

Chairman's Statement

CAPITAL

Over the year to 31 October 2006 the net asset value per ordinary stock unit with borrowings valued at par rose by 19.2%, ahead of the company's principal comparator indices, the FTSE All-World Index which rose by 11.9% and the UK FTSE All-Share Index which rose by 17.9%. Measured with borrowings at market value, the net asset value per ordinary unit increased by 18.7%. This performance reflected the contribution from the global equity portfolio which outperformed world equity markets for a third consecutive year. Good stock selection was achieved across the portfolio. At the AGM in January 2006, stockholders voted to amend the company's objectives by dispensing with the company's single benchmark index which, for the record, rose by 14.4%.

The largest absolute contribution came from our Financials holdings which provided almost one third of the gains in portfolio value. Outstanding individual contributions included UK bank Barclays, Canadian oil company Suncor Energy, UK housebuilder Persimmon, UK energy company BG Group and Taiwanese electronics company Hon Hai Precision Industry. Effective gearing over the year was maintained at an average of 105%. During the year we took profits and we made material reductions in the proportion of the portfolio in Oil & Gas, including Suncor Energy, and increased substantially the proportion of the portfolio in Financials.

Industry sector returns over the year were mostly within a relatively narrow range as cyclical sector leadership in the early part of the year gave way to a more defensive tone. Merger and acquisition activity increased sharply with certain sectors including pharmaceuticals, telecoms, transport and utilities featuring prominently. Our own portfolio benefited with share prices in a number of holdings, including P&O, AWG and Rinker, reacting to actual or rumoured bids.

The restructuring of the investment management approach in January 2004 continued to yield benefits. Between the end of January 2004 and 31 October 2006, the global equity portfolio and NAV per ordinary unit both rose by 47.6%, outperforming our comparator indices: the FTSE All-World Index which rose 32.7% and the UK FTSE All-Share Index which rose 43.6%. They also exceeded the company's former benchmark which increased by 37.1%.

The number of holdings in the global listed portfolio increased during the year by 1 to 117.

INCOME

Dividend income generated was strong and again ahead of our expectations, reflecting the strength of corporate balance sheets and the surge in global corporate profitability.

As I intimated last year, the board decided to lower the proportion of interest and expenses charged to capital from two thirds to one half in view of the increasing emphasis on dividends as a component of return. As expected, this has had the effect of lowering revenue return for the financial year to October 2006. However, good dividend growth meant that earnings per ordinary unit only declined to 9.39p (2005 – 9.86p).

The board is recommending a final dividend of 4.57p which makes an increase of 3.8% in the dividend for the year from 8.40p to 8.72p per ordinary unit, which compares with the October year on year UK RPI inflation rate of 3.7%. We have increased our dividend in each of the last 23 years and it is a stated objective of the company to increase the dividend by more than the UK rate of inflation. In view of the strength of dividend income growth and the company's strong revenue reserve position, the board is also recommending an additional special dividend of 2.0p per ordinary unit, making a combined distribution for the year of 10.72p, an increase of 27.6%.

STOCK PRICE AND DISCOUNT TO NAV

The stock price rose by 19.6%, reflecting a slight narrowing, to 8.5%, of the discount to NAV (after deducting dividends proposed but not paid and with borrowings valued at market) and the strong NAV performance. The year end discount level was the lowest for many years. The average weekly discount over the year, with borrowings valued at market, was 8.9%.

TENDER OFFER AND STOCK BUYBACK POLICY

As many stockholders will be aware, following the outcome of the EGM in January 2006, the company undertook a tender offer in February in order to provide any stockholders seeking an exit with an opportunity to sell some, or potentially all, of their stock back to the company. The terms of the tender provided that

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up to 40% of the company's stock would be repurchased at a 9% discount to the NAV (with borrowings taken at par). In the event, only 27.75% of issued stock was tendered, including the entire 10.6% holding of the company's then largest stockholder. Consequently, the company repurchased 58.0m stock units at a tender price of 436.0834p per unit, a return of capital of £252.8m. The cash requirement for the tender was realised by a sale of listed equities carried out at low cost by means of a portfolio programme trade.

The company's gearing potential was maintained at pre-tender levels by the subsequent repurchase of £42.0m nominal of the company's 5.75% secured bonds due 2030 at a margin of 0.25% over gilt yields at a total cost of £51.8m.

The terms of the tender offer and proportion tendered provided a net asset value increase for continuing stockholders of 1.7%, which was close to the estimated increase detailed in the tender offer circular.

Stockholders also voted in favour of the introduction of a stock buyback scheme intended to maintain the stock price discount to NAV at 9% or less in normal market conditions (taking borrowings at market value). Under this authority, which excludes the tender-related stock repurchases, over the year the company repurchased for cancellation 7.8m stock units (5.16% out of the 14.99% authority) at an average discount of 9.5% and a cost of £34.3m inclusive of dealing expenses. The repurchases were funded from net reductions to the equity portfolio. The estimated average daily discount since the introduction of the scheme was 9.2%.

Post-tender, some 65% of the company's stock is now in the hands of private investors and private client managers and, despite the return of capital, the company remains cost-competitive with an expense ratio of 0.55% (2005 – 0.49%) which is considerably lower than the average of all investment trusts.

ACCOUNTING CHANGES

In addition to the above-mentioned reduction in the proportion of interest and expenses charged to capital, the accounts also feature a number of mandatory changes including those required by the convergence of UK Accounting Standards with International Accounting

Standards. Also, adoption of UK Accounting Standards Board's FRS17 – Retirement Benefits means that the company's pension liability for employees came on to the balance sheet with effect from 1 November 2005.

BOARD

Hamish Leslie Melville will be retiring at the AGM and will not be standing for re-election. He has served the company with distinction both as a board member and as chairman of the remuneration committee since appointment in November 1996 and I thank him for his contribution.

OUTLOOK

Global stockmarkets are now well into their fourth year of a recovery from the low point of March 2003 and are again nearing record highs. That conventional valuation measures appear to remain within acceptable historical ranges reflects the extraordinary recovery in corporate profitability that has occurred, taking corporate profit margins to cyclical highs. The strong return achieved masks the difficult markets of mid-year which provided a sharp reminder that the investment conditions in recent years have been exceptionally benevolent.

While long-standing global imbalances remain and the international political environment is unpredictable, the global economy and corporate profits are expected to grow again in 2007, albeit at a slower rate than 2006. Stockmarket valuations are for the short term supported by the high level of merger and acquisition activity, bolstered in turn by private equity funds. However, four years into the stockmarket rally, the scope for high annual returns in the near term has most probably diminished.



Douglas McDougall

Chairman

8 December 2006