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Scottish Mortgage Investment Trust PLC

James Anderson is interviewed by Robert O’Riordan

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Robert O’Riordan: James, one question I find quite hard, but we have had a lot of questions from shareholders about it, is about gearing. I know hindsight is a wonderful thing, but the question a lot of people ask is has your attitude to gearing changed and also do you have any thoughts about being geared this time a year ago to the extent that you were?

James Anderson: Well, my attitude has changed. My attitude has become more positive. When you see assets fall to low prices and prices well below what is justified by the prospects of the assets, the equities or in some cases bonds, below what you think are the long term returns you can gain from them, it is only intelligent to become more optimistic about the level of gearing one has rather than less optimistic, so I stress that whilst we will always keep our borrowings within a prudent level, I might point out that we still do have a

AAA rating, a real AAA rating rather than some of the rather questionable ones going about over the last few years, our health financially has never been in doubt. So, I think that the long run contention that we should strategically remain geared is very much intact if not stronger than it was before.

I am not sure thinking back 12 months. As you say Robert, hindsight is a very, very wonderful beast and I am not sure it is appropriate to look back in those terms to be honest; I think we should concentrate on looking forward. But I will say, as I hope I have always said, that for a moment, to be slightly similar to some of our dear politicians, I do regret it if I had had perfect hindsight, foresight in hindsight one might almost say. I think that it's very, very strange to think that the entire world economy was temporarily thrown into a complete halt because of problems in the Western financial system, problems which had long been on the agenda. Would I be rewinding the tape, be willing to take the bet that the world would freeze in the way that it did? I am sorry but I still have some doubts as to whether that was a bet that one should have been making at that point. So I am sorry that it turned out not to have been the correct element, but I do not think we were adopting an unconsidered or imprudent policy.

Robert O'Riordan: Have you made a lot of changes to the portfolio and/or has your view of the world changed? Obviously the events will have an impact on you but its companies you focus on to the greatest extent of course.

James Anderson: It is certainly companies that we focus on. I think in that light what one is trying to do is fundamentally two tasks above all. The first one, which is unchanged and I hope will be unchanged for the next 100 years, is that we should assess the value of companies by the long run cash flows and free cash flows they can generate. Now in that light, as you will know only too well Robert but I think it is worth stressing, what happens in any one, six or twelve month period is frankly exaggerated in its importance by markets. The long run value of the company does not come from any one year's earnings. In fact for the medium company in which we invest, probably only about 10% or 12% of the value comes from the next five years of earnings or free cash flow generation, partly because we purchase companies that are investing for the future. So that element in the way we think about our job as both being company orientated and being very long term has not changed one iota. The part that has changed is that we are very much looking for companies who actually are

strengthened by what is going on at the moment rather than weakened and secondly I would suggest to you – I am sure we will come back to it later – but I would suggest to you that it is very evident that many emerging markets are thriving despite the turmoil in what used to be called the “developed world”, so I think the process of economic geography has stepped changed in the course of the last twelve months as well.

Robert O’Riordan: So your top 10 or 20 holdings are very much the same companies? You have added to some, reduced some I expect. One or two may have gone but the composition generally is much the same? You have stuck with the companies?

James Anderson: The composition is generally very similar. In stock market terms I would point out to you that most of the emerging markets have enjoyed quite splendid rallies rather stronger than the mere bounce backs we were referring to in the developed markets so far this year, and I think that is because their economies have actually decoupled from the West in an even more impressive manner than I would have hoped for 12 months ago given again this tough road test that we have all been through.

Equally, it seems to me to be fairly self-evident that India has actually progressed through the economic crisis really in pretty good shape, perhaps rather better shape than we had anticipated. The same would go for Brazil. You mentioned earlier are there ones, are there changes in the portfolio that may have happened. One where I will apologise and say sorry for in this context, to get back to the political comparison, is that I think we were overly optimistic about how Russia would fare throughout this crisis. Now, I think that is for a slightly different reason than most people would have hypothesised which is that many of the oligarchs, for very strange emotional reasons, found themselves over-gearred, over-borrowed and couldn’t survive the crisis. I don’t think the political system has coped very well with the degree of change that has been opening but I really would stress that to have been right broadly speaking about three of those four major economies, so to be basically feeling even more hopeful about the progress of China, of Brazil and of India and just more pessimistic about one, in the shape of Russia, doesn’t seem to me to be that bad an outcome.

Just perhaps to sum that up in both stock market and economic terms, you will probably have seen recently that it now appears that emerging markets will account for over half of world GDP this year which is bringing forward that expected development by about half a dozen

years so this whole process again seems to have accelerated a change that both we believed was going to happen and that is of profound importance to the way that we should all invest.

Robert O’Riordan: OK. So, a Devil’s Advocate question here is that maybe you can see that the Brazilian stock market capitalisation is now bigger than many Western markets’ capitalisation, the same obviously in China. But your view is now possibly becoming a consensual view which was something which I remember made you a bit nervous a while back. Do these same feelings come to the front of your mind and how, as a fund manager investing for the long term with companies, do you cope with feelings like that? Do you think it is consensual is the first question.

James Anderson: I think that is a very interesting question and one that I will probably need to come back to in the years ahead Robert but I think I would at the moment point to two differentials between our view and what might be thought to be dangerously consensus driven.

The first one is that we feel that although many people express such views and tend to want to say that they believe emerging markets will be increasingly important but if you look at their portfolio, that’s not really the views they are expressing. I would claim that the distinctiveness of our portfolio is probably every bit as great now as compared with that of most of our esteemed competitors. I don’t see many major international trusts who have ventured far beyond the staples of the Anglo American world.

Secondly, and I think this is important to add before you challenge me with another question, I would suggest to you that within the stocks that we own in that very nebulous and wide ranging description of emerging markets, we are seeing a quite separate process take place again even quicker than expected, and again because of the economic ructions that we have been having to endure and that is that we are seeing more and more ideas, more and more fascinating companies, more and more appealing valuations in companies that are exposed to domestic growth of emerging markets and I would stress again that within that generality of emerging markets we think this is acutely and hugely important, really more so in China than anywhere else. We really do see evidence that domestic consumption, domestic property, domestic lending as well as the magnificent infrastructure that they are creating presents more and more stock opportunities. So to go back, we have for instance bought exposure in

the course of the last year in such companies as Baidu which is, as you will know, effectively the Chinese equivalent of Google, China Merchants Bank which seems to us to be the bank that is most suited to that renewal after several thousand years of domestic consumer growth, Tencent which is an instant messaging and gaming company and we are trying ever more so to try and attune ourselves to that domestic source of growth. So I think it has moved quite a long way from just being the big exporting and commodity companies that were so much more consensus driven in recent years and so much more likely to be found in other peoples' portfolios even if not to the scale that we do.

Robert O’Riordan: One question which will help us talking to shareholders about Scottish Mortgage is how do we convince Scottish Mortgage shareholders that the time horizon you are judged on is five years, that that’s what the Board is looking at. We need shareholders to be aware that it is not the six months; it’s not the one year. I know the way we report to the Stock Exchange every year maybe doesn’t help but how can we really convince shareholders that the five year performance is what counts? People are becoming or are nervous – how do we reassure them?

James Anderson: Well, I’d say, that we really do need to be judged as I was saying by actions rather than just words and I would put that on two different levels. The first level I would put it on is as we have been discussing in some depth the underlying contentions and the exhibition of those contentions in terms of what we own suggests that we haven’t changed our views and the portfolio remains whether it be in having some exposure to gearing or whether it be more importantly in terms of that thesis about change in the world both in emerging markets and technological change are intact. So I don’t think that we have shown the inclination to run away in the course of what is going on and frankly that was quite a big test. It’s not easy when people are panicking to try and take that sort of view but I stress that that is what our actions would demonstrate. But I would also stress and hope this is of some reassurance to shareholders in the spirit you will take it that we take our commitments and our efforts extremely seriously over that rolling five year period. Of course there will always be slight oddities in terms of periods coming out and in which can distort it but I really do stress to you Robert, and to anybody listening, that if we were to find ourselves performing badly over prolonged periods of time, such as that rolling five year period, we know where our responsibilities lie.

Robert O’Riordan: We have got to be determinedly long term and make sure everybody knows that our view is the five year view.

James Anderson: I think that is absolutely right but it seems to me a frivolous exaggeration of the moment. Scottish Mortgage as you know is just coming up to its 100th birthday and when I look back at some of the challenges well described and otherwise in the annual report over those previous 99 years I think that we are being self-indulgent if we believe that the last twelve months is really the severest challenge that we have ever faced. If you look back to the annual report for 1960, if you look back to the annual report for 1929/30, even if you look back to the splendidly vociferous phrases used in the annual report for 1975 and the Trotskyite conspiracies that were thought to inhabit the British investment world, I think you might get a somewhat better context for thinking about it. We have endured 99 years and, what is it now, 358 days I think it is. I would hope that those long experiences teach us not to get too preoccupied with the moment.

Robert O’Riordan: So it’s perspective.

James Anderson: Perspective.