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RIT Capital Partners (RCP.L): Successfully preserving capital (Buy)

Preserving capital in challenging markets: RIT Capital produced a NAV total return of 0.8% in 2018; in an environment where over 90% of 70 global asset classes failed to deliver an absolute return, this was no mean feat. The benchmark total return (50% MSCI ACWI (£)/50% MSCI ACWI local currencies) was -5.8% while the average total return of the IMA Flexible sector was -6.7%.

The key drivers were the Private Investments portfolio (both direct and indirect) and currency (the rally in the dollar) which contributed 4.9% and 2.2% respectively. These gains more than offset falls in quoted equities, particularly in Asia; the equity weighting averaged 47% during the year, towards the lower end of the historical range, and a reduction ahead of the Q4 sell-off was well-timed. Meanwhile, the government bond and gold weightings were increased and so benefitted from the flight to safety. Notwithstanding the headwinds in credit markets, the absolute return and credit portfolios made a positive return of 0.5%.

Investment outlook – cautious and selective: Given the accumulation of downside risks, RIT remains cautious about prospects for markets. Global growth and earnings are slowing, while geopolitical risks have not subsided, including the UK which is “witnessing the worst political situation since the Suez crisis”. Although RIT continues to see specific opportunities across equity and debt markets, the key priority is capital preservation. Accordingly, new investments must provide a margin of safety in terms of valuation, while private investments are structured with an emphasis on downside protection.

In terms of Sterling, the company has taken a “balanced” approach; while there is a possibility of a destabilizing political outcome, the domestic currency is fundamentally undervalued. The US is facing greater economic challenges, and these have not been fully discounted by the market, although RIT and their external managers have been able to find attractive investments that have discounted these challenges and offer an asymmetric profile looking forward. The emerging markets exposure has been a drag although RIT has taken advantage of attractive valuations to increase exposure. In Europe, the manager believes there needs to be a tangible structural shift to offer a viable long-term investment alternative.

Revisiting the philosophy: RIT Capital seeks to deliver long-term growth, while preserving shareholders capital; the portfolio is structured to give investors a healthy participation in up markets, and reasonable protection in down markets. Since launch, RIT has participated in 74% of the market upside but only 39% of market declines; this translates to an annualised NAV total return is 11% vs. 6.7% for the MSCI AC World blended benchmark.

Canaccord Genuity view: Last year further underlined the value of RIT Capital within a diversified investment portfolio. In challenging conditions, in terms of the number of asset classes failing to deliver absolute returns if not the quantum of price falls, RIT Capital was able to preserve capital.

RIT Capital is now the longest-standing constituent of our flexible model portfolio. We believe it gives investors a genuinely differentiated approach, it has used the closed-end structure to enhance returns and the unique network of contacts represents a distinct competitive advantage. Meanwhile an asymmetric participation in financial markets has delivered far superior returns over the long-term.

Today marks the 10th anniversary of the S&P Composite touching a low point of 666; since then this index has delivered a total return of 413% or an annualised total return of 17.8% with actions by Central Banks a key driver. However, with reference to last year, the Chairman notes how the dangers of holding assets that have been inflated by low interest rates and quantitative easing are now visible to all. Looking forward, we fear that last years' experience was merely an hors d'oeuvre compared to what comes at the end of the economic and debt cycle. In what is likely to be a highly challenging environment, we believe that a low participation in price falls should represent significant outperformance.