The most recommended investment trusts

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When picking an investment trust you should do extensive research on performance, cost and discount/premium to net asset value (NAV). It is also worth seeing what investment professionals think about a trust, including the ratings assigned by data companies and brokers. So we have aggregated the ratings assigned by a number of these to find out which investment trusts are most highly recommended.

Fewer investment platforms rate investment trusts than open-ended funds. Platforms that do rate investment trusts include Charles Stanley Direct and The Share Centre.

Financial Express (FE) Crown Fund Ratings also rates investment trusts, based on quantitative analysis of alpha, volatility and consistently strong performance. The top 10 per cent of funds are awarded five FE Crowns, the next 15 per cent four Crowns, and each of the remaining three quartiles are given three, two and one Crown respectively. The ratings are rebalanced twice a year in January and July. Only the trusts with the highest rating of five Crowns were included in our survey.

Morningstar has two ratings systems. Its star ratings are a quantitative system based on how well funds have performed in comparison to similar funds based on their past risk and load-adjusted returns. Only investment trusts with Morningstar's top five-star rating were included in our survey.

The trust is structured to benefit from the ongoing disruption to businesses we're seeing globally – it invests in digitally-based businesses that are taking market share or could be big in the future

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The Morningstar Analyst Ratings are a qualitative system, which incorporates forward-looking analysis of a fund. This is based on an analyst's conviction in the fund's ability to outperform its peer group and/or relevant benchmark on a risk-adjusted basis over the long term. A fund with a positive rating of Gold, Silver or Bronze means Morningstar analysts think highly of the fund and expect it to outperform over a full market cycle of at least five years. Only trusts with the highest Gold rating were selected for inclusion in our survey.

Bestinvest used to produce a list of its top-rated trusts, but has not done so for the past couple of years. However, the platform says it plans to reintroduce this service.

Top-rated investment trusts

No investment trust received recommendations from all five companies we covered in the survey, but **Scottish Mortgage Investment Trust** (SMT) and **Worldwide Healthcare Trust** (WWH) gained ratings from four of them. Both trusts also feature in the IC Top 100 Funds list.

Over five years, Scottish Mortgage Investment Trust has made outstanding returns, beating broad global equity indices such as FTSE World. It aims to maximise total return from an actively managed global portfolio and achieve a greater return than FTSE All World Index in sterling terms over a five-year rolling period. Its managers, James Anderson and Tom Slater, look for strong businesses with above-average returns, and have no fixed limits on geographical, industry or sector exposures. As well as listed equities, Scottish Mortgage can invest up to 25 per cent of its assets in unquoted companies because its managers believe some of the best opportunities for future growth lie outside public markets. The trust recently reported that it had made a return of 419 per cent on its unquoted investments between June 2010 and September 2018. Scottish Mortgage also has a very low ongoing charge of 0.37 per cent.

This trust has typically traded on a premium to net asset value (NAV) for the past three years, which as of 7 November was 1.2 per cent, according toWinterflood Securities.

Scottish Mortgage Investment Trust is on Killik & Co's buy list. “Investors in this trust need to be more adventurous and willing to tolerate higher peaks and lower troughs," says Mick Gilligan, head of fund research at Killik & Co. "The trust is structured to benefit from the ongoing disruption to businesses we're seeing globally – it invests in digitally based businesses that are taking market share or could be big in the future. It also seeks to benefit from the trend of private businesses staying private for longer.”

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However, the trust’s holdings in unquoted companies increase its risk profile, and rising interest rates around the world could be bad news for the valuation of the high-growth companies it owns. Such companies tend to be valued using a discounted cash flow model, which uses future free cash flow projections but discounts them to arrive at present value estimates, using the current interest rate.

“Discount rates tend to increase in line with a rising interest rate environment," explains Mr Gilligan. "All else being equal, this tends to have a greater negative impact on the valuation of assets with higher growth rates, as these higher growth rates lead to a higher proportion of value in the future.”

And over short periods Scottish Mortgage Investment Trust can be volatile. In October it was hurt by a sell-off in US tech stocks as it has high exposure to these assets. The falls suggest that although its growth-focused investment style has been a tailwind for several years, if the market were to rotate towards preferring value-style investments, it could suffer.

The fortunes of biotech companies often depend on win-or-lose trials, and more mature companies can find it difficult to maintain growth when their patents expire

“Investors who think that the long bull run in growth stocks is over and expect the recent market rotation away from tech and growth to continue, should take profits on [Scottish Mortgage],” says Iain Scouller, managing director of investment funds research at broker Stifel. “After a 10-year bull market, Scottish Mortgage's strategy has not until recently been tested in different market conditions, such as more prolonged negative market scenarios. On the other hand, those who want a high-conviction approach should hold on. Given that we tend to be a bit contrarian on funds and asset classes that have performed well, and with the [trust’s premium to NAV], we maintain a neutral recommendation.”

The other most recommended investment trust, Worldwide Healthcare, has made a share price return of 125 per cent over five years, in contrast to 95 per cent for MSCI World Health Care Index. The trust is trading on a premium to NAV of 0.8 per cent and has an ongoing charge plus performance fee of 1.73 per cent.

Worldwide Healthcare aims to grow capital by investing in pharmaceutical, biotechnology and healthcare services companies across the world. It has 76.4 per cent of its assets in North America, 8.8 per cent in Europe, 8.5 per cent in emerging markets and 6.3 per cent in Asia.

The trust has been on broker Numis Securities’ buy list since 2012. Ewan Lovett-Turner, director of investment companies research at Numis, says: “Worldwide Healthcare remains our favoured vehicle

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for diversified global exposure to the listed healthcare sector. The fund has an excellent long-term track record through stockpicking based on fundamental research, and it has typically been less volatile than most of the listed peer group. Its managers seek undervalued companies with strong product pipelines, high-quality management teams and a robust financial position. Fundamental research is undertaken on the likely outcomes of clinical trials and regulatory approvals, which have historically been the key driver of share price moves in the sector."

David Liddell, chief executive of online investment service IpsoFacto Investor, adds: "Long-term performance has been very strong and the trust is not on a large premium to NAV, but it has a sectoral risk as it is concentrated in biotech and pharma. So, if you're a general [private] investor, I don't think it should be a core part of your portfolio because it is dominated by one sector."

The fortunes of this trust are strongly linked to the economic and political conditions of one country – the US – as more than 75 per cent of its assets are listed there. Political risk is always a key issue when investing in healthcare funds. For example, if the US Congress passed industry-altering legislation on drug pricing, this could have a negative impact on the trust's holdings. And although the US economy has been growing strongly over the past year, there are increasing concerns about how long the economic expansion can continue. The US central bank, the Federal Reserve, has said it plans to continue raising interest rates into next year. But higher interest rates might be detrimental to the earlier-stage biotech stocks Worldwide Healthcare holds, as these are also valued via the discounted cash flow model. If long-term interest rates rise above 4 per cent this could cause problems for the trust's biotech holdings.

Over one year the trust's NAV and share price returns have been weak, at only 1 per cent, and less than the 10 per cent return of its benchmark, MSCI World Health Care index. "This reflects the overweight exposure to biotech companies, which the manager believes offer attractive value," explains Mr Lovett-Turner.

Meanwhile, the fortunes of biotech companies often depend on win-or-lose clinical trials, and more mature companies can find it difficult to maintain growth when their patents expire.

Over the past year, there have also been some management changes at Worldwide Healthcare. In December 2017, the trust's manager, Sam Isaly, stepped down after former employees made harassment allegations against him. The rest of Worldwide Healthcare's management team remains in place, and is now led by Sven Borho, managing partner and co-founder of the trust's investment

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manager, OrbiMed, and Trevor Polischuk. They have managed the trust with Mr Isaly since 1995 and 2003, respectively.

"However, the fact that the main investment manager has left is bound to add a bit of risk if he was more influential than might have been suggested," adds Mr Liddell.

Other highly recommended trusts

Six trusts received three recommendations from the five platforms and data providers we covered in our survey. They are:

- **Baillie Gifford Japan Trust** (BGFD)
- **Fidelity Asian Values** (FAS)
- **Finsbury Growth & Income Trust** (FGT)
- **Jupiter European Opportunities Trust** (JEO)
- **RIT Capital Partners** (RCP)
- **Schroder Asian Total Return** (ATR)

Performance of eight most recommended trusts

Investment trust/benchmark	Premium to NAV (%)	1 year share price return (%)	3 year cumulative share price return (%)	5 year cumulative share price return (%)	Net gearing (%)	Ongoing charge (%)*
Scottish Mortgage Investment Trust	1.2	6	82	148	8	0.37
FTSE World Index	na	2	50	74	na	
Worldwide Healthcare Trust	0.8	1	44	125	10	1.73
MSCI World Health Care Index	na	10	40	95	na	
Baillie Gifford Japan	5.2	-3	71	117	10	0.78
Topix 1st Section index	na	-5	42	65	na	

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Fidelity Asian Values	1.0	3	69	88	0	1.18
MSCI AC Asia Pacific excluding Japan Index	na	-10	44	45	na	
Finsbury Growth & Income Trust	0.5	2	37	72	1	0.71
FTSE All-Share Index	na	-3	24	29	na	
Jupiter European Opportunities Trust	2.3	7	40	85	3	2.50
FTSE Europe excluding UK Index	na	-8	32	40	na	
RIT Capital Partners	5.6	3	32	72	15	1.02
Schroder Asian Total Return Investment Company	3.0	-9	77	89	4	2.68
MSCI AC Asia Pacific excluding Japan Index	na	-10	44	45	na	

Source: Winterflood Securities as at 07/11/18, *Association of Investment Companies including any performance fee

These trusts have performed well over the past five years, making them very popular and causing them to trade at premia to NAV. So consider whether buying these trusts at the moment offers value for money or whether other funds might fulfil your requirements better.

Sometimes it is possible to buy open-ended funds run by the same management teams as trusts trading on premia to NAV. “Baillie Gifford has a strong Japanese desk,” says Jason Hollands, managing director at Tilney Group. “But Baillie Gifford Japan Trust is trading at a 5.2 per cent premium to NAV, so we prefer **Baillie Gifford Japanese** (GB0006011133), an open-ended fund managed by the same team. It also has a lower ongoing charge of 0.63 per cent [compared with 0.78 per cent for the trust].”

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Jupiter European (GB00B5STJW84) is run by the same manager, Alexander Darwall, as Jupiter European Opportunities Trust and has an ongoing charge of 1.03 per cent. The trust currently has an ongoing charge of 0.9 per cent, but also a performance fee, which in its last financial year took this up to 2.5 per cent, according to the Association of Investment Companies (AIC).

“Alex Darwall is a manager we rate highly," says Mr Hollands. "He follows an unconstrained approach, investing in a concentrated portfolio of 30 to 40 companies that offer well differentiated products and services that are able to grow throughout the business cycle. We like both Jupiter European Fund and Jupiter European Opportunities Trust. But as well as the higher costs, the latter is very heavily exposed to **Wirecard** (WDIX:GER), the largest holding, which accounts for 17.6 per cent of the trust's assets.”

Before committing cash, you need to be comfortable that a trust's strategy will be relevant for the future market outlook

The eight most recommended trusts, with the exception of Fidelity Asian Values, invest via a growth style. So a market rotation away from growth stocks to value stocks could be detrimental to their performance.

“Most of these trusts tend to invest in non-UK assets and I think that’s a problem for UK investors, as the exchange rate could move quite significantly depending on what happens with the Brexit deal,” says Mr Liddell. “Sterling could carry on going down if there was no deal. But if there is a deal, which the market thinks is positive, you could see sterling gain quite significantly. And that would be bad for trusts with overseas exposure as generally these do not hedge currency. Also, investors should realise that the currency effect is one of the reasons why all these trusts have done so well, as they got a 20 per cent boost in summer 2016 after the depreciation of sterling.”

Look beyond the ratings

Although fund ratings are useful, you should not base your decision solely on them. There is a risk of conflicts of interest with fund supermarket best buy fund lists, as reported by the Financial Conduct Authority (FCA) last year. And often companies do not include information about when the rating was published and what price the trust was trading on at that time. This information is needed for investors to properly judge the rating, says Mr Liddell.

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Perhaps unsurprisingly, fund buy lists tend to feature funds and investment trusts that have performed strongly in recent times. But just because a fund has performed strongly lately does not mean it is likely to continue performing well in future.

“History shows that over the long term buying investments that are out of favour tends to lead to better performance," says Mr Liddell. "Over a longer period of time you tend to get mean reversion when you buy investments that are out of favour or cheap.”

Mr Hollands adds: “Before committing cash, you need to be comfortable that a trust’s strategy will be relevant for the future market outlook and that its shares are not trading at an excessive premium to NAV.”

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Most recommended investment trusts

Investment Trust	Share Centre Recommendation	Charles Stanley Recommendation	Morningstar Five Star Quantitative Rating	Morningstar OBSR Analyst Gold Rating	Financial Express Five Star Quantitative rating	Total recommendations (Out of 5)
Scottish Mortgage Investment Trust		Y	Y	Y	Y	4
Worldwide Healthcare Trust	Y	Y	Y		Y	4
Baillie Gifford Japan Trust	Y		Y		Y	3
Fidelity Asian Values		Y	Y		Y	3
Finsbury Growth & Income Trust			Y	Y	Y	3
Jupiter European Opportunities Trust	Y		Y	Y		3

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RIT Capital Partners	Y	Y	Y			3
Schroder Asian Total Return Investment Company		Y		Y	Y	3
Acorn Income Fund			Y		Y	2
Allianz Technology Trust		Y	Y			2
Baillie Gifford Shin Nippon			Y		Y	2
BlackRock World Mining Trust	Y				Y	2
Fair Oaks Income			Y		Y	2
Henderson European Focus	Y		Y			2
HG Capital Trust	Y		Y			2
Independent			Y		Y	2

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Investment Trust						
JPMorgan American Investment Trust	Y		Y			2
JPMorgan Emerging Markets Investment Trust	Y		Y			2
Miton Global Opportunities			Y		Y	2
Monks Investment Trust	Y				Y	2
Personal Assets Trust		Y		Y		2
Schroder Asia Pacific Fund	Y		Y			2
Standard Life UK Smaller Companies Trust	Y			Y		2

Source: Investors Chronicle

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Please note we only considered trusts for this article. If you are interested in the open-ended funds that are the most recommended by platforms, see "Six highly recommended funds" on the Investors Chronicle website or in the magazine of 12 January 2018.

INVESTMENT TRUST PREFERRED LISTS AND RATING SYSTEMS USED FOR THE RESEARCH

Charles Stanley Foundation Fund List

https://www.charles-stanley-direct.co.uk/Foundation_FundList/Filter?filter-fund-type=investment-trust&filter-ima-sector=

The Share Centre

https://www.share.com/investments-and-recommendations/other-investment-tips/our-preferred-investment-trusts

Morningstar Five Star Quantitative Ratings

http://tools.morningstar.co.uk/uk/cefscreener/results.aspx?LanguageId=en-GB&Universe=FCGBR%24%24ALL&Rating=0%7c0%7c0%7c0%7c1&CurrencyId=GBP&URLKey=t92wz0sj7c&Site=UK

Morningstar OBSR Analyst Gold Ratings

http://tools.morningstar.co.uk/uk/cefscreener/default.aspx?Site=UK&Universe=FCGBR%24%24ALL&LanguageId=en-GB

Financial Express 5 Crown Fund Ratings

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