

Temple Bar Investment Trust PLC – Monthly update 30th June 2013

Trust Facts

Launch date: 1926

Wind-up date: None

Year end:
31st December

Dividends paid:
March & September

AGM:
March

Benchmark:
FTSE All-Share

ISA status:
May be held in an ISA

Capital Structure:
Share class No. in issue* Sedol
Ordinary 61,616,818 0882532
*As at 24th July 2013

Debt:
5.5% Debenture Stock 2021 £38m
9.875% Debenture Stock 2017 £25m

Charges:

Management fee: 0.35% per annum based on the value of the investments of the Company.

Ongoing charges: 0.47% (June 2013)

Board of Directors:

John Reeve (Chairman)
Arthur Copple
Richard Jewson
June de Moller
Martin Riley
David Webster

Auditors: Ernst & Young LLP

Investment Manager:
Investec Asset Management Ltd

Registrars: Equiniti Ltd

Savings Scheme Administrator:
Equiniti Financial Services Ltd

Secretary:
Investec Asset Management Ltd

Stockbrokers:
JPMorgan Cazenove

Bankers & Custodian: HSBC Bank Plc

Solicitors: Eversheds

Trust Objective

To provide growth in income and capital to achieve a long term total return greater than the benchmark FTSE All-Share Index, through investment primarily in UK securities. The Company's policy is to invest in a broad spread of securities with typically the majority of the portfolio selected from the constituents of the FTSE 350 Index.

Top ten equity holdings (%) *

GlaxoSmithKline PLC	8.2
HSBC Holdings PLC	7.1
Vodafone Group PLC	6.8
Signet Jewelers Ltd.	6.5
Royal Dutch Shell PLC (CL B)	6.4
Grafton Group PLC	4.8
BT Group PLC	4.5
Unilever PLC	3.4
SIG PLC	3.0
Avon Products Inc.	2.6
	53.3

* % of total assets, including cash

Financial data

Total Assets (£m)	750.92
Share price (p)	1142.00
NAV (p) (ex income, debt at mkt)	1099.12
Premium/(Discount) (%)	3.9
Historic net yield (%)	3.21

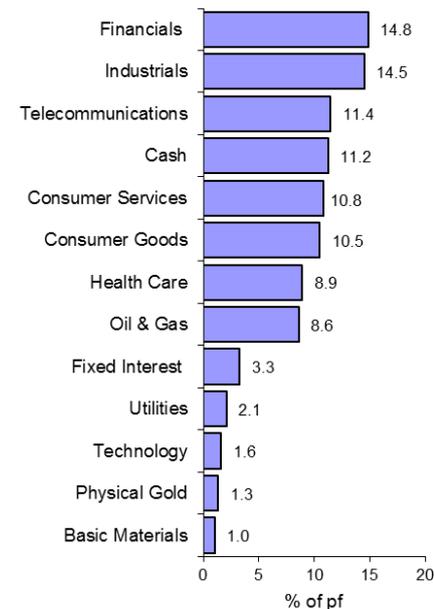
Performance

Share Price % change

	TBIT	All-Share *
1 month	-1.5	-5.3
3 months	3.3	-2.7
1 year	26.7	13.8
3 years	55.2	29.3
5 years	92.7	15.2

* Capital return only

Sector Analysis



NAV total return % change

	TBIT	All-Share *
1 month	-3.6	-5.0
3 months	0.5	-1.7
1 year	30.1	17.9
3 years	69.6	43.5
5 years	109.8	38.2

* Total return

Source: Thomson Datastream, Investec

Dividend History

Type	Amount (p)	Ex date	Pay date
Final	22.00	13-Mar-13	28-Mar-13
Interim	14.65	21-Sep-12	28-Sep-12

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Manager's Commentary

One bonus of marketing to clients is that it provides a perfect environment for one's views to be challenged. Given the current market volatility I thought it was worth covering the areas that seem uppermost in clients' minds currently. As I always explain to clients, I have no crystal ball and therefore cannot forecast the future. What I do instead is consider the many ways the future may pan out and try to construct a portfolio strong enough to navigate through numerous environments.

Here are the most frequent questions asked in the last few months.

Gold has been highly correlated to the growth in Central Banks' Assets. Isn't the gold price on a downward slope to oblivion now that Quantitative Easing (QE) is coming to an end?

It is certainly true that prior to the last few months the gold price had been correlated to QE. However, such relationships can be misleading. After all, the gold price had been strong for over a decade (before QE had even been dreamt of) and weak in recent months, well before 'tapering' became the word of the year.

A number of investors apparently purchased gold on fears of inflation and of it being a natural consequence of QE. We purchased gold as a hedge against markets losing faith in central bankers. This wouldn't necessarily have to occur on the back of inflation; deflation could be just as bad, as could economies slipping back into recession.

It is interesting that Sir Mervyn King's retirement appears to have included everything but an open top bus tour and that Sir Alan Greenspan (who received his honorary Knighthood for 'service to financial stability') is still given plenty of airtime in the FT. Respect for past and present Central bankers seems to be alive and well

despite their confident assertions some years ago that by now quantitative easing would have kick-started a much healthier economic recovery.

Those who believe there is a tight correlation between QE and the price of gold should also consider that 'tapering' is very different from 'reversing'.

We have always questioned whether gold would prove a good hedge for investors in their hour of need. In many investors' eyes it has failed that test in recent weeks. However, we would see the last weeks as a small correction. Gold's opportunity to impress may come if markets fall very significantly.

Do you retain your confidence in Gold shares?

Gold shares have performed very poorly in recent months. The reasons appear to be the same old, same old: poor management and capital allocation, weakening balance sheets, exposure to economies with variable political conditions, increasing costs and a general belief that gold mining companies are simply too complex an investment. Having had little correlation to the gold price while it was strong, the shares were very weak once the gold price weakened.

It is easy to have sympathy with the sellers, but it is difficult to rationally capitulate now. However, we have not added to our existing holdings. The difficulty we have constantly faced with gold shares is how to assess fair value given the significant reliance on the price of gold. A falling gold price can demand a reassessment of fair value, but if the share price remains below fair value, a value manager will always be tempted to make further purchases. We worry that this is a slippery slope, particularly as there is no guarantee that gold shares will pick up on the back of a higher gold price. We have therefore hedged our bets with a purchase of gold bullion to

complement our holding in gold mining shares.

Whatever happened to those wonderful uncorrelated assets? Where did they vanish to in May and June?

A lot of effort has been expended in recent years searching for uncorrelated assets. This is not surprising – market volatility in the last 15 years has encouraged investors to seek a quieter life. A number of investments have been credited with uncorrelated features (or aspirations), but even during the mini-sell off of recent months, these investments have disappointed. This is not really a massive surprise. Uncorrelated assets are typically uncovered in backtests using periods when the asset class was not widely held. Unfortunately, as these assets enter the mainstream and are held by the masses, they appear to lose their uncorrelated powers – if nothing else they are used as a ready source of cash in sell-offs, thus ensuring their own demise.

We understand why investors are eager to find such a perfect asset, but fear that many will be disappointed. It has become a modern marketing-led fund management urge to reduce volatility, but too great a focus on volatility can greatly reduce the chance of a decent return.

Typically equity market cycles are multi-year, equities perform well and then are flat for long periods before performing well. Given US and UK markets are flat over many years, aren't we at the beginning of a new cycle?

If you stand on one foot, squint, and use my son's bendy ruler it is possible to see all sort of trends and cycles over the years. However, it is difficult to take most of them seriously. Often markets are flat for years as a consequence of a preceding bull market which often end in a period of euphoria. The following years are ones of capitulation and revulsion which can lead to equities hitting

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valuation lows thus putting everything in place for a new bull market. While markets have gone nowhere for many years – albeit they are up very strongly compared with where they were five years ago – a stumbling block this time around is that even with my son's special ruler it is impossible to claim that equities are super cheap relative to their history.

Bernanke has explained tapering will only occur if the US economy is strong enough to survive without it. If not, QE will be maintained. With patient on either life support or in recovery aren't equity markets supported all ways?

This is a Goldilocks argument envisaging an economy which is neither too hot nor too cold thus providing a perfect backdrop for the equity market. Two problems here: firstly, the Goldilocks scenario probably only covers a very tight range of outcomes and secondly it assumes that if an analyst can correctly forecast the path of the economy, then it is just a small jump to correctly forecasting equity market returns. As we have said a number of times, history suggest that the path of corporate profitability and the current level of valuations are far more important factors.

Surely one only need worry for real when QE begins to be withdrawn? Really, did you watch the last couple of weeks? Markets love to discount the future and will not be waiting to see Mr Bernanke's deal slip to sell a trillion dollars worth of treasuries before acting. Instead, the competition for those who enjoy market timing will be to work out when the market is going to start worrying about the potential for the reversal of QE.

The other issue that came out of meetings were two very consensual points: that emerging market economic growth will continue to be higher than western economic growth and that Diageo and other consumer staples are very expensive.

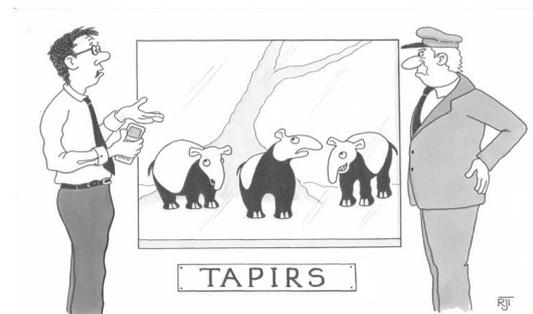
The dominance of emerging economies is not considered a forecast by many, more a statement of the bleedin' obvious. But is this as straightforward as it seems? Probably not. Perhaps of most relevance, the Asian emerging economies, in particular, are very reliant on China, not the most transparent of economies, as a driver of economic growth. We have always believed it is dangerous to buy stocks simply on the basis of underlying economic forecasts. This is most important to bear in mind when those forecasts are most embedded in share prices – such as now, in particular with consumer staples companies.

This brings us nicely, but a touch paradoxically on to the second point. As we have written before, it is almost everyone's 'perfect' stock, being lauded for its quality management, cashflow, brands, economic spread, earnings visibility, geographical spread and so on. However, what holds many investors back is the shares' rating. At a p/e of around 18 only the most dedicated buyers of quality franchise stocks appear to believe the shares are fantastically cheap – and the same can be said for a number of Diageo's peers.

Certainly Diageo's long term rating is high relative to its history, but it is easy to see what encourages the bulls. If one believes Diageo's long term earnings power then an investor is buying into a current p/e of approximately 18 for the year ended June 2013. Although this is optically high, the reciprocal generates an earnings yield in excess of 5%. Admittedly only about 50% of this will be returned in cash via in dividend, but the bull would see the earnings and dividend stream growing strongly (and of course in a straight line) and this would compare admirably with a whole host of assets from corporate bonds to conventional government bonds and even index-linked bonds. If this argument is followed to its logical conclusion then it is fairly simple to justify a p/e of 30 or even 40, particularly if bond yields remain low.

Our concern would be twofold. Firstly, by comparing the shares of consumer staples with bond yields, investors are employing a straw man approach. With bond yields very close to multi-hundred year lows, it is unsurprising to find many alternative assets are quite attractive in comparison. While we would not disagree with investors who are switching out of a 40 year gilt into a portfolio of consumer staples, this hurdle seems in appropriately low for an equity investor. Secondly, as always we would warn against extrapolating current earnings trends too far into the future. Historically, it has not been wise to pay too high a price for equities because the subsequent earnings stream often fails to justify the original valuation.

“I was on the phone talking about tapering and the next thing I know they're all backing away from the glass!”



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