Investment Trust Newsletter

PUBLISHED MONTHLY SINCE 1996 • MAY 2019 ISSUE •

The expansion of the investment trust industry into numerous new areas means that investors have easy access to an eclectic mix of assets these days. Just look at the list of movers below for the range. The AIC recognises this too, and is shuffling its sector definitions to better accommodate the broad scope of alternative asset trusts. Equity investments still form the heart of the industry though, and that's where much of our analysis is focused this month.

Major Price Changes Over One Month

Leaf Clean Energy Company	+233.33%
Lindsell Train Investment Trust	+14.86%
EPE Special Opportunities	+12.50%
UIL Limited	+10.61%
Menhaden	+9.90%
Amedeo Air Four Plus	+9.79%
Livermore Investments Group	+9.09%
Green REIT	+8.58%
JZ Capital Partners	+8.53%
Henderson Opportunities Trust	+8.35%
RDL Realisation	-13.82%
Syncona	-9.57%
Biotech Growth Fund	-8.44%
Symphony International	-7.77%
Worldwide Healthcare	-7.09%

Major Price Changes Over One Year

Leaf Clean Energy Company	+452.63%
Lindsell Train Investment Trust	+67.97%
Gulf Investment Fund	+33.20%
Gresham House Strategic	+31.45%
LXI REIT	+30.81%
BB Healthcare	+29.18%
3i Infrastructure	+28.94%
BH Macro USD	+26.03%
BBGI	+25.96%
Life Settlement Assets 'A'	+25.49%
CATCo Reinsurance Opportunities	-65.33%
CATCo Reinsurance Opportunities 'C'	-57.96%
CIP Merchant Capital	-31.09%
Dolphin Capital Investors	-30.00%
RDL Realisation	-29.47%

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

That extraordinary rise in **Leaf Clean Energy Company** (LEAF, 105p) obviously requires some comment. This £47m investment company provides capital to renewable energy firms, but its recent change in value has been all about a lawsuit in Delaware, America. The back story here is that Leaf Clean held an investment in Invenergy Renewables, which it claims engaged in a material partial sale without obtaining consent or paying Leaf Clean a return, so it has been seeking damages. The court initially opined that Leaf Clean was only entitled to nominal damages, but at the start of May the court held that Leaf Clean was entitled to the full amount of its contractually defined target multiple, obviously a much larger sum. This is why the shares suddenly jumped in value, but this is really a legal matter now rather than an investment judgement, so we don't intend to offer any opinion on what happens next.

Another riser over the last month has been **Green REIT** (GRN, €1.73), a property investor concentrated on prime office and logistics assets in Dublin, with a portfolio of 17 properties valued at €1.48bn. On 15th April its board announced that after a strategic review is has taken the decision to initiate a process for the sale of the company or its portfolio of assets, blaming the structural discount in the share price. Further announcements will be made as and when appropriate, but the key figure here is perhaps the NAV, which at the end of 2018 was €1.83 per share on an EPRA basis. That suggests limited upside from this point, we think.

On the downside, **RDL Realisation** (RDL, 374p), which is winding down its portfolio of loans, is currently suspended, pending the publication of its Report & Accounts, which should happen no later than 17th May. The auditors required additional time following the impairment of the company's exposure to the Vehicle Services Contract platform, against which an additional reserve of US$9m has been taken.

THE BIOTECH GROWTH TRUST (BIOG, 695p)

It has been a bumpy period for this sector and for this trust, which ranks among the worst performers over the last month, so we were glad to have some explanation of recent events from Geoff Hsu, the manager, in a recent update call.

We have heard Geoff speak many times, and he is unfailingly positive, confident, and highly articulate. Listening to him, it is easy to be swept up in a wave of enthusiasm for the exciting developments in the biotech industry, the "golden era of innovation" which he describes, and the strong outlook for a sector where the valuations have not kept pace with the apparently attractive developments. And therein lies the rub – actually, biotech is not a sector in fashion, nor has this trust kept pace with its main rival, **International Biotechnology Trust** (IBT, 617p). It is bottom of its sector over one and three years, biotech faces political headwinds, and the prevalence of M&A activity, often cited as a positive, perhaps robs investors of the chance of really substantial long-term gains from companies that emerge as sector winners.

The Nasdaq Biotechnology Index is up by just 3.1% over the last twelve months, compared to 6.6% for the S&P 500 Index and 9.6% for the Nasdaq Composite Index, clearly lagging behind. One of the big factors that deters investors is drug pricing, which is a highly emotive subject and one that regularly hits the headlines. Geoff argues that a split Congress precludes any substantial change, and he stressed that the President does not have executive powers over the matter. To date the changes that have been made under this administration have been fairly benign, and Geoff believes their practical impact will be small. That may be so, but heading into the 2020 election cycle, there is scope for more political noise and volatility in a sector that has just had to cope with a change of commissioner at the Food & Drug Administration (FDA).

The good news is that the FDA has clearly been accommodating and has approved a record number of new biotech drugs, with 59 new molecular entities approved in 2018, up from 46 in 2017. Geoff Hsu reckons the aggregate market potential from new technologies could yield US$10bn of annual revenue in the years ahead, from areas like gene therapy and protein correctors. Big pharmaceutical companies that want access to these new areas have always had an appetite for M&A, and that is true now, with Celgene being bought by Bristol-Myers Squibb a recent example. One new trend that we have not really heard about before are the new opportunities emerging in China, the second largest pharmaceutical market in the world. Geoff explains that recent developments are encouraging innovation, with the Chinese FDA tightening standards and the Hong Kong Stock Exchange relaxing its listing rquirements. Biotech Growth has participated in two recent IPOs, an oncology company called Shanghai Junshi Biosciences, and a vaccine manufacturer, CanSino Biologics. Both have done well, and the trust has two analysts in the region to examine the long queue of other opportunities.

Dealing specifically with the trust's disappointing performance, Geoff said that in the second half of 2018 the portfolio's overweight position in large cap biotech was a drag, and that sentiment remains very depressed in that sector, with valuations "very, very low." He says that biotech is now the cheapest sub-sector in the S&P, having been the most expensive at the turn of the century. The trust's holding in Biogen has also been a detractor, and Geoff has been frustrated that positive fundamental developments have not led to positive share price reactions. He says he is "confident we can restore outperformance", but accepts it may take some time for latent value to be recognised by the market.

In January we said that we were becoming a little disheartened with this trust, and that we were looking for a quick improvement. That hasn't come, and this update contained no signal of any changes in management style. Rather, the message is the same upbeat assessment of the prospects that we think really need to bear fruit sooner rather than later. Biotech Growth Trust is sorely testing our patience, and we think we should probably revisit its performance at the time of its interim results in November. We hope that at least some of Geoff Hsu's optimism proves justified.

THE NORTH AMERICAN INCOME TRUST (NAIT, 1442.5p)

Since our last write-up in April 2018, NAIT has progressed nicely, with the shares rising from 1215p to 1442.5p and the dividend rising as well. We met manager Fran Radano, over from his office in Philadelphia, for an update.

The story from Fran is really one of 'steady as she goes' for the trust, with no major changes to the approach or outlook, which is fairly positive. The hunt here is for quality and value, a typical Aberdeen Standard Investments approach, resulting in a portfolio of around 40 equities, with some fairly minor assistance from US corporate bonds and options to give the income a boost. The dividend rose from 39p per share to 42.5p last year, with a helpful residue added to reserves as well. Fran speaks of a 'cadence' to the steady annual dividend rises which he clearly wants to maintain, although he will have to think in different units shortly. A 5-for-1 share split is coming, assuming it is voted through at the AGM in early June, mainly to enable investors in share plans to add small sums more efficiently. The trust's income flow from its holdings is fairly predictable at present, although the wild card here is currency – the income is earned in dollars and paid out in sterling – and that's why the revenue reserve of 32.3p per share is particularly important here.

In the nature of an income trust, NAIT is not looking for quick turnarounds or swift trading, but Fran does say "if the opportunities are there, you've got to swing the bat." In the last year he has changed perhaps eight or nine of the 40 companies in the portfolio, which is more than average. A lot of the sales are due to strong performances reducing the available yields – that has been true for stocks like Microsoft and Abbott Laboratories. The largest holdings at the end of March were in Chevron, Cisco Systems, Philip Morris, and Johnson & Johnson, so these are big companies that are probably familiar to many investors. Further down the list are some companies that exhibit more volatility, like Tiffany, the jeweller, which yields around 2%.

Dividends are generally growing at a decent pace, Fran says, although a little lower than the trust's long-term average of 10% from its portfolio companies. Last year there was a double benefit from President Trump's corporate tax changes, which both made more capital available and also meant that some capital previously stuck overseas was repatriated and became available for distribution. This year the growth may be more like 6%-7%.

The gearing used by the trust, typically around 5%-10%, really means that Fran can maintain exposure of around 100%-102% in equities, with the rest in bonds. Essentially the status quo for the trust is to stay fully invested in equities. We asked whether the small bond element might just be an unnecessary distraction, but Fran says it is useful to have this allocation, gaining a different perspective from the fixed interest team. The trust also writes options on some stocks to generate some extra income, and sometimes that provides an exit for holdings that have hit target prices.

Talking about valuations, Fran seemed fairly relaxed about the forward P/E ratio of 16.4x for the S&P 500. That's just slightly above the long-term average of 15.8x, but with interest rates and inflation subdued, it seems well supported. When the earnings multiples for the 50 largest companies in the S&P 500 are plotted, their current median of 17.8x is much lower than the 31x earnings multiple witnessed at the market top in 2000. Equally important, unlike 2000, these earnings multiples are distributed now with a much tighter range, with far fewer speculatively valued equities. These indicators don't suggest there is much froth in the market, although Fran does wonder whether the big US growth stocks could have some trouble ahead after a very extended period of outperformance against value stocks, which is where this trust concentrates. Still, apart from a handful, there are not many high-profile IPOs, no heavy inflows into equity funds, no shift towards defensive leadership, and generally very few of the markers that signalled market tops in 2000 and 2007.

Fran says he "generally feels pretty good about the market", and we generally feel pretty good about his trust, which seems to deliver what it promises – steady US exposure with a decent yield of 2.9%. As before, we think this trust can be combined with a growth trust if you want to cover all bases, or just as a core long-term US holding if you wish to be more conservative. We think there is an opportunity now to switch into NAIT on a 1.5% discount from BlackRock North American Income (BRNA, 180.25p), trading on a 3.7% premium.

EDINBURGH WORLDWIDE INVESTMENT TRUST (EWI, 187.5p)

Ranked second of 20 global growth trusts over the last year by NAV performance, and third over the last three years, behind the two much better-known trusts Lindsell Train and Scottish Mortgage, investors might want to hear more of Edinburgh Worldwide. Very much in the Baillie Gifford long-term growth style, the trust invests in entrepreneurial companies around the globe with market capitalisations of less than US$5bn at the time of the initial investment, but the manager feels the 'small cap' tag is inadequate as a description.

Douglas Brodie is the manager of Edinburgh Worldwide, this Baillie Gifford trust that seeks to find the most interesting and innovative global companies when they are small and immature. He explains that it may not be quite right to think of the trust as a small cap investor, because while that may describe the pond in which it fishes, it ultimately wants to continue holding these companies as they become much, much larger, perhaps becoming dominant businesses of the future. The manager is not constrained by a market cap limit, and has no intention of selling as companies grow beyond a certain size. Douglas says he looks for "businesses doing something novel" that have an element of disruptive flair, looking to reshape their industries. He says "we are attracted to those businesses really because of the extreme investment asymmetry they offer us as long-term shareholders." Management quality is crucial, and Douglas likes founder-led companies where the incentives and motivation are well aligned. He also looks for scaleability and for network effects that can help companies find greater economies and growth as they mature. As an example, the online grocer Ocado – the trust's largest holding at 5.2% of assets - has an active founder, setting the tone and vision for a company that is setting out to define how a new industry really functions.

The trust invests in unlisted companies too, up to 15% of assets, using a similar process, and has about a hundred holdings overall. There is a bias towards biotechnology, software and internet businesses, and just over 60% of holdings are in North America, with 16% in the UK, 9% in Asia, and 9% in Europe. Gearing is modest at around 7%.

Douglas speaks of 'losing' six companies from the portfolio to M&A over the last 18 months or so. While many shareholders are happy to receive premium payouts, Douglas greets such news with "a reluctant acceptance" that this is how the world works. Big businesses struggling to innovate themselves can effectively buy more dynamic growth – they are often looking for the same qualities as the trust is seeking in its investee companies. In the last quarter of 2018, when markets declined, the trust added to a few of its larger and newer holdings, adding to Yext, to Zillow, and taking a new holding in Axon, which makes taser devices and body cameras for police forces. Douglas is excited by the prospects for smaller companies to work with new technology, with different revenue models and avenues for growth. "That's the backdrop we love, and it's a challenge we relish", he says.

Growth investing has been doing well against a more value-oriented style, and as an investment house that emphasises growth, technology, and a desire to find the great companies of the future, Baillie Gifford has been leading the way. Both Scottish Mortgage and Edinburgh Worldwide have been developing extremely strong track records, in EWI's case since it adopted this investment policy five years ago. Capitalised around £550m, Edinburgh Worldwide does not have the very high public profile of SMT, the largest of all conventional trusts, but its merits are still sufficiently appreciated for the shares to trade on a 3% premium to asset value. This is no bargain, there is no dividend, and there is currency risk, but if your investing intentions align with those of Douglas Brodie, it's hard to argue against this trust as a long-term core portfolio holding.

BLACKROCK LATIN AMERICAN (BRLA, 461.5p)

For us, Latin America is probably the most foreign of overseas regions, by which we mean it is the most difficult to understand unless you really specialise in following it closely. It is fairly easy for investors to ignore as well, especially during a period when developed markets have generally been producing decent returns, and in the emerging markets realm the overwhelming importance of China tends to focus attention on Asia as a region. Yet the profits can on occasions be excellent from Latin America, as they were for example in 2016. For these reasons we were very glad to have an update from Timothy Chiang, a product specialist at BlackRock.

We started the meeting with two big reasons to be wary of BlackRock Latin American. The first is that the trust's highly regarded manager Will Landers has left and moved on to a domestic Brazilian bank, and we know much less about his successor, Ed Kuczma. Second, the trust pays out some of its capital as regular dividends, which is a policy we find difficult to swallow for trusts largely oriented towards capital growth. Add in a single-digit discount of 9.9%, well below its one-year average of 14.3%, and we think there are some hurdles to jump here.

Tim explained that Ed Kuczma is quite bottom-up in style, and has been a top analyst at BlackRock with over 15 years of experience in the region. He works with Sam Vecht, more of a big picture thinker, to combine top-down macro views with bottom-up alpha, aiming to generate more stable returns through the cycle. Tim described this as an "evolution of the process" that allows Ed to leverage the manager's extensive macro research to find entry points. The managers do believe that emerging markets are cyclical, so whilst they are aware of longer-term themes, they are also on the lookout for opportunities to target areas that have suffered downturns and to take profits where they look unsustainable. The trust is about 7% overweight in Brazil now, for example, having been 11% overweight at the end of the year, and the market has corrected since January.

As a group now, BlackRock favours Latin America amongst the emerging markets, feeling it is better placed in the cycle. Their model is overweight Argentina, Brazil and Mexico (but underweight Chile), and these views are reflected in the portfolio of around 45 stocks. Tim suggested that in Brazil "the stars could be aligning" with a decent macro backdrop, a favourable currency outlook, low indebtedness, and the possibility of a re-rating from pension reform. The trust has 70% of assets there. Negative sentiment also looks to be overdone in Mexico, where the market is trading at a 25% discount to historic averages and the trust has 20% of assets. Argentina looks particularly attractive now too, trading at around 7.5 times earnings, similar to where it was after the financial crisis. Argentina is not in the trust's benchmark index, but it has 4.6% of assets there.

It is good to know that BlackRock has a positive view on Latin America in this early part of 2019, and to learn a bit more about the new manager. In view of our reservations though we would not be rushing to buy BRLA on its current discount. We also think the JPMorgan Brazil (JPB, 64.25p) trust has its drawbacks, particularly its sub-scale size, although its shares are on a more attractive discount of 16.8%.

STOCKBROKERS' RESEARCH

Stifel issued a note on **ICG Enterprise Trust** (ICGT, 881p) on 16th April, after the trust's final results to the end of January. The broker said "this was another strong year with realisations and earnings growth resulting in a net asset value total return of 12.4%. We think the shares are attractive on a c.20% discount to the historical NAV and reiterate our buy recommendation." The end-January NAV of 1057p was at the top end of Stifel's 1015p-1060p estimate, helped by significant realisations such as Cambium, The Laine Pub Co, and Swiss Education Group. The 60 realisations over the year crystallised an aggregate uplift of 35%. Over the year, the largest 30 investments, accounting for nearly half of the assets, saw EBITDA growth of 16%, up from 12% a year earlier.

A dividend is paid quarterly, and was 22p over the full year, only 12% covered by revenue earnings of 2.7p, which fell heavily from 23.8p in the previous year, when there was a significantly greater figure for rolled-up interest. Stifel say "the trust aims to pay a minimum of 20p per year and has a progressive policy, but this should be viewed as an effective return of capital in our opinion." One other important factor here is that Emma Osborne, who has led the company's investment team since 2004, will be moving to a senior adviser role within ICG at the end of 2019. As a senior adviser, she will remain on the Investment Committee to provide oversight of the portfolio, but ICG is in the process of identifying her successor, expected to transition into the leadership of the investment team in the second half of this year.

With regards to the investments, the proportion in the US has been creeping higher, from 24% in July 2018 to 26% in January, and likely to rise towards 30%-40% in the next few years. The UK weighting is 31%, with 39% in Europe. Stifel conclude "we think prospects for NAV growth continue to look good, both from an earnings perspective and in terms of realisations. While there has been a shift towards younger vintages following exits, there remains 42% of the portfolio in 2015 and earlier vintages. The shares are trading at around a 20% discount to the historical NAV at 31/01/19, which we think offers reasonable value. Given the strong balance sheet, good long-term performance and scope for realisations from the more mature vintages mean we think the shares could justify trading at a sub-10% discount to historical NAV. Our fair valuation is 955p. Taking into account the 2.6% dividend yield and our 955p fair valuation suggests a total return of c.15% on a one-year view and we reiterate our buy recommendation."

Cantor Fitzgerald have handily identified some trusts trading on wider than normal discounts. **Aberdeen Japan** (AJIT, 540p) is on a discount close to 14%. A rising NAV since mid-March has resulted in AJIT trading around its widest discount of the last three years, having been as narrow as 6% as recently as early January. **Chelverton UK Dividend Trust** (SDV, 177.5p) has suffered share price weakness since early February alongside a stable NAV, resulting in the discount widening out towards 20% - its widest level in the last three years - having traded on a premium as recently as October 2018. For **Aberforth Split Level Income** (ASIT, 83.75p), on a 13.3% discount at the time of the note on 2nd May, Cantor says that share price weakness since early April alongside a rising NAV year to date has resulted in ASIT trading around its widest discount in the last three years, having been on a small premium as recently as late March.

A note from Numis on **Schroder European Real Estate*** (SERE, 109.75p) says it provides core European property at a discount. The note says the trust offers investors "a fully covered yield of 6.2% from a core portfolio of 13 European property assets located in the 'winning cities' of Europe. We believe the portfolio is in good shape, providing a robust income stream and asset management opportunities to boost NAV returns. Lead manager Jeff O'Dwyer has over 25 years experience of European property investing, and is backed by a team of 180 local experts at Schroders. Their ability to source attractive deals has been proven by the purchase and subsequent disposal of Casino's supermarkets assets, which added 2.6p to NAV. NAV total returns to date have been eroded by acquisition costs, but now the portfolio is fully invested (at c.30% loan to value), we see potential for returns of 7% pa over the next two financial years, supported by a growing dividend."

Canaccord Genuity issued a note on **Aberdeen Standard European Logistics Income*** (ASLI, 94.4p) on 24th April, saying that ASLI has made considerable progress following a measured start to life after its launch in December 2017. The company has now invested its IPO proceeds, secured debt against four properties, and the portfolio comprises ten assets located across five countries. The background is that there is significant demand for logistics space in Europe, driven by e-commerce, globalisation and urbanisation, whilst there remains a considerable under-supply of suitable logistics assets in many European markets. The broker says "there has been a sharp re-pricing in the sector in the period since launch; however, yields on European logistics assets combined with low financing costs remain attractive. Given these strong fundamentals, we remain comfortable with our buy recommendation."

The trust's end-December net asset value was €1.08, meaning the NAV total return in 2018 was -2.98%, primarily due to the impact of transaction costs on acquiring properties following its IPO in December 2017. It paid dividends of 3p per share in the period from launch to 31 December 2018, in line with the target set at IPO. Following discussions with its largest shareholders, the company has reduced its target yield from 5.5% to 5% on the IPO price as a result of the considerable yield compression in the sector in the period since launch. The total return target of 7.5% pa (in euro terms) remains unchanged.

The portfolio is well diversified and comprises ten assets located in five different countries and 26 tenants. Once completed, the Netherlands will represent the largest market (39%), followed by France (26%), Germany (20%), Poland (9%) and Spain (6%). Six of the assets are new and were delivered in 2018 or are still under construction. The Investment Manager has a significant depth of resource, based locally, with over 20 transaction managers and 80 asset managers across the European business.

Following the year-end, a €33m bank financing was put in place on the two French assets in Avignon and Meung-sur-Loire, with a maturity of 7 years and a fixed interest rate of 1.56%. Two further facilities have been drawn: Erlensee (€17.8m, 7 years, fixed interest rate of 1.62%) and Flörsheim (€12.4m, 10 years, fixed interest rate of 1.54%). The company is looking to put debt finance in place on the warehouses in the Netherlands to bring the loan-to-value ratio to the c.35% target. During the year, the company announced that the management fee on the first €500m of assets would be reduced from 0.95% of NAV to 0.75% of NAV. Canaccord note that this compares favourably with the management fee charged by **Tritax Eurobox** (EBOX, 96.9p, 1.3% on first €1bn of net assets).

JPMorgan Cazenove is keeping its overweight rating on the oil & gas investor **Riverstone Energy*** (RSE, 975.5p) in spite of disappointing first quarter 2019 portfolio valuations that were well below its expectations. Its estimate of the end of March NAV, which is complicated by tax and by carry fees, has dropped by 12% to US$15.48 per share (currently equivalent to 1190p, implying a discount of 18%). The trust's holding in Hammerhead Resources was written down, and there are some weaker valuation comparatives.

The broker comments "our hope remains that the bidding war for Permian operator Anadarko between Chevron and Occidental leads to a more general pick up in M&A and transaction multiples, and thus exit opportunities for RSE. CDEV, RSE's one listed holding, for example, is now up 20% in Q2 so far." The note continues "our US strategy team is bullish on energy and our US shale analysts see a massive valuation disconnect in the sector, as exemplified by the bidding war for Anadarko mentioned above. While burned so far, we are keeping faith, and we remain overweight RSE, keeping the shares in our model portfolio."

Winterflood has published a meeting note on **Jupiter European Opportunities** (JEO, 790p), reiterating that the manager Alexander Darwall remains committed to the trust. As we reported last month, he is stepping down from his investment management commitments to his open-ended funds, but is to continue managing Jupiter European Opportunities, which he has managed since its launch in 2000. Winterflood notes the trust has a very strong long term record, with a NAV total return of 832% since its launch in November 2000 compared with a rise of 183% for the FTSE World Europe ex UK index and 245% for its European peer group. Over the last five years, the trust has delivered a NAV total return of 87% compared with 46% and 57% for its benchmark and peers respectively. The broker concludes "while there is a high level of commonality between the investment trust and open-ended funds at present, there is likely to be growing divergence in the months ahead as Mark Nichols takes responsibility for the latter. We suspect that a number of existing investors will be tempted to switch from the open-ended funds to the investment trust, in order to maintain their exposure to Alexander Darwall and his unconstrained, stock driven investment approach. His emphasis on special, growth-orientated companies has resulted in a concentrated portfolio that is very different from the benchmark and this has allowed the fund to generate an exceptionally strong performance record. Consequently, we would not be surprised to see it re-rated as a result and trade on a premium rating once again. We continue to recommend the fund."

A note from Shore Capital on **Downing Strategic Micro-Cap*** (DSM, 71.75p) on 7th May suggested the trust may be "poised to recover." It has been a very poor investment since launch at 100p two years ago, but in the trust's annual results the manager and the board said they believe the intrinsic value of the companies in the portfolio is substantially higher. The trust is around 85% invested with 13 investments, the majority of which are performing in line with market expectations or better at an operational level. Judith MacKenzie, the manager, believes that the portfolio's intrinsic value compared to the current market values of these positions has increased since last year. The board believes that the portfolio comprises a spread of businesses all of which are at an interesting transformational stage and some of which are likely to deliver exceptional long-term shareholder returns.

The note says "the entire small and mid-cap market in the UK has had a period of relatively muted returns partly because investor sentiment has been depressed by the fog of Brexit. Thus, there is little appetite among portfolio managers to seek new exciting opportunities as the stocks they already feel positively about continue to get de-rated. In this environment positive earnings surprises by companies may be overlooked while relative minor earnings misses could trigger selling pressure in a market lacking sufficient capital. This asymmetric reaction to news could cause a portfolio whose underlying companies are performing reasonably well to get de-rated. MacKenzie believes that this true about the current situation of DSM's portfolio." The managers believe that strategic initiatives introduced by the portfolio companies can provide the building blocks for future growth, and the note says that short term damage to DSM's NAV has come predominantly from three or four investments and has been due almost entirely to failings in corporate management and governance. The broker concludes "we believe that as the uncertainty of Brexit is lifted and capital flows back in to UK smaller companies, the portfolio companies should benefit from a combination higher valuations and improving fundamentals."

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

NEWS ROUND-UP

Lord Rothschild is to step down as chairman of **RIT Capital Partners** (RCP, 2067.5p), taking up the new honorary role of 'President.' This might unsettle some long-time holders, but we think this is a natural step, and it has been a while since he has been involved with the day to day activities of the trust. The family remains committed to the trust, with total holdings of 27.5%, and the new chairman, Sir James Leigh-Pemberton, has indicated he will maintain the trust's existing culture.

Back in December we reported that the board of **Establishment Investment Trust** (ET., 217p) was considering alternative plans for its future: more details have now been released. Shareholders will have the choice of a roll-over into **Henderson International Income** (HINT, 164.25p), or into a new OEIC run in part by the existing manager Henry Thornton, or to receive cash at NAV, less costs. That's a good choice, we think, and depending on your tax position we would opt for cash, or HINT if a roll-over is more appropriate for your circumstances.

AIC SECTORS

The Association of Investment Companies (AIC) is revamping its investment company sectors at the end of this month, following an industry-wide consultation. Its new list of sectors and constituents comprises 13 new sectors, 15 renamed sectors and 31 sectors that are unchanged.

Several of the new sectors reflect the greater numbers of investment companies investing in alternative assets. The amount of money invested by investment companies in alternative assets has grown by 92% over the past five years, rising from £39.5bn in 2014 to £75.9bn in 2019. For example, the growing debt sector has been separated into three new sectors, Debt – Direct Lending, Debt – Loans & Bonds, and Debt – Structured Finance. Similarly, there will be more specialist property sectors: Property – UK Commercial, Property – UK Healthcare, Property – UK Residential, and Property – Debt. Most of the equity sectors are unchanged, but Asia has been split into three new sectors, Asia Pacific, Asia Pacific Income, and Asia Pacific Smaller Companies. There are new sectors for Growth Capital and for Royalties.

Ian Sayers, chief executive of the AIC, said "we undertook this review to ensure that investment company sectors accurately reflect the shape of the industry today. Recent years have seen significant growth in investment companies investing in alternative assets, such as property, debt and infrastructure and the emergence of new asset classes such as leasing and royalties. Our new sectors allow investors to find and compare companies with similar characteristics easily." Doubtless we will become used to the new classifications.

Mike Prentis is to retire as manager of **BlackRock Smaller Companies** (BRSC, 1458p), the trust has announced. Roland Arnold, who has worked closely with Mike for 14 years and was appointed co-manager of the trust alongside him in April 2018, will be named as sole manager of the portfolio upon Mike's retirement at the AGM. This is not a great surprise, but it is a disappointment, as Mike told us a year ago that Roland's appointment was with a view to "eventual" succession. We had hoped he might stay a little longer. One year on, and shareholders must face the loss of their hugely successful manager, under whom the trust has beaten its benchmark for an impressive 16 consecutive years (having squeaked past it by a narrow margin in the last financial year). He will be missed, certainly, and Roland has his work cut out now to maintain the trust's fine record and reputation. For now, we don't think holders have anything to worry about.

We introduced **Oakley Capital Investments** (OCI, 208.5p) a year ago, when the share price was 176.75p and the discount was 29.3%. The shares are up by 18% since then, helped by a modest narrowing of the discount to an estimated 25.1%. The fund's results for 2018, released in March, were at the top end of prior guidance, with a 16% NAV total return for the year, and two recent transactions illustrate Oakley's positioning in TMT, as well as education and consumer companies. You may remember that Oakley cultivates its contacts and will often try to reinvest with entrepreneurs it already knows well, hence the sector specialisation that reminds us of **HgCapital Trust** (HGT, 2145p).

At the end of March, Oakley's Fund III agreed to acquire Ekon, a Spanish software provider, with this fund committing around £20m. And just this week, Fund III also announced a joint venture with the insurers Admiral Group and Mapfre, to combine two Spanish digital brokers, Rastreator and Aceierto.com. OCI's interest will be £17m, and it will hope to continue its successful track record of investing in digital platforms across Europe. Having previously invested in Verivox, Germany's leading energy price comparison website, and Facile, the price-comparison market leader in Italy, Oakley has considerable expertise in the price comparison market. The Spanish market is at an early stage in its development, and therefore presents a similar growth opportunity to that experienced by Verivox and Facile as the market develops.

OCI is undoubtedly out of the mainstream, but it does seem to be trying to generate shareholder value and to attract new shareholders. It operates in some exciting areas, and now that private equity discounts have narrowed to an average closer to 15%, with some of the high-quality trusts rated much more highly than that, we think the opportunity to buy on a 25% discount is not to be sniffed at.

We'll also take the opportunity for a quick comment on a second-line property trust that we introduced in September, **Stenprop** (STP, 114.5p). Its shares have barely moved on balance since then, apart from a temporary dip during the market sell-off in December. We think most of the time they are simply overlooked, and we suspect investors may have missed the news in mid-March that the company sold its Euston House office building in central London for £95m, against a valuation of £80.5m, already more than 10% of the portfolio value. This should mean an uplift to NAV, other things being equal, and it also helps the company to advance its stated aim of moving further towards a multi-let industrial portfolio, with a lower loan-to-value ratio. We will be keen to watch in June to see if the shares react positively to the final results announcement at that time, when investors may be reminded of what might be a 20% discount to net assets and a 7% dividend yield.

Matthew Jennings of Fidelity has been talking about the UK market in which **Fidelity Special Values** (FSV, 260.5p) is investing. He says it is a deeply unloved market within the global equity market complex, primarily because of the Brexit uncertainty. As contrarian investors, this creates a rich opportunity set for Fidelity, and FSV has been adding more good value domestic defensive stocks with sterling exposure. Matthew says "I want to urge people to get ahead of the curve here, and not wait for the good news."

The popular **Merian Chrysalis Investment Company** (MERI, 116p), which trades at a significant premium to its NAV, has raised an extra £100m to invest into its pipeline of young growth companies. Likewise, the **SDCL Energy Efficiency Income Trust** (SEIT, 105p), which raised £100m from its IPO in December, for investment in energy efficient investments such as cooling/heating and power plants and LED lighting, has raised an additional £72m from a placing. This seems quite common now for trusts trading on premium ratings to tap the market for extra capital. Separately, the **US Solar Fund** (USF, US$1.035) that we mentioned in the March newsletter raised a total of US$200m from its IPO and has now started trading at a premium to its offer price.

The next issue of Investment Trust Newsletter is published on Saturday 8th June.

The FTSE 350 Equity Investment Instruments Index is up 19.2 points (+0.19%) to 10,151.35 since the last newsletter.