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As we moved past our 20-year anniversary for Investment Trust Newsletter we thought it might be useful to continue with our annual summaries as a record of events in this fascinating and ever-changing sector. The investment trust industry has proved highly adept at adapting to a changing world, creating different opportunities along the way for well-informed investors. Recent years have exemplified this well.

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2017: More gains as the long bull run continues

At the start of 2017, many managers and commentators seemed wary of forecasting more gains after the devaluation-fuelled advance of 20% for investment companies in 2016. The US was widely tipped though, and we said that **North American Income Trust** was one to consider. We also discussed the artificial dividend created out of capital by **International Biotechnology Trust,** saying that it did not make sense to us and left us less comfortable with the structure. Average discounts in the private equity sector still looked enticing, from trusts such as **Aberdeen Private Equity Fund** (24.1% discount), **Harbourvest Global Private Equity** (19.9%), and **NB Private Equity Partners** (21%).

Alliance Trust decided after a strategic review to follow the lead of **Witan Investment Trust** in switching to a multi-manager set-up under the management of Willis Tower Watson. In February we noted a seasonal bump in manager contact, with a large number of meetings on which to report, and also that improving communications technology was contributing as well. Conference calls and webinars were now supplementing our face-to-face manager meetings. Amongst other write-ups, we introduced subscribers to **India Capital Growth Fund** and we admired the lower-risk income-generating qualities of **GCP Asset Backed Income.** We had another look at the GCP trust later in the year, when the stockbroker JPMorgan Cazenove said that 'alternatives' trusts accounted for 41% of the sector's market capitalisation compared to 22% five years previously.

The strong performance of **Scottish Mortgage Trust** boosted its assets and it joined the FTSE 100 Index, making it the third equity investment trust to do so, after **Alliance Trust** and **Foreign & Colonial Investment Trust,** which both subsequently dropped out again. Two giant asset managers with trust mandates announced a merger to form Aberdeen Standard Life. We did not expect any immediate changes, but wondered about the future for **Dunedin Smaller Companies** and **Standard Life Equity Income.** Takeover activity reared its head in the investment companies sector with the takeover of the commercial property trust **Industrial Multi Property Trust** by Hansteen.

Noting that a reduction in the nil band tax rate for dividends made ISAs even more attractive as a wrapper for investment trusts, we made four seasonal ISA recommendations, **Temple Bar Investment Trust, RIT Capital Partners, Baring Emerging Europe,** and **Kennedy Wilson Europe Real Estate.** We noted some takeover talk about the latter, at odds with a wide discount and high yield. Two months later it received a bid from its manager, although not on great terms. These were later improved, and there was also an offer for **Prospect Japan Fund.**

In June we sent a third edition of our popular Statistical Supplement to subscribers, helping them navigate markets made more complicated by an indecisive British general election.

We wrote about **Tetragon Financial Group,** a little-known US$2bn fund trading on a 34.7% discount to net asset value and offering a 5.3% yield. Unfortunately many subscribers found it difficult to deal on trading platforms that did not have the shares on their systems.

Caledonia Investments joined the elite group of investment trusts to have raised their dividends for 50 consecutive years. A music royalty investor called **Hipgnosis Songs Fund** was looking for £200m from an IPO, but we noted the fees looked high – eventually the IPO was not a hit and was pulled.

At the half way stage of the year, trusts had done reasonably well, gaining 9% against the FTSE 100 Index's gain of 3%, helped by narrowing discounts, tightening to just 4.1% on average.

In August we reported on a fizzing performance from **Independent Investment Trust,** where its largest holding in Fevertree Drinks had been soaring in value. This trust would go on to become the best performer of the year. **Woodford Patient Capital Trust** also recovered its issue price, moving back over 100p, but on a 2.1% discount we said "with more than half of the assets in unquoted companies and a concentration in biotechnology we consider this a high risk trust and would normally demand a much higher discount to compensate for greater uncertainty."

Dunedin Enterprise, in 'run-off' mode, saw its shares rise as it began to return capital to investors after some successful disposals. In the same sector, **Aberdeen Private Equity Fund** agreed to sell is entire portfolio at a premium. Sarah Whitley, the long-serving manager of **Baillie Gifford Japan,** announced she would retire in April 2018. Japanese trusts enjoyed a strong autumn as Mr Abe's ruling party was re-elected and the Nikkei 225 Index hit its highest level since 1992 after a storming 16-day winning streak in October. Daniel Godfrey was forced to abandon his **People's Trust** project after it failed to raise sufficient capital to be viable. Towards the end of the year, Gervais Williams, the manager of **Diverse Income Trust,** expressed caution about equity markets, as did a number of other managers. In 2017, the FTSE 350 Equity Investment Instruments Index rose by 14.4%.

2018: New regulations cause confusion, but flourishing IPOs enliven a tough final quarter

New MIFID II and PRIIPS financial regulations that came in at the start of the year caused confusion, as mandatory 'Key Information Documents' (KIDs) appeared misleading in some cases, or were absent, leading to disruptions in dealing. Later in the year the AIC would issue its own stinging criticism and said it would not put KIDs on its website.

In January, in our usual industry round-up, we said we felt there was some value in the global emerging markets sector, from trusts such as **JPMorgan Emerging Markets** (10.7% discount) and **Templeton Emerging Markets** (12%). We warned again that **Woodford Patient Capital Trust** was "a far riskier proposition" than its KID suggested.

A market correction shook out some complacency, and there was a surprising name amongst the worst fallers, with **HICL Infrastructure** dropping more than 10% due to its contracts with Carillion, a giant construction firm that went into liquidation. The trust estimated the impact at £50m. **River & Mercantile UK Micro Cap** also came thumping down as its successful manager was sacked for professional misconduct. Manager Carlos

Hardenberg announced he was leaving **Templeton Emerging Markets.** In a completely new sector, **Gore Street Energy Storage Fund** sought capital for its IPO, and Baillie Gifford announced a new US trust, its first launch for 32 years. They would have contrasting success, with Gore Street postponing its launch and eventually struggling to raise just £30m, but Baillie Gifford capping demand for the **Baillie Gifford US Growth Trust** at £250m. Baillie Gifford also took over as managers of the UK trust that was formerly **Schroder UK Growth,** renamed **Baillie Gifford UK Growth Fund.**

Foreign & Colonial Investment Trust celebrated its 150th anniversary and decided to adopt a more modern name, simply **F&C Investment Trust.** F&C rebranded most of its other trusts as BMO, to reflect the management name. The AIC conducted some research on the longest-held shares by trusts, and Alex Crooke of **Bankers Investment Trust** said he believed the trust had held HSBC continuously for 129 years.

CATCo Reinsurance Opportunities fell sharply as the fund was forced to raise its loss reserves for the catastrophic events of 2017, notably Hurricanes Harvey and Irma. More bad news arrived later in the year from the Californian wildfires, Hurricane Michael and Typhoon Jebi.

Invesco resigned as managers of **Invesco Perpetual Enhanced Income** over a fee disagreement, and a board shake-up was then demanded by a group of shareholders. After a public spat, Invesco were reappointed and the trust's chairman stepped down. Many trusts have been cutting the fees they are paying to managers. **Tetragon Financial Group** introduced a new sterling quote for its shares. **BlackRock Emerging Europe** decided to wind up after an enthusiastic shareholder response to its tender offer. **Picton Property Income** converted to UK REIT status from a Guernsey property company, to be more tax efficient.

Research from the Cass Business School comparing the performance of closed-end and open-ended funds from 2006 to 2016 found that investment trusts outperformed significantly, perhaps because managers do not have to contend with constant inflows and outflows.

In July – when we also sent out our Statistical Supplement again - we reported that **Dunedin Smaller Companies** was proposing a merger with the larger **Standard Life UK Smaller Companies Trust.** That was not a great surprise, but we had not expected to see the **Hipgnosis Songs Fund** finally strike the right note and raise £200m from a refreshed IPO. Usually, when an IPO fails first time around, that's the end of the project.

As the FTSE 350 Equity investment Instruments Index passed through 10,000 for the first time in August there were some dramatic price movements including a monthly rise of 175% for **Infrastructure India** as its major holding secured a critical refinancing. **Lindsell Train Investment Trust** also jumped by more than 25%, up to a premium of 49.2%, which we felt was "unlikely to be sustainable." Much as we admired the performance, we felt the risk/reward trade-off looked poor. There was also a jump of 22% in the value of **John Laing Infrastructure Fund** after a recommended cash offer at a premium to net asset value. We looked again at **Tetragon Financial Group,** by now on a 43% discount to NAV.

In the autumn, weathering some choppy market conditions, the new issue market sparked into life. **The Mobius Investment Trust,** managed by Mark Mobius and Carlos Hardenberg, raised £100m, and **Merian Chrysalis Investment Company** picked up the same amount. **AVI Japan Opportunity Trust** came to the market with a distinctive offering focused on corporate change in a highly conservative market, raising £80m. **Smithson Investment Trust,** a global smaller companies trust, also arrived with the managers bearing all the costs of the IPO, and raised a record £822.5m. We said "holders must hope the trust can break the hoodoo sadly established by previous record IPOs that have subsequently run into problems and become disappointments." **Woodford Patient Capital Trust** shares were back 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, 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.

The November newsletter contained an article on trusts paying dividends out of capital, which we said might destroy value for many shareholders. We urged caution towards trusts with this policy, including **Aberdeen Emerging Markets, BB Healthcare Trust, European Assets Trust, International Biotechnology, JPMorgan Global Growth & Income, Martin Currie Asia Unconstrained, Montanaro UK Smaller Companies, Princess Private Equity,** and **Securities Trust of Scotland.**

Over the year the FTSE 350 Equity Investment Instruments Index fell by 3.8%, outperforming the FTSE 100 Index (-10.9%) and the MSCI World Index, down by 10.3% over the same period.

2019: Climbing the wall of worry; Woodford loses grip

January brought rare news of M&A activity in the sector, a merger between **Primary Health Properties** and **MedicX Fund,** effectively a takeover by the larger trust, PHP. A de-merger of a different sort was still on the cards as the UK headed uncertainly towards Brexit, and manager Mark Barnett said at the annual Winterflood conference that **Perpetual Income & Growth** and **Edinburgh Investment Trust** were both positioned to benefit from a potential re-rating of UK revenues once there was more clarity on the future of Britain's relationship with the EU.

Markets started the year well after a difficult last quarter of 2018, helped by the US Federal Reserve softening its stance on interest rates and the Chinese government injecting more fiscal stimulus. We still worried about too many investment trusts being on premium ratings, and about more trusts starting to pay dividends out of capital, which we felt was sleight-of-hand that would actually depress long-term returns.

We met a lot of investment trust managers, some for the first time, including **Regional REIT, Impact Healthcare REIT, Gresham House Energy Storage Fund, Dunedin Income**

Growth, Odyssean Investment Trust, and **Ecofin Global Utilities & Infrastructure.** Some managers were clearly expanding their horizons to reach new groups of potential investors and to explain the investment case for their trusts. Others were fortunate enough to find instant popularity: **Merian Chrysalis** quickly returned to the market to raise more capital once it had invested its IPO proceeds, and with minimal marketing Baillie Gifford raised US$477m for **The Schiehallion Fund,** investing in unlisted equities, and its shares went to an immediate premium.

Jupiter European Opportunities manager Alexander Darwall said he would be stepping down from his management commitment to his open-ended funds, but would continue to manage the investment trust in which he has a large personal stake. Later in the year, the trust would transfer the mandate to his new investment firm, Devon Equity Management. Lord Rothschild, meanwhile, stepped down as chairman of **RIT Capital Partners.** A number of very experienced managers reached retirement, but their trusts had sensible succession plans that were implemented smoothly. Another long-established trust, **British Empire Securities,** succumbed to the pressures of the age and changed its name to the far less colourful **AVI Global Trust.** Similarly, **Scottish American Investment Company,** commonly known as SAINTS, changed its ticker code from SCAM to SAIN.

In April the AIC revamped its investment company sector classifications, partly to reflect the greater amount of investment in alternative assets. The AIC said the amount of money invested by investment companies in alternative assets had grown by 92% in five years, from £39.5bn in 2014 to £75.9bn in 2019. The result was more sectors for debt and property, plus new sectors for growth capital and for royalties.

In the June newsletter we reported the serious news that the largest open-ended fund run by renowned fund manger Neil Woodford had suspended dealings while he disposed of illiquid and unquoted assets. His investment trust, **Woodford Patient Capital Trust,** continued to trade normally, although at a lower price, sending a reminder that the investment trust structure is a far better choice than open-ended funds for strategies involving illiquid assets. Terry Smith's emerging markets trust, **Fundsmith Emerging Equity Trust,** also owned up to some sub-par performance, perhaps raising a question about paying up for access to 'star' fund managers.

Research by the AIC found the three investment companies that outperformed most often over the previous ten years were **Finsbury Growth & Income, Jupiter European Opportunities,** and **BlackRock Smaller Companies,** each outperforming in nine out of ten years.

When we sent the Statistical Supplement in August, investment trusts were being supported by strong international market conditions and a lower sterling, as the tough rhetoric of new Prime Minister Boris Johnson proved divisive. The UK market was depressed in relative terms against other global equities, due to ongoing Brexit uncertainty, which kept overseas investors away. Simon Gergel, the manager of **Merchants Trust**, showed us a chart of the cyclically-adjusted P/E ratio that showed the UK trading below the long-term US historic average, joined only by markets like Brazil, Spain, Turkey and Russia.

In November we reported that Woodford Investment Management was closing, and that Schroder Investment Management would be taking over the management of **Woodford Patient Capital Trust** and renaming it the **Schroder UK Public Private Trust.** Changes were afoot in Parliament too, with an early General Election called for December after the impasse on Brexit proved impossible to break.

In the US, biotechnology enjoyed a late-year rally, from which **Biotech Growth Trust** was a particular beneficiary after a disappointing spell of performance, and UK smaller companies trusts rose on hopes for a clear Conservative victory to clear the political logjam. When the result confirmed that optimism, **JPMorgan Smaller Companies** would become the year's strongest share price performer with a rise of 67.5%. Mark Barnett ran out of time though as manager of **Edinburgh Investment Trust** and was replaced by James de Uphaugh of Majedie Asset Management. **Hadrian's Wall Secured Investments** became the latest debt provider to run into problems and be severely punished by the market, but there was no reduction in the enthusiasm for other alternative assets, including the IPO for **Octopus Renewables Infrastructure Trust,** which was enthusiastically received. **Hipgnosis Songs Fund** had also been growing, and moved to the Premium Segment of the London Stock Exchange.

In spite of much hand-wringing over Brexit and the state of trade relations between China and President Trump's US, markets made good progress over the year and investment trusts rose on average by around 15%, outpacing the FTSE 100 Index.

This supplement is intended to be read with Investment Trust Newsletter. Not for sale separately.

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