• Issue 43 / September 2018 •

FE Trustnet

magazine

When trusts go bust

GETTING ONBOARD
Do investment trust boards really add value?

CUTTING OUT THE MIDDLEMEN
How to avoid platform fees

TRADE-OFF
Do Asia's growth prospects outweigh the risks?

+ Fund, Pension, Trust / Sector Profile / Stockpicker / What I Bought Last

ISSUE 43

CREDITS

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

WEBSITE: **www.trustnet.com**
EMAIL: **editorial@financialex-press.net**

CONTACTS:

Anthony Luzio
Editor
T: **0207 534 7652**

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

Editorial
Gary Jackson
Editor (FE Trustnet)
T: **0207 534 7680**
Jonathan Jones
Senior reporter
T: **0207 534 7640**
Mai Sardon
Reporter
T: **0207 534 7625**
Henry Scroggs
Reporter
T: **0207 534 7692**

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

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

BE BETTER INFORMED

Editor's letter

The structure of investment trusts gives them many advantages over funds, but their status as limited companies means they can go out of business. In this month's cover story, Adam Lewis finds out how often this has happened in the past five years and reveals what to expect if the board decides to pull the plug.

This independent board of directors is often cited as one of the biggest advantages of investment trusts, but how much value do they really add? This is the question Cherry Reynard asks on page 13. Meanwhile, Rebecca Jones casts her eye over biotech, one of the best performing closed-ended sectors over the past decade, to see if it can keep up the good work.

In our regular columns, I find out whether "trade wars" will affect Asia's long-term growth story, John Blowers weighs up the pros and cons of investing directly with an asset manager, and CFP Sanford DeLand's Rosemary Banyard names three stocks given a premium valuation thanks to their small number of shares in issue. Finally, Liontrust's John Husselbee reveals which fund he is using while noise is trumping fundamentals in emerging markets.

Enjoy reading,

Anthony Luzio
Editor

Contents


34

The end of the road
Adam Lewis finds out what happens when investment trusts go out of business
P. 2-7

UK market ripe for stock pickers
Baillie Gifford's Milena Mileva says the UK contains some "tremendously exciting businesses" that are world leaders in their field
P. 8-11

Getting onboard
Cherry Reynard asks: how much value does an independent board of directors really add?
P. 13-16

Income facts
David Smith of the Henderson High Income Trust explains why dividends should be an important consideration for every type of investor
P. 18-21

A clean bill of health?
Big biotech recovered quickly from the threat of price caps, but Rebecca Jones says it faces a larger threat from within
P. 23-27

Fund, pension, trust
AXA Framlington Global Technology, Marlborough UK Micro Cap Growth and Independent Investment Trust find themselves under the spotlight this month
P. 28-33

Trade-off
The recent spike in volatility is the price investors must pay to access Asia's powerful long-term growth themes, writes Anthony Luzio
P. 34-39

Data hub
Crunching the biggest trends down into figures
P. 40-41

Cutting out the middlemen
John Blowers weighs up the pros and cons of bypassing platforms and advisers and investing directly with an asset manager
P. 42-47

Scarce story
CFP Sanford DeLand Free Spirit's Rosemary Banyard says the market often places a premium valuation on businesses with a lower number of shares in issue
P. 48-49

What I bought last
Liontrust's John Husselbee names a fund he says represents a useful addition to his portfolios while noise is trumping fundamentals in emerging markets
P. 50-51


42

Adam Lewis finds out what happens when investment trusts go out of business

The end of the road

A criticism often laid at the door of the open-ended investment industry is that not only are there too many funds, but the vast majority of these are either poor performers or are too small to be economically viable.

For example, the latest edition of the biannual Bestinvest Spot the Dog list, which names and shames the open-ended portfolios that have underperformed for three consecutive years and by more than 5 per cent over the cumulative period, highlighted 58 dog funds, the highest number recorded since the study began in 1994.

The closed-ended universe, on the other hand, tends to face a lot less criticism, for the simple reason that its funds face the prospect of being liquidated and wound up if they underperform for a sustained period of time.

Survival of the fittest

According to the AIC, this fate can befall an investment trust for a number of reasons: if it has reached the end of its fixed life, the investment objective is no longer in demand, or performance has been poor.

"Darwin's theory of evolution applies to investment trusts, it's all about the survival of the fittest," says Annabel Brodie-Smith, communications director at the AIC. "Investment trusts have been around

...

Open-ended funds do not have independent boards and often investors' money languishes in a poorly performing, lacklustre fund without any option for change

Case Study

ASHMORE GLOBAL OPPORTUNITIES

Launched in December 2007, Ashmore Global Opportunities quickly racked up assets of close to £365m from investors attracted by a focus on special situations in emerging markets.

However, after a continued period of share price falls which led the trust to trade on a wide discount, shareholders voted to wind up the trust in March 2013 and the objective was changed to an orderly realisation of assets so cash could be returned to investors.

Some five years later, however, and the trust is still being unwound. Yet in an odd quirk of fate, the £14m of assets left in the trust returned an impressive 40.49 per cent to those remaining shareholders in the second quarter of 2018, making it the fourth best-performer in the closed-ended universe over that time.

It will take longer to wind up an investment company that holds property or other physical assets. However, the process is not always brisk for equity trusts either

• • •

for 150 years and have evolved to meet shareholders' needs and deliver strong long-term returns. Open-ended funds do not have independent boards and often investors' money languishes in a poorly performing, lacklustre fund without any option for change."

So how often do investment trusts go out of business and what happens when they do? According to the AIC, 52 investment companies have come to the end of their life in the last five years, which is about 10 a year.

The first step in the process of closing down a trust is taken by the board if the directors believe shareholders no longer want to continue investing. In this case, they can recommend it is liquidated or wound up, before putting this proposal to shareholders to vote on.

If they agree with the proposal, Brodie-Smith says the board may simply decide it is best to sell all of the investments and return the cash to shareholders.

Alternatively, it may allow them to invest in another fund, which may be a closed-ended one with a similar investment objective or an open-ended one that holds the same type of assets. This process is often referred to as "rolling over" the investments. One advantage of taking this route is that the shareholders will not incur capital gains tax on any profits they have made, which may be the case if they take cash instead.

How long the wind-up process will take depends on the type of assets the trust invests in. For example, Brodie-Smith says it will take longer to wind up an investment company that holds property or other physical assets. However, the process is not always brisk for equity trusts either.

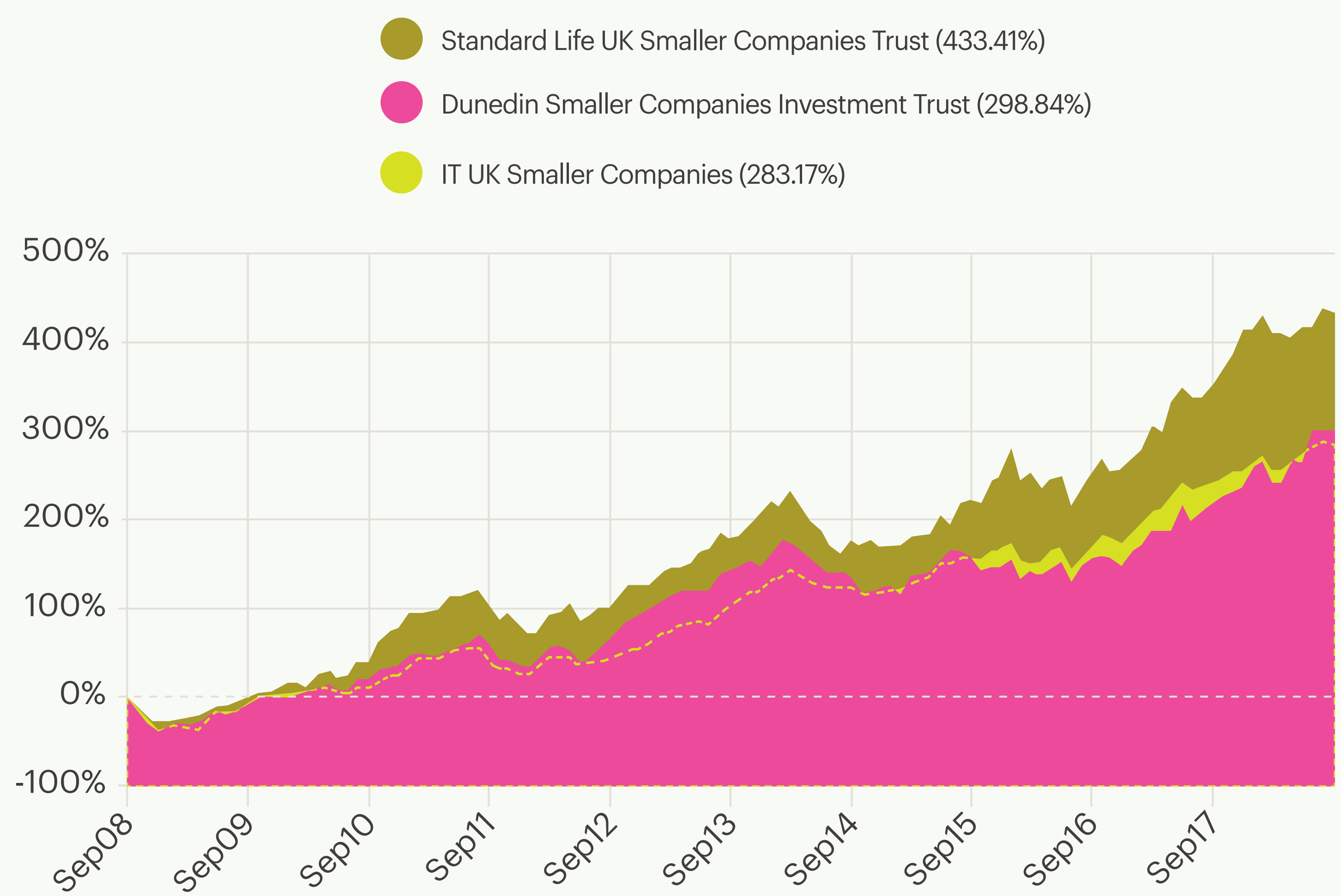
M&A

In addition to recommending closures or switches into other funds, directors may propose merging two trusts so one no longer exists.

The most recent example of this took place in June last year when the board of Dunedin Smaller Companies proposed a merger with Standard Life UK Smaller Companies. This followed a strategic review by Dunedin's board, which was concerned about its wide discount to NAV, believing that

• • •

PERFORMANCE OF TRUSTS VS SECTOR OVER 10YRS



Source: FE Analytics

it reflected the fund's small size and illiquidity of its shares.

Shareholders of both trusts will vote on the proposals later this year, and if agreed the result would be the voluntary liquidation of Dunedin Smaller Companies and a rollover of its assets into the Standard Life trust.

Simon Elliott, head of research at Winterflood Investment Trusts, says that while there has been a handful of mergers in recent years and demand for larger, more liquid trusts is growing, consolidation across the sector remains rare.

"Given there are more than 100 investment companies with market caps of less than £150m, one might be forgiven for expecting more mergers as funds look to retain and attract key investors," he says.

12

Number of trusts in the AIC Hedge Funds sector that have wound up since August 2013

FATE OF ALL TRUSTS WOUND UP OVER PAST 5YRS

Fate of trust	No. of trusts
Liquidated, no rollover vehicle	35
Rolled over to another vehicle	5
End of life/rollover	6
Merged	3
Acquired	3
Total	**52**

Source: The AIC

> "A cynic would suggest that some directors are reluctant to push for a strategy that would leave them at a loose end"

"This includes the larger wealth manager groups which have experienced rapid growth over the last 10 years and are in danger of outgrowing the investment trust sector. A cynic would suggest that some directors are reluctant to push for a strategy that would leave them at a loose end."

Reflecting on mergers which have taken place, Elliott picks the rollover of the Henderson Global Trust into Henderson International and Bankers in 2016, while last year Aberdeen UK Tracker was merged into Aberdeen Diversified Income & Growth and Threadneedle UK Select merged into Henderson High Income. Elliott says the latter merger reflected Threadneedle UK Select's small size and inability to grow despite its adoption of a zero-discount policy.

Hostile bids

Another type of merger is an aggressive/hostile bid for a company. Unlike the previous examples, this is a bid by one trust to merge into another, a move that is not welcomed by the latter party.

Although in the past such hostile bids have largely proved unsuccessful (and as a result, few and far between), Nick Greenwood at Miton believes in an environment in which improved corporate governance is very much on the agenda, this may change.

"Hostile bids are an expensive exercise, with lots of money being spent on fees to fight off the approach," he says. "This has traditionally been seen as a disincentive for such approaches, but in the current environment in which corporate governance and ESG factors are being scrutinised more closely, such hostile bids could be more likely to succeed than they have done in the past 10 to 15 years."

Like Elliott, Greenwood believes there needs to be more consolidation in investment trusts, especially with traditional equity offerings.

"Funds need to be offering something different to justify their existence, so there is scope to lose some traditional equity funds in wind-downs or mergers," he says. "However, at the same time we are likely to see growth in alternative funds, such as forestry, infrastructure and more illiquid assets."

If you are a shareholder of an investment trust which is in the process of being liquidated, the AIC says you should receive paperwork explaining what will happen next, what your choices are and what the tax consequences will be. It recommends that you read this carefully before completing and returning it on time so that the company knows which option you want to take.

As always, if you are unsure which is the best option to take, you should seek financial advice. ●

An independent board of directors is often cited as one of the advantages of investment trusts. But, asks **Cherry Reynard,** how much value do they really add?

Getting onboard

The oversight of an independent board has been a key selling point for investment trusts. The board should represent the interests of the shareholders, replacing poorly performing management teams, negotiating fees and ensuring good communication. But, as the recent spat between Invesco Perpetual and the board of the Invesco Perpetual Enhanced Income trust has shown, it is an imperfect system. Do boards really add value?

The Invesco example seemed to be a personal clash. The board exerted some pressure over fees, the relationship deteriorated and Invesco took the rare step of resigning as manager of the trust. Shareholders were understandably concerned to lose the services of the highly regarded pair of Paul Read and Paul Causer. The relationship has since been repaired, but not without the resignation of two board members. The affair highlighted the potential tensions between board members and investment managers.

There are other examples where board oversight has not seemed to deliver tangible benefits for investors. A notable case would be British Assets, moved from F&C Investments to BlackRock in 2015 on performance grounds, it was then moved to Aberdeen after performance weakened further under

"Since 2013, over a third of investment companies have reduced their charges to benefit shareholders by cutting management fees, eliminating performance fees or introducing a tiered fee structure"

• • •

BlackRock's tenure. The board of Alliance Trust must also take some responsibility for the slow resolution of its long-running problems.

Success stories

There are also plenty of success stories with boards, however, with great progress made on reducing fees, for example. Ian Sayers, chief executive of the Association of Investment Companies (AIC), says: "Since 2013, over a third of investment companies have reduced their charges to benefit shareholders by cutting management fees, eliminating performance fees or introducing a tiered fee structure."

He adds that boards have also been instrumental in introducing discount-control policies and now two-thirds of investment companies have one of these strategies in place.

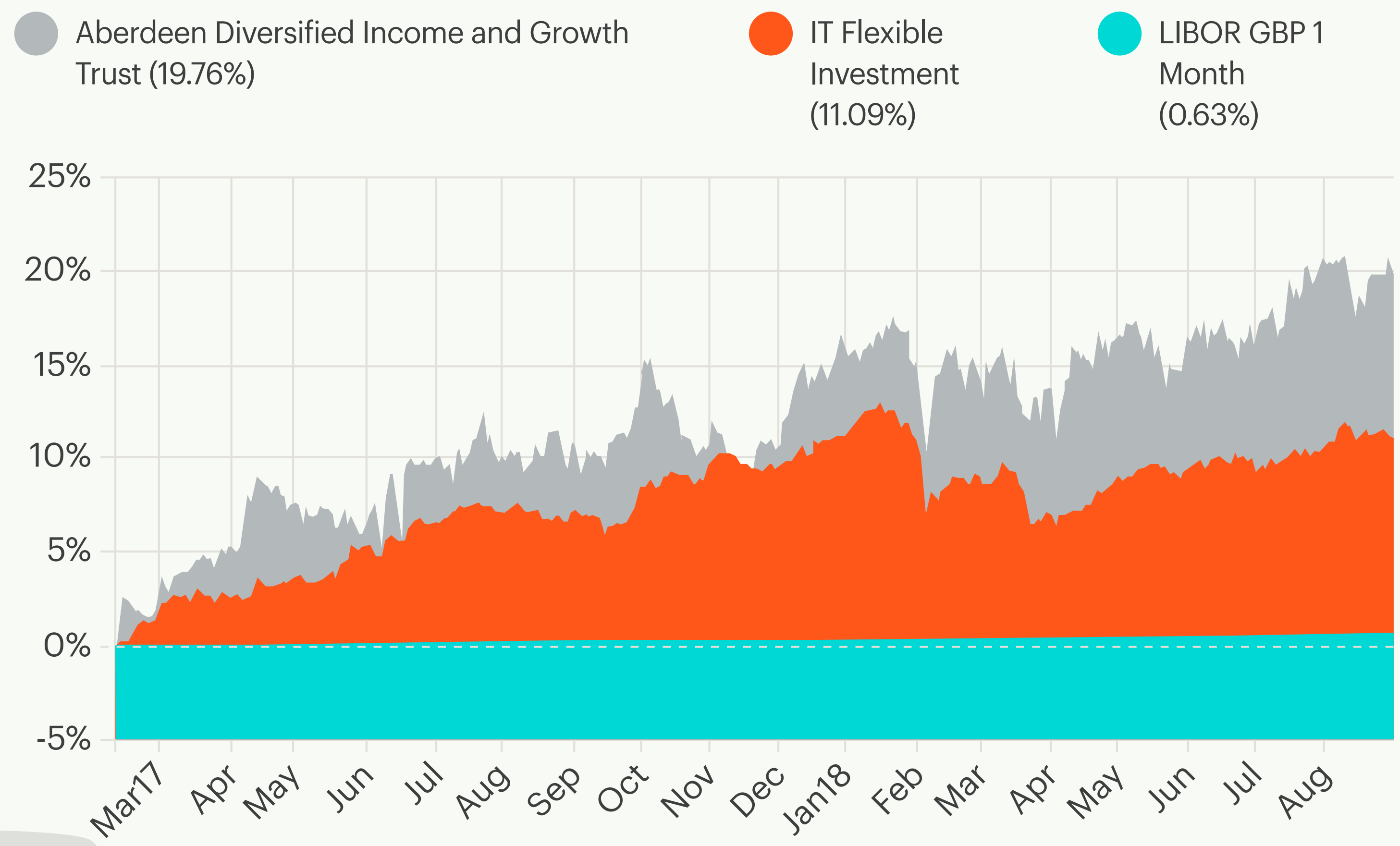
Board costs can vary significantly, but Peel Hunt's head of investment trust research Anthony Leatham says: "Based on a typical board of four experienced individuals, the basic annual directors' costs would be circa £120k. For a trust with, say, £150m of net assets, the board cost would contribute 0.08 per cent to the overall ongoing charges figure. Putting this into context, if we look at a sample of circa 140 equity trusts with net assets of £150m or greater, the average ongoing charges figure would be around 1.1 per cent, so the board would account for 7 per cent of total recurring expenses that a trust may have."

Accountability

There have also been moves to make boards more accountable. In recent IPOs, for example, Leatham says he has seen moves to align the interests of board members and shareholders: "The recent launch of Ashoka India Equity saw all four non-executive directors paid in shares subject to a minimum 12-month holding period." The most recent "skin in the game" report from Canaccord Genuity showed the total investment by boards and managers stood at £2bn, meaning the figure has doubled since 2014. Only 14 per cent of directors have no holding in their trusts, compared with 19 per cent in 2012.

Nick Greenwood, manager of the Miton Global Opportunities fund, says boards are changing because the environment is changing: "These are directors of listed companies

PERFORMANCE OF TRUST VS SECTOR AND INDEX SINCE MANAGEMENT CHANGE



Source: FE Analytics

in a more litigious world, taking on responsibility and liability. They need to be more alert to anything going wrong." While he believes this also sees board members more worried about their own liability than shareholder interests, in general he believes it has improved governance. He also believes the calibre of people looking to become board members is improving as interest in the non-executive director sector increases.

"Dragons' Den"

Leatham agrees that a well-balanced board can have a "Dragons' Den" style impact on an investment company. "A good example would be the board of BB Healthcare, which launched in December 2016," he says. "This board features a Fellow of the Royal College of Physicians, a chartered accountant, a fund manager with 20 years' experience, a fund manager who trained as a vascular surgeon and a Pulitzer Prize-winning professor who also happens to be one of the world's pre-eminent oncologists."

Sayers adds: "Investment company boards are also attracting more directors from outside the investment company industry,

• • •

The calibre of people looking to become board members is improving as interest in the non-executive director sector increases

• • •

bringing experience of specialist asset classes, for example, or commercial expertise."

Room for improvement

Nevertheless, it is clear that there are some areas where the structure could be working better. Simon Moore, senior investment manager at Seven Investment Management (7IM), says a change in investment manager is still a rarity: "While we don't condone a 'hire and fire' mentality, as a tool of last resort it is nevertheless notable in its infrequency."

"Recent exceptions to the rule include the Schroder UK Growth trust, which moved to Baillie Gifford, and similarly Carador, perceived as too small, is currently conducting a shareholder review with a view to a potential merger."

Moore believes a board is only as good as its people and too few directors meet the shareholders they are supposed to represent. He says Aberdeen Standard Investments and its investment trust boards set a strong example, with one director attending all of Aberdeen Standard Investments' investor roadshows with the fund managers.

Greenwood believes that if boards were working properly, the sector would naturally see more takeover activity. This has happened infrequently to date, but the recent merger of Harry Nimmo's Standard Life UK Smaller Companies trust with Aberdeen's Dunedin Smaller Companies vehicle shows it can be done in the right circumstances.

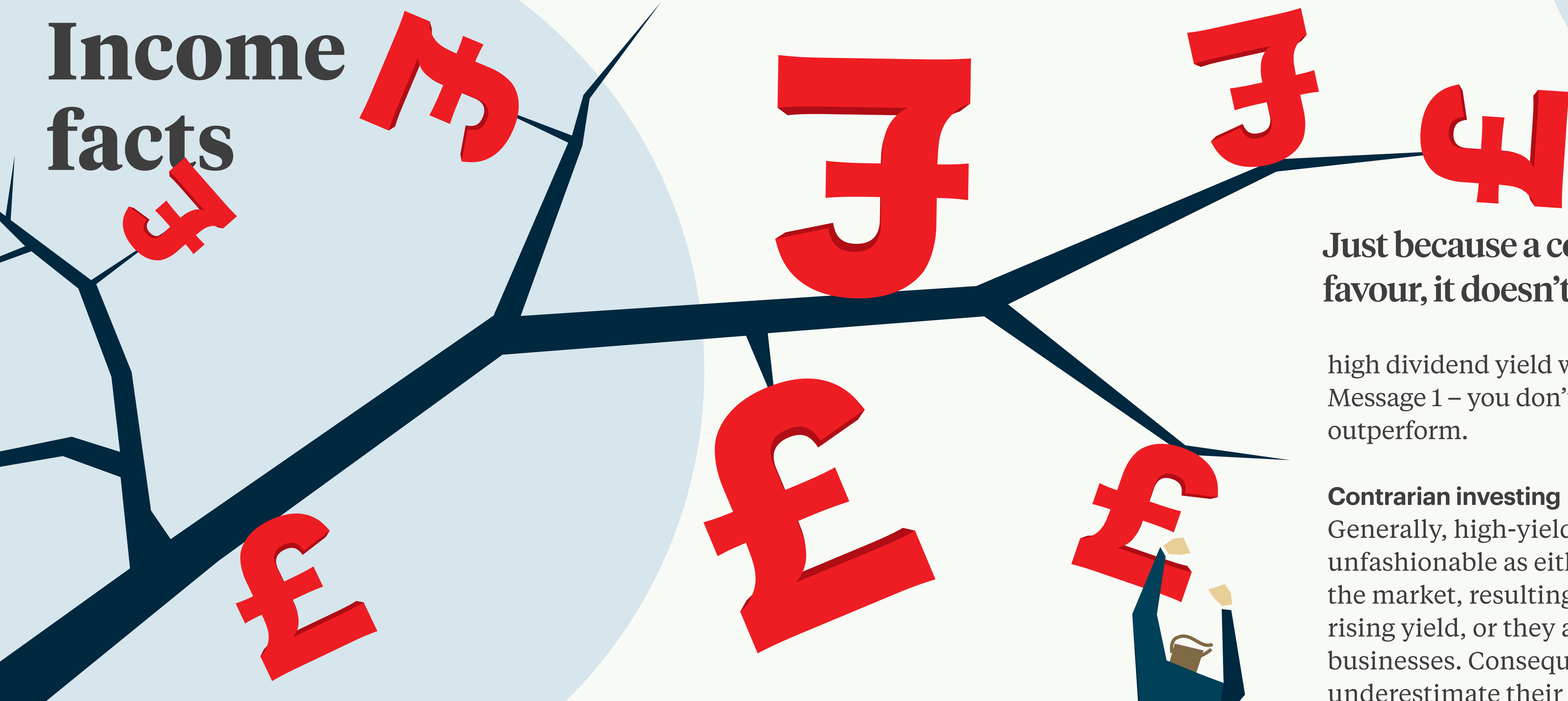
There are good and bad boards. Nevertheless, the limitations of individual ones do not negate the tangible benefits these structures have brought to shareholders in general, over and above their costs. Boards are improving, albeit gradually. •

£2bn

The amount boards and managers have invested in their own trusts

David Smith of the Henderson High Income Trust explains why dividends should be an important consideration for every type of investor

Income facts



Income fund managers constantly bang on about dividends. Maybe it's in our genetic makeup, but actually dividends should be important for all equity investors. In my mind there are five key reasons for this:

Total returns

I can bore you by reciting data from numerous studies showing dividend yield and dividend growth make up the majority of an investor's total return over the long-run, but it would be more interesting to look at a real-time example. I bought Imperial Brands for the Trust 5 years ago when the stock was trading on an 11x price to earnings multiple. Today the multiple is still at 11x. The market is valuing the company at the same rating it did 5 years ago. So does that mean the company has been a bad investment? In short, no. The shares have delivered a total return of 64%, outperforming the UK equity market by over 20% in that time period. That return has been driven by the high dividend yield which has grown at 10% p.a. Message 1 – you don't need a re-rating for shares to outperform.

Just because a company is out of favour, it doesn't mean it can't change

Contrarian investing

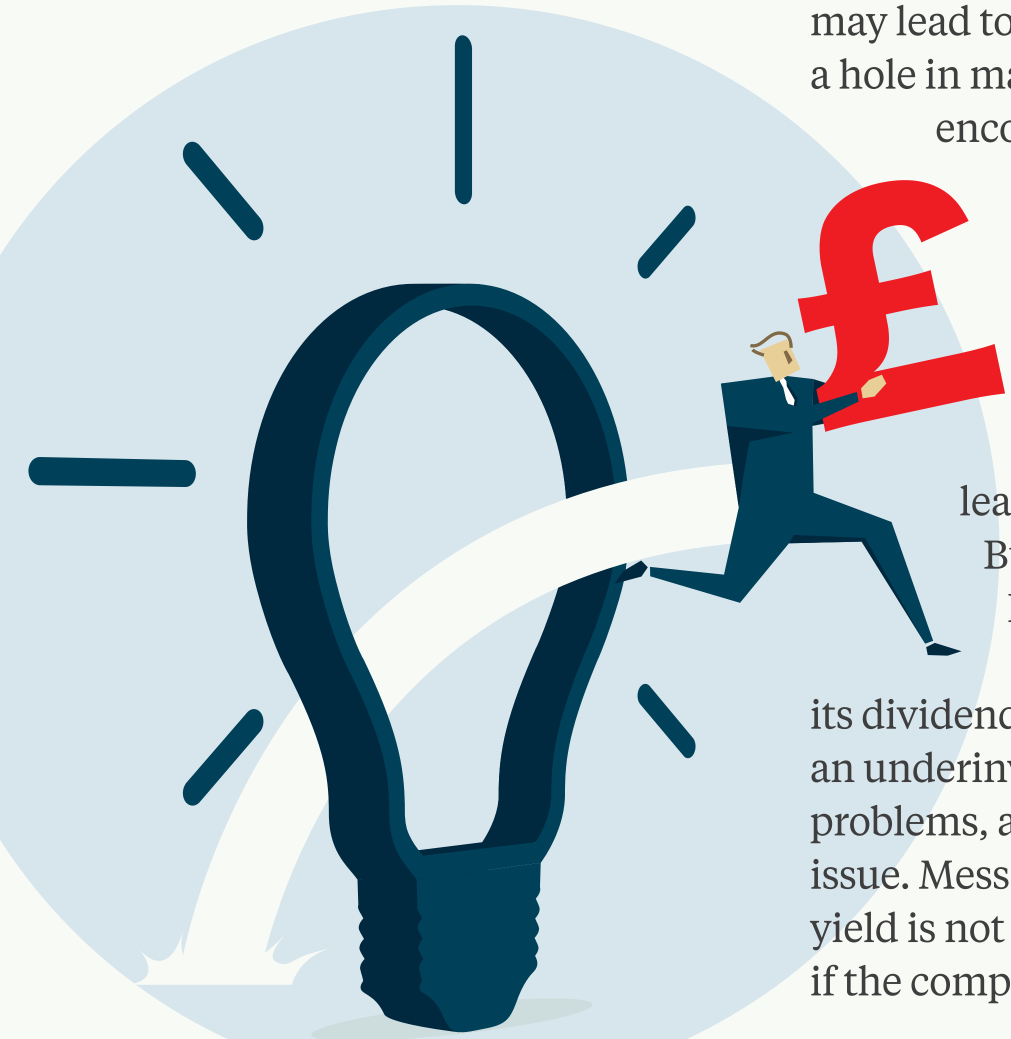
Generally, high-yielding stocks tend to be unfashionable as either they have disappointed the market, resulting in a falling share price/ rising yield, or they are mature, low-growth businesses. Consequently, investors either underestimate their ability to produce decent returns or assign a too-low valuation to these returns. Back in 2012, AstraZeneca had a dividend yield of 7%, but was facing a patent expiry on its main drug, was unloved by analysts, was perceived to have no new drugs in its pipeline and people questioned the dividend sustainability. Not a compelling investment case. Since then, the company has committed to the dividend, developed a pipeline full of exciting immuno-oncology drugs which are the envy of the industry and the shares have returned 186%. Message 2 – Just because a company is out of favour, it doesn't mean it can't change.

• • •

• • •

Investor discipline

Fund managers love to talk through their investment process and how it led them to buy a particular stock, but frequently skip over their sell discipline. A focus on dividend yields provides a clear valuation discipline for fund managers. When the dividend yield of a stock moves to a discount to the market through strong share-price appreciation, it forces the fund manager to re-evaluate the investment. Can I still justify holding a low-yielding company as an income fund manager? The answer is, sometimes. Hilton Food Group now yields only 2.3%, having been one of my strongest performers over the last few years, however, given the good visibility over its future growth, it still has a place in the portfolio. When MoneySuperMarket's dividend yield fell to less than 3% in 2015, the payout ratio was already high, while the rate of growth was slowing. Despite being a good performer, it was time to move on. Message 3 – Stay disciplined, even with your favourites.



Company management discipline

Company management's role is to keep us shareholders happy. One way is to pay a sustainable dividend while the other way is to invest and grow the business. It's a fine balance in capital allocation. Paying a too-small dividend may lead to the cash-flow burning a hole in management pockets and encourage them to spend it irresponsibly. Think Rio Tinto's $38bn acquisition of Alcan in 2007. Paying a too-big dividend may constrain investment in the business and lead to issues in the future. Bus and Rail operator FirstGroup cut capital expenditure to maintain its dividend which ultimately led to an underinvested fleet, operational problems, a dividend cut and a rights issue. Message 4 – A high dividend yield is not always attractive, especially if the company can't afford it.

Glossary

Price to earnings ratio: A popular ratio used to value a company's *shares*. It is calculated by dividing the current share price by its earnings per share. In general, a high P/E ratio indicates that investors expect strong earnings growth in the future, although a (temporary) collapse in earnings can also lead to a high P/E ratio.

Discount: When the market price of a *security* is thought to be less than its underlying value, it is said to be 'trading at a discount'. Within *investment trusts*, this is the amount by which the price per share of an investment trust is lower than the value of its underlying *net asset value*. The opposite of trading at a *premium*.

A focus on dividend yields provides a clear valuation discipline for fund managers

Cash-flow

Companies are unable to pay dividends without sufficient cash-flow. Cash-flow is harder to manipulate than earnings and provides a better indication of a company's value. Before Carillion got into trouble, the valuation used to screen "cheap" on-earnings metrics, but the company always generated poor cash-flow. This should have been the early warning sign to investors. Message 5 – Don't ignore the phrase "Cash is King".

Dividends are very important to investors, but only if they are sustainable and can grow into the future. Focusing on a well-diversified portfolio of companies that pay a good and growing dividend should help drive outperformance over the long term. •

Big biotech recovered quickly from the threat of price caps, but **Rebecca Jones** says it faces a larger threat from within

A clean bill of health?

The IT Biotechnology & Healthcare sector enjoyed a stellar period of growth in the three years to the start of July 2015, its gains of 142.58 per cent almost treble those of the average IT Global trust. The rally came to a grinding halt that summer, however, when Donald Trump and Hillary Clinton chose drug pricing as a key battleground of the US election campaign. Nervous that any win would lead to drug price-caps, investors ran for the hills and by 31 March 2016 the sector had fallen by more than 20 per cent from its peak.

Nothing to worry about

The subsequent two years have, arguably, shown there was nothing to worry about. The Trump

• • •

administration is so far fostering innovation in the sector with plans for speedier drug approvals, including the controversial "right to try" bill for terminally ill patients. Meanwhile, US health secretary Alex Azar has ruled out a key election proposal that threatened to see the government negotiate directly with drug companies for Medicare health plans – considered an existential threat to many healthcare companies.

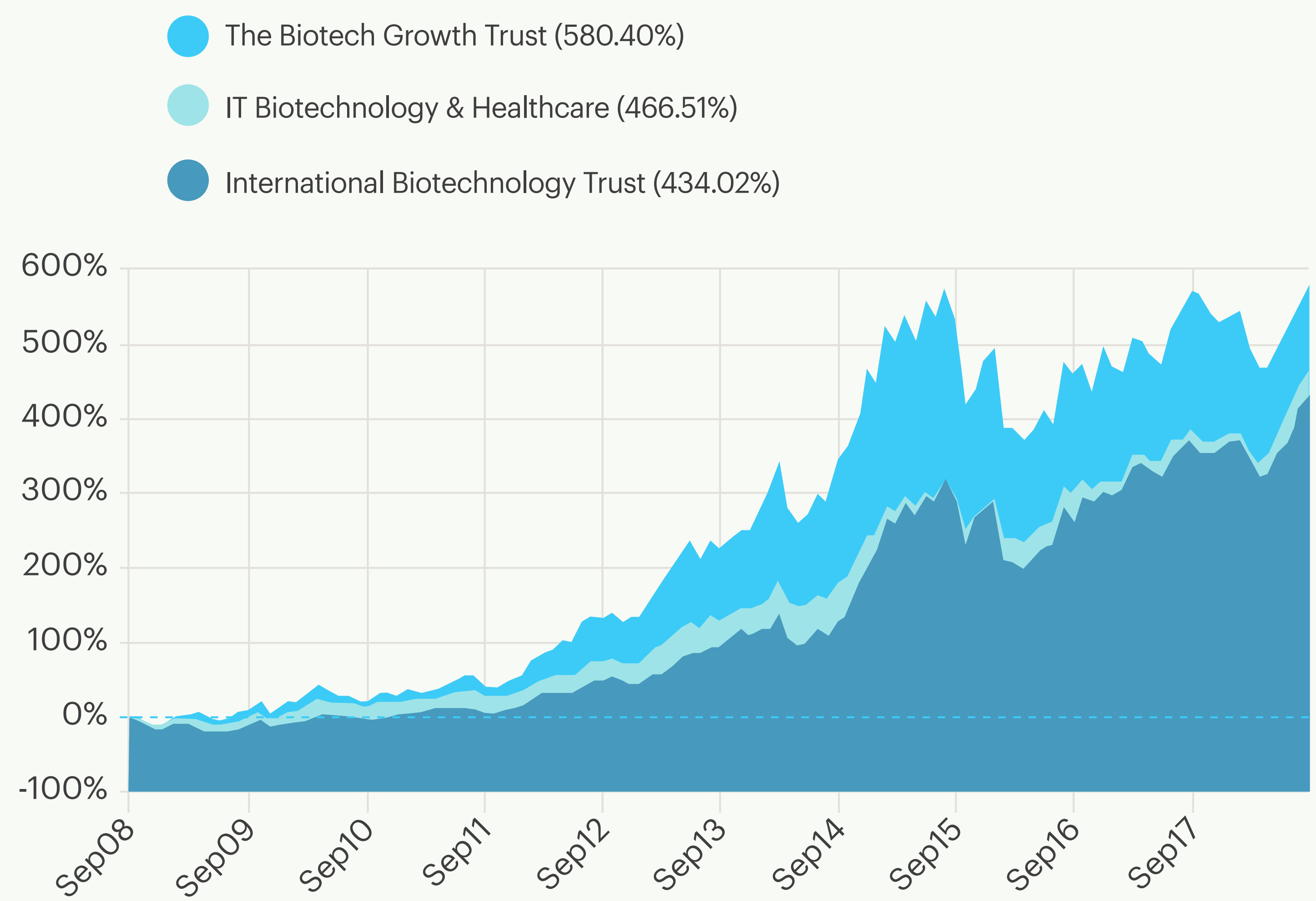
Even though investors have returned to the sector, however, growth has continued to lag, with valuations at many of the bigger firms still hovering well below 2015 highs. This, says Geoff Hsu, manager of The Biotech Growth Trust, is in part

> "Many firms are now encountering a lot of competition as patents come to an end on some of their key products"

due to a slowdown at the top: "The industry has matured quite a bit over the past five to 10 years. A lot of the big names now have quite significant market capitalisations, while over the course of that period innovation has been dramatic. Many firms are now encountering a lot of competition as patents come to an end on some of their key products," he explains.

According to Paul Mason, manager of BB Healthcare – one of the newest trusts in the sector – higher standards

PERFORMANCE OF TRUSTS VS SECTOR OVER 10YRS



Source: FE Analytics

are also playing a role in the decline of large caps. "We live now in an age of evidence-based medicine," he explains. "Twenty years ago Pfizer and Glaxo [Smith Kline] etcetera ruled the world because they could spend billions of dollars on marketing. Today, doctors have greater access to research and so it really is about how good the drug is." This, he says, is leading to fierce competition from smaller firms, many based in China, that can now develop and launch better drugs faster than larger rivals.

Specialise for success

This shifting landscape is visible in the Biotech Growth trust. Long the sector leader, a failed trial at key holding Celgene (a $63bn company) followed by a general sell-off in large caps has hit the trust hard, with shares barely breaking even since July 2015. Hsu says the portfolio has been repositioned, but that it retains a "healthy weight" to large caps, which he believes will recover.

• • •

The threat from Amazon

In January 2018 it was announced that Amazon would launch a healthcare company for the 1.2 million employees of Berkshire Hathaway and JP Morgan in the US and there are fears that the biotech sector could be the next industry to be disrupted by the online retail giant. However, Paul Mason of BB Healthcare brushed off the threat, pointing out Amazon is focusing more on the supply of medicines rather than manufacturing.

"There have always been economies of scale in procurement, particularly with generics, and these guys can have a lot of volume on the direct side," he says.

"Amazon is already active in over-the-counter pharmaceuticals via its Solimo range, which is manufactured by Perrigo. So there is nothing really new here, and while this incremental creep into healthcare is continuing, I think generally it is well appreciated by the healthcare investment community."

$25bn

Amount wiped off S&P 500's top pharma stocks in January 2017 after Donald Trump tweeted "they're getting away with murder"

"There are lots of drugs in areas like diabetes and arthritis, which keeps prices low. So we try to invest in areas that have an unmet need"

• • •

Other portfolios that have suffered include Neil Woodford's Patient Capital Trust, which has taken enthusiastic positions in biotechnology firms.

Meanwhile, BB Healthcare is up 50 per cent since launch in December 2016, which Mason says is due in-part to a focus on innovative medical technology, rather than drugs: "It used to be the biotech market was 70/30 drugs to technology, now it's reversed. People have realised drugs are only a small part of the story: what's really important is identifying roadblocks." As an example, he cites the blood glucose monitors developed by Dexcom, which help diabetes sufferers pinpoint and avert hypoglycaemic episodes.

The International Biotechnology Trust – the oldest vehicle in the sector – is also focusing on new areas, particularly so-called "orphan drugs" for rare diseases. Co-manager Ailsa Craig explains: "There are lots of drugs in areas like diabetes and arthritis, which keeps prices low. So we try to invest in areas that have an unmet need." For example, the trust holds Genmab, owner of the only drug available to treat rare blood cancer multiple myeloma.

"You still get competition in this space, but if you're working on it every day you know what's coming through," she adds.

It would seem that being a generalist doesn't cut it in today's biotechnology sector. Investors looking for long-term growth are embedding themselves further into the medical landscape and carving out niches. Patience is key, but so is unwavering attention to this fast-moving world where newer, smaller companies are running circles around old leaders. As for the end investor, the answer is likely ever thus: diversify. ●

Jeremy Gleeson's fund is one of the best long-term performers in the IA Technology & Telecommunications sector

AXA Framlington Global Technology

Technology has been one of the dominant investment themes over the past decade, with the FAANG (Facebook, Apple, Amazon, Netflix and Alphabet's Google) stocks in the US and BAT (Baidu, Alibaba and Tencent) stocks in China responsible for much of the growth in markets over this time. However IA Technology & Telecommunications remains one of the smallest equity-focused peer groups in the Investment Association universe.

While there are just 16 funds to choose from, there is no shortage of top performers in absolute terms. One of the best of these is AXA Framlington Global Technology, with gains of 483.94 per cent over the past 10 years compared with 317.77 per cent from its sector.

Manager Jeremy Gleeson believes that not only is the tech sector driving change across the wider economy but that it is also having a significant impact on everyday life, with individuals and governments adapting to technological changes faster than at any point in history.

The manager runs the fund with a thematic overlay that helps the strategy benefit from long-term trends. Among the themes he is currently looking to tap into are productivity enablers, ubiquitous computing, globalisation, digitalisation and Web 2.0.

Gleeson believes the last two themes in particular will play a vital role in the businesses of tomorrow.

"Eleven years ago, if we'd had this conversation, I would have told you how many things we did in the analogue world were changing to the digital world," the manager explained.

"I would have talked about things like physical maps that we have in the car changing to digital maps, or about analogue film changing to digital cameras. That's kind of done and dusted now, but digitalisation continues."

Gleeson said that the most important aspect of this theme today concerns the shift from physical to digital cash, with tech allowing customers to transfer money or pay using their phones.

"Web 2.0 is about using the internet as a medium to transact business across, share information or collaborate using applications like Salesforce.com, for example." ●

FACT BOX

MANAGER: **Jeremy Gleeson** / LAUNCHED: **10/05/1999** / FUND SIZE: **£637.3m** / OCF: **0.83%**

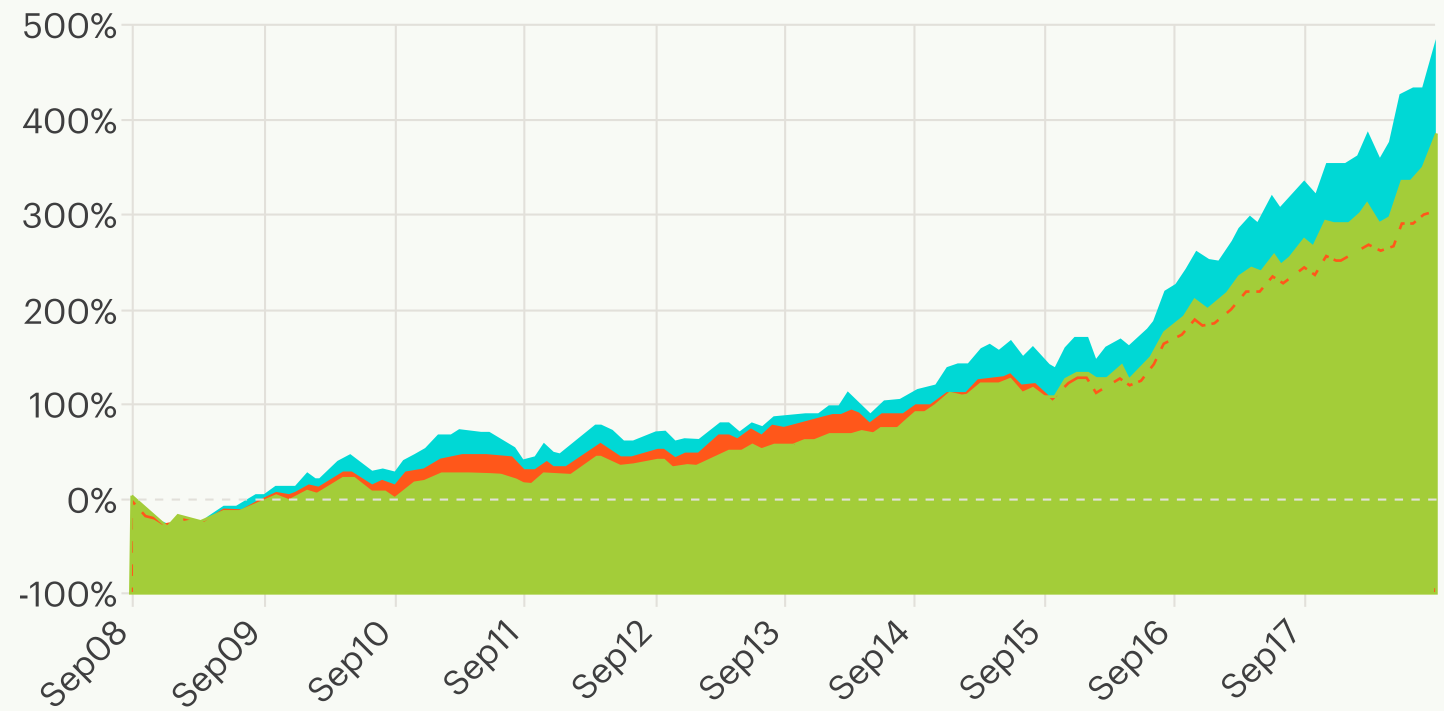
FE CROWN RATING

PERFORMANCE OF FUND VS SECTOR AND BENCHMARK OVER 10YRS

AXA Framlington Global Technology (483.94%)

MSCI World Information Technology (381.92%)

IA Technology & Telecommunications (317.77%)



Source: FE Analytics

This fund could be used to inject some growth potential into a pension portfolio dominated by income payers

Marlborough UK Micro Cap Growth

You are likely to draw an income from your investments in retirement, but doing so at the expense of capital growth can be detrimental to your overall returns.

Focusing too heavily on income will hamper the impact of compounding dividends, which are responsible for the majority of market returns over the long term. Focusing too heavily on growth, however, means you may not have enough to live on.

As such, a blend of growth and income strategies may be a prudent approach – and will also help you diversify away from the handful of stocks responsible for the majority of dividends paid by the UK market.

A fund you may want to consider pairing with an income strategy is Marlborough UK Micro Cap Growth, run by FE Alpha Manager Giles Hargreave and Guy Feld. This portfolio benefits from the vast experience of the two managers – Hargreave has been running funds for more than 40 years, while Feld has more than 25 years' experience of researching small- and mid-cap equities.

The managers start with top-down analysis, taking a view on the wider economy to filter out large numbers of companies and sectors. They then undertake extensive company analysis and meet management teams, ensuring companies are profitable or have a clear path to profitability in the near future. This ensures they avoid "blue sky" companies, which receive a lot of attention but never actually make any money.

This approach has helped the fund make 441.65 per cent over the last decade – the fourth-highest return in the IA UK Smaller Companies sector during this time.

Marlborough UK Micro Cap Growth is a diversified portfolio of around 250 stocks, with the managers initially taking small positions in each company before adding to these as their stories unfold. This helps to minimise company-specific risk and as a result, the fund stacks up well on a number of capital-preservation metrics: for example, it is a top-quartile performer in terms of supressing volatility and maximum drawdown (the most an investor would have lost if they bought and sold at the worst possible moments).

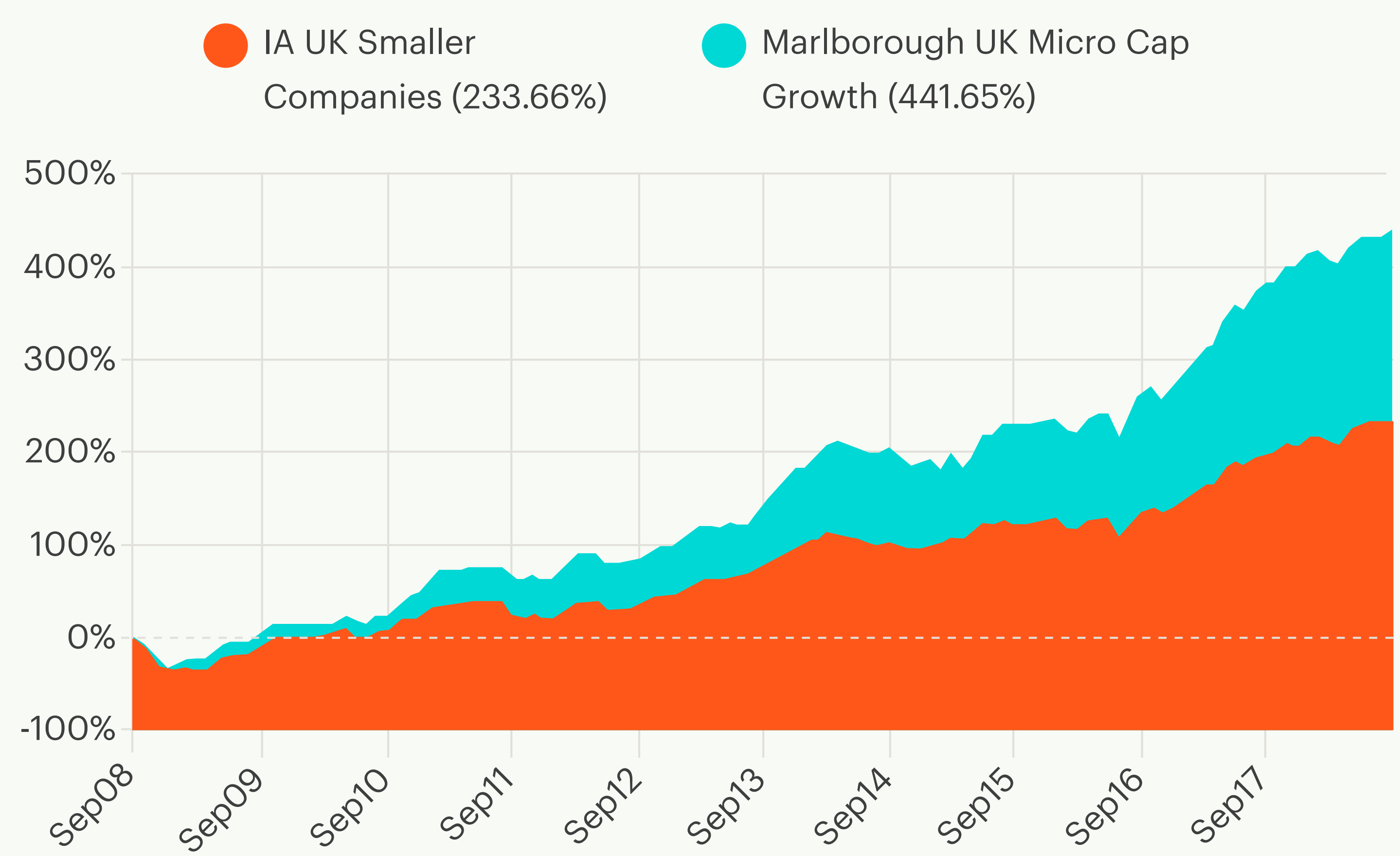
The fund's largest sector weighting is currently to industrials, with technology, consumer services and financials also double-digit positions in the portfolio. ●

FACT BOX

MANAGER: **Giles Hargreave & Guy Feld** / LAUNCHED: **04/10/2004** / FUND SIZE: **£1.3bn** / OCF: **0.79%**

FE CROWN RATING

PERFORMANCE OF FUND VS SECTOR OVER 10YRS



Source: FE Analytics

A buying opportunity may have opened in this highly concentrated trust

Independent Investment Trust

Investment advisers often talk about the benefits of diversification, but the flipside to this is that it can dampen the impact of your top-performers. This is not a problem faced by the Independent Investment Trust, whose concentrated portfolio of 23 stocks – around a quarter of the number held by its average peer – has helped it to deliver returns of 818.79 per cent since launch in 2000, compared with 314.54 per cent from its IT Global sector.

Moreover, now could be a good time to buy in to this long-term outperformer. While the trust is trading at a premium of 1.7 per cent, this figure has been as high as 21.4 per cent over the past year.

Kepler Trust Intelligence said that manager Maxwell Ward has no formal investment style or approach as he believes such concepts are overly constrictive and detrimental to long-term shareholder returns.

"Instead he considers the fundamental characteristics of each underlying holding – such as cyclicality, profitability, balance sheet structure and valuation – to arrive at a subjective assessment of the level of risk associated with each stock – and therefore the amount allocated to those stocks at any one point in the cycle," said the group.

"He then makes a further subjective assessment to the extent of levels of concentration in particular industries (maximum of 40 per cent of NAV in any one sector)."

Kepler said the downside to the manager's high-conviction approach is that it can leave the trust liable to bouts of underperformance and its volatility is among the highest in its sector. The recent underperformance can, in part, be attributed to falls in three of its largest holdings – Redrow, Crest Nicholson and Frontier Developments. However, its biggest position is in drinks company Fever-Tree, which has continued its meteoric rise and is up more than 60 per cent year-to-date.

While the trust is in the IT Global sector, less than 10 per cent of the portfolio is invested in companies listed outside of the UK – making it concentrated in more ways than one.

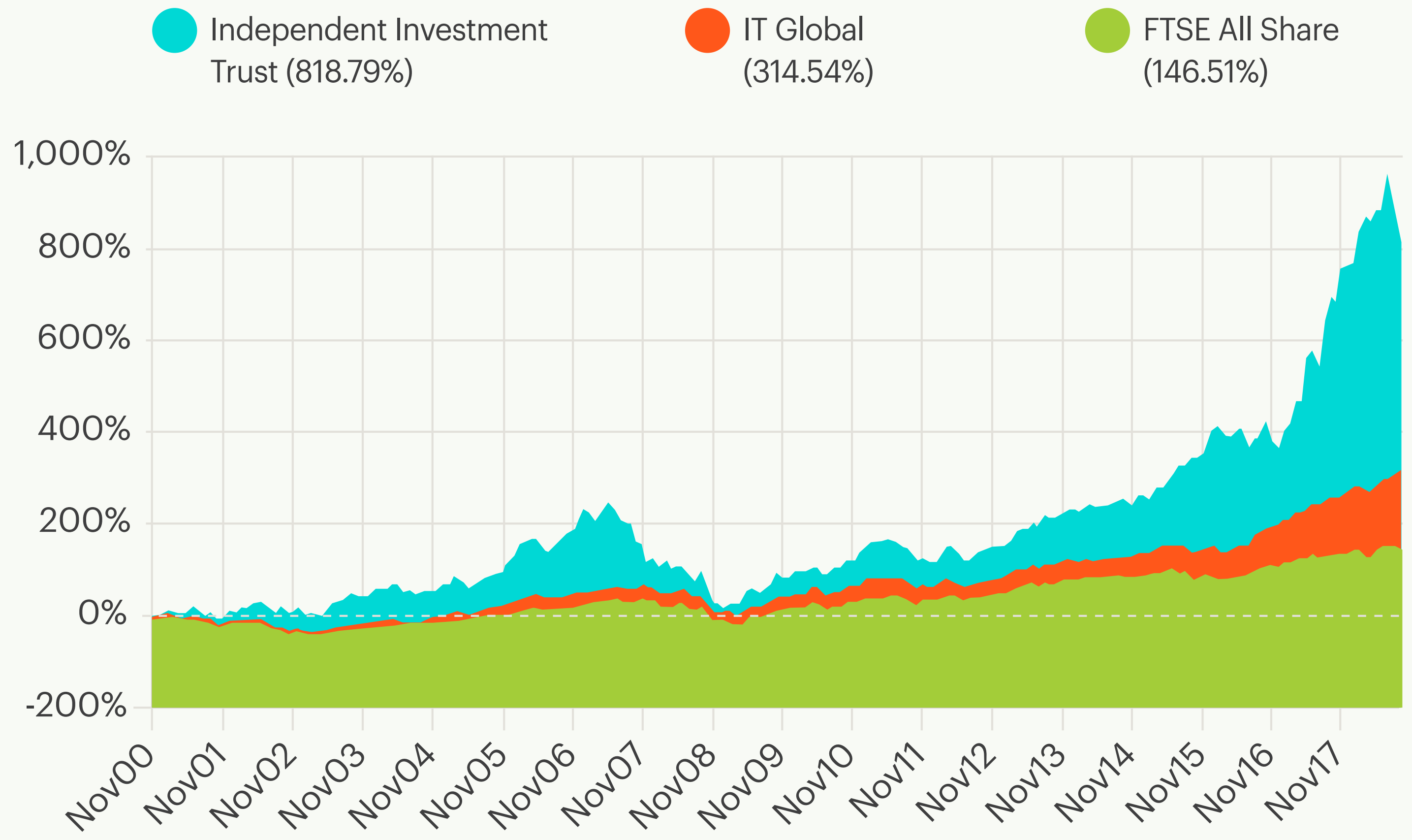
Independent Investment Trust has ongoing charges of 0.25 per cent and the maximum five crown-rating from FE. Although its investment policy permits gearing, it is not allowed to employ this strategy as long as it is registered as a small UK Alternative Investment Fund Manager. ●

FACT BOX

MANAGER: **Maxwell Ward** / LAUNCHED: **18/10/2000** / PREMIUM/DISCOUNT: **+1.7%** / OCF: **0.25%**

FE CROWN RATING

PERFORMANCE OF TRUST VS SECTOR SINCE LAUNCH



Source: FE Analytics

The recent spike in volatility is the price investors must pay to access Asia's powerful long-term growth themes, writes **Anthony Luzio**

Trade-off

It is difficult to talk about the Asia Pacific region without discussing "trade wars": the tariffs placed by Donald Trump on imports of certain goods and raw materials in an attempt to address the US's trade deficit with China and other countries. While many fund managers and analysts attempted to brush off the impact of these policies, China's threat to retaliate with tariffs of its own in early June led to fears of escalation and helped push the MSCI Asia ex Japan index down by close to 7 per cent in a month.

So have the recent developments changed the fund managers' outlook on the region? In short, the answer is no.

Andrew Graham, manager of the Martin Currie Asia Unconstrained trust, believes that while the tariffs will have an impact on certain sectors, the overall economic impact will be muted.

"While China has a trade surplus with the US, net exports are now relatively low," he says. "The tariffs will only affect about $200bn of exports, so the expected impact on Chinese GDP growth is only 0.4 percentage points in the worst-case scenario. When you have an economy growing at between 5 and 6 per cent, that puts it into perspective.

"So is it meaningful? Yes. Is it disastrous? Absolutely not."

Medha Samant, investment director on the Fidelity Asian Values Trust, agrees trade-war fears have been overblown and says that, rather than escalating, the impact of tariffs on China and other Asian countries may be subject to the law of diminishing returns.

"There is now more intra-Asian trade, so these economies are becoming less dependent on developed markets and the vulnerability to global trade is no longer there," she explains.

"Everyone is being very negative on China, but most of the largest companies such as the tech stocks are focused on 'new China', which is where consumer demand is coming from."

"These economies are becoming less dependent on developed markets and the vulnerability to global trade is no longer there"

"We think investors will eventually realise there has been an indiscriminate sell-off in emerging markets, which will lead them to look more closely at fundamentals and then cherry-pick. It is hard to predict, but we think there will be a rotation towards companies that are more stable."

"The hard landing"

This is not to say that fund managers don't have concerns about the region. It has been difficult to talk about China over the past decade without mentioning the dreaded "hard landing" and Miton's Gervais Williams says he is "kind of terrified" about the current debt situation, likening it to the credit crunch seen in the West in 2008.

He points to a report from Andrew Hunt Economics, which says this year's global dollar funding shortage has curtailed Chinese banks' ability to access US funding at a time when their ability to issue bonds and borrow from the People's Bank of China has been reduced.

"Contrary to the many rumours, the People's Bank of China has not in fact provided a wave of cheap funding for the banks this year," says the report.

"And, despite some wild rumours to the contrary, fiscal policy seems static/tighter. So far, the central authorities have not responded to the slowdown in a meaningful way."

Williams says that while the Chinese government is hoping to "squeak it

"Contrary to the many rumours, the People's Bank of China has not in fact provided a wave of cheap funding for the banks this year"

through" and keep some companies going, eventually it will lose control of the situation.

"And at that stage the currency will completely collapse," he adds. "That would be very unnerving because that would undermine the competitive nature of the rest of the world and you would see margins coming down in most products, leading to a big setback in markets. I'm really bothered by that."

However, Graham is sceptical of this threat as well. Rather than a credit crunch, he describes what is happening as "an engineered process" in which the government is trying to control the many sources of unofficial funding going into the economy. The manager adds that any type of major financial process such as this one will inevitably have an impact but, while it has the potential to cause dislocation in the economy, China is if anything already coming out of the other side.

"There are probably areas of concern, for example P2P lending – which is not a massive part of the credit system – grew very rapidly and in a way that went under the radar of the regulator," he explains.

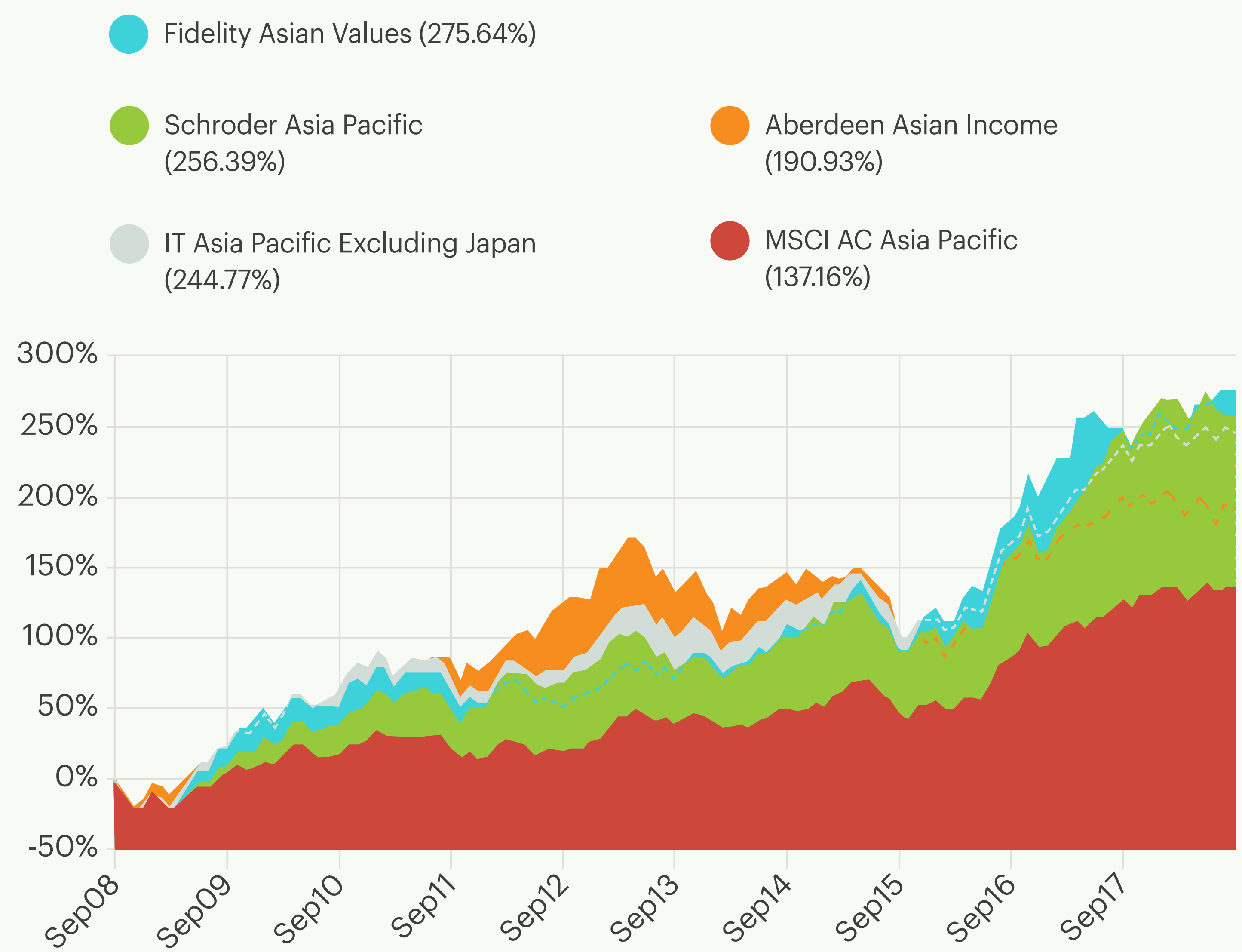
"The regulator is just trying to get its arms around this right now. And a lot of the companies that played that space have seen their access to credit severely curtailed."

"There are definite pockets of challenges if you like, but we think these are really quite manageable and really quite necessary as well."

The bright side

Graham says that while he doesn't want to be flippant about the short-term threats to Asia, he is far more concerned with the long-term secular dynamics which he is hoping to tap

PERFORMANCE OF TRUSTS VS SECTOR AND INDEX OVER 10YRS



Source: FE Analytics

• • •

into in his portfolio. His co-manager Damian Taylor says there are four trends in particular they "would hang their hat on": consumption, infrastructure, trade and technology.

> **"There are hundreds if not thousands of stocks that will suddenly become available to these managers to buy in size"**

Class action

"Underpinning those themes is the fact the middle class is going to grow by 140 to 150 million people per annum globally," he says. "As income rises, the nature of consumption changes quite remarkably."

"And about 90 per cent of that growth is coming from Asia."

On the subject of infrastructure, Graham says this is rapidly improving following a significant hiatus in the wake of the financial crisis. It is not just in physical infrastructure, either – there has also been large-scale investment in rules and regulations around trade, making it easier to do business in different countries.

Markuz Jaffe, investment companies analyst at Cantor Fitzgerald, says one example of this is the liberalisation of China's A-shares: previously limited to domestic investors, this market has opened up and MSCI is introducing shares to its indices on a tapered basis.

"That is opening a massive opportunity set," he explains. "One closed-ended fund manager recently hired another analyst just to cover A-shares because there are hundreds if not thousands of stocks that will suddenly become available to these managers to buy in size."

Graham says that entwined with consumption, infrastructure and trade is the final theme – technology.

"You've got these large economies, all in close proximity and all enjoying organic growth, which are seeing a broadening in their manufacturing bases and the lowering of trade barriers. Technology weaves into that by opening up markets to a broader range of people. And this is reflected in our portfolio where companies are using the technology to access markets they wouldn't have been able to touch five or 10 years ago."

"Asia's biggest trading partner is itself and that's only going to grow."

A recurring theme

Despite these long-term drivers, many investors remain sceptical of Asia while Trump is on the warpath.

However, Jaffe believes that in the long term, the trade wars could even work in China's favour.

"China is interested in becoming a dominant global economy and these tariffs only make the US seem isolationist," he explains.

"It has done a good job of extending credit and development funding to Asian and African countries, a role the US and the West used to play. If the US isn't careful, its role as the dominant economy or the dollar's role as the dominant currency may be under threat. For us it would be a weird dichotomy where an English-speaking country is no longer driving world markets. •"

The core holding: Schroder Asia Pacific

The dominance of a handful of tech firms in the Asian market makes it difficult to differentiate between the mainstream growth trusts. Nevertheless, Numis has picked Schroder Asia Pacific as its core recommendation, pointing out it benefits from an experienced manager, Matthew Dobbs, has an impressive long-term track record and has consistently achieved top-quartile performance versus both open- and closed-ended funds. The trust has made 256.39 per cent over the past decade compared with 244.77 per cent from its IT Asia Pacific ex Japan sector and 166.84 per cent from its MSCI AC Asia Pacific ex Japan benchmark. It is on a discount of 11.64 per cent.

The discount play: Aberdeen Asian Income

Jaffe says an interesting timing play at the moment would be Aberdeen Asian Income, which is currently on a discount of 11 per cent, but was on a premium of 6 per cent a little over three years ago. "Aberdeen has got this rule where the managers won't buy a company if they don't understand the valuation or business model, so it got caught out by not owning the Chinese large-cap tech stocks," he explains. "Returns have lagged in the strong market – but there could be a big pick-up to par there." The trust has made 190.93 per cent over the past decade and is currently yielding 4.5 per cent – almost twice the sector average.

The small-cap choice: Fidelity Asian Values

Another way to diversify away from the mega-cap tech stocks is to look further down the market-cap scale. While the best performers in the sector over the past 10 years – Aberdeen Asian Smaller Companies and Scottish Oriental Smaller Companies – focus on this area of the market, they made the majority of their gains in the first half of the decade and more recently have lagged their peers. Instead, Jaffe prefers Fidelity Asian Values. "Manager Nitin Bajaj is running a fairly unconstrained portfolio, he's got some interesting ideas and high-conviction positions," the analyst says. The trust is a top-quartile performer over one, three, five and 10 years and is on a discount of 2.56 per cent.

Crunching the biggest trends down into figures

The themes driving growth in Asia

8.7%

of China's population **– or 120m people –** have passports. This number is expected to double by 2020

88%

of next **billion entrants** into the middle class will be Asian

60%

of the world's population live in Asia

416 million people

– expected increase in India's urban population by 2050

816

– number of billionaires in Asia – more than any other continent

260%

– China's debt as a proportion of GDP – up from **140%** since the financial crisis

48,882

patent applications from China in 2017 – second only to the US

800 million

people lifted out of poverty in China since 1978

6%+

- expected 2018 GDP growth for the Philippines, Cambodia, Myanmar, Laos and Vietnam

Source: The Brookings Institution, World Bank, United Nations, Bank for International Settlements, Martin Currie, Wealth-X and WIPO

AltRetire's **John Blowers** weighs up the pros and cons of bypassing platforms and advisers and investing directly with an asset manager

Cutting out the middlemen

During the long, hot summer, I took a bit of time to think over my investment strategy. This stemmed from a conversation I had with a friend over a lazy sundown beer at a lovely country pub on the Romney Marsh.

He had just transferred his company defined benefits pension into a defined contribution scheme after it made him "an offer he couldn't refuse".

Of course, I was too polite to ask how much it was worth.

He planned to entrust half of his money to Brewin Dolphin and half to Charles Stanley and wanted to know my opinion.

Both of his choices were sound and the two wealth managers have a long history of decent client outcomes, even if that comes at a price.

Like many people in the UK, he didn't feel confident enough to invest his own money, so he immediately discounted opening his own SIPP, even though he was likely to save around 1 per cent a year on fees.

Significant impact

I tried – in vain – to persuade him to reconsider, explaining the significant impact of paying 1 per cent plus fund and other charges, which was likely to wipe 2 per cent each year from the value of his portfolio. He argued that he was expecting his wealth managers to do such a good job that these fees would be eradicated in a sea of good performance and, to some extent, he had a point.

I then tried to persuade him to put a little money aside to try his hand at DIY investing. Nothing taxing, just £10,000 in a low-cost, simple-to-understand portfolio and I offered up the Vanguard LifeStrategy funds as a case in point.

The annual charges for my favourite 100% Equity version of the range are just 0.22 per cent a year if you invest directly on its platform.

It's not as if you have to spend much time researching funds to invest in. Vanguard constantly adjusts the underlying investments of the portfolio to keep its asset allocation within set parameters

And it's not as if you have to spend much time researching funds to invest in. Vanguard constantly adjusts the

• • •

Case study

Sally, 47, inherited £100,000 and wants to use this as a pension pot when she retires at 65. She looked at three different options – investing through an IFA, investing via a platform, or buying a managed portfolio direct from a fund group.

To her, a few percentage points on charging didn't cause undue concern, until she did the maths and saw that, over the next 18 years and assuming all things being equal, the difference in charging models caused a huge difference in outcomes.

If her money grew at 8 per cent per annum over the next 18 years, her £100,000 could be worth between £179,248 and £232,029 depending on the charges levied by different providers.

That's a difference in outcomes of almost £53,000, which on an initial outlay of £100,000 is pretty significant and could make a huge difference to her income in retirement.

"Full-fat" charging model (2.1% per annum)

My investment (£100,000)

Platform charges 0.35% p/a
Fund charges 0.75% p/a
IFA fees 1% p/a

Effect of paying 2.1% p/a charges over 18 years on a £100,000 investment*:

- 4% growth p/a: £96,249
- 6% growth p/a: £131,639
- 8% growth p/a: £179,248

Typical platform charging model (1.1% per annum)

My investment (£100,000)

Platform charges 0.35% p/a
Fund charges 0.75% p/a

Effect of paying 1.1% p/a charges over 18 years on a £100,000 investment*:

- 4% growth p/a: £109,074
- 6% growth p/a: £149,150
- 8% growth p/a: £202,762

Investing directly with a low-cost fund management group (0.37% per annum)**

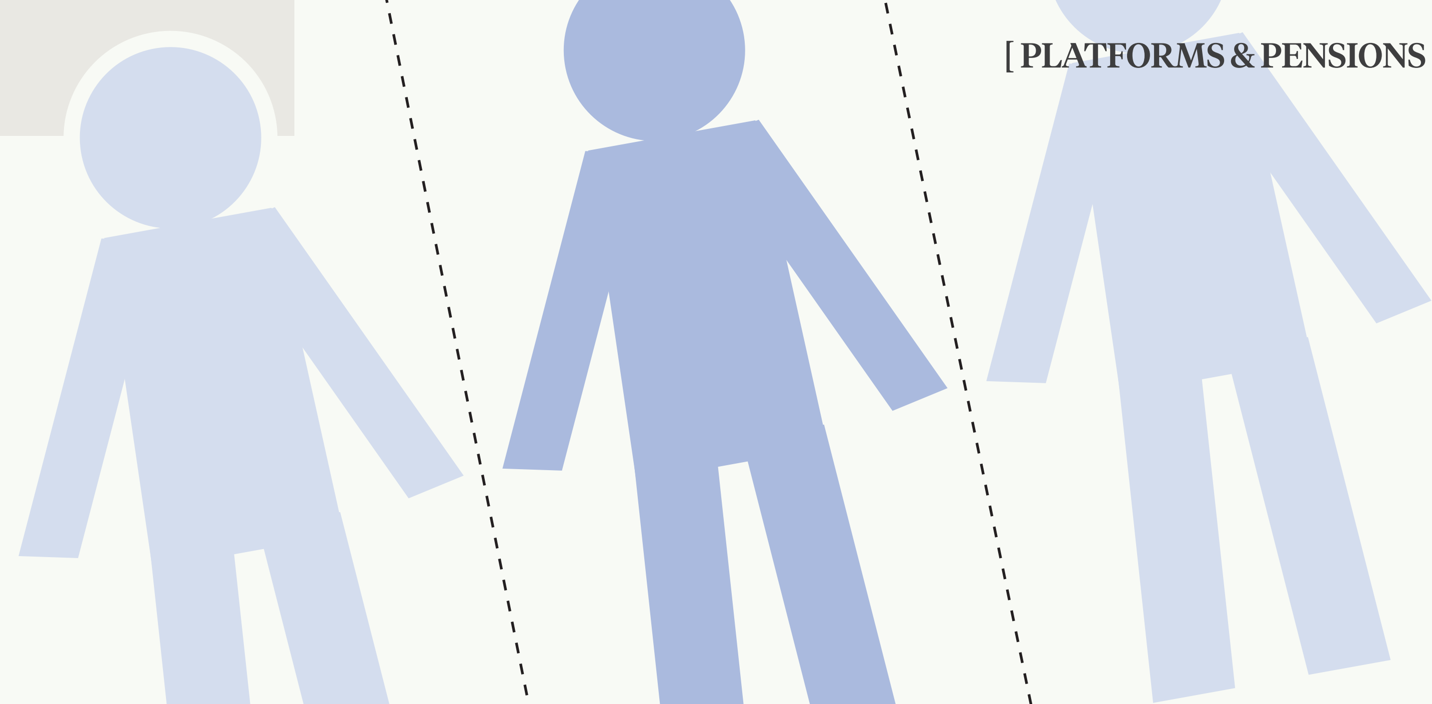
My investment (£100,000)

Fund charges 0.22% p/a

Effect of paying 0.37% p/a charges over 18 years on a £100,000 investment*:

- 4% growth p/a: £119,611
- 6% growth p/a: £167,185
- 8% growth p/a: £232,029

* Adjusted for inflation at 2.5% per annum over the period
** Additional transaction costs apply



• • • underlying investments of the portfolio to keep its asset allocation within set parameters, so for the purposes of my friend, it seemed ideal.

Since launch in May 2011, it has turned £10,000 into £21,166.14, which is good, even though there are better performers out there. But when you take charges into account, it's a more compelling proposition. Remember, performance comes and goes with all funds, but charges are constant.

Additional charges

The point I really wanted to make is that nowadays, some fund managers are selling fund solutions directly, so do you really want to a), take on the laborious task of managing a portfolio on a day-to-day basis and b), rack up the additional charges levied by an investment platform or wealth manager?

I suspect that more and more fund managers will be offering discretionary managed portfolios direct to the end client, rather than distributing their individual funds through IFAs and investment platforms.

If this trend accelerates, you will be able to invest in two or three fund managers' portfolios to achieve great ongoing diversification and performance, without sweating over whether you're keeping your asset allocation where it should be.

With more than 7,000 funds to choose from, it's getting tougher to pick the winners on a consistent basis and constantly fiddling with your portfolio flies in the face of the best advice – choose well and leave alone.

The price to pay

The downside is that you won't be able to see all your investments in • • •

There is a real opportunity to cut out the intermediaries, with their additional costs, now that some fund groups are offering well-diversified portfolios at highly competitive prices

• • •

one place (although sites such as FE Trustnet offer the virtual portfolio service), but is this such a big price to pay for reduced fees and freeing up more of your time to do other things?

If you invest as a hobby, you'll be vehemently disagreeing with me by now and to some extent, I'm surprised I'm even writing the words, but the industry is changing fast and multi-asset, discretionary managed portfolios sold directly at a lower cost have a certain appeal.

There is no doubt that fund management groups need to change how they supply the end investor. Until recently, they had a huge "love-in" with IFAs, using them as their sales force and depending upon them for much of their business. As a result, they ensured they were pampered and remunerated accordingly.

Nowadays, IFAs don't receive commission on fund sales and instead charge directly for their services, as do accountants and solicitors. The typical 0.75 per cent of your assets that fund managers used to pay to advisers each year has mercifully disappeared, but you'll still pay advice fees plus a platform administration fee, like you do if you invest directly via a platform.

Getting to market

There are three methods that fund managers have of getting their funds into the market: 1) selling them to institutional investors, 2) selling through advisers and 3) making their funds available on investor platforms. However, both IFAs and investor platforms are beginning to sell more of their own products in the form of discretionary portfolios and model portfolios.

Suddenly this cosy relationship between fund management groups and their distributors looks blurred and they are now looking to protect themselves with a new generation of direct "solutions".

With the advent of new technology and the development of their own investment solutions (i.e. portfolio-based multi-asset or multi-manager funds), fund management groups now have the opportunity to sell directly to the public, where they have more control over their distribution. Previous attempts to crack this market failed because the groups tried to sell individual funds rather than packaged solutions.

The gloves are off

Often, fund managers charged the public more to buy directly than through a platform or adviser, as they didn't want to upset their distributors.

Now the gloves are off and I believe we will see more fund groups offering direct solutions at competitive prices, partly in response to Vanguard's audacious low-cost portfolios but more to shore up their distribution strategies.

So, is this good news for investors?

The answer has to be "yes" for a number of reasons, primarily related to cost. But it is also a chance to rethink your investment strategy and ensure you are not making life more complex than it needs to be.

If the trend is for fund groups to offer low-cost, well-diversified solutions direct to clients, this puts pressure on platforms, which are charging an extra layer of fees on top of those levied by the fund manager. At present, almost no fund groups offer a pension wrapper, which is a major obstacle for many investors, but these will come soon.

He was expecting his wealth managers to do such a good job that these fees would be eradicated

The point I'm trying to press home is that there is a real opportunity to cut out the intermediaries, with their additional costs, now that some fund groups are offering well-diversified portfolios at highly competitive prices.

In summary, the investment world is about to go through some significant changes, with fund groups entering the fray to see if they can catch some of your investments directly. They know they need to reduce costs and the gauntlet has already been thrown down by Vanguard, which has proved you can offer a well-diversified managed portfolio at a low cost. It is working to deliver this by the end of the year.

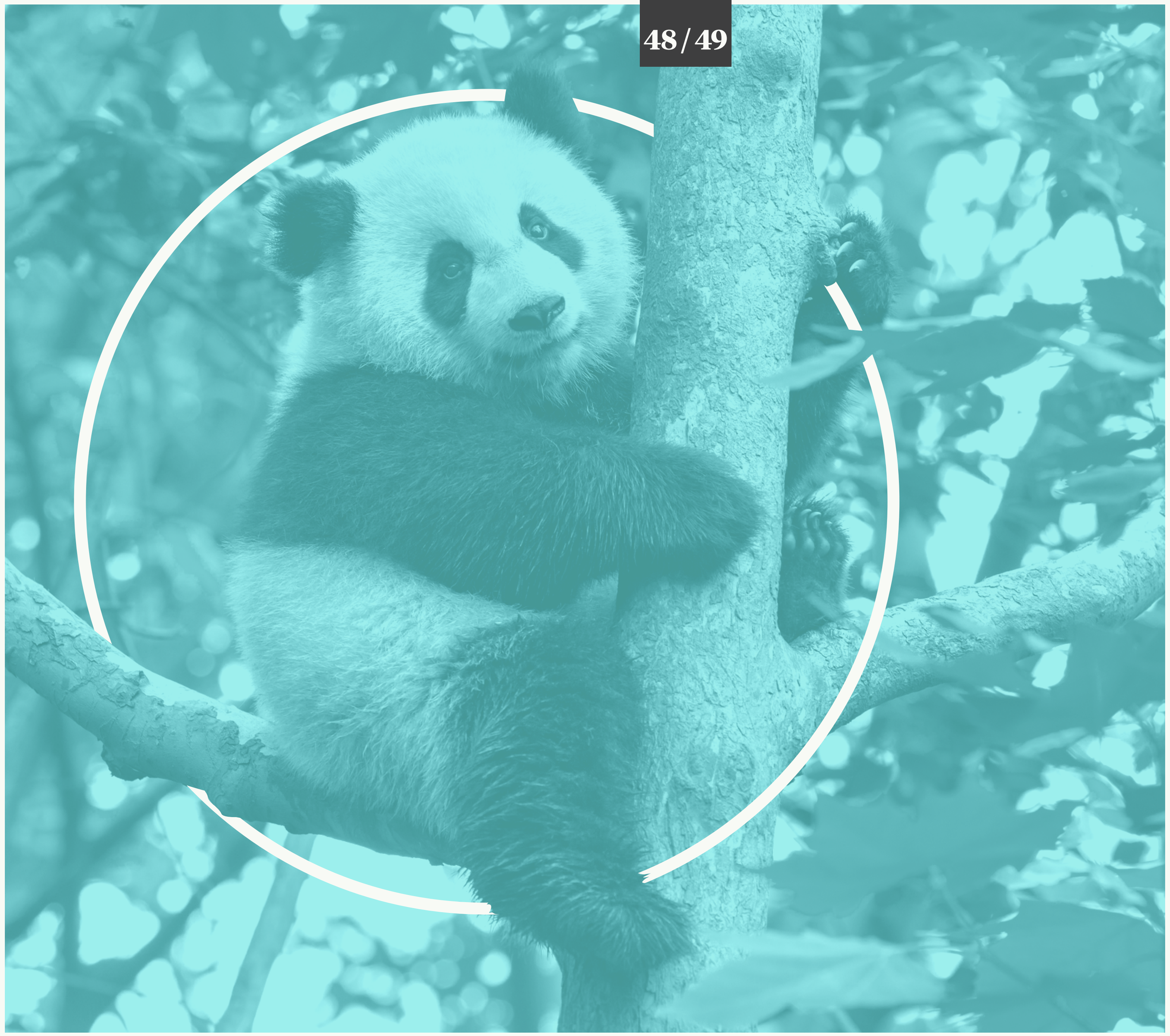
I have talked enough about Vanguard and there are other managed portfolios out there from the likes of Liontrust, BlackRock, Jupiter, Aberdeen Standard and Quilter. Just keep an eye on the costs they charge and how easy it is to manage and monitor the investments you make.

More fund groups are to follow and, as I hope I have demonstrated, the need for paying out to additional intermediaries from your investments is finally being challenged.

I'm not sure if my friend ever took my advice, which is a pity, because it would have been a very interesting experiment to report on at a later date. •

CFP Sanford DeLand Free Spirit's **Rosemary Banyard** says the market often places a premium valuation on businesses with a lower number of shares in issue

Scarce story



A few weeks ago I looked at the 10-year record of one of the UK's most successful manufacturing businesses, Renishaw, and was struck by the fact this company has not issued a single share over this time. This is perfectly understandable given the two founders own half the company and don't wish to be diluted. It confirmed my view that founder- or family-controlled listed companies can be an attractive hunting ground for investors, as equity issuance is kept to a minimum, forcing management to invest in internally financed growth, which requires excellent cash-backed returns on capital rather than the pursuit of "earnings-enhancing acquisitions". One has to accept the long-term investment horizon of such businesses and some liquidity constraints, but fewer shares in issue equals scarcity value and hopefully a premium valuation for owners. ●

One has to accept the long-term investment horizon of such businesses and some liquidity constraints

S&U

S&U, which has always been engaged in responsible non-standard lending, has just under 12 million shares in issue, with the Coombs family owning at least 45 per cent of the group. Its Advantage subsidiary lends money to near-prime borrowers for the purchase of second-hand cars, which the borrower usually needs to get to work. This division has a home-grown technology-based credit scoring system, which is regularly being enhanced, and an established broker network. It has also seen unbroken growth since launch in 2009. The shares offer an historic dividend yield of more than 4 per cent.

VP

With 39.5 million shares in issue, specialist plant-hire group VP is roughly 50 per cent owned by the Pilkington family trust. It focuses on niches such as excavation support systems, rail-infrastructure portable plant and survey and safety equipment, giving it much higher returns on capital than those generally achieved by UK plant-hire businesses. The recent acquisition of Brandon Hire for cash offers the potential for regional expansion in the South West and integration benefits such as better purchasing power and better equipment utilisation.

CRANEWARE

Craneware licenses software to US hospitals under a recurring model, with contracts typically lasting five years – at the end of which they are often renewed. Its software modules, which include information on all medicines stocked by the hospital pharmacy, let hospitals track the costs of a patient journey. This data is used to charge the payer, whether insurance company, federal programme or individual, but could also be used to benchmark hospitals against one another. It has 26.6 million shares in issue, with chief executive and founder Keith Neilson owning 13 per cent of the group.

Liontrust's **John Husselbee** says this fund is a useful addition to his portfolios while noise is trumping fundamentals in emerging markets

Artemis Global Emerging Markets

Given our desire to buy assets when they are cheap, we see plenty of opportunity in emerging markets, particularly at such depressed valuations

The mid- and higher-risk mandates in our target-risk range have increased exposure to both Europe ex-UK and emerging market equities in recent months after relative weakness year-to-date, largely caused by a stronger dollar and a softer patch for global growth.

In Europe, we have topped up our tracker holding and favoured active funds, while maintaining a broad tilt towards value. As part of increased exposure on the emerging markets side, we revisited our value allocation by buying into the Artemis Global Emerging Markets fund, run by Peter Saacke and Raheel Altaf, based on the Smart-GARP process.

Offshoot

While this portfolio only launched in 2015, it is an offshoot of the successful Global Growth fund, also run by Saacke, which has a much longer track record of using the same process. Smart-GARP (growth at a reasonable price) is an in-house quantitative system that screens companies' growth, valuations, earnings forecasts and share price momentum with the aim of identifying those that are cheap compared with their predicted growth rates.

The fund's largest overweight positions are currently to China and Russia, with underweights in Korea, Taiwan and India. By sector, its largest overweights are in energy, utilities and construction, and it still has less exposure than its peers to the more popular segments of the market such as technology.

The fund continues to offer attractive financial characteristics, trading on a forward price/earnings ratio of 8x and a 30 per cent discount to the index, which makes it a strong option to cover the value end of our emerging markets allocation.

In terms of performance, it is comfortably ahead of both its benchmark and IA Global Emerging Markets sector since launch in April 2015.

Soured sentiment

Some may question the wisdom of investing in emerging markets now given the situation in Turkey, which has undoubtedly soured sentiment towards the sector as a whole. I see this as yet another example of noise trumping fundamentals, however, and given our desire to buy assets when they are cheap, we see plenty of opportunity in emerging markets, particularly at such depressed valuations.

Weaker global growth, combined with higher interest rates and a strengthening US dollar, have laid bare vulnerabilities in countries reliant on external borrowing such as Turkey and Argentina. But plenty of other emerging markets, especially in Asia, continue on the path towards sustainable long-term growth.

We see little chance of contagion from Turkey and yet markets are once again tarring a whole asset class with the same brush, based on the problems of its weakest constituents. For investors prepared to look beyond the surface, that represents a significant opportunity. ●

***John Husselbee** is head of multi-asset at Liontrust*

FE Trustnet

magazine

October preview

Passive aggression

October's edition of FE Trustnet Magazine will focus on passives. There has been a surge of money into tracker funds and ETFs in recent years as investors have wised up to the difficulty of consistently beating the market once active charges are taken into account. But has this created its own set of problems?

Our sector focus will fall on IA North America, a market in which it is notoriously difficult for active managers to outperform – so is there any reason not to play it with passives?