

FOREIGN & COLONIAL INVESTMENT TRUST PLC

AGM 1 MAY 2009

FUND MANAGER'S PRESENTATION

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

I am going to talk about four topics – what we have done so far in 2009, dividends, private equity and what issues we face in the future.

At last year's AGM I was much too optimistic about how the world could survive the credit crunch and I thought then that the biggest risk to investors was inflation. The collapse of Lehman Brothers and the rescue of AIG in September made it crystal clear deflation was the only problem to worry about.

That has continued so far in 2009. Economic growth forecasts have been cut back. Companies have been scrambling to cut costs and conserve cash. Interest rates have continued to fall so savers are making next to no return on their cash.

Many companies have been raising money from shareholders with HSBC in the lead followed by a posse of property companies. All of these rights issues have been accompanied by dividend cuts

We were cautious at the start of the year and in January and February we took decisive action to raise £130m from our UK and US portfolios and eliminate all our short term borrowings. In April, after the strong rally from the lows in early March, we took more action raising another £60m from emerging markets, Japan and Europe. So far this year we have raised cash equivalent to about 10% of the total assets of the company. After the payment of the final dividend next week we will have cash of about £40m and £110m of long term borrowings at their repayment value.

Within the portfolio the main features of the first quarter were a strong performance from emerging markets where we remain heavily overweight and good stock selection in all markets, offset by further reductions in private equity valuations. These trends have continued in April.

The share price has been very volatile, falling from 228.5 pence at the year end to a low of 185 pence in early March and back to 233 pence yesterday.

On 23 March we went into the FTSE100 index for the third time. On the previous occasions in December 1995 and March 2003 this was followed by at least a year of poor share price performance compared with the index, leading to a fall out of the index and lots of shareholder discontent. The good news is that while Foreign & Colonial had a tough time, the FTSE100 performed very well on both occasions. What was bad for us was good for markets overall. Of course in the long term we have outperformed the index substantially. Between 18 December 1995, our first FTSE entry, and 23 March 2009, our third, the index rose by 9.9%. Our share price was up 40.6% over the same period. A journalist on the Financial Times said Foreign & Colonial was the most boring company in the FTSE100 Index but I think many companies would love to be as boring as us.

Some people also think dividends are boring but they could not be more wrong. One of the most striking developments of the past year has been the rise in dividend yields above base rate and gilt yields for the first time in fifty years.

However, maybe the last fifty years were an aberration which has ended with a return to the position that prevailed when Foreign & Colonial was launched in 1868 and for ninety years thereafter. Equities are riskier than bonds so ought to have a higher immediate income return to compensate investors for that risk. Any capital appreciation is a bonus that cannot be relied upon.

The world is experiencing the worst economic conditions since the 1930s, a period of widespread dividend cuts. Indeed Foreign & Colonial's own dividend fell by 60% between 1931 and 1935. In the US this is the worst year for dividends since 1938 and it is probably the same in the UK.

Some analysts expect global profits to fall 50% from the peak in 2007 to a trough in 2010. It is unlikely dividends would fall as much as this but my personal opinion is that global dividends will fall by about a third over the three year period.

As you know, the board has already made a forecast that our dividend will be at least maintained at 6.45 pence per share in 2009. The board can make this forecast with confidence because of the size of the revenue reserve. This reserve has been built up over the years from the difference between income earned on the portfolio and dividends paid out; and now amounts to £125m. Our large revenue reserve puts us in a much stronger position than most investment trusts but using the reserve will reduce the net asset value per share.

We look very closely at our top twenty dividend payers. Eight of these have reduced or eliminated their dividends this year, eight have increased and four have not yet announced. The biggest negative has been the HSBC dividend cut but our biggest exposures now are BP and

Shell which together account for about 14% of our expected revenue in 2009.

So at the moment our income is about 20% down on 2008 but this will be affected by portfolio changes and currency movements so the final outcome will probably be different. We will update you on dividend progress and prospects at the interim results in July when we will have a clearer picture of the outcome for 2009 and possibly the prospects for 2010.

Let me now turn to private equity.

As you know we have been investing in unlisted companies for more than sixty years with some conspicuous successes such as Robert Fleming and Resolution. In 2002 the Board decided that future investment in unlisted stocks should be concentrated on funds of funds managed by specialist private equity managers. An initial target of 5% exposure was set and this was increased to 10% in 2006.

Up to the end of 2008 this strategy has done everything we could have hoped for back in 2002. We have a hugely diversified global portfolio with over ten thousand underlying holdings. The returns have been better than the listed portfolio.

However, 2009 is going to be a lot more difficult. The falls in our listed portfolio have pushed up the private equity exposure to 15%. The private equity industry is facing acute pressures from the credit crunch as its easy access to bank debt has evaporated. Very few new investments can be made and even fewer can be sold. Meanwhile existing holdings are suffering from the global recession. Some investors are over exposed to private equity and will struggle to meet their commitments and may even be forced sellers. The final problem is uncertainty about private equity valuations which are lagging the fall in listed share prices. You can see all these problems in their most acute form in the private equity investment trust sector where many share prices have collapsed in the last year.

We are managing our exposure to these problems very vigorously. Last November we made a pre-emptive write down of our portfolio in anticipation of lower valuations at the year end. The lower year end valuations duly arrived and were included in the year end accounts. So far in 2009 we have continued to make a downward only adjustment to these valuations to reflect falls in listed markets so that at 31 March we were valuing our private equity holdings at a discount of 10.7% to the estimated year end values. This meant the net asset value per share was about 4 pence lower than if we had stuck to the year end valuations. So our policy is conservative in absolute terms and also more conservative than most other investors who are not adjusting down the 31 December 2008 valuations.

Ultimately we are only really interested in the cash we get back from our private equity investments when they are realised. Market conditions mean that there will be very low cash returns in 2009 and probably 2010. But market conditions also mean that there will be few new investments because there is no bank finance to support deals. We have money committed ready to invest when our managers see good opportunities and we have no worries about meeting these commitments from our listed portfolio or from borrowings. We believe that investments made in difficult economic conditions will be done on very attractive terms for us and that, after the current very difficult period, private equity will continue to produce strong results for shareholders.

I have talked at length about dividends because they are so important and private equity because it will have a negative impact in 2009. Let me conclude by talking about the bigger picture and what we might do.

We are in the worst economic conditions since the 1930s and until the banking system is sorted out it will be impossible for economic growth to resume in a sustainable way – there won't be enough money and credit to support it. Huge efforts have been made and are being made to sort out the banks but the problems are deep seated and complicated. Every possible solution creates knock on problems making it very difficult to resolve the crisis. The longer the financial crisis lasts the worse the long term impact on the economy. So for the rest of 2009 the biggest risk is still deflation and falling asset prices.

On the other hand, huge amounts of money are being created and once this comes out of the banks and into the general economy it is almost certain to create inflation.

It is impossible for anyone to know when deflation turns to inflation but what is crystal clear is that the period of steady economic growth and steady inflation of most of the last twenty years has come to an end. The volatility of the last eighteen months may reduce but we are not going back to the period before 2007.

So where can you go to protect your assets, savings or pension? In cash earning nothing? In government bonds yielding next to nothing? In index linked bonds yielding nothing but with inflation protection? In gold? In property? In shares? In the UK or other countries?

I don't know the answers but I think there are some points one can be pretty confident about.

Countries with current account surpluses and well capitalised banks are far better placed than countries with deficits and weak banks. So most emerging markets are in better shape than the US and UK.

Companies operating globally and those with low debt levels are much less risky than those dependent on individual markets and continuing

access to bank borrowings. So most large listed companies are in relatively good shape compared with small businesses.

Some companies are cutting dividends to save their balance sheets but many others are not in such dire straits and will maintain or increase their dividends.

So it looks as if the most likely path for economies is a sharp contraction in 2009 accompanied by falling prices followed by a gradual recovery and sharply rising inflation. Profits and dividends will fall dramatically and recover only slowly. We will all be paying more tax.

It is hard to think of a more difficult path to navigate for investors.

How can we position Foreign & Colonial to survive and prosper in these conditions?

This has been the dilemma of the last eighteen months and it is not getting any easier. We can dash for cash to protect your capital but that would mean a big reduction in income and missing out on any rally. We could take the view that share prices are very cheap and that buying now is bound to make money over the next ten years but then we might still see another big drop in share prices before we reach the promised land of rising markets.

In practice we have changed tack frequently to limit the downside without removing the potential upside and we will continue with this policy. The cash raising that has taken place in 2009 will give us much greater flexibility to respond to the challenges and opportunities in markets

We will continue our emphasis on emerging markets and Asia as the areas that will show the most robust sustainable growth and continue reducing our exposure to the more mature markets in the UK, US, Europe and Japan. We can move gearing up and down though the opportunities to exploit interest rate differentials and currency volatility are smaller now than in the past. We will keep a very close eye on our private equity exposure and look out for opportunities that others will not be able to exploit.

The last eighteen months have been the most difficult in my working lifetime and I was far too optimistic. Despite this, Foreign & Colonial is still in good shape and has the flexibility and diversity to cope with very difficult and volatile conditions. Let's all hope markets become less volatile and difficult in the next twelve months.

Thank you.

