Investment Trust Newsletter

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Markets seem to have recovered their poise somewhat after a stormy October, but this has been a testing time for all investors. When volatility strikes it is even more important to have confidence in your selected trusts and their managers, which is why it makes sense to follow the newsflow, analysis, and industry developments on a regular basis.

Major Price Changes Over One Month

EPE Special Opportunities	+16.95%
Dunedin Enterprise	+9.39%
BlackRock Latin American	+7.25%
JPMorgan Indian	+6.93%
LXI REIT	+6.11%
Range Direct Lending Europe	+5.71%
SQN Asset Finance Income 'C'	+5.21%
BH Macro USD	+4.79%
Value and Income Trust	+4.64%
Standard Life Invs Property Income	+4.35%
JPMorgan Japan Smaller Companies	-12.35%
Atlantis Japan Growth Fund	-12.05%
Aberdeen Japan	-11.93%
JPMorgan Japanese	-11.65%
Fidelity Japan Trust	-11.49%

Major Price Changes Over One Year

Lindsell Train Investment Trust	+52.20%
Syncona	+51.58%
Dunedin Entrprise	+33.93%
EJF Investments	+26.33%
BH Macro USD	+24.52%
Gulf Investment Fund	+22.12%
LXI REIT	+21.89%
3i Infrastructure	+21.14%
BB Healthcare Trust	+19.46%
Edinburgh Worldwide	+18.65%
Adamas Finance Asia	-50.43%
EPE Special Opportunities	-46.92%
CatCo Reinsurance Opportunities	-44.44%
Better Capital PCC 2012	-38.24%
TR European Growth	-28.20%

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

There's no question that Japan was the weakest area in October. From 24,270 on 2nd October, the Nikkei fell to 21,149 by 29th October, recording a fall of 12.9% before mounting a partial recovery. Trusts with gearing and widening discounts have not fared well, with **JPMorgan Japan Smaller Companies** (JPS, 382p) suffering most, down by 12.35%. Japan has been in a tough spot, affected by general fears of a US-China trade war, and a number of more specific concerns. The mobile phone company NTT Docomo and the motorcycle manufacturer Yamaha both warned on future earnings, technology leader Softbank has been weak, and exporters have been hurt by strength in the yen, which is seen as a 'safe haven' currency in times of stress. We're intrigued to see whether these Japanese trusts will bounce back as quickly as **EPE Special Opportunities** (ESO, 172.5p), **JPMorgan Indian** (JII, 615.5p), and **BlackRock Latin American** (BRLA, 436p), all of which have appeared in the list of biggest losers over the last three months.

BlackRock Latin American manager Will Landers provided an update after the Brazilian presidential election first-round results that saw a lead established by Jair Bolsanaro (winning 46% of the votes, close to the required 50%), who then went on to win in the second round run-off. He is a right-of-centre politician that Will said he is "comfortable with", and there was a positive reaction from equity and currency markets. A new wave of senators was also elected, along with new congressmen, so there has been quite a change of the guard in Brazil. This should help Mr Bolsanaro's ability to govern, which had been a prior concern. His economic team is headed by Paulo Guedes, the new finance minister whom Will knows well. There is likely to be a focus on getting pension reform done early, plus fiscal reform to simplify the country's complex tax laws and encourage new investment, plus privatisation and reducing the size of government. Will says "I think if you put all this together you have a country that would have a lower risk rating – it will be able to keep interest rates low for a longer period of time, and start to normalise rates with other countries and attract investment at a much higher level." This is the "government of continuity" that he had been looking for. Accordingly, the trust has a "very large overweight" in Brazil – Will explains that most of the trust's leverage has been deployed in Brazil, which now accounts for close to 74% of assets. He adds that he is "very positive on the prospects for Brazilian equities" – Will believes the country could enter into a virtuous circle of faster, sustainable growth without inflation, being more competitive in international markets as well. On a 16.1% discount we think the shares remain a sensible choice if you can take sufficient confidence from Mr Bolsanaro's fresh start.

Over one year, the fifth-largest faller in the table above is **TR European Growth** (TRG, 881p), which is a volatile performer, still with an enviable longer-term track record. Over five years its returns still place it in the top 20% of all investment trusts. We think we can accept a patch of lower relative returns, particularly as manager Ollie Beckett believes some of the valuations are "almost absurdly attractive" after many stocks have been sold off. Amongst its peers though, we are much less sure about the premium valuation given to **European Assets Trust** (EAT, 105.25p), where the discount is the narrowest in the sector, at 5.2%, less than half the sector average of 11.2%. Yet the trust is one of the poorer performers in this group, and is able to support that higher rating in our view because of its policy of paying back capital each year in the form of an enhanced dividend. The annual dividend is equivalent to 6% of the net asset value as at 31st December each year, but a part of this is the trust simply slicing off some of shareholders' capital and giving it back. We think that is likely to result in lower long-term returns that should not be rewarded with a higher rating. Our advice is to sell European Assets Trust and SWITCH into either TR European Growth or either of the other two trusts in the sector, **JPMorgan European Smaller** (JESC, 372p, discount 13.5%) or **Montanaro European Smaller** (MTE, 875p, discount 11.5%). All three of these trusts have superior long-term records and more attractive discount ratings. We write more about these 'artificial' dividends in this issue.

WITAN INVESTMENT TRUST PLC (WTAN, 1033p)

We were pleased to catch up again with James Hart, the investment director of Witan, for an update exactly two years on from our last in-depth look at this well-known global trust. Witan is the tenth largest conventional investment trust, with a big following. This £2bn trust is also one of the so-called 'dividend heroes' that has raised its dividend every year for 43 years, and James says that he and Andrew Bell, the trust's chief executive, are determined that record will be maintained and extended under their guardianship.

You may have noticed those unusual terms, investment director and chief executive, deployed because Witan is a self-managed trust that employs a small cadre of staff directly. This small group (actually just seven people) run the trust's affairs and keep the costs in check. Witan sub-contracts the management of its portfolio to a group of ten different specialist managers around the world, and until recently was unique in offering this multi-manager approach, until **Alliance Trust** (ATST, 730.5p) switched to a similar style of remit. Now, James says, Witan is "in a peer group of two." More broadly, Witan falls into the 'global' grouping, and whilst we might expect to find it firmly in the middle of the pack, it has actually been through a relatively poor year and is placed 19th out of 22 global trusts over that period. We asked James whether that was a style issue.

One benefit of the history of this newsletter, which now stretches back 22 years, is that we have a long perspective. For many years, the majority of so-called 'international generalist' trusts were more UK-plus in style, meaning they still had quite large chunks of their portfolios rooted in London, invested in British companies. That has changed considerably over the last decade as communications have improved, overseas markets have developed, and as investors have become more demanding. With about a third of its assets listed in the UK, Witan is definitely more UK-centric than many of its peers – at first glance at least. Of course many of those UK-listed companies derive their revenues overseas, but the higher UK element is probably the main reason for Witan's lag against the peer group over the last year. The British market has underperformed against most overseas markets, notably the US, and as a result James says "the UK is the cheapest developed market in the world." Of course, holdings in overseas equities have also benefited from the weakness in sterling, which has provided a boost when values (and income) and translated back into sterling. That could of course reverse next year if a reasonable Brexit deal is reached, but that remains to be seen. James also likes the prospects for Asia and emerging markets, covered for the trust by Matthews Asia and GQG Partners, but suggests the US markets are priced closer to perfection.

Ultimately, Witan is not a trust to buy for short-term profits anyway: this is more of a long-term savings vehicle, and over five years the trust is tucked nicely in the pack, ranked 10th of 21 trusts in the global sector.

The bulk of Witan's portfolio is with its ten investment managers, each allocated a specific percentage to invest according to their segregated mandates. Witan aims to select these managers because of special skills and traits they have, and is not interested in frequent chopping and changing. Each manager takes a high conviction approach, but when their individual results are blended together, the result is a highly diversified mix of strategies and risks that still has the potential for outperformance. Whilst the UK bias has proved a drag, at a manager level we think Witan has proved adept at selecting good custodians for the capital. All three of its UK managers (Artemis, Lindsell Train and Heronbridge) have outperformed quite strongly in 2018, and since appointment, nine of the ten managers have outperformed their benchmarks. James says that two managers are currently "below par", but if their returns can be explained and understood, that's not necessarily a problem. Witan is more likely to make a change if there is a change of personnel or ownership at one of the management firms, or if a portfolio seems to be moving away from the agreed mandate.

In addition to its appointed managers, Witan has a direct portfolio that it manages itself, amounting to about 10% of assets. James explains it is a slight weakness of the multi-manager structure that certain smaller parts of the markets are not addressed. He is really talking about the little niche areas such as healthcare, mining and private equity where specialist expertise is required, but where it is not worth appointing a separate manager. Witan makes these choices itself, buying into trusts such as **Syncona, Apax Global Alpha, Electra Private Equity, BlackRock World Mining Trust,** and **Princess Private Equity.** There is also a new initiative the trust is pursuing with a 2.5% pool of its assets to effectively try out future potential managers with a small allocation. James says this is "an interesting departure for us" and describes it as "extended due diligence" on managers who may not quite meet the existing criteria, particularly in terms of longevity of track record. At present only one small allocation of £14m (0.7%) has been made, to Freddie Lait at Latitude Investment Management in London.

The trust has benefited from the "fee deflationary environment" that has seen investment management charges come down, in Europe more than the US, and Witan's overall costs are now running at a fairly competitive 0.78% per year. That includes performance fees from two managers who charge a lower-than-average base fee, but those are not a big consideration for the trust. James says the multi-manager process has evolved since Witan broke new ground back in 2004, and that the existing range of managers "sit well together." The number is unlikely to change significantly from the current ten, and Witan is not currently anticipating any alterations.

It is 'steady as she goes' with the dividend as well, which has been growing steadily, up by 10.5% last year to 21p per share. A 2% fully covered dividend yield (the revenue reserve has only been used twice in the last 20 years) won't set anyone's heart racing, but that's not the point here – this is not an income-focused trust – it is more of a general equities fund for long-term savers, and we think that its professional management should ensure decent results in the future that should provide satisfactory returns against the markets. Witan is largely owned by smaller investors who want to have it as a reliable core holding, and we don't see why it won't continue to fulfil than function for years to come.

PAYING DIVIDENDS OUT OF CAPITAL

A small number of investment trusts have taken advantage of the flexibility afforded by the current tax and status regime that was introduced in 2012 to pay dividends from their capital, rather than simply from the income they have received from their assets. As time has passed, so we have strengthened our view that this policy generally serves to destroy value for many shareholders, and that patient investors are best served by exercising caution towards these trusts that have implemented this policy for marketing reasons and to try to make themselves more attractive to one particular group of investors, wealth managers, who require dividends to be paid. Our view is that income trusts should pay generous dividends and that capital growth trusts should be able to grow their capital – it is up to investors to decide between the two for themselves. To have trusts paying out 'artificial' dividends that they have simply created by board mandate muddies the waters and risks misleading investors as well, in our opinion.

So why do trusts decide to start paying dividends out of their capital, effectively slicing off part of the money invested and returning it to shareholders? The answer stems from the thirst for income that has driven the demand for so many trusts with attractive yields over recent years, in a world of low interest rates. Dividends have grown in importance and have been emphasized as a key part of total returns. As more mandates for wealth managers have included an income requirement, so they have become less inclined to buy pure capital growth trusts, and some discounts have widened out. Offering to create a regular dividend out of capital is a wheeze that works effectively to solve that problem, create extra demand, and narrow those discounts. In that case, everyone wins, right? Well, only in the short-term. For longer-term investors, having a portion of your capital returned each year simply eats into your returns. Either that capital is no longer deployed, as you use that money for something else, or you have the cost, irritation, and possible tax consequences of needing to reinvest your dividends.

When expressing this negative view to managers and their marketing departments, we have been told time and time again that 'most people like it.' That may be true, but we think that is simply because they are not thinking clearly about the longer-term consequences and the extra costs and administration as well for private investors who are not professional money managers. We are definitely not convinced of the merits of paying dividends out of capital, and rather suspect it will eventually prove to be a fad that is reversed. For us, while we would certainly not rule out any of these trusts for recommendations, their dividend policies give us pause for thought.

Aberdeen Emerging Markets (AEMC, 520p) has its dividends funded by a combination of income and capital; **BB Healthcare Trust** (BBH, 140p) pays out 3.5% of NAV, paid mostly out of capital; **European Assets Trust** (EAT, 105.25p) was an early adopter of this policy, with a special structure; **International Biotechnology** (IBT, 612p) announced its intention in September 2016 to pay a dividend yield equivalent to 4% of the NAV of the preceding financial year; **JPMorgan Global Growth & Income** (JPGI, 309p) targets a dividend of at least 4%; **Martin Currie Asia Unconstrained** (MCP, 343.5p) has a policy for a capital distribution of 2% of prior year NAV, to 'top up' its dividend; **Montanaro UK Smaller Companies** (MTU, 113.75p) has just started to pay 1% of NAV per quarter; **Princess Private Equity** (PEY, €10.05) targets 5%-8% per share, funded by distributions from its portfolio; **Securities Trust of Scotland** (STS, 162.5p) enhances its dividend with capital.

NEW ISSUES

Before we introduce a couple of IPOs that are currently on the books, let's just recap on some recent issues to see how their fund-raisings compared. There is only one place for us to start, and that is with the **Smithson Investment Trust** (SSON, 1078p), which increased its initial target from £250m to £600m and ended up accepting £822.5m, making it the largest investment trust launch ever. We felt there was merit in the launch, particularly as the managers absorbed all of the launch costs so that the trust's opening NAV was 1000p exactly (and is now 1001.7p, little changed). As expected, the shares are trading at a small premium. Now, holders must hope the trust can break the hoodoo sadly established by previous record IPOs that have subsequently run into problems and become disappointments. In spite of a recent rally, the shares of **Woodford Patient Capital Trust** (WPCT, 86.5p) are well below their 100p April 2015 launch price and were relegated from the FTSE 250 Index in May. To some extent this mirrored the experience of many of the largest trust launches, which have raised capital on the back of mass optimism about a particular theme or strategy that has then struggled to meet high expectations. Launches such as **Fidelity China Special Situations** (FCSS, 198.6p), **Amerindo Internet Fund,** and further back, **Mercury European Privatisation** and **Kleinwort European Privatisation,** have failed to match their grand designs. In the IPO market, it's easy to squash the assertion that big is beautiful with historic examples, but we hope that Smithson will break the mould and prosper from the start.

Elsewhere, **AVI Japan Opportunity Trust** (AJOT, 102.25p) raised £80m and has started trading above the issue price. The trust's manager Joe Bauernfreund commented "this will be a portfolio of some of the extraordinarily cheap smaller companies in Japan at a time when an improving corporate governance regime is forcing change. We will have the right to make shareholder resolutions at annual general meetings, which are becoming more common with a record number this year. AJOT is an opportunity we see for investing in Japan today as evidenced by the more than £1m invested by the AVI team in AJOT."

As we feared, it was not so straightforward for **Gresham House Energy Storage Fund,** which raised a total of £100m – half of its target – and has been required to issue a supplementary prospectus because the net receipts of £98m are less than the previously required minimum. The shares will start trading on 13th November (under the ticker code GRID). Similarly, **Merian Chrysalis Investment Company** (MERI, 104p) raised £100m of the £200m it sought, but it has started trading very well at 104p (dealing spread 103p-105p). The price may have been helped by the announcement that the manager has agreed to cap the trust's ongoing charge expense ratio at 0.85% for the next 12 months or until the NAV reaches £200m, whichever occurs earlier.

The Global Sustainability Trust plc

New from Aberdeen Standard Investments, this trust promises to "access the private market investments creating a better world." That's a bold promise, and what it means is that this trust will aim for long-term capital growth from a diversified global portfolio of unlisted investments that try to create positive environmental and social benefits. So, this is an ethical trust with a twist, being focused on companies that are usually only available to major institutional investors. Of course Aberdeen Standard has the size, clout, and resources to reach these opportunities, with £67bn of private markets assets under management, 19 private markets offices worldwide, and 400 investment professionals working in this sector.

The managers argue that these investments have the potential to provide attractive returns, lower volatility, and a higher positive impact in environmental and social terms. Goals include material recycling, energy efficiency, sustainable agriculture, clean water, drug development, access to financial services, affordable housing, and access to education, amongst many others. Aberdeen Standard is using the 17 sustainable development goals of the UN as a framework. There is a broad sweep of issues within the remit here, so a large investment universe. To illustrate the sort of portfolio the trust might create, Aberdeen Standard reckon it could be split roughly 31% in private equity, 23% in infrastructure, 22% in real estate, 14% in private credit, and 9% in natural resources, with a little cash. The management charges look reasonable to us, a continuation vote in 2026, plus a buyback authority, ought to help manage the discount, and gearing will be a maximum of 25%. The trust is targeting annual returns of 6%-8%.

The prospectus is available now, together with a dedicated website (http://www.globalsustainabilitytrust.co.uk) that contains further information. Shares are being offered at 100p each, with a minimum subscription of £500 and a deadline for completed applications of 11th December. Trading is due to begin on 17th December under the ticker code GSTR. We imagine this trust could well be of interest to investors wishing to incorporate ethical values into their investments, although we would definitely point to the 16.4% discount on **Henderson Alternative Strategies Trust** (HAST, 274.5p) as offering far better value, as we outlined last month. Just before we leave Aberdeen Standard, we'll quickly point out here that **Standard Life Equity Income** has changed its name to **Aberdeen Standard Equity Income Trust** and its ticker has changed from SLET to ASEI.

Specialist Healthcare Properties plc

Looking for £200m for investment in accommodation for residents with lifelong acute mental health conditions, neurological problems, or severe addiction, this new REIT from Civitas is aiming to deliver a 6% annual yield to investors. The plan is to acquire modern, purpose-built, occupied standing assets and to forward finance new pre-let facilities to on-site care providers. Leases will be 25-35 years, and the trust says the care providers receive almost 100% funding from central government. After the boost to mental health funding in Philip Hammond's budget, this would seem well supported for now. Civitas is an experienced manager in this realm and says it has built trusted relationships from completing over 80 transactions involving 93 care providers in the last two years for **Civitas Social Housing** (CSH, 109.25p). Assuming the placing is well received at 100p, trading on the main market should start towards the end of this month.

STOCKBROKERS' RESEARCH

Canaccord Genuity released a flash update on **Alliance Trust*** (ATST, 730.5p) after it announced the sale of its Alliance Trust Savings subsidiary to Interactive Investor. The total price payable under the sale agreement, which includes ATS' office building in Dundee, will be £40m. At 30th June, ATS was valued at £38m and accounted for 1.3% of the portfolio, while the office building was valued at £4.9m. The proceeds of the sale will be re-invested in the global equity portfolio. On completion of the sale, non-core assets will have a value of just £13.4m, or 0.48% of net assets.

This transaction brings together the two largest fixed price investment platforms, creating a platform with £35bn of assets under administration, 400,000 customers, and more than 1m users; this scale is critical in an increasingly technology-driven sector. Notably, ii has a strong track record of acquiring, integrating and investing in complementary platform businesses.

The broker concludes "the board has previously advised that they would seek to simplify the business model and realise value from non-core assets. This transaction further streamlines the investment proposition and accordingly is a welcome development. The past 18 months have been transformative for Alliance. The company has adopted a unique and innovative approach to global equities, which features high conviction and genuine active management. Although still early days, the initial performance has been encouraging with the equity portfolio generating a total return of 18.1% versus a MSCI ACWI total return of 16.4%. We believe the company has put in place strong foundations on which to build; if Alliance can sustain this superior performance record, then we would expect returns to be enhanced by an improvement in the rating, which continues to be more a function of legacy issues than undoubted potential." The broker rates the shares as a buy.

On 22nd October Numis Securities issued an update on the performance of alternative asset investment companies in the year to date. They say that in general, it has been a good year for the listed alternatives, with significant outperformance of quoted markets in 2018 to date. The infrastructure funds have been boosted by the bid for John Laing Infrastructure, and there remains strong investor demand for long-dated income from alternative asset classes with a low correlation to equities and bonds. As would be expected given the market correction in recent weeks, the listed private equity funds have given back some of their gains, and sentiment towards some of the property funds has also been impacted by concerns over the weak UK economy given the uncertain outcome of Brexit. In aggregate, alternative asset investment companies (ex 3i) are trading at a modest discount to NAV of 0.5%. This has changed little since the start of the year, but represents a recovery from late March when the average discount reached 3.7%, reflecting a de-rating of the listed infrastructure funds. In general, Numis say, value is hard to find, with the exception being the listed private equity sector.

Numis is adding **Secure Income REIT** (SIR, 375.5p) to its recommended list as a core buy. The broker says it has a strong track record through a focus on long term rental income (average unexpired term of over 21 years) let to financially strong businesses in defensive sectors. Despite solid operating performance, Numis say the shares have been weak of late and are currently trading close to NAV, paying a quarterly yield of 3.5% pa. Numis believe this provides an attractive entry point. At the same time, the broker has removed **CATCo Reinsurance Opportunities' C shares** (CATC, US$0.985), currently trading at an 11% discount to the September NAV. However, the manager has indicated that there is potentially a "single digit impact" to NAV from Hurricane Michael in Florida and a "low single digit" impact from Typhoon Jebi in Japan. Finally, Numis previously added both **HICL Infrastructure** (HICL, 159.6p) and **BH Macro** (BHMG, 2310p) as trading buys. Since then, both have performed strongly, partly as a result of a re-rating. However, Numis say "we continue to believe that both funds are attractive investments and have reclassified them as core buys. We believe that the listed infrastructure sector offers high quality, inflation-linked cash flows, which are difficult to replicate, while we regard BH Macro as an attractive portfolio diversifier at a time of increased volatility in equity markets."

On October 25th, Stifel issued a note on **Aberdeen Asian Income Fund*** (AAIF, 193.5p), suggesting it offers a defensive strategy for volatile markets. The trust has outperformed in recent difficult markets, helped by its defensive income focus and quality approach. Stifel says "should markets remain tumultuous, it is to be hoped that the trust will continue to outperform. The trust has a dividend yield of almost 5% and trades on a 10% discount, its widest level for over 12 months. This appears anomalous given all of its Asian income peers trade at premiums, despite having only marginally better performance over the last three years. The attractive yield and wide discount makes AAIF the value play in the Asian income sector and so we retain our positive rating."

Cantor Fitzgerald issued a note on **Henderson Opportunities Trust** (HOT, 1022.5p) last week with a 'positive' rating. The note explained this trust has been managed in the same style since 2007: an unconstrained multi-cap approach to UK equities driven by stock selection with ideas generated via company meetings. Small and mid-cap growth stocks form the core of the portfolio, differentiating HOT from other strategies managed by James Henderson and Laura Foll, and from its trust peers. A substantial exposure to AIM stocks (around 60%) is another distinguishing factor, as is the flexibility to transition between market-cap segments. Cantor say "we believe the current discount presents an attractive entry point for a differentiated, long-term buy-and-hold UK equity fund."

The trust's portfolio is growth-oriented, comprising 70-100 stocks across the UK equity market cap spectrum from micro to mega-caps, including AIM listed companies. A low turnover approach allows the identified growth theses to play out, with stocks initiated and trimmed gradually to control portfolio sizing. Macro considerations are only involved at the individual stock analysis level, with six classification buckets used to ensure portfolio diversification. The discount of 15.4% is the widest of the trusts managed by the team, the others being **Lowland** (LWI, 1387.5p) and **Law Debenture** (LWDB, 583p), and the second widest of the comparable closed-end peer group, which excluding HOT averages 5.4%. Cantor say "this is despite HOT's impressive track record against its benchmark and peers, and we believe presents an attractive entry point for a strategy well suited to long-term investors." There is a 2% yield as well.

Winterflood issued a note on **JPMorgan Chinese*** (JMC, 240p) at the very end of October, noting that Chinese equities had been hit hard over the month, with the market down 14% in October in US dollar terms (-13% in sterling). A number of its bellwether technology stocks have been de-rated, including Alibaba (-19% in US dollar terms), Tencent (-21%) and Baidu (-21%). As a consequence the MSCI China Index is down 22% in US dollar terms in the year-to-date or 17% in sterling terms. The market faces considerable headwinds, including US tariffs, as the Trump Administration seeks to address the quantum of the US trade deficit with China, and growing fears of a Chinese economic slowdown. Despite these dramatic falls it is clear that the Chinese equity market continues to evolve apace, with the inclusion of its A-share market into MSCI indices this year reflective of the growing importance and size of its domestic market.

The note says that changes to the investment team behind JPMorgan Chinese reflect these developments. There have been four additions to the team in the last year and there are currently 12 research analysts, with plans to recruit two more. The team covers 450 stocks, 160 of which are A-shares, and this is expected to rise to 250 in the future. The head of the Greater China team, Howard Wang, has been involved in the fund since 2005, while the fund's co-manager, Rebecca Jiang, joined last year from Fidelity.

Over the last ten years, JPMorgan Chinese has performed broadly in line with its benchmark, the MSCI China Index. However, it has endured a difficult year so far in 2018, with a NAV total return decline of 28% and it is now trading on a 12% discount to its NAV. Winterflood say "the fund's portfolio is positioned towards long-term structural growth companies and is designed to benefit from the shift from 'Old China' to 'New China'. Consequently, we believe that the fund would benefit from a change of sentiment towards China and we would expect it to outperform a market rebound, assisted by its gearing, which stood equivalent to 18% of net assets at the end of September."

JPMorgan Cazenove has issued an equity strategy note on miners, where it sees a positive risk-reward ratio. The broker says that sentiment over China's prospects remains poor, and investors are increasingly concerned with respect to the health of the global upcycle, meaning that prices in the sector are depressed. Amongst the points it makes to support an investment case, it expects Chinese activity to show stabilisation into the year end. China started to ease policy from May, which may lead to higher bank lending, and bottoming out in total social financing. New bond issuance earmarked for infrastructure projects has more than tripled compared to the first half, and Chinese fixed asset investment is likely to rebound from October, in the broker's view. Chinese house prices are holding on to gains, with steady monthly appreciation in most cities. Real estate investment has been picking up, similar to the early 2016 bounce. JPMorgan Cazenove note that Chinese equities are currently trading near all-time lows in terms of their median P/E.

Next, they argue that the growth differential between the US and the rest of the world has potentially peaked, which could cap further advances in the US dollar. Emerging markets currencies are holding up well and appear to have bottomed in early September. This is a help for relative emerging markets equity performance and for miners. JPMorgan Cazenove analysts believe miners are likely to have earnings per share (EPS) upgrades of 10% for 2019 and 20% for 2020, if underlying metal prices stay at current levels. They note that EPS momentum for miners relative to the broader market has been extremely strong. Encouragingly, metal prices such as iron ore have been moving up recently, and the inventories of a number of metals are near multi-year lows. The broker's commodities analysts highlight that current declines in inventories suggest strong metals consumption. The balance sheets and free cash flow generation of miners are much better currently than they were in 2015.

Finally, while investors are increasingly concerned about the global growth outlook, and miners are traditionally seen to be a high beta play on activity, the broker finds there are important benefits of owning miners at this stage of the cycle. Industrial metals have historically performed well in late-cycle periods, and miners have also tended to have positive correlation to rising bond yields. In addition, the note argues miners remain a good hedge on rising inflation, with the second highest positive correlation to inflation forwards, at the sector level. With this strategy in mind, the broker says that **BlackRock World Mining*** (BRWM, 349.75p) on a 15.8% discount remains "the only credible pure play in the AIC's commodity and natural resources sub sector, and is a constituent of our model portfolio."

Liberum Capital commented on the Q3 results from **AEW UK REIT** (AEWU, 94p) after the fund announced its NAV per share rose by 1.7% to 100.1p per share at 30th September. Its NAV total return in the period was 3.8% due to a combination of strong income and a 1.3% like-for-like portfolio valuation gain. Quarterly EPRA earnings rose by 1% to 2.06p. This represents dividend cover of 1.03x. Key asset management successes during the period included the letting of vacant space at Eastpoint Business Park in Oxford, and Bath Street in Glasgow. The value of Eastpoint Business Park increased by 23%, mainly as a result of the new 20-year lease to Genesis Health Care. A small vacant property in Sheffield has also been sold. As a result, the portfolio vacancy rate has fallen to an all-time low of 3% (June 2018: 5.3%). AEWU remains lowly geared with a net LTV ratio of 21.6% (gross LTV 25.8%). The company had £7m of cash available for investment at the period end and expects to deploy this in the coming months. The manager reports a strong pipeline of potential acquisitions.

Liberum conclude "AEW UK REIT has made significant progress in reducing portfolio vacancy in the quarter to 3%. In addition to the increased income, portfolio void costs have been reduced by c.33%. This should lead to an incremental improvement in dividend cover as the benefits flow through to the income statement over a full period. We calculate an 8.6% NAV total return for AEWU in the nine months to September. AEWU is well-positioned to outperform the peer group in the current market given its relatively high weighting to industrial assets and greater focus on income. We note comments from the manager that the industrial assets are experiencing 20-30% rental value growth when a lease event is reached. We regard the current -5.3% discount and 8.4% dividend yield as an attractive opportunity."

NEWS ROUND UP

As expected, the liquidation proposals from **BlackRock Emerging Europe** (BEEP, 319p) were published on 19th October. The trust is due to be wound up on 26th November, so shareholders must chose now between a cash exit or to roll over into **BlackRock Frontiers** (BRFI, 136.75p). Given that our initial recommendation was to benefit from the closing of the discount, and because we specifically liked the prospects for eastern Europe, a cash exit seems the logical conclusion now.

Edinburgh Dragon Trust (EFM, 348p) has proposed that if the trust passes its continuation vote next month, it will offer shareholders the chance of a 30% partial cash exit at a discount to NAV of 2%. With the shares currently on a discount of 11.5%, slightly narrower than its 12.1% twelve-month average, we certainly think holders will want to TAKE UP the tender offer in full, should it be offered. The trust does not stand up particularly well against its peer group over recent periods, ranked 11th of 15 over five years, so we suspect the tender offer was necessary to squeeze the continuation vote through. The trust's largest shareholder with 22.3% of the shares has already committed to voting for continuation.

A special report has been issued by **Henderson Far East Income** (HFEL, 338.5p), which yields 6.4%. The trust has created the Henderson Far East Income Index, which shows the trends in dividends paid by companies listed in this fast-growing part of the world. The index reiterates the point that Asian companies have been paying out much greater dividends than in the past. Since 2009, Asia-Pacific, excluding Japan, dividends have more than tripled in value (+210%); dividends from the rest of the world have doubled (+103%); UK dividends are up an impressive 76.5%, but still lag behind. As a result, the Asia-Pacific share of global dividends has risen from £1 in £9 in 2009 to £1 in £6 in 2017. Taiwanese and South Korean payouts have risen close to 150% in five years, helping this region to catch up with other parts of the world as companies mature and a dividend culture becomes entrenched. Dividends from the region are forecast to set a new record and reach around £239bn by July 2019, led by companies such as China Mobile, HSBC, and China Construction Bank Corp. The trust's manager Mike Kerley says "Asia-Pacific, excluding Japan, is much more than just a crucible of investment and growth that has enticed investors interested in making capital gains: as economies have developed and companies have matured, it's now a huge income-generating machine too." We think the trust creates a very decent argument for itself as a complement to UK income trusts. The yield is comparable to that of many alternative assets trusts, but of course here there is the added potential for long-term capital growth from a fast-growing region.

Philip Hammond's autumn Budget, delivered a couple of weeks ago, included the news that he would not be signing or approving any more private finance initiative (PFI) deals, as he questioned their value for taxpayers. This may have been slightly alarming for some holders of infrastructure trusts, wondering if their existing deals might be scrapped and whether their pipeline of future deals has just been cut off at a stroke. We don't believe holders need to worry on either count. There have not been any new PFI deals since 2016 in any case, and Mr Hammond confirmed the government would continue to honour existing contracts. Newspaper reports say there are around 700 active PFI and PF2 deals, which the government estimates will cost the taxpayer £199bn by the 2040s. In reality, private involvement will still be desirable in the future, and perhaps necessary, so a new model will likely evolve, some form of PPP (private-public partnership). There was no adverse reaction from infrastructure investment trusts on this Budget news, with **HICL Infrastructure** HICL, 159.6p), for example, holding steady.

Riverstone Energy (RSE, 1244p) is offering to buy back up to £55m of shares through a tender offer, at a price somewhere between 1200p and 1375p, returning part of its large existing cash balance. Its NAV per share at the end of September was 1614p per share, so the share price is at a significant discount. Shareholders must tender shares at a strike price of their choosing, in 25p increments between 1200p and 1375p, and the actual strike price used by the trust will be the lowest price at which £55m of shares can be acquired (all at that single price). If you really want to exit, you could tender all of your shares at 1200p, but the risk then is that many other people do the same and your exit price is poor. It seems more sensible to us to tender at a small premium to the existing share price, perhaps 1275p, then the worst-case scenario is a small uplift, and you may be able to achieve a better price. If the price is lower, you can choose to stay, or simply to sell in the market as usual. For the trust, and for remaining shareholders, who will benefit from an NAV uplift, this seems like a clever and efficient mechanism, if a bit confusing.

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

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The FTSE 350 Equity Investment Instruments Index is up 58.82 points (+0.61%) to 9636.12 since the last newsletter.