

Investment Trust Newsletter

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Change is coming. This is the message from America's new President. Talk about a new-found confidence in the country's future might just be premature, however. Barack Obama does not even take office until January, and we will probably have seen a few more twists and turns in our current financial and economic crisis before then. It is hard to say what kind of economic prospects he might inherit, and even harder to say what the stockmarket might be indicating. A big pre-election rally for the Dow Jones was tempered by a 5% drop once the polls actually closed. This might not yet be the new dawn for global stockmarkets.

Equities have shown some good signs of recovery, but they are still markedly lower than they were a month ago. Few trusts have risen: the gains are limited to a few specialist trusts only, such as **Vietnam Opportunity Fund, Melchior Japan, Vietnam Property Fund, Kenmore European Industrial Fund, JPMorgan Japanese, Baillie Gifford Japan, JPMorgan American, and Schroder Japan Growth.** Japan has obviously outperformed over the last month, and we take a closer look at the sector this month. On the downside, there have been plenty of nasty falls. Some of the worst have been from **Dhir India, European Equity Tranche Income, Invesco Leveraged High Yield Fund, Lewis Charles**

Romania Property Fund, Prospect Japan, Close European Accelerated Fund, and Pantheon International Participations. The latter, a private equity fund, has seen a very large discount to net asset value develop very quickly as the market focuses on funding problems. In the private equity sector, many trusts have seen their share prices fall dramatically because of potential issues with cashflow. It is normal for trusts which invest in private equity funds to 'over-commit' capital – in other words, to take up more capacity than they can currently fund. The usual idea is that the commitment is only drawn down in full at a later date, when cash has been raised from other exits and realisations, or from bank finance if necessary. Now, of course, the crash in equity markets means that hardly any useful exits are occurring, and bank finance is very hard to source as well. The fear is that private equity trusts will be forced to sell portfolios at distressed prices, simply to deal with cashflow issues. This is somewhat akin to property funds selling in terrible markets to reduce their debt. We'll revisit this issue a few times in the following pages.

THE HUNT FOR CONSISTENCY AND VALUE

The level of volatility in stockmarkets is thankfully abating. The VIX Index, which measures the volatility in US equities, has started to fall from its remarkable highs set in late October. Markets are settling down to some degree – for the moment at least – which might tempt investors to reconsider equities and to hunt for a few trusts able to deliver long-term returns from this lower base. Some observers are suggesting this bear market still has one more down-leg to run yet, but that remains to be seen. Helpfully, the AIC has run some analysis and identified what it says are the 20 investment companies with the most consistent performance record in the industry over the last ten years. Interestingly, these are not the 'boring' international generalists as you might expect. Far from it. The five most consistent performers over the last decade have been **JPMorgan**

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Russian Securities, Genesis Emerging Markets, Advance Developing Markets, Aberdeen New Dawn and Black Rock World Mining.

In order to calculate these figures, the AIC looked at the industry's discrete annual returns over each of the last ten years. Each year, the investment company's performance was benchmarked against the overall performance of the investment company sector and the companies that most consistently outperformed on an annual basis were identified. Where two companies had the same consistency score, the volatility of the returns (standard deviation) was used to differentiate between them. **JPMorgan Russian Securities (JRS)** led the field as the most consistently outperforming company and also has the best ten year performance record, with a £100 investment growing to £4,854 (to the end of September). Outside of the emerging markets, which dominate the list, the other trusts which feature as providing consistent outperformance include **JPMorgan European Fledgeling, Candover, British Empire Securities & General, Lowland, Caledonia Investments, HgCapital, Fidelity European Values, Montanaro UK Smaller Companies, Henderson EuroTrust, and Invesco English & International**. We have featured most of these trusts in the newsletter over the years.

Moving on to valuations, it has to be worth a trawl through the figures now to see whether the recent turmoil has thrown up any obvious bargains – or at least some investment ideas. In general, we think there may be fewer than you expect – the average discount to net asset value is only 9.4%, which is not at all wide in these circumstances. Starting with the international generalists, we have liked **Caledonia Investments (CLDN)** for a long time and note the shares are trading on an 11.8% discount against their 12-month average of 9.5%. The trust's assets are down by 19.9% over the last six months, which is better than average, maintaining the trust's strong relative record. Elsewhere in the sector, **Alliance Trust (ATST)** is still on a 19.1% discount in spite of a reasonably resilient performance (NAV down 21.3% over six months), but we have little reason to expect much narrowing of that discount in the near-term. **Personal Assets Trust (PNL)** and **RIT Capital (RCP)**, both of which have been quite successful in protecting capital, continue to trade on a premium rating. Before leaving this sector we should probably mention the dreadful short-term performance of **Scottish Mortgage (SMT)**, which has lost more than 40% of its asset value over the last six months. The trust has been geared into sectors such as oil and commodities, and has been hit hard by the market downturn. That is why its discount has moved out to 15.2%.

Amongst emerging markets trusts, the discounts generally look tight – perhaps too tight. **Utilico Emerging Markets (UEM)**, for example, commands a 2.9% premium after losing 39.9% of assets over six months. Similarly, **Templeton Emerging Markets (TEM)** is on a slim 4% discount in spite of a loss over six months of 43.4%. These shares seem to be pricing in some recovery.

Back in the UK, **Hansa Trust (HAN)** has not fared particularly well in the downturn, losing 32.2% of assets over six months. Its very large holding in Ocean Wilsons Holdings has fallen sharply, losing more than half of its value since the end of June. Those expecting a bounce might like the look of Hansa shares on a 23.2% discount, against a twelve-month average of just 9.8%. In the UK smaller companies sector, most of the falls in assets have been awful: **Eaglet (EIN)** is possibly the only trust which looks like a bargain on its rating, but we have our reservations about that (see round-

up section). In Europe, much the same applies. It is tricky to find any bargains. Perhaps the closest to that we can find is **JPMorgan European Fledgeling (JFF)**, on a discount of 20.7% against a 15.3% twelve month average. The trust has been outperforming quite strongly against its peers, but in absolute terms the performance still looks poor with a six-month loss of 27.6%.

We would have liked to have found some good value in Asia, but most trusts look fully valued to us in that region. In the US, there is one price which looks like a striking anomaly. **North Atlantic Smaller Companies (NTAS)**, managed by Chris Mills, is on a 35.1% discount against a twelve-month average of 17.2%, even though its performance over six months has been quite reasonable with a loss of 21.7%. The trust's board and managers rightly suspected that the sub-prime crisis would cause many more problems, and have been very cautious in their investment policy as a result. According to the figures on the Citywire website (see the investment trust section at www.citywire.co.uk), the trust has 24% of assets in cash. Looking forward, Chris Mills says the current six month period is likely to be very active. Two holdings - Castle Support Services and RPC - are conducting strategic reviews. Inspired Gaming, Georgica, Augean and Filtronic have all publicly stated that they are in offer talks. Fayrewood, which is now a cash shell, expects to return money to its shareholders in the near future. Chris adds "obviously there can be no assurance that the transactions will happen but there is the potential to add very considerably to the company's net asset value and already substantial cash balances." We like the trust, and think on this rating that the shares are a GOOD LONG-TERM BUY at 658.5p. The estimated NAV is currently just over £10 per share.

From what we have read, Barack Obama's election as US President could be good news for alternative energy. He wants to invest US\$15bn a year over the next ten years to spur commercial development of alternative energy — wind, biomass and solar — and more energy-efficient

buildings and automobiles. Whether or not he can find the cash to do this is debatable now, but his intentions are clear: his administration is likely to be very supportive of new energy. With this in mind, we wondered whether **BlackRock New Energy Technology** (BRNE) shares at 37.75p might be worth a look on a discount to net assets of 20.5% against a twelve-month average of just 2%. The assets have been hit badly over six months, and have fallen by 37.3%, but over five years the NAV is still up 63.1%, which is still a reasonable result. The shares are **WORTH THINKING ABOUT**, in our view, and if you have a holding already we might be tempted to top it up at this level.

The specialist biotechnology and life sciences sector has been quite strong over recent months, displaying excellent defensive characteristics. All three trusts in the sector have been able to increase their net asset value over six months, and two of them trade on reasonable discount of 7.6% and 7.8%. The third trust – **International Biotechnology Trust** (IBT) – has traded on an average discount of 10.9% over the last year, but now finds its shares at 119p on a 20.1% discount. This may well be a case of the baby being thrown out with the bathwater, and of some indiscriminate markdowns. The trust has actually increased its assets by 9.1% over the last six months. This is behind the other two trusts in the sector, but it is still well ahead of most other trusts over this period – and over three years International Biotechnology leads this sector too. This rating looks too harsh to us, especially as the trust has a buyback programme.

JAPANESE INVESTMENT TRUSTS

Japan seems to be back in fashion, as much as any equity market is these days. We have read quite a few bullish opinions recently on the prospects for the Japanese economy, and the Nikkei 225 Index has bounced very strongly from its low in late October, already recording a 33% rise to 9521. This is in spite of more negative comments from the Bank of Japan, which has warned of the possibility that the economy will deteriorate further because of lingering global financial turmoil. The BoJ Governor Masaaki Shirakawa said this week “for the time being, it’s important to pay attention to the economy’s downside risks, including developments in the U.S. and European financial systems and the effect of global market movements.” On the plus side, Japan has cut its already low interest rates, the country is a major beneficiary of lower oil prices, and there are

signs of investor confidence returning. The latest monthly report from Nomura Securities points to a much more bullish view from individual investors, with 45% expecting the Nikkei 225 Index to rise by at least 2000 points in the coming three months, from its close on 22nd October at 8674. So far, it is heading the right way. The November report also said the Nomura I-View Index, a diffusion index gauging retail investors’ sentiment based on the monthly survey, climbed 30.8 points from the previous month to 45.6, marking the sharpest rise since the data started to be compiled in April 2006. The latest figure also marked the highest level since September 2007.

If your view accords with those bullish Japanese investors, which are the most interesting trusts? Arguably, the smaller company trusts have the most to gain, although the smaller firms may not be first out of the recession. Let’s look at the mainstream trusts first, where **Perpetual Japanese** (PJI) leads the way over most recent periods. The trust looks fairly fully valued though, on a 5.2% discount to net assets, and we think that **Schroder Japan Growth** (SJG) might offer better value on a 13.9% discount at 66.75p. The trust is geared by around 17%, so it will tend to outperform on the way up, and underperform on the way down (as it did for the year to 31st July). In the smaller companies segment, **Fidelity Japanese Values** (FJV) also incorporates gearing of around 31% - the highest in the sector – and trades on a 14.7% discount to net asset value, which is a couple of percentage points wider than its twelve-month average. We think the £65m Fidelity trust is for confident bulls only, but it could deliver very good returns if and when Japanese equities have another spurt upwards. An alternative, and the best performer by far in the sector over the last month, is **JPMorgan Fleming Japanese Smaller Companies** (JPS), with 7% gearing, and a narrower 8.9% discount at 134.25p.

STOCKBROKERS’ RESEARCH

On 23rd October, WINS issued a new research note on **JPMorgan Overseas** (JMO) at 416p, following the trust’s change of manager. Jeroen Huysinga succeeded Ed Walker as manager at the start of October. Jeroen, who joined JPMorgan in 1997, is an experienced global manager and will manage the fund along the same lines as the open-ended JPMorgan Global Focus Fund, which he has run since 2003. This fund has performed well in rising markets although it has struggled since last summer, partially as a result of being underweight the US at a time when sterling has weakened. The investment approach will now place greater emphasis on stock selection, based on the manager’s considerable research resources. There has already been a substantial change at the stock level with around 80% of the portfolio repositioned. The fund currently has 77 stocks, with the top ten representing 21% of assets. Some of the big names in the portfolio include Bank of America, Merck, Vodafone, Cisco Systems, and IBM.

Over 2000 stocks are covered by JPMorgan’s 59 regional sector specialists who operate out of four regional centres in London,

New York, Tokyo and Singapore. Under the new manager, particular attention is paid to estimates for a company's normalised level of earnings over the medium term, and a proprietary dividend discount model is used to aid comparison across markets. Before an investment is made, four price drivers must be met: (i) a strong valuation signal; (ii) significant growth potential; (iii) an identifiable catalyst, such as new management, a restructuring, or M&A; and (iv) a timeline - the catalyst must be likely to be within a 12-18 month period. When one of these price drivers is no longer met, the holding will be sold.

With a target of outperforming the MSCI World AC by four percentage points per year over the course of a market cycle, JPMorgan Overseas is attempting to differentiate itself in performance terms from its peers, many of whom have strong long-term records. The fund has a normal gearing range of 95% to 120% of total net assets. It currently has a short-term borrowing facility of £10m. This is almost fully employed so, at present, the fund has market exposure of approximately 108% of net assets. The manager believes that markets are currently attractively priced and is considering taking on further debt so the fund will be closer to its maximum gearing range. The manager's view is that lower economic growth and weakening consumer spending will lead to caution amongst investors until the outlook for company profits is clearer. However, he believes that this uncertainty is largely priced in and therefore equities are seen as attractive over the longer term.

At present, Jeroen's favoured themes and areas for investment include financials. The fund has moved from an underweight to overweight position over the last few months. The emphasis is on companies that have a strong balance sheet and the ability to increase their market share in the aftermath of the current crisis. Holdings include Bank of America, TD Ameritrade and the National Bank of Greece. The portfolio is also 4%-5% overweight in healthcare, with exposure to Celgene, Intercell and Shire Pharmaceuticals. In geographic terms, Jeroen favours both China and Japan. In China, opportunities are now being seen following the two-thirds fall in the Chinese stock market from its peak last year. The manager has invested in non-cyclical companies such as Huabao, a producer of tobacco flavouring. Turning to Japan, the fund has 10% of its assets there. The manager believes the country faces a number of issues but likes individual holdings such as Nintendo, Japan Tobacco, Yakult and Mitsubishi Corp. Elsewhere, the trust has a significant underweight exposure to the UK

WARRANTS AND SUBSCRIPTION SHARES

At what might eventually prove to be an inflexion point for the markets, some investors will undoubtedly be looking for those securities likely to benefit most from a recovery. Warrants and subscription shares are tempting because of their gearing, and because it is possible to obtain a reasonable amount of exposure for a relatively small amount of capital. Be careful, though. Our sister newsletter, Warrants Alert Professional, warns "many warrants will never recover, we suspect, because their underlying shares have now fallen too far away from their fixed exercise prices to make recovery a realistic proposition. Other warrants are just too short-dated, and do not allow sufficient time for a good profit to be generated."

The newsletter ran a number of filters over its investment model this month in its quest to find some suitable warrants, and eventually created a short-list of five. In each case these are securities which have fallen heavily over the last six months, but where the technical positions indicate sufficient scope to allow for recovery. The five recommendations were **3i Infrastructure** warrants (3INW) at 9.5p (now 13.75p); **Elephant Capital** warrants (ECAW) at 11p (still 11p); **Ludgate Environmental** warrants (LEFW) at 6p (now 6.5p); **Perpetual Income & Growth** subscription shares (PLIS) at 28p (now 39p); and **RCM Technology Trust** subscription shares (RTTS) at 12p (still 12p). If you are interested in this sector, it is important to conduct some research and to ensure you have up-to-date information on the technical valuation, as this can change rapidly in these markets. If you feel the warrants newsletter might be useful, you can request a sample copy by email at enquiries@mchattie.co.uk.

compared with its peer group, but an overweight exposure to Europe compared with both the benchmark and peers due to the manager's view that business and consumer confidence remains relatively robust.

Despite a change in the investment approach in mid-2005, which allowed greater stock-specific risk, the fund's performance has been dull relative to the benchmark. Against its global growth peers, the fund's relative performance has trended downward over the past three years. The trust has bought back a large proportion of its capital, and in April 2006, as the result of arbitrage buying, the fund held a tender offer which saw 46% of the share capital repurchased. Since 1999 the trust's share capital has shrunk by 80%. At the same time, the board introduced a share buyback policy with the aim of maintaining an average discount of around 5% with debt at book value.

Since the tender, 10.6m (28% of the share capital) has been bought back, worth £64.2m. The average discount over the past year has been 6%.

WINS say “the appointment of Jeroen Huysinga, in our opinion, represents a clear attempt by the board to improve investment performance and therefore give the fund a clearer identity. The new manager performed well in rising markets with a similar mandate although he has struggled more recently in difficult market conditions.”

Cazenove has issued an update on **Invista Foundation Property** (IFD) after the trust reported a third quarter NAV of 81.3p, down by 13.7% (12.9p) from 30th June. This reflected an underlying fall of 6.9% on a like-for-like basis in the portfolio, or 8.0% if the value of the joint ventures is included. This was worse than the 6.2% fall reported by the IPD Monthly Index. The trust also had plenty to say about its debt position. The remaining investment in the joint ventures that had not already been written off - Crendon Industrial Partnership and Merchant Property Unit Trust - were written down to zero. This cost £5.34m from 30th June. Both of these joint ventures are in negotiations to remove or waive their covenants, with reasonable progress being made. Ongoing discussions also continue with regard to the loan-to-value covenant breach at Plantation Place (where the fund has a 28.19% interest that has been written off). The fund announced further disposals totalling £22m (unconditionally exchanged or completed) in the third quarter, which followed £47.3m of disposals announced in July. Further disposals are being considered to increase cash where asset management plans have been completed or there is concern over future performance. On 15th October, the fund repaid £50m of debt, bringing on-balance sheet debt down to £213.5m. Following this repayment of debt and the disposals completed, the loan-to-value ratio in the security pool is 46% relative to the covenant of 60%. However, net of current cash (£51.7m), the loan-to-value ratio would fall to 37.5%.

Cazenove say that since the strategic review completed in July, £8.8m worth of shares have been repurchased for cancellation at an average cost of 43.4p. The fund set aside £20m to repurchase shares at the time of the review, implying that some £11.2m of

firepower is potentially available for repurchases. The fund has not repurchased shares since late September, having been in a close period. The underlying decline in the portfolio was slightly worse than peers, and the NAV was further affected by the write-off of the remaining joint venture investments. However, wiping the slate clean with the joint venture investments is, the broker believes, a sensible thing to do. More positive were the announced disposals, which help to further reduce risk in the fund and show, in Cazenove’s opinion, the proactive nature of the management in facing the challenges of current markets face-on rather than as a necessity to stay within loan-to-value covenants, the motive for other peers that have been selling property. Cazenove estimate that the net loan-to-value is around 40%, meaning that on a net basis the portfolio can fall by around 33% (from the end of September) before it hits the 60% covenant. Cazenove could see some ‘wiggle room’ in the valuation, which they said was “compelling” with the shares at 31.75p. They have since risen to 43p. Cazenove also gave its view on two other trusts, rating **Standard Life Property** as an underperform on valuation grounds, and noting the discount on **UK Commercial Property** has widened out over the last month as the share price has fallen 30%. Cazenove say the shares no longer look overvalued and they upgrade their recommendation from underperform to In-line.

On 3rd November, UBS commented on **Graphite Enterprise** (GPE) after the trust sold its interest in ten funds managed by AlInvest Partners NV. The sale is expected to generate proceeds of around £47.1m and release the company from undrawn commitments of about £45.2m. At 30th June, the net value of the Interests was £56m and since then a further £4.2m (net of distributions) has been drawn down, bringing the adjusted value of the Interests to £60.2m. The sale proceeds of £47.1m represent a discount of 21.8% to this adjusted value. At 30th June, Graphite Enterprise’s NAV per share was 520.5p and if this were adjusted to take account of the sale it would fall by 18.1p or 3.5% to 502.4p. As at 30th June the trust had net assets of £386.6m of which £280m was in the investment portfolio and £106.6m was in cash. Undrawn commitments less cash were £239.7m or 62% of net assets. Graphite now has cash balances of £75m and undrawn commitments less cash of £237m. The sale increases the pro forma cash balance to £121.6m and reduces undrawn commitments less cash to £144.7m or 37.4% of the adjusted June NAV. UBS view this transaction by Graphite as a positive and say “we would expect it to help the shares re-rate from their current excessive discount of 65% to the adjusted NAV of 502.4p at 30th June. The commitments less cash are down to £144.7m or 37.4% of the adjusted June NAV, which is now one of the lowest in the private equity sector. We do expect other funds to deal with over-commitment problems in the months ahead and this may be a catalyst for a positive re-rating.”

With markets changing rapidly, we are wary of reproducing research from a few weeks ago, but the 62-page Investment Companies Review from Collins Stewart, published on October 7th, deserves a mention. Analyst Alan Brierley has been consistently bearish and consistently right for some time, and in this review, little seems to have changed. The review opined “we believe it is too soon to call the bottom and recommend investors maintain a highly risk averse strategy, with any rallies an opportunity to further reduce exposure.” The report continued “despite the potential for a short-term rally, we believe

the de-leveraging process has much further to run, and with credit markets frozen over, housing markets in freefall, and consumer spending to slow dramatically, we continue to recommend a highly risk averse strategy with a focus on capital preservation rather than the generation of absolute returns. Our core recommendations remain **BH Macro, Candover, Dexion Absolute, Finsbury Worldwide, Perpetual Income & Growth** and **RIT Capital**. Given its defensive value qualities, we have also introduced **Alliance Trust.**”

NEWS ROUND-UP

Advance Developing Markets has issued its new subscription shares (ADDS), free as a bonus to shareholders on a 1-for-5 basis, and these have started trading, currently at 29p. The idea is that this issue creates value for shareholders, and allows new investors to take a geared investment if they wish. **JPMorgan Indian** also has new subscription shares (JIS) in issue. The problem in both cases is that the liquidity in the subscription shares (warrants by another name) is extremely poor, which makes it near-impossible for investors to deal in any reasonable size. This is a pity, as it negates many of the benefits which these extra securities are intended to bring.

The latest news from **Close Enhanced Commodities** (CED) does not make for comfortable reading. Straight after last month's newsletter was published, the promises made by the Icelandic government over the debts of its banks became impossible to sustain. Glitnir Bank has subsequently been put into receivership, and Close Enhanced Commodities has addressed this question in its half-yearly financial report, issued on 22nd October. The trust says that one of its six debt securities was issued by Glitnir, and that this accounts for approximately 19% of the total nominal value of the company's debt securities. The manager and the board of the company consider it likely that Glitnir may not pay in full on its obligations. They add “whilst recovery rates from issuers that default vary, and in this case are currently unknown, the worst case scenario would see the company receive nothing at the maturity of the relevant debt security.” This means that it might be necessary to slice almost 20% off the final capital entitlement for shareholders, which is a harsh blow. Based on the commodity values ruling on 30th October, the projected final capital value at that time was 177p. Deducting 20%, to give us the worst-case projection, brings this down to 142p. Against this, Close Enhanced shares at 116.5p are trading on an

18% discount, which does not seem unreasonable now. This has been a sorry episode for the trust, and a hard-to-swallow lesson in counterparty risk for its shareholders. For the moment it seems reasonable to value the Glitnir debt securities at zero, in which case we think the current share price is only FAIR VALUE. We are not aware of any similar issues, by the way, at the sister trust **Close Enhanced Commodities 2**.

Eaglet Investment Trust is to change its name to **The Directors' Dealing Investment Trust**, reflecting its new investment policy under Knox D'Arcy Investment Management. The changes at the trust have been a long time in coming, although they have not perhaps been badly timed. Some of Eaglet's holdings have been sold, the portfolio has been de-gearred, and cash balances have been held. This allowed the portfolio to outperform in the six months to 30th June, and more recently as well – its limited losses have propelled Eaglet to rank fourth out of 24 smaller company trusts over the last three months, in terms of net asset value performance. Now the trust is proposing a change in the trust's investment policy so that it will invest in UK listed shares which are identified as having patterns of directors' dealing which suggest that following such signals will lead to superior investment performance. It is also (finally) proposing a tender offer under which shareholders on the register on 3rd March 2008 will be able to sell up to 49% of their shares to the trust for cancellation at a price close to net asset value. As the shares are currently trading on a discount of 26.9%, it makes complete sense for eligible shareholders to TAKE UP the tender offer and sell as many shares as possible at a price close to NAV. It is good that Eaglet is also proposing to sell a proportion of the remaining portfolio to Laxey Partners at a price close to NAV, as smaller company holdings can be awkward to dispose of. Once these proposals are passed, we'll see how Knox D'Arcy gets along with the new investment remit. We need to be convinced of its merits, and in the meantime we would probably not be tempted even by the apparently large discount to net asset value. There will be some more costs to be borne by the reorganisation, we should imagine, and it might take some time for the new managers to prove their value to the market.

The **Invesco Leveraged High Yield Fund** (ILH) has run into trouble. The trust announced on 17th October that the fixed income market had deteriorated sharply as equity markets have collapsed and interbank lending has virtually ceased. The trust explained there has been a significant amount of forced selling and unwinding of highly leveraged vehicles, but very few buyers. The managers said the market was not “functioning normally.” The trust saw a significant fall in the value of its investments, and its leverage rose. In the light of the above market conditions, the board resolved to raise additional equity capital by means of a placing. The board intends to use the proceeds of the placing to rebalance and position the trust in order to take advantage of market opportunities in the short to medium term. The board also resolved to postpone payment of the final interim dividend until the capital raising is successfully completed, which is expected to be by the end of November. Initially the board said this would be at 2.5p per share, but in a subsequent

announcement the board said that if it can raise a minimum of £20m through the placing, it will pay a final dividend of 5p per share. The board currently expects that the company will thereafter maintain an annual dividend of not less than 5p per share, again in the absence of unforeseen circumstances and subject to market conditions. With the shares now at 31.5p, the proposed dividend is offering a very high prospective yield of 15.9%, but the share price includes a fair amount of scepticism. The shares were over 100p a year ago, so holders have some basis for their fear.

JPMorgan American (JAM) has actually seen its shares edge up over the month, to 636p. The trust is on a tight discount to net assets of just 0.5% as investors have suddenly sought out dollar assets. The trust's manager, Garrett Fish, has also been promoting the merits of the trust, which invests in US large capitalisation stocks. Garrett said "history has shown that during times of severe stress in the markets there are decent buying opportunities. We are currently seeing multi decade lows in terms of sentiment and multi-decade highs in terms of volatility. If you are interested in buying high quality merchandise [shares], many are now on sale. Looking out over the next few years this should prove to be another example of buy on fear, sell on greed." His view is that a lot of the bad news is already priced in. The manager expects to see further weakness for the global economy but pointed out that inflationary pressure is normally reduced in low growth or recession environments.

A detailed update from the managers of **JPMorgan Chinese (JMC)**, which has lost 37.8% of its assets over the last six months, has been very welcome. The managers argue there is little case for a downturn triggered by the post-Olympics effect in China. They say that with inflation moderating, China has some scope for monetary loosening if it wishes to support its economy during this period of global stress. The managers add that according to most market observers and major participants, China's banking system should not come under significant strain unless prices for nationwide property fall by 20%-30%. JPMorgan reports that whilst there have been sharp property price corrections in cities like Shenzhen and Guangzhou, for the country as a whole Chinese property prices have edged up modestly compared to those of the same period last year. Retail sales remain robust in China. In terms of strategy, the trust remains constructive towards the China urbanization theme and favours consumer-related sectors. It also maintains its preference of industry leaders/consolidators and the major players with strong pricing power in respective markets and/or industries.

The managers say that among the positives for the Chinese market, (i) the earnings per share estimate for MSCI China in 2008 has fallen from 26% to 19%. Their sense is that the market has already discounted most of the earnings downgrades for the second half; (ii) even after the recent downgrades, China in terms of EPS forecasts still ranks among the highest in Asia; (iii) the MSCI China index is trading at a

forward P/E of around 10x, which is close to the trough level over the past 15 years; and (iv) macro indicators in China remain solid, despite slowing. JPMorgan say "valuations are attractive relative to underlying growth in our view. In truth, out of all the major markets in Asia, we believe that China offers investors the best risk/reward trade-off. Any rally in Asian markets will likely be led by China, especially since it is the country in which inflation was the first to peak, and is the country with one of the strongest fiscal positions." The managers conclude "volatility could be a dominant theme for Chinese equities in the short-to-medium term. But we expect Chinese equities to be significantly higher than their current level one year from now. Over the longer term, we continue to believe that China, along with the rest of Asia, will increasingly become a core asset class for international equity investors, with benchmark representation in all major indices continuing to increase structurally with the passage of time." They may well be right.

Kenmore European Industrial Fund (KEIF) has been a very poor investment. A year ago the shares were trading around the 90p-mark, but since March they have fallen steadily, and hit a low of 24p in early October. The shares are now 29p, having bounced a little on news that the company is taking steps to improve its financial position. On 16th October the trust said it had sold an industrial site in Germany for EU2.3m, and it also arranged a long-term letting on another one of its assets. Rob Brook, the MD of Kenmore Financial Services, said "this disposal and letting are in line with our ongoing strategy to de-gear the company, whilst simultaneously rolling out a steady operation of active asset management initiatives on those properties that have yet to reach their full investment potential." Generally, it seems to us that the market prefers trusts with debt issues to deal with them pro-actively, and Kenmore has been regaining some status for doing just that.

Marwyn Value Investors (MVI) has announced it is moving to the 'Specialist Fund Market' of the London Stock Exchange. You could be forgiven for not knowing about the SFM. Since opening for business a year ago it has attracted a grand total of one fund (the Da Vinci CIS Private Sector Growth Fund). Now Marwyn plans to double the number. The company says this will raise its profile and provide access to a broader base of potential investors, but in view of the rather low profile of the SFM so far, we are not certain this will be the case.

There was a disappointing announcement for shareholders in **Mithras Investment Trust (MTH)** on 29th October. At the company's AGM back in May, shareholders passed a resolution directing the board to put forward proposals for the orderly winding up of the company or alternative ways of crystallising value. Since then the board

says it has considered a wide range of proposals from external parties against the backdrop of unprecedented market conditions, which in turn resulted in “a more challenging and prolonged review process than expected.” Ultimately in the opinion of the board none of these proposals provided acceptable value for shareholders. Now, the board is recommending that the trust soldiers on, but without any new commitments to private equity funds. The plan is to focus all investment activity on meeting existing commitments, and to return any surplus cash when possible. Mithras says its existing cash resources of £12.7m, together with the availability of a medium term bank credit facility of up to £35m, provide more than adequate liquidity to finance undrawn commitments. At least that is not too bad, but this is not a great outcome. Mithras shares are trading at 90.5p against a net asset value of 136p, and shareholders must have been looking forward to existing at closer to NAV. That looks a distant prospect now.

Pantheon International Participations (PIN) is not really known for its volatility. One of its selling points is that its fund-of-funds approach means that its investments are ultimately very widely spread. As the trust itself says “the diversification of PIP’s portfolio across buyout, venture and special situations sectors, and across all major geographical regions of the private equity industry, should help mitigate any difficulties experienced by specific companies or sectors in the current economic conditions.” This has not prevented its shares, however, from falling very sharply from 820p in mid-September to just 368p now. We have been a little shocked by this precipitous decline, particularly as Pantheon has around 60% of its assets in US dollar assets, and will therefore have benefited from recent currency movements. We do know

from the trust’s recent results that it has suspended its future commitment programme because it expects calls to exceed distributions over the coming quarters, but the trust said it has adequate financing, and we are not aware of any debt problems. Certainly some of Pantheon’s investments are likely to see valuations falls, but after the results we noted that UBS left its NAV estimate for December 2008 unchanged at 1095p-1100p. This implies a huge discount at the current share price, so the market is pricing in some future debt refinancing risk. Pantheon is towards the higher end of the scale with its commitments against its asset value, but it is by no means unusual, and to us the size of the discount now does seem to incorporate a great deal of fear about the future. There may be some problems ahead, definitely, but even so, the net asset value per share was 1108.7p at the end of June, and we cannot see sufficient reason to be marking those assets down to just a third of that level. At 368p we rate the shares a BUY, although you should be aware that this would certainly be a contrarian move at the moment.

We are sad to record the death of Ian Rushbrook, the manager of **Personal Assets Trust** (PNL). Ian was rightly bearish well before the credit crisis, and protected the assets of the trust very well throughout this dreadful period for equity markets. The trust is continuing for the moment, with support from F&C Asset Management, but we will have to see what happens to it. Ian was a large shareholder in the company, with a family holding of 7.5% of the shares, and it is quite possible now that the estate may wish to sell out. Some kind of reconstruction seems likely, although this may not happen for some time.

Princess Private Equity Holding Limited (PEY) has announced the publication of its interim report for the nine months ended 30th September 2008. As this time the NAV stood at EU9.52 per share, translating into a total return to shareholders (NAV plus dividend) of 2.1% during the first nine months of the year, demonstrating the portfolio’s stability even against the backdrop of the challenging current market environment. The board has thought carefully about the tough environment for private equity and has said in consideration of the uncertain financial market environment, and the prudent forecasts for future cashflows from the portfolio by the investment adviser, it will suspend the dividend payment for the second half of 2008. This decision has been made independently of the stable NAV development and is to be considered as a measure to manage short-term working capital requirements. Princess says it is keeping its long-term dividend policy which targets an annual dividend yield of 5%-8%pa on the NAV – just not now. This is a disappointment for shareholders, particularly as the dividend was seen as a prop for the shares. Now that this has been kicked aside, the shares have fallen heavily over the month from EU5.50 to EU3.745. This price represents a large discount of 60.7% to the last-reported NAV, but the market appears to be discounting some more funding problems. Princess does have a relatively high level of over-commitments, and the market is worried it might not find enough cash when it needs it. The shares might be a bargain at this level, but we admit it would take some bravery to buy now, when the shares look completely unloved.

The next issue of Investment Trust Newsletter is published on Saturday 6th December.

RALLY FAILS TO RECLAIM ALL OF EARLIER LOSSES

The FTSE 350 Equity Investment Instruments Index is down 118 points (-2.70%) to 4251.3 since the last newsletter.