Chairman's Statement

Performance

The net asset value per share (NAV) total return for the year to 31 October 2012 was 8.4% (with borrowings at market value) which compares to the 9.4% sterling total return of the global FTSE All-World Index and 9.8% from the UK FTSE All-Share Index. The share price total return was also 8.4%. The company's global equity portfolio achieved a total return of 12.1% which was ahead of both of the company's global and UK comparator indices.

The 12.1% equity portfolio total return was not fully translated into NAV and share price performance predominantly due to two related features of the company's long-term borrowings. First, the company has significant long-term borrowings which in recent periods have been held largely in cash and short-term bonds reflecting a cautious outlook for markets. Consequently, there was no worthwhile return on these secure liquid assets to offset the 1.1 percentage point deduction to the NAV total return from interest charges. Second, variations in the market value of these borrowings, which reflect changes in the market level of bond yields, must be accounted for each year even though the fixed rate cost of servicing the borrowings is unchanged. Consequently, the NAV return was lowered by a further 1.4 percentage points owing to the increase in the market value of the borrowings. This increase in the value of borrowings has affected the NAV return negatively for the last four consecutive years. Adjusting for this distortion, the NAV with borrowings at par rose by 9.2%, broadly in line with the global index.

Global equity returns over the year were again driven by North America, which accounts for almost half of the FTSE All-World Index and achieved a total return of 14.4% in sterling terms. This compares to a sterling total return for the rest of the world of around 5%. North America was the only region to generate a sterling return ahead of the FTSE All-World Index. Sterling strength lowered sterling returns materially for Europe (ex UK), Latin America and Middle East & Africa.

Despite a relative under-exposure to North America, the global equity portfolio again outperformed owing to strong regional stock selection. There were notable absolute and relative sterling total returns from our North American investments which returned 19.9%, some 5 percentage points ahead of the North American index return. Asia Pacific (ex Japan) holdings returned 15.8% compared with a regional index return of 7.4%. UK and Latin American holdings' returns also exceeded regional index returns by good margins. On an industry analysis of performance, stock selection contributed positively.

Gearing and Portfolio Activity

After a cautious start to the year, gearing was increased steadily from 6% net cash to a geared position of 7% by year end (with borrowings at market value). Average gearing was 0% and potential gearing at the year end amounted to 23%. The global equity portfolio appreciated in value by £46.5m with £51.3m net investment in equities as gearing was increased. Most of these funds (£43.5m) were added to Europe (ex UK), an area which has lagged in recent years. North American holdings were reduced by £23.8m after a long spell of strong performance, primarily through profit-taking in Apple (£13.5m) and McDonalds (£11.5m). Equity portfolio turnover was 27%.

Income

Total income decreased by 4.5% to £20.6m owing to a lower level of investment in equities over the year and a smaller contribution from special dividends. This was offset to a degree by good dividend growth from portfolio holdings. Expenses rose by 4.3%, and on a lower average number of shares outstanding following share buybacks net income per share fell by 3.4% to 12.01p (2011: 12.43p).

Dividend

The board is recommending a final dividend of 6.65p per share (2011: 5.80p). If approved, taken together with the interim dividend of 4.60p per share (2011: 4.60p), this will result in an increase of 8.2% in the total dividend for the year to 11.25p per share (2011: 10.40p) which compares with October UK CPI inflation of 2.7% and RPI of 3.2%. If the proposal is approved, the company will have increased its dividend in each of the last 29 years.

Share Buybacks, Discount and Secured Bond Repurchases

The discount to ex-income NAV (with borrowings at market value) was broadly stable moving from 8.2% at the previous year end to 8.6%. 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, 2.4m (2011: 3.9m) shares were repurchased for cancellation over the financial year accounting for 2.1% of the shares in issue at the start of the period. The shares were repurchased at an average discount of 9.6% and a cost of £11.1m (2011: £19.3m) inclusive of dealing expenses. The average discount over the year was 9.3% and the average between the introduction of the scheme in February 2006 and the year end was 8.7%. As an offset to the reduction in shareholders' funds, the company repurchased for cancellation £4.0m nominal of its 5.75% Secured Bonds 2030 at a cost of £5.3m. The cost of repurchasing the secured bonds was below the prevailing market value of the bonds in the NAV. Consequently, there was an immaterial enhancement to the NAV (with borrowings at market value).

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.

125th Anniversary Investment Seminars

To mark the 125th anniversary of its founding, the company held two well-received investment seminars during the year, in London and Edinburgh. The seminars featured presentations covering the current investment outlook from leading investment strategists used by the company. The audiences comprised institutional shareholders, professional investors and other interested stakeholders.

Board Committee Composition

During the year, Russell Napier was appointed to the audit and remuneration committees and Francis Finlay was appointed to the audit committee.

EU Alternative Investment Fund Managers (AIFM) Directive

Along with the rest of the investment trust industry, we are awaiting final details of the proposed AIFM Directive to which the company will regrettably become subject. One almost inevitable consequence of this directive will be additional costs to be borne by investment trust investors.

Outlook

Despite a further deterioration in the outlook for the global economy, companies in most industry groups are expected to report positive growth in earnings in 2012. However, a fall in profits in some cyclical sectors may hold back aggregate earnings growth to leave global equities on around 12x earnings. While this appears reasonable by historic standards, profit margins do remain at elevated levels and longer-term stockmarket valuations such as the cyclically-adjusted PE (CAPE) are less supportive. The company's global portfolio stands on around 12x earnings with a dividend yield of 3.0%.

Many of the issues which clouded the outlook a year ago remain unresolved and include the combined deflationary pressures from prolonged austerity-driven economic weakness in Europe, the long-term funding requirements of the US economy and developments in the Chinese economy. While earnings growth expectations for 2013 are currently being moderated, global corporate earnings growth is still expected to be robust in 2013 and there have been broadly helpful if still inconclusive developments in some of the areas of uncertainty. The company has entered the year with £87m of its long-term borrowings available for investment on material weakness in markets.

Douglas McDougall
Chairman
12 December 2012