AVI Global

AGT is the top-performing global trust over three years...

Update
05 April 2023

Overview

AVI Global Trust (AGT) offers investors a truly benchmark-agnostic exposure to global equity markets. As discussed in **Portfolio**, AGT's long-standing manager, Joe Bauernfreund, looks for differentials between the underlying asset value of an investment and its share price. This has resulted in three distinctive company exposures: holding companies, closed-ended investment funds, and asset-backed securities, with the latter predominantly made up of Japanese smaller companies.

The first half of 2022 saw an influx of cash through the sales of some lower conviction holdings. However, in early 2023, the pull-back in valuations led Joe to reinvest across more idiosyncratic, event-driven strategies, such as companies seeing strategic reviews at the corporate level or portfolio sales. The team believes these companies provide a less correlated source of returns and potential source of alpha. These investment opportunities have given them the confidence to take a more aggressive stance on **Gearing** over the last few months, increasing it to 7%.

The team has also identified more opportunities in US holding companies but maintain AGT's significant underweight to the region and high-growth sectors relative to global benchmarks and the global sector peer group. Japan remains a key focus for the team where their regional expertise presents opportunities for them to actively engage where they can influence corporate governance or shareholder-friendly actions.

As discussed in **Performance**, AGT has generated competitive returns compared to the MSCI ACWI ex. USA Index and is the top performing trust within the global sector over the past three years. AGT's **Discount** is currently 9.4%, however, the continued wide discounts exhibited by its underlying investments means the 'double discount' of c. 45% is at its widest level since the Eurozone crisis – significantly wider than the 33% average.

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Analyst's View

In our view, AGT's strict bottom-up and valuation-sensitive approach has the potential to offer a more consistent long-term return profile if higher inflation and interest rates persist, particularly compared to some growthier strategies within the peer group. Furthermore, we believe the managers' focus on identifying idiosyncratic and event driven strategies may provide a less correlated source of returns for investors should the individual investment theses and catalysts materialise as the managers expect. This is in addition to AGT's significant allocation to Japan where positive regulatory reforms around corporate governance combined with the managers' experience and focus on active engagement have proven to be accretive to NAV in the past.

We believe AGT's double discount, which is at its widest level since the eurozone crisis, may offer a particularly strong long-term performance outcome. Furthermore, Joe's more aggressive stance on gearing may enhance returns, however, we are conscious that short-term market uncertainties may exaggerate the trust's volatility. We believe the increased level of diversification across the portfolio through the private equity and venture capital basket and the team's renewed interest in the US may further improve the consistency of the trust across the market cycle.

BULL
Differentiated investment strategy offering a less-correlated source of idiosyncratic returns
Strong long-term performance track record
Double discount is at one of its widest levels since the Eurozone crisis

BEAR
Value focus may lag should a focus on growth return to markets
Gearing can amplify losses on the downside, but can enhance gains on the upside
High OCF and KID RIY

Portfolio

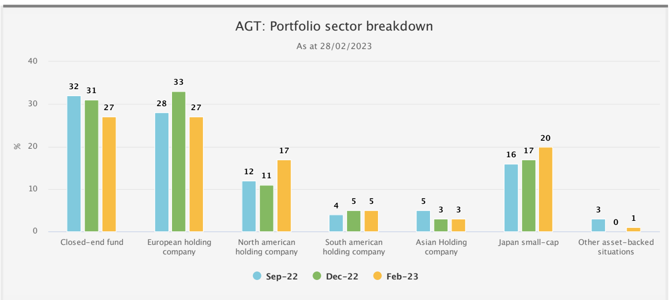
AVI Global Trust (AGT) seeks to offer investors a truly differentiated investment proposition. The strategy is centred around a bottom-up 'value' approach to global equity investing. However, AGT's portfolio managers, Joe Bauernfreund and head of research, Tom Treanor, also aim to identify investments that can provide a unique source of returns that are less correlated to the broader equity markets. The managers focus on exploiting the dislocations between an investment's underlying asset value and its share price. As a result, the portfolio is made up of closed-ended funds, holdings companies, and asset-backed situations. More recently, Joe and Tom have increased their focus on idiosyncratic, event driven strategies with a demonstratable catalyst on the horizon that may narrow the discount - leading to a naturally benchmark-agnostic investment strategy.

The team's investment process is bottom up, with the fundamental characteristics and the underlying value of each investment opportunity assessed on a case-by-case basis. Where they have identified attractively valued opportunities, the managers have re-deployed the dry powder accrued from the sale of lower conviction ideas. This has led to a portfolio with a differentiated geographical exposure to others in the global sector peer group and to global benchmarks. On a look-through basis, as at 28/02/2023, AGT had a 21% allocation to Japan and a 36% allocation to Europe, which are significantly overweight than that of typical global equity strategy, and a significantly underweight allocation to the US of 25%.

The team has over three decades of experience investing in Japan and have bolstered their resources through hires of Japanese nationals in recent years. The investment manager, Asset Value Investors (AVI), also manages a dedicated Japan Trust, AVI Japan Opportunity (AJOT). The NAV overlap between the two trusts' Japanese holdings is just 21% which reflects the team's ability to allocate to less liquid opportunities through AJOT. AGT's Japanese holdings form the bulk of the allocation to asset-backed special situations, and as shown in the chart below, AGT's allocation to Japanese smaller companies has increased in recent months. Joe believes the region presents opportunities through the lack of research, weak disclosures, and historic lack of investor interest. Government-led corporate governance reforms and an improving environment for shareholders means AVI is well placed to benefit given their focus on active engagement with management around operational improvements and shareholder-friendly actions. Examples of such opportunities are medical equipment manufacturer Nihon Kohden, and DTS Corp which we discussed in our **previous note**.

Although the team do not tend to make macro-calls, part of the reason for adding a 3% allocation to regional Japanese banks in recent months was the expected positive impact that tighter monetary policy would have on the sector. In addition, the team are seeing high-profile activist interest in a call for consolidation due to the saturation of the industry that has had to contend with interest rates pegged to the floor, an ageing population, a slowing economy, and demand for loans. If it were to materialise it may provide a catalyst which generates an idiosyncratic source of returns.

Fig.1: Evolution Of Portfolio Sector Breakdown



Source: AVI Global

The team looks to exploit the 'conglomerate discounts' associated with the perceived complexities of holding companies' management teams having to oversee distinctly different companies. This naturally leads to long-standing family-owned companies with a greater number of opportunities found outside the US. An example is FEMSA, which is the owner of the Oxxo-branded convenience store chain taking over Mexico. The convenience-based business model means they have strong pricing power, and low capital intensity with the construction of a new store recuperated after three years. Store dependency is high as they are used to pay bills and subscriptions, and the expected launch of a payments app is going some way to addressing the lack of personal bank accounts in the region. The company currently trades on a stub multiple of 8.4x and the team are happy to hold until it reaches the level of competitors at 15x.

Early in 2022 the team identified the US as a further potential source of idiosyncratic, event-driven strategies. For example, Spectrum Brands is an event-driven US conglomerate. The team are looking to exploit a re-rating opportunity associated with the company's simplification strategy as they seek to sell numerous assets to focus on their core pet care and homes and gardens businesses. A potential catalyst is the sale of their home improvement and hardware arm to Sweden's Assa Abloy. Following the initial announcement in 2021, regulators have prevented the deal's approval on competition grounds. However, the team are optimistic the deal will be approved following Assa Abloy's sale of US assets, which should alleviate the competitive concerns. If successful, management will have significant capital at their disposal, with debt reduction and the return of capital to shareholders through an aggressive buyback, being top priorities.

Joe has been actively rotating the portfolio to accommodate the team's higher conviction investment ideas. Former top holding, Pershing Square Holdings, has been trimmed to 6% leading to a reduction in AGT's closed-ended fund exposure. However, the team's conviction in the holding remains strong particularly in Universal Music Group which makes up 25% of Pershing's portfolio. However, the wide discount has remained sticky, and they believe there isn't a significant catalyst on the horizon for it to narrow, particularly given the size and ownership structure of the fund leaving little room for active engagement.

In our **previous note**, we highlighted that excessively wide discounts in UK-listed private equity and VC closed-ended funds, and the opportunities for funds to exploit the widening dislocation between prices in the secondary and listed markets, resulted in a basket allocation to the sectors over the past 12-18 months. Recently, Joe has added to AGT's long-term holding in Oakley Capital Investments (OCI) which now stands at 8.2% of NAV. OCI's wide discount combined with OCI's conservative valuation policy provide the team with a high level of conviction in their ability to continue delivering uplifts to carrying value upon realisation events. Over 2022, OCI realised five investments at an average weighted 70% premium to NAV. AGT is OCI's largest shareholder and AVI enjoy a constructive relationship with the manager/board. Corporate governance has improved markedly with shares being repurchased at a sector-leading rate over the last few years, and NAV returns have been sector-leading with a compounded annual growth rate of 25% over the last five years. AVI expects the next catalyst could be the partial realisation of OCI's largest holding, the private universities operator IU Group.

Top Ten Holdings (Incl. Listed Private Equity And VC Basket)

HOLDING	WEIGHT (%)
Listed private equity / VC Basket	8.5
Oakley Capital Investments	8.2
Schibsted ASA 'B'	7.2
Aker ASA	6.7
KKR	6.2
Pershing Square Holdings	6.0
Christian Dior	5.9
EXOR	5.5
FEMSA	5.2
Brookfield Corporation	4.9
Apollo Global	4.4
Total	**68.7**

Source: AVI Global, as at 28/02/2023

The bottom-up focus has also resulted in the reduced allocation to European holding companies where the idiosyncratic opportunities to generate alpha have recently proven to be less obvious, including the partial sale of EXOR, and full sale of Eurazeo. However, Joe has more than doubled AGT's position in Norwegian holding company Schibsted, which offers an exposure to high quality online classified ads. The team believes the industry has dominating network effects which translate into protected positions, pricing power, and considerable opportunity for organic growth which could prove attractive in the current high inflationary environment. Currently, it trades on a 31% discount and at an 8.6x stub-multiple rating. The team expects the managers to announce the spin-off or sale of its large stake in listed company Adevinta as a result of their strategic review, which based on the peer group, could see Schibsted's multiple expand from 8.6x to between 15-20x.

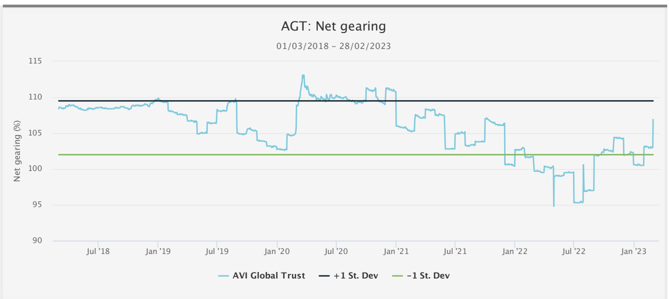
Finally, AGT maintains a significant allocation to 'asset-heavy' alternative asset managers such as long-term holdings KKR and Apollo. Having performed strongly in 2020 and for most of 2021, these holdings have been hit hard in the market sell-off and have been added to. Tom contends that the market misunderstands the companies as levered plays on financial markets and fails to recognise the resilient and defensive nature of their revenues with management fees predominantly charged on long-duration committed capital. Brookfield Corporation was a more recent addition to the portfolio as an event-driven play ahead of the spin of a 25% stake in its asset management business. The spun business (Brookfield Asset Management) has traded well as expected and has been sold to fund an increased position in Brookfield Corporation, which trades at what the team believe to be an unsustainably wide discount to the value of its investments in its own listed funds, private real estate assets, and its remaining 75% stake in Brookfield Asset Management. Tom believes the success of the Brookfield Asset Management spin-off provides a template that KKR management may use at some point in the future to resolve their own undervaluation. Note that the Brookfield investment was accompanied by the purchase of a short total return swap on an S&P 500 tracking ETF to minimise additional broader market exposure.

Gearing

In recent months, Joe has taken a more aggressive stance on gearing with the aim of enhancing shareholder returns over the long term should valuations recover. AGT's net gearing has increased to 6.9%, as at 28/02/2023, which is higher than the AIC global sector simple average of 1.8%, according to JPM Cazenove, and AGT's five-year average of 5.8%. Whilst the board overseas the gearing policy, the deployment of debt is, ultimately, a portfolio management decision undertaken by Joe.

The last three years has seen Joe take a more cautious approach to gearing. Given the uncertain macroeconomic backdrop, this continued into 2022 and AGT's gearing remained relatively flat averaging 0.5%, according to Morningstar. In fact, AGT briefly held a net cash position, as shown in the chart below. This was not a conscious decision and was primarily due to the profitable sale of the Romanian closed-ended fund Fondul Proprietatea in September 2022. This and other sales, led to a significant level of dry powder which Joe accessed to capitalise on new and existing positions.

Fig.2: Five-Year Net Gearing



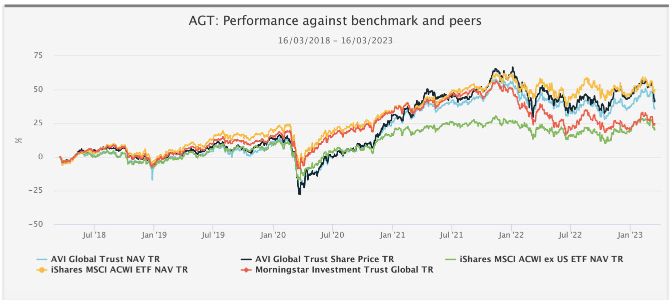
Source: Morningstar

To take advantage of the low interest rate environment, on 07/07/2022 the board announced the issue of Japanese Yen (JPY) 8bn fixed-rate debt at an annual interest rate of 1.38% which expires in ten years – the equivalent of £49million at the time of issue. This is in addition to AGT's long-term outstanding sterling and euro debt which includes £30m at 4.184% p.a. and €30m at 3.249% p.a., both with 2036 maturities, and one €20m at 2.93% p.a. which matures in 2037. This represents a total sterling value of c. £91m in loan notes issued, representing c. 9.3% of NAV based on AGT's NAV, as at 16/03/2023. AGT also has a JPY12bn (c. £71m) short-term, unsecured multicurrency revolving credit facility.

Performance

While the past three years have been a particularly volatile period across financial markets, AGT has been the top performing trust within the global sector generating a NAV total return of 75.1% versus the peer group average of 42.5%. AGT has also delivered strong performance over the past five years, generating a NAV total return of 36.2%. This compares well against its benchmark (proxied here using an ETF) and the global sector (peer group) which generated a return of 20.7% and 24.7% respectively, as at 16/03/2023. As we discuss in **Portfolio**, AGT has a significant underweight allocation to the US, and as a result the trust is benchmarked against the MSCI ACWI Ex USA Index.

Fig.3: Five-Year Performance



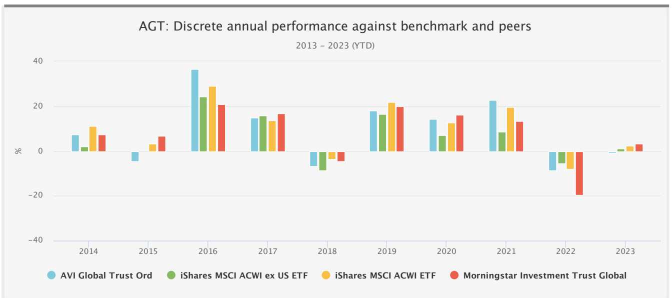
Source: Morningstar

Past performance is not a reliable indicator of future results.

We believe the consistency of AGT's long term performance can be attributed to Joe's focus on the fundamental strengths of the portfolio's holdings and the attractiveness of their valuations. We think key characteristics such as their competitiveness and pricing power could mean there is less pressure on margins should inflation remain elevated. The managers' focus on active engagement and fundamentals has resulted in a greater exposure to more idiosyncratic opportunities that can generate absolute returns regardless of broader market performance. For example, AGT's holding in Japanese IT software developer DTS, which has seen share price growth of 72.2% over the last five years. This is also demonstrated in the chart below through AGT's more consistent annual performance compared to the peer group over both 2020 and 2021 – periods that saw distinctly different stylistic biases outperform.

Furthermore, the team's investment process leads to a lower allocation to high-growth areas of the market that are typically included within the peer group's portfolios. This means AGT has been naturally less exposed to the shift in macroeconomic conditions which has hurt growth strategies. Despite suffering a return of -8.6% over 2022, the trust significantly outperformed the peer group which generate an average return of -19.6%.

Fig.4: Discrete Annual Perfromance



Source: Morningstar

Past performance is not a reliable indicator of future results.

The start of 2023 has remained volatile, and impacted many global equity strategies, however, AGT performance has been flat generating a NAV total return of -0.7% versus the peer group's 3.2%. The diversified nature of the broader index means AGT has underperformed the benchmark which generated a return of 1.2% over the same period. In a recent meeting with AGT's head of research, Tom Treanor, he argued that a misunderstanding of some of the portfolio's core holdings in US alternative asset managers has been a contributing factor and that the current sell-off is somewhat disconnected to the fundamental strengths of these companies. Furthermore, as we discuss in **Gearing**, Joe has recently increased AGT's level of gearing to 6.9%, to take advantage of more attractive valuations in the market. Although this was a long-term decision, the timing has been unfortunate, and investors may have to be patient as it may take longer than expected for investor sentiment to shift.

Below is our proprietary KTI Spider Chart. This shows how AGT has performed versus an expanded peer group of all global strategies, which includes AIC global, AIC global equity income, and the AIC global smaller companies' sectors, over the past five years in some key categories. Each category is scored out of ten based on returns over the period and scores are normalised to the peer group, with a higher score indicating a superior characteristic. As can be seen in below, AGT has a relatively consistent score across all five characteristics. The relatively 'average' aggregate performance amongst its peer group is perhaps unsurprising given AGT's unique and value-focused investment strategy has been less exposed to the growth-focused sectors that benefitted from loose monetary policy pre-2022. The structure of the portfolio naturally offers a diversified exposure; however, this can water down any diversification benefits relative to the broader market. It is likely that the cautious approach to gearing over the past three years has had a positive impact on downside protection and risk.

Fig.5: KTI Spider Chart

Source: Morningstar, Kepler calculations

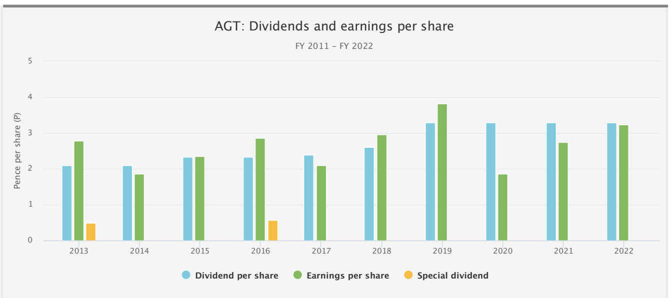
Past performance is not a reliable indicator of future results.

Dividend

AGT's portfolio is managed primarily to generate long-term capital growth, therefore the investment strategy does not target income generation. Based on the current share price, AGT currently has a dividend yield of 1.8%, which is below the AIC Global peer group's average 1.9% dividend yield, according to JPM Cazenove. During the last financial year, AGT's revenue return per share increased by 18.4%, which follows an increase of 40% for the previous financial year as the trust's underlying holdings continued to pay increased dividend levels following the COVID-19 pandemic. However, this increase has yet to be reflected through AGT's dividends per share as the total dividends payable over the financial year have remained unchanged since the financial year 2019 at 3.30p per share.

Since 2017, AGT's board has been permitted to distribute capital profits generated within the portfolio as dividends, with the trust's investment philosophy leading to its underlying holdings paying increased or special dividends, if the company has exceptional income from its investments, which can cause a somewhat volatile revenue stream across years.

Fig.6: Dividend And Revenue Per Share



Source: AVI Global

Past performance is not a reliable indicator of future results.

Management

AGT's is managed by Joe Bauernfreund, who has been the sole manager of the trust since October 2015. Joe is also the CEO and CIO of Asset Value Investors (AVI), the investment manager, and has been with the group since 2002. Joe also manages the AVI Japan Opportunity Trust (AJOT). Joe started as an analyst on European holding companies before becoming a co-manager of AVI Global, then British Empire Trust, in 2013. It is worth noting that AGT has operated with a very low manager turnover, having had only three portfolio managers in over 35 years.

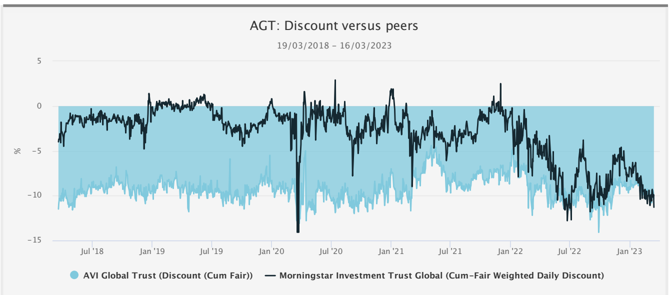
Joe is supported by Tom Treanor. Tom is the head of research and has been an AVI director since 2017. Tom joined AVI in 2011 and leads on closed-ended fund research, having had significant analytical experience covering the sector with a focus on activism engagement. The pair are supported by a team of dedicated analysts, and, thanks to the success of AVI, they have been able to bolster their analytical resources in recent years. The additions include two new junior analysts, two dedicated Japanese analysts and one dedicated ESG analyst, making a total of 12 dedicated investment specialists within the AVI investment team.

Discount

AGT is trading at a discount of 9.4% at the time of writing. This compares to the AIC Global sector's simple average discount of 9.3% according to JPM Cazenove. This discount is not particularly unusual for AGT given its average discount over the last five years is 9.2%, however, AGT's discount has been on a widening trend since halfway through 2021, as illustrated in the chart below.

Despite the recent widening, the board's implementation of a discount control mechanism (DCM) has helped to ensure AGT's discount volatility has remained significantly lower than the peer groups. Through the DCM, the board utilises share buybacks when it is deemed to be in the shareholders' best interests. During the previous financial year, which ended on 30/09/2022, AGT's board repurchased 19.1m shares or 3.7% of the original number of shares in issue at the start of the period, at a weighted average discount of 10.3%. Pressure on the discount has remained and since then, the board has repurchased a total of 11,251,782 shares or 2.3% of the shares in circulation at the start of the 2023 financial year. Investors should also be aware that on 9 November 2021, AGT implemented a five-for-one share split, increasing substantially the number of shares in circulation from c. one million to c. five million.

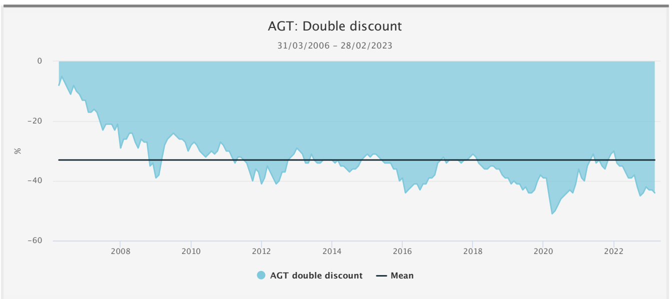
Fig.7: Five-Year Discount



Source: Morningstar

In addition, Joe and the team seek to identify investment opportunities where they believe the share price is relatively undervalued compared to the value of the underlying assets. As a result, AGT can trade on a 'double discount'. Data provided by the manager, suggests that AGT's double discount was 44% as at 28/02/2023. At these levels it is significantly wider than the 33% average since AVI took over the management of the trust. In fact, barring the coronavirus pandemic, these figures are close to their widest levels since the Eurozone crisis in 2011. We believe this may be suggestive of good potential returns for a longer-term investor, however, we are aware of the potential for short-term market falls – particularly in the current uncertain environment.

Fig.8: Double Discount



Source: Morningstar

Charges

AGT's latest available ongoing charges figure (OCF) is 1.34% as at 30/09/2022. This includes both direct costs of 0.88% and underlying fund costs of 0.42%. We note that the calculation methodology is not consistently followed across the funds in the investment trust universe, therefore, we would argue that it is also fair to consider AGT's direct costs in isolation. On this basis, AGT is the most expensive trust amongst the AIC Global sector peer group, although it is more in line with the peer groups simple average of 0.74%, according to JPM Cazenove.

There is an annual management fee which is calculated using a tiered cost structure based on the NAV of the portfolio, which is 0.7% on net assets up to £1bn. Were the NAV to rise above this, it would be charged at 0.6%. AGT charges 70% of its management fee and finance costs to capital, based on the board's anticipated long-term split of total returns in the form of capital and revenue returns of 70% and 30%, respectively.

AGT's latest KID RIY is 2.91%, which is higher than the peer group's 1.35% simple average KID RIY. AVI notes that the KID RIY includes the additional costs associated with the underlying investments, such as the gearing costs and the performance fees. Since many of the underlying holdings are investment trusts and private equity vehicles, this naturally inflates the KID RIY. AGT itself has no performance fee.

ESG

Although AGT is not an ESG-focussed investment strategy, the team understand the importance of integrating ESG risk factors throughout the investment process. Over the last two years, the team have been actively enhancing their analytical capabilities which include the development of their proprietary ESG database. This provides the team with an independent system that aligns with the team's unique approach and deeper understanding of its companies, which allows them to avoid a passive reliance on third-party data providers.

This commitment by the team to ESG is demonstrated by the addition of a dedicated analyst, Esme Morter. Having such a resource enables AVI to engage with a greater number of portfolio companies and encourage progress on a wider variety of ESG issues.

AVI conducts ESG analysis across all their strategies, monitoring the performance and progress of their portfolio companies against defined ESG metrics. Their analysis breaks down 'E', 'S', and 'G' into distinct subcategories to assess the extent to which ESG risks and opportunities are being managed and to highlight areas for improvement. The team are focussed particularly on helping to build resilience to ESG risks and avoiding ESG controversies, given the significant effect they can have on a company's valuation.

Morningstar has assigned AGT a sustainability rating of 'average' when compared to its wider global equity peers. This is an upgrade from the trust's previous rating, demonstrating the improvements being made to the trust's ESG process. However, we believe it is unlikely for AGT to be able to demonstrate superior ESG credentials due to the notoriously poor level of ESG disclosures and complex structures of family-backed holding companies and pooled investment vehicles. Investors can find a more detailed breakdown of AVI's ESG policy **here**.

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