Investing **ESSENTIALS**, expert **INSIGHTS** and powerful **TRENDS** and **DATA**

THE INVESTMENT TRUSTS HANDBOOK

"A clear and comprehensive guide to a sector every intelligent investor needs to know about."
MARTIN VANDER WEYER
BUSINESS EDITOR, *THE SPECTATOR*

2022

EDITED BY
JONATHAN DAVIS

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AS FEATURED IN *The Financial Times, MoneyWeek, The Spectator, Interactive Investor & Shares Magazine*

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Investing essentials, expert insights and powerful trends and data

EDITED BY

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INTRODUCTION

A year of steady recovery

After the excitement and drama of 2020, which gave us the pandemic and an unprecedented market and economic crisis, it was inevitable that the next 12 months would follow a rather different narrative. And so it has proved. This latest edition of *The Investment Trusts Handbook*, now in its fifth year, chronicles, among other developments:

- a continued period of equity market recovery;
- record issuance of new shares by investment trusts;
- some marked rotation in investment styles;
- a series of manager and mandate changes; and
- the arrival of some interesting newcomers (in such diverse areas as space, digital infrastructure and energy efficiency).

As we have noted in previous editions, one of the great strengths of the investment trust sector is its ability to adapt to a changing environment, so the way that it has over the past year is entirely in keeping. You can be sure that there will still be plenty of new topics to write about next year. This sector is never dull!

More high-quality content

The Investment Trusts Handbook 2022 follows a now familiar pattern:

- a detailed review of the last 12 months by our resident experts;
- a look ahead to the future and what it may bring;
- Q&As and conversations with a selection of analysts and fund managers;
- my own thoughts on the year just gone and the one that lies ahead;
- reviews of the models I monitor for readers; and
- a detailed how to/data section at the end of the book.

This year's *Handbook* includes articles by many of our regular contributors, including Max King, Sandy Cross, James Carthew, Alex Davies and Simon Elliott, plus three newcomers, Sir John Kay, William Heathcoat Amory and Stuart Watson. The forum features six of the best-known professionals who analyse or invest directly in investment trusts. As always the data and analysis sections have been completely revised and updated.

I am happy to report that many of the readers of the *Handbook* now also listen to the free Money Makers weekly investment podcast that I record every Friday with Simon Elliott, the impressively knowledgeable and articulate head of investment trust research at Winterflood Securities. He and I started the podcast at the height of the great market sell-off in April 2020, with the idea of helping listeners navigate their way through a traumatic phase in the markets.

The hour we spend each week going through the latest news from the investment trust sector seems to have struck a chord with many private and professional investors, and so we have turned it into a permanent offering with over a thousand listeners a week. Some of you also now subscribe to the Money Makers circle, a membership club which for a modest monthly or annual fee gives you access to a range of content relevant to an investment trust investor.

These include:

- regular Q&As with investment trust experts;
- a weekly series of in-depth profiles of individual trusts;
- a comprehensive weekly list of recent news announcements; and
- my current thoughts on the markets and individual trusts.

The connoisseur's choice

The Investment Trusts Handbook is where I pull together all the most important developments of the past 12 months into a single, handy reference volume, which I like to think might one day become recognised as the *Wisden* of the investment trust world. It has already been bought or downloaded more than 35,000 times and the publishers and I remain grateful for your continued support.

For reasons that have been well rehearsed here and elsewhere, investment trusts remain the connoisseur's choice when it comes to selecting investment funds. There are good ones and bad ones, just as in any field of activity, and while there are always challenges facing the sector, in my judgement a careful selection of the best in their field will continue to serve you well whatever the future brings, through both good times and bad.

JONATHAN DAVIS

JONATHAN DAVIS *MA, MSC, MCSI is one of the UK's leading stock market authors and commentators. A qualified professional investor and member of the Chartered Institute for Securities and Investment, he is a senior external adviser at Saunderson House. His books include* Money Makers, Investing with Anthony Bolton *and* Templeton's Way with Money. *After writing columns for* The Independent *and* Financial Times *for many years, he now writes a private circulation newsletter. Find out more from the Money Makers website: www.money-makers.co.*

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Producing *The Investment Trusts Handbook 2022* is, as it has been for the last five years, an intensive and collective effort. Thanks to all of those who have helped to bring it to fruition, whether as contributors or handmaidens to the production process.

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Transcripts: Ben Gamblin.

TRUST BASICS

For first-time investors in trusts, here is an overview of investment trusts – what they are and how they invest – from editor JONATHAN DAVIS.

What is an investment trust?

Investment trusts, also known as investment companies, are a type of collective investment fund. All types of fund pool the money of a large number of different investors and delegate the investment of their pooled assets, typically to a professional fund manager. The idea is that this enables shareholders in the trust to spread their risks and benefit from the professional skills and economies of scale available to an investment management firm. Funds are able to buy and sell investments without paying tax on realised gains.

Collective funds have been a simple and popular way for individual investors to invest their savings for many years, and investment trusts have shared in that success. Today more than £250bn of savers' assets are invested in investment trusts. The first investment trust was launched as long ago as 1868, so they have a long history. Sales of open-ended funds (unit trusts, OEICs and UCITs funds) have grown faster, but investment trust performance has generally been superior.

How do they differ from unit trusts and open-ended funds?

There are several differences. The most important ones are that shares in investment companies are traded on a stock exchange and are overseen by an independent board of directors, like any other listed company. Shareholders have the right to vote at annual general meetings (AGMs) on a range of things, including the election of directors, changes in investment policy and share issuance. Trusts can also, unlike most open-ended funds, borrow money in order to enhance returns. Whereas the number of units in a unit trust rises and falls from day to day in response to supply and demand, an investment trust is able to deploy permanent capital.

What are discounts?

Because shares in investment trusts are traded on a stock exchange, the share price will fluctuate from day to day in response to supply and demand. Sometimes the shares will change hands for less than the net asset value (NAV) per share of the company. At other times they will change hands for more than the NAV per share. The difference between the share price and the NAV per share is calculated as a percentage of the NAV and is called a discount if the share price is below the equivalent NAV and a premium if it is above the NAV.

What is gearing?

In investment, gearing refers to the ability of an investor to borrow money in an attempt to enhance the returns that flow from his or her investment decisions. If investments rise more rapidly than the cost of the borrowing, this has the effect of producing higher returns. The reverse is also true, meaning that gains and losses are magnified. Investment trusts typically borrow around 5–10% of their assets, although this figure varies widely from one trust to another.

What are the main advantages of investing in an investment trust?

Because the capital is largely fixed, the managers of an investment trust can buy and sell the trust's investments whenever they need, rather than having to buy and sell simply because money is flowing in or out of the fund, as unit trust managers are required to do. The ability to gear, or use borrowed money, can also potentially produce better returns. The fact that the board of an investment trust is directly accountable to the shareholders is important. So too is the ability of boards to smooth the payment of dividend income by putting aside surplus revenue as reserves.

Because their capital base is permanent, investment companies are free to invest in a much wider range of investments than other types of fund. In fact, they can invest in almost anything. Although many of the largest trusts invest in listed stocks and bonds, the biggest growth in recent years has been in a range of more specialist areas, such as renewable energy, infrastructure, debt securities, music royalties and private equity. Investment trusts offer fund investors a broader choice and greater scope for diversification, in other words.

And what are the disadvantages?

The two main disadvantages are share price volatility and potential loss of liquidity. Because investment trusts can trade at a discount to the value of their assets, an investor who sells at the wrong moment may not receive the full asset value for their shares at that point. The day-to-day value of the investment will also fluctuate more than an equivalent open-ended fund. In the case of more specialist trusts, it may not always be possible to buy or sell shares in a trust at a good price because of a lack of liquidity in the market. Investors need to make sure they understand these features before investing.

How many trusts are there?

According to the industry trade body, the Association of Investment Companies, there were just under 390 investment trusts with more than £260bn in assets (as at the end of October 2021). They are split between a number of different sectors, reflecting the regions or type of investments in which they invest. Scottish Mortgage, the largest trust, has approximately £19bn in assets.

What are alternative assets?

While investment trusts have traditionally invested primarily in publicly listed stocks and shares, whose values are known every day, the last decade has seen significant growth in so-called alternative assets. These are trusts which invest in longer term assets which are mostly not traded daily and therefore can be valued only at less frequent intervals. Examples include commercial property, renewable energy, infrastructure and private equity. Many of these alternative trusts are popular because of their ability to pay higher levels of income.

How are they regulated?

All investment companies are regulated by the Financial Conduct Authority. So too are the managers the board appoints to manage the trust's investments. Investment trusts are also subject to the Listing Rules of the stock exchange on which they are listed. The board of directors is accountable to shareholders and regulators for the performance of the trust and the appointment of the manager and are legally bound by the requirements of successive Companies Acts.

How do I invest in an investment trust?

There are a number of different ways. You can buy them directly through a stockbroker, or via an online platform. A few larger investment trusts also have monthly savings schemes where you can transfer a fixed sum every month to the company, which then invests it into its shares on your behalf. If you have a financial adviser, or a portfolio manager, they can arrange the investment for you.

What do investment trusts cost?

As with any share, investors in investment trusts will need to pay brokerage commission when buying or selling shares in an investment trust, and also stamp duty on purchases. The managers appointed by the trust's directors to make its investments charge an annual management fee which is paid automatically, together with dealing and administration costs, out of the trust's assets. These management fees typically range from as little as 0.3% to 2.0% or more of the trust's assets.

What are tax wrappers?

Tax wrappers are schemes which allow individual investors, if they comply with the rules set by the government, to avoid tax on part or all of their investments. The two most important tax wrappers are the Individual Savings Account (or ISA) and the Self-Invested Personal Pension (SIPP). The majority of investment trusts can be held in an ISA or SIPP. There are annual limits on the amounts that can be invested each year (currently £20,000 for an ISA). Venture Capital Trusts (VCTs) are a specialist type of investment trust which also have a number of tax advantages, reflecting their higher risk. VCTs invest in start up and early stage businesses.

Who owns investment trusts?

Twenty-five years ago life insurance companies were the biggest investors in investment trusts, which they used to manage their client funds and pensions. These days such institutional investors mostly manage their own investments directly. Other than some specialist types of trust, the largest investors in trusts today are wealth management firms (formerly stockbroking firms), other types of intermediary and, increasingly, private investors. The growing number of individual investors reflects the growing influence of online platforms, which give individual investors the ability to choose their own investments for ISAs, SIPPs and taxable share/fund accounts.

Are they as difficult to understand as some people say?

Investment trusts are a little more complex than a simple open-ended fund, but no more difficult to understand than most types of listed company. It is important to understand the concept of discounts and premiums before you start to invest, but buying, selling and following the fortunes of your investment could not be easier. If you like the idea of making the connoisseur's choice when investing, you will find the effort of understanding investment trusts worthwhile.

Key terms explained

Investment trusts (aka investment companies) pool the money of individual and professional investors and invest it for them in order to generate capital gains, dividend income, or both. These are the most important factors that determine how good an investment they are:

SHARE PRICE

The price (typically in pence) you will be asked to pay to buy or sell shares in any investment company. Your interest is to see it go up, not down.

SPREAD

The difference between the price per share to pay if you want to buy and that you will be offered if you wish to sell – can be anything from 0% (good) to 5% or more (bad). The bigger the trust, the tighter the spread should be.

MARKET CAPITALISATION

The aggregate current value of all the shares a trust has issued – in essence, therefore, what the market in its wisdom thinks the investment company is worth today. (The market is not always wise and would be a duller and less interesting place if it were.)

NET ASSET VALUE (NAV)

The value of the company's investments less running costs at the most recent valuation point – typically (and ideally) that will be yesterday's quoted market price, but for some types of investment trust, whose assets are not traded on a daily basis, it might be one or more months ago.

NET ASSET VALUE PER SHARE

This is calculated, not surprisingly, by dividing the NAV (see above) by the number of shares in issue. You can compare it directly with the share price to find the discount or premium.

DISCOUNT/PREMIUM

When the share price is below the investment company's net asset value per share it is said to be trading 'at a discount'; if it trades above the NAV per share, then the trust is selling 'at a premium'.

DIVIDEND YIELD

How much a trust pays out as income each year to its shareholders, expressed as a percentage of its share price. The usual figure quoted is based on the dividends a company has paid in the previous 12 months. Over time you hope to see the dividend increasing at least in line with inflation.

DIVIDEND HERO

A catchy term invented by the industry trade body to describe trusts which have increased their dividend every year for more than 20 consecutive years (see the data section for a full list).

THE FUND MANAGER

The person (or team) responsible for choosing and managing the investment trust's capital. Will typically be professionally qualified and highly paid. How much value he or she really adds is a lively source of debate.

THE BOARD

Investment companies are listed companies, so they must comply with stock exchange rules and appoint a board of independent directors who are legally responsible for overseeing the company and protecting the interests of its shareholders, which ultimately means replacing the manager or closing down the trust if results are not good.

GEARING

A fancy word for borrowing money in order to try and boost the performance of a company's shares – a case of more risk for potentially more reward. A number of different types of borrowing (e.g. with fixed or variable interest rates) can be used.

FEES AND CHARGES

What it costs to own shares in an investment trust – a figure that (confusingly) can be calculated in several different ways. More important than it sounds on first hearing.

OCR

Short for Ongoing Charge Ratio, one of the most commonly used formulas used to measure the annual cost of owning a trust. Expressed as a percentage of the NAV.

SECTORS

Investment trusts come in many shapes and sizes, so for convenience are categorised into one of a number of different sectors, based on the kind of things that they invest in.

PERFORMANCE

A popular and over-used term which tells you how much money an investment trust has made for its shareholders over any given period of time – by definition, a backward-looking measurement. Does not guarantee future performance will be as good.

BENCHMARK

The outcome against which a trust and its shareholders have agreed to measure its performance. This is typically a stock market index relevant to the area or style in which the portfolio is being invested (e.g. the FTSE All-Share index for trusts investing in UK equity markets).

TOTAL RETURN

A way of combining the income a trust pays with the capital gains it also generates (you hope) over time, so as to allow fair comparisons with other trusts and funds. Shown either as a simple percentage gain over the period or as an annualised gain, the compound rate of return per annum.

RISK AND RETURN

Riskier investments tend to produce higher returns over time, typically at the cost of doing less well when market conditions are unfavourable and better when they are more helpful. Risk comes in many (dis)guises, however – some more visible than others.

BETA

This is a term used in financial economics to measure the extent to which the shares of a company rise or fall relative to the stock market as a whole. The stock market has a beta of 1.0, so if the market rises 10%, then a trust with a beta of 1.2 is expected to rise by 12% (=10 × 1.2). If it falls by 10%, the shares should fall by 12%.

ALPHA

A statistical measure of the additional returns that a trust has made after adjusting for the relative risk of its portfolio. It is often used (not entirely accurately) as shorthand for fund manager skill.

ACTIVE MANAGEMENT

What is going on when the investment manager of a trust makes a conscious decision not to include in its portfolio all the stocks or shares that make up its benchmark index. The latter can be easily and much more cheaply replicated by a computer – what is known as passive management. All investment trusts are actively managed.

INVESTMENT STYLE

An attempt to characterise the way in which the manager of a trust chooses to invest. One common distinction is between value and growth. The former style aims to find companies whose shares are cheap relative to their competitors or historic price. The latter concentrates on finding companies with above average sales and profit growth prospects.

IS THERE ANY DIFFERENCE BETWEEN AN INVESTMENT COMPANY AND INVESTMENT TRUST?

Basically no. Strictly speaking, investment trusts are investment companies but not all investment companies are investment trusts. Feel free to use either term interchangeably, without fear of embarrassment.

CLOSED-END FUNDS

Investment trusts are an example of what is called a 'closed-end fund', meaning that its capital base is intended to be fixed and permanent (unlike unit trusts, OEICs and horribly named UCITs 3 funds, which take in and return money to investors on a daily basis and are therefore called open-ended). The distinction is no longer quite as important as it was, as it has become somewhat easier for successful investment companies to raise new money through regular share issues.

USEFUL SOURCES OF INFORMATION

Industry information

The Association of Investment Companies | www.theaic.co.uk

Data, news and research

Money Makers | www.money-makers.co

Morningstar | www.morningstar.co.uk

Trustnet | www.trustnet.com

Citywire | www.citywire.co.uk

Platforms

Interactive Investor | www.iii.co.uk

Hargreaves Lansdown | www.hl.co.uk

A.J.Bell | www.ajbell.co.uk

Fidelity International | www.fidelity.co.uk

Research

Edison | www.edisoninvestmentresearch.com

QuotedData | www.quoteddata.com

Trust Intelligence (Kepler Partners) | www.trustintelligence.co.uk

Specialist publications

Investment Trusts Newsletter (McHattie Group) | www.tipsheets.co.uk

Investment Trust Insider (Citywire) | www.citywire.co.uk

Publications that regularly feature investment trusts

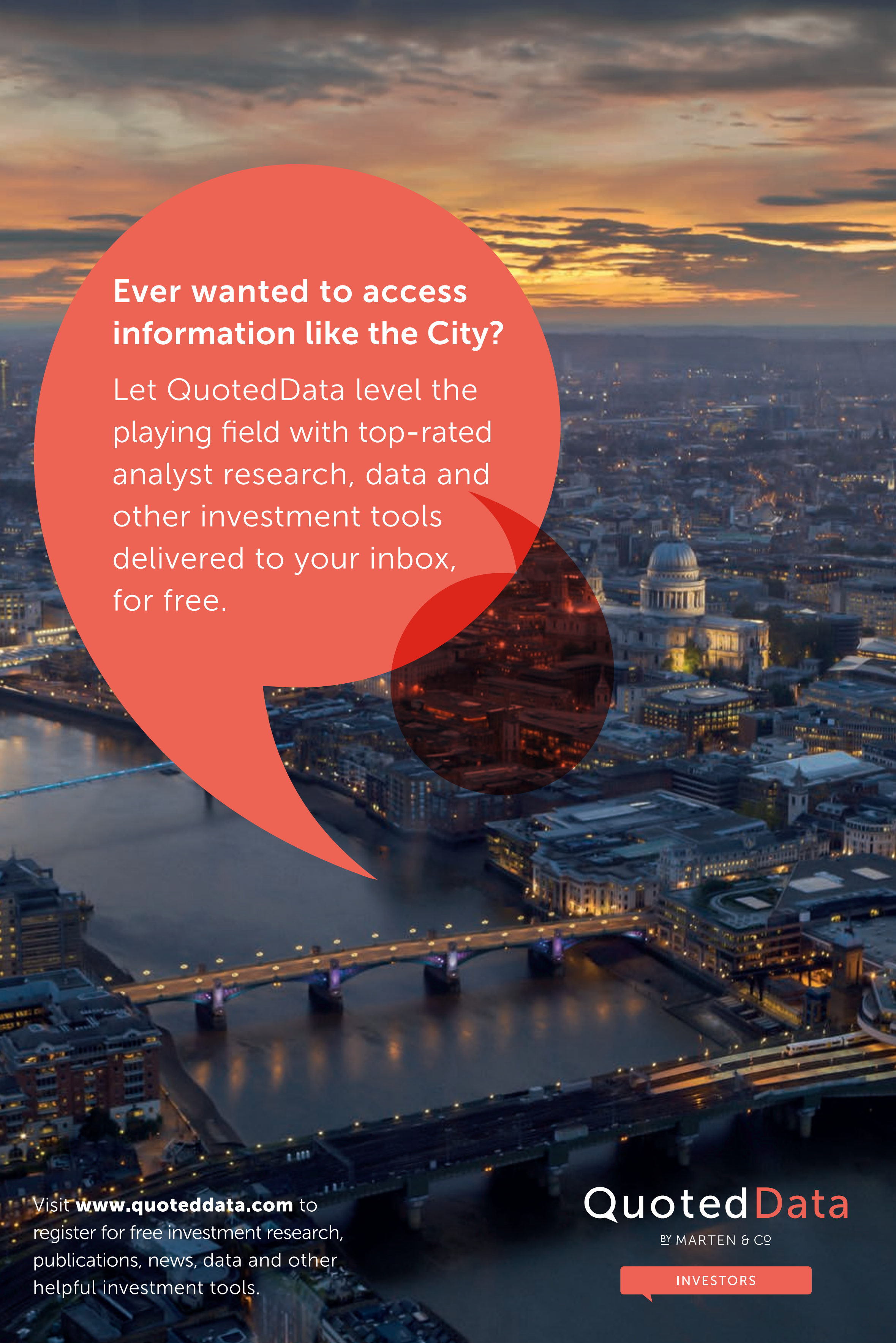
Financial Times | www.ft.com

Investors Chronicle | www.investorschronicle.co.uk

Money Makers newsletter | www.money-makers.co

MoneyWeek | www.moneyweek.com

The Telegraph | www.telegraph.co.uk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EDITOR'S NOTES

A remarkable recovery – JONATHAN DAVIS *reviews the year just gone.*

As we plunged into the seeming catastrophe of a lethal global pandemic in February to March last year, sending financial markets into a deep dive, who would have thought that normality would have returned as quickly as it has? Looking back with the advantage of hindsight 18 months later, it is remarkable how well investors have come through the experience. A look at the chart below shows that the US, worldwide and emerging markets are all well above where they were in January 2020 before the coronavirus hit. The US market has been particularly impressive, delivering a return of more than 35% since January 2020.

Given that nearly all equity markets fell by 30% to 50% in little over a month not long after the start of this period, the scale of the comeback from the depths that the decline produced has been nothing less than extraordinary. Note too that returns from bonds have also been positive over the same period, albeit only producing small single-digit returns, but doing their diversification job by offering offsetting positive returns during the big equity market sell-off. As with the 1987 stock market crash, the more time passes the more likely it seems that the pandemic crisis will eventually appear as just a blip in the longer-term rear view mirror.

Stockmarket returns over 10 years

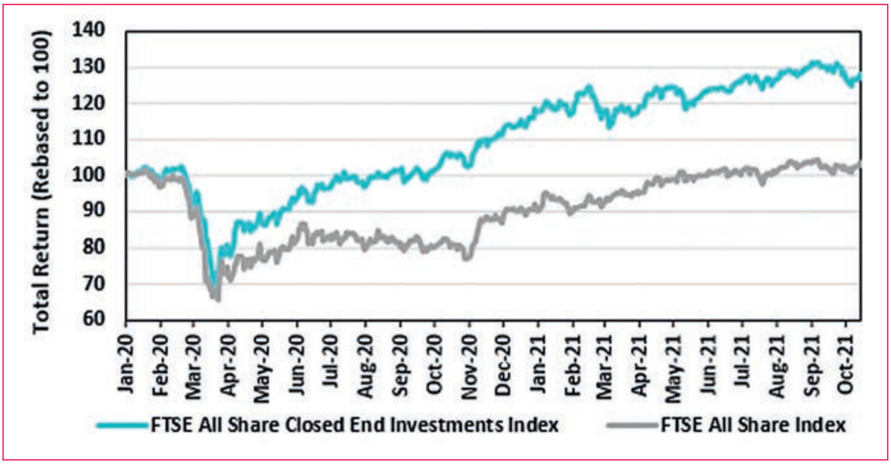
Key	Chart	Instrument	1m	3m	6m	1y	3y	5y	10y
D	☑	iShares Core S&P 500	3.6%	6.6%	12.0%	32.7%	71.6%	110.2%	410.2%
A	☑	FTSE World	2.4%	4.6%	8.8%	30.4%	58.2%	82.8%	262.6%
C	☑	FTSE All Share	1.5%	2.9%	5.6%	35.4%	19.4%	30.7%	101.2%
B	☑	UK Consumer Price Index + 5%	0.7%	2.2%	5.3%	8.2%	22.1%	41.9%	93.9%

Source: FE Trustnet October 30 2021

Equity market progress has been particularly noticeable in the year since the last edition of the *Handbook*. The announcement of an effective vaccine in November 2020 triggered a near universal surge in the value of shares, with renewed confidence morphing into optimism as an end to the wave of covid-related deaths, in most developed markets at least, started to come into view. Even a second lockdown and the emergence of the more transmissible delta variant failed to dent investors' belief that the world economy was heading for a stronger than first expected recovery. While 2020 was dominated by a narrow range of spectacular performers (with healthcare and new technology stocks well to the fore), 2021 has been a year of much broader improved performance.

Over the last 12 months even the UK stock market, having badly lagged its global peers after its feeble initial response to the crisis, but buoyed by the completion of Brexit, has been outperforming most of the rest, with the notable exception of the US market. The FTSE All-Share index is finally back above its pre-covid peak, though not by much. While unquestionably now looking cheap in comparison with most of its peers, the UK remains a laggard over the two-year period as a whole. As I write, it seems clear that investors have moved on from covid and Brexit to new preoccupations, notably the risk of rising interest rates and the potential for higher (and more permanent) inflation.

Performance of Investment Companies Sector since start of 2020



Investment trusts soldiering on

Against this backcloth it is pleasing to be able to report that investment trusts in aggregate have continued to deliver steady results. If you take the Equity Investment Instrument Index as a guide, in 2020 the investment trust sector outperformed the UK All-Share index by the best part of 27%, the highest margin of outperformance on that measure we have ever seen. While the return from the FTSE All-Share index was negative in 2020, down around 10% over the year, the investment trust index delivered a positive total return of nearly 18%.

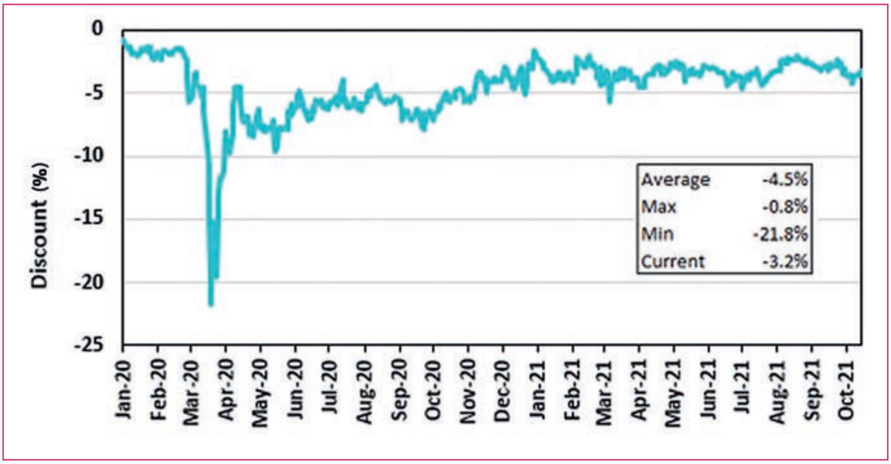
That reflected the more global nature of the investment trust universe, as well as its bias towards growth companies, a style factor that until recently has performed particularly strongly. Scottish Mortgage went into 2020 as the biggest trust in the universe and finished it even further ahead of its nearest competitors, having produced a return of more than 100% in a single year – a phenomenal result for a fund of its size. China and technology trusts also delivered exceptional returns.

That margin of outperformance, by both the sector and its most dominant member trust, was never to going to last, given the exceptional characteristics of the pandemic year. As I write these notes, the investment trust index, now renamed the UK Closed End index, is up around 10% but is trailing the All-Share index by 5% and the still dominant US equity market by slightly more. Given the sector's traditional global bias, the strength of sterling in the first half of the year has worked against the sector to some extent, reversing the trend of the last few years. Scottish Mortgage for several months moved from trading at a premium to trading on a discount, in a change of sentiment that also affected the other big winners of 2020.

Just as significant perhaps is the fact that the composition of the investment trusts index, like the sector itself, has been changing. The popularity and continued rapid growth of alternative asset trusts, in property, private equity, infrastructure, renewable energy and other specialist areas, has increased their weighting in the index and in the trust universe. By their nature alternative asset vehicles are bought mainly for their secure income streams and single-digit total returns, not for their potential to produce startling capital gains, as Scottish Mortgage and some other conventional equity trusts have been able to do. In tough years those characteristics will stand shareholders in alternative asset trusts in good stead: in good years for equities, they will tend to lag.

What has been encouraging is how well overall discounts have held up since the market collapse 18 months ago. As chronicled in last year's *Handbook*, widening discounts magnified the fall in share prices across many sectors during the sell-off, but most have since recovered strongly. Discounts are now back, on average, to their pre-pandemic levels too, oscillating this past year in a range between 1% and 7%, but mostly below 5%. Many alternative asset trusts have continued to trade at premiums, reflecting the appeal of their solid and reliable dividends to income-starved investors in a period when yields on cash and bonds have remained at miserly levels. Once inflation is taken into account, yields on both cash and government bonds have remained decisively negative throughout the year, so the attraction of positive and sustainable real dividend yields has not been lost on investors.

Investment Trust Sector (ex 3i) average discount since start of 2020



Plenty of style rotation

Any aggregated measure of investment trust performance inevitably disguises a smorgasbord of very different experiences as you look deeper into the picture. This year has seen a lot of volatility in the kind of investments that have found favour with the investment community. The first few weeks of 2021 saw the big winners of 2020 reach new peaks before falling out of favour, while the post-vaccine surge in value and cyclical stocks continued into the spring. (A special acknowledgement and note of thanks should be given to Kate Bingham, the head of the vaccine taskforce which engineered the UK's successful and world-beating vaccine campaign. She was made a dame for her extraordinarily effective contribution to fighting the virus, after ending her secondment and returning to her job as part of the management team at the International Biotechnology investment trust.)

After having been out of favour for years, value as an investment style continued its comeback over the course of the spring, with trusts such as Aberforth Partners, Temple Bar, Polar Capital Global Financials and Fidelity Special Values all performing strongly. During this period the biggest winners of 2020, including Scottish Mortgage, the two big technology trusts (Allianz and Polar Capital) and the sector's three all-China trusts, all sold off, moving from handsome premiums to discounts, as the growth style went out of favour. In the summer that trend largely reversed itself for a while, with growth to the fore again back in favour and value stocks falling back, before making a bit of a further comeback as we moved into the autumn – a real rollercoaster of a year from this perspective.

Investment professionals like to characterise this kind of behaviour as style rotation. Other style factors that move in and out of fashion include small versus large companies, quality versus deep value stocks (the latter a sub-set of the value bucket), high dividend yield versus low dividend yield and those with positive versus negative momentum. You can readily find investment trusts whose managers favour each of these different styles, some of which – notably growth, quality and smaller companies – have been dominant for the best part of a decade. Fund managers whose style happens to be in favour are not necessarily geniuses, any more than those whose approach does not fit the prevailing tides are incompetent – it's more about being in the right place at the right time.

The past 18 months have been, for a change, a period during which almost every kind of style has been able to boast of outperformance at some point. Whether these short-term changes in trend amount to an enduring range of direction remains to be seen. Suffice it to say that many professional investors are conscious of the importance of style, but in my experience the best ones to back are those who stick to a single approach, regardless of fashion. It is more productive to change the mix of styles among the trusts you own than it is to entrust your money to a fund manager whose job is to navigate from one style to another. That rarely seems to work well. The most important takeaway for investors, however, is the need to understand exactly what style of investment the manager of your trust is adopting and to allow for that when choosing whether it is right for you to own – or get rid of – that holding.

Consolidation is continuing

Style is one of the factors that has undoubtedly contributed to the wave of manager changes that has been another feature of the past 12 months in the investment trust sector. A timely and influential report from Numis Securities in mid-2020, highlighted in the *Handbook* a year ago, argued the case for continued consolidation across the trust universe. Its contention was that there are too many trusts that are either too sub-scale (too small to command attention) or insufficiently differentiated (by style, or objective, or performance) to justify their continued existence. Boards that are doing their job, it argued, should grasp the nettle and take action to remedy sustained periods of poor absolute or relative performance, either by changing the manager, changing the mandate, merging with another trust or, as a last resort, liquidating the trust and returning the cash to shareholders.

This call to arms was not entirely disinterested: Numis is one of the biggest and most active corporate brokers which stands to earn handsome fees from almost any kind of corporate activity. But nor was it misdirected, since one of the valid criticisms of trusts in days gone by was that boards of directors, even when nominally independent, were often slow to change or hold a failing manager to account (and certainly reluctant, on the turkeys-don't-vote-for-Christmas principle, to put themselves out of a job by liquidating the trust). Today's boards in general are made of more robust stuff and have become rather more active in taking decisive steps of this kind.

In 2020 we saw three sizeable trusts in the UK equity income, Perpetual Income and Growth, Temple Bar and Edinburgh, ditch their existing managers and switch to other firms after long periods of underperformance. This year the same process has claimed two notable scalps among trusts with global mandates. The mandate to manage Genesis Emerging Markets, with more than £1bn in assets under management, has been passed from Genesis Investment Management, the firm that launched the trust 32 years ago, to Fidelity, while the venerable Scottish Investment Trust, which dates its origins all the way back to 1887, is to be merged with J.P. Morgan Global Growth and Income. By a remarkable coincidence, the latter was founded (under a different name, the British Steamship Investment Trust) in the very same year.

A number of other, smaller trusts have also been wound up or merged, but what is striking about these two deals is that they involve well-established companies with hundreds of millions in assets. In the case of the Scottish Investment Trust, its deep value contrarian style has been completely out of sync with current market dynamics and has undoubtedly been a significant factor in the trust's poor track record of performance in recent years, so the change is not unexpected. The board will presumably be hoping, though, that they have not made the classic mistake of ditching the pilot just at the very moment that style and market conditions are about to change in its favour.

The Genesis/Fidelity change is a rather different story, as the outgoing managers evidently were shocked to discover that they were being replaced after more than 30 years at the helm of a trust they had founded and which has subsequently delivered a creditable near 12% annualised rate of return over the whole of that period. More recent performance has been less impressive, however, and the board appear to have concluded that, given a share register which is unusually still dominated by institutional investors, the Genesis team had become somewhat complacent and were less well suited to the task of marketing the trust in a period when private investors are an increasingly important target audience. As such this may be something of a wake-up call to the boards of other trusts that are struggling to remain relevant.

Record secondary fundraising

As detailed in the data and analysis section which makes up the back end of the *Handbook*, the performance of investment trusts has been less impressive this year than the ability of the sector to raise new money. The calendar year is not yet over, but already the amount raised through primary and secondary issuance is the best of any year since before the global financial crisis 15 years ago. Unlike 2006 and 2007, which witnessed the last great boom in fundraising, more than 80% of the money raised has come through secondary issuance by already listed investment companies. IPOs have been much rarer – only eight this year at the time of writing, compared with many times that number in those last two pre-crisis years. In other words, it has become harder and harder for new trusts to find a way to market but seemingly easier and easier for existing trusts to raise money once they have cleared that initial hurdle.

It is true that the bulk of the secondary fundraising has come from the most popular alternative asset sectors: renewable energy, infrastructure, private equity and niche property companies. Yields in the 4% to 6% range, based on secure and often index-linked income streams, are the primary attraction in these sectors. Many of these trusts are relative newcomers, but their ability to come back to scoop up more capital is remarkable by past standards. Trusts such as Tritax Big Box have raised more money in five years than the majority of conventional equity trusts will ever do. Even more remarkably, a trust that listed only at the start of this year, Digital 9 Infrastructure, has already raised almost as much from shareholders with two subsequent placings as Smithson, the smaller-company version of Terry Smith's popular Fundsmith fund, which holds the record for being the biggest investment trust launch we have seen on the London market. Nine trusts raised more than £300m through secondary issuance in the first nine months of the years.

The secondary fundraising phenomenon is a great boost for the investment trust business and an indication of the ability of the trust sector to adapt to change and provide popular new investment solutions in the low-growth, low-interest-rate world we have lived in since the global financial crisis. Even though they have been few in number, the IPOs that have succeeded in the last couple of years have brought an interesting range of new types of investment to the market, among them trusts that specialise in digital infrastructure (including the one just mentioned), energy storage and energy efficiency, space exploration, shipping and music royalties. Diversity, not the traditional old-fashioned me-too equity trust, is very much the flavour of the day.

This is all to the good, but it is only fair to add a mild warning. Periods when new money flows into popular sectors or asset classes in large quantities do not always work out well. As the internet bubble of 1999–2000 and the banking boom that preceded the global financial crisis in 2008 demonstrated, you can definitely have too much of a good thing. The City has always been very good at creating a new supply of whatever it is that investors think they want, but almost invariably it leads eventually to indigestion and subsequent disappointing performance from many of the new arrivals.

So, while many alternative trusts currently trade at big premiums, thanks to their temptingly juicy dividend yields while risk-free assets like cash and government bonds are paying next to nothing, you can be sure that at some point in the future those premiums will come under pressure and may even disappear. A trust that pays a dividend equivalent to 5% of today's share price, but later moves from a 10% premium to a 5% discount, can easily involve you giving back three years of past dividends. Don't get carried away, in other words. What goes around tends to come around, which suggests that after several years in which growth has taken the bulk of switched mandates there may well be good opportunities for trusts with a strong track record and a value approach to offer more choice in the sector in the years to come. Fidelity Special Values, Aberforth Smaller Companies and Temple Bar are obvious examples of those who could benefit.

There is theatre too

Money – and especially the stewardship of other people's money, which is the hallmark of the service that investment trusts provide – is a serious business, as it should be. That said, I hope that it won't be considered too flippant to observe that one of the pleasures of tracking the trust world this year has been the chance to enjoy some live corporate theatre, most of which has been concentrated in what remains of the hedge fund sector. Whatever you think of their performance history (and I have been a long-term sceptic about hedge funds), you could never call the managers of hedge funds blushing violets. As self-styled 'masters of the universe' they certainly don't like to be told what to do. This can lead to tensions when they are managing an investment trust, where boards – and, to a lesser extent, significant shareholders – traditionally expect their voices to be heard and respected.

In the past 18 months we have seen something of a power struggle at a number of trusts. Brevan Howard, the managers of BH Macro and BH Global, threatened to walk away as investment managers of both trusts unless their demands for higher fees were accepted. After a show of resistance, both boards eventually gave in to this rare show of defiance (the recent trend has been for managers to cut their fees under pressure from boards, rather than the other way round). Both boards also sensibly insisted by way of return that the two companies were merged into a single entity, allowing shareholders who were unhappy with the proposed increases to get out by means of a tender offer, which a minority did. Meanwhile another trust, Gabelli Value Plus+, which had a very poor track record of performance, was eventually liquidated after a shareholders vote this year, but only after a protracted and heated year-long standoff between the board and the management company. The latter had a 27% shareholding and was therefore able to veto any special resolution requiring a 75% vote in favour of change.

The bitterest war of words, however, has been reserved for the very public struggle between Dan Loeb, founder and leading light at Third Point Investors, and Asset Value Investors, an activist shareholder which has been leading a campaign on behalf of several investors for changes to help reduce the wide discount at which the trust has persistently traded. AVI's campaign was carried on through a series of open letters, rather than through a more usual behind-the-scenes approach to the board, which on this occasion – although announcing some plans of its own to reduce the discount – has so far mostly come down on the side of Loeb and his colleagues. While the discount has narrowed since these skirmishes began, for which both sides will doubtless claim the credit, it seems that this particular show has longer to run.

One of the problems in the Third Point case is the trust's dual share class, which gives some shareholders, including Loeb, more rights than others – always a potential source of tension and a deterrent to many sensible investors. Pershing Square Holdings, meanwhile, the biggest hedge fund investment trust, has also struggled to reduce the discount at which its shares trade. Given its exceptional performance in the last couple of years (it's not been so good over longer periods), this is another indication that there are persistent cultural and structural differences between managers and shareholders in the hedge fund space which make an investment trust a not entirely satisfactory vehicle for either party. While not quite such compulsive viewing as the TV series "Billions" or "Succession", these real-life cases of business confrontations still made for good spectator sport.

Change at the AIC

This year marked the retirement of Ian Sayers from the Association of Investment Companies, the industry's trade association, after 22 years – the first 11 as technical director and the last 11 as CEO. The Q&A with him we published in the 2020 *Handbook*, available on the Money Makers website, is probably the best potted history of the substantial changes that the investment trust business has experienced during his two-decade tenure. The journey that investment trusts have made from the depths of the split capital scandal to today's vibrant and successful industry is a tribute to Sayers' dedication and quiet but effective management style. His replacement, Richard Stone, who took over in September 2021 after a long stint as finance director and CEO of The Share Centre (itself recently taken over by a rival acquisitive platform, Interactive Investor), has a hard act to follow.

When I asked Stone what his immediate priorities were, he said updating the rules governing the need for prospectuses in secondary fundraising and making it easier for private investors to participate in them were top of his agenda. The arrival of the web-based platform Primary Bid, which enables private investors to participate in IPOs and secondary placings on virtually the same terms as wealth managers and other professional institutions, has been a welcome development this year. Its success in raising (admittedly small amounts of) money directly from private investors in more than a dozen issues has highlighted the disadvantage individual investors normally face when new primary or secondary share issues are announced. Stone's ambition to rectify the disadvantage is good to hear, and his experience running one of the bigger retail investor platforms for so long should effectively enable him to assist the moves many investment trusts are already making to improve their communication and interaction with individual shareholders.

At the moment participation by individuals in new and secondary issues is at the discretion of the issuing company and its brokers, while the amount of shares that Primary Bid, as a newcomer, is enabled to offer under existing rules is limited to a small percentage of any issue. The big platforms could – and should, in my view – be more active in promoting the more interesting fundraising opportunities. Because secondary issues are done at a premium to NAV but at a discount to the current share price, existing shareholders, although not diluted directly, can easily miss out on the opportunity to subscribe for more shares on the same attractive terms as the big boys – particularly when those shares immediately revert to trading at a bigger premium once the issue is completed.

The AIC has also called for the useless and much hated KIDs (key information documents) required by EU regulations to be scrapped now that Brexit is out of the way. Although a review of the regulations was promised after Brexit, the Financial Conduct Authority, the financial services regulator, has so far only announced that it is reviewing the regulations and will be proposing a new version in January 2022. As so often, the pace at which regulators move to resolve long-running issues is glacially slow. The problems with KIDs – which prompted the distinguished economist and academic Sir John Kay to offer the memorable advice "burn before reading" when they were first introduced – have been known for several years, and it grates that managers of open-ended funds have not been required to follow the burdensome and misleading requirements to the same extent.

Let the music play

My prize for the most entertaining and unusual piece of investment trust research this year has to go to Christopher Brown, the lead analyst at J.P. Morgan Cazenove, for his work on the two music royalty trusts, Hipgnosis Songs (ticker: SONG) and Roundhill Music Royalty Fund (ticker: RHM). By their nature, being trusts that invest in the earnings of publishers, composers and performers of the most well-known popular music of the last 70 years, these two trusts undoubtedly have a broader intrinsic appeal than many of their more mundane peers. The majority of individual investment trust shareholders come from a generation and demographic that will have grown up with popular music (of any genre) very much in their consciousness and very much part of their lives.

In an attempt to determine which of these two trusts had the better catalogue, Christopher decided to take a detailed look at a newly released list of the 500 greatest popular music tracks, as chosen and published by *Rolling Stone* magazine. This list was an updated version of a seminal earlier article originally published in the year 2000 and repeated in 2014. You don't have to agree with the decidedly idiosyncratic choices made by the panel of music experts who came up with the rankings in order to appreciate that this kind of exercise can produce enormous scope for argument and debate. (Bob Dylan has been knocked off the top spot by Aretha Franklin since the last review, while the highest-ranking Beatles song is only at number seven and the Rolling Stones don't even make the top ten.) Compare the streaming numbers of all the 500 tracks mentioned with the music rights acquired by the two trusts does, however, give the shareholders some basis on which to assess the likely earning potential that each enjoys.

All-time winners

Position	Song	Recording Artist	Year	Spotify Streams (m)	Top Twenty Position in 2004/10
1	Respect	Aretha Franklin	1967	363.9	5
2	Public Enemy	Fight the Power	1989	34.8	
3	A Change is Gonna Come	Sam Cooke	1964	115.4	12
4	Like a Rolling Stone	Bob Dylan	1965	239.9	1
5	Smells Like Teen Spirit	Nirvana	1991	1071.1	9
6	What's Going On	Marvin Gaye	1971	177.2	4
7	Strawberry Fields Forever	The Beatles	1967	123.1	
8	Get Ur Freak On	Missy Elliott	2001	190.6	
9	Dreams	Fleetwood Mac	1977	801.1	
10	Hey Ya!	Outkast	2003	761	
11	God Only Knows	The Beach Boys	1966	171.5	
12	Superstition	Stevie Wonder	1972	69.6	
13	Gimme Shelter	The Rolling Stones	1969	367.7	
14	Waterloo Sunset	The Kinks	1967	73.9	
15	I Want To Hold Your Hand	The Beatles	1963	260.8	16
16	Crazy In Love	Beyonce ft Jay-Z	2003	633.3	
17	Bohemian Rhapsody	Queen	1975	1598	
18	Purple Rain	Prince and The Revolution	1984	283.7	
19	Imagine	John Lennon	1971	383.2	3
20	Dancing on My Own	Robyn	2010	223.6	

J.P.Morgan CAZENOVE

Source: *Rolling Stone*, Spotify, J.P. Morgan

I cannot, unfortunately, share all the results of this exercise with readers, as wider circulation of the research is restricted by current regulations (so do write to your MP or the Financial Conduct Authority and demand some change if you think the current regime is misguided). Suffice it to say that the portfolios of the two trusts are clearly differentiated on a number of measures – RHM's catalogue has more 1960s and 1970s hits, including an interest in one of the famous Holland-Dozier-Holland combo of Motown hit writers, while Hipgnosis has a broader range of more recent music titans and more of the 500 tracks. You can find the *Rolling Stone* list online, and both trusts have filled their own websites with details of their key assets, so there is room to do your own happy hunting if popular music is your thing.

Reviewing the portfolio

Each year I provide a progress report on the model investment trust portfolio that I started for the first edition of the *Handbook* when it came out four years ago. The portfolio started life in January 2017 with ten investment trusts and £10,000 invested in each one. All of them were trusts that I either own or have owned myself at some stage. The majority were – and remain – run by longstanding managers with a significant personal stake in their trusts, a good track record over many years and, most importantly, a reputation for personal integrity and a willingness to put shareholders' interests above their own. That means (sorry) no hedge funds, because the fee structure they employ is too heavily weighted in the manager's favour. I would characterise the portfolio as being medium-risk and very much designed for long-term investors. It is not intended to constitute a list of recommended funds per se, but rather an illustration of the way that one reasonably knowledgeable observer thinks about investing his own money.

How the Handbook portfolio has grown

The initial £100,000 portfolio had performed satisfactorily when I reported on progress last year, increasing in value despite the intrusion of the pandemic from £148,000 to just under £160,000, including dividends reinvested, at the time of writing (which was just before the end of October 2020). Since then the value of the portfolio has increased again, to £187,000, an increase of approximately 13.5%. This, as it happens, is slightly above the annualised rate of return that the portfolio has achieved since it was initiated in January 2017. At one point early in 2021 the value of the portfolio touched £194,000, but it has since fallen back quite sharply, in part because of the style rotation factors I mentioned earlier. Poor relative performance by some key holdings, notably Fidelity China Special Situations, the largest and most successful holding coming into 2021, and Edinburgh Worldwide, also contributed.

My personal bias, on both temperamental and philosophical grounds, has always been towards managers who favour quality growth stocks and smaller companies over larger. I have also been reluctant to invest too much in the UK market while Brexit was still hanging over us. This year has prompted me to review those biases and make some slight adjustments. As a long-term buy and hold investor, the most important feature of the portfolio has always been my willingness to let the winners run, without annual rebalancing, and to keep portfolio changes to a minimum. Dividends are not automatically reinvested but used to make marginal adjustments to existing holdings or to add to new holdings that may also meet my criteria.

The number of holdings had crept up to 13 a year ago. This year, however, a combination of that style rotation, the evidence that the current equity market cycle is threatened by high valuations and the potential for rising bond yields, and the fact that the largest single holding had crept up to to more than 10% of the value has prompted me to review the balance of the portfolio and make some changes, most of which closely track the changes that I have made to my own real-life holdings.

The effect has been to increase the number of holdings to 14, cut back some of bigger positions and (ever so gingerly) commit a bit more money to the patently cheap UK market and (though it is not my preferred style) increase the amount awarded to managers with a value bias.

Turnover has therefore been unusually elevated. The increased number of names is intended to give a more balanced overall shape to what has become a bigger pool of money. New names added to the portfolio include Scottish Mortgage, bought when it was trading on a helpful discount, Fidelity Special Values and Temple Bar. Overall, however, given my caution about potential future returns, I remain reasonably pleased with the performance to date. Regular updates about this and other model portfolios I track can be found by subscribers on the Money Makers website, together with two other portfolios, including one for income investors, that I monitor on a regular basis.

Where next in 2022?

My crystal ball has always been clouded, and this year it is even more so than usual. There is much debate in professional circles about the risks of higher inflation and rising bond yields, both of which, if they materialise as more than transitory phenomena, will clearly have a significant impact on market returns. So too will many other specific corporate developments which remain by their nature unknown. The great beauty of investment trusts is that they give you plenty of scope to diversify your risk, while holding out – though never guaranteeing – the prospect of market-beating returns in individual sectors. The remarkable growth of alternative asset trusts in recent years has helpfully widened the universe of potential diversifying assets.

It is easier to note the most obvious cases of relative undervaluation than it is to predict the absolute level of returns that might be achieved over any future period. Mainstream UK equity trusts look cheap, as already noted, on most valuation measures, and it will be astonishing if the value style does not continue to do rather better over the next few years. Emerging markets, though not an area of great interest to me, have many professional advocates on current valuations. For those worried about inflation, defensive trusts such as Capital Gearing, Ruffer and Personal Assets will continue to look appealing. While wary of the big premiums on many alternative asset trusts, I have been adding holdings in some of the newer specialist property trusts to my personal portfolio.

We are moving into the second year of the US presidential cycle, which is historically not the greatest year for equity market performance. Discounts on investment trusts still remain on average narrow by historical standards, meaning there may be scope for sharper price falls if we get a significant market correction, or worse, in the next 12 months. So I believe caution continues to be called for, but there is no doubt that the investment trust sector remains in good health and the marked improvement in corporate governance and the range of available instruments gives me every confidence that the sector will continue to justify its billing as the connoisseur's choice.