



## Quarterly Report

October 2022

Our policy is to protect and increase (in that order) the value of shareholders' funds per share.

### T.I.N.A. R.I.P.

*"If the old, and tried, and safe investments no longer yield their accustomed returns, we must take what they do yield or try what is untried. We must either be poorer or less safe; less opulent or less secure."*

Walter Bagehot

2022 is turning out to be a dreadful year for investors. According to Bloomberg, this is the worst year for equities and bonds combined since 1926. We had been concerned by the risks to all asset prices, which have been supported for so long by unorthodox monetary policy – the combination of zero interest rates and quantitative easing ('QE'). For the first time in a generation, fighting inflation and supporting Main Street take precedence over bailing out Wall Street. Financial markets must accept they are no longer the priority.

Since 2009, in the post-Global Financial Crisis world, the traditional price of money has been depressed to zero or even sub-zero. Investors were dragooned into paying more and more for riskier assets as liquidity found its way into all of the cracks. As yields fell valuations surged across asset classes from bonds to equities, from the esoteric, crypto and NFTs, to the opaque, private equity and 'alternatives'.

For many investors though, equities have been the next best option. This year that has changed. TINA – 'there is no alternative' (to equities) – was well past her sell-by-date, but living without her requires a painful adjustment.

Bagehot's words above, from 1856, are prescient and neatly describe the events of the past decade or so. Asset prices' largest support – zero interest rates – is gone and investors' insecurity is in full view.

### There is an alternative

The story of 2022 is that there is now an alternative (to equities) and one long-forgotten. Back in 2009, as we exited the Great Recession, Mohamed El-Erian of PIMCO, the world's largest bond fund manager, identified a new era. He called this the 'New Normal', which featured muted economic growth, low inflation and low interest rates. This correct analysis was followed up four years later by Harvard Professor Emeritus, Larry Summers, who identified the 'Age of Secular Stagnation'. According to Summers, central bankers found themselves in a trap of low interest rates and were impotent to boost economic growth. Claudio Borio of the Bank of International Settlements summed up the prevailing environment back in 2014: 'the highly abnormal is becoming uncomfortably normal'. That era has now ended with sharply rising inflation and higher interest rates.

In the United States, the Federal Reserve has increased interest rates from 0.25% at the beginning of January to 3.25% (as at end-September 2022) and is expected to raise them again in November to 4%. In the UK, the Bank of England has been somewhat more tentative, with the base rate at 2.25% today but likely to rise to 3% at their next meeting. Bond markets have taken note, with US 2-year

government bonds offering investors an almost unrecognisable 4.5% yield-to-maturity. In the UK, thanks in part to the unforced error of September's 'mini' Budget, the 2-year gilt yield rose to over 4.5%, before settling down to 3.8% (see Figure 1). Gilts, usually the dullest of securities, have moved like speculative stocks, making daily headlines. Markets imply interest rates have further to rise in 2023. These are yields not seen in the Treasury or gilt markets for almost 14 years.

The true cost of capital, missing in action since the Global Financial Crisis, has returned with a bang. As prudent investors, we welcome this return to the 'Old Normal' and the end of Secular Stagnation. Investors can now earn a nominal return on their savings. There **is** now an alternative, and this has profound implications for asset prices.

This has been a rude awakening. Central banks are no longer back-stopping financial markets. The 'Fed put' has gone, with eyes set on inflation and the real economy. Generating a 'wealth effect', a dubious policy in any event, has taken a back seat.<sup>1</sup> As long ago as 2004, Donald Kohn, Federal Open Market Committee (FOMC) member, admitted low interest rates were cut below the long-term equilibrium 'to boost asset prices in order to stimulate demand'. Today, with interest rates returning to historically more normal levels, price discovery is at long last being rediscovered.

### We have been expecting you

Eighteen months ago, in [Investment Report No.68](#), we highlighted the uncomfortable risks of bonds trading on very low yields. Bonds have not provided their usual sanctuary this year. The good news today, however, is that, at long last, we have a yield. We were able to lock in yields of over 4% in short-dated gilts and Treasuries in September and October, with relatively little risk to capital and providing a healthy nominal, if not real, income – something not available for 14 years. In the past three months, we have invested c.15% of the Trust in short-dated gilts and Treasuries.

Logic might suggest that inflation-linked bonds do well in an inflationary environment. Yet the Trust's holdings in US TIPS (Treasury Inflation-Protected Securities) have failed to generate positive returns this year, with prices heavily impacted by rising conventional yields. Meanwhile, breakevens (market inflation expectations for inflation, the other component driving prices of index-linked bonds) have remained remarkably stable, seemingly ignoring US CPI hitting 40-year highs (see Figure 2). This indicates the bond market's belief that the break-out in inflation is temporary. This may prove to be the case – we suspect it is not, a topic addressed by my colleague Marc de Vos in [Special Paper No. 10](#). But in the event that breakevens are right, and inflation swiftly returns to c. 2%, then conventional yields are too high. They are currently pricing in rates in the 4-5% range for the next 10 years, something which is likely to inflict a lot of pain on an over indebted economy, and something which the Federal Reserve is only able to justify currently because of high inflation. So something has to give. Real yields offered by TIPS remain in substantially positive territory, implying higher growth, lower inflation and a return to central bank hegemony and sound money. We suspect this is wishful thinking. At some stage investors will want to pay for inflation protection.

The Bank of England's £65bn QE package to stop the pension sector from collapsing may herald a further step towards financial repression and away from sound money. Longer-dated bond yields may not be permitted to rise much further, given their implications for the corporate credit market and for mortgage rates. Yield curve control is coming, it is just a matter of when. The Bank of England's reluctance to see gilt yields approach the 5% level is the shape of things to come if financial stability is to be maintained.

Central Banks, like the Bank of England, find themselves in an invidious position with their dual policies (low, stable prices and high employment) apparently in conflict. Raising rates triggers default and recession, yet not

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<sup>1</sup> The 'wealth effect' is the idea that as households become wealthier because of rising asset values they spend more to stimulate the economy.

raising them leaves inflation unchecked. So, on the one hand they raise interest rates to dampen inflationary forces, while on the other hand they reverse quantitative tightening to stabilise febrile markets. This is the equivalent of having their foot on the accelerator and the brake at the same time. No wonder the ride in markets has been so uncomfortable of late.

### The Price of Time

I recently read *The Price of Time* by Edward Chancellor, a book which holds several important lessons for long-term investors. It provides a helpful history, not only of interest rates but of their role in providing an essential anchor to the economy and to the prices of financial assets. Without a price for interest, we are all at sea, and any valuation can be justified. Chancellor is rightly highly censorious of policy makers over the past decade or so. Zero and negative interest rates have not led to a stronger economy but a more fragile one. In five millennia of interest rate history, rates had never been as low for so long.

Chancellor tells us that as interest rates decline, business is inclined to invest in projects with more distanced payoffs. But if interest rates remain low for too long, misguided investments, or 'malinvestments' occur.<sup>2</sup> We have seen this with so-called unicorn companies flying up in value, only to then come crashing back down to earth.

More importantly, Chancellor reminds us that 'the valuation of a company's shares depends on the rate of interest'. John Law, of 1720 Mississippi bubble fame, justified a profit multiple of fifty times, predicated on the inverse (reciprocal) of the interest rate at the time of 2%. As Scottish economist Sir James Steuart commented on this episode, '*value in capital, really existed relatively to the rate of interest.*' With US Treasury yields rising from 1% to 4% in the past two years, the conclusion should be obvious, but recency bias dictates that many remain anchored in the experience of the past few years. The valuations of the late 2010s are yet to be seen as an aberration.

As Edward Chancellor informs us, the desire for low interest rates is as old as time itself, bringing with them, as they do, rising asset prices. Yet '*the trouble is that soaring asset prices don't make a nation any richer. They only produce the illusion of wealth. Investors enjoy the capital gains when asset prices rise, but any immediate gains are offset by lower investment gains going forward.*'

### The anatomy of a bear

The current bear market started with the peak of meme and profitless technology stocks in the first half of 2021 but the dominos really began to fall almost a year later in January 2022, exacerbated by the war in Ukraine. The timing of the war aggravated inflationary pressures which had already built in Covid's wake.

This episode underpins the importance of Personal Asset Trust's Discount Control Mechanism for its shareholders by limiting the discount volatility experienced.

The early part of this bear market exhibited a number of the same features as were present during the 2000-2003 dot-com bust. Back then, the stock market fell for almost three years straight. The FTSE 100 index peaked not far from where it stands today, at 6950, while the S&P 500 tracked sideways for a decade from its 2000 peak. The Nasdaq took almost 15 years to regain the high recorded in the year 2000.

The latest, Autumnal phase of this current bear market is revealing. Rising bond yields have driven less speculative, supposedly safer, parts of the market lower. REITs (property), credit and other areas, where valuations are predicated on interest rates, have all suffered. In 2000-2003, these securities afforded investors somewhere to hide and defend capital; not so today. Rates are ordinarily loosened entering a recession, providing support for such asset prices. Today's backdrop of tightening rates is a key point of differentiation in the deflation of what many have described as the 'Everything Bubble'.

<sup>2</sup> This was the term used by Austrian economists (Haye, Schumpeter and Von Mises) to denote excessive investment in long-term projects relative to short-term ones

Pain is widespread from high-yield bond funds to private equity trusts. But a bear market's work is not done until value is seen. Long-term equity valuations, such as the cyclically-adjusted price-to-earnings ratio (CAPE) for the S&P500, indicate that we are not there yet.

Bear markets are characterised by sharp rallies on low transaction volume, driven by short-covering and the fear of missing out. 2022 has been no exception with a bounce in June and July, supported by the hope of a pivot towards a more accommodative monetary policy. These hopes were dashed in August at Jackson Hole in Wyoming, as Federal Reserve Chairman Jerome Powell committed to fight inflation with further tightening of monetary conditions. Observing bubble-like conditions in 2021, we reduced equity exposure towards historic lows, but in hindsight we could and should have done more. We used this summer's bear market rally as an opportunity to reduce the Trust's equity exposure to below 25%.

### The mighty dollar

In 1971, John Connolly, US Treasury Secretary, told his G10 counterparts that *'The dollar is our currency, but it's your problem'*. Connolly made the comment as Nixon closed the gold window and the dollar weakened. Today, the opposite is happening. During 2022 the dollar has strengthened, causing almost all asset prices to fall when denominated in US dollars. The recent parochial headlines on sterling's decline against the dollar ignore the similarly weak performance of the yen and the euro. In April my colleague Marc de Vos wrote Special Paper No.9 Currency – Last But Not Least, addressing the importance of the dollar in protecting capital when there were so few other defensive options open to investors.

The US dollar has come to our aid this year. We held exposure to the greenback of approximately 30% of the Trust's value, net of hedging. This has provided essential protection in a challenging environment and has contributed c.+5% to returns year-to-date. Amidst sterling's sharp September sell-off, when it reached close to parity versus the

dollar, we reduced the Trust's net dollar exposure to just above 20%. We expect the dollar to remain robust as markets falter but its upside from here is likely to be more limited.

### The great reset

What of the outlook? This is a very different backdrop to the past 30 years. There remains optimism that inflation will normalise. We however think there is a risk that inflation becomes more embedded, especially while the labour market remains tight. Underinvestment in raw materials (including energy) combined with onshoring or 'friend-shoring', do little to alleviate the supply/demand imbalances we have experienced over the past 18 months.

We suspect the repricing of assets has further to go but bonds have probably incurred much of the damage, at least for now. Credit will suffer from a weaker economy, so spreads over government bonds may still widen from here, but at some stage longer-dated credit may offer attractive returns. Equities have partially de-rated, but when bonds were at these yield levels before the Global Financial Crisis, stocks were considerably cheaper. The cost of capital has risen now and asset prices are yet to fully reflect this new reality.

Bear markets generally end with disinterest and revulsion but the siren voices to buy the dips today remain strong. We would suggest that this bear market has room to run.

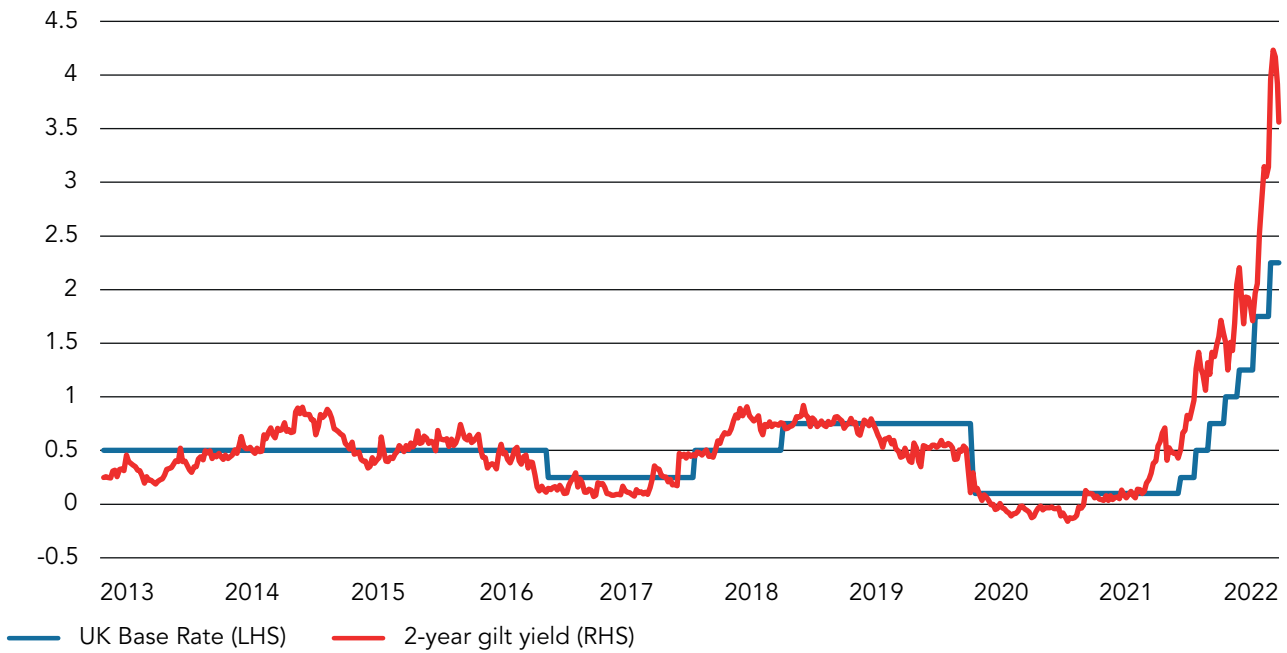
Sebastian Lyon October 2022

**Investment Manager of Personal Assets Trust**  
**Founder & Chief Investment Officer of Troy Asset Management**

Charlotte Yonge  
**Assistant Manager of Personal Assets Trust**

Figure 1: There is an alternative

Bank of England base rate and 2-year gilt

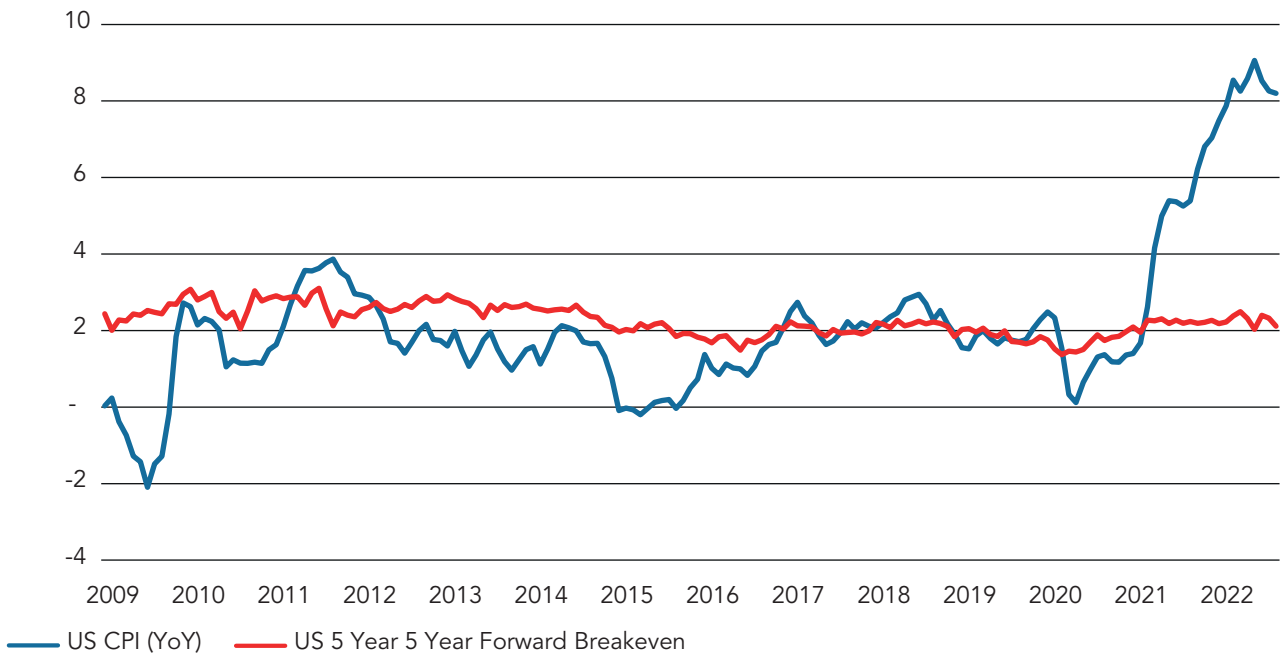


Past performance is not a guide to future performance.

Source: Bloomberg, 18 October 2022.

Figure 2: Inflation expectations

US Inflation (CPI YoY) & 5year/5year Inflation Breakeven\*



Neither past nor projected results are indicative of future results.

Source: Bloomberg 24 October 2022.

\* This series is a measure of expected inflation (on average) over the five-year period that begins five years from today. It is the average 10-year bond breakeven minus an average 5-year bond breakeven.

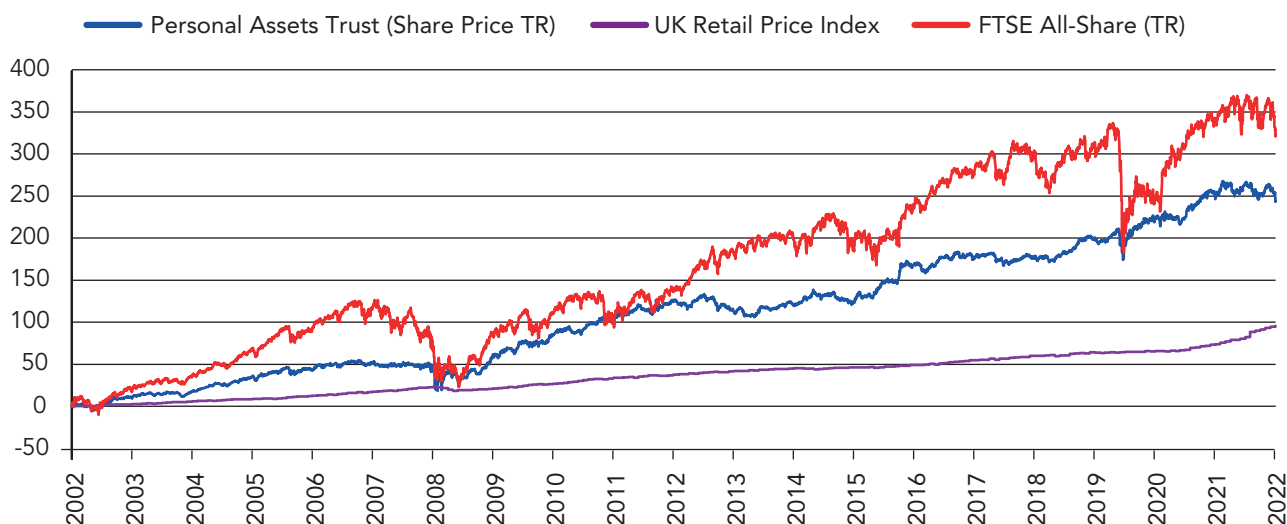


# PERSONAL ASSETS TRUST PLC

As at 30 September 2022

Share Price	469.50p
NAV	468.84p
Premium/Discount %	+0.14
Market Cap (£)	1.81bn
Shares in Issue	386.2m

## Percentage Growth from 30/09/2002 to 30/09/2022



Source: Lipper

Past performance is not a guide to future performance

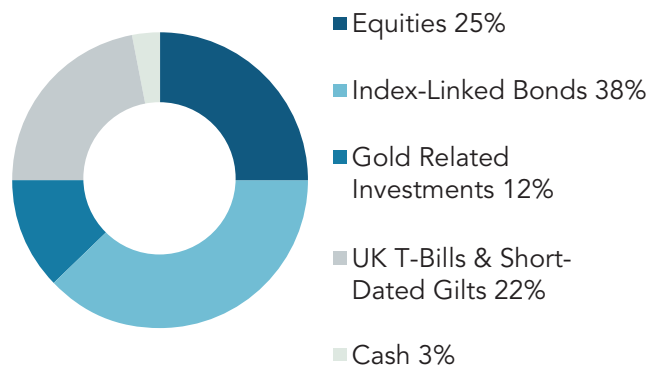
## Total Return to 30 September 2022

	20 years	10 years	5 years	3 years	1 year	6 months
Personal Assets Trust (Share Price TR)	+243.8%	+52.5%	+24.5%	+15.0%	-1.7%	-6.0%
UK Retail Price Index	+95.7%	+42.3%	+26.4%	+19.5%	+12.6%	+7.4%
FTSE All-Share Index (TR)	+323.0%	+79.5%	+11.3%	+2.4%	-4.0%	-8.3%

Source: Lipper

Past performance is not a guide to future performance

## Asset Allocation



## Top 10 Holdings

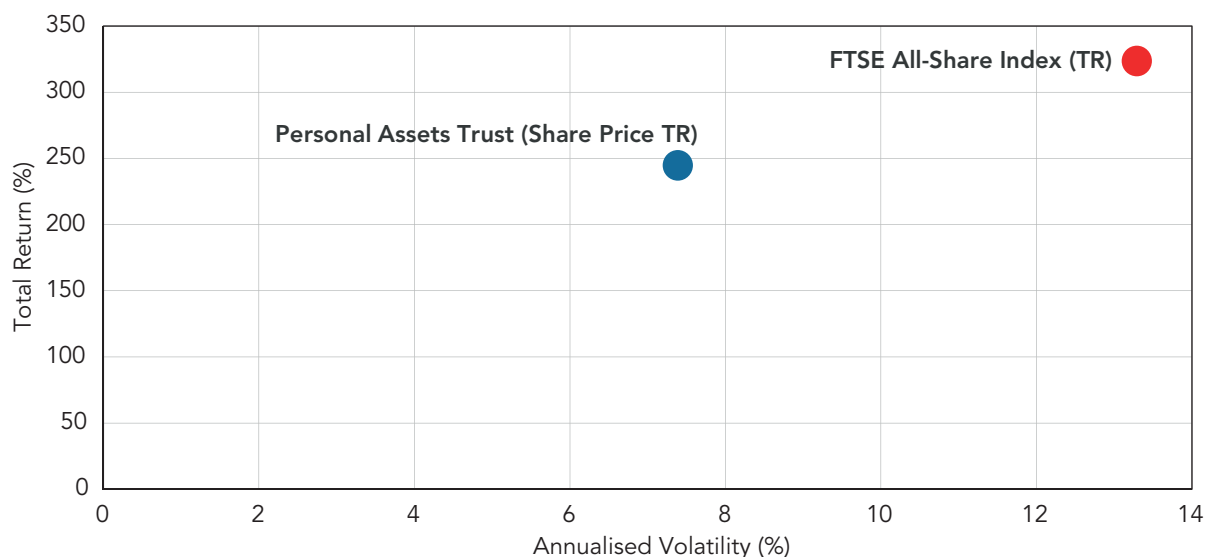
(exc. Government Bonds)

	% Trust
Gold Bullion (Bars)	9.3
Unilever	3.4
Nestlé	2.9
Visa	2.9
Microsoft	2.9
Franco-Nevada	2.8
Diageo	2.7
Alphabet	2.1
Agilent Technologies	1.8
Becton Dickinson	1.7
<b>Total Top 10</b>	<b>32.4</b>
5 other equity holdings	4.9
Index-Linked Bonds	38.2
UK T-Bills & Short-Dated Gilts	21.2
Cash	3.1
<b>TOTAL</b>	<b>100.0</b>

Source: Factset, Asset Allocation and holdings subject to change.

Source: Factset, Asset Allocation and holdings subject to change.

## Risk Analysis from 30/09/2002 to 30/09/2022



Source: Lipper

**Past performance is not a guide to future performance**

### Risk analysis since 30 September 2002

### Personal Assets Trust (Share Price TR)

### FTSE All-Share Index (TR)

Total Return	+243.8%	+323.0%
Max Drawdown <sup>1</sup>	-23.5%	-45.6%
Best Month	+6.9%	+12.7%
Worst Month	-7.8%	-15.1%
Positive Months	+63.8%	+60.4%
Annualised Volatility <sup>2</sup>	+7.4%	+13.3%

<sup>1</sup> Measures the worst investment period

<sup>2</sup> Measured by standard deviation of annual returns

Source: Lipper

**Past performance is not a guide to future performance**

#### Fund Manager Awards



#### Structure

London Listed Investment Trust

#### Investment Manager

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London W1K 4BP  
Tel: 020 7499 4030  
Fax: 020 7491 2445  
email: busdev@taml.co.uk

#### Manager

Sebastian Lyon

#### Assistant Manager

Charlotte Yonge

#### AIFM

Juniper Partners Limited  
28 Walker Street,  
Edinburgh, EH3 7HR  
0131 378 0500

#### Board of Directors

Iain Ferguson CBE (Chairman)  
Mandy Clements  
Gordon Neilly  
Paul Read  
Robbie Robertson  
Jean Sharp

#### Currency

£ Sterling

#### Established

22 July 1983

#### Troy Investment Advisor

March 2009

#### Troy Investment Manager

May 2020

#### ISIN

GB00BM8B5H06

#### SEDOL

BM8B5H0

#### Ongoing Charges (30 April 2022)

0.67%

#### Year End

30 April

#### Pricing

Share price is listed daily in the FT

#### Auditor

PricewaterhouseCoopers LLP

## Disclaimer

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The Trust's performance is given in a 20 year period. Volatility of the Trust is run from 2000 in the Annual Report because that was the year end following 'discount freedom day' or when investment companies were permitted to buyback shares.

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