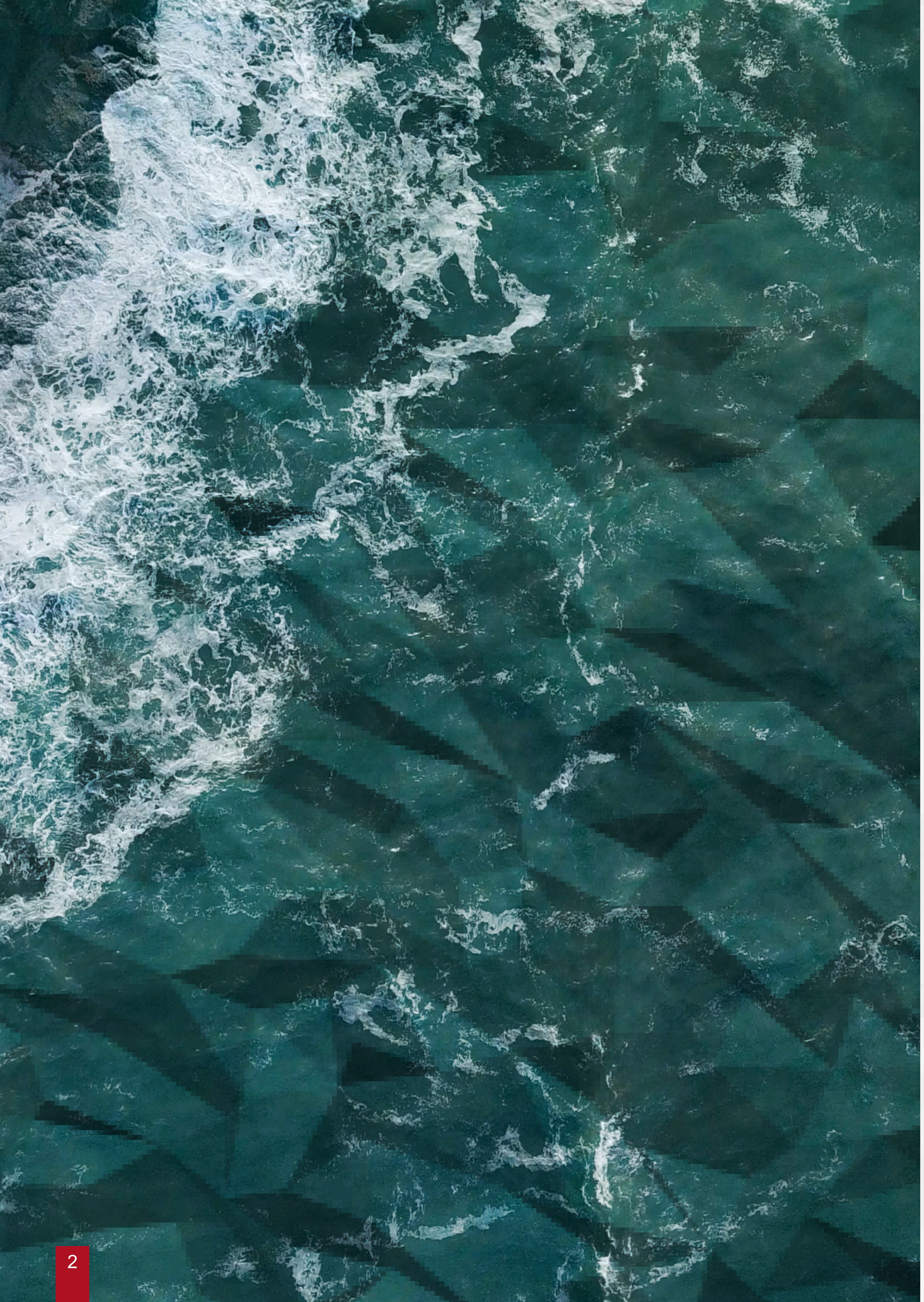
Janus Henderson
INVESTORS

WHITE PAPER

EVERYTHING YOU ALWAYS WANTED TO KNOW ABOUT INVESTMENT TRUSTS… BUT WERE AFRAID TO ASK

APRIL 2020



EVERYTHING YOU ALWAYS WANTED TO KNOW ABOUT INVESTMENT TRUSTS… BUT WERE AFRAID TO ASK

Investment trusts recently celebrated their 150th anniversary. They are part of the group of collective investment funds that includes unit trusts, open-ended investment companies (OEICs) and exchange-traded funds (ETFs).

Despite being fewer in number and less well-known than other members of the investment fund family – there are over 400 investment trusts compared with almost 2,500 investment funds – they include some of the UK's longest-established and best performing funds. Indeed, many believe them to be the investment industry's best kept secret.

Recently, they have been growing steadily in popularity as an investment vehicle however: in the last 10 years, their total assets have increased by over £120 billion, more than doubling the size of the sector.

We have produced this guide in response to the burgeoning demand for investment trusts amongst investors of all kinds, and to answer the most commonly asked questions from those seeking an attractive route to long-term returns. We hope you find it useful.

WHEN AND WHY DID THE INVESTMENT TRUST INDUSTRY START?

Investment trusts are a Victorian invention. They were established to enable those of modest means to access the stock market in much the same way as wealthier individuals and institutions, lowering the risk to the individual by spreading their investment over a wide range of holdings. The true catalyst for their existence was the need to fund the vast sums required by ambitious new investment initiatives across the globe, as the burgeoning British Empire spread its tentacles ever wider.

The first investment trust – the Foreign & Colonial Government Trust (now known as the Foreign & Colonial Investment Trust) – was set up by Philip Rose in London in 1868 "to give the investor of moderate means the same advantages as the large capitalists in diminishing the risk by spreading the investment over a number of stocks". As the name suggests, the initial portfolio comprised 'foreign and colonial' assets, largely government bonds.

In subsequent years, Scotland became a breeding ground for new investment trusts, initiated in order to fund a wide range of commercial activities: the building of the railway network which would ultimately link the United States of America, lending to pioneer farmers in the north western United States, and offering mortgages to Malaysian rubber plantation owners to fulfil the growing demand for rubber from the Ford Motor Company, to name but three.

By the outbreak of the First World War in 1914, 90 investment trusts had been established. Of those, 26 still exist today, including the Bankers investment trust and the City of London investment trust – a testament indeed to their extraordinary resilience.

WHAT IS AN INVESTMENT TRUST?

An investment trust is simply a type of collective investment fund that is constituted as a public

Lorem ipsum dolor sit amet, consectetur adipiscing elit. Pellentesque justo nisi, tempus consectetur neque nec, ornare luctus lorem. Nunc volutpat suscipit odio, ac fermentum dui tempor eu.

limited company. They may invest in other companies' shares – known as 'equities' – and/or in a range of other assets, such as property or fixed interest securities such as government or corporate bonds.

By enabling investors to pool their money with that of others, they offer exposure to a broad range of companies, industries and territories that one would struggle to access as an individual. Investment trusts therefore offer all investors – even those of modest means – the benefits of a ready-made, diverse portfolio of assets.

HOW ARE INVESTMENT TRUSTS STRUCTURED?

Oddly, the term 'investment trust' is somewhat inaccurate in that they are not actually constituted as 'trusts' in the legal sense of the word, since all investment trusts are established as public limited companies (PLCs). In common with all public limited companies, they are required to maintain an independent board of directors appointed by the shareholders to supervise their activities, to make key strategic decisions about the future direction and to safeguard the interests of the shareholders.

The shares of an investment trust are listed and traded on a recognised public stock market, such as the London Stock Exchange and, as a result, investors are able to verify the current price of the shares at any time. In common with any stock market quoted company, investment trusts are required to publish an annual report and produce audited accounts.

HOW DO THEY INVEST?

Every investment trust will have a clearly stated investment objective which sets out:

- the nature of the return it is aiming to deliver, eg growth, income or a balance of the two;
- the asset types in which it is seeking to invest, eg equities or fixed interest securities;
- the geographical remit, eg UK or the Far East.

Like other investment fund types, investment trusts are grouped into 'sectors' which describe the geographical area and type of asset in which they seek to invest. The Association of Investment Companies (AIC), the trade body which represents investment trusts, maintains over 30 different sectors: UK Equity Income, Global Smaller Companies etc.

A professional, third party investment management business will be engaged by the trust to undertake the day-to-day process of asset selection and will manage the investment portfolio, which will typically encompass anywhere between 50 and a few hundred individual holdings. The investment manager will be required to report on its activities to the trust's board and shareholders on a regular basis, and the board will be empowered to source an alternative investment manager in the event that the performance of the incumbent is felt to be poor.

HOW DO INVESTMENT TRUSTS DIFFER FROM OTHER TYPES OF INVESTMENT VEHICLE?

Largely due to their legal structure as public limited companies, investment trusts operate differently to other investment funds, such as unit trusts or OEICs, in some important and interesting ways. The key differences are explained below:

Closed not open

Investment trusts are ‘closed-ended funds’ – so called because they issue only a fixed number of shares for investment on launch via an Initial Public Offering (IPO). These shares are issued in accordance with company law. Investors are not entitled to redeem their holdings on demand.

Rather than trading with the fund manager, as with an open-ended fund, investors in closed-ended vehicles trade amongst themselves on the secondary market through a recognised stock exchange, in a similar way to a standard company share. Unit trusts and OEICs, by contrast, facilitate trading by issuing or cancelling units according to investor demand, with no limit on the number of units that may be in issue at any one time, and so they are classified as ‘open-ended funds’.

Premiums and discounts

An investment trust with £10m worth of underlying assets (after any liabilities) and 10 million shares in issue would have a ‘net asset value’ (NAV) of 100p. The NAV of an investment trust is published daily. The trust’s share price, however, will be dependent on two key factors: the performance of the assets within the portfolio, and supply and demand for the shares in the marketplace.

The price actually paid to buy the shares will therefore – and unlike a unit trust or OEIC – very rarely be exactly the same as the NAV. At any particular point in time, the shares could be trading at a discount (where investor demand is low), or at a premium (where investor demand is high) to their net asset value.

Most investment trusts try to smooth out the swings in their share price rating. If the stock is consistently trading at a premium, they will issue new shares to meet that investor demand. Conversely, if there is insufficient demand and the price has been trading at a discount for a protracted period, many will also buy back some shares to reduce excess supply.

Power to borrow

Unlike most other types of investment fund, investment trusts are able to borrow money, which can be invested alongside the capital injected by purchasers of the trust’s shares. This facility provides the trust with leverage and is known as ‘gearing’. It gives the fund managers freedom to take advantage of a long-term view, or to react swiftly in terms of a favourable situation with a particular asset, without having to dispose of any existing investments to raise the necessary cash. Needless to say, the investment manager needs to be confident they can generate a higher return than the cost of borrowing the money.

Gearing increases the volatility of the portfolio and, as a result, the rise or fall in the value of the assets will be magnified. Whilst it offers the potential to enhance returns when markets are rising, by the same token it can have a detrimental effect by exacerbating losses when the investment climate is less healthy. All other things being equal, the more highly geared the trust, the riskier it is for the investor.

In order to understand the effect of gearing, consider an example:

An investment trusts with net assets of £100 million has a bank loan of £20 million, and therefore gross assets of £120 million. Assuming the fund is fully invested and the underlying value of the assets rises by 10%, the new gross asset value will be £132 million. However, given that the bank loan is unchanged, the new net asset value is £112 million whereas, without the gearing, the net asset value would only have risen to £110 million based on the same 10% market rise.

Not all investment trusts take advantage of gearing however – a gearing rating of 100 means the trust has no borrowing, whereas a rating of 110 means that an investment trust capitalised with shareholders’ equity of, say, £100 million has a further £10 million of borrowings.

The AIC publishes full details of each investment trust's gearing policy.

Income flexibility

Whilst other types of investment fund are obliged to distribute the full value of any income generated by the portfolio's assets, investment trusts are permitted to hold back up to 15% of that income in any year, thereby creating a 'reserve' for future years should they prove to be leaner.

Many investment trusts take advantage of this facility by aiming to grow their annual income distribution to shareholders consistently, year after year. Through prudent management, they can build up long records of dividend increases in this way – as evidenced by the fact that a number of investment trusts have grown their dividend payouts in every year for over half a century, with many more having achieved the same feat for at least 20 years.

Moreover, these dividend increases have often been ahead of the prevailing rate of inflation, thereby ensuring that the real value of that income is preserved. Recently, a number of trusts have started paying dividends from the capital gains they have made; whilst this can reduce their overall growth, it represents another valuable tool for income maximisation.

Few, if any, other forms of investment fund can match those long records of steady dividend growth, through good times and bad.

Longer-term view

As closed-ended funds, investment trusts don't experience inflows and outflows of investors' funds and therefore don't need to dispose of any assets or hold a proportion of their assets as a 'cash reserve' in order to fulfil the needs of those wishing to sell their shares.

As a result, the trust enjoys the benefits of remaining fully invested at all times, and the fund managers can maintain a long-term investment strategy without any disruption. For that reason, investment trusts are often regarded as having greater control over their investment decision-making and are thought to be well-suited to more illiquid assets that can take time to dispose of, such as real estate or unquoted shares.

Lower charges

Investors in an investment trust incur an annual management fee and other ongoing administration costs – these are normally set against the income a trust receives from its investments, with the difference being distributed to the shareholders as a dividend.

Analysis has shown that the full amount of these charges, known as the Ongoing Charge, tends to be lower than for unit trusts and OEICs, especially for the largest investment trusts (those with assets of £500m or more).

WHAT ARE THE BENEFITS OF BEING AN INVESTMENT TRUST SHAREHOLDER?

Holding shares in an investment trust means you are a shareholder in that company and, by virtue of that, you are entitled to:

1. benefit from any appreciation in the price of the trust's shares should you elect to sell;
2. receive any dividends that the trust distributes (there is no guarantee that a dividend will be paid in any particular year, although trusts do generally look to grow their dividend payments year-on-year);
3. receive the annual and half-yearly reports, which will contain comprehensive information about the trust, its investment strategy, its asset holdings and its overall financial position;
4. attend and vote at annual general meetings: you can vote on issues such as the appointment or removal of directors, the trust's investment objective, the remuneration of board members and specific tabled motions. (NB: investors purchasing investment trust shares through an online investment platform should verify that these shareholder rights will be passed on to them.)

WHEN ARE DIVIDENDS PAID, HOW IS THE AMOUNT DETERMINED AND HOW IS THE YIELD CALCULATED?

In order to provide a regular stream of income during the course of the year, an investment trust will pay a dividend either half-yearly or quarterly (although not all investment trusts pay a dividend – say if the trust is aiming for capital growth rather than income).

The actual amount of the dividends paid by the trust is dependent on the income generated by the assets within the underlying portfolio. All investment trusts publish their dividend yield, which is calculated as the dividends actually paid in the last 12 months divided by the current share price.

WHAT ARE THE AIC'S 'DIVIDEND HEROES'?

The Association of Investment Companies (AIC) publishes an annual list of 'dividend heroes': those investment trusts which have increased their dividend payouts for at least 20 consecutive years.

In its most recent publication, 20 investment trusts companies qualified and, of those, four had increased their dividends for more than 50 years in a row: City of London Investment Trust, The Bankers Investment Trust, Alliance Trust, and Caledonia Investments.

CAN AN INVESTMENT TRUST BE HELD WITHIN AN ISA OR SIPP?

The dividends generated by an investment trust are subject to income tax whilst any profits made on selling investment trust shares will be liable to capital gains tax (CGT). However, investment trusts can usually be held and traded within a Stocks & Shares Individual Savings Account (ISA), where income and gains can be sheltered from tax.

Investors can also buy investment trust shares in a pension plan, such as a Self-Invested Personal Pension (SIPP). The investment trust's factsheet should provide full details.

HOW ARE INVESTMENT TRUSTS REGULATED?

UK investment trusts are listed on the London Stock Exchange, are subject to the listing rules of the UK Listing Authority established under the Financial Services and Markets Act 2000, and are also subject to the Companies Act 1985, as amended.

Investment managers which promote packaged products, eg Individual Savings Accounts (ISAs) or Self-Invested Personal Pensions (SIPPs), with investment trusts as underlying assets, are regulated by the Financial Conduct Authority (FCA).

HOW ARE INVESTMENT TRUSTS BOUGHT AND SOLD?

Those looking to trade investment trusts have two immediate options: since they are listed on the stock market, they can be traded using either a stockbroker or an online investment platform. This will typically involve the payment of a trading fee plus, when purchasing shares, the usual 0.5% stamp duty that is chargeable on the purchase of all types of share.

There is no shortage of brokers and or online platforms to choose from and so, for those without an existing relationship, it pays to take into consideration a full range of factors: costs, customer service record, the user-friendliness of the platform etc. Needless to say, the cheapest providers don't necessarily excel in all areas.

Alternatively, for those who know the specific trusts in which they want to invest, it can be cheaper – particularly for regular investors – to transact with an investment company directly since they often charge no fees to those investing in their own trusts, although this obviously limits the choice of trusts. There may well be an exit fee however.

WHAT IS THE 'SPREAD' FOR AN INVESTMENT TRUST?

The spread is the difference between the price received when selling investment trust shares (known as the 'bid' price) and the price paid to buy the shares (known as the 'offer' price).

It is dependent on supply and demand for the shares and is set by firms known as market-makers. Remember that government stamp duty – a tax at 0.5% of the value of all share purchases – is not included in the spread.

WHAT IS THE 'MID' PRICE?

The mid price is the average of the 'bid' and 'offer' prices when the market closes each day. This closing mid price is used to value the underlying investments of an investment trust (known as the 'net asset value').

WHAT IS THE ROLE OF A COMPANY SECRETARY FOR AN INVESTMENT TRUST?

A company secretary manages the operational aspects of an investment trust, thereby ensuring that it fulfils its obligations regarding:

- legal and financial reporting;
- convening board meetings and producing minutes;
- liaison with the Board and external advisers.

WHAT IS THE ROLE OF AN INVESTMENT TRUST BOARD?

One of the most defining features of investment trusts is the existence of a board of directors which is wholly independent of the appointed investment manager and provides a critical supervisory function.

The board will usually consist of a broad range of directors with complementary skills, including investment management, commercial management, finance, risk, compliance, and sales and marketing.

The Board is responsible to the investment trust's shareholders and is responsible for managing the trust's external relationships – most importantly the fund managers. It seeks constantly to ensure that the investment trust is managed in the best interests of its shareholders, that the managers perform well and that they comply fully with the stated objectives of the trust.

It does so by scrutinising the activities of the investment manager, challenging decisions made and taking whatever action it deems necessary to ensure that investors' interests are protected. The board will also apply its own collective wisdom to the investment decision-making of the investment manager, working collaboratively to ensure that the right strategies are being pursued.

WHAT IS THE ROLE OF THE INVESTMENT TRUST REGISTRAR?

The Registrar maintains the register of shareholders and warrant holders.

RELATED DATA

Content targets these key searched terms and will be marked up with tags to further reach.

Keyword Search	Search Volume
F&C investment trust	1600
Exchange Traded Funds	1300
Foreign and colonial investment trust	720
Property trust	720
Henderson far east income	590
Foreign & colonial investment trust	590
OEIC fund	390
Investment grade bonds	320
Growth fund	260
Investment Trust vs Unit Trust	170
Board of investment contact	90
Unit Trust investment trust	90
Janus Henderson annual report	90
Henderson far east income fund	90
Investment trust ISA	90
Best performing investment trusts over 20 years	70
Ongoing charge fund	70
Unit trust fund manager	70
Income trust	50
Market gearing	50
Capital gearing investment trust	50
High yield corporate bond fund	50
Global access platform	50
Investment grade spreads	50
Best investment trusts over 10 years	50
Gapital gearing trust review	40
Unit Trust vs Investment Trust	40
Income and growth investment trusts	40
Gearing investment	20
Total	**7810**

Total UK annual search volume 93,720

DISCLAIMER

For promotional purposes. For UK investors only. The value of investments, and the income from them, can go down as well as up, and you may not get back the amount you invested. Tax assumptions and reliefs depend on an investor's particular circumstances and may change if those circumstances or the law change. Before investing in any investment referred to in this communication, you should satisfy yourself as to its suitability and the risks involved. Nothing in this communication is intended to be, or should be construed as, advice or as a recommendation or solicitation to buy, hold or sell any investment.

Issued in the UK by Janus Henderson Investors. Janus Henderson Investors is the name under which investment products and services are provided by Janus Capital International Limited (reg no. 3594615), Henderson Global Investors Limited (reg. no. 906355), Henderson Investment Funds Limited (reg. no. 2678531), AlphaGen Capital Limited (reg. no. 962757), Henderson Equity Partners Limited (reg. no.2606646), (each registered in England and Wales at 201 Bishopsgate, London EC2M 3AE and regulated by the Financial Conduct Authority), and Henderson Management S.A. (reg no. B22848 at 2 Rue de Bitbourg, L-1273, Luxembourg and regulated by the Commission de Surveillance du Secteur Financier). Janus Henderson, Janus, Henderson, Perkins, Intech, AlphaGen, VelocityShares, Knowledge. Shared and Knowledge Labs are trademarks of Janus Henderson Group PLC or one of its subsidiaries.