

Chairman's Statement

Performance

Over the year to 31 October 2008, the net asset value per ordinary unit (NAV) fell by 31.2% with borrowings at market value, in between our primary comparator indices, the UK FTSE All-Share Index which fell by 36.8% and the global FTSE All-World Index (-28.9%). In total return terms, the outcome was -29.7% compared with -34.4% for the FTSE All-Share and -26.9% for the FTSE All-World.

In stark contrast to the previous year, which saw new stockmarket highs reached in October 2007, last year was a very difficult one for investors. Extraordinary turbulence in financial markets and stresses in the domestic and international banking systems as the US mortgage crisis unfolded prompted major falls in the main international equity markets and a sharp slowdown in the world economy. The bursting of the US mortgage bubble was attributable to the over-promotion of mortgages in the US, the incorrect risk assessment of securities comprising parcels of such mortgages and the excessive leverage applied by banks purchasing these securities. What followed was a domino-like collapse of major institutions which had become over-extended and vulnerable, with the failure of Lehman Brothers being a pivotal moment. The subsequent wholesale deleveraging by banks and hedge funds has added further downward pressure on stockmarkets culminating in the heavy recent sell-offs. This unwinding process has been rendered more complex by the opaque transference of risks around the world by means of credit derivatives. An unfortunate aspect has been the extent of the involvement by UK banks, several of which were paying increased dividends as recently as this year.

While the NAV performance was ahead of both the UK FTSE All-Share Index and the average of global growth investment trusts, it was below the FTSE All-World Index owing to the equity portfolio's lagging that index for the first time in five years. This in turn was due principally to a relative under-exposure to North America, which has a dominant presence in the global index, and to a lesser extent Japan. This was despite having raised our North American allocation to its highest level for many years. Sterling returns from these two areas benefited materially from currency strength against sterling which transformed their poor local currency returns. A corresponding over-exposure to the UK was also detrimental to relative performance despite the allocation there being its lowest in many years. The 22.2% appreciation of the dollar meant that in sterling terms North America was the most resilient area globally, down by 20.0%. The same issue affected Japan, as its 47.0% decline in local terms was reduced in sterling to a fall of 20.2%. Stock selection was mixed this year with a small

number of consumer-exposed selections performing poorly in relative terms and sub-optimal selection in banks and telecommunications also holding back returns. Overall, our sector positioning was appropriate as the portfolio was moved to a defensive stance over the year. We also benefited from the creation of a large position in oil production and service companies in the spring, with profits taken as the oil price peaked.

Gearing deployed in January 2008 was eliminated over the early summer as markets deteriorated. Equity exposure was maintained at or near 100% as markets fell heavily in September. By the end of September effective equity exposure was around 93%. Markets then fell further in October as economic concerns came to the fore and at that point the decision was taken to buy a number of good quality growth and cyclical companies which had fallen heavily. Gearing was thereby restored to around 104% by the year end.

Having sold some £74m of financials in the 2006/07 year, we sold a further £39.8m during the year. We also made useful reductions of £46.4m to our Asia Pacific (ex Japan) holdings fearing a slowdown in China and related economies which now appears to be underway.

The purchase of a number of new holdings late in the year at depressed valuations necessitated a deliberate reversal of the trend over recent years whereby the number of holdings had been coming down. It is expected that the number of listed portfolio holdings will fall from the year end level of 117 (2007: 98) over the coming year.

The company outperformed the main comparator indices, the UK FTSE All-Share and FTSE All-World, over the last 3 and 5 years in terms of both share price total return and NAV total return. Against the AIC group of global growth investment trusts, the company has generated an above-average NAV total return and share price total return over the past 1, 3 and 5 years.

Income

Good dividend growth from holdings, exchange rates and lower expenses combined to offset the effects of falling interest rates on cash deposits and a lower allocation in UK equities, resulting in earnings per ordinary unit of 11.00p (2007: 11.02p).

The board is recommending an increase of 4.4% in the regular dividend for the year to 9.50p per ordinary unit (2007: 9.10p), which compares with the October UK RPI annual inflation rate of 4.2%. We have increased our dividend in each of the last 25 years and it is a stated objective of the company to increase the dividend by more than the UK rate of inflation over the longer term.

Stock Price, Buybacks and Discount

Having reached a new all-time high of 535p in October 2007, the stock price fell by 29.7% over the year to 31 October 2008. The stock price discount to ex-income NAV (with borrowings at market value) narrowed over the year from 9.9% to 7.5%. Under the company's buyback policy, which is intended to keep the discount at or below 9% in normal market conditions, 4.6m stock units were repurchased for cancellation over the financial year (adding 0.3% to NAV performance and utilising 2.22 percentage points of the 14.99% authority renewed at the January 2008 AGM) at an average discount of 9.6% and a cost of £22.9m inclusive of dealing expenses. The average discount over the year was 8.5% and the estimated daily average since the introduction of the scheme in February 2006 was 8.9%. During moments of extreme volatility in stockmarkets late in the year, the discount narrowed materially and was at times close to being eliminated.

Board Composition

Sir George Mathewson retires from the board at the Annual General Meeting. He has been a most stimulating colleague over a long period of service to the company and I thank him on behalf of the stockholders.

Outlook

Much of the developed world is already in an economic recession which may prove to be both deep and long. Interest rates have been lowered in many regions and are likely to be cut further as the authorities grapple with the problems of the damaged banking system and widespread economic weakness. Earnings expectations for companies worldwide are being reduced and the outlook for dividend growth is the weakest for many years. While there are numerous imponderables facing investors, it is reasonable to assume that much bad news has been discounted by the recent sharp falls in stockmarkets worldwide. Consequently, as we have retained the bulk of our long-term relatively low coupon borrowings in cash we are in a position to deploy this capital while equity markets are at depressed levels for the long-term benefit of stockholders.

Annual General Meeting

The 121st Annual General Meeting will be held at the Roxburghe Hotel, Charlotte Square, Edinburgh, on Friday 30 January 2009 at 10.30am. I hope to see as many stockholders there as possible.



Douglas McDougall
Chairman
8 December 2008