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Seven investment trusts offering portfolio diversification and inflation protection

Some fund managers have flagged the risk that bonds and equities may fall in tandem.

As fears of higher inflation prove anything but transitory and interest rates climb out of their depths, investors have been searching for where to move their money to diversify their portfolio and gain some inflation protection.

As this follows a period where actions by central banks have provided unprecedented catalysts for outsized returns from both equities and bonds, some newer investors may have no idea what such an investment looks like.

With threats to the 'Goldilocks environment' since the 2008 financial crisis rising, inflation and interest rates, twinned with slowing economic and earnings growth, have already taken a big stick to all sorts of assets in recent months.

As fund manager Peter Spiller, manager of Capital Gearing Trust for the past 40 years, recently said, "the zombie that is stagflation is now ominously stirring".

For those who want a selection of investments that both offer portfolio diversification and inflation protection, analysts at Investec suggested a group of seven London-listed investment funds that offer "genuinely differentiated exposure", along with a mix of long-term consistency, outperformance during downturns and protection from the big shifts taking place in markets.

These closed-ended investment companies are: Aberdeen Diversified Income & Growth Trust PLC, BH Macro (LSE:BHMG) Limited, Capital Gearing Trust PLC, JPMorgan Global Core Real Assets Ltd, Personal Assets Trust (LSE:PNL) PLC, RIT Capital Partners (LSE:RCP) PLC and Ruffer Investment Company Ltd (LSE:RICA).

"Unlike previous risk-off markets, the conundrum now facing previously omnipotent central banks is that, given rampant inflation, they do not have the same toolkit to provide the same explicit/implicit support to markets. Given these clear headwinds/challenges, we struggle to reconcile global equity levels, which are now just 6% off all-time highs," the analysts said.

A depressing new investment theme is now felt likely to hold sway for some time: the transition from the 'great moderation' to a new regime of higher inflation/volatility and lower growth, which is projected to create a significant challenge for investors.

Indeed, Ruffer recently flagged the risk that bonds and equities fall in tandem.

"This would be catastrophic for traditional 60/40 investors, who may now face a re-run of the 2000-09 period, with annualised nominal and real returns of 2.3% and -0.3% respectively," the Investec team said.

The magnificent seven?

Thus we turn to the seven investment companies mentioned above, which have a combined market cap of £9.3bn, markedly different investment philosophies, portfolios and risk profiles.

“We strongly believe that the companies featured in this report have both strategic and tactical value. Given a genuinely differentiated exposure and low correlation with equities, these companies have an important role to play in improving portfolio diversification while providing some inflation protection.”

Aberdeen Diversified (LSE:ADIG), which seeks to provide income and capital appreciation over the long term through investment in a globally diversified multi-asset portfolio, carried out a strategic review in 2020 where exposure to listed equity and long-term debt was reduced and a new 6% long-term performance target.

BH Macro (BH Macro (LSE:BHMG)) is unique, boasting on its website that higher returns are achievable when risk assets underperform, “and it has done exactly what it says on the tin”, with cumulative NAVs are 79.2% during the last six risk-off markets versus cumulative MSCI ACWI total returns of -152.4%.

Capital Gearing, managed by Spiller since 1982 and FTSE 250-listed since 2021, with a record of 39 years of positive return out of 40. The portfolio is defensively positioned, with a focus on inflation protection as Spiller and co believe prospective returns for most asset classes are “lousy” at present.

JPMorgan Global Core (LSE:JARA), which seeks to provide investors with stable income and capital appreciation from a portfolio of investment in private or managed accounts focused on real assets across real estate, infrastructure and transportation, targets a total return of 7-9%, including a dividend yield of 4-6%.

Personal Assets Trust has a flexible, long-term, long-only multi-asset approach described by the analysts at “conservative”, with no derivatives, which the manager believes guarantees cost but not protection, and the equity weighting recently reduced to just 37% of NAV, versus a 15-year range of 32-72%.

RIT aims to have a healthy participation in strong equity markets, with reasonable protection in down markets, the analysts said “we believe it gives a higher beta exposure than some of the peers in this sector, and it comfortably has the highest 10-year NAV total returns”.

Ruffer is positioned by its managers “to protect investors from what may prove to be a generational event of wealth redistribution” and compared to its two closest peers, Capital Gearing and Personal Assets, has no exposure to derivatives. Ruffer has 13.6% invested in illiquid strategies and options as a key differentiating feature as we now head into uncharted waters.