

Investment Trust Newsletter

PUBLISHED MONTHLY SINCE 1996 • JULY 2023 ISSUE •

June was a thoroughly dispiriting month for the markets and for investment trusts. Already beset by rising interest rates and sticky inflation, the sector was further depressed by news of trusts throwing in the towel that further undermined prices. Discounts have widened out now to an average of 18.7%, and the majority of trust prices fell over the month. The flip side of so much negativity is that bargains arise amongst the collateral damage, and we do think there are many good quality trusts available on attractive discounts for patient investors to snap up. That has been true for a while, and that patience is being tested as prices and valuations continue to fall, but we think this is a time to hold your nerve and keep buying at these lower levels. We believe that composure will be rewarded in time.

Major Price Changes Over One Month

Hansa Investment Company	+18.37%
Globalworth Real Estate Investments	+16.53%
Hansa Investment Company 'A'	+15.94%
VietNam Holding	+7.35%
Geiger Counter	+7.19%
Seraphim Space Investment Trust	-24.07%
Ecofin US Renewables Infrastructure	-23.92%
Schiehallion Fund	-19.81%
Balanced Commercial Property Trust	-18.74%
Warehouse REIT	-18.73%
SDCL Energy Efficiency Income	-16.42%
JPMorgan Emerging EMEA Securities	-14.39%
Taylor Maritime Investment	-12.89%
BH Macro GBP	-12.14%
BH Macro USD	-11.43%

Major Price Changes Over One Year

Amedeo Air Four Plus	+82.11%
3i Group	+70.00%
Macau Property Opportunities	+59.03%
JPMorgan Emerging EMEA Securities	+49.84%
Doric Nimrod Air Two	+46.76%
Rockwood Strategic	+46.72%
India Capital Growth Fund	+36.82%
Nippon Active Value Fund	+33.24%
Doric Nimrod Air Three	+31.06%
abrdn Japan Investment Trust	+23.86%
Home REIT	-64.99%
Schiehallion Fund	-55.25%
Seraphim Space Investment Trust	-49.38%
Chrysalis Investments	-46.73%
Schroders Capital Global Innovation	-45.72%

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

Starting with the fallers over the month, these included **Seraphim Space Investment Trust** (SSIT, 28.65p) and **The Schiehallion Fund** (MNTN, US\$0.605) in the absence of any appetite for portfolios of unlisted investments. SSIT had a NAV per share of 91.77p at the latest (31st March) calculation, has sufficient cash to fund its portfolio requirements, and looks like one of the unfortunate walking wounded from the crash in venture and growth investing. We don't see any reason why it cannot recover from this 68.8% discount, but it will need to prove it has winners in hard cash with profitable exits as the portfolio matures. It is too early for that yet, but we would not be sellers at this price.

Ecofin US Renewables Infrastructure (RNEW, US\$0.5625) has a concentrated portfolio and has suffered a disaster with its largest asset, which represented 38% of NAV at the end of March. This wind farm in Texas, ironically called Whirlwind

Warning: the value of all shares and the income from them can fall as well as rise. You should not buy securities with money you cannot afford to lose, or rely on dividend income for non-discretionary living expenses. Investment trusts may use or propose to use the borrowing of money to increase holdings of investments or invest in other securities with a similar strategy and as a result movements in the price of the securities may be more volatile than the movements in the price of underlying investments. Your investment may be subject to sudden and large falls in value and you may get back nothing at all. Investment trust share prices can also fall in response to changes in discount or premium ratings that are separate from changes in the asset value. You run an extra risk of losing money when you buy shares in certain smaller investment trusts which have the characteristics of 'penny shares.' There is a big difference between the buying price and the selling price of these shares. If you have to sell them immediately, you may get back much less than you paid for them. The price may change quickly, it may go down as well as up, and you may not get back the full amount invested. For many investment trusts, especially those denominated in another currency, changes in rates of exchange may have an adverse effect on the value or price of your investments in sterling terms. As with other investments, transactions in investment trust securities may also have tax consequences and on these you should consult your tax adviser. We have taken all reasonable care to ensure that all statements of fact and opinion contained in this publication are fair and accurate in all material respects. Figures for net asset values and historical track records supplied by Morningstar, JPMorgan Cazenove, or by the trusts themselves. Investors should seek appropriate professional advice if any points are unclear. This newsletter is intended to give general advice only, and the investments mentioned are not necessarily suitable for any individual. It is possible that the officers of the McHattie Group may have a beneficial holding in any of the securities mentioned in this newsletter. Andrew McHattie, the editor of this newsletter, is responsible for the preparation of the research recommendations contained within. Data and privacy policy: as you have subscribed to this newsletter, we will retain your data for the purpose of sending you the product for which you have paid, and we will retain those details indefinitely in order to offer you renewals, offers from our business, and any other products we think may be of interest to you. We take all reasonable precautions to ensure the security of personal data stored on our system, which is only accessible to staff of The McHattie Group. You should contact us if you wish your details to be removed from our database. Published by The McHattie Group, St Brandon's House, 29 Great George Street, Bristol, BS1 5QT. Tel: 0117 407 0225. E-Mail: enquiries@mchattie.co.uk. Web Site: <http://www.tipsheets.co.uk>. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form by any means, electronic, mechanical, photographic, or otherwise without the prior permission of the copyright holder. ©2023. The McHattie Group is a media firm and offers restricted advice on certain types of investment only. Authorised and regulated by the Financial Conduct Authority.

Energy, was hit by a severe tornado on 21st June that damaged five transmission poles and a local substation. Operations have ceased and cannot resume until the substation is rebuilt. The trust is making insurance claims, but whether or not it is able to recoup its losses, RNEW expects the outage to have “a material short term impact on cash flows.” RNEW shares sunk on the news to a new low of US\$0.5625, marking a new chapter in what was already looking like a very poor investment.

Hansa Investment Company (HAN, 196.5p; HANA 185.5p) was one of the few risers last month. The trust’s shares jumped on 12th June because of an announcement by Ocean Wilsons Holdings, which represents 21.5% of the trust’s assets and has long been its largest holding. In response to Brazilian media speculation that the company may be negotiating the sale of its 57% owned subsidiary Wilson Sons, which operates ports and runs maritime services, the company said it was reviewing its options. There is no further information, but a sale could be transformative for Hansa, where the Ocean Wilsons stake has long been an oddity and over recent years, a brake on returns. We don’t see any reason to get too excited at this stage, but this could eventually be good news for the trust.

JPMORGAN GLOBAL GROWTH & INCOME (JGGI, 463.5p)

During this difficult period for the sector, amidst much in the way of disappointing NAV performance, widening discounts, consolidation, and disillusion, there are still plenty of trusts that have continued to deliver good results for investors, and we think JGGI has been a winner in more than one respect. We met James Cook, one of the trust’s three principal managers, for a first-hand update.

Just as investors flock towards the relatively safe haven of larger companies in market downturns, so they also turn towards larger trusts and more established fund management names, and JGGI fits the bill on both counts. This £1.8bn trust has not always been so prominent, but the board has grasped the nettle and picked up extra assets from other trusts during this period of consolidation. In the summer of last year it merged with Scottish Investment Trust, and then added the assets of JPMorgan Elect over the winter. This speaks to the attractions of the trust, and of course the resulting expansion helps to lower the ongoing costs for all shareholders.

The trust combinations are one reason for the expansion of the asset base here; the other is simply the performance, which has been strong in both absolute and relative terms. By NAV performance, the trust is ranked 25th out of 252 conventional investment trusts across all sectors over five years; 31st out of 268 over three years; and 22nd out of 284 over the last year. Over three years the net assets per share are up by 58.5%. That’s an impressive record, created by investing in an unconstrained, style agnostic, concentrated global best ideas portfolio. James explains that he and his co-managers Helge Skibeli and Tim

Woodhouse are “looking for the best 50 ideas” across a very large universe of around 2500 companies globally. To perform such a huge task they have a system to tap into the insights of over 90 JPMorgan research analysts around the world, and the ‘unconstrained’ part of the brief includes the income element. This bears explaining.

Although the trust’s name is ‘Growth & Income’ and it sits in the global equity income sector, we think that is plainly misleading. This is for all intents and purposes a global growth trust that happens to pay out a predetermined slice of its assets each year in the form of a dividend equal to 4% of assets. This is a significant caveat for us, that some investors may think they are buying into a far more conservative vehicle here than in reality, and they might think the natural yield from the portfolio is 4% when it is closer to 2.5%. This is a growth trust and we think it belongs in the global growth sector, where it would still stand up very well indeed against the peer group. We like both the portfolio and the results, but we feel the dividend – which the managers describe as ‘enhanced’ and we describe as ‘synthetic’ – provides a false picture of what’s under the bonnet.

With that said, the managers seem to do an excellent job of sifting through the mass of JPMorgan resources to find companies with higher quality earnings, faster earnings growth, and a good valuation. They have a good consistent record of excess returns from companies like Microsoft, Amazon, UnitedHealth, Taiwan Semiconductor, Meta Platforms, Coca-Cola, Mastercard, and Nvidia. You may note the strong exposure to the recently in-vogue AI theme, and there is heavy representation here for technology, media, and pharmaceuticals and medtech – very much an outcome from the bottom-up stockpicking rather than a deliberate sector bias. We asked about some of the heady valuations in the US technology sector and about Nvidia in particular. This was not a holding initially in this financial year, as the managers felt the valuation was too aggressive, but further research made it clear that the company had market-leading GPUs that would play an important part in what was becoming a pivotal moment in the development of AI, so it made its way into the portfolio on the basis of exceptionally strong prospects. Geographically, the spread is 65% US, 12% Europe, 7% emerging markets, and 3% each in Japan and the UK, with a smattering elsewhere and some net cash (no gearing at present). James says that free cash flow yields are better in the US than in Europe, adding that US earnings have been through the downgrade

cycle, and that there are more premium companies to be found there at a time when fragile macro makes conviction important.

The names in the top ten do vary quite a bit over time as the turnover is relatively high in the portfolio at around 80%, although a lot of that dealing activity takes the form of adding or trimming positions as valuations shift. James said the average duration of a holding in the portfolio is more like three years, and holdings will change according to different market conditions. The managers are not tied to growth or value, and their data shows they have outperformed and added value in all sorts of style environments. This stems from the competitive advantage, James believes, of the extremely broad coverage from the underlying team of career analysts. James says he can draw on “an unrivalled breadth of research.”

In addition to the corporate activity and the performance, there is actually a third reason why the trust has grown – and that is the regular tap issuance it has undertaken while the shares have traded at a premium. The trust issued 10m shares in 2022 and has already issued another 15m in the year to date because of the strong share price rating. The trust will also buy back shares over a 5% discount, which it did briefly in 2022 around the time of the merger with Scottish Investment Trust. Generally we expect the rating to remain strong as long as it is backed by good performance. The shares currently stand at a 0.7% premium.

JGGI has had a great run of performance, and it is possible that might moderate in a different environment. The managers have shown their ability to adapt and to continue finding good prospects though, and there is a good mix of big, premium quality names in the portfolio. This is a growth trust with an artificial dividend payment, but that can nevertheless provide a good blend for investors who understand this structure and what they are buying. Our view is that the managers are well resourced to continue performing and that JGGI is deserving of its high standing.

In the same sector, Securities Trust of Scotland has changed its name to **STS Global Income & Growth Trust** (STS, 212p) to better reflect its investment policy. One of a small number of trusts in the global equity income sector, this £220m trust managed by Troy Asset Management does not stand out, and we would struggle to think of any reason for buying it.

HARBOURVEST GLOBAL PRIVATE EQUITY (HVPE, 2062.5p)

HVPE has been one of our preferred trusts in the private equity sector for quite some time, and it was one of our ISA picks back in 2018 at 1222p. The trust has been a consistently strong performer but has been unable to shake off the general malaise and scepticism surrounding the private equity sector that has led to wide discounts seemingly unrelated to the quality or history of the trusts involved. HVPE shares trade on a discount of 46.3%, which could easily suggest something is wrong here besides negative market sentiment. To support our recommendation of HVPE we signed up to the trust’s Capital Markets Day where a number of speakers provided a huge amount of detail.

Ed Warner is the chairman of the trust and immediately spoke of his frustration with the share price and discount so much at odds with the

“incredibly resilient performance” of the assets. As a reminder, the net asset value was down by 1.2% in the financial year to the end of January, and the latest estimate we have is that it has fallen by 2.3% over the last six months. That’s not really consistent with such a wide discount, but Ed says there is no easy solution to dealing with the discount. “No-one’s come up with a silver bullet” he said, adding “no-one’s even come up with a bronze bullet.” He believes the trust’s valuations are good, and cited the 31% uplift in valuation on realisations as proof that should provide reassurance. The portfolio – this is a fund of funds - is also extremely diversified without any individual investments dominating. As managing director Richard Hickman explained, the trust invests into Harbourvest Partners funds, both primary and secondary, and ultimately has exposure to more than 1000 portfolio companies. Richard said that HVPE is the “most diversified in the sector” with some direct co-investment holdings too.

“This has to be a patient capital game”, Ed says, and that seems spot on to us, both from a trust perspective and an investor perspective. The trust is buying back shares, the directors have bought shares, and the marketing has been sharpened to refer to the trust by the shorter name ‘HVPE’. The longer-term context is worth remembering too, that HVPE has returned 14.6% compound growth in NAV per share in US\$ terms over the ten years to 31st January 2023, and that the trust had very good 2021 and 2022 financial years. The trust has underperformed the FTSE All-World Index in only one of the last five years. The managers have 40 years of experience and are big players in this market. HVPE itself is a sizeable trust with £3bn of net assets and US\$800m of credit available (although as its main bank is Credit Suisse, it will have to refinance most of that within the next five years). Focusing on the shorter-term, Richard said the market had feared the trust’s Q4 results would be bad, but they actually weren’t at all, and the trust was able to recycle capital into new investments at some lower prices.

As we have explained in previous newsletters, the private equity sector is not homogenous, and one concern is that HVPE has exposure to the sharp end of the market, namely venture and growth capital. The proportion of assets in these areas has fallen from 40% to 34% (the slack has been taken up by buyouts, up from 51% to 57%), and actually the positive performance from buyouts, mezzanine finance and infrastructure all helped to mitigate the losses in venture and growth, hence the overall neutral result. Richard ran through the good operational performance of companies in the underlying portfolios, and mentioned the broad range of vintages that should allow for a consistent return from exits. He showcased a chart that plotted HVPE's month-end discount against the subsequent three-year total return from the shares, which showed a decent 67% correlation. The key conclusion here from Richard was that "at least historically we have seen a discount of this level followed by a return of more than 80% over the following three years." Most of the other wide discounts were from the great financial crisis and the initial Covid period, and Richard concluded "if history is anything to go by, this could be a good opportunity."

We'll resist the temptation to dive into too much of the remaining detail, but just a couple of other points stood out. One, from Billy McAulay, director of finance, was that the top five M&A transactions in the portfolio in this financial year experienced a 109% uplift over carrying value, and the broader number was 31%. That is comforting for the prevailing level of valuations. The presentation also included interviews with two of the specialist underlying partner fund managers, who both spoke of the sharp valuation declines in their sectors that were not matched by any meaningful decline in the operational performance of the portfolios.

This series of presentations was obviously intended to provide reassurance to investors worried about the widespread negativity about private equity in general, and about HVPE more specifically, as expressed through that wide discount. We do believe the risks are fully discounted here and that the rating has probably overshot on the downside, providing the sort of opportunity that Richard Hickman pointed out from the historic data. The shares are a BUY in our view along with other trusts in the sector such as ICG Enterprise (ICGT, 1062p), HgCapital Trust (HGT, 371p), Literacy Capital (BOOK, 485p), and Pantheon International (PIN, 249.25p). We noted in a separate interview that Pantheon manager Helen Steers says she is "somewhat baffled" by the trust's wide discount to NAV, which she sees as unwarranted against a resilient performance – very much an echo of what we heard from HVPE.

RTW BIOTECH OPPORTUNITIES (RTW, US\$1.225)

If you didn't recognise the name, this is the freshly rechristened RTW Venture Fund, which felt the growing maturity of its portfolio merited a change. Although we definitely classify RTW as an early-stage US biotech investor, the majority of its investments are publicly listed now, and the trust's management has been trying to raise its profile as a leading investor deserving of a higher rating. The trust's shares are on a discount to net asset value of 28.8% and this

looks anomalous to us in view of the recent portfolio successes.

Rod Wong, the managing director of the managers, spoke in a webinar in early June to explain the case, which we find compelling. His firm, first of all, was founded in 2009 and has grown to a team of 75 people across three continents with US\$6bn of assets under management. They adopt a detailed scientific approach to their research and aim to invest over the lifecycle of companies, not just at an early stage. This is relevant in terms of the re-branding of the trust, which is not a typical private equity style investor seeking to get in and out within a five-year timeframe. RTW is more focused on building long-term value, investing early but without any imperative to exit once companies go public or reach a certain point in their development. Rod says "over 80% to 90% of the value of what ultimately becomes a blockbuster product is actually created after a company IPOs." He sees the managers as true business builders and believes they are more attractive partners as a result, much as we reported for **Literacy Capital** (BOOK, 485p) last month.

In terms of the opportunities for the trust, Rod explains that biotech has been critical to the significant gains in health in society over the last 20 years. Biotech companies are responsible for more than 50% of the roughly 40 to 50 new drugs that are approved by regulatory agencies each year, and they have been the ones to really add new modalities, things like antibodies and protein based drugs to the armamentarium that we have to fight disease. He continues "on top of this legacy for biotech, in the past five to 10 years, the industry has really entered a new phase, a new productivity boom. And I think that we're only in the early to maybe mid innings of the biggest innovation boom that our sector has ever seen." Access to cheap information has increased the odds of discovering new medicines, as have the newer antibodies and proteins now being used in development.

Yet against this backdrop the Russell 2000 Biotech Index is just starting to recover from its second largest drop ever, meaning that prices are not exactly stretched after the growth sell-off. Rod says "valuations are very, very attractive after the correction, only modestly above financial crisis lows." He says there are a record number of companies

trading below cash, and he sees a positive tailwind from continuing M&A as the large cap pharmaceuticals need to replace revenues from older drugs now reaching patent expiry. The trust recently benefited from an offer at a big premium for its largest holding, Prometheus Biosciences, and Rod says the company actually received three bids and had discussions with six potential buyers, so there are plenty of buyers around. So far this year, the trust has had three company holdings going public, adding 30% to their prior holding values, validating their private valuations. It's been a busy year for the portfolio, with two takeouts, two successful IPOs, one SPAC merger, participation in a handful of bespoke strategic financing packages, plus three new private investments. The trust is also expecting an FDA update for Rocket Pharmaceuticals, has moved to monthly factsheets, and will be holding its first Capital Markets Day in November, so there are plenty of potential triggers ahead to attract more investors.

RTW is still a relatively young trust without a long track record, having floated in 2019, and it has already experienced its ups and downs in that time. It takes a brave investor now to buy into a growth area paying no dividends, but we do think RTW merits a place in balanced portfolios as a riskier bet with exceptional potential. The trust's NAV is up 37.6% over the last year and we think the shares merit a higher rating.

It might make sense to balance a holding in RTW by pairing it with Worldwide Healthcare Trust (WWH, 3097.5p), the mainstream choice at the other end of the healthcare spectrum. WWH invests across the sector and has big holdings in some of the sector's well-known names such as AstraZeneca, Bristol-Myers Squibb, Novo Nordisk, Roche, and Sanofi. Holders should note the shares are about to go through a 10-for-1 subdivision at the end of July that will make them easier to trade in small quantities.

AVI JAPAN OPPORTUNITY TRUST (AJOT, 119p)

Much more attention is being paid to Japan at present as investors have been attracted by some strong performance. The Nikkei 225 Index has posted a 25% gain over the last six months, hitting new multi-year highs, and the country is arguably a beneficiary of the worldwide increase in inflation. We have felt for some time that the best opportunities in Japan are likely to come from the two trusts that combine the macro elements with a focus on growing corporate activity, Nippon Active Value Fund (NAVF, 141p) and AJOT. We tuned into an update from AJOT manager Joe Bauernfreund for the latest news.

Launched in 2018, this £160m trust has a specialist objective, to invest in small-cap Japanese equities with overcapitalised balance sheets. It aims to engage with company

management and help to unlock value in this under-researched area of the market. It has been successful so far, though tempered in part by the weakness of the Japanese yen against the pound, which has eaten into the returns for UK investors. Joe says the trust really needs to see an end to the weaker yen, and he said it seems cheap on most measures now. He sees signs that the Bank of Japan's divergent monetary policy, still easing whilst others are tightening, may be coming to an end. Japan has of course been stuck in what Joe calls "a deflationary mire" for decades, but now there is some "good inflation", actually above the BoJ's 2% target level. Japan's inflation remains lower than other developed markets, but the gap has been shrinking.

Japan has started to see some inflow of international investment funds into equities, but Joe says foreign investors are still significantly underweight, as are domestic investors. There has been no big trend of buying equities yet, so there is scope for further demand to develop. Where things really have been moving though is in the realm of corporate governance. AJOT's figures show the number of activist events rising, along with buybacks. Anecdotally, Joe also says that more companies are open to ideas and discussions, although there remain lots of overcapitalised balance sheets that mean Japan is still the "standout value market."

AJOT's portfolio is very focused, with the top ten holdings accounting for around 70% of assets and a total of 15-20 core holdings. It makes sense for AJOT to have larger stakes in its holdings so that it has greater influence when it engages with management. The managers have a team of eight professionals who tend to begin quietly, with verbal engagement and private letters and presentations that try to be constructive, addressing operational improvements as well as financial aspects. Public campaigns are something of a last resort.

Joe ran through three of the trust's largest holdings to explain the significant potential upside in each case. In the case of TSI Holdings, the largest holding at just over 10% of assets, the company has excess cash, investment securities and property worth more than the market capitalisation, with its underlying apparel business thrown in for free. Management is now aiming at quadrupling its meagre margins and AVI, which also owns some TSI shares in its global investment trust **AVI Global** (AGT, 187.4p) is engaging to find ways to rectify the undervaluation, estimated at 63%. Nihon Kohden is a medical equipment manufacturer that AVI believes is poorly managed with 74% potential upside if management can implement its recommendations to reduce costs and improve margins. The third case was NC Holdings, where AVI

has a large stake and has gone public by submitting resolutions to the AGM to appoint two new outside directors, to be held just as we go to press.

We like AGOT's approach and feel it has exhibited a decent track record of success to date. Of course it does not always work, but Joe said he has learned quite a lot as the team has gathered experience here, particularly about the importance of other shareholders, who may or may not be supportive of change. The managers seem positive, with gearing moving back up towards its maximum level of 10%, and whilst the shares on a 0.9% premium are no bargain, we can see the trust's rating tends to stay close to par. Overall, we think AJOT has a decent chance of extending its track record, particularly if the yen changes direction and stops acting as a brake on the sterling returns.

SHIRES INCOME (SHRS, 242p)

Shires Income has not frequently made it on to our radar screens as a small player in the UK equity income sector with a fairly lacklustre track record over recent times and a low media profile. The trust has been mentioned though as a possible partner for abrdn Smaller Companies Income (ASCI, 258p), which is seeking a merger, and we had the chance to meet manager Iain Pyle to ask him about this and about the outlook for UK stocks.

With net assets of just £77m, Shires Income is one the smallest trusts in a large peer group that contains some of the largest and most well-known trusts in the sector like **City of London (CTY, 397p)** and **Finsbury Growth & Income (FGT, 875p)**. Without a great performance record – which SHRS does not have at present – it is hard to see how it attracts much attention, but perhaps it has no need to do so, trading on a perfectly acceptable 2.4% discount to net asset value and throwing off a good dividend yield of 5.9%.

The trust's differentiator is that it combines its standard UK equity holdings with a portfolio of fixed income preference shares currently yielding around 8%, funded by borrowings at the cheaper rate of 3.9%, fixed until 2027. Iain says the preference share portfolio is around 20% of the total, providing a nice base for the income and an offset for some more growth-oriented holdings in the equity portfolio. Rising interest rates mean the preference shares have been a bit of a drag on performance of late, but they enable him to take some more risks elsewhere and help with the overall balance of the trust.

In terms of the equity holdings, these are quality income selections that include a range of blue-chips such as AstraZeneca, Shell, BP, SSE, Anglo American and Diageo, plus some smaller holdings including the very high yielding US gas producer Diversified Energy. With a little bit of option writing the portfolio yield more than covers the dividend payout and the trust has just over a year of revenue reserves as well, so the dividend looks very secure. Iain believes these uncertain markets create opportunity, and he thinks he can find good income paying stocks with attractive potential for dividend growth in this market. He does look for dividend growth potential from the portfolio stocks, which provides momentum and means he does not have to start each year immediately chasing extra income to try to grow the dividend. Broadly, Iain seemed sanguine about the dividend outlook for UK stocks, saying the payout ratio is quite modest and balance sheets are not overlevered. For dividends the UK is "not in a bad place" he said, with decent prospects for most major sectors in the portfolio, namely energy, banks, utilities and miners.

On the subject of a possible merger with ASCI, which is obviously a decision for the boards involved, Iain said the Shires Income chairman has already spoken about how this seems desirable, and the trust has put in its bid for the assets. We'll wait to see if it is chosen, but we think it makes sense given the already strong links between the two trusts. Shires Income has a holding in ASCI, and Iain says he would see no problem in integrating the portfolio.

The proposition here is for a high, secure income with the potential for growth in both the capital and income. We can't get excited about the trust, but that's not really its raison d'être, which is rooted more in its above-average yield for the sector and its quality bias. At a time when many smaller trusts are feeling under pressure, we sense that SHRS can keep on doing what it is doing, regardless of whether it combines with ASCI in due course.

RIVER & MERCANTILE UK MICRO CAP (RMMC, 145p)

It has been a tough couple of years for UK smaller companies and for RMMC, which has seen its shares more than halve from a peak of 327p to 145p, on an 18.7% discount to NAV. We have a soft spot for the trust though, which uses a clever structural mechanism to make sure it does not grow too large to invest efficiently in micro caps, returning capital to shareholders during upswings in the market. It may be too early to put that capital back to work here, even for the most staunch contrarians, but we were keen to stay in touch with manager George Ensor for his latest views.

Against the background of the UK being unloved, smaller companies selling off particularly hard, growth being out of fashion as a style, and investment trusts de-rating to boot, we asked George if this was the toughest time he could remember.

The trust has been facing multiple headwinds. He said he has been through downturns before, and that there are quite a lot of parallels with 2019 when the trust was out of favour. The difference this time is that the negative environment is continuing for longer, and that the downswing has been far greater in both depth and duration. He showed us data illustrating that we need to go back to 1989 for a worse period of small cap underperformance. His view is that it is a cyclical industry, and he says “we are starting to see evidence that it is bottoming out.” International investors are waking up to the value in the UK, George says, and when the macroeconomic backdrop settles down some obvious opportunities will draw bargain-hunters now that pessimism is thoroughly baked into valuations. “I’m pretty confident that we’re close to the bottom of the de-rating”, George concludes. His optimism is reflected in a low cash level in the trust, below 1% compared to a more normal level of 3%-7%. George sees a good number of “massively mispriced” stocks in his micro-cap universe.

Portfolio turnover is quite normal, picking up more organic ideas now to replace the investments that might normally be made in IPOs or placings, which have dried up. And looking at the exit door, the portfolio does have one bid currently, for a company called Smoove, but M&A has been muted in this sector of late. As has been the case for some time, the portfolio is around 50% growth, with the other half spread around quality, recovery, and asset-backed situations. The median market cap of the holdings is £58m.

The trust itself has shrunk now to a market cap of £49m. This looks small, but it is in the nature of the trust’s structure that it will fluctuate, and George believes the shares are in the hands of appropriate shareholders who understand and accept the limited liquidity. He does point out that the trust gave £35m back to shareholders in 2021, which was quite good timing. There is a continuation vote next year, but George believes the trust has a supportive base and has still outperformed since inception. The trust has had some very big ‘multi-bag’ winners in the past such as Maxcyte and Keystone Law. George also spoke about some other holdings, in particular the buy-and-build healthcare software company Instem.

The overall message here, from a trust that has clearly suffered a cyclical downturn, is that the manager has every intention of sticking to his strategy and that he can look past the current pessimism to the great opportunities on offer. It seems impossible to say precisely when RMMC will bounce back, but we think it will, and there is value on offer here for contrarian investors.

NEWS ROUND-UP

The board of **abrdn Diversified income & Growth** (ADIG, 82.4p), which we covered in the March newsletter, has

announced a strategic review to consider how the trust can best deliver value to shareholders. In spite of what the statement describes as “steady investment performance” – very much the aim of this multi-asset portfolio – the shares have traded at a material discount to NAV, currently 28.1%. Davina Walter, the trust’s chair, says “as part of this exercise we will consider all options, including but not limited to a combination with an existing investment trust.” Whilst the outcome here is far from certain, we view this as the board throwing in the towel and actively seeking a merger. Some brokers suggest that might not be straightforward in view of ADIG’s substantial private holdings, but we think ADIG’s £260m asset base could still prove attractive to another trust at a time when fundraising is generally difficult. The small hurdle of ADIG’s debenture borrowing that had looked very expensive is also easier to overcome now that interest rates have spiked up. There seems decent scope here for shareholders to benefit from an uplift in valuation from some kind of corporate action, and we were surprised the shares did not exhibit a stronger reaction on this news that the trust is effectively ‘in play’. We rate the shares a speculative BUY, backed by a 6.9% yield while you wait.

Blackstone Global Loan Financing (BGLF, €0.68) is also looking for the exit. The trust is proposing a managed wind-down that means capital will be returned as the trust’s CLO investments are realised, largely because of the persistently wide discount to net asset value on which the shares have traded. The latest NAV per share for the end of May was €0.8845, implying a 23.1% discount, and the discount has been wide for most of the last five years in spite of consistent performance against a volatile backdrop. This is a high income trust that delivers a very high dividend yield for investors and we are sorry to see it go. The trust has always been somewhat complex, we have felt, for private investors, but we have no arguments with the management or its returns. The nature of the underlying investments means that the return of capital could be a lengthy process, but as the dividend will be maintained in the meantime and the discount is wide, our view is that shareholders should **STAY WITH THE SHARES** during this process in anticipation of some uplifts. A circular with more detail is due to be published in September.

We added an update to our members site during the month on the news that the 80p per share offer for **Civitas Social Housing** (CSH, 79.8p) was accelerated by the bidder. It reached its amended closing point on 23rd June and our recommendation was to ignore it, but after a late surge of acceptances the bidder CK Asset Holdings acquired a sufficient level of support to declare the bid unconditional. This is a disappointment, as we felt the offer price was too low against the trust’s asset value, and this opens the door now for more

opportunistic bids in the sector. Holders have little choice now but to accept the bid (or sell in the market at the same price), take the 80p per share, and to look for reinvestment opportunities. One obvious candidate in the exact same sector is **Triple Point Social Housing REIT** (SOHO, 50.05p) on a huge discount to its 31st March NAV per share of 111.5p, although the trust shares some of the problems with its working partners that dogged Civitas. There are plenty of other candidates for alternative investment across a depressed REIT sector.

Numis Securities has published its first half property sector review, digging into the detail of a difficult first half of the year. The 'long income' category suffered most, notably **Supermarket Income REIT** (SUPR, 74.05p) and **LXI REIT** (LXI, 87.625p), followed by healthcare, generalist, office, and self storage. Whilst actual transaction prices from deals in the market have been only modestly lower, and quite calm, markets are anticipating more falls to come, hence the wide discounts across the sector. The cost and availability of debt is a large negative factor, along with inflation and EPC requirements causing higher operating costs. On the plus side, occupancy levels are generally quite good, balance sheets look resilient and reasonably geared, and of course the discounts have factored in a lot of the weakness, offering high yields at the same time. Existing valuations are attracting corporate activity, and Numis "expect more combinations to transpire in H2 this year." We hope that if and when those happen, they are at prices that reasonably reflect the NAV, unlike the Civitas Social Housing deal, which will sting for many investors.

We also provided an update on **Phoenix Spree Deutschland** (PSDL, 187.5p) ahead of its AGM vote at the end of June because of an unexpected shift in strategy and a new proposal on the manager's fee structure. The board has now decided it needs to sell condominiums to generate cash for dividends and share buybacks in an attempt to tackle the large discount to net asset value. It intends to incentivise the managers to make the sales or even to cultivate an offer for the entire

portfolio, which is counter to the previous strategy of taking a long-term view and waiting for valuations to improve. We do not feel this change of direction has been communicated at all well to shareholders, although at the same time we hope it might have some positive near-term impact. On balance we rate the shares a HOLD, but we feel the risks have increased and this is one we'll be watching closely.

Matters have unfolded at **Crystal Amber Fund** (CRS, 61.5p) as we explained in May. The takeover of its major holding Hurricane Energy was completed, meaning the trust received an initial payment of £34.7m, equal to 41.6p per CRS share, and decided to pay out 25p per share (£20.8m) as a special dividend. The trust has retained some capital to ensure it can support its other holdings, in particular the banknote printer De La Rue. Remember too that under the terms of the Hurricane Energy transaction, CRS could receive substantial deferred consideration over the next three years, so more capital returns seem likely once the future of De La Rue becomes clearer. CRS shares are now ex-dividend and the 25p per share should be paid to shareholders on July 7th.

The board of **Mid Wynd International** (MWY, 695.5p) has decided to switch its mandate away from Artemis to Lazard Asset Management following Simon's Edelsten's retirement and a subsequent review. The investment objective and policy of the trust will remain the same and Lazard will take over in the fourth quarter of this year. The trust's chairman Russell Napier said "we are delighted to appoint Lazard and their Global Quality Growth team, headed by Louis Florentin-Lee and Barnaby Wilson, as managers of Mid Wynd. The team has produced strong performance through their disciplined approach and also a resilience of relative returns through very different market conditions."

We are expecting more news shortly from the board of the **US Solar Fund** (USF, US\$0.685), which has now completed the US\$52m sale of its interest in the Mount Signal 2 asset, announced earlier in the year. Shareholders should hear in the next fortnight whether this capital will be returned or whether there have been further developments from the trust's strategic review. For now, we think holders should sit tight and await the next steps.

VPC Specialty Lending (VSL, 71.5p), which is entering wind-down, has said it expects to continue paying its 2p per share quarterly dividend for at least a year and potentially longer. This implies a yield of more than 11% on the current share price that we believe provides more than enough support for shareholders to continue holding current positions.

The next issue of Investment Trust Newsletter is published on Saturday 29th July 2023.

www.tipsheets.co.uk

www.itnmembers.co.uk

www.itbook.uk

The FTSE 350 Closed End Investments Index is down 209.01 points (-1.91%) to 10,715.91 since the last newsletter.