8	68.8	95.3
NAV per Share	£391.83	(2.6)	9.9	21.6	68.1	96.1
UK RPI	283.0	2.5	9.4	12.0	34.7	66.4
FTSE All-Share Index (“Index”)	3,825.62	(7.5)	14.7	9.4	84.0	27.4
NAV relative to Index		5.3	(4.2)	11.2	(8.6)	53.9

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 Jan 2019 £’000**	**Shareholders’ funds %**
Microsoft	USA	Technology	30,685	3.3
Coca-Cola	USA	Beverages	29,865	3.2
Nestlé	Switzerland	Food Producer	26,335	2.9
Philip Morris	USA	Tobacco	23,432	2.6
Unilever	UK	Food Producer	22,405	2.4
British American Tobacco	UK	Tobacco	21,677	2.4
Berkshire Hathaway	USA	Insurance	20,050	2.2
American Express	USA	Financial Services	17,244	1.9
Procter & Gamble	USA	Household Products	17,236	1.9
Sage Group	UK	Technology	16,902	1.8
			225,831	**24.6**

Portfolio Analysis

	Valuation 31 Jan 2019 £’000	**Shareholders’ funds %**
Equities	305,273	33.3
US TIPS	247,284	26.9
UK T-Bills	165,650	18.0
Gold Bullion	80,921	8.8
US Treasuries	36,907	4.0
UK Index-Linked Gilts	31,945	3.5
Cash and Cash equivalents	50,598	5.5
Shareholders’ funds	**918,578**	**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