

## **Presentation by Matthew Strachan**

Ladies and gentlemen, I think we're close enough to 2 o'clock to start the last presentation of today. Thank you very much for turning up, we do appreciate it on such a lovely day. Just a quick introduction, I'm Matthew Strachan, I head up the North American desk at Alliance and have done so for the last five years but have a certain amount of experience in other areas prior to that.

Jonathan Bolton here has been with us for just over a year, he joined us back in January last year, he also has considerable experience almost entirely out in the Far East including long stints living in Japan so between us, of those 600 years of investment experience, we can count for a much larger proportion than we'd care to admit to.

The aim of this afternoon's presentation is to give some colour to what we think about when we try to invest, what we're trying to do when we invest your money and how we actually go about investing it. Contrary to what Lesley promised I'm afraid it won't be a particularly combative presentation, it'll be much more sympathetic than that, I don't fancy my chances in a hand to hand against Jonathan but I do fancy my chances of running away from him.

Now, the current news as Shona put before you is filled with stories of strikes, hung Parliaments, runs on currencies, debt crises and IMF loans and strangely my thoughts return to the 1970s.

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Now for those who don't remember them here's a wee reminder. They were a bit of a nightmare, back then we had an energy crisis, a three day week, rampant inflation, prices and incomes policy and the winter of discontent. However, from these troubling times lessons were learned, there were some good things that came out of it and my own particular lesson actually came from one of my favourite TV shows at the time. It was called the Water Margin, it was a sort of Chinese Robin Hood if you would, this was about a gang of outlaws fleeing the outrageous taxes of the Emperor and hiding at the edge of the Water Margin. It was full of proverbs and wonderful parables and the one that struck a chord with me came when our hero was in a market place and desired a particularly fine sword, his wife then came out with the money and purchased what was a princely sword, he was astonished at this and seeing his amazement she replied with the immortal proverb; "the true secret of wealth is a thrifty wife." This I took most seriously in later life, indeed I went to the extent of actually marrying a Scottish Accountant, and not only that, she's a Fifer.

**[SLIDE]**

Anyway, if you really want to learn lessons, it often pays to go back to your roots and as you probably know this company's roots were in lending mortgages to settlers in North America. This is a picture of a genuine property that we lent a mortgage on in Oklahoma, as you can see not all of them went well, in fact before they sexed up the Antiques Roadshow you would have perhaps heard somebody refer to it as a fine example of an early

sub-prime. The last report we received from our agent in the 1940s read – “vacant for several years, one room stolen, should be sold. “ We did.

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Of course at the end of the nineteenth century we were also investing in railroad bonds. This picture shows a Canadian Pacific train crossing Cluny , that’s in Alberta, not the middle of Fife. Formed in 1881, the company completed the Ocean-to-Ocean Railway in 1885 with the first Canadian Trans-Continental train in 1886 leaving Montreal from what was then Dalhousie Station - you may be getting a Scottish connection here. It arrived in Vancouver six days later. Not only do we share a similar length of history with Canadian Pacific or CP as it’s known, it’s almost certain that with an agency in Winnipeg we lent mortgages to farmers settling on Canadian Pacific land adjacent to the tracks. However the real reason for highlighting Canadian Pacific is that it is one of our top ten North American holdings and the reason for owning it has much more to do with the future than the past. Today 70% of Canadian Pacific’s business is west of the Great Lakes, this is a company that faces Asia, whether freighting grain, fertiliser, coal or lumber to Vancouver and then returning with containers of manufactured goods, they are very much tied in to Asian economic expansion. Not only can you ship ten times the volume per gallon of fuel as you can by truck but it takes two days less to cross the Pacific to Vancouver than it does to Los Angeles.

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This is a chart of the return of Canadian Pacific's shares since 2004 and it's against the market. Obviously we show you one that's done better than the market. One of the key reasons though that the total return is stronger is that it includes a dividend which we were talking about earlier this morning. They have a strong and consistent dividend policy and in fact, almost to order, last night announced a 9% increase in their quarterly dividend so timing could not be better.

This is the first great lesson of history, dividends count. In fact it was practically my first day lesson. Dividends, I was told, are the rent payable on shareholders' capital.

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This chart shows the historic dividend yield of the US market from the 1870's so, again, more or less over the lifetime of Alliance Trust. Over this entire period dividends have provided nearly half of your investment return. In fact interestingly, had you invested \$1,000 at the start of the Wall Street crash a decade later it would have fallen in value by more than 40% however, over that same decade you would have received \$560 worth of dividends actually making you better off at the end. As I say, it's not sort of modern parlance in financial circles but dividends really do matter.

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So, so much for history, what about the future? This item here is an iPhone. If you don't own one there's a good chance that your children or more likely your grandchildren do own one. It's a remarkable piece of technology. With this you can surf the internet; you can watch videos; there's an incredible number of applications on it however it does mean that it requires huge amounts of data to be transferred and that brings me to our next stock. Unfortunately, this is the most exciting picture I could find. The company referred to which is also a top ten holding in the US is American Tower. Their business is actually very, very simple. They have built and acquired a network of towers throughout the US, which they then rent out to mobile companies who then place their antenna on them. It's a very stable, very cash generative business.

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We first acquired it back in 2005 and this is how the shares have performed since then, they have almost doubled. Although its growth prospects are still excellent with the required data now and the new Smart phones, there was a time when it's growth prospects were perceived to be even more exciting.

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This completes the chart going backwards. American Tower was considered to be a tech stock back at the peak of the tech bubble and then it was trading at fantastic multiples and this provides us with our second great lesson from history; valuation matters as well. Very high levels of growth normally have

short lives. As long term investors it is often better to be in companies with lower levels, but much more sustainable levels of growth. American Tower will still grow from increased data usage particularly through the use of smart phones but it is already looking for its future growth and they are currently in the final position of actually requiring a significant tower operator in India which brings me rather neatly to Jonathan who can give you some Asian perspectives on investing with Alliance Trust.

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### **Presentation by Jonathan Bolton**

Thank you Matt. I'd really like to start my bit of the presentation with a quote, well actually two quotes which I think are quite pertinent not only because of the title of our talk – Back to the Future – but also because of events that have been unfolding in Europe over recent months and look like they will probably rumble on for some time yet. The first comes from the Spanish American philosopher, George Santayana, who wrote the Reason of Life in 1905 and this was “those who cannot remember the past are condemned to repeat it”, Winston Churchill though came out with one very similar “those that fail to learn from history are doomed to repeat it”. The common theme in both of these and in Matt's talk is that history does tend to repeat itself. Certainly, as an Asian specialist, as I said earlier events in Europe do appear to be following a familiar pattern and I would like to take you back now fourteen years to the build up to the Asian crisis that we had of our own, back in the mid-1990s.

I will focus on the three main protagonists of that crisis in the form of Indonesia, Korea and Thailand and look at the price of those stock markets in the build up and through the crisis itself. The markets actually fell anything between 50% and 75% through that period in 1997 and 1998; quite sharp falls but it was not just the markets that fell, currencies also came under heavy selling pressure, also with declines up to 75%. Putting this in perspective in June of 1997 it cost 25 Thai Baht to buy \$1 but by December it had fallen to 55 Thai Bhat before stabilising around the 38 level. Quite sharp falls, but if you think that was bad have a look at Indonesia and the rupiah; the declines were even sharper. Over the same time frame from June '97 to December '97 the rupiah fell from 2,500 against the dollar to 16,000. Now I actually thought at the time that this was quite good because my family and I had Christmas and New Year in 1997 in Bali and we were actually billed in rupiah but paid later in sterling and the holiday turned out to be substantially cheaper than we originally budgeted so there was one happy person out of that.

Now, the collapse of both the markets and the currencies was the culmination of a number of factors, but behind this there was the issue of debt. These economies, through the first half of the 1990s, all ran consistent current account deficits and the cost of running these deficits built up and built up and eventually became unsustainable. The reason behind this was over-investment, particularly in the property sector and the unsustainable debt levels led to this collapse. Now this is probably beginning to sound familiar in view of what is happening in Europe as I mentioned earlier and you may

begin to see a familiar story. But you will notice from the charts that from 1998 onwards there was a big turn around and the economies all started running surpluses. How did they get to those surpluses from these big deficits? Well, first and foremost, there were massive rescue packages co-ordinated by the IMF. The absolute numbers on their own don't actually look very big in comparison to the numbers that have been bandied around today, but in relative terms these are not insignificant, ranging from 12% of GDP for Thailand to 17% of GDP for Indonesia.

But, of course, money alone was not going to be enough as the economies and corporates in those regions were forced to adopt quite severe austerity and restructuring programmes. The pain did lead to significant gain and the end result was that those economies are now in much, much stronger financial positions with quite significant foreign currency reserves.

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Moving on a decade and it is now the European nations that have the excessive debt levels as can be seen on this chart and was highlighted by Shona earlier this morning. The countries, or should we say corporates with the highest debt levels are on the left while those with the lowest levels are on the right and it is no coincidence that the three tigers that we've been discussing: Thailand, Korea, Indonesia are all on the extreme far right, I think this is an important chart as it is probably no coincidence that it is the economies of the countries on the right that were the most resilient through the recent global financial crises than those on the left hand side.

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Compare the degrees of economic contraction in the crisis in 1997/1998 against the more recent ones of 2008 and 2009, the downturns of Korea and Thailand were not only sharp but prolonged. Now while I don't have the data for Indonesia because it's actually rebased all its figures in 2000, you can probably assume that it was a similar contraction there. If you look at the more recent data there was a much less pronounced downturn, but also shorter, and in fact Indonesia seemed to ignore what was happening in the rest of the world and seemed to avoid a recession completely. The key message is Asia went into this global crisis from a position of strength and weathered the storm comparatively better than the west.

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Of course it's not just economies, we do invest in the stock markets so I'm looking now at each of the three markets in those economies and will start with Korea, I've circled the three major events over the last fifteen years or so, the Asian crisis in 1997/1998, the bursting of the tech bubble of 2000 and the more recent global financial crisis of 2008/2009. You can see that on each occasion the events became more of a correction and a pause before the market moved higher. So after the 1997 crisis the markets have actually performed reasonably well.

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But it's not just the market itself; it's the components and the individual stocks that we need to look at. That is what we are investing in, and I'd like to highlight Samsung Electronics which is one of the largest holdings we have in the Asian portfolio. Just to put this in perspective of the sort of growth you're looking at in the region, Samsung Electronics in 1997 had revenue just shy of \$20 billion but twelve years later in 2009 this had grown to \$121 billion; a six fold increase in revenues. And the reason behind this increase: it is that it is a global leader in three high growth industries; semi-conductors, handsets and in LCDs used for TVs and PCs. So you see that the stock itself has actually performed very, very well and each circled period has again performed just as a correction in the trend higher.

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Indonesia, with again these same three periods circled, again these have just been pauses in the almost constant move higher and in fact although it looked like it corrected quite sharply in the global financial crisis it recovered very rapidly and actually earlier this month hit an all time high again.

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Now one of the stocks we've got in the portfolio is a company called Semen Gresik, this is a cement company, you don't have to be in hi-tech or technology to grow; growing economies need resources and you can see here that Semen Gresik is a leader in the industry in the country. It has a 46% market share in Indonesia for cement and demand for cement has grown at

nearly double that of GDP. So sales in 1997 were only \$90 million dollars but by 2009, it's \$1.5 billion, again a rapid increase in revenues and a rapid appreciation in the share price, again more recently going to ever new highs. So I hope the charts of both Samsung and Semen Gresik help to strengthen the case for long term investment in companies in Asia.

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But I'd like to just finish by touching on one country that has failed to join in the Asian party and this is Japan. Since Japan's own bubble burst in 1990, the stock market has been in almost constant decline. It's had its corrections during the Asian crisis, the tech bubble bursting and the global economic crisis but it's failed to rally so Japan is a market that gives you all the downside but none of the upside. Why? We come back to a familiar story – debt.

During Japan's own high growth period of the 1970s and 1980s it coincided with low levels of public sector debt but as the bubble burst Japan continued to spend more and well in excess of revenues and the debt levels have risen and risen and risen and they're now about 180% of GDP. Now Japan is lucky because it's been able to bully its financial institutions to sell equities and buy Government bonds to help fund this debt but it cannot go on forever. However, the one bright spot is that we don't invest in countries per se, but in the individual companies and even in countries where you have floundering economic growth, floundering stock markets you can still find some gems.

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I've put up here the 20 year price chart of a company called Nidec which makes spindle motors which are used in hard disk drives in PCs, they're small components in PCs but this company has an 85% global market share in this industry so it is a price setter and a price leader. It is also developing new applications for these motors, such as in the auto industry, and its revenue and profits have continued to grow through the economic downturn in Japan. In the year that's just finished it made a record level of profits and you can see the price chart that we have here on Nidec over the last 20 years. Put very simply, whereas over the same timeframe the Japanese market has fallen by 75% this stock has actually increased five fold so while I've managed to end on a positive note rather than all the doom and gloom that was going earlier, I think I will leave that as an opportunity for Matt to sum up rather more eloquently than myself.

### **Summary by Matthew Strachan**

Thank you Jonathan, now if you were concerned by Shona's talk and the mounting levels of debt and moral hazard that we have now you are not alone, or the first, take the words of Herbert Hoover from the 1930s; "at some point the piper has to be paid". That price may well include higher taxes, lower growth and greater government interference but as Jonathan has shown, it may be painful at the start but the rewards are worth it in the end. Hopefully, we have shown you that what we really invest in is companies and we invest in them because over time good companies have consistently demonstrated a positive return to shareholders. This company, your company

may not be the shiniest or sleekest vessel in the harbour but it has been tempered by past storms and our predecessors have ensured that she is a sturdy ship made from solid timbers. Our job now is to ensure that we take her safely through the current financial storms so that you can own a share of the future and that is the end of our formal presentation.