Investment Trust Newsletter

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Investment trusts might not seem to be the most thrilling part of the stockmarket, but we reckon there is never a dull moment. From private equity trusts returning cash to shareholders to a market warning from a leading manager; from an each-way bet to a discount switch; and from a new set of awards to downgrades in the biotechnology sector, welcome to another breathless month in this ever-changing universe.

Major Price Changes Over One Month

Marwyn Value Investors	+18.97%
Globalworth Real Estate Investments	+13.21%
Fidelity Japanese Values	+11.92%
Weiss Korea Opportunity	+11.71%
Baker Steel Resources Trust	+11.67%
Manchester & London	+11.38%
Macau Property Opportunities	+11.04%
Baillie Gifford Japan	+10.74%
Dunedin Enterprise	+9.89%
Henderson Opportunities Trust	+9.80%
Electra Private Equity	-42.16%
Blue Capital Alternative Income	-19.43%
Infrastructure India	-8.82%
LXB Retail Properties	-7.78%
CATCo Reinsurance Opportunities	-6.82%

Major Price Changes Over One Year

Independent Investment Trust	+83.54%
Globalworth Real Estate Investments	+75.64%
TR European Growth Trust	+67.16%
River & Mercantile UK Micro Cap	+62.61%
Manchester & London	+59.14%
Baker Steel Resources Trust	+58.04%
Aberdeen Smaller Companies Income	+57.27%
3i Group	+56.70%
BlackRock Smaller Companies	+56.35%
JPMorgan Chinese	+53.02%
Infrastructure India	-65.93%
LXB Retail Properties	-57.87%
Qannas Investments	-33.06%
Electra Private Equity	-31.22%
Blue Capital Alternative Income	-21.90%

£25m market capitalisation filter applied. Source: Morningstar.

There's a lot to talk about from these lists of risers and fallers. Starting with the biggest risers from last month, both **Fidelity Japanese Values** (FJV, 148p) and **Baillie Gifford Japan** (BGFD, 812.75p) have performed well after a strong election result for Mr Abe's ruling party ensured that at least one major developed economy can enjoy further political stability. The Nikkei 225 Index is at its highest level since 1992 after a storming 16-day winning streak during October. Also on the way up was **Baker Steel Resources Trust** (BSRT, 44.5p), which invests in small and unlisted resources companies. Renewed hopes for strength in the commodity sector have helped the discount on this trust to narrow to 14.8%. **Dunedin Enterprise** (DNE, 455p) made another successful realisation, this time a £15.9m exit from Kee Safety against a book value of £11.6m. We should expect news of a distribution to shareholders very shortly.

One name on the list that may well be new to many is **Globalworth Real Estate Investments** (GWI, €8.55). With over a billion euros of gross assets, Globalworth is a sizeable property investor focused on Eastern Europe, with a particular focus on offices in Romania and Poland. There is an excellent company overview available on its website www.globalworth.com if you want to learn more.

On the way down, apart from the hurricane-related insurance losses for both **Blue Capital Alternative Income** (BCAI, US$0.775) and **CATCo Reinsurance Opportunities** (CAT, US$1.04), we must explain the apparent drop in **Electra Private Equity** (ELTA, 966p), which actually paid out a large special dividend of £350m or 914p per share to investors as the latest part of its restructuring. This was Phase II of its strategic review, and there are more changes on the way, including a change of name to simply 'Electra.' For private investors our advice would be to tread carefully if you hold this trust outside of a tax-free wrapper like a SIPP or ISA, not least because this kind of restructuring can have unexpected effects, such as creating a large taxable income. There is probably some value in the remaining rump of assets here though – the latest figures we have suggest a NAV of 1114p, implying a discount of 13.3%. As part of that is cash too, the discount on the actual assets is even wider.

DIVERSE INCOME TRUST (DIVI, 101p)

Gervais Williams is a well-known small cap fund manager, and a man of firm opinions. We have met him several times – we last wrote up the trust in March 2016 - and he is never dull. This time he had some worrying thoughts to share. "Boy, am I quite cautious about the bigger picture," he said.

It's hard to avoid some nagging doubts about the longevity of this current equity bull market, which began in 2009, flourished throughout the era of quantitative easing (QE), and has driven some valuations up to historically high levels. The justification tends to be threefold – that markets are supported by ample liquidity, by coordinated global growth, and by decent earnings progression. Gervais takes a different view though, one that he supports by referring to several different indicators. Starting with global productivity growth, which has stalled, he argues that long-term dividend growth must moderate as a result. He sees corporate cash flows coming under pressure, dividend cover coming down, and because employees are not getting pay rises, the scope for further political unrest as well. He is concerned we could see a big change in the trend for political policies and for markets. In the near-term, equities have been propped up by QE and by the Federal Reserve running down its capital surpluses in 2017, but Gervais believes that will come to an end soon. A resurgence of bond issuance next year may push the dollar higher and make life uncomfortable for many markets.

Using another indicator called the Wicksell Spread, Gervais also argues that capital is often misallocated when credit conditions are too easy. This happened in the US prior to 2007, and he presented evidence that it has been recurring now, both in the US and in the UK. He expressed disquiet about what he calls 'zombie' companies with an EBIT to interest expenses ratio below one, meaning they can repay the interest on debt, but not the principal. These could account for more than 10% of the market value of developed economies.

"There's an unhealthiness" in the market, Gervais believes, particularly as the QE-driven liquidity gains have pushed markets relentlessly higher and made naysayers seem foolish. Complacency is wide-ranging as a result, he warns, saying "the risk is that prudence appears too negative." Volatility is low despite elevated risks at a time when the monetary cycle is turning and interest rates are starting to head higher.

These risks are no reason at all to avoid small caps, Gervais argues. They can be more agile in times of uncertainty and are often 'special situations' less subject to general macroeconomic trends. He is still finding pockets of value for this trust, which can invest right across the capitalisation spectrum in its hunt for good dividend growers. These might be large companies such as Rio Tinto or Legal & General, or they might be much smaller AIM stocks. Gervais is able to find plenty of opportunity in the UK, where he says the market also allows good "access to smallness" where not many value investors operate. The trust does, curiously, have about 3% of its assets in Iceland as well – a country that Gervais really likes. There is no inflation, the country is about to pay off its entire national debt, and it has positive demographics. The trust has been adding Icelandic insurance companies to the portfolio.

In the UK the trust has very little in the way of consumer stocks (an exception being McColl's Retail) or property, but more in resources and insurance services. The focus is very much on finding stocks that can grow their income, with rising turnover, sustainable margins, good management, strong balance sheets, and low expectations baked into their share prices. This process "takes us to some funny places", Gervais says, talking about Stobart Group, which completely reinvented its business model. He also mentioned Zotefoams as a company he particularly likes. "All the green lights are on" for that company, he said.

As its name suggests, the trust runs a diversified portfolio of around 148 holdings, with no single stock accounting for more than 2.4% of assets. Spreading the risk over the full opportunity set is of key importance, with about a third of the assets in mid and large caps, another third in AIM stocks, and the final third in small caps, overseas, bonds, and in a FTSE 100 put warrant that accounts for 1.2% of assets and is in there for an "extreme rainy day." In the event of a crash, the idea is that this might give the trust an extra 10%-15% of cash to reinvest at bargain levels. There is a gearing facility that could also be used in unusual circumstances, although this is not normally called upon.

Including a special dividend, the trust is currently paying dividends at a rate of 3.4p per share, so the yield is 3.4%. That's not tremendously exciting as a base yield, but this trust has grown its dividends at a faster rate than its peers and also has a revenue reserve equal to more than a year's payments, so we think the dividend should be secure. Gervais says DIVI has delivered higher returns with lower volatility than average since its launch.

Entering what could be a much tougher period for economies and markets, Gervais argues it is more important than ever to 'think small' and to choose special investments from a wide universe. We think this approach has been working so far for the trust, which has a strong track record. It is ranked fourth out of 22 UK equity income trusts over the last three years, and we think it justifies its consistently strong rating on a 2.4% discount to NAV.

BH GLOBAL LIMITED (BHGG, 1341p)

If all of this talk about the potential for imminent market declines has spooked you, here's a fund that promises uncorrelated performance in all markets, and positively welcomes volatility. BH Global is a hedge fund where the managers believe the market has missed some of its key attractions. Dan Riggs from Brevan Howard talked us through the case.

Effectively, since September 2014, this US$450m trust has been a feeder for the US$1bn Brevan Howard Multi-Strategy Master Fund (BHMS), which provides exposure to BH trading strategies across all different asset classes. BHMS allocates 24% of its assets to the BH Master Fund, 8% to a systematic trading fund, 7% to BH Asia, and the remaining 61% to its direct investment portfolio (DIP). The DIP is the real key here, and this is where money is allocated to specific individual proprietary traders, rather like a multi-asset trust might pick different managers. Dan explained this has been driving performance, allowing BH Global to outperform its stablemate BH Macro. It means as well that BH Global is exposed to all kinds of strategies, roughly 46% macro, 22% credit, 12% rates, 12% emerging markets, 6% systematic, and 2% FX. That may be fairly tricky to understand, but what we can say is that the returns are not correlated to equity markets at all.

The trust has a good track record of making modest positive returns in all conditions, posting only one loss (of just 1.32% in sterling) in 2015. Over the last twelve months the trust's NAV return (for the GBP shares) is 6.9% compared to just 0.5% from BH Macro, yet the two sets of shares trade on a similar rating, with the discount of 8.2% on BH Global only slightly narrower than the 9.4% on BH Macro.

Dan believes the improvement in performance as the DIP has expanded has not really been picked up by the market, which is why he is on an education offensive now. This is time sensitive too, as changes could be afoot. The managers' fee has already been halved from 2% plus a performance fee to 1% plus the performance fee, and the chairman said in the interim report in August that "if during 2017 circumstances are not forthcoming that will lead to a substantial and sustained reduction in the discount to NAV at which the company's shares trade the board will consider such further options as are available to enhance shareholder value." A continuation vote is possible if the average discount for 2017 is greater than 10% (we believe it is currently just below this), and there is a real chance here of an either/or scenario where either the discount narrows as improved performance is recognised, or otherwise the board initiates some sort of reconstruction to force a change. There is also the chance, we think, of better performance if macro conditions become a bit more choppy, as traders seek volatility and have found their opportunities limited in the calm market conditions we have enjoyed for some time.

As an each-way bet we think there is a good argument to be made here. The board is keen to see a narrowing of the discount one way or another, and the managers are striving to improve performance while maintaining strict limits to downside risks. We think the potential risk and reward may be skewed in buyers' favour here – just the kind of asymmetric return profile BH traders are seeking. It also diversifies your portfolio at the same time and offers a way to potentially profit from any near-term market dislocations. We don't often recommend hedge funds, but this is a special situation that we think merits a BUY tag.

ABERDEEN NEW THAI INVESTMENT TRUST PLC (ANW, 557p)

Seasoned subscribers may remember that we championed this trust numerous times from 2011 to 2013, but we have

not mentioned it for a while. We were pleased to meet the trust's manager Adithep Vanabriksha for a detailed review. Unlike those earlier years, the returns from Aberdeen New Thai have been outpaced recently by other single-country funds focused on India and China, meaning this trust may have drifted off the radar. We wanted to learn whether 'Teflon Thailand' was still as resilient to political and natural shocks - of which there have been plenty.

As we would expect, Adithep presented Thailand as an attractive investment destination, characterising it as mid-sized Asian economy with a relatively strong currency, stress tested through the cycles. The country has seen an economic recovery underpinned by improving exports and solid tourism, plus strong public and private finances and some pockets of improving domestic consumption. New infrastructure spending has been proposed, companies are paying good dividends, and the SET Index has been rallying strongly, up from a low of 1224 at the start of 2016 to 1711 now.

GDP growth is expected to reach 3.8% this year and is forecast to be the same in 2018, well up from some disappointing figures in 2013 and 2014 around the time of the coup. Exports are growing well, tourism is up by 5% as more Chinese visitors arrive, and there are plans for a major US$50bn public investment programme to upgrade rail networks and to improve other infrastructure. Adithep says this is much-needed and that the finances should not be a stumbling block. Interest rates and inflation are both low. The issue is rather whether the country can remain sufficiently stable, with possible elections next year or in 2019. Adithep is hopeful, saying that the new King is not powerful and should not interfere, while a new constitution offers the prospect of more fragmented control (with a veto from the military).

The fact that the SET Index is fairly close to its 1994 high in spite of so many setbacks from terrible floods and political upsets says something about the quality of companies in Thailand. Adithep says that both equities and bonds have been in demand, assisted by abundant liquidity as net foreign inflows have kept the currency strong. Thai equities trade on an average P/E of 15x earnings now, which Adithep says is a bit expensive against their own history, but still cheap when compared to other countries in the region. The holdings in the portfolio are slightly more expensive again, on 15.7x earnings, because of the trust's quality bias. The portfolio yields 3.4%, allowing the trust to pay out a useful dividend, providing a yield on the shares of 1.8%.

Turnover in the portfolio of around 40 companies is generally low, in the usual Aberdeen value style, but there has been a little more activity of late. The trust has taken new positions in a property developer called Land & Houses, plus a power generation company, Banpu Power, as well as a new IPO in TOA Paint. Four positions have been exited, and others have either been topped-up or top-sliced. The trust has underperformed against the SET Index over recent periods because large caps and more speculative companies have rallied, but Adithep stressed the trust is taking less risk than the market. Gearing is low, at around 2%.

Aberdeen New Thai has a variable historic record, mainly because of the political instability that has dogged the country. That's why a 15.4% discount does not seem especially attractive now for this single-country trust. Yes, the Thai market has managed to shrug off a dreadful string of mishaps, but the risk is apparent for all to see, and that remains. These risks are mitigated to some degree by sensible management with the usual Aberdeen virtues, but we wouldn't say this market looks cheap.

NB PRIVATE EQUITY PARTNERS (NBPE, 1012.5p)

Over the years we have watched this Neuberger Berman private equity trust go through a number of changes, achieving a London listing, switching from a fund of funds to more direct investment, and since April, moving to the main market and having a price quotation in sterling rather than dollars. Paul Daggett gave us an update on exactly where things stand now.

This £485m trust is mainly a direct investor now, with 68% of the portfolio invested this way, together with 17% in income investments and 15% in legacy fund holdings that Paul expects to shrink further and perhaps disappear entirely within two or three years. Let's deal with that rump, first of all. The trust has not made any new fund investments for quite a while, having decided to target better returns through direct investment, but it can of course take some time for existing funds to work through their investments and realise their value. The managers have taken the view that it is better to be patient rather than accepting a haircut on the value to sell these interests in the secondary market. Paul doesn't expect any fireworks from the remaining holdings though – he says that often the investments left at the very end tend to be the less exciting ones.

The income element of the portfolio has also been falling, down from 39% in the spring of 2015 to 17% now, meaning the dividend cover has dropped from 132% to just 56%. This is less deliberate – it is not a long-term policy to reduce the income element, this is simply the result of market conditions. The trust has received a lot of money back from debts being repaid, but has found the returns available from this segment less enticing of late, hence the net fall. And of course now that it is possible (and not uncommon) for trusts to pay dividends out of capital, there is no pressure on the managers to generate income if they see better opportunities elsewhere. Paul highlighted that the current dividend payment is covered many times over by realisation receipts, meaning he is very relaxed about the US$0.50 the trust is paying out to shareholders to generate a yield of around 3.8%. The managers can continue to consider private equity debt and can participate when the returns look sufficiently attractive.

In terms of the recent returns, the managers' decision to focus their activity on the trust's main business of direct investment in mainly mid-market deals in the US, has clearly been the right one. In the twelve months to the end of September the trust's returns from direct equity investments was 22,3%, against 10.3% from income investments and 6.4% from funds. Paul says the private equity market is "thriving" and that they are seeing a lot of deal flow, adding quickly that the market does not seem frothy like 2006/07.

NBPE's direct equity portfolio has 114 investments spread over 50 sponsors, meaning it sits somewhere between highly concentrated portfolio such as **HgCapital Trust** (HGT, 1788p) with 34 companies, and funds of funds like **Pantheon International Participations** (PIN, 1869p) that are massively diversified with exposure to thousands of companies. Those sponsors, such as KKR, The Carlyle Group, and Veritas Capital, can be important because they are co-investors and specialists at developing certain types of companies. Revenues and profits are growing at the investee companies, and there is a regular stream of exits at good prices (seven in 2017 with three more in progress). The trust's top investments are often around US$15m-US$25m, and Paul says that future stakes may start at this size as they look to concentrate slightly towards 80-100 holdings.

Overall, the trust is just over 100% invested now, and wants to move towards using more of its credit facility to shift closer to 100%-115% exposure, making the most of that strong dealflow. At lot of those deals will be new ones, but NBPE will also co-invest in 'mid-life' deals on occasions, where companies raise extra capital for growth, takeovers, or to recapitalise balance sheets. Paul says that not many participants do this, so this is an area where NB can really add value. Current investments are made with the possibility of tougher economic conditions in mind, so the managers are looking for some defensive qualities, plus secular growth trends and a sponsor who has a good track record of adding value. Paul gave the example of the office supplies retailer Staples, where the turnaround specialists Sycamore are working with the company to change its structure and is growth path. Private equity prices don't look cheap, at an average P/E of 10.3x earnings in the US, but that is less expensive than public markets.

On a discount of 19.2% we think these shares offer some value and that there is a case for investors to consider some SWITCHING out of other funds in the sector where discounts have narrowed to single digits. We are thinking of Apax Global Alpha (APAX, 150p, 8.1% discount), Princess Private Equity (PEYS, 923.5p, 5.0% discount), F&C Private Equity (FPEO, 360p, 3.2% premium), ICG Enterprise Trust (ICGT, 841.75p, 8.4% discount), and Standard Life Private Equity (SLPE, 352p, 8.1% discount). Whilst we have enjoyed the period where big discounts ruled across the board in this sector, that is no longer the case, but some selective value remains.

NB GLOBAL FLOATING RATE INCOME FUND LIMITED (NBLS, 94.55p)

We last wrote about NBLS back in July 2013, after a presentation by Martin Rotheram, one of the trust's senior portfolio managers for Neuberger Berman. We have just seen Martin again for an update on this US$1.3bn trust, which aims to generate regular sustainable dividends while preserving capital value by investing in a global portfolio of non-investment grade senior secured corporate loans (plus some senior secured bonds).

In short, this is a loan fund that mainly exists to create an income stream, and the board's policy is effectively to empty the piggybank every quarter, paying out whatever income the trust has received, less costs. This is quite different from many investment trusts. There is no dividend smoothing, no revenue reserve, and no long record of steady dividend growth. This means the returns can be variable, but the current portfolio yield is quite decent. The last four dividend payments have been 0.85p, 0.9p, 0.84p and 0.82p, making 3.41p for a share price yield of 3.6%. That doesn't seem outstanding to us – not when there is no real prospect of meaningful capital growth – but as a highly diversified loan fund we can see this has the attraction of being highly defensive if equity markets start to wobble.

Martin explained more about the defensive nature of the portfolio, and the relatively cautious positioning preferred by NB's experienced team of over 40 investment professionals who work in these credit markets. It is non-investment grade, which means there is some default risk that must be gauged and minimised (even though these loans sit at the top of the capital structure as far as repayments are concerned). So far the trust seems to have done a very good job of exactly that, suffering just 50 basis points of defaults (in 2015) – way better than the market average of closer to two or three percentage points. The trust sticks generally to the larger deals in the market, with better liquidity, providing funding to companies with long-term track records that have made it through past economic cycles. The portfolio yield of 4.56% is below that of the leveraged loan market index of 4.73% because the managers focus on quality, and they judge it is not worth taking on the additional risks required to chase those (modest) extra returns. The portfolio is stuffed with loans to companies in dull industries such as cable TV, containers & glass, utilities and telecoms, and is underweight to young tech companies and retail. There is no large exposure to any single issuer, the largest being a 2% allocation to Valeant Pharmaceuticals. In line with the underlying market, about 90% of the assets are in US dollar loans, and about 10% in Europe.

The message from Martin was one of stability – that if investors are buying a loan fund for sustainable dividends, they are not looking for risk-taking, lumpy returns, or any surprises to upset their expectations. This includes the rating of the shares, which tend to trade quite close to NAV (the current discount of 2.5% on the sterling shares is wider than the 12-month average of 1.3%), supported by a share buyback program. The returns are likely to be fairly stable too – Martin reckons the returns for 2018 could be similar to 2017. That looks unexciting – but in some ways that is the point of this trust.

Our view is that the trust seems well managed, in a conservative style, and with considerable managerial resources deployed to ensure the risk/reward ratio is constantly optimised. The problem we have is that the underlying market does not look all that attractive. There has been some coupon compression and repricing of loans by companies that have reduced the returns. Demand is "robust" for loans, and the fairly modest amount of issuance means that buyers like this trust have little pricing power at present. That seems to be reflected in the returns on offer, which look moderate to us and probably not sufficient to attract investors who are unfamiliar with this largely institutional market sector.

CITYWIRE INVESTMENT TRUST AWARDS

We expect to report as usual next month on the winners of the annual Investment Week 'Investment Company of the Year' awards, but now they have a rival. The financial news site Citywire has just held a ceremony for its first investment trust awards. Citywire's seventeen Performance Awards were given to the investment trusts and investment companies whose fund managers had done the best job in their categories against their stock market benchmarks in the three years to the end of July. There was also a Best Board award for the board of directors its judges considered had best served their shareholders' interests in recent years. The important point to note about the performance awards is that they do not reward the investment trusts with the best shareholder or NAV return over three years. Instead, the 'information ratio' is used as the basis, measuring how much value fund managers add to an investment trust's portfolio for the risk they have taken against their stock market benchmark.

So without further ado, here is the list of winners: **Independent Investment Trust** (UK All Companies); **Finsbury Growth & Income** (UK Equity Income); **Rights & Issues** (UK Smaller Companies); **JPMorgan Asian** (Asia Pacific Equities); **JPMorgan Indian** (Emerging Market Single Country); **TR European Growth** (European Equities); **BlackRock Frontiers** (Global Emerging Markets Equities); **Scottish Mortgage Trust** (Global Equities); **3i Infrastructure** (Infrastructure); **Schroder Oriental Income** (International Income); **Baillie Gifford Japan** (Japanese Equities); **JPMorgan US Smaller Companies** (North American Equities); **3i Group** (Private Equity); **Picton Property Income** (UK Property); **Taliesin Property** (Specialist Property); **Fair Oaks Income** (Specialist Debt); and **International Biotechnology Trust** (Specialist Equities). The award for best board went to **VinaCapital Vietnam Opportunity Fund.** Citywire explain "in the past four years the fund has moved from the Caymans to Guernsey, upgraded from the junior Alternative Investment Market to a premium London Stock Exchange listing, switched to sterling from dollars and changed some of its accounting practices."

That leads us nicely into some developments at **VietNam Holding** (VNH, US$2.395), which we covered last month. At the trust's recent AGM there were some new director appointments, and there has been a change of broker as well. We spoke to the company's management again, who explained they had been engaging with a "vocal" group of shareholders who wanted some changes and a more active board. Interestingly, we think a fee reduction could be on the horizon – we did highlight the relatively high management charges in our article. Other costs could be addressed as well to reduce the total expense ratio (TER) for the trust.

These changes should benefit all shareholders, and it seems as though the equity market in Vietnam is still very vibrant in terms of the IPO activity and the opportunities that provides. The boom is continuing – portfolio manager David Kadarauch told us about VinCom Retail, a mall operator that has just floated and become a major stock. David told us that while many IPOs may be over-hyped and over-priced, some are genuine growth companies that can offer reasonable value if you take their future prospects into careful account. He was also optimistic again about the future elevation of Vietnam into the 'MSCI Emerging Markets' category by 2020 or 2021, potentially creating a lot of extra demand. At the end of September the trust's NAV per share was US$2.759, implying a discount to NAV of 13.2%.

STOCKBROKERS RESEARCH

Stifel asks whether the re-rating of the biotechnology trusts is justified, in a note published on November 7th. The note says that despite the biotech funds delivering only moderate NAV growth of 6% over the last six months and with the potential negative impact of US healthcare reform ongoing, the biotech sector still has experienced a strong positive discount re-rating and now all the biotech funds trade close to NAV, their highest level for three years. The broker concludes "whilst we continue to believe that valuations on the underlying mega-cap biotechnology companies are unchallenging we are cautious about investing in the funds at such full valuations and so are downgrading our ratings for both the **Biotech Growth Trust** (BIOG, 814p) and **International Biotechnology Trust** (IBT, 622p) to neutral."

Stockdale Securities rates **Chelverton Small Companies Dividend Trust*** (SDV, 269.25p) as a buy for rising income and strong total returns. The broker says that over the last one, three and five years the trust has been the top performing UK equity income trust. SDV is managed by David Horner and David Taylor, who both have a long history of generating strong returns by investing in the mid and smaller company space. Using a disciplined investment approach, the trust invests in smaller, less well researched companies that are yielding over 4% at the point of investment and exits when the yield falls to below 2%. The trust has significantly outperformed both the UK equity income sector as well as indices such as the MSCI UK Small Cap Index and the Numis SC Index over the long term. Stockdale say "it provides a differentiated and attractive combination of mid and small cap growth and rising income. We recommend investors buy SDV." Separately, the trust has announced plans to raise up to £75m through an issue of 'C' shares plus £30m from new zeros.

On 2nd November Numis Securities issued a note on **Edinburgh Worldwide*** (EWI, 704.5p), the Baillie Gifford trust managed by Douglas Brodie that invests in a diversified portfolio of innovative, disruptive companies, with a market cap of less than US$5bn at the time of initial investment. Exposure to companies operating in technology and healthcare makes up two-thirds of the portfolio. Positions tend to be initiated at the start of the commercialisation phase, when the technology is proven but the market has not yet priced in its potential. A key tenet of the approach is 'running the winners', as the manager is not forced to sell by a limit on market capitalisation. Stocks that prove their commercial viability on a global basis can generate multiples of the original investment over the longer-term, examples being MarketAxess, Alnylam Pharma and Tesla. Little emphasis is placed on conventional valuation metrics such as P/E multiples, as the manager believes the size of the market opportunity and the extent to which it can be exploited is more important. Up to 5% of the portfolio can be invested in unquoted companies. Two have been sold at a profit, while two remain in the portfolio.

Edinburgh Worldwide has delivered strong NAV total returns of 32% in 2017 to date, compared to 11% from the S&P Global Small Cap Index. Share price total returns have been higher still, at 40%, due to a narrowing of the discount. NAV total returns have marginally lagged the S&P Global Small Cap Index since the fund's change in mandate in 2014. However, Douglas Brodie notes that the focus on immature growth companies will inevitably lead to periods when the approach "is out of sync with the myopic gyrations that are all too common in stock markets." Numis view the longer-term outperformance of the open-ended equivalent fund (BG Global Discovery) since its inception in 2011 as a better indicator of the strategy's success.

Numis conclude "we believe Edinburgh Worldwide is an attractive vehicle to access a portfolio of the most innovative and disruptive companies around the world. In keeping with Baillie Gifford's house-style, the focus is on long-term growth with no regard to index composition. As a result, it is significantly differentiated from the other global equity funds, and only 5% of the portfolio overlaps with Scottish Mortgage. Edinburgh Worldwide currently trades at a 3% discount to NAV, having steadily narrowed since mid-2016. In line with many other Baillie Gifford funds, we see potential for it to trade at a premium given its unique mandate." Numis add that while there are similarities between Edinburgh Worldwide and **Woodford Patient Capital** (WPCT, 95.7p) which invests primarily in early-stage companies, WPCT has a significantly higher weighting to healthcare (58%) and over half of the portfolio in unquoteds.

JPMorgan Cazenove issued an update on **Riverstone Energy*** (RSE, 1330p) after the trust's second largest holding, representing 29% of net asset value, released its third quarter results. Centennial Resource Development (CDEV), which is developing oil resources in Texas, has bold plans to increase its production from around 21,000 barrels per day to 60,000, and the broker says its Q3 results were "strong", both operationally and financially. CDEV's share price has rallied strongly, up by more than 30% since the end of June, partly in reaction to a rising oil price, with WTI crude up by 24% over the same period. JPMorgan Cazenove's oil team has raised its target prices for oil in 2018. Yet the broker notes that despite the strong oil price rise and the strong performance of CDEV since 30th June, Riverstone Energy's share price has remained largely flat. The broker says "we believe RSE has many options for value creation across its portfolio and is not dependent on oil price rises for NAV growth although clearly a higher oil price is helpful. We remain of the view that RSE is one of the best opportunities for NAV growth in the investment companies sector and, at an 18.0% discount to NAV, represents excellent value. It is worth noting that with 29% of the NAV invested in a quoted company the implied discount on the unlisted portfolio is 25.7% at the current share price. We are overweight and the shares are a constituent of our investment companies model portfolio." The holding in CDEV has since been reduced to around 23% of assets after RSE realised around US$91m from the sales of shares in a secondary public offering.

Canaccord Genuity published an update on **Edinburgh Dragon Trust** (EFM, 373.25p) on 2nd November, noting that while the trust has delivered strong absolute returns since the beginning of last year, the performance relative to the benchmark in recent years has been disappointing. Being underweight in China has proved damaging. This prompted the board to review the manager and process, following which they have re-affirmed Aberdeen's continued appointment. Canaccord welcome the further decisive action to reduce the ongoing charge. With effect from 1st September 2017, the management fee has been reduced from 0.85% of net assets to 0.85% of net assets up to £350m, and 0.5% thereafter. The broker concludes "a constituent of our model portfolio, we see increasing contrarian value here. We remain comfortable with our buy recommendation."

** asterisks in this section indicate that the trust is a client of the stockbroking firm providing the research.*

NEWS ROUND-UP

Civitas Social Housing (CSH, 109.75p) is aiming for up to £350m from an ambitious 'C' share issue to double the size of the fund. The company says it has a pipeline of £500m of investment opportunities to buy more regulated social housing, offering shareholders a target yield of 5%. We are not completely convinced this offers the diversification that many home-owning investors need, but the trust has had a decent first year since flotation last November.

Law Debenture (LWDB, 616.5p) has announced the surprise departure of its CEO Michael Adams after just over a year in the job. Tim Fullwood has moved up to interim CEO while a recruitment process is initiated, and we can't see any reason to worry here.

When we wrote about **Majedie Investments** (MAJE, 288.75p) in April we mentioned its expensive debt, with two debentures set to run to 2020 and 2025. The trust has announced it is opting for an early redemption of the £15m 2020 notes next month, at a cost to NAV per share of 0.6%. That seems worth it, we would say, and this is in line with what William Barlow told us about wanting less debt in the structure. On the same subject, and following on from our update on **Merchants Trust** (MRCH, 491p) in the last newsletter, we couldn't help but sneak a wry smile a couple of weeks ago. When talking about the maturity of an expensive debenture we said in our article "the trust is likely to seek refinancing at a much lower rate, perhaps around 3%." On 23rd October the rust revealed it had priced an issue of a £35m fixed rate 35-year secured private placement note at a coupon of 2.96%.

The latest results from **Scottish Mortgage Trust** (SMT, 457.85p) for the six months to the end of September were exemplary again, with net assets rising by 17.5% against a meagre 1% rise in the FTSE All-World Index in sterling terms over the same period. The trust's growth investments, especially in technology and healthcare, have been performing very strongly, providing excellent returns for the large number of investors who have this trust at the core of their portfolios. We have recommended the trust and would not dissuade new investors from following suit. It would be unwise though to expect such stellar returns to continue indefinitely, and we note the trust itself struck a note of caution in the outlook statement with these figures, emphasizing its long-term approach. Sitting proudly at the top of the global growth sector over the last five years with a net asset value total return of 213.5%, Scottish Mortgage looks like a tempting prospect, but we are not certain this is the best time to commit large sums of fresh capital as lump sums. At this point in the cycle our preference would be for a long-term monthly savings plan to average out the fluctuations.

The next issue of Investment Trust Newsletter is published on Saturday 9th December.

The FTSE 350 Equity Investment Instruments Index is up 123.65 points (+1.29%) to 9675.57 since the last newsletter.