THE SCOTTISH Investment Trust

The CONTRARIAN

AUTUMN 2018

ANALYSIS AND INSIGHT FROM **THE SCOTTISH INVESTMENT TRUST**

As good as gold...

Going for gold

For centuries past, humans have coveted and revered gold. From the Aztecs in the 1400s, to the discovery back in July of the UK's largest ever gold nugget, the lustrous metal has long captured imaginations. But lately, gold has fallen out of favour – and attracted our attention, as contrarian investors. In the current market environment, we believe that gold merits its place within our portfolio.

Historically, gold's enduring appeal has been its ability to retain its purchasing power. It has a tendency to keep pace when inflation rises and also to act as a store of value in deflationary times. As well as being a store of value, gold symbolises status and longevity – gold is still associated with success.

And of course, gold has offered investors a safe haven when markets are turbulent and politics frays investors' nerves. That appeal still holds true today. In a late-July interview, President Trump criticised the US Federal Reserve, saying that he's "not happy" about the trajectory of rising rates. While he's no stranger to a contentious remark, it's rare for a sitting president to rebuke the actions (and risk undermining the independence) of the Fed. While markets took some notice, they have largely ignored the issue. But perhaps President Trump is on an inevitable collision course with the Fed.

For you see, President Trump's pledge to "Make America Great Again" is taking precedence over fiscal prudence. Although the sweeping tax cuts he's implemented have boosted economic growth, they've also increased the budget deficit. It's expected to balloon to $804 billion this fiscal year and to $1 trillion by 2020. Deficit spending is inflationary and there is no plan to curtail this.

In addition, gold prices have fallen significantly from the highs they reached in 2011. Back then, investors feared that the eurozone could break up, while even a US debt default was deemed a possibility. Although gold prices have received a boost from President Trump's recent remarks, gold is still trading at levels significantly below its peak. Politicians like to print money – it buys votes. Once they get the taste for it, they print as much as they can get away with. In contrast, gold sees a modest increase in supply – newly mined gold typically increases by around 2% per annum.

Continued: Overleaf

ABOUT

The Scottish Investment Trust

At The Scottish, our experienced team actively manages a high conviction, global investment portfolio with the aim of generating above average investment returns over the longer term for our investors. Our contrarian approach is benchmark agnostic and aims to benefit from profitable opportunities in any market environment. Founded in 1887, the trust has a long tradition of providing shareholders with an accessible, low cost way to invest in companies from around the world, whilst further boosting returns through the provision of a growing dividend. The Scottish has grown its regular dividend every year for the last 34 years. Our independently managed, closed-ended fund structure allows us to be patient with our investments.

DIVIDEND **REINVESTMENT**

Certificated Shareholders

The default arrangement for shareholders who hold share certificates, is for dividends to be paid out as income. However, certificated shareholders who would prefer to have their dividends automatically re-invested into further purchases of Scottish Investment Trust shares, can easily arrange this by joining the **Dividend Reinvestment Plan (DRIP).**

Details of the Dividend Reinvestment Plan, together with an application form, can be found on our website; **www.thescottish.co.uk**

Alternatively, to receive a DRIP application form and booklet by post, please telephone our Registrar, Computershare Investor Services PLC, on 0370 703 0195.

Other Shareholders

If your shares are held elsewhere, you should refer to your broker or platform provider for details of their dividend reinvestment facilities.

Most brokers and platform providers offer a dividend reinvestment service which allows you to have dividend cash automatically reinvested to buy more shares.

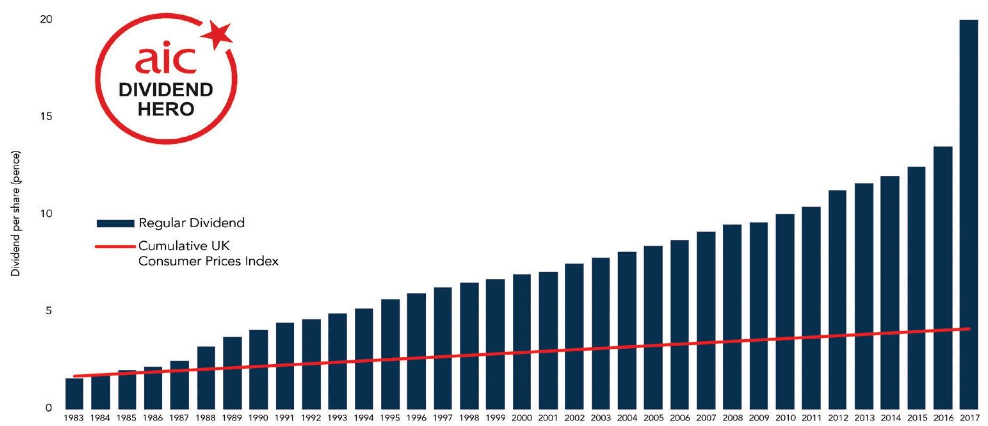
Please note that most of these services charge for each dividend reinvested, and you should establish the cost of any such facility with your provider.

We do not offer advice about the suitability of any arrangement for your personal circumstance. Should you require financial advice you should consult a suitably qualified financial adviser.

QUARTERLY DIVIDEND PAYMENT DATES 2018

FIRST INTERIM	11 May 2018
SECOND INTERIM	3 August 2018
THIRD INTERIM	2 November 2018
FINAL	8 February 2019

Increasing our regular dividend for 34 consecutive years



As good as gold...

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Sitting on a gold mine

For those seeking to invest in gold, there are three main routes. Buying (and storing) gold bullion, investing in an exchange traded fund (ETF), or buying shares in gold mining companies. Because of the disadvantages of owning physical gold, we prefer to express our contrarian view on gold through gold mining stocks. Although mining companies can suffer from the inherent risk of on-the-ground mining projects, certain stocks have fallen to more reasonable valuations than has historically been the case, for various reasons. Firstly, gold miners were very overvalued some years back, because they offered investors an accessible way to invest in gold. But in 2004, gold ETFs came along, which offered a new way to access gold in an easy manner. Some gold miners lost the premium they once enjoyed, while suffering the double whammy of falling gold prices. But as contrarian investors, we have been searching for 'ugly ducklings' – unloved stocks that have the potential to flourish in the future.

From ugly duckling to golden goose?

One 'ugly duckling' we identified is Newcrest Mining, the largest listed gold miner in Australia. Newcrest has faced some problems in the past decade, namely disappointing production, profit warnings and a weakening balance sheet. But Newcrest's recovery from these setbacks makes it an interesting prospect for the contrarian investor. Management are cutting costs and improving efficiency and the company has restarted dividend payments. Meanwhile, there are plans to expand its Cadia mine in New South Wales. That, plus the development of its Golpu mine in Papua New Guinea, could drive output growth. Of course, we can't promise that Newcrest will turn from an ugly duckling to a golden goose. But we do think that the company merits a place in our portfolio, as our contrarian view on gold underpins what we consider to be a compelling investment case.

Please remember that past performance may not be repeated and is not a guide for future performance. The value of shares and the income from them can go down as well as up. You may not get back the amount you invest.

POSTCARD FROM THE US

by Alasdair McKinnon, Manager

"If I'd lived in Roman times, I'd have lived in Rome. Where else? Today America is the Roman Empire and New York is Rome itself." John Lennon

I've just spent a week in New York, visiting companies and trying to get a feel for what's going on in America. New York isn't the US, of course; it's not even the capital. It is, however, now the real seat of power, as the blocked-off streets around Trump Tower testify.

But whatever the distortions of seeing the US from the Big Apple, it does give you some idea of what's happening to the country as a whole.

It's a big country. But its stockmarket is even bigger. The US now accounts for 55% of the world's market capitalisation. That's not far from the level of Japan in 1990. And look what happened there. All empires grow decadent eventually. So are there signs of decadence in the American Empire?

Well, there are certainly major changes underway. One theme that came through clearly was the depopulation of rural areas and the rise of the megacities. Various rural areas are advertising bursaries to tempt graduates back from the big cities. The shift to megacities is a global phenomenon, and the US is no exception.

Whenever I visit New York, I always keep an eye out for the fads – because where New York leads, the rest of the world very often follows. Fifteen years ago, the fads in evidence were the Atkins diet, the BlackBerry and the iPod – all of which went global soon after.

This time, the most obvious fad was the salad bar. Salad was everywhere – tossed with any of a myriad dressings, most of which looked sufficiently calorific to offset any health benefits.

What interested me most, though – and ruffled feathers when I mentioned it – was the fondness of my fellow investment professionals for technology and growth stories: basically, the pursuit of growth at any price – even at the expense of actually making money.

Many of today's start-up brands are sustained by an endless flood of cheap funding – a product of the decade-long experiment in quantitative easing.

There's certainly a degree of blind faith in disruption. During my trip, I spoke to the toothpaste manufacturer Colgate-Palmolive. The company pointed out that its toothpastes and those of its big-name rivals are, demonstrably and scientifically, the best in the business. But that hasn't stopped the appearance of niche toothpaste start-ups, even though their products don't work particularly well.

Another good example comes from the shaving market where Gillette has long dominated through its technically excellent products, sold at ever increasing prices. The expense of shaving may be one reason for the rise of beards in recent years! A potential disruptor loomed in the form of Dollar Shave Club, which supplies cheap shaving products on a subscription model. Its razors aren't nearly as good as Gillette's. But that didn't stop Unilever paying a cool $1 billion to buy the business with no immediate plan to make profits. It simply wanted to grow.

I saw lots of odd niche products being heavily advertised during my visit – fresh dogfood, for example, which requires special fridges in supermarkets. I'm sure it's very appetising for the dogs, but it appears to be yet more evidence that raising cash has just been far too easy.

It is safe to conclude that growth fuelled by lavish advertising spending will never be sustainable. Those ventures can only exist because of cheap money. And with that gradually coming to an end as the Fed raises rates, it will be interesting to see how this particular symptom of decadence plays out.

One area in which I detected robustness rather than decadence, though, was retail. My visit allowed me to sample the shops in Manhattan.

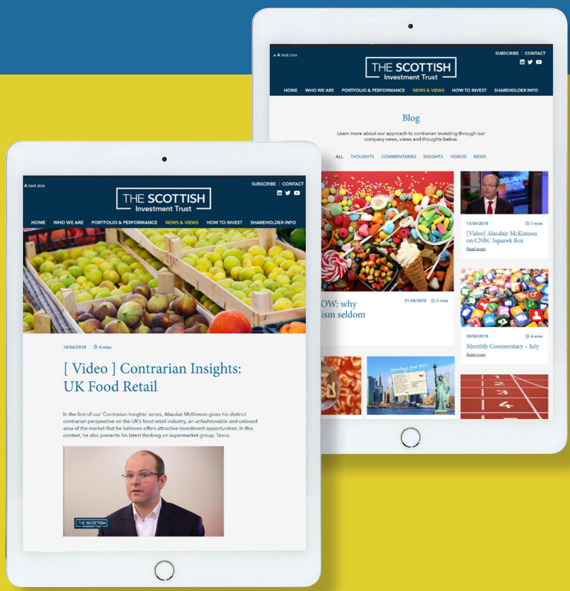
I was particularly impressed by Macy's flagship department store, which seemed to offer just about every product and brand you could want. It was easy to see how you could succumb to 'Costco syndrome' in such a place – buying much more than you initially planned.

And that helps to explain why traditional retailers are doing much better than many expected in the face of the threat from e-commerce. Now that retail chains have added online platforms to their bricks-and-mortar stores, which offer convenience to consumers through central locations and easy returns, they are increasingly achieving 'best of both' status. With more money in their pockets as wages rise, US consumers are spending again, and the likes of Macy's are well placed to benefit. The share prices of US retailers have shown signs of life recently, as investors begin to reassess their prospects.

It's hard to sum up such a huge and varied market as the US. But while retail appears to be reviving, other sectors remind me of Wile E. Coyote running off a cliff – the legs are still going, but there's not much holding them up. Investors' indiscriminate appetite for technology and for growth at all costs might need to be drastically reappraised as the era of cheap money comes to an end.

A final thought: one thing that struck me when visiting various company headquarters was just how commonplace 'Summer Fridays' have become. Employees can take a half or full day off every Friday during the summer. In many ways, this is a good thing. But I'm fairly sure that the same companies' factory workers won't be getting this perk in Indonesia or other low wage economies. Despite a feeling that the market's current complacency is probably misplaced, there are, for contrarian investors like us, plenty of great opportunities in the US.

More insight on our website…



Access much more on our refreshed website:

See details of any events we will be presenting at, keep up-to-date on performance and portfolio statistics, browse through annual and interim reports and access other key shareholder information.

In our blog, find interesting and thought provoking materials from our investment team, including weekly thoughts, monthly commentaries, videos and more.

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