

# Chairman's Statement

## CAPITAL

Over the year to 31 October 2005 the net asset value per ordinary unit (NAV) with debt valued at par rose by 21.2%, ahead of the 16.3% benchmark return. Measured with debt at market value, the NAV increased by 19.5%. The performance reflected strong contributions from the global listed portfolio, which outperformed for the second consecutive year and our unlisted holdings, together with a modest net benefit from gearing.

The listed portfolio outperformance was attributable to good sector positioning and stock selection across the portfolio with a notable performance from our North American oil selections including Suncor Energy, Todco and ConocoPhillips. Our unlisted portfolio generated excellent returns with strong contributions from the Aberforth Limited Partnership 1B, HG Capital Trust and Apax Europe V. Our unlisted portfolio is maturing rapidly and we have seen material realisations over the year. Our return in this area also benefited from a change in valuation basis for Aberforth which added approximately 0.6% to NAV.

Effective gearing was maintained at an average of 106% over the year with sizeable distributions from unlisted being largely reinvested in the listed equity portfolio, principally through additions in Europe (ex UK).

While equity markets performed well over the year, the majority of the returns came in the second half of our financial year. Markets made steady progress over the first third of the year only to fall away following weak economic indicators and some poor corporate trading statements. In spite of the headwinds of high oil prices and rising US interest rates, markets regained their upward momentum over the summer months as investors regained confidence in the outlook for global growth and corporate profits. The Resources sector comprising oil and mining stocks was the dominant share price performer over the year, reflecting high oil prices and surging Chinese demand for raw materials.

Of the regional stock markets, Japan produced the strongest returns for the first time in many years, rising 32.8% in local currency terms and 25.4% in sterling. Foreign investors pushed the Japanese market higher sensing an improvement in the outlook for reform within the Japanese economy and corporate sector. Elsewhere, Europe (ex UK) performed well, rising 22.2% in local currency terms and 18.7% in sterling, in spite of the weak European economy. The Pacific (ex Japan) markets rose 17.1% in local currency terms and 22.8% in sterling while the UK market rose 16.0%. The main laggard was the US which rose 8.2% in US dollar terms and 12.0% in sterling. The return achieved by our own North American holdings was substantially higher however as we had switched much of our global oil exposure to this region. The main global sector change was to reduce Telecommunication Services exposure by £21.7m, principally through sales of Vodafone.

## PORTFOLIO MANAGEMENT CHANGES

Following the restructuring of the investment management approach in January 2004, there has been a marked improvement in the company's investment performance. Between the end of January 2004 and 31 October 2005, the NAV has risen by 23.1% outperforming the benchmark which rose 19.9%, despite the impact on NAV performance of approximately 3.1% from the early repayment of debentures in July 2004. During this time, the global equity portfolio (including unlisted) returned 26.8% in capital terms. In order to focus the investment management team's efforts on its strongest investment opportunities and raise the performance potential of the company, the number of holdings in the global listed portfolio was reduced further over the year from 150 to 116. The portfolio remains well diversified by geography and sector but is now clearly differentiated in its construction from underlying investment indices.

## INCOME

Dividend income generation exceeded our expectations with strong growth in dividends from companies across the globe, particularly from continental Europe, and a number of special dividends. After three years of recovery in corporate profits, balance sheets have been rebuilt thereby enabling these increased payouts. Higher dividend income and lower interest payable allowed earnings per ordinary unit to increase by 6.1% to 9.86p.

The board has reviewed the long outstanding Italian withholding tax owed to the company and has taken the decision to write off the balance of £824,000 which, while material, is small in relation to the company's assets. However, we will continue to work to secure reimbursement of the amount outstanding.

The board is recommending an increase of 3.7% in the dividend for the year to 8.40p per ordinary unit, which compares with the October year on year UK RPI inflation rate of 2.5%. We have increased our dividend in each of the last 22 years and it is a stated objective of the company to increase the dividend by more than the UK rate of inflation.

## STOCK PRICE AND DISCOUNT TO NAV

The stock price rose by 26.2%, driven by the increase in NAV and the narrowing of the discount to NAV (with borrowings at market value) from 14.7% at 31 October 2004 to 9.9% at the year end.

## PROPOSED TENDER OFFER AND STOCK BUYBACK POLICY

Your board has undertaken a long-term strategic review of the company, having particular regard to the improved performance of the company over the

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past two years, the reduction in the discount to net asset value at which the stock has traded over the past six months, and the differing requirements of institutional and private stockholders. Having completed that review, the board has concluded that the company remains an attractive vehicle for investors, particularly private investors and private client asset managers who are seeking a cost-effective exposure to global equity markets through a diversified portfolio of investments. At the same time, the board believes that it would be appropriate to provide an opportunity for those stockholders who so wish to realise all, or substantially all, of their investment in the company. Accordingly, the board is putting forward proposals for a tender offer for up to 40% of the company's issued share capital at a price representing a discount of 9% to the net asset value per stock unit with borrowings valued at par.

The board is also introducing a new stock buyback policy which, it is intended, will be used in conjunction with the buyback authority which the board is seeking to renew at the 2006 Annual General Meeting. Under this policy, the company will actively seek to buy back stock with the aim, in normal market conditions, of maintaining a discount to net asset value of 9% or less (taking the secured bonds at their market value). The board has set the stock buyback policy with borrowings at market value so that the buyback level in the future will take account of the effect of movements in long-term interest rates on the value of borrowings. Full details of these proposals will be contained in a circular being sent to stockholders. The directors believe the proposals are in the best interests of stockholders as a whole. None of the directors will be tendering his stock in the proposed tender offer. Stockholders are encouraged to vote for these proposals at the forthcoming Extraordinary General Meeting on 27 January 2006.

## PROPOSED AMENDMENTS TO INVESTMENT OBJECTIVE

Having outperformed the existing benchmark over the two year period to 31 October 2005, even after accounting for the costs of early repayment of higher coupon debentures in July 2004, the board believes this to be an appropriate time to reconsider the use of a benchmark. The board would prefer the company to be managed without reference to market capitalisation-weighted indices which may from time to time be dominated by a small number of large companies. Subject to approval by stockholders at the forthcoming Annual General Meeting, the company's investment objective is being amended to dispense with the link to a formal benchmark, thereby removing the constraint it imposes on investment policy. Future performance will be reviewed in the context of returns achieved by a broad basket of UK equities through the FTSE All-Share Index™ and of international equities through the FTSE All-World Index,™ but the portfolio will not be modelled on any index.

## NEW DIRECTOR

In September, we announced the appointment of Mr James S MacLeod as a non-executive director of the company. Mr MacLeod was a partner in the accountancy firm Ernst & Young and its predecessor firms for over 25 years specialising in corporate tax, particularly for investment trusts and insurance companies. He has been appointed chairman of the company's audit committee and will seek election by stockholders at the AGM. The board is unanimously recommending his election.

## ACCOUNTING CHANGES

There are a number of accounting changes which will be implemented in the year to October 2006 including the UK Accounting Standards Board's FRS17 – Retirement Benefits. As a self-managed investment trust, FRS17 brings the company's pension liability for its employees onto the balance sheet with effect from 1 November 2005. We will also see changes in respect of UK accounting standards as they converge with International Accounting Standards.

Since 2000, when the company issued a large secured bond, interest and investment-related expenses have been charged one-third to revenue, two-thirds to realised capital reserves in line with the directors' prevailing expectations of the nature of long term future returns from the company's investments. In view of the increasing emphasis on dividends as a component of return in major international equity markets, the board has decided to lower the proportion of interest and expenses charged to capital, from two-thirds to one half. All else being equal, this will have the effect of lowering revenue return for the financial year to October 2006. However, we do not expect this change to inhibit the company's dividend policy.

## OUTLOOK

Global equity markets have been recovering from the bear market of 2000-03 for two and a half years during which time corporate profitability has been restored to cyclically high levels and company balance sheets have been rebuilt. Markets have rallied in the face of high oil prices, rising short-term interest rates and an uncertain political backdrop in the Middle East. It is notable that the US market has de-rated relative to better performing areas such as Europe and the Pacific. While the much discussed global economic imbalances remain unresolved corporate profits seem likely to grow in 2006 and valuations in most regions are within acceptable bounds by past standards.



**Douglas McDougall**

12 December 2005