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Edinburgh Worldwide Investment Trust plc

Mark Urquhart is interviewed by Robert O’Riordan

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RO’R: Mark, we are sitting here in April 09. This is your sixth year of managing Edinburgh Worldwide. What are your first impressions of the year behind you?

MU: Well, it’s fairly been a pretty extraordinary year in many respects with the stock market events. There have been things which haven’t been seen for decades long really in terms of some of the moves and gyrations. I think if we put ourselves back 12 or 18 months we had a fairly strong view that the world was changing and the sort of shape of global wealth and GDP and economic growth was changing and I think that has probably been exacerbated by the events of the last 12 or 18 months. Most of the problems and most of the bombs have occurred in the well established countries in the financial systems. Obviously in our own country and in America and in Switzerland and in places of these and its going to be quite a long hard road to recovery in those economies that are most affected. From an EWIT point of view we are glad that we can avoid some of those areas and can focus on the areas where we think there is proper growth and genuine growth in the world going forward.

RO'R: So you'd see it as a one-off historic 100 year shock. Were you geared when it all happened?

MU: Yes. I think if we go back through the portfolio hasn't changed a great deal over the last twelve months. The performance has gyrated wildly and I think if we dissect the crisis of the original credit crisis back in August 2007 we had no financials, we were focused on areas of growth and we felt fairly unaffected by it. Going forward a year in to the late summer of 2008, and obviously lots of people point to the Lehman's bankruptcy as the moment when the world changed and for two or three months after that everything that was perceived to be risky was sold wildly and the Trust had a very difficult period then, but we felt very strongly that many of those moves were people acting in a knee jerk fashion, they were seeing things through the prism of what had gone in the previous 10 or 20 years and they weren't actually thinking about some of the fundamentals. So the gearing hurt us in that period undoubtedly but in the subsequent four, five, six months where things have, I think, returned to a kind of normality, that gearing has helped on the upside, so we have recovered quite a lot of those large falls. We always say don't judge us on three months, six months, it's a three, four, five year view and on that sort of length of time we are reasonably happy with where we are and having sort of survived the last 12 or 18 months.

RO'R: You must have been tempted to ditch some of your large holdings and maybe buy some of the banks as they were crashing? Or did you just sit tight and wait for the dust to settle? How did you actually go about managing the portfolio in those months?

MU: I think it's a good question. Behavioural aspects of living through and trying to manage money through something like that are quite interesting because as you know, to see share prices declining by 10, 12, 15% in a day you have to be pretty sure in your beliefs that you are not wrong, that the market is behaving and that the temptation is to become one of the herd. We have bought one or two financial institutions. We bought shares in UBS and that so far hasn't been a happy investment - we bought that in December 2007/January 2008, round about that time, after the first lurch down. Probably the best thing I can say about that is seeing how quickly that's unravelled and the complexities helped us hold back and think very long and hard about some of the others. More recently we have bought shares in Banco Santander which we do think is a survivor. It has a strong capital base and has been acquiring some very distressed assets but, in general for us, the difficulty with financials is pinning down competitive advantage. The whole crisis arguably was caused by people replicating each other, replicating products - "oh you are doing that, I'll do that as well" - and trying to piggyback on ideas. Banks have commodity products at the end of the day, they take deposits and they sell loans and more or less anyone can do that. At the moment you could say it is a bit different because you need some capital to be able to do it and that is pretty scarce in many of these institutions. What we have been doing in the financial sphere here recently is

buying some shares in Berkshire Hathaway, which we don't need to introduce but its share price has been very weak on some worries on AIG type unravelling which we think are very misplaced and a collection of businesses and deals that Warren Buffet has done in the last 12 or 18 months getting 12 – 15% on preference shares which we think are very interesting from a long term point of view so it was a good opportunity to acquire some shares there.

RO'R: That's quite symbolic. You are buying; you are being greedy when everyone else is fearful – as he says.

MU: Absolutely, and he himself is doing the same thing and you are never going to catch the bottom perfectly on these things but you can hopefully put the probabilities in your favour and average down and get a good entry price that you will look back on in three, four, five years time when things have moved on and hopefully the share price will be substantially higher.

RO'R: So, you really manage this portfolio looking at the companies rather than looking at the markets. You've got 30 or so stocks. You must by now be getting a pretty good feel of how deep this recession is within those companies. What are companies' earnings looking like as they come in over the last few months – is this succour or?

MU: I think that's one of the beauties of the remit we have, of being able to buy anything, anywhere in the world. It's around 40 stocks we have at the moment – it's gone up a little and that is because there have been opportunities. Many of those companies are actually delivering pretty good growth. The likes of Amazon, one of our largest holdings, is growing at 20% - 25% as more and more people shop on-line – the secular move there and price comparisons in a recession – you can get absolute clarity on who has got the lowest price and then you click and buy it. That sort of power comes through. Of course there are some more cyclical names in there – in some of the mining equipment companies we have seen some downturns there but we think these are very good long-term businesses and these aren't surprises to the market. But on the whole we are able to find we think still a good number of companies that have really interesting secular growth opportunities. Just the other day Vestas had outstanding results in wind turbines. That whole alternative energy area is an area of the market that has seen wild gyrations in share price but actually operationally the businesses have carried on doing pretty well and they have now got the added kicker of course of lots of government stimulus money coming in, ploughing in to that area and it is an easy way for governments to actually spend money pretty quickly.

RO'R: So turnover has stayed low obviously?

MU: Yes, in the last six months we haven't done much. In the year to October 2008 it was a bit higher than usual, but over the four or five years previous we have been

around the high teens, low twenties and that matches our five year plus holding period. We have only I think, in the six months since October, we have bought shares in Berkshire Hathaway as I said and we have bought shares in a couple of Chinese names – one called New Oriental Education which is an English language school company in China and its something which Wanyi Yao, one of our Chinese researchers, is very interested in and passionate about. Chinese parents who are still growing richer, Chinese incomes are still going up absolutely want their children to have the best and they pay for English language outside that. And the other is called BYD; a battery technology company which we think is very exciting.

RO'R: BYD standing for?

MU: “Build Your Dreams”. It has come from nowhere in 10 years to dominate the mobile handset battery. Your Nokia phone will have a BYD battery on it and it has got superior technology in terms of keeping the charge. But the real excitement is in electric cars where they seem to have made a large breakthrough. The issue historically there has been how can you charge the car quickly and how far can you go on that charge and they seem to have managed to better both of those sides of the equation in that you can charge these things in 5 or 10 minutes and you can drive 150 to 200 miles and most journeys are far less than that.

RO'S: So, it sounds a little bit like here we are in April and then six months ago in October, November everybody was saying de-coupling is dead and that was all wrong, it was a bubble driven by resources being consumed by China who can no longer export. I know you can't have top down layers put on to you management style, but it sounds to me like in your mind you might think that the argument for de-coupling is actually stronger.

MU: Absolutely. Well I think the people who said that were the people sitting in London and Edinburgh and New York and there was an arrogance to it, saying how can China possibly grow if we are not consuming their stuff. It's the old sun never setting on the British Empire attitude, that we are the be all and end all. But actually Chinese retail sales through the last twelve to eighteen months haven't really varied. China has a vibrant domestic economy. It is bigger than Germany now. It will soon overtake Japan. The Chinese auto market is the largest in the world now, it has overtaken America and I very much doubt we will ever see that relationship move the other way again certainly in the next five or ten years. I think the view from Beijing and from Mumbai and from Sao Paolo of the events of the last 12 or 18 months was pretty different. These are economies whose macro-economic outlook is significantly better, whose monetary funding and fiscal positions are eons away from what we face and if you arrived from Mars today and you looked at the balance sheets of the UK and America you would struggle to think that those are developed nations and are G7.

RO'R: Ironic really. So here we are, we have had this huge, maybe once in a century crisis, but some companies and some countries appear, although their share prices are down, appear to be strong although there have been rallies in a lot of prices. Have you managed to find any British companies you like at all, talking of the Empire and so on, where consumer spending hasn't completely disappeared here?

MU: No, we don't have anything in the UK at the moment and it's not for lack of looking. I think there are a few interesting ideas. Things like Experian who do the credit scoring we think might be interesting but it's valuation there. Autonomy which is the technology search company but again that is quite well known by the market so we don't feel any compunction to own anything in Britain. I think its going to be a long hard grind for the UK economy, consumers need to delever and government finances are going to take several years to sort out I think.

RO'R: So, in currency terms then you don't hedge anything and it looks to me like if we are as British people holding these overseas assets shareholders shouldn't be encouraging you to hedge at all.

MU: We don't hedge. There are so many moving parts with currencies. If I invested in a Korean manufacturer of electronic goods what currency movements are going on there. The yen won has moved 40/50% in the last twelve months. And then bringing it back to sterling you are adding another layer of complexity. I think there is a real risk that one could really damage NAV by that. We are great believers that over 3 or 5 years currencies will come out in the wash and that the price of a country the markets will rectify that. It's not something that I think we are experts in and I think we could damage NAV quite substantially.

RO'R: So a Devil's Advocate question – I was looking at some figures the other day. You have had a very strong recovery in your share price. If people had been bold enough to go into the market just as Warren Buffet says and be greedy when everybody was fearful they would have done very well over the short term. But doesn't this rally we are experiencing at the moment make you feel a little bit nervous and tempted to possibly find a little bit of shelter from the ructions and the after waves of the shock?

MU: I think that's a case of anchoring isn't it to a very potentially artificially low point – you could say from that point to there. But if you look over nine months or twelve months or fifteen months many of these share prices are still quite well below where they are whereas earnings are higher, sales are still going up, so the valuation we are paying for these shares is actually substantially lower. But if we were worried about the macro-economic outlook in every country then I think your question would be more valid but we still think there are substantial areas that can and will grow and the premium that those growth companies should be afforded in tougher economic times we think is quite interesting, you might see substantial valuation moves to reflect the scarcity of that growth.

RO'R: Now you mentioned in America, Amazon. Obviously it's a cut price retailer and it's a low cost operator and it's convenient for customers and it's wonderfully cash generative. Have you found any other new businesses in America which you have bought or are there any other businesses in America which you have sold from your portfolio?

MU: We haven't sold anything in the last six months or so. Over a year, 18 months we have been buying some shares in Monsanto which is the seed science and improves agricultural productivity and is heavily involved in the GM area. That again was a business we liked but we felt the share price was reflecting many of its attributes. It fell from roughly \$150 to \$80 in very short shrift over the summer last year. Some of the agricultural worries started to appear. It hasn't missed a heartbeat in terms of what it has been doing in sales.

Over longer periods of time we have been reducing exposure to the US consumer so we sold our holdings in Wolseley, UK listed with a large building materials company, we sold our holdings in Poulty Homes, we sold our holdings in Carnival, the cruising company, so we think some of those more directly exposed to the Anglo Saxon consumer just face a tougher time. I think some of the snapback that people are looking for just won't occur because the consumption backdrop was so easy for so long with lots of people using loans to borrow consumption from the future and I think that is going to be somewhat harder.

RO'R: On the other hand you had big holdings a year ago I remember in CVRD, an iron ore producer in Brazil, and nickel as well I think too, and you had a very large holding in Petrobras another Brazilian oil company. Resources prices have fallen quite a bit. Have you made any changes to the size of those holdings at all – they must be smaller holdings obviously but are they still holdings of a high conviction?

MU: Yes, they are both still in the portfolio – we cut both back in early 2008, CVRD from about 7.5% to about 5% and then it subsequently fell during the crisis and has rallied somewhat since. The story for both of those we think is fairly straightforward. It's that they have the resources that the rest of us need. Petrobras is finding oil for fun off the coast of Brazil. Every time it drills a well it hits a bonanza at the moment. It won't have escaped your notice that elsewhere that's not the case. BP and Shell have both reported numbers this week and yet again they are struggling to replace their reserves. Of course near term some demand has disappeared from the oil market but we think longer term that the prices of \$50, \$60, \$70 oil are sensible starting points in constructing new models and you are not far off the bottom end of that range at that moment with the bounce back. The period above \$100 and up to \$147 was a very brief period of a speculative bubble. So on a longer term view the range of oil prices where we are it's not far from the long-term price charts. From an energy security point of view Petrobras in Brazil is a very

friendly place for America to do business with where the problems are probably most acute and I think America will reduce its dependence on oil over long periods of time but that does take 15 or 20 years or so. The other interesting thing is certainly in the case of CVRD that many of the spivier smaller start-up companies have completely disappeared. Their financing has gone. The idea of setting up an AIM or on the Aussie stock market and going off to prospect, no-one is going to fund that these days and it is actually the guys who are standing and of course the stimulus packages that we are seeing around the world should have a substantial impact on mineral demand. Many of these are commodity heavy infrastructure projects and we are starting to see that in some of the Chinese numbers, certainly for imports for iron ore etc.

RO'R: So it's a healthier world in some ways. Asset prices are down; there has been some cleansing of the financial system which will go on for a while. How about bonds then? EWIT over the last six years has mainly been an equity vehicle, I know you've had some bond holdings, but yields have gone way up in a number of bonds. Are you tempted to look at the bond market in any detail? How would you as an equity investor in a global equity team in Baillie Gifford go about doing that?

MU: We have one bond at the moment which is the catastrophe bond Bay Haven where we are basically insuring against some catastrophes and that was a very special situation where we get an 18% per annum coupon over three years and we need three catastrophes to wipe out the capital and we are two years in and there have been none so far. Luckily stock market crashes don't count for that sort of thing.

Yes, there may be one or two opportunities. The difficulty I have is actually knowing where you are in the capital structure. In a lot of these bonds they appear to be yielding a heck of a lot. Actually the underlying structure, you may not get your capital back.

RO'R: You might be wiped out.

MU: Exactly, the promise of holding it to redemption and certainly, in some of the financial ones which are some of the most distressed, that appears to be the case - the tier one, the tier two and all these new types of capital structure. That's not to say there might not be one or two opportunities, but I am pretty straightforward. I like the fact that I can buy an equity and I can sell it when I want to because the other feature of the bond market is just the huge difficulty in actually dealing. You have an idea or you see a bond on the screen at 30 and you try to deal and the actual price is 80, so the pricing transparency and the market clearing mechanism is pretty broken there. I think it will be slowly mended but it's a tricky market. I think when you have got such attractive equity opportunities you don't need to get too greedy.

RO'R: So you are sticking to your last?

MU: Yes.

RO'R: Thank you very much Mark.

MU: OK, my pleasure.