

FOREIGN & COLONIAL INVESTMENT TRUST PLC

AGM 6 MAY 2010

FUND MANAGER'S PRESENTATION

Good afternoon, ladies and gentlemen, and may I too welcome you to the meeting?

Foreign & Colonial has been around since Disraeli first became Prime Minister. In the last 142 years we have seen 24 years of Liberal governments, 32 years of Labour, 65 years of Conservatives and 21 years of coalitions. So we think we can cope with whatever result comes out of today's competing event.

I will come back to the election later but first I want to expand on what the Chairman has said about progress in 2010 and explain what is happening in private equity and with dividends.

The market rally that began in March 2009, continued unabated in the first quarter of 2010 and cooled a little in April. It has cooled a lot more this week.

Markets rose despite the increasing concerns about Greece, where I should point out we have no exposure whatsoever. Largely as a result of Greece, Europe has been the worst performing region so far this year though our stock selection within Europe has continued to be good. The most interesting market development has been that emerging markets have stopped outperforming and indeed the US and Japan has both made good starts to the year.

For us the main positives have been performance in Europe and being geared into the rising markets. The main negative was in stock selection in other markets where we were defensively positioned, so lagged the rises in the local indices.

Turning to private equity, our portfolio rose in value but not by as much as the listed portfolio. Let me explain why this is.

The valuation process for all private equity investments is backward looking and time consuming. This is why our private equity portfolio was a drag on performance in 2009, and so far in 2010, and why we are optimistic about the prospects for the rest of 2010. It can take up to nine months for movements in listed share prices to have an effect on private equity valuations. So the private equity values in our accounts at 31 December 2009 were only partly influenced by the recovery in listed share price that began nine months earlier in March 2009.

But this year we expect private equity valuations to gradually adjust to what has happened in listed markets.

This process has already started to happen. In the last few weeks we have received formal valuations of all our private equity funds at 31 December 2009. These have shown an increase in value from the figures we included in our own year end accounts. In total the private equity portfolio has increased in value by about £15m or over two pence per share.

Private equity managers have been chastened by the financial crisis and are not rushing to push up valuations so it will be a measured process which will probably take most of this year to play out. But we are confident the value of our private equity portfolio will continue to grow in the rest of 2010.

However, valuations are yesterday's story – we are now much more focussed on cash flows.

We invest in private equity to make money but we only get cash in our hands when holdings are sold. That's why private equity managers come into a room backwards – they are always focussed on the exit.

In 2009 only £3.4m of cash came back from our portfolio and in the first quarter of 2010 we received another £1.8m.

On the other hand we expect the rate of drawdowns into our existing funds to accelerate this year as the opportunities to make new investments pick up. In the first quarter we invested £8.6m and our best estimate currently is that we will invest a net £50m into private equity in 2010. Thereafter we expect cash realisations to accelerate. We will finance the net investment this year either from additional borrowings or from sales from the listed portfolio.

Regardless of how private equity is financed, the increasing percentage of the portfolio invested in assets producing no income is having an effect on our overall revenue. Our revenue has already suffered from dividend cuts from many companies so let me explain how we manage this and what the outlook is for 2010 and beyond.

2009 was the worst year for dividend cuts since the 1930s. We experienced an underlying fall in income of 15% but increased our own dividend by 3.1%.

We were able to do this because of the revenue reserve built up over the years in case we experienced such difficult times. As you know, investment trusts have the ability to smooth out their dividend payments by using this reserve and this is what Foreign & Colonial has done very actively.

In the ten years to 2009 the dividend has increased by 8.7% per annum while inflation has been 2.7% per annum. Over the same period we have increased the revenue reserve from £37m to £94m.

We did not foresee the big dividend cuts last year but we did know that there would be a time when dividends would come under pressure.

We did not foresee all of the problems in the private equity sector but we did know that we needed to manage the position that none of our private equity investments were likely to deliver any income.

But in 2009 we suffered a perfect storm of the worst dividend cuts for seventy years and a big increase in the private equity weighting so we had to draw on the reserve to meet the cost of the dividend. But even after this perfect storm we are still in a very strong position.

Dividend growth is now resuming and the Board has already forecast that we expect to pay at least the same dividend for 2010, but it may be several years before the current level of dividend is covered by earnings again.

Returning to the election, whatever the result, I am certain that all of us in the room will be paying more tax.

We have been doing a lot of work about the implications of this.

The divergence between capital gains tax rate of 18% and the top rate of income tax of 50% meant we looked last year at issuing a zero dividend preference share. We were pretty confident that investors would have been very attracted to a Foreign & Colonial zero but only at an implied interest rate that would have represented a significant transfer of value from you, the ordinary shareholders, to the zero investors. It would have been very unattractive for you so we did not pursue it.

We also considered issuing B shares which would effectively pay the dividend in the form of capital with significant tax advantages. The disadvantages of this are that it might be quite complicated for individual shareholders and the very fact that we did it might prompt the government to change the rules to prevent it. However, another investment trust is currently seeking to issue B shares and we will look very carefully at how they get on.

Although the election will have an impact on all of us individually I do not think it is going to have much of an impact on our total portfolio. Only a third of our assets are invested in UK stocks. Looking at where those companies operate, some two thirds of their profits arise from outside the UK. So our exposure to the UK economy is about 10% of our total assets. To put it bluntly what happens in the domestic UK economy, rather than the UK stock market, is of limited importance to us.

We have seen this very clearly in the last few days when a proposed tax on Australian mining companies has had more impact on UK listed mining stocks and thus the FTSE100 index than any news from the election campaign here.

Much more important for us are long term economic and market trends.

The most obvious of these is the rise of emerging markets and the relative decline in developed markets. Seven years ago, when we changed our strategy to invest more in emerging markets, this was a minority view. Now everyone believes it. It is still true but is probably in the price. So one risk we have to be alert to is an emerging bubble in emerging markets. It has not happened yet but it could easily do so.

I have always found that one of the most reliable indicators of bubbles is the investment trust market so the recent launch of the Fidelity Chinese investment trust was a worry. A worry made worse by the simultaneous launch of the JP Morgan Brazil investment trust. The last specialist Brazilian investment trust was wound up on 18 December 1998. From then until now the Brazilian stock market has gone up more than six and a half times. Finally the Templeton Emerging Markets investment trust now has a larger market value than we do. When it goes past Alliance Trust and enters the FTSE100 we will know the bubble is for real.

But for the time being I do not think there is a bubble, the long term arguments in favour of emerging markets are very strong and we will maintain our current positions in these markets.

The other significant trend that is going to have profound impact on all of us is the huge increase in government debt. So far this year Greece has been at the forefront of concerns but many other countries – Portugal, Spain, Italy, the UK and the US – share some of the same problems as Greece and market attention could shift to any one of them at any time.

There is too much debt and too little confidence about how it will be repaid. As a result there is no way that government bonds are going to be a good investment in the next ten years. There are lots of things that are uncertain in investment but this is as close to a cast iron certainty as you can get.

I have been amazed how blasé many commentators were about what was happening in Greece until very recently. 140 years of experience gives us a different perspective.

Greece has been in default for more than 50 of those 140 years and Spain has defaulted thirteen times. It is less likely governments now will do anything as crude as default but the same effect can be achieved by inflation, currency devaluation and interest rate reductions.

For example, the UK has never defaulted on its debt but has devalued sharply in 1931, 1949, 1967, 1992 and since 2007. In 1931 one pound bought almost five dollars. Today it buys one and a half.

So in the next decade I think there will be a bust in government bond markets and a bubble and bust in emerging markets. Have I anything more cheerful to say?

One cheerful point is that it depends where you are starting from. The last ten years have been dreadful for equity markets compared with house prices, commodity prices and bond markets. Even now equities are not fantastically cheap on any objective statistical measure. However, they are relatively cheap compared with all other investments. So you are much more likely to make money investing in shares than you are investing in anything else. And even if you are gloomy about the future, you will lose less in shares than in other assets.

Ten years ago there was huge hype about the internet and mobile telephony. Ten years on a lot of the huge changes that were predicted then have come to pass plus a whole lot more but the share prices of most of the companies involved are still lower than they were in 2000. The best example in our portfolio is Vodafone which peaked at 384 pence in March 2000 and whose share price now is just over 140 pence.

Another cheerful point is that it almost always pays to go against the herd. In 1999 30 times more money was invested in US equity funds than US bond funds. Since then equities have experienced a lost decade and bonds have done well. By 2009 bond funds received thirty times more money than equity funds.

Buying shares is the best way to participate in the growth associated with these changes and buying shares in a global fund like Foreign & Colonial is the best way to spread the risk and keep your costs down. But growth does not just come from technological change. Climate change will probably have a big impact in the future, as the Icelandic volcano has just shown us, but social change is likely to have an even bigger impact and in some surprising ways.

If I asked everyone in the room who had a tattoo to raise their hands I doubt many would show – not because of shyness but because the demographics of Foreign & Colonial AGM attendees would not include many people with tattoos.

But we are not representative of the population as a whole or the trends. In the US, 6% of the adult population had tattoos in 1936 but by 2006 the figure was almost 25%. This is a great business to be in but it gets even better. One in five of people who are tattooed come back later to have a tattoo removed – often because it contains the name of someone from a previous relationship. We do not have any direct investments in tattooing parlours but on this trend we may do before long.

Tattooing is a light hearted example of change but economic, financial, social and technological change will always be the most profound driver of markets and the most important reason to invest in a well diversified portfolio of shares.

Foreign & Colonial has adapted to and exploited huge changes in the last 142 years and remains very well placed to adapt to and exploit the changes that will come from today's general election and everything else that is going on.

Thank you.