TRUSTNET magazine

Issue 39 / April 2018

PROTECT OR SURVIVE
Should you use trusts for capital preservation?

MULTI-COLOURED ONE-STOP SHOP
Closed-ended multi-manager funds

THE HISTORY BOYS
Where to find the oldest investment trusts

LOAN SURVIVORS

The trusts shaking a multi-decade headwind

ISSUE 39

CREDITS

TRUSTNET MAGAZINE (FORMERLY INVESTAZINE) IS PUBLISHED BY THE TEAM BEHIND FE TRUSTNET IN SOHO, LONDON.

WEBSITE: **WWW.TRUSTNET.COM**
EMAIL: **EDITORIAL@FINANCIALEXPRESS.NET**

CONTACTS:

Anthony Luzio
Editor
T: 0207 534 7652

Art direction & design
Javier Otero
W: www.feedingcrows.co.uk

Editorial
Gary Jackson
Editor (FE Trustnet)
T: 0207 534 7680
Rob Langston
News editor
T: 0207 534 7696
Jonathan Jones
Senior reporter
T: 0207 534 7640
Mai Sardon
Reporter
T: 0207 534 7625

Sales
Richard Fletcher
Head of publishing sales
T: 0207 534 7662
Richard Casemore
Account manager
T: 0207 534 7669

Photos supplied by iStock and Photoshot
Cover illustration: **Javier Otero**

EDITOR'S LETTER

IT WAS PUT TO ME WHEN I FIRST STARTED WORKING IN THE ASSET MANAGEMENT INDUSTRY that an average annualised return of 8 per cent could be regarded as a fairly respectable outcome from an equity fund. It came as something of a surprise then, to learn that many investment trusts took out long-term debentures in the 1980s when interest rates were in the double-digits, meaning they had to make the same return from the market just to break even.

The good news is that, with much of this debt now maturing, many of these trusts are now refinancing at more attractive rates. Holly Black finds out in this issue's cover story just how much of a tailwind this will prove to be in the coming years.

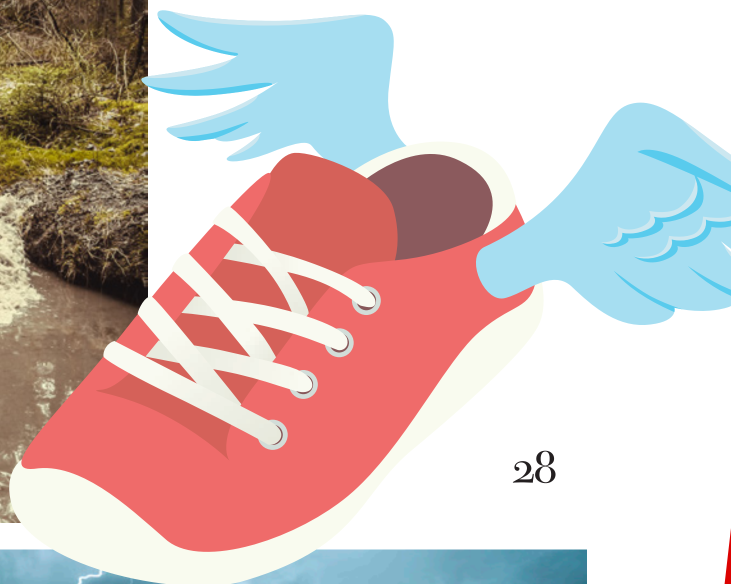
On the subject of historic issues, this month's sector focus falls on IT Global, home to numerous trusts with a track record of more than 100 years. As Adam Lewis discovers, however, there is more to the sector than longevity. Meanwhile, Sam Shaw runs the rule over multi-manager funds in the closed-ended space while I investigate whether investment trusts have a role to play in terms of capital preservation.

In our regular columns, SAINTS' James Dow highlights three stocks whose capital-light business models should help them deliver long-term earnings growth and The Share Centre's Sheridan Admans reveals why he is turning to GAM Star MBS Total Return for its diversification properties.

Enjoy reading,

Anthony Luzio
Editor

IN THIS ISSUE



28

LOAN SU

Much of the long-term debt taken out by trusts in the era of astronomical interest rates has now begun to mature. **Holly Black** finds out how this will affect performance

THE 1980s IS OFTEN LABELLED BY FASHIONISTAS as the decade that style forgot. Whether it is shoulder pads, fluorescent tracksuits or the frankly indefensible mullet, photos of anyone demonstrating a faithful adherence to the fashions of the day naturally seem to gravitate towards the back of the family album.

Another feature of the 1980s – and early 1990s – that many investment trust managers wish they could forget about is double-digit interest rates. While just a distant memory for most of us old enough to remember them, many trusts arranged long-term finance during this period when the cost of servicing debt was astronomical and inflation was climbing. In October 1989, for example, the Bank of England base rate stood at 14.87 per cent. A decade later the base rate had fallen to 5.5 per cent but, even then, few investors could have foreseen just how low it had to go.

A DRAG ON RETURNS

As a result, many investment trusts have found themselves saddled with debt at rates of 10 per cent or even higher, which seemed good value when it was secured.

Charles Cade, head of investment companies research at Numis Securities, says: "These have proved to be a drag on returns in a falling interest rate environment, but many of these older debt issues are now maturing, allowing the funds to refinance more cheaply."

Gearing is a well-publicised advantage of investment trusts. These vehicles are able to borrow money to invest, giving them the opportunity to boost their returns and income. In good times the strategy can provide a serious uplift to performance, while in a market downturn it can serve to magnify losses.

But part of the success of a trust's gearing strategy will be determined by whether it can outperform the interest rate on its debt – and, for some trusts, this just got a lot easier.

Long-term debt is much cheaper to service than the short-term variety – this is true for consumers arranging a mortgage or loan, for businesses securing finance and, similarly, for investment trusts taking on gearing. This is because you are taking a risk

URVIVORS

that the interest rate you agree upon for that debt will not be such good value in the future. While it is a bet that has backfired spectacularly for a number of investment trusts in the past, many are now taking advantage of rock-bottom interest rates to secure cheap long-term debt.

SIGNIFICANT IMPROVEMENT

Witan has arranged the longest financing agreement at 37 years, paying a 2.74 per cent rate on the £30m debt, according to data from Numis. City of London has secured a 32-year £50m arrangement at 2.94 per cent and Merchants £35m for 35 years at 2.96 per cent.

More recently, in March, Foreign & Colonial took on £75m in debt – equivalent to 2.1 per cent of its assets – for 30 years at 2.92 per cent. This represents a significant improvement on long-term debt it has taken out in the past.

Paul Niven, manager of Foreign & Colonial, says: "An 11.25 per cent debenture seemed like a good idea when the base rate was 13 per cent but, with the benefit of hindsight, I'm not sure we made sufficient excess return to warrant that borrowing decision."

As a result of maturing debt and refinancing, F&C has seen the weighted average cost of its debt drop from 7.1 per cent at the end of 2013 to just 2.5 per cent today. The trust currently has £260m of gearing, equivalent to 7.2 per cent of assets. This ranges from £50m at 1.12 per cent due to mature this year, to $80m at 4 per cent maturing next year, with the longest debt – worth £50m – set to mature in 2031. Niven says he is looking for further long-term debt opportunities while rates remain attractive.

MILLSTONE

The average interest rate paid on borrowings at the City of London Investment Trust currently stands at 8.8 per cent, owing to some legacy debt. One debenture at 10.25 per cent is due to mature in 2020, and another at 8.5 per cent will end in 2021, with manager Job Curtis saying he will be pleased to see the back of them.

"They have been a bit of a millstone," he adds. "I was involved in the decision to take on the 8.5 per cent debenture in 1997 [but] it was the prevailing rate at the time."

•••

While there is the option to offload this legacy debt earlier, in most instances the costs involved outweigh the benefits, so trusts often bide their time instead.

However, expensive historical debt, which has been a hindrance in an environment of falling interest rates, has not put boards off from tying into longer-term arrangements. Curtis says that while City of London has access to short-term lending facilities from banks, he doesn't like to be dependent on them. "The moment when you want money is the time that banks tend to be least willing to lend it," he explains.

Cade adds: "With hindsight, it was obviously a mistake to take out long-term debt at double-digit rates, but we were in a very different environment at the time. Few would have predicted the collapse in rates in recent years."

He believes a better strategy is for trusts to use gearing on a more flexible, opportunistic basis rather than tying themselves into long-term debt. "Nevertheless," he adds, "there is now an argument for boards to consider taking out long-term, fixed-rate debt at current levels to protect against possible future interest-rate rises."

A COMPLICATED EQUATION

Merchants has one more tranche of legacy debt left to mature in 2023, having taken it out in the 1980s at more than 11 per cent – this is another case where the idea of getting rid of the debt early doesn't stack up, a decision which involves a "complicated equation with many moving parts".

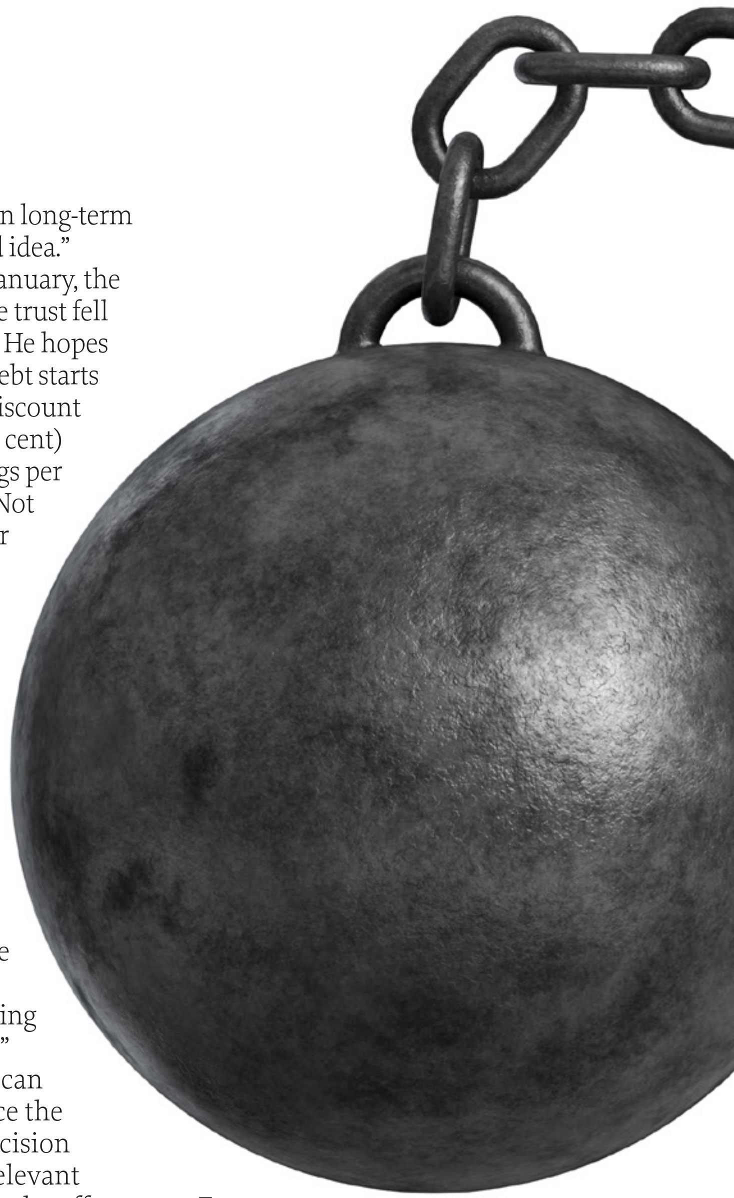
Manager Simon Gergel says: "Interest rates at the time were in double digits and inflation was near 10 per cent, so locking in long-term debt seemed like a good idea."

After refinancing in January, the average debt cost for the trust fell from 8.5 to 6.1 per cent. He hopes that as the drag of the debt starts to wear off, the trust's discount (currently around 4 per cent) will narrow and earnings per share will also benefit. Not all trusts have seen their price-to-NAV suffer as a result of their finance arrangements, and City of London has been at a steady premium for some years.

Gergel adds: "[The debt] has been a frustration but we're now at an interesting and exciting stage where it can be turned into a benefit. When we arrange new debt now, there is definitely a feeling of the longer the better."

Arranging new debt can be relatively swift. Once the board has made the decision to issue debt and the relevant documents are created, the offer is made to a handful of insurance companies and similar businesses whereupon pricing, terms and duration are agreed. The whole process can take around six weeks, after which the deal is announced to the market.

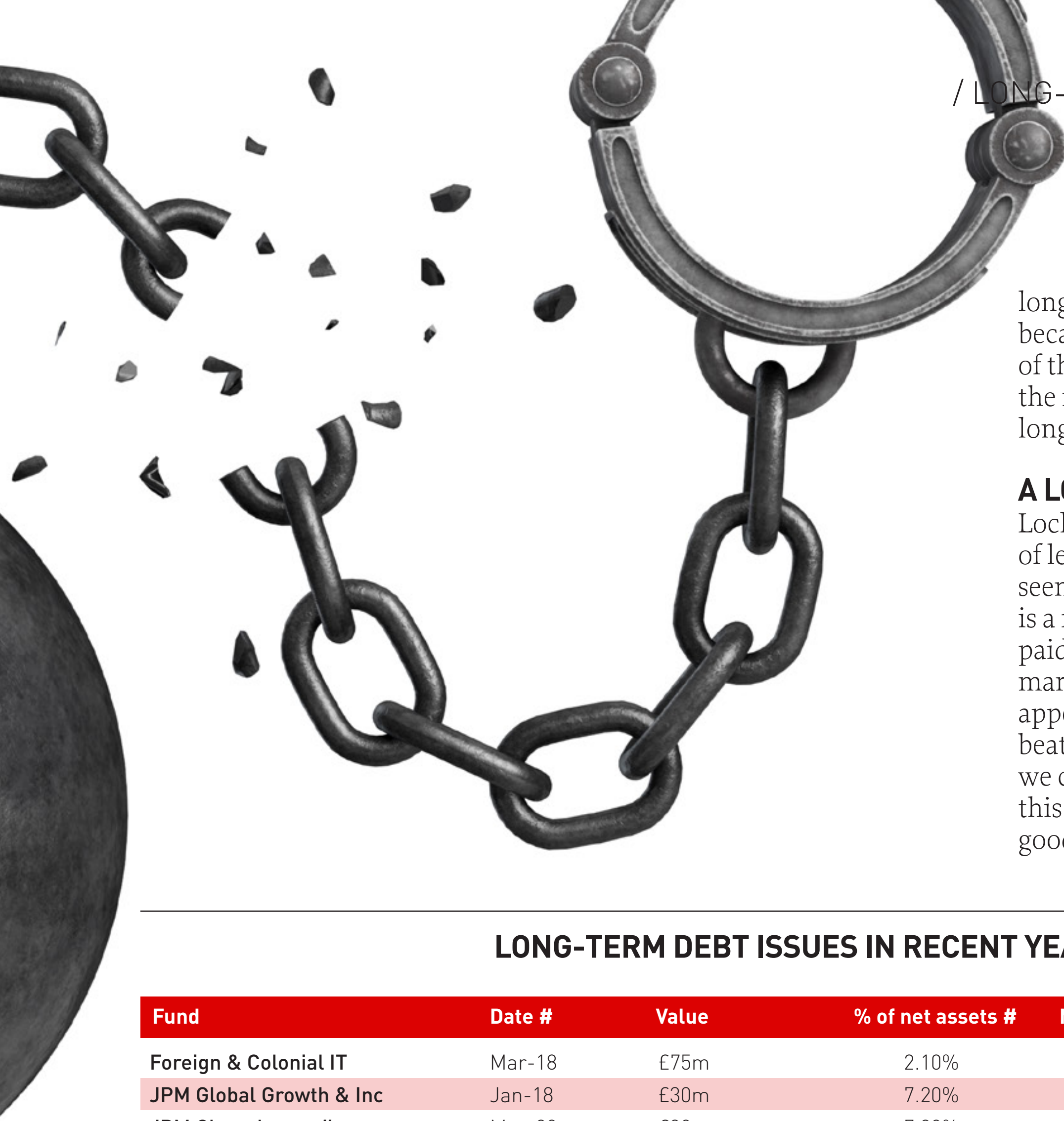
Investment trusts can often secure some of the best rates available because, with a long history, they are seen as a reliable issuer. Gergel explains: "The great thing about trusts is they're viewed as very secure investment vehicles and are highly sought after by these companies who are trying to manage their long-term liabilities."



For trusts that are yet to lock in debt at ultra-low rates, time could be running out with the next interest-rate hike expected to take place as early as May. Some boards may be hesitant to secure such long-term agreements after being badly burned in the past, while others may have to weigh up the cost benefits of getting out of their existing arrangements early.

Annabel Brodie-Smith, communications director at the AIC, says: "The trend around gearing has changed and trusts now tend to take on a relatively small amount of

"The great thing about trusts is they're viewed as very secure investment vehicles and are highly sought after by these companies who are trying to manage their long-term liabilities"



long-term debt, and that's partly because they've learnt the lessons of the past. Interest rates are low at the moment, however, so locking in long-term debt is more attractive."

A LOW HURDLE

Locking in long-term debt at a rate of less than 3 per cent certainly seems like the right thing to do – it is a fraction of what trusts have paid in the past and even with markets looking fully valued it appears to be an easy hurdle to beat. However, if there is one lesson we can learn from the 1980s, it is this – even the mullet seemed like a good idea at the time.●

LONG-TERM DEBT ISSUES IN RECENT YEARS

Fund	Date #	Value	% of net assets #	Maturity	Interest rate
Foreign & Colonial IT	Mar-18	£75m	2.10%	30yrs	2.92%
JPM Global Growth & Inc	Jan-18	£30m	7.20%	30yrs	2.93%
JPM Claverhouse #	Mar-20	£30m	7.20%	25yrs	3.22%
Merchants	Dec-17	£35m	6.20%	35yrs	2.96%
Murray Income	Nov-17	£40m	7.00%	10yrs	2.51%
British Empire	Nov-17	€20m	1.90%	20yrs	2.93%
City of London	Nov-17	£50m	3.60%	32yrs	2.94%
Witan	Nov-17	£30m	1.60%	37yrs	2.74%
Temple Bar	Oct-17	£25m	2.70%	30yrs	2.99%
BlackRock SmCos	May-17	£25m	3.80%	20yrs	2.74%
Scottish Mortgage #	Sep-20	£20m	0.40%	24yrs	3.65%
Scottish Mortgage	Apr-17	£45m/£30m/£30m	2.20%	25/27/30yrs	3.05/3.3/3.12%
Lowland	Jan-17	£30m	7.80%	20yrs	3.15%
Foreign & Colonial IT	Jun-16	£25m/£50m	2.70%	12/15yrs	2.80/3.16%
Henderson Smaller Cos	May-16	£30m	5.60%	20yrs	3.33%
TR Property	Feb-16	€50m/£15m	3.7/1.5%	10/15yrs	1.92/3.59%
British Empire	Jan-16	£30m/€30m	7.50%	20yrs	3.80%
Dunedin Income Growth	Dec-15	£30m	7.80%	30yrs	3.99%
Law Debenture	Sep-15	£75m	14.20%	30yrs	3.77%
JPMorgan European	Aug-15	€50m	12.20%	20yrs	2.69%
Foreign & Colonial IT	Jul-15	£50m in €	1.80%	7yrs	1.69%
Henderson High Income	Jul-15	£20m	10.80%	19yrs	3.67%
Bankers IT	May-15	£50m	7.60%	20yrs	3.68%
RIT Capital Partners	May-15	£151m	6.30%	16yrs*	3.45%*
Witan	Apr-15	£54m/£21m	3.8/1.5%	30/20yrs	3.47/3.29%
Alliance Trust	Jun-14	£100m	3.50%	15yrs	4.28%
Perpetual Income & Growth	Mar-14	£60m	6.40%	15yrs	4.37%
City of London	Dec-13	£35m	3.10%	15yrs	4.53%
Temple Bar	Sep-13	£50m	7.00%	15yrs	4.05%

#Ordered by date when debt was arranged (Scottish Mortgage and JPM Claverhouse have fixed debt for a future date) / *****Weighted average

Source: Numis Securities Research

WHY THE TIGER ECONOMIES ARE POISED TO POUNCE

Henderson Far East Income's **Mike Kerley** discusses how local Asian companies are challenging multinational brands and driving growth across the region

AFTER SEVEN YEARS OF FLAT EARNINGS GROWTH, the Asian market is showing signs of life again. The Tiger Economies are waking up and are on the prowl, led by a resurgent China.

Asian stocks, excluding Japan, outperformed the world in 2017 and many analysts believe the region is likely to continue its growth story through 2018 and into 2019, but of course analyst forecasts are by no means a guarantee of performance.

Asia has historically been geared into whatever the rest of the world has been doing because it was making products and selling them to the rest of the world. The region has done very well out of this but we think this story is at an end.

Firstly, low-cost labour is not low-cost anymore – especially in China, where wage growth has been quite rapid. Secondly, Asia's market share of world-produced goods is so high it can't gain any more market share. As of May last year, Chinese companies accounted for more than 25% of the global manufacturing industry, while the country was the leading producer of 220 of the world's 500 major industrial products. (Source: Ministry of Commerce of the People's Republic of China, May 25, 2017).

In terms of growth, where does China go from here? Firstly, we think local brands will gradually eat into the market share of multinationals in local markets. The next growth leg of Asia will then come from increasing the value of the goods they sell to the rest of the world.

CHINA'S GROWTH STORY

Historically, Asia has generally been associated with low-cost manufacturing and consumer goods. That's changing. China is at the forefront of this change, and for the first time ever, we believe China will spend more on research and development (R&D) this year than the US and within five years we think it may spend more than the EU and US put together (see chart). This is a huge shift and it's in new areas, like electric vehicles, renewable energy, healthcare, artificial intelligence and virtual reality – things we will embrace in years to come and that have the potential to become part of our day-to-day lives.

Our belief that China will lead Asia's cutting-edge growth story stems from the increasing number of patents filed from the country, and across the Asian continent. Of course, filing patents does not necessarily equal growth or economic success. But as you can see in the chart, China is producing more robotics on an annual basis than South Korea and the US put together, and we believe the efficiency of its manufacturing over time will continue to improve.

So, what does all this mean for investors? Historically, Asian growth has been accessible for investors via Western firms selling goods into the region – think HSBC, Louis Vuitton and BMW, for example.

That's probably not the way we can look at it going forward. Local companies are targeting the market share of global brands as the quality of their goods and services improves.

The next step for local brands is to be competitive internationally. How many Chinese brands are we going to start seeing in our shops? Some brands already have a sizeable presence in Western markets. For example, Chinese video surveillance company Hikvision has grown to become the largest CCTV hardware provider in the world – although not many of us would recognise the name.

A more familiar brand, perhaps, is Alibaba: founded in 1999 as an e-commerce platform, it has grown into a $480 billion organisation with a success story similar to US rival Amazon.

ECONOMIC AND POLITICAL HEADWINDS

Of course, the region's growth is still vulnerable to economic and political risks. The war of words between the leaders of North Korea and the US are a cause for concern, but recent developments have given us some encouragement that the situation is improving.

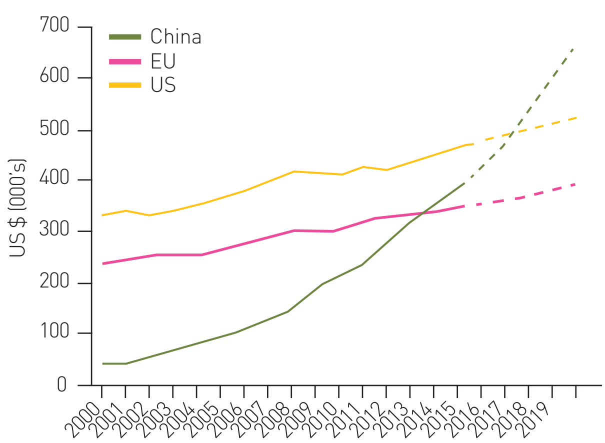
The US President's protectionist policies are a more immediate concern. His decision to impose a 25% tariff on steel imports and a 10% tariff on aluminium imports might cause some nervousness in the markets with talk of a 'trade war' doing the rounds. From China's perspective, however, exports have become less and less important to the national economy, dropping as a percentage of the country's GDP from 37% to 19.6% in the 10 years between 2006 and 2016.

In our view, we think this all points towards sustained growth in Asia, and that local companies will facilitate this growth, rather than Western brands selling goods into Asia. We believe there is significant earnings growth potential for local Asian brands and we hope this will be matched by dividend growth.●

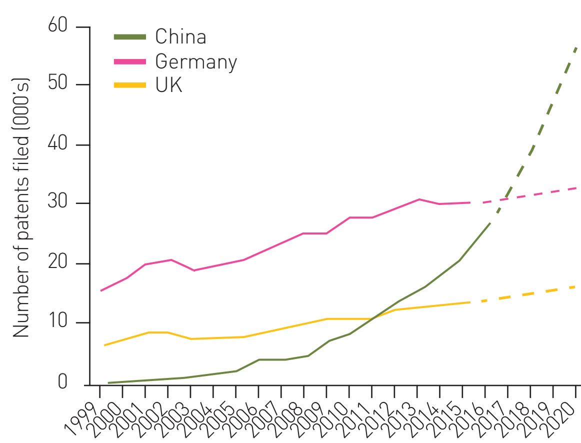
MOVING UP THE VALUE CHAIN

Innovation - a clear driver of growth

Gross domestic spending on Research & Development *2000-2015 (US$ 000's)



Number of patents filed (000's)



Please note that this is a forecast. Actual future government spending on research and development and the number of patents filed from these countries may differ considerably.

The information in this article does not qualify as an investment recommendation. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.Prospective investors should be aware of the risks of investing in shares listed on emerging markets, which may be more volatile than more developed stock markets. Changes in the rates of exchange between currencies may cause your investment/the income to go down or up. Issued in the UK by Janus Henderson Investors. Janus Henderson Investors is the name under which Janus Capital International Limited (reg no. 3594615), Henderson Global Investors Limited (reg. no. 906355), Henderson Investment Funds Limited (reg. no. 2678531), AlphaGen Capital Limited (reg. no. 962757), Henderson Equity Partners Limited (reg. no.2606646), (each incorporated and registered in England and Wales with registered office at 201 Bishopsgate, London EC2M 3AE) are authorised and regulated by the Financial Conduct Authority to provide investment products and services.

MULTI-COLOURED

Sam Shaw takes a closer-look at the wide variety of multi-manager trusts available in the closed-ended space

MULTI-MANAGER PRODUCTS COME IN ALL SHAPES AND SIZES. When applied to the closed-ended space, the scope broadens even further: funds of investment trusts, investment trusts of investment trusts or private equity, trusts investing in collectives and direct investments, and multi-managers running segregated mandates.

Many benefits of the traditional open-ended multi-manager sector – namely diversification through a single holding (the "one-stop shop") and outsourcing the portfolio construction – still apply, but other characteristics also come into play.

For example, funds of trusts have to cope with heightened governance where the overarching vehicle is itself closed-ended. Open-ended managers tend to have more of a "free rein" in not having to report to a board every quarter – notwithstanding internal and external legal and compliance stipulations.

SECURITY CHARACTERISTICS

Senior analyst at Hargreaves Lansdown Laith Khalaf says that in his experience, multi-manager investors tend to place greater emphasis on "security" characteristics: these are often high net-worth clients who prefer to hold a couple of multi-manager funds rather than construct their own diverse portfolio.

Yet he says this theory is contradicted somewhat when multi-manager funds are made up of investment trusts, which are often regarded as more volatile.

"When you bring in trusts – because of the discount/premium – you are bringing risk back in because in rising markets you are going to do better, the discounts will close and the trust will move to a premium. The flipside happens when markets fall. You then have to consider gearing, which amplifies that effect."

Peter Hewitt runs the F&C Managed Portfolio Trust (MPT), which is about to celebrate its 10-year anniversary. Constructed

D ONE-STOP SHOP

as a two-part portfolio – one part focusing on income and the other focusing on growth – but under one corporate structure, Hewitt is able to "cross-subsidise" the level of income in one fund with another, balancing out the capital growth in both. This allows him to maintain a more consistent dividend payment without having to take on unnecessary risks to do so.

THE TRADE-OFF

Hewitt says that as a result of gearing, most closed-ended funds outperform their open-ended counterparts over the long-term, but the trade-off from a multi-manager's point of view is liquidity. He cited the experience of his open-ended peers Gary Potter and Robert Burdett, whose F&C MM Navigator Distribution fund has £1.2bn in AUM.

"[Due to their size], Gary and Rob will likely want to buy £50m or £20m of a trust and you can't do that with all trusts, so you have to be more selective and patient."

> **"Funds of trusts have to cope with heightened governance where the overarching vehicle is itself closed-ended"**

With liquidity a defining characteristic of investment trusts, it makes them a natural home for alternative assets. This is what the Henderson Alternative Strategies Trust (HAST) seeks to profit from by investing in closed-ended vehicles in the more esoteric areas of the market. Manager James de Bunsen, who also runs open-ended multi-manager portfolios at Janus Henderson, says the main difference between the structures is the extent to which you are forced to prioritise liquidity.

"If the market backdrop changes, we don't want to become forced sellers, we want those decisions to be ours rather than end up skewing a portfolio because we've had to sell 50 per cent of our holdings to meet redemptions. So we find that daily dealing is a comfort to investors."

So while HAST is designed to take advantage of the more illiquid nature of non-traditional assets, giving investors a door to otherwise less accessible areas of the market, de Bunsen is mindful not to invest solely in illiquid assets.

"Investors don't necessarily want that and you are likely to attract a discount at the ...

overarching trust level if investors think that the valuations of the underlying assets are not completely fresh and up to date."

Witan is an example of a multi-manager trust that appoints segregated mandates to its underlying investment managers.

Khalaf says this could bring costs down as you aren't buying a typical fund with associated charges. The negotiating power, however, will come down to scale, so a smaller multi-manager trust may lend itself better to a mandated set-up.

SECOND-GUESSING

Nick Greenwood, whose Miton Global Opportunities trust of investment trusts has more of a value focus, notes net asset value (NAV) is more "subjective" than in an open-ended fund.

"We are different from an open-ended equity fund because we recognise the value now and do not try to second-guess what might happen in the future," he says.

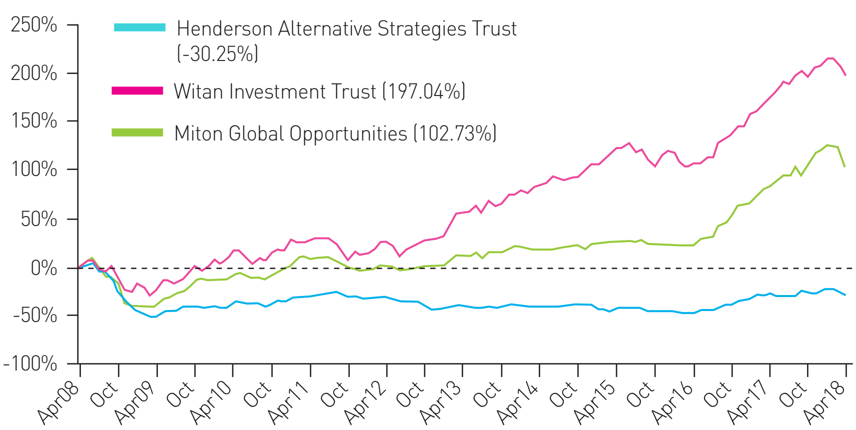
The trust aims to extract value from the discount opportunities present due to the changing nature of the audience. The traditional buyer of an investment trust used to be the old private client stockbroker, which have – in many cases – consolidated and grown into huge chains. As such, their size prevents them from investing in smaller trusts.

The traditional buyer of an investment trust used to be the old private client stockbroker, which have – in many cases – grown into huge chains

Greenwood adds: "We have a situation where the natural buyer is gone but there are still sufficient sellers to drive the share price down and create a very large discount, which is what we are looking to exploit."

It is difficult, then, to generalise about multi-manager trusts. While there are fewer of these vehicles available in the closed-ended space, there is a greater variety in the ones to choose from. It is worth remembering though that if you buy a trust that specialises in a certain area, you shouldn't regard it as a one-stop shop – no matter how many underlying holdings it has.●

PERFORMANCE OF TRUSTS OVER 10YRS



Source: FE Analytics

GOING OFF-ROAD

Charles Plowden, manager of the Monks Investment Trust, talks about why the investment case for Fiat Chrysler has very little to do with either Fiat or Chrysler

A ONCE PROUD ITALIAN CAR COMPANY with a history of turbulent labour relations, and an American automobile giant that recently filed for bankruptcy protection. On the face of it, the investment case for Fiat Chrysler Automobiles (FCA) looks dire. But this would be missing the point. It's not about either Fiat or Chrysler. It's about SUVs, in particular Jeep, and a deft management team that has turned around the company's fortunes.

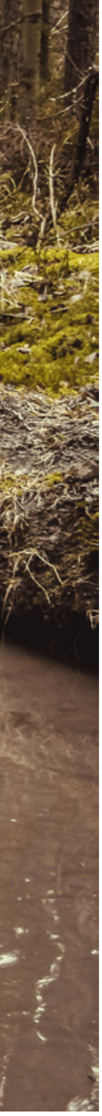
FCA is a classic latent growth stock with a mismatch between the company's low valuation and its potential. When Monks purchased FCA shares in March 2015, we believed it could move quickly from large losses to sustainable profits. It also owned Ferrari, a super-premium brand, which was unrecognised. This was shown when FCA spun off Ferrari in October 2015 in a successful New York listing. Monks enjoyed the rise in the Ferrari share price and sold its stake in April 2017. The financial crisis then handed Fiat a rare opportunity that would transform its fortunes. When Chrysler went bankrupt in 2009, Fiat purchased a sizeable stake in the US company then gradually acquired other shares and completed the acquisition in 2014. This transformed Fiat from being a small European car company to a global player with a significant North American presence.

Baillie Gifford had good relationships with FCA's core management team of John Elkann (chairman) and Sergio Marchionne (chief executive). Elkann is the grandson of Gianni Agnelli, the suave European industrialist who ran Fiat in its pomp. And Marchionne is the proven, professional executive who successfully managed companies in the Exor stable.

Marchionne's great strength is that he is an outsider in the car industry. As a result, he questions everything. He sees much duplication in the industry. He wants to avoid wasting money and time on marginal differentiation, believing that the differentiation and value is not in the engine, it's in the brand – the look and feel of the vehicle.

Marchionne's desire for consolidation drove Fiat's risky purchase of Chrysler, a once great American company that was haemorrhaging sales and cash. His five-year turnaround plan for Fiat Chrysler involved spending billions of dollars on new models, stripping out costs and revitalising the brands. Many investors ran for the hills.

However, FCA has defied sceptics and done almost everything it said



ANNUAL PAST PERFORMANCE TO 31 DECEMBER EACH YEAR (%)

	31/12/12 - 31/12/13	31/12/13 - 31/12/14	31/12/14 - 31/12/15	31/12/15 - 31/12/16	31/12/16 - 31/12/17
Share price	25.8	3.2	8.9	33.8	35

Source: Morningstar. Share price, total return.

All data as at 28 February 2018 unless otherwise stated. Past performance is not a guide to future returns.

it would do. The two big challenges for Fiat were continual industrial unrest from its heavily unionised workforce, and selling cars that people didn't want to buy. Instead of closing some large factories, FCA started making higher value Jeeps for export, avoiding industrial action, costly redundancies and pension pay-offs. In 2009, Jeeps were produced in four US plants. This is now 10 plants in six countries.

Jeep production has risen from 338,000 in 2009 to 1.4 million in 2016, with a 2 million target for 2018. The other star performer has been the pick-up truck maker Ram, which sold 545,851 vehicles in 2016. Along with Dodge, they dominate FCA's North American business, which accounts for five-sixths of the company's operating profits. When Fiat bought Chrysler, these brands were almost exclusive to North America. Now, about one-third of Jeep's sales are outside America.

SUV sales have benefited from low oil prices and low interest rates. We believe the market will grow further, and that FCA's SUV and pick-up divisions remain seriously under-appreciated. The FCA group was valued at €22 billion in December 2017. However, at the same time Goldman Sachs estimated that Jeep alone was worth €22 billion and Ram an additional €13 billion.

> **"It's not about either Fiat or Chrysler. It's about SUVs, in particular Jeep"**

As always, success is not assured. The SUV market is becoming increasingly crowded with newcomers such as Jaguar, BMW and Audi. Over the long term more of the industry's value is shifting from car manufacturers to their suppliers, particularly the research and development, and lucrative software. This trend will accelerate with the move to electric vehicles.

Maybe the biggest question concerns Marchionne, who will retire in 2019. Whoever takes over will inherit minimal debts, a young model range and one of the world's strongest brands.

The biggest risk in buying Chrysler was macro. If the economy had turned, the company would have been vulnerable. But it didn't. FCA's five-year turnaround plan is in its final year – the capital expenditure has been made, profits are growing and its brands are more established. The growth in profits will give the company ammunition to pay down debts and potentially return money to shareholders.

Elkann and Marchionne did not invent a business. They rescued and revitalised two businesses. FCA is not about Fiat or Chrysler. If the company was called Jeep Ram, it would be clear what you were owning and why – a collection of premium car brands with global growth potential. ●

PROTECT OR SURVIVE?

The question of whether investment companies have a role to play in reducing risk depends entirely on what you mean by "risk", writes **Anthony Luzio**

WHEN ANALYSTS TALK ABOUT THE MANY ADVANTAGES OF INVESTMENT TRUSTS, capital preservation tends to come a long way down the list. Being able to gear means these vehicles tend to outperform funds over the long term, while the ability to hold back income earned has led to a trend of increasing dividends every year over multi-decade periods.

However, the ability to gear also counts against them when markets fall, amplifying losses, and while the ability to consistently raise the dividend provides some respite during times of market weakness, this is more than outweighed in the short term by discount volatility.

So should these factors automatically preclude investors from using trusts for dampening risk? Not necessarily. David Coombs, head of multi-asset investments at Rathbones, says it depends on what you mean by "risk". "The thing about investment trusts is they are not forced sellers of assets in the way open-ended funds are when the market is weak because they don't get the redemptions," he explains.

"Will you get more volatility? Yes you will, if your discount widens. But in small caps, for example, if the market is weak you aren't

In the 20th century, exchange controls, high inflation and high tax rates meant equities were the only game in town

forced to sell the stock into an illiquid market where there are only sellers, not buyers, which isn't a great place to be. So you won't suffer the permanent loss of capital.

"I would argue capital preservation is definitely enhanced in an investment trust, but volatility is ironically greater."

As a result, Coombs does not use investment trusts specifically to suppress risk in his multi-asset portfolios, but says he would use these products – and never open-ended funds – to gain exposure to less liquid areas such as small caps, for example.

HAEMORRHAGING MONEY

Many investors' first port of call when looking to preserve capital in the open-ended space is an absolute return fund. However, Cantor Fitzgerald investment companies analyst Markuz Jaffe says the problem here is that a large proportion of these strategies have by and large disappointed – with the issue of illiquidity again coming into play.

"A fund can only buy a certain group of assets that have an expected return," he explains. "Some funds such as Standard Life Global Absolute Return Strategies [GARS] tried to replicate a hedge-fund type strategy and arguably failed, that is why it has been haemorrhaging money."

At just under £20bn in size, Standard Life GARS is still the fifth-largest fund in the IA universe – but it used to be the biggest. Despite its aim to provide a positive return in all market conditions, it is down 3.8 per cent over the past three years while the FTSE All Share is up 18.09 per cent.

"I think what is quite handy in the closed-ended space is that often they get more flexibility," Jaffe continues, "so even in terms of straight-up equity investment trusts, some of the Fidelity ones have the ability to use derivatives and go short to reduce their overall market exposure. Some funds might be able to do this in the open-ended space, but it makes more sense in the closed-ended space where they don't have to meet daily fund flows, particularly if it is a smaller fund."

THE DATA

There isn't an investment trust equivalent of the IA Targeted Absolute Return sector. However, looking at a straight-up comparison between the open- and closed-ended versions of the Flexible Investment sector, it may come as a surprise to some investors that the latter has fared better under a variety of capital preservation

metrics over the past decade, including maximum drawdown, downside capture and volatility. This has come at the expense of significant underperformance in terms of total return.

Among the most successful names in this sector for preserving capital are Personal Assets Trust and Ruffer Investment Company. Both of these use discount control mechanisms, which sees them buy back shares if the discount falls to a certain level, containing losses. The disadvantage here is these can also limit upside potential for new investors hoping to buy in on the cheap and have led some critics to point out you may as well just hold an open-ended fund.

CUTTING THE BONDS

One anomaly of the closed-ended universe – and perhaps another reason why investors tend to overlook it for capital preservation – is the lack of vehicles focused on fixed income.

Peter Spiller, manager of the Capital Gearing Trust, says investment companies held plenty of bonds in the 19th century. In the 20th century, however, exchange controls (restrictions on the movement of currency between countries), high inflation and high rates of tax meant "equities were the only game in town".

"This flexibility perhaps suggests that active management worked effectively. It was also good news for investors because in the 20th century equities produced fabulous returns, around 6 per cent above inflation," he says.

"Capital preservation is enhanced in an investment trust, but volatility is ironically greater"

However, he warns conditions now are "far less propitious than then" adding that both equities and bonds are now at the opposite end of the value scale.

"Capital preservation looks more important until the prices of financial assets that have been inflated by QE return to more 'normal' levels," he explains.

Spiller knows plenty about capital preservation, with his trust losing money in just one of the past 10 calendar years. His preferred asset for this strategy has long been index-linked government bonds, currently making up 38 per cent of his portfolio, although he has sold down the UK variety in favour of US TIPS over the past 12 months.

LOOKING FORWARD

Investment companies are always likely to be more volatile than funds in the short term. The issue with the latter is that with bonds looking expensive, managers focused on capital preservation are being forced to look at alternative assets – which often expose the shortcomings of the open-ended structure in times of market stress.

Whatever else you can say about investment trusts is that, with the first one celebrating its 150th birthday this year, they have proved more than capable of withstanding anything the market has had to throw at them.●

PERFORMANCE OF SECTORS (%)

Name	1yr	3yrs	5yrs	10yrs
IA Flexible Investment	2.36	16.64	36.15	71.15
IT Flexible Investment	4.19	25.85	34.23	43.4

Source: FE Analytics

Fund

BAILLIE GIFFORD POSITIVE CHANGE

The fund has quadrupled the IA Global sector's gains since launch, but its short track record makes it difficult to draw any conclusions about management skill

INVESTORS OFTEN WAIT FOR A FUND to demonstrate at least a three-year track record before buying in and, on the surface, this makes a lot of sense.

However, while you are waiting for a fund manager to prove they can deliver the returns and stick to the process they promised, you can miss out on some impressive gains.

Although there is more risk associated with backing new fund launches, there is also more potential for growth as a smaller volume of assets allows the managers to invest in a wider range of stocks.

This could be the case with Baillie Gifford Positive Change, which launched in January last year. The fund is the best performer in the IA Global sector since then with gains of 45.2 per cent compared with 8.98 per cent from its peer group composite and 7.54 per cent from the MSCI AC World index.

The £24.4m fund invests in 25 to 50 stocks that offer products the management team believes can have a positive impact on the world.

Geographically, the portfolio has a relatively even split with 36.6 per cent in the US, 30.2 per cent in Europe, 19.8 per cent in emerging markets and 11.9 per cent in the developed Asia Pacific region.

Its four main areas of interest are centred around social inclusion and education; environment and resource needs; healthcare and quality of life; and bottom of the pyramid (addressing the needs of the world's poorest populations).

The fund is managed by Julia Angeles, Kate Fox, Kirsty Gibson, Lee Qian, Thomas Coutts and Will Sutcliffe.

Neil Shillito, fund manager at Downing, described Baillie Gifford Positive Change as the most intriguing fund launch of last year and "one for investors to keep an eye on" – even if they have not yet bought in.

He said this is partly because parent company Baillie Gifford still has all the characteristics of a boutique, despite its size. By this, he means it hires managers that are talented, disciplined and aligned with shareholders, adding that the company has an immaculate pedigree of recruiting, training and promoting talent.

Another factor is the strong environmental, social and governance (ESG) stance the fund takes, which should help to focus it on a better quality of company.

The Downing manager claimed that drilling deeper into a company in a bid to understand its credentials in terms of ethos and responsibility pays dividends over the long term.

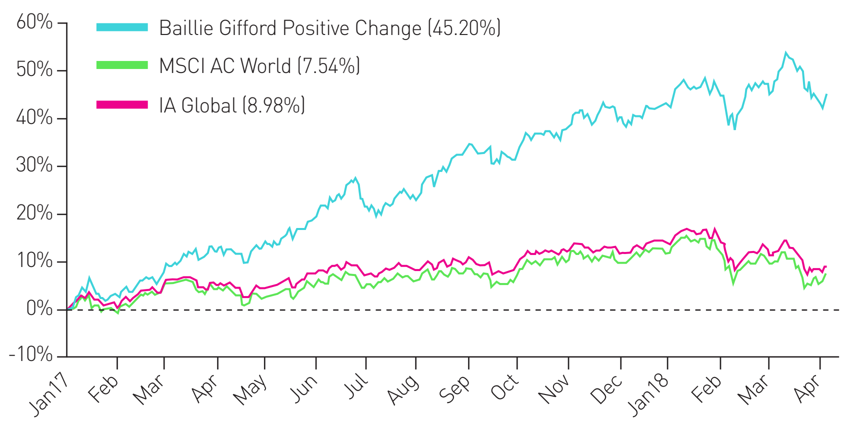
While there is no guarantee Baillie Gifford Positive Change will be a top performer over the long term, given the firm's reputation and consistency it has a better chance than many of its peers.

"If I were betting on the 3.30 at Newmarket and had the choice of the thrice winner favourite or the donkey with a broken leg in the outside stall..." Shillito finished.●

FILE

MANAGERS: **Julia Angeles, Kate Fox, Kirsty Gibson, Lee Qian, Thomas Coutts & Will Sutcliffe**
LAUNCHED: **03/01/2017**
FUND SIZE: **£24.4m**
OCF: **0.6%**
FE CROWN RATING: **N/A**

PERFORMANCE OF FUND VS SECTOR AND INDEX SINCE LAUNCH



Source: FE Analytics

Pension

LINDSELL TRAIN GLOBAL EQUITY

This fund is one of its sector's best short- and medium-term performers in terms of both total return and suppressing volatility

GLOBAL EQUITY FUNDS ARE OFTEN USED AS MAINSTAYS in long-term portfolios such as pension pots as investors search for diversification away from home shores and the growth opportunities offered by the likes of the US and emerging markets. One standout performer in this space is the £4bn Lindsell Train Global Equity fund.

Managed by Michael Lindsell, Nick Train and James Bullock, the fund has a long-term focus that rarely sees it invest in new companies or sell existing ones while their investment case remains intact. The managers like firms with excellent brands, strong franchises and unique market positions; they also insist their holdings are conservatively financed and are capable of producing a high and stable return on capital.

The fund has a concentrated portfolio of around 25 holdings, including Unilever, Diageo, Heineken Holdings, Nintendo and London Stock Exchange. As these names suggest, the fund has a bias towards consumer staples, information technology and consumer discretionary.

These defensive sectors have enjoyed a strong run since the fund was launched in March 2011 after seeing a surge in popularity among investors following the global financial crisis. Reflecting this, Lindsell Train Global Equity posted a total return of 211.57 per cent between inception and the end of March 2018 – making it the third best performer in the IA Global sector. It has also beaten its benchmark by close to 100 percentage points over this period.

Furthermore, FE Analytics data shows that the fund has posted top-decile returns over one, three and five years to the end of March. It has also been one of the sector's best performers in terms of Sharpe ratio, annualised volatility and maximum drawdown since launch.

This performance profile has left the fund with strong ratings: it holds five FE Crowns while Lindsell and Train are both FE Alpha Managers. However, some critics argue that, after such a strong run, the areas favoured by the fund are likely to come under pressure and underperform.

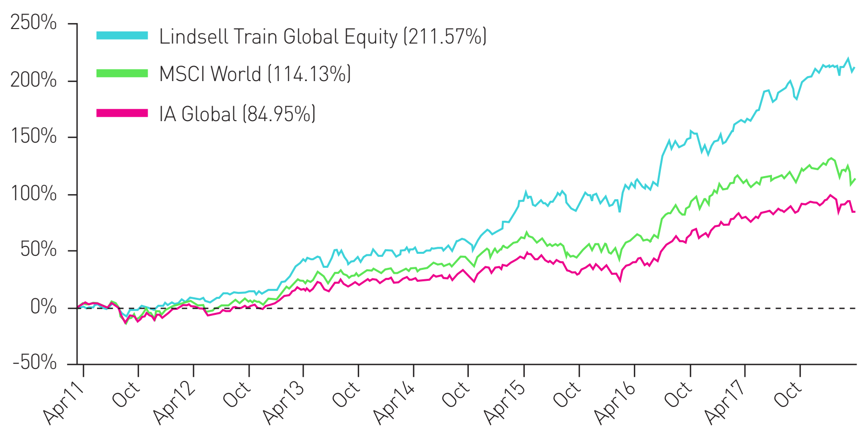
Commenting on this in the second half of 2017, Lindsell said: "Obviously in the short term, re-ratings and swings in valuation will impact short-term returns – sometimes favourably for us and sometimes less so. However, in the long run, our belief is that companies such as these can outperform even when purchased at meaningful premiums to the wider market.

"In a much-cited speech given several years ago, Warren Buffett's partner Charlie Munger stated that 'over the long term, it's hard for a stock to earn a much better return than the business which underlies its earnings'. We feel inclined to agree and look to invest in only those with sound long-term underlying prospects." ●

FILE

MANAGERS: **Michael Lindsell, Nick Train & James Bullock**
LAUNCHED: **16/03/2011**
FUND SIZE: **£4bn**
OCF: **0.74%**
FE CROWN RATING:

PERFORMANCE OF FUND VS SECTOR AND INDEX SINCE LAUNCH



Source: FE Analytics

Trust

ALLIANZ TECHNOLOGY TRUST

This trust has made more than 400 per cent over the past decade, but manager Walter Price says there is still value to be found in tech

THE GROWING IMPORTANCE OF TECHNOLOGY in almost every aspect of daily life has driven numerous stocks in this sector to ever greater heights. Much of the growth seen in global markets in the past five years has been driven by the FAANGs – Facebook, Amazon, Apple, Netflix and Alphabet (Google) – in the US and the BATs – Baidu, Alibaba and Tencent – in emerging markets.

Walter Price, manager of the Allianz Technology Trust, said the runaway success of these companies in recent years has led many investors to ask: "What is the encore? Where does technology go from here?"

He said the answer is that ageing demographics and the need for greater productivity are likely to drive the next phase of growth in the sector.

As such, Price has been hunting among enterprise technology names – which serve organisations rather than individuals – for the stocks set to drive the market over the next generation. He said this "fourth industrial revolution" is likely to be funded by increased spending on investment as industry struggles to meet a shortfall in labour.

"You have the capability of new products that enable productivity and you have both demand and supply coming together to meet it," he explained.

"I think the result is that we're embarking on a very favourable period for enterprise technology, [which] is going to last for another decade. It's not like a one-year [trend], it's going to last for a long period of time."

While FAANGs such as Amazon and Netflix feature in the trust's top-10 holdings, so do a significant number of "as a service" companies, such as cloud computing and some internet firms.

The strong performance of technology in recent years may lead new investors to worry they are late to the party. "There's a tendency in the big run in technology and value creation on the consumer side to say 'oh, it's over', 'should I be selling?' and 'valuations are too high'," said Price. However, the manager pointed out that valuations – even in more consumer-focused companies – are justified given the cashflows and strong earnings growth potential.

He added there are areas such as cloud computing – where data is stored, managed and processed online – and artificial intelligence (AI) that are developing and have the opportunity to improve upon existing processes.

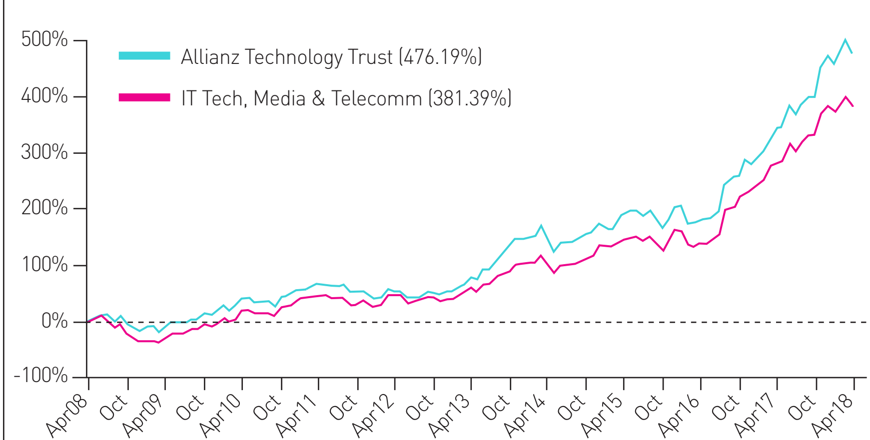
Many of the companies focused on these sectors are small caps and just 24.7 per cent of the Allianz Technology Trust is invested in stocks with a market capitalisation of more than $100bn. Price also has a large weighting to North American stocks, which represent 89.1 per cent of the portfolio.

The trust has made 476.19 per cent over the past 10 years, compared with 381.39 per cent from its sector average.●

FILE

MANAGER: **Walter Price**
LAUNCHED: **1995**
PREMIUM/DISCOUNT: **-1.4%**
OCF: **1.0%**
FE CROWN RATING:

PERFORMANCE OF TRUST VS SECTOR OVER 10YRS



Source: FE Analytics

Shopping around – opportunities in retail

If you look at the share prices of conventional retailers today, you'd be forgiven for thinking that the high street is on its last legs. Meanwhile, the eye-watering valuation of Amazon's stock already reflects a very optimistic future, leaving little room for any disappointment. Amazon now trades on over 170 times 2018 earnings. In contrast, Marks & Spencer is on just 11 times and Gap 16 times.*

Does this gulf in valuations point to the extinction of the high street? We believe it's misguided to assume that online will be the only way to shop. Online transactions are here to stay, but investors shouldn't underestimate the staying power of shops.

Instead, the market's disdain for conventional retailers should be a buying signal for contrarian investors. Shopping is a major leisure activity for a great number of people – not just a necessity, but a social activity, even a hobby. The convenience of clicks can't compete with that.

Meanwhile, many bricks-and-mortar retailers are meeting the e-commerce challenge head on, by creating multi-channel offerings with mobile apps and 'click and collect'. Some are also adding other leisure services to their sites, increasing footfall and encouraging spending. And many have powerful brands that e-commerce has yet to rival. Gap and Marks & Spencer provide two good examples.

Although Gap has fallen from favour since its peak of popularity in the 1990s, a turnaround is underway. The company is refocusing on its popular Old Navy and Athleta brands, while reducing Gap branded stores and bringing products more quickly to market to capitalise on current trends. All of this should boost earnings and improve margins. So too should its drive to move away from a reliance on promotions – which has encouraged consumers only to buy when there's a sale on.

Marks & Spencer is also reducing promotions as part of its own turnaround plan. Revivals in its fortunes have been heralded before, but we believe that this time really is different. Led by veteran retailer Steve Rowe and turnaround specialist Archie Norman, the company is shedding excess stores, revitalising product lines and improving its pricing strategy. Its food division is still market-leading, and its investments in IT and infrastructure are creating a robust multi-channel offering.

We see these and many other retailers as 'ugly ducklings' – unloved shares that most investors shun. Although they have been under pressure from online competitors, they have considerable potential to defy the market's pessimistic expectations and turn their circumstances around. And while we wait for our ugly ducklings to become swans, most – like Gap and M&S – offer higher-than-average dividend yields. We believe that the depressed shares of high-street operators conceal compelling opportunities. Smart investors should look out for high street bargains.

* As at 2 February 2018.

Telephone: 0131 225 7781 | Email: info@thescottish.co.uk | Website: www.thescottish.co.uk

IN FOCUS

THE HISTORY BOYS

IT Global is home to numerous trusts with a track record of more than 100 years – but there is far more to the sector than longevity, writes **Adam Lewis**

HOME TO A TOTAL OF £27BN OF ASSETS, IT Global is by far the largest sector in the closed-ended universe.

With investors generally shunning UK equities in 2017, thanks largely to political uncertainties surrounding Brexit, both open- and closed-ended global funds have proved popular hunting grounds.

However, while the open-ended sector has at times struggled to beat the MSCI World, its closed-ended counterpart has excelled. Not only has it outperformed the index over one, three, five and 10 years, it has also significantly outperformed IA Global over every one of these periods.

Over the past decade, for example, the IT Global sector is up 146.95 per cent compared with 110.86 per cent from IA Global and 89.02 per cent from the MSCI World.

TIME ON THEIR SIDE

The trusts in the closed-ended sector certainly have experience on their side. Aside from the 150-year-old Foreign & Colonial trust, IT Global features several other vehicles – Bankers, British Empire and Scottish Investment Trust – that were launched in the 1880s, while the £6.1bn Scottish Mortgage and £1.9bn Witan trusts are relative saplings with both opening for business in 1909.

Over this time, these trusts have witnessed two World Wars, the Great Depression, Black Monday in 1987, the global financial crisis of 2008 and, most improbably of all, England's World Cup victory in 1966. It is this history of not only investing throughout – but also surviving – so many market cycles that helps to explain the broad appeal of these trusts. But what other factors lie behind the popularity of this behemoth sector?

Adrian Lowcock, investment director at Architas, says the obvious benefit for closed-ended global funds is their ability to gear, which gives them a significant advantage during rising markets. At the same time, being closed-ended means the fund managers do not have to worry about inflows and outflows.

•••


EUROPE

"For me, IT Global is the one investment trust sector where the history of these funds makes a difference," says Lowcock. "You are investing in the trusts, not just the managers, which is rare. Having a disciplined dividend policy also helps their long-term focus and I am not surprised, given these factors, they have outperformed the open-ended sector."

PERFORMANCE OF SECTORS VS INDEX

	1yr (%)	3yr (%)	5yr (%)	10yr (%)
IA Global	2.66	27.54	57.44	110.86
IT Global	13.03	47.12	81.64	146.95
MSCI AC World	11.23	23.76	64.25	89.02

Source: FE Analytics

"For me, IT Global is the one investment trust sector where the history of these funds makes a significant difference. You are investing in the trusts, not just the managers"

TOP OF THE PILE

Sitting top of the pile over three and five years with returns of 153.4 and 264.8 per cent is Lindsell Train IT, managed by Nick Train. However, the trust is currently trading at a 37.2 per cent premium to net asset value (NAV), meaning new investors are likely to find better opportunities elsewhere – especially with the sector trading at an average discount of 3 per cent.

"In this instance, investors may wish to look to the unit trust to get access to Train's investment style, because while they may be missing out on the effects of gearing, they are not paying such a huge price to get invested," he adds.

Winterflood Investment Trusts holds three IT Global funds in its model portfolio: Foreign & Colonial, Monks and Scottish Mortgage. While it has recommended the Baillie Gifford-managed duo of Monks and Scottish Mortgage for some time now, it added the F&C trust in January this year at the expense of Law Debenture, which was launched in 1889.

"Foreign & Colonial is an attractive 'one-stop' global equities savings product," explains Innes Urquhart, a research analyst at Winterflood. "It makes good use of the closed-ended structure through its allocation to private equity and the active use of gearing."

Urquhart adds that the trust is also likely to benefit from the publicity and attention generated by its 150-year anniversary.

"We think this could increase demand for its shares, particularly from retail investors, and this could lead to a further narrowing of its discount (which was 3 per cent at 28 March). Downside risk is limited by the fund's policy to defend a 7.5 per cent discount."

"Its size and fee structure means its ongoing charges (0.79 per cent) are competitive, particularly given they include a look-through to fees on its private equity investments."

Regarding fees, Annabel Brodie-Smith, communications director at the AIC, says the lowering of charges across the sector has also boosted its appeal.

"Since the start of 2013, one-third of funds in the sector have cut their fees," she says. "When you add this to the fact they can gear, have the freedom to invest in areas such as private equity and have a board of independent directors, you can see why investors treat the sector as a one-stop shop."

••• Brodie-Smith notes that while gearing has driven performance in the past, the average level now stands at just 4 per cent. Majedie Trust has the highest level at 11 per cent of assets, followed by Foreign & Colonial at 8 per cent and Witan at 6 per cent.

CLAIM TO FAME

"The investment trust industry has a great claim to fame – it literally invented the concept of the collective investment vehicle," notes Simon Moore, a senior investment manager at Seven Investment Management (7IM).

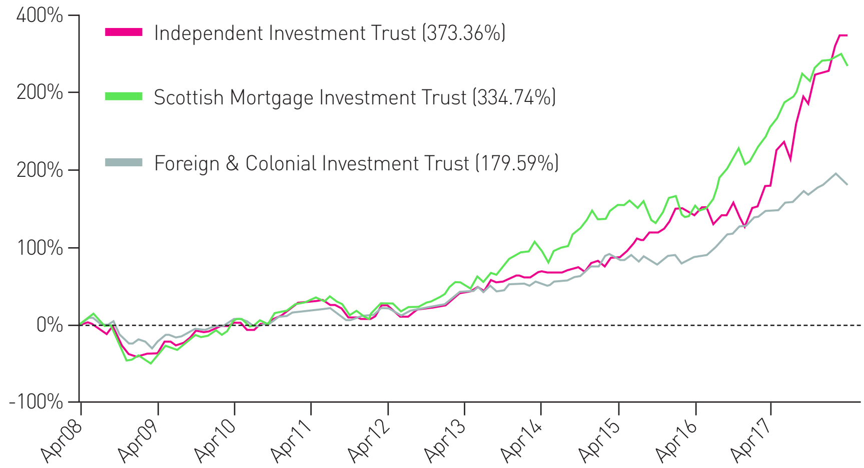
"It's a great story to tell, and while there is comfort to be taken in something that has been around the block a number of times, we are living in the here and now."

As a result, Moore says that while trusts have tangible benefits, he prefers to look at funds across the entire collective investment universe and picks out those he considers to be the best in class.

"When it comes to managers, we do like to see a long track record, but a couple of market cycles – maybe 10 to 20 years – will suffice, and less so if a fund manager is known to us from previous incarnations. There are times when we will favour investment trusts and in the global space we like Witan, Scottish Mortgage and Murray International."

"But equally we like open-ended funds such as Fundsmith Equity and Lindsell Train Global Equity. In terms of the latter, we actively prefer this fund over its investment trust sister given its current whopping premium. It really is a case of assessing each fund on its own merits – don't be blinkered by the structure. It is what is under the bonnet that counts." ●

PERFORMANCE OF TRUSTS OVER 10YRS



Source: FE Analytics

The birthday boy
FOREIGN & COLONIAL

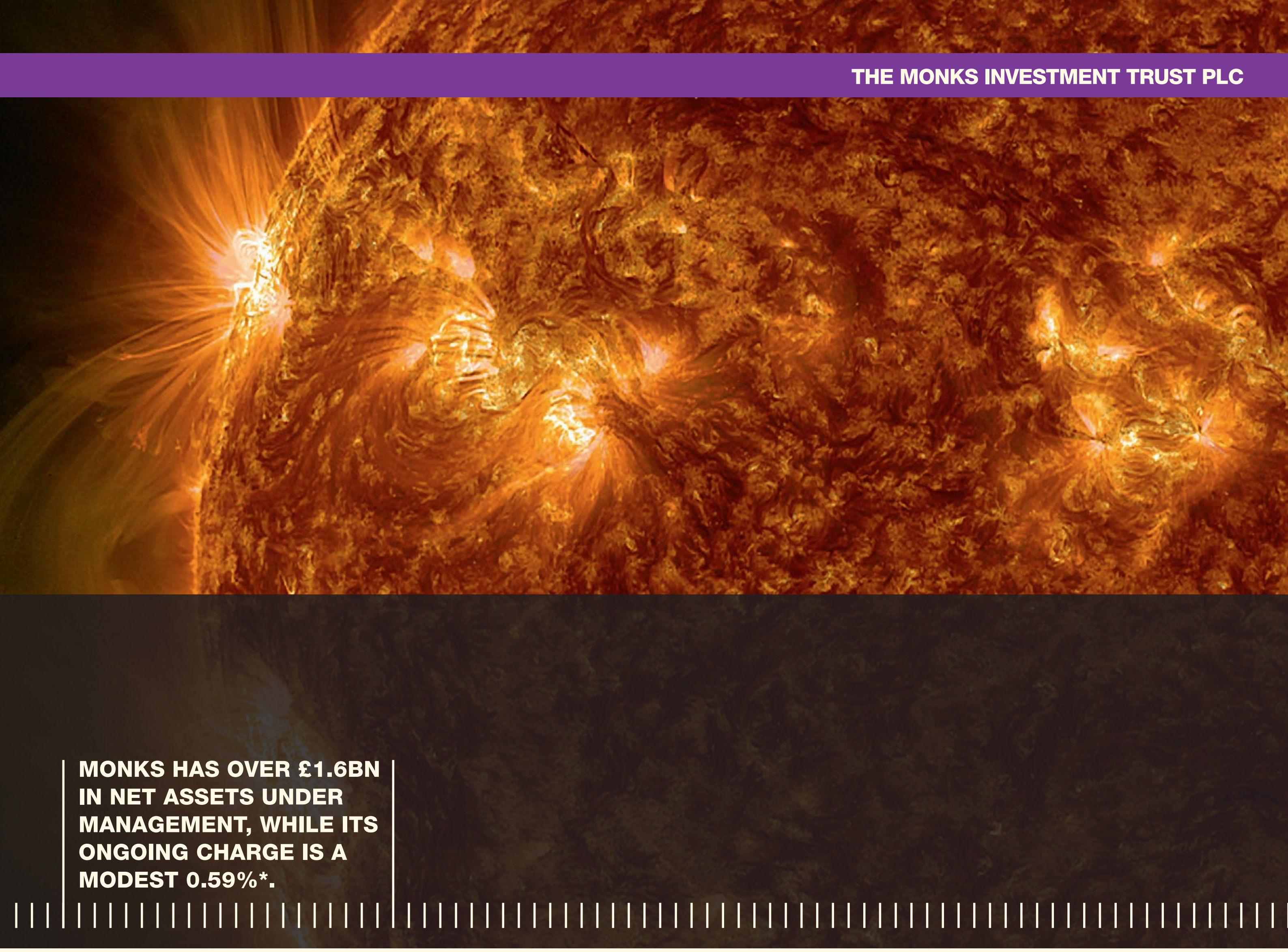
THE YEAR WAS 1868, VICTORIA WAS ON THE THRONE, Benjamin Disraeli was prime minister and Andrew Johnson became the second US president to be impeached. At the same time, Foreign & Colonial set out to raise £1m in a new collective investment scheme known as the investment trust. Fast-forward 150 years, today it sits on assets just shy of £3.5bn and is regarded as a "one-stop" global savings equity product. It had exposure to 459 holdings as at 30 January, with its largest position in the US at 49 per cent of assets, followed by Europe ex UK at 20 per cent and emerging markets at 13 per cent. It has just 5 per cent in the UK, which Winterflood notes is a significant fall from the 34 per cent held at the end of 2012.

New kid on the block
INDEPENDENT INVESTMENT TRUST

WHILE MUCH OF THE CURRENT BUZZ IN THE INVESTMENT TRUST UNIVERSE concerns its long history, the fund sitting top of the rankings in the IT Global sector over one year is a relative newcomer. Max Ward, formerly of Scottish Mortgage, has headed up the self-managed Independent Investment Trust since launch in 2000. This "best ideas" vehicle of just under 30 stocks has delivered a 67.92 per cent return over the past 12 months and is also close to the top of the rankings over three and five years, even though its portfolio is mostly made up of stocks listed in the out-of-favour UK.

What's in a name?
SCOTTISH MORTGAGE

A CENTURY BEFORE THE 2007 GLOBAL FINANCIAL CRISIS, Scottish Mortgage was launched just after another catastrophe – the "bank panic" of 1907. Moore points out that while Scottish Mortgage's name still harks back to its Baillie Gifford origins, its holdings today mean it could not be more different, dominated by tech giants such as Amazon, Tencent, Alibaba and Facebook. Moore says this means it is not for the faint hearted, adding: "Scottis Mortgage remains a fund run on high conviction, with meaningful stakes in some exciting high-growth companies. The investment trust has also been able to increase its dividend for each of the last 34 years, making it an AIC Dividend Hero."



THE CENTRE OF YOUR PORTFOLIO.

Monks Investment Trust, we believe, could be a core investment for anyone seeking long term growth. It is managed according to Baillie Gifford's £33bn Global Alpha strategy. As a result, **Monks** takes a highly active approach to investment and its portfolio looks nothing like the index. The managers group their holdings into four different growth categories – stalwart, rapid, cyclical and latent. This allows for excellent diversification and offers the chance to unearth some of the more interesting companies listed on global stock markets.

moneywise Investment Trust awards 2018 WINNER
GLOBAL
Monks Investment Trust

Please remember that changing stock market conditions and currency exchange rates will affect the value of the investment in the fund and any income from it. Investors may not get back the amount invested. If in doubt, please seek financial advice.

If you're looking for a fund to shine at the centre of your portfolio, call **0800 917 2112** or visit **www.monksinvestmenttrust.co.uk**

A Key Information Document is available by contacting us.

BAILLIE GIFFORD

Long-term investment partners

*Ongoing charges as at 30.04.17. All other data as at 31.12.17. Your call may be recorded for training or monitoring purposes. Monks Investment Trust PLC is available through the Baillie Gifford Investment Trust Share Plan and the Investment Trust ISA, which are managed by Baillie Gifford Savings Management Limited (BGSM). BGSM is an affiliate of Baillie Gifford & Co Limited, which is the manager and secretary of Monks Investment Trust PLC.

FLEET *of* FOOT

SAINTS' **James Dow** highlights three stocks whose capital-light business models should help them deliver consistent earnings growth over the long term

A FUNDAMENTAL TENSION EXISTS IN MANY COMPANIES between dividends and growth. Most obviously this occurs in business models that require large investments of capital to increase production. Oil producers are the classic example: the natural decline rate of oil fields forces managers of these companies to reinvest a large chunk of profits every year just to keep their output flat, let alone grow.

An investor seeking long-term income growth can tilt the universe substantially in their favour by recognising this tension. Fortunately, not all companies require large capital investments to grow. By focusing on businesses that are naturally capital-light, investors increase the probability of enjoying both profit and dividend growth from their holdings. Here are three long-standing investments in SAINTS that follow this core philosophy.

C.H. ROBINSON

US-BASED SOFTWARE BUSINESS CH ROBINSON matches companies that need to ship freight with small trucking firms across the US. Growth in network volume occasionally requires the company to build data centres, but servers are cheap, as is land in rural Minnesota where it is based. The capital-light business model has allowed it to increase cash returns to shareholders while investing for growth and it has raised its dividend in every year since it listed in 1997.

Wolters Kluwer

WOLTERS KLUWER'S CHIEF EXECUTIVE NANCY MCKINSTRY has done a terrific job of transforming this publishing business to focus on providing digital information. The company is now looking for methods to improve its products, such as UpToDate, which helps doctors use the latest medical research to diagnose diseases. This should help it raise revenues and earnings without large capital investments and it recently announced an 8 per cent increase in its dividend.

AVI

WE WERE FIRST ATTRACTED TO TEA AND BISCUIT MAKER AVI by its cash-generative model and consistent dividend growth, but fretted about the outlook for South Africa where it is based. The profit and dividend have compounded upwards since then despite cost pressure from the rand and there is a good chance it will deliver income growth for years to come. AVI's management knows the local market inside-out and is always finding methods of expanding the business in a disciplined manner.

GAM Star MBS Total Return

The Share Centre's **Sheridan Admans** says mortgage-backed securities provide significant diversification opportunities, despite their unfavourable reputation

FOR SOME TIME NOW I HAVE BEEN SEARCHING FOR ASSETS that deliver high risk-adjusted returns but with a low correlation to the rest of the market. Assets that provide ample liquidity, duration flexibility and exposure to US growth in areas where active management can really add value.

I have therefore introduced GAM Star MBS Total Return to our TC Share Centre Multi Manager Cautious fund, as its management team's extensive experience should allow it to successfully navigate the current interest-rate cycle.

Mortgage-backed securities, or MBSs as they are more commonly known, were unfamiliar to UK investors until the financial crisis. While the asset class remains unpopular, it provides significant opportunities that are hard to overlook when constructing a diversified portfolio.

MBSs represent approximately 24 per cent of the US fixed income market. It is possible to obtain a significantly higher yield from MBSs than that offered by US treasuries with similar maturities, including higher quality agency and non-agency bonds. Agency refers to government-supported issuers of mortgages such as Freddie Mac and Fannie Mae which guarantee mortgages. Non-agency issuers are those that are not guaranteed. Arguably higher yields come with little or no additional risk from holding positions in both Freddie Mac and Fannie Mae. The MBS market is highly liquid with approximately $200bn traded daily and it has a size of around $8trn.

The US housing market has been recovering since falling from its peak in 2008 and has seen homeowner vacancy rates fall significantly, single-family housing under construction move below its long-run average, homeownership rates start to pick up since their collapse and an improvement in housing affordability.

MBSs still have an unfavourable reputation due to the role sub-prime played in the financial crisis and while some of those risks have faded, others remain. These include mortgage holders defaulting in large numbers or property values falling significantly, as a result of mismanagement of the US economy, and the return to a softer regulatory environment. Another major threat is prepayment risk, which is the early payment of the loan on the mortgage, not dissimilar to a callable bond.

The GAM team has enormous experience of evaluating and understanding the impact of interest rate changes, credit risk and mortgage prepayment behaviour. It has managed three US interest-rate cycles, including the peak of 5.25 per cent in 2006 and the historic low of 0.25 per cent in 2008, and has delivered positive returns since 2002.

The managers currently have duration of 1.24 years in their portfolio and can flex between -3 per cent and +3 per cent. The average coupon in the portfolio is 2.96 per cent with the average life of the mortgages it holds at around 4.5 years.●

***Sheridan Admans** is an investment manager at The Share Centre*

TRUSTNET magazine

MAY PREVIEW

Going green

The next issue of Trustnet Magazine will look at all aspects of ethical investing. We will reveal why a focus on environmental, social and governance (ESG) issues is no longer the preserve of eco-warriors but is now regarded as a fundamental component of any long-term investment process.

We will also look at some of the most attractive opportunities in areas such as clean technology and renewable energy and name the best funds and trusts for playing these themes.