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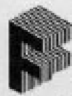
10 INVESTMENT TRUSTS FOR YOUR ISA

Dave Baxter sets out 10 investment trusts for your portfolio in 2020


eatures such as the use of gearing – debt – and the ability to pay income from capital reserves give trusts advantages that could give your Isa an edge. They are also, arguably, better suited to investing in illiquid assets such as property and private equity, so could be a good way to diversify your Isa. Below are 10 suggestions for investors seeking growth, income and wealth preservation, plus a contrarian pick and something a bit different.

GROWTH

Monks Investment Trust (MNKS)

Alan Brierley, who leads the investment companies research team at Investec, says: "Portfolio construction is driven by a bottom-up process, with stock selection focusing on the identification of world-leading companies that can deliver strong growth over the long term. Rigorous analysis focuses on the long-term revenue and earnings growth potential, while macroeconomic forecasts or the structure of the index are of little or no interest [so that] the current active share is 90 per cent. Investments are classified in four growth categories: stalwarts, rapid, cyclical and latent. This is to ensure a diversity of growth drivers within a disciplined framework.

"Since the change in [management team and investment philosophy in 2015] the performance record has been impressive. The NAV and shareholder total returns are 98.8 per cent and 140.1 per cent, respectively, versus a FTSE World index total return of 73.8 per cent [as of January 2020]. During this time period, out of a peer group of 271 open and closed-ended global funds, Monks Investment Trust's shareholder total return is ranked fourth. Following two reductions in the management fee in recent years, the ongoing charge is now just 50 basis points. Growing recognition of the track record and the distinct process has ignited a re-rating, with Monks having traded on an almost uninterrupted premium over the past two years."

INCOME

Henderson Diversified Income Trust (HDIV)

James Carthew, head of investment company research at QuotedData, says: "Henderson Diversified Income offers investors a 4.6 per cent yield from a portfolio currently dominated by high-yield and investment-grade corporate bonds, but which has the flexibility to invest across a wide variety of debt. High yield may sound risky, but many investors forget that when companies run into trouble it's equity investors that get hit first. Their money serves as a protective cushion for debt investors. "This trust's managers subscribe to the theory that we are stuck, for the time being, in a world of low growth, low inflation and low returns. They are keen to preserve investors' capital, which means minimising the risk of defaults – a borrower failing to pay interest or capital when it is due. So there is a great emphasis on understanding credit risk, focusing on defensive businesses that don't have too much debt, and not chasing yield at the expense of credit quality. The managers have the freedom to enhance returns using gearing, which can either be bank borrowings or derivatives such as interest rate futures."

WEALTH PRESERVATION

Capital Gearing Trust (CGT)

Mr Carthew says: "Capital Gearing Trust [is] the best performing trust since Peter Spiller took on responsibility for it in April 1982 and, over more than a decade, the one that best preserves capital when markets are falling. Its managers think that the returns available from most asset classes are currently poor. They are concerned about the level of debt that has built up in the global economy. They also think that inflation may eventually creep back into the system as governments and central banks, fearful of another financial crisis, throw money at staving off a recession – something the Chinese are doing [following the coronavirus outbreak].

"The portfolio is split between risk assets – funds and equities, preference shares and corporate debt, cash, gold, conventional government bonds, and index-linked government bonds [in which it has around a third of its assets]. Even in the risk asset portfolio, the approach is conservative. The trust's underlying exposure to equities is probably the lowest of any of its peers. If valuations correct to levels at which they think future returns are attractive, the managers are prepared to increase the allocation to risk assets. The high levels of liquidity in the portfolio will help them achieve this. This also allows them to operate a zero-discount control mechanism, which means the trust trades close to asset value."

RIT Capital Partners (RCP)

Myrto Charamis, director for investment companies research at Numis Securities, says: "RIT Capital Partners should continue to deliver attractive risk-adjusted returns for investors seeking a fund that can perform [well] through the cycle. The trust [aims for] long-term capital growth while preserving shareholders' capital, by investing in a range of asset classes including equities, private investments and uncorrelated absolute return and credit, via a high-conviction, unconstrained approach.

"It is differentiated by the depth of its managers' investor network, which provides access to unique investment opportunities. Lord Rothschild, who founded RIT and drove its strategy from inception in 1988, has stepped down as chairman to take a role as president of RIT. But it continues to have an impressive senior management team led by Francesco Goedhuis and Ron Tabbouche. Importantly, the Rothschild family, which holds a 21.4 per cent stake [in the trust], remains a committed long-term shareholder.

"RIT has outperformed MSCI AC World Index by 2.3 per cent a year [on average] since inception, despite a lower risk profile. The diversified nature of RIT's portfolio and its low equity exposure mean that the NAV is unlikely to keep up with equity indices during bull markets. However, the capital preservation benefits have been demonstrated during volatile markets."

Dunedin Income Growth IT (DIG)

Simon Elliott, head of research at Winterflood Investment Trusts, says: "Dunedin Income Growth has been repositioned over the past three years and this has resulted in a notable pick-up in its performance. A board-led review in 2016 led to a shift in strategy, with a greater emphasis on companies that can grow their dividends. This has been overseen by Ben Ritchie and Louise Kernohan of Aberdeen Standard Investments. They have been its co-managers since September 2016, although Ben was involved in the trust's management for six years prior to that.

"The emphasis remains on quality companies that can deliver sustainable returns and [avoiding] high-yielding stocks with unsustainable dividends. However, the percentage invested in companies with dividends growing at over 5 per cent per year doubled from 21 per cent at the start of 2016 to 40 per cent at the end of July 2019. The active share has risen from 60 per cent to 70 per cent, and the percentage invested in small and mid-cap companies has increased from 15 per cent to over 30 per cent."

DIVERSIFYING ASSETS

Standard Life Private Equity Trust (SLPE)

Mr Elliott says: "Due to the illiquid nature of private equity investments, this asset class is ideally suited to the closed-ended fund structure. Standard Life Private Equity offers a high-quality private equity portfolio that benefits from the considerable resources of Aberdeen Standard Investments. However, it was left behind by its fund of private equity funds peers in the last quarter of 2019, which re-rated as market conditions improved. As a result, it is now trading on a substantial discount to both its NAV [18.8 per cent at time of writing] and the average discount for its peer group [11.5 per cent at time of writing]. This presents a value opportunity.

"The [level of the discount] is hard to justify given the trust's long-term performance record, quality of its investment portfolio and strength of its balance sheet. The trust has paid an enhanced dividend over the past few years and yields [3.7 per cent at time of writing]. Its board has 'committed to maintaining the real value of this new enhanced dividend and growing it at least in line with inflation'."

Sequoia Economic Infrastructure Income Fund (SEQI)

Mr Brierley says: "Sequoia Economic Infrastructure provides access to a portfolio of economic infrastructure debt investments. The trust is managed by Sequoia Investment Management, a specialist in infrastructure debt asset management, and the experienced advisory team comprises four partners and 10 credit analysts.

"The portfolio is diversified by borrower, jurisdiction, sector and sub-sector, and the average yield to maturity is 8.2 per cent. There is a focus on private debt, which comprises 92 per cent of the portfolio, and 71 per cent [of the securities it holds have a floating rate coupon].

"Private debt generally attracts an illiquidity premium and consequently a higher yield compared with rated, listed bonds. Given their fundamental 'buy and hold' strategy, its managers aim to capture this illiquidity premium. They estimate that, on average, this yield pick-up is around 1 per cent. Bonds account for 8 per cent of the portfolio and as some sectors, such as US utility companies, predominantly borrow through listed markets this aids diversification. [Also] having some liquid assets in the portfolio [allows] the managers to take advantage of future obligations and opportunities."

CONTRARIAN

Asia Dragon Trust (DGN)

Mr Elliott says: "Despite an indifferent five-year performance record and concerns over the impact of the coronavirus on the Asia Pacific region, Asia Dragon Trust is an attractive proposition. It saw a notable pick-up in performance in 2019, which followed prolonged periods of underperformance between 2013 and 2017. This resulted in the trust de-rating. Much of the turnaround in performance is due to the changing nature of the team's engagement with the Chinese equity market, with more resources being deployed to analyse listed Chinese companies in recent years.

"Despite the turnaround in performance, the trust remains on a wide discount [of 11 per cent compared with an average of 7.6 per cent for its peer group at time of writing]. If outperformance can be maintained, the trust is likely to attract more buying interest, which could see it re-rating in time. Downside risk from the current level should be alleviated by an active [share] buyback programme."

Lowland Investment Company (LWI)

Mr Brierley says: "A disciplined, mildly contrarian, value-oriented investment philosophy has delivered excellent long-term performance. Over 25 years, the NAV total return has outperformed the FTSE All-Share index and the Association of Investment Companies (AIC) UK Equity Income sector by an annualised 2.3 per cent and 2.5 per cent, respectively. However, the past few years have been more challenging, with style headwinds a drag on relative performance, and its focus on UK equities a millstone on absolute returns.

"The NAV total return relative to the benchmark peaked in September 2015, and more recently the company encountered a near-perfect storm in the 18 months ending September 2019, when it lagged by 18 per cent. Key reasons for this were an overweight in mid and small-caps, a bias to industrials and a focus on undervalued stocks. However, there has been a stealth-like recovery in recent months.

"Lowland pays quarterly dividends and has a progressive dividend policy that we believe is sustainable. In its last financial year, dividend cover was strong, while significant revenue reserves give an extra level of comfort. Its manager, James Henderson, notes that the underlying portfolio yield is at a level not seen for many years and believes the trust can deliver a healthy level of dividend growth in the current financial year.

"Although capital returns in recent years have been dull, the five-year annualised dividend growth rate is 10 per cent. While UK equities have typically traded at a discount to global equities, Mr Henderson highlights that this is now stretched in a historical context, with a return to the long-term average implying 30 per cent upside from recent levels."

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HgCapital Trust (HGT)

Ms Charamis says: "HgCapital targets consistent long-term returns in excess of the FTSE All-Share by investing predominantly in unquoted companies, where value can be created through strategic and operational improvement. Over the 20 years to September 2019, the last full portfolio revaluation date, HgCapital Trust made a NAV total return of 13.6 per cent a year versus 5.4 per cent for the All-Share.

"[Its manager] Hg has £10bn in assets and more than 100 people in its technology investment team. The core to Hg's approach is deep sector specialisation focused on technology-enabled businesses in niches such as tax/accounting, legal/compliance, HR, insurance, financial data, small to medium sized enterprise hosting, healthcare and autos. The majority of Hg's investments share most or all of the following characteristics: recurring sales, intellectual property protection, a fragmented customer base, business-critical low-spend products and services, and high earnings before interest, taxes, depreciation, and amortisation (Ebitda) margins. Many of Hg's portfolio businesses have a strong presence in cloud-based software as a service."