# Chairman's Statement

## Performance

Over the year to 31 October 2010, the net asset value per share (NAV) total return was 17.0% (cum income and with borrowings at par). The total returns of the comparator indices, the global FTSE All-World Index and the UK FTSE All-Share Index, were 18.2% and 17.5% respectively.

Portfolio performance benefited from strong returns from Asian holdings which offset a weak first half from a number of US holdings. The principal contributors to investment performance included Apple (US), Kia Motors (Korea), Aspen Pharmacare (South Africa), Spectris (UK), CIMB (Malaysia), BHP Billiton (UK), Hengan International (Hong Kong) and Li & Fung (Hong Kong). The three most negative contributors were all in the oil industry – Diamond Offshore Drilling (US), BP (UK) and Petrobras (Brazil).

After a disappointing first half, relative investment performance picked up sharply in a second half in which the portfolio rose in value despite global equity markets falling modestly. Over the year, industry sector positioning was broadly helpful.

Equity markets were volatile throughout the year. Effective equity gearing levels were managed actively but cautiously and deployment added 0.7% to NAV performance. The uplift to NAV from share buybacks largely offset the 0.8% cost to NAV performance from interest and expenses charged to capital.

Positive investor sentiment stemming from resurgent corporate profits, broadly improving economic data and abundant merger and acquisition activity was intermittently punctured by bouts of weakness reflecting concerns over policy measures to cool Chinese growth and over the European sovereign debt crisis centred on Greece and other indebted countries on the EU periphery. Much of the equity market gain made in the first six months was eliminated by August as risks of a slowdown in the US economy emerged. However, the indications by the US monetary authorities in late August that further quantitative stimulus would be applied prompted a sharp rally in equity markets and other risk assets. A striking feature has been the close inverse correlation between the US dollar and asset prices, a symptom of the pressures and imbalances within the global financial system.

Industry sector performance was equally volatile with sequential rotations in and out of more cyclical sectors as markets rose and fell. The China demand-linked Basic Materials industry stocks produced the best returns over the year, followed by other consumer cyclicals and industrials. While more defensive sectors lagged generally, it was Oil & Gas which performed worst as heavyweights BP and Petrobras succumbed to stock-specific pressures. In geographic terms, the fall in sterling exchange rates transformed overseas returns for UK-based investors and propelled the emerging market regions of Middle East & Africa, Latin America and Asia Pacific (ex Japan) to sterling returns well in excess of 20%.

There were a small number of main themes behind portfolio activity. First, effective equity gearing was deployed actively in volatile and uncertain markets during a year in which equally clear cases could be made for either further equity gains or a major sell-off if fears of a return to recession were vindicated. Gearing was deployed in a range of 101% to 112% and at an average level of 106% over the year. Second, a £50m addition was made to US holdings early in the year ahead of a dollar strength-fuelled spell of strong performance from US equities, although our holdings lagged the wider US market. Third, the move into the US was funded in part by significant reductions to Europe (ex UK) ahead of regional market weakness relating to euro sovereign debt worries. Later, reductions were made to North America with assets swapped back into UK and European equities ahead of stronger relative spells by these regions.

Over the year, the portfolio appreciated by £83.6m. For the second consecutive year, the largest contributions came from Industrials (+£24.7m) and some reductions were made here to lock in some of the good gains made over the last eighteen months. Consumer Goods holdings, which were built up during the year, rose by £19.2m. By region, Asia Pacific (ex Japan) produced the largest appreciation (+£27.6m). Oil & Gas generated the worst portfolio returns although reductions made early in the year were usefully recycled into Basic Materials holdings. With dividend income recovering, some of the short-dated corporate bond holdings, held to boost income in the face of declining interest rates, were sold.

In the period from end January 2004, when the current management approach was introduced, to 31 October 2010, the NAV and share price total returns were ahead of the two comparator indices. The NAV total return was 76.3% compared with 70.9% for the FTSE All-World and 70.3% for the FTSE All-Share. The share price total return was 98.9%.

## Income

Dividend payouts started to recover after one of the worst spells for dividends in decades. Good dividend growth from holdings allied with control over expenses, which saw the expenses ratio decline, and a lower number of shares outstanding, left earnings per share (EPS) at 10.26p (2009: 10.62p). The passing of dividends by BP resulted in a loss of projected income of around 0.25p per share or 2.4% of EPS.

## Dividend

It is a stated objective of the company to increase the dividend by more than the UK rate of inflation over the longer term. The board is therefore recommending a final dividend of 5.60p per share (2009: 5.15p). Taken together with the interim dividend of 4.45p per share (2009: 4.45p), this would result in an increase of 4.7% in the total dividend for the year to 10.05p per share (2009: 9.60p) which compares with October UK CPI inflation of 3.2% and RPI inflation of 4.5%. If the proposal is approved, the company will have increased its dividend in each of the last 27 years.

Over 5 years the company's dividend has increased by 19.6%. This compares with RPI inflation of 16.8% and CPI inflation of 14.4%.

## Share Price, Discount and Buybacks

The share price rose by 14.5% as the discount to ex-income NAV was stable over the year and ended the period at 9.0% (2009: 8.9%). The company's buyback policy is intended to keep the discount to ex-income NAV at or below 9.0% (with borrowings at market value). Under the policy, 8.1m shares were repurchased for cancellation over the financial year (adding 0.7% to NAV performance) and utilising 4.62% of the 14.99% authority renewed at the February 2010 AGM. The shares were repurchased at an estimated average discount to ex-income NAV of 10.2% and at a cost of £36.0m inclusive of dealing expenses. The buybacks were funded from sales of fixed interest holdings and equities and from net current assets. The average discount over the year was 9.6% and the daily average between the introduction of the scheme in February 2006 and the year end was 8.4%.

The company's savings schemes, ISA and SIPP operated by its regulated subsidiary, SIT Savings Ltd, continued to provide steady net demand for the company's shares over the year.

## European Regulatory Proposals – Impact on Self-Managed Trusts

Investors may recall the concern expressed by the Board last year regarding the EU draft directive governing so – called "Alternative Investment Fund Managers (AIFM)". These proposals were aimed primarily at hedge funds and private equity funds but inadvertently caught conventional UK investment trusts and risked the imposition of some inappropriate measures. While the worst outcomes appear to have been avoided, it will be some time before the boards of self-managed and other investment trusts can assess the increase in costs which will almost certainly follow. Indications are that the new regime will not come into force before 2013.

## Outlook

Global equity markets rose by 61% in sterling terms between the end of the bear market in March 2009 and the end of October 2010 as a series of emergency monetary and fiscal measures supported troubled developed world economies and encouraged money to flow into riskier assets. It was perhaps ironic that stockmarkets should rally on the suggestions in August that the US authorities felt compelled by the economic outlook to sanction further quantitative stimulus measures. Central bank policies are again exposing the various structural imbalances in the world economy and may give rise to competitive currency devaluations around the world, the spread of capital controls and, in time, price inflation. The debt situation in the periphery of the EU remains a concern and it is still troubling that interest rates in several major economies remain at or close to zero. The challenge for authorities is to achieve an adequate stimulus without sparking inflation, fears over which have been growing throughout the year, and a normalisation of interest rates. Corporate profits and balance sheets have recovered well and profits are expected to grow in 2011. Our portfolio is currently valued less highly than the global market on aggregate, has a higher dividend yield and good prospective dividend growth.

Douglas McDougall

Douglas McDougall
Chairman
16 December 2010

# Board of Directors

## *†Douglas McDougall OBE

was appointed to the board in September 1998 and became chairman in October 2003. He is chairman of The Law Debenture Corporation, The Independent Investment Trust and The European Investment Trust and a director of The Monks Investment Trust, Pacific Horizon Investment Trust and Herald Investment Trust. He is a former senior partner of Baillie Gifford & Co and a former chairman of IMRO, the Association of Investment Companies and the Fund Managers' Association.

## Francis Finlay

was appointed to the board in November 1996. He is former chairman of Clay Finlay, the New York-based international fund management firm he co-founded in 1982 and led until 2006. He is a director of the London-listed investment trust, SVG Capital, as well as serving on the boards of a number of international investment institutions and charitable organisations. Previously he held senior investment positions with Lazard Frères and Morgan Guaranty Trust in Paris and New York.

## *†Hamish Buchan

was appointed to the board in November 2003. He is a director and former chairman of the Association of Investment Companies and was formerly chairman of NatWest Securities in Scotland. He is chairman of JP Morgan American Investment Trust and Personal Assets Trust, a director of Aberforth Smaller Companies Trust, Standard Life European Private Equity Trust and Templeton Emerging Markets Investment Trust PLC. He is chairman of the remuneration committee.

## *†James MacLeod

was appointed to the board in September 2005. He is a chartered accountant. He was a partner in Ernst & Young and its predecessor firms for 25 years until his retirement in 1998 and specialised in corporate tax, particularly for investment trusts and insurance companies. He was a visiting professor at the University of Edinburgh until 2001. He is a director of British Assets Trust, INVESCO Perpetual AIM VCT and INVESCO Perpetual Recovery Trust 2011. He is chairman of the audit committee.

## Russell Napier

was appointed to the board in July 2009. He is a consultant global macro strategist with CLSA Asia-Pacific Markets. He began his career as an investment manager at Baillie Gifford & Co and then moved to Foreign and Colonial Emerging Markets where he managed Asian portfolios. From 1995 to 1998 he was Asian equity strategist for CLSA in Hong Kong. He is a director of Mid Wynd International Trust and a limited partner of Cerno Capital Partners. He is also a member of the investment committee for the National Trust for Scotland and runs a course in financial history at The Edinburgh Business School. He is author of the book "Anatomy of The Bear: Lessons from Wall Street's Four Great Bottoms".

* Member of audit committee

† Member of remuneration committee

# Management

## Manager

John Kennedy

## Assistant Managers

Hugh Duff

Martin Robertson

## Secretary

Steven Hay