Athelney Trust plc

Strategic Report

Chairman's Statement and Business Review

I enclose the results for the year ended 31 December 2015. The salient points are as follows:

- The total return, which is the increase in NAV plus the dividend, is 10.4 per cent (31 December 2014: 6.5 per cent)
- Audited Net Asset Value ("NAV") was 245p per share (31 December 2014: 228p) an increase of 7.5 per cent.
- Revenue return per ordinary share was 9.3p (31 December 2014: 7.8p).
- Recommended final dividend of 7.9p per share (2014: 6.7p), an increase of 17.9 per cent.

Review of 2015

Live long and prosper. – Dr Spock, played by Leonard Nimoy (1931-2015).

When someone says that it is not about the money, it's about the money. – H. L. Mencken

If a second chamber dissents from the first, it is mischievous. If it agrees, it is superfluous – Abbé Sieyès (1748-1836).

The problem with Barack Obama is that all too frequently he is totally immersed in his own production of Hamlet – heard on BBC World Service.

The year 2015 had better be dubbed *the year of shocks and surprises* – in no particular order:-

The British steel crisis, partly self-inflicted by the failure to diversify into stainless and other special steels (as in Sweden) and sheet steel (Germany) and partly because of slab steel being dumped on international markets by Russia, China and Belarus.

- The Volkswagen emissions scandal.
- China slowing down.
- The crash in Shanghai and Shenzhen stock markets.
- Greece, at one point, on the verge of being ejected from the euro.
- Brent crude oil slipping to below $40 per barrel.
- Base metals plunging by 20-35%.
- An emerging markets debt problem following the credit binge (in U.S. dollars).
- The migration crisis.
- Three terrorist attacks in Paris (how I hate the BBC using the word *militant* instead of terrorist).
- Unpredicted General Election results in the U.K. and Spain.
- More than enough tornadoes, hurricanes, fires and floods to shake a stick at.

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The upshot in stock market terms was surprisingly good with one major exception, as you will see. In major markets, Tokyo and Shanghai rose by 8.8 and 10.1 per cent respectively, New York was unchanged but London, with its index crammed with oil, gas, mining and bank shares, fell by 3.8 per cent. Among smaller markets, Hungary, Argentina and Denmark went up by 44.4, 36.4 and 34.2 per cent respectively whereas Columbia, Greece and Egypt fell by 26.7, 25.3 and 23.9 per cent. The interesting thing about New York is that, if you had failed to buy the FANGs (Facebook, Amazon, Netflix and Google) then your performance would be much the poorer for it. Back to London, with small companies yet again outperforming blue chips. The FTSE Small Cap, Fledgling and AIM All-share indices rose by 6.2, 12.7 and 4.7 per cent respectively whereas the NAV of Athelney Trust moved ahead by a decent 10.4 per cent in terms of total return (i.e. growth in NAV plus dividend).

The Scottish government has rejected an attempt by Donald Trump to defeat the installation of a wind farm because, he says, it would have spoiled the view from his Aberdeenshire golf course. Edinburgh must now move ahead with all speed to enrich his horizons with, say, a Mexican restaurant and, er, a mosque.

So the Federal Reserve Bank finally achieved lift-off with a 0.25 per cent increase at the last possible moment in 2015. Three months before that, it declined the opportunity to raise rates because *recent global developments and financial developments may restrain economic activity.* And yet the world since September did not become any more peaceful. Commodity prices tumbled: iron ore fell below $40 per metric ton, an all-time low, and Brent crude oil ended the year near a seven-year low. The reason to raise rates lay with the real economy. US unemployment fell consistently, close to full employment at 5 per cent. Core inflation hit 2 per cent, bang in line with the Fed's target. Big companies like Pfizer and Du Pont still felt confident enough to pursue transformational deals. Let the market bicker about whether asset prices are too high, about right or still cheap: the Federal Reserve has spoken.

October's meeting of the Public Administration Select Committee had as its guest the kaleidoscopically flamboyant Camila Batmanghelidjh, the former CEO of Kids Company, who looked more than ever like a pile of Aladdin's laundry. For over three hours, she seemed incapable of giving a straight answer to the charges that the charity was financially mismanaged and that there had been allegations of sexual abuse. This time Bernard Jenkin MP had gone too far, On what basis have you decided that this was a failing charity *she inquired?* It's gone bust, *was the reply*.

More shocks and surprises (see above) in the foreign exchange (FX) market: January's *de-pegging* of the Swiss franc, August's renminbi devaluation and December's euro correction were all the result of central bank action, which left currency traders exhausted and distinctly out of pocket. The Swiss National Bank set the tone by abandoning the floor set for the Swiss exchange rate against the euro only three days after calling it the *cornerstone* of its policy. Result: swings of up to 40 per cent against the franc's main currency rivals: second result, the local economy has stalled as have exports. If the SNB chose surprise, the People's Bank of China appears to have stumbled into its August currency shock. Days before the move, investors had digested unexpectedly soft trade data which raised questions about a possible hard landing for China's economy. Arguably, this move (only 3 per cent, it is true) was more important in that it hit global markets and stopped the US raising interest rates in September. December's euro correction showed again the effects of poor central bank communication. Investors had expected more QE and bet against the euro: when the ECB did not deliver, the euro rose by 4.5 per cent. Every little word in central bank texts is pored over for meaning which is not at all a healthy state of affairs.

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The Bank of Japan is giving its employees a pay rise of 0.2 per cent. It has been so long since the last rise that some long-term employees had to ask what the term in Japanese was – they had never heard it before………

From Chile to China, the sense that an once-in-a-lifetime raw materials boom has come to an end is haunting global commodities markets. On 9 December, the shares of mining and oil giants took a further battering as iron ore and oil fell below £40 per ton and barrel respectively. On the same day, Anglo-American said it would shed up to 85,000 jobs, shrink its business by 60 per cent and scrap the dividend until at least the end of 2016. Iron ore is certainly a problem area with the world having a third more steel-making capacity than is actually needed. China produces roughly half of global annual output of 1.6 billion tons a year with the largest 100 firms in that country having lost an estimated $11 billion during the first ten months of 2015. Unwanted product is finding its way onto global markets, even at a loss to the producer. China exported 200 million tons in the first 10 months of the year, which is more than the total production of any country save Japan. Excess supply on this scale will not disappear overnight and yet, and yet….. Forced liquidation by exchange traded funds (a sophisticated version of tracker unit trusts) and hedge funds having sold huge quantities of commodities which they do not own have massively distorted market prices. China's volume of copper and iron ore imports actually rose in November and copper inventories were down to only 13 days' supply in Chinese warehouses. Recovery beckons although only contrarians will be taking note and seeking to buy into undervalued mining and oil shares.

Best TV interview of the year?

Andrew Neil

Given Labour's response to the issue of national security and Syria, do you have confidence in Jeremy Corbyn?

John Mann, Labour MP

I have total confidence in Hilary Benn.

Andrew Neil

So you have confidence in your foreign affairs spokesman Hilary Benn but not in your leader Jeremy Corbyn?

John Mann

Jeremy has confidence in Hilary as well.

Andrew Neil

But you can't bring yourself to say you have confidence in Jeremy Corbyn.

John Mann

I have huge confidence in Jeremy allowing Hilary to lead on Syria.

You couldn't make it up, could you?

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Over the past year, China has put its mark on the world economy as never before. Not only did its economic slowdown inflict pain on energy and commodities markets, it acted as a serious restraint on the rest of the developing world and held back global economic growth. The renminbi spent the early part of the year pegged to the rocketing dollar at the same time as Japan was deliberately devaluing its yen and other Far East currencies were sliding. China's effective exchange rate has risen by 30 per cent since 2012. At the same time, wages have been rising fast as China runs out of cheap labour from the villages. The effect has been a huge squeeze on profit margins with corporate profits falling month by month. The carnage has been terrible with East Heavy Industry and Mingde Heavy Industry (both shipbuilding) going bust and state giant Sinosteel defaulting. It is not all bad news, though, with the services sector increasing from 44 per cent of GDP in 2010 to 51 per cent now so that the *new economy* is doing well as the country abandons its obsolete model and shifts up the development ladder. Figures for GDP are, at best, opaque but a decent guess would be that economic growth is running at about 5 per cent at the moment. Rumours abound about the state of politics with Premier Li Keqiang promoting economic reform so as to centralize power in his hands while the old guard still controls much of the Central Committee. Let us all hope that he is not shoved aside by the old guard: the stability of the renminbi and global markets rests on such thin ice.

De La Rue's foreign banknotes are collected all over the world but, shame, the venerable security printer's shares are not, having fallen by 50 per cent over the past two years or so and slipped 7 per cent on the interim results published in December. The Company has won Banknote of the Year for seven out of the last eight years and stands a good chance this year with its jolly 'parrot and president' 100 dalasi note for Gambia, a serious Queen on the Canada $20 note and the Argentina 50 peso note with the inscription next to a map of the Falklands, Islas Malvinas. *Perhaps a left-field (baseball) off-the-wall (squash) suggestion for 2016.*

Brent crude was $115 per barrel in July, 2014 and $55.60 at the end of that year: it has now closed 2015 at an amazing $36.69. How much lower can it go? No idea, but I cannot leave the subject without mentioning *World Oil Outlook* published by OPEC towards the end of the year. World demand for oil and gas will continue to rise, says the document, for another 25 years so that fossil fuels will make up 78 per cent of global energy in 2040, barely less than today. There will be no meaningful advances in technology with rival fuels disappointing after costing a great deal of money to develop so that the old energy order will be preserved. Emissions of CO^2 will carry on rising as if nothing had been agreed in a solemn and binding accord by 190 countries at the Paris climate summit. Global demand for oil will rise by 18m barrels a day to 110m in 2040. The document swats aside electric vehicles with impatience. The world's fleet of cars will rise from 1bn to 2.1bn over the next 25 years but 94 per cent will still run on petrol and diesel. This is a brave call with Apple, Google, Ford, VW, Tesla and Toyota all developing new technologies involving electric, hydrogen or hybrid cars. In Norway, for instance, electric vehicles already account for over 16 per cent of all cars sold. Saudi Arabia and the Gulf states are lucky: they have 25 years to plan a new future that will require far less oil. If they have any sense, they will work to move prices back up to $60 then, over a period, slot oil into the $70 to $80 range then keep it there. Sheik Ahmed Yamani, the former Saudi oil minister, warned 15 years ago that this moment of reckoning was coming, *Thirty years from now there will be a huge amount of oil and no buyers. Oil will be left in the ground. The Stone Age came to an end not because we had a lack of stones.* Not sure that OPEC was listening then – or now.

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To absent friends, including the remarkable Jim Slater and Cynthia Payne. The former was one of the best share-tippers of my generation yet, when he was asked what he would like to be remembered for, he rattled off his sponsorship of the British chess championship, his support for Birthright and wild salmon, his happy marriage and his books. And Slater Walker? I'm not particularly proud of that, it failed after all but I'm not ashamed of it either. *Cynthia Payne, hostess, opened the door to a police raid in 1978: detectives found 53 men in various stages of undress. Newspapers had enormous fun – one cartoon showed a vicar in bed with a young lady and confronted by a policeman:* I demand to see my solicitor who is in the next bedroom *says the vicar. Afterwards, when released from Holloway prison, Mrs Sin was asked why she wouldn't name any of her customers.* Well, me morals is low but me ethics is high. Two remarkable people……

A boom, perhaps, just coming to an end is buy-to-let here in the UK. I am indebted to asset manager *Brewin Dolphin* for a rather scary worked example of a landlord with an 80 per cent loan-to-value (LTV) mortgage receiving £10,000 in rent and paying £8,000 in interest. On his £2,000 profit, he currently pays 40 per cent (£800) in tax leaving him with a net gain of £1,200. However, come 2020, his tax bill will be calculated on his turnover minus a 20 per cent tax credit: 40 per cent of £10,000 is £4,000. The relief comes to 20 per cent of the interest (£8,000 at 20% = £1,600). The result is a £2,400 tax bill. Add that to his mortgage interest and his annual profit turns into a loss of £400 – Ouch! The *Daily Telegraph* ran an article in December looking at a higher-rate taxpayer with a £240,000 mortgage on a £300,000 property. He has a five-year interest-only fixed-rate mortgage at 3.99 per cent. That costs £800 a month. He then receives £1,000 in rental income giving him a current annual profit of £1,440. However, his profit falls to nil in 2019 and becomes a loss of £480 in 2020. According to a recent survey, a large part of the UK population still doesn't think that any of this matters and that buy-to-let is a great investment. I am not so sure – getting into buy-to-let now with borrowed money just doesn't seem to be worth the risk.

Britain's biggest buy-to-let landlords, Fergus and Judith Wilson, have sold their 1,000-dwelling Kent property empire. Mr Wilson is also the author of Larry the Liger *(a Liger is a cross between a lion and tiger) and a former maths teacher, as was his wife. The Wilsons had no capital and expanded using debt. The era of easy money has long gone so perhaps they are right to get out now. That will please those who have criticised the Wilsons for throwing out 200 tenants on housing benefit and zero hours contracts in favour of eastern Europeans.*

So much for buy-to-let residential property but what about prospects for commercial property with Athelney Trust's portfolio having a 24.4 per cent per cent interest in the sector? On the face of it rather problematic in that pension funds, traditionally significant investors, are now paying out a large proportion of annual cash flow in pensions, which makes illiquid property less attractive relative to bonds and equities. At the same time, insurance companies, also big investors, face regulatory obstacles in buying any illiquid asset in that they have often faced a capital penalty since the financial crisis. Yet despite these headwinds the commercial property market has been enormously helped by globalisation. Before the financial crisis, excess savings in Asia and elsewhere tended towards US Treasuries, German Bunds or similar. Since 2008, sovereign wealth funds have poured money into real estate in the search for a higher income and better growth prospects. The first stage is over with *trophy assets* now fully priced but the gap between government bond yields and the income available on non-trophy assets very wide indeed. So far from becoming the Cinderella of capital markets, commercial property will continue to attract big money and the shares of regional property companies remain highly attractive.

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John McDonnell, shadow chancellor of the exchequer, responded to George Osborne's November Autumn Statement in a wholly singular way by reaching into his trouser pocket and saying, To assist Comrade Osborne in his dealings with his newfound friends [from China] I've brought along Mao's *Little Red Book! Deputy leader Watson could not believe his ears: there was his colleague, flicking casually through the selected musings of one of the most prolifically murderous Communists in history. Mr Osborne rose and picked up the book which Mr McDonnell had tossed in his direction*, Oh look, it's his personal signed copy! Obviously, John was just joking *said a staffer afterwards and, indeed, the joke went down very well albeit with the wrong side. Beyond parody, is it not?*

Capital Gains

During the year the Company realised capital profits before expenses arising on the sale of investments in the sum of £332,648 (31 December 2014: £478,743).

Portfolio Review

Holdings of *AEW UK REIT, Harworth Group, Heath (Samuel) & Sons, Low & Bonar, Premier Farnell, Record, Regional REIT Ltd, River & Mercantile Group, Safestyle UK* and *Trinity Mirror* were all purchased for the first time. Additional holdings of *Begbies Traynor, Capital & Regional, DX Group, Games Workshop, Goodwin, Juridica Investments, Picton Property Income, Quarto Group Inc Com* and *UK Commercial Property Trust* were also acquired. *Brit plc, Chime Communications, GLI Finance, Hydrogen, ISG, Nationwide Accident Repair, NewRiver Retail, Plus 500, Redefine, Renew Holdings and RWS Holdings* were sold. In addition, a total of nine holdings were top-sliced to provide capital for the new purchases and *Japan Residential* was bought and sold in the year.

Corporate Activity

The holding of *Catlin* was taken over at a capital profit of 21.5 percent.

Dividend

The Board is pleased to recommend an increased annual dividend of 7.9p per ordinary share (2014: 6.7p). This represents an increase of 17.9 per cent over the previous year. Subject to shareholder approval at the Annual General Meeting on 7 April 2016, the dividend will be paid on 14 April 2016 to shareholders on the register on 18 March 2016.

For those patient investors who subscribed for Athelney Trust shares in the IPO of 1994, the annual return has now risen to 15.8 per cent net of basic rate tax on the capital originally invested.

Update

The unaudited NAV at 31 January 2016 was 235.8p whereas the share price on the same day stood at 215p. Further updates can be found on www.athelneytrust.co.uk