AVI Global

AGT's increasing focus on idiosyncratic opportunities may offer a good source of diversification...

Update
28 March 2024

Overview

AVI Global Trust (AGT) offers investors an opportunity to diversify their portfolios away from traditional equity-focused strategies. The benchmark-agnostic approach taken by portfolio manager Joe Bauernfreund is characterised by his valuation-sensitive investment process, which seeks to exploit the dislocations between an investment's underlying asset value and its share price, to generate capital growth over the long term. The team focus on holding companies, closed-ended funds, and asset-backed special situations, with the latter predominantly made up of allocations to overcapitalised Japanese smaller companies, currently making up 17% of the portfolio (see **Portfolio**).

As discussed in **Performance**, AGT has generated strong returns over multiple time frames, significantly outperforming the average of the Global investment trust sector and performing well relative to its new benchmark, the MSCI ACWI Index, which was changed from the MSCI ACWI ex. US index in October 2023. This reflects the unrestricted global investment mandate and the broader range of opportunities the team are seeing – particularly in US holding companies. The team take a highly active approach with a strong track record of successfully engaging with companies to unlock value and finding idiosyncratic catalysts that have driven performance regardless of the macroeconomic environment.

The increase in corporate activity and what Joe believes to be an outstanding opportunity set within his investment universe, have given him the confidence to gradually increase **Gearing** to 10% – the highest level since the start of 2022. Discounts on underlying holdings have started to narrow; however, AGT's double discount stands at 44% compared to the long-term mean value of 34%, whilst AGT's own **Discount** is 8.9%.

Analysts:
Nicholas Todd
nicholas@keplerpartners.com

Analyst's View

The broad portfolio of opportunities that Joe has built provides a genuine diversification opportunity for investors. Given the frothiness and concentration of global equity markets we believe the collection of idiosyncratic, event-driven themes that can provide a less correlated source of returns is particularly attractive. The growth in the investment team has bolstered the resources, increasing the range of coverage and ability to actively engage with companies to unlock value, be that in Japan, across holdings companies or in closed-ended funds.

With interest rates expected to ease over the course of 2024 we believe it is likely to lead to an improvement in investor sentiment and could lead to further movement in discounts across some of AGT's core holdings – particularly in private equity. Thanks to AGT's wide double discount versus its history, we believe this could be a good long-term entry point, whilst Joe's more aggressive stance on gearing should also provide an added kicker to returns.

BULL
Strong performance over multiple time frames
Focus on idiosyncratic catalysts offers a less correlated source of returns and exposures
Double discount presents a good long-term entry point, particularly given the potential for easing interest rates

BEAR
Valuation focus may lag in a high growth driven environment
High OCF relative to peer group and charges can be complex
Gearing can exaggerate losses but can enhance gains on the upside

Portfolio

AVI Global Trust (AGT) seeks to identify a range of high-quality investments that are trading at what portfolio manager Joe Bauernfreund and head of research Tom Treanor believe to be significant discounts to their underlying value. Portfolio construction is unrestricted, offering investors a benchmark-agnostic exposure to a range of assets not commonly found within other global-equity funds. Joe's process is valuation driven and looks to exploit the dislocations between an investment's underlying asset value and its share price to generate capital growth over the long term, resulting in allocations to closed-ended funds, holdings companies, and asset-backed special situations.

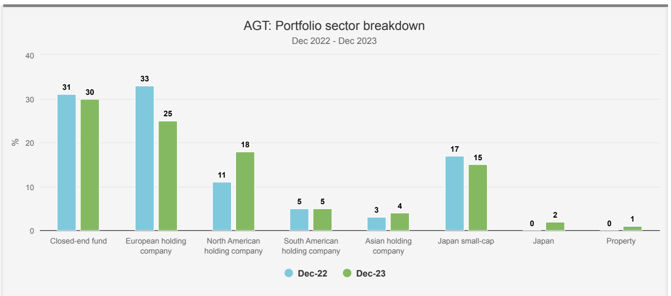
The investment process is fundamentals driven; however, the team also look for a clear catalyst for a share-price re-rating, and over the past couple of years a greater focus has been on identifying more idiosyncratic investment opportunities that are typically less exposed to broader markets and the macroeconomic environment. Arguably their approach is quite contrarian in that they will look to invest in companies that are either under-researched or misunderstood by the market. Given the number of opportunities the team are seeing, gearing has been gradually increasing over the last 18 months (see **Gearing**).

The team also take a very active approach to engaging with investee companies to extract value – particularly through their significant allocation to Japan. The investment manager, Asset Value Investors (AVI), has over three decades of experience investing in Japan and also manages a dedicated Japan trust, AVI Japan Opportunity (AJOT). The team have bolstered their expertise with the hire of several Japanese nationals in recent years and increased their presence in Tokyo. The focus is at the smaller end of the market-cap spectrum where cash-rich, relatively attractively valued companies have the potential to re-rate as the team provides recommendations to improve efficiencies across investee companies' operations. We discussed examples such as Nihon Kohden, Fujitec and DTS Corp in previous notes. The allocation currently makes up 17% of the portfolio (as at 31/12/2023), making up the bulk of the allocation to asset-backed situations. The key rationale for the position is the ongoing political drive to improve corporate governance standards. In particular, pressures from the Tokyo Stock Exchange for companies to improve return on equity have the potential to contribute to a re-rating of portfolio holdings. During a recent meeting, Tom also cited the improving macroeconomic environment, which has seen sustained inflation and increasing wages and is an additional potential driver of returns in Japanese equities.

AGT's allocation to North American holding companies has increased from 11% to 18% over the 12 months to the end of 2023. This has come through strong performance of alternative asset managers such as KKR and Apollo, which are benefitting from growth tailwinds from greater allocations to alternatives (see **Performance**).

Joe has also built a position in News Corp, which is controlled by the Murdoch family. Joe and Tom believe this holding company is fundamentally misunderstood and after the Murdochs pulled out of a proposed merger with Fox News, following negative feedback from shareholders, they initiated a position. They also believe the underlying assets are very high quality and misunderstood by the market, including what they call the jewel in the crown, unlisted business Dow Jones, which owns the Wall Street Journal and a collection of high-margin, largely recurring revenue-information-services businesses. Joe and Tom believe the family are acutely aware of the conglomerate discount and management have become more vocal about taking steps to correct this. A blue-sky scenario for Joe and Tom would be the spin-off of the Australian listed real estate property portal REA Group. At 39% of NAV, returning the asset when News Corp is trading at a 40% discount to NAV could provide a catalyst to unlock a significant amount of value.

Fig.1: Portfolio Evolution



Source: Asset Value Investors

Top-slicing some high-performing holdings such as Schibsted (see **Performance**) has allowed for Joe to increase the allocation to holding companies by ten percentage points over the last 12 months to 58%. The breadth of opportunities has increased the competition for capital, as Joe has rotated into positions he believes have a greater catalyst for re-rating. That said, AGT remains concentrated with the top ten and 20 positions accounting for c. 55% and 88% of NAV respectively. The sale of Pershing Square Holdings has been redistributed to the likes of Hipgnosis Songs Fund (SONG), as the team increased their stake in Q3 and Q4 of 2023, playing a leading-activist role in advising shareholders to vote against continuation and a related party sale of catalogues, and proposing new board members. Tom continues to engage with stakeholders and believes a reconstituted board and sale of the catalogue could drive significant upside.

They have also built a position in Bolloré, which Tom notes is one of the few remaining complex European holding companies. It is controlled by Vincent Bolloré and its complex self-ownership loops mean the share count is around half that is stated. The cancellation of these shares would provide an increase in the relative stake in Universal Music Group (UMG) and Vivendi, which make up 18.3% and 29.5% of NAV respectively. This also replaces AGT's indirect stake in UMG held via Pershing Square, but via a holding structure with a clearer catalyst for a share-price re-rating. Furthermore, the sale of an African logistics business puts Bolloré in a net-cash position equating to a third of the NAV (€6bn). With this amount of dry powder, they believe Vincent will likely squeeze out minority shareholders, offering them a tighter discount to NAV over time.

Discounts across the listed private equity sector also continue to present AVI with opportunities. With transactions in the private secondary markets taking place between 10–15% discounts to NAV and fund of funds still trading at 30–40% discounts, there are clear valuation disconnects. They have also benefitted from corporate activity, including Pantheon International's board announcing a commitment to buybacks, and the tender offer in September 2023. They also hold a significant stake in Princess Private Equity – a position they initiated on the back of an announcement of a dividend suspension (see **previous note**) and have since engaged extensively with the board. On 25/03/2023 Princess announced a new capital-allocation policy that will see large amounts of excess free cash flow automatically allocated to share buybacks at certain discount trigger points.

More recently, wide discounts in the infrastructure sector have also resulted in a position being built in GCP Infrastructure, although Tom noted this was still at an early stage. This has been alongside building a more diverse range of opportunities in the likes of retail giant Frasers Group and sports betting and gambling business Entain, which are discussed in greater detail in their monthly **newsletter**. Ultimately, we believe the portfolio offers exposures which are rarely held by other global equity strategies, providing a good source of diversification and idiosyncratic opportunities in an increasingly concentrated market.

Top Twenty Holdings

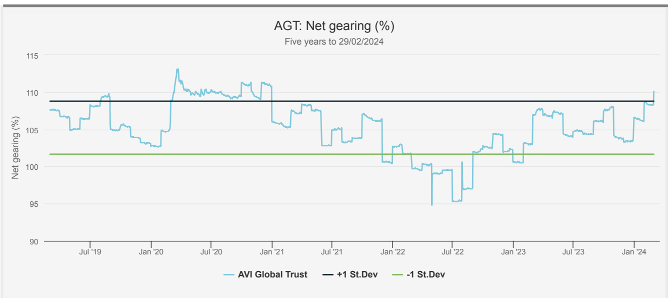
INVESTMENT	NAV (%)	DISCOUNT (%)
Oakley Capital Investments	7.0	-33
FEMSA	6.1	-19
Princess Private Equity	5.7	-27
Schibsted B	5.5	-18
Aker ASA	5.2	-24
KKR	5.2	-16
Apollo Global	5.1	-27
D'leteren	5.1	-32
News Corp A	5.0	-45
Pantheon International	5.0	-34
Hipgnosis Songs Fund	4.7	-51
Brookfield Corporation	4.2	-41
Japanese Regional Bank Basket	4.2	-
Christian Dior SE	3.8	-19
Bolloré	3.7	-44
Godrej Industries	31	-54
Nihon Kohden	3.0	-33
IAC	3.0	-43
GCP Infrastructure	2.6	-32
Wacom	2.5	-17
Total	**89.7**	
Average discount		**-32.1**

Source: Asset Value Investors, 31/01/2024

Gearing

Since the second half of 2022 Joe has been taking a gradually more aggressive stance on gearing, following a prolonged period after the pandemic where gearing was reduced as discounts across the portfolio and universe narrowed. Net gearing has increased to 10%, which is its highest level since the start of 2021 and more than one standard deviation higher than its five-year average. During a recent meeting Tom explained this higher level of gearing is based on their bullish views on the discounted and idiosyncratic opportunities they are seeing in the market. That said, gearing is unlikely to rise materially above the current level. Whilst the board oversees the gearing policy, the deployment of debt is ultimately a portfolio-management decision undertaken by Joe.

Fig.2: Five-Year Net Gearing



Source: Morningstar

To take advantage of the low-interest-rate environment, in July 2022 and July 2023 the board announced the issue of Japanese yen (JPY) fixed-rate debt, adding to its outstanding long-term sterling and euro denominated debt listed in the table below. This represents a total sterling value of c. £137.6m in loan notes issued, representing c. 12.1% of AGT's net assets, as of 12/03/2024. AGT also has a JPY12bn (c. £62m) short-term, unsecured multi-currency revolving credit facility; however, there were no drawings on this facility as at 30/09/2023.

Long-Term Debt

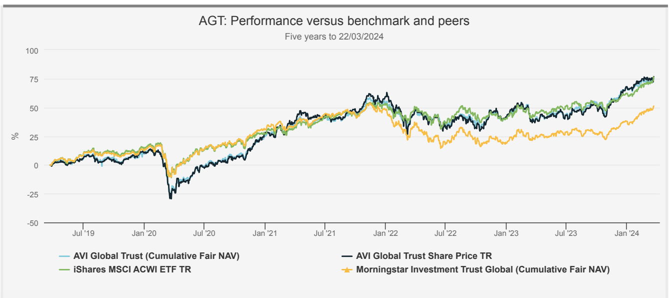
NOTE	STERLING VALUE (AS AT 19/03/2024)	INTEREST RATE	MATURITY DATE
Japanese yen (JPY) 8bn	£42m	1.38%	July 2032
JPY4.5bn	£23.5m	1.44%	July 2033
€30m	£25m	3.249% p.a.	2036
£30m	-	4.184% p.a.	2036
€20m	£17.1m	2.93% p.a.	2037

Source: Asset Value Investors

Performance

The past five years has been a particularly volatile period in financial markets; however, AGT has been one of the strongest-performing strategies in the in the AIC Global sector, generating a NAV total return of 75.0% compared to the 51.2% generated by the average of the sector in the five years to 22/03/2024. Over the past several years the US allocation has crept up as the team has been identifying a greater number of opportunities there. Therefore, at the start of the current financial year (01/10/2023), the benchmark changed to the MSCI ACWI replacing the MSCI ACWI ex. US Index before this date. Impressively, despite being significantly underweight in the US, AGT has also performed well compared to the MSCI ACWI, as represented here using the iShares MSCI ACWI ETF, which has generated a return of 76.4% over this period.

Fig.3: Five-Year Performance

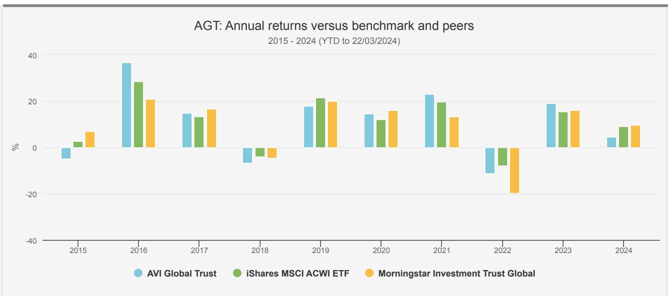


Source: Morningstar
Past performance is not a reliable indicator of future results.

Breaking down AGT's performance over the last ten calendar years we see that it has provided investors with a relatively high average annual return, generating 11.5% versus the peer group and the new benchmark, which have generated a return of 9.6% and 11.3% respectively, as at the end of 2023. AGT's focus on finding idiosyncratic opportunities has been a source of alpha versus both the benchmark and peer group average. We would argue it is because the portfolio has been less exposed to the uncertain macroeconomic conditions that have had a greater effect on growthier-focused strategies such as those typically found within the global sector. This was a particular benefit in 2022 where AGT experienced a significantly lower drawdown than the peer group.

We would argue that the strong performance coming out of tough financial market conditions, such as that seen in 2021 following the pandemic, and in 2023 following high inflation and a sharp series of rate hikes over 2022, demonstrates the team's eye for finding good value through discounted opportunities. The outperformance over 2023 was particularly impressive, given the dominance of the Magnificent Seven and their concentration within global indexes and many global-sector strategies. During our recent meeting, Tom noted that the returns for AGT can be attributed to a broader range of holdings, including Mexican holdings company FEMSA and Norwegian holding company Schibsted, both of which undertook significant corporate transactions and structural changes to simplify their group structures and narrow the discounts at which they trade. Furthermore, alternative asset managers KKR and Apollo did very well as the market became more appreciative of their resilient fee-related earnings and less wary of their balance-sheet heavy business models and as investors shook off their negative sentiment towards US-based asset managers following the banking crisis earlier in the year, generating a total return of 69% and 47% respectively.

Fig.4: Discrete Annual Returns

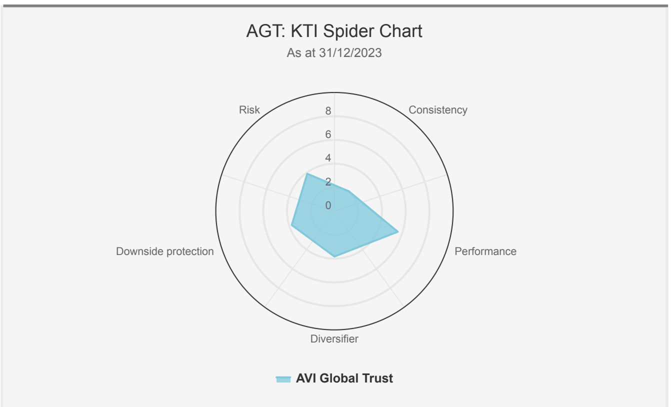


Source: Morningstar
Past performance is not a reliable indicator of future results.

We note that there were a handful of detractors over the year, the largest of which, with a -3% share-price return, was the Norwegian holding company Aker BP, although this was mainly due to the weakness in the krone over the year. Hipgnosis Songs Fund (SONG) also struggled, having been impacted by a range of governance and accounting concerns, and the team added aggressively at declining share prices and see a clear investment case once the dust settles (see **Portfolio**). That said, the detractors were more than offset by the stellar performances across a range of AGT's highest-conviction positions.

Below is our proprietary KTI Spider Chart, which compares AGT's five-year performance characteristics versus an expanded peer group of all global equity investment trusts, across generalist and specialist sectors. A selection of key characteristics is considered, with ten being the maximum score and a higher score indicating superior performance in that characteristic, relative to the peer group average. AGT has delivered a good performance score relative to the wider peer group. However, this is likely to have been held back by the strong performance of other trusts within the global sector that have had a higher weighting to US equities in general, and compared to the more specialist strategies, which includes sectors that have driven returns over this period. AGT's risk score has been impacted by its slightly higher level of volatility likely due to discount moves. Given the strategies' focus on identifying discounted opportunities, the propensity for the portfolio's underlying holdings discounts to widen out during periods of uncertainty, combined with the gearing, has had a negative effect on the trust's worst five months and the downside capture.

Fig.5: Performance Characteristics



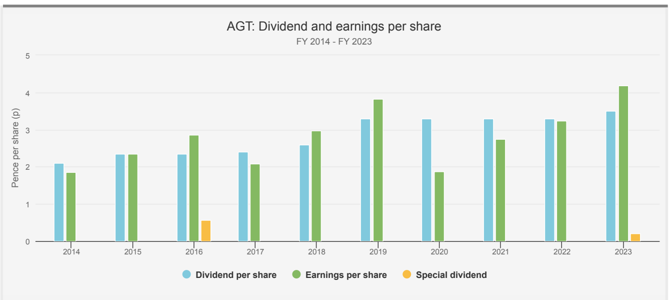
Source: Morningstar, Kepler calculations
Past performance is not a reliable indicator of future results.

Dividend

Joe manages AGT with a focus primarily on capital growth and there is no specific income target. This is reflected in AGT's historic dividend yield of 1.5%, which is below the AIC Global sector's simple average of 1.78% according to JPMorgan Cazenove, as of 22/03/2024.

However, the board recognises that a steady dividend which is able to rise over time is attractive to many shareholders. It has shown its commitment to this by utilising the revenue reserves to hold the dividend at a consistent level following a sharp fall in revenues in the 2020 financial year. The board can also pay out of capital reserves if it wishes, so it has the flexibility to maintain the payout. Since then revenues have steadily recovered, with the 2023 financial year experiencing an increase in revenues of 29% on the previous financial year. This resulted in a fully covered total ordinary dividend for the year, which was made up of an interim and a larger final dividend payment totalling 3.5p per share, representing an increase of 6% on the previous financial year. There was an additional discretionary special dividend of 0.20p per share paid, reflecting a range of what the board considers as one-off increases in revenue. Special dividends can be paid if the trust has exceptional income from its underlying investments, although they can increase the volatility associated with the income stream.

Fig.6: Dividend And Revenue Earnings Per Share



Source: Asset Value Investors
Past performance is not a reliable indicator of future results.

Management

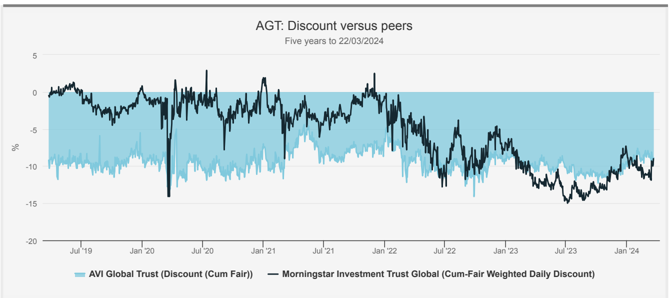
Joe Bauernfreund has been the sole named manager of AGT since October 2015. Joe is also the CEO and CIO of Asset Value Investors (AVI), the investment manager, and has been with the group since 2002. Joe also manages the AVI Japan Opportunity Trust (AJOT). Joe started as an analyst on European holding companies before becoming a co-manager of AVI Global Trust, then British Empire Trust, in 2013. 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 experience covering the sector with a focus on activist 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 analysts, two dedicated Japanese analysts – which has improved their ability to engage with their holdings in Japan – and one dedicated ESG analyst, making a total of 13 dedicated investment specialists within the AVI investment team.

Discount

At the time of writing AGT trades at a discount of 8.9%. This compares to the AIC sector's simple average discount of 10.1%, according to JPMorgan Cazenove, as of 22/03/2024. Since the Federal Reserve communicated its more dovish stance on monetary policy in October 2023, discounts have narrowed across the investment trust universe, particularly across more growth-focused strategies, as investor sentiment has improved. As a result AGT's discount has also narrowed, and at its current level is not particularly unusual, given its average discount over the last five years is 9.4%, compared to the average discount for the Global sector of 5.1%.

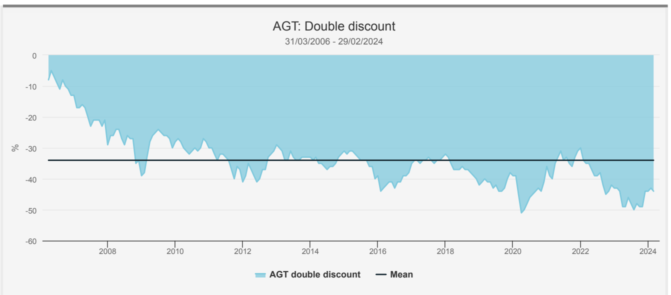
Fig.7: Five-Year Discount



Source: Morningstar

However, we note that as AGT's underlying holdings trade on significant discounts, there is an effective double discount of much more than this (see below). Data provided by the manager shows it was 44% as of 29/02/2024, which is significantly wider than the 34% average since AVI took over the management of the trust. Although it has narrowed slightly from its historically wide levels, we believe this may be suggestive of good potential returns for a longer-term investor, particularly if the likely prospect of interest rate cuts materialises over the course of this year.

Fig.8: Double Discount



Source: Asset Value Investors

The board utilises share buybacks when it is deemed to be 'unnaturally wide' and when it is in shareholders' best interests, which is an approach they encourage with many of their investee companies. During the previous financial year, which ended on 30/09/2023, 29 million shares were bought back, equating to 6% of the total outstanding shares (ex. treasury) at the start of the period. Since then, the board has continued to buy back shares, albeit at a slower rate.

The board noted that AGT has been caught up in the regulatory pronouncements relating to consumer duty and cost disclosures relating to investment companies. The inconsistencies associated with the reporting of higher costs, including strategies such as AGT's, has been a reason some investors have been put off from more alternative, and seemingly more expensive investment strategies such as AGT, which has weighed on the discount. However, if the latest reforms go through then we believe this may contribute to a narrowing of AGT's discount.

Charges

AGT's latest ongoing charges figure (OCF) is 1.27%. It includes an expense ratio of 0.86%, which is lower than the 0.88% of the previous financial year and represents AGT's direct costs relative to its net assets. This includes a tiered annual management fee charged at 0.7% on net assets up to £1bn and 0.6% thereafter. Added to this expense ratio is the cost of gearing (0.34%) and transaction costs (0.07%) to make the OCF. It is arguably fairer to consider AGT's expense ratio in isolation, which compares to a simple average OCF of 0.68% for the AIC global sector, according to JPMorgan Cazenove, as of 22/03/2024. This is because OCFs do not usually contain the cost of debt or transaction costs. AGT itself has no performance fee.

AGT no longer cites underlying fund costs as part of its charges. The board argues that these costs are already implicitly reflected in underlying fund share prices and thus in AGT's NAV, so it is fairer to exclude them. This view is increasingly viewed sympathetically by the regulator: the government and FCA are working to deliver reforms to ensure the charges associated with investment trusts are presented in a clearer and fairer way relative to other forms of investments for the benefit of investors, with the key problem to be solved being how to treat such underlying fund costs.

AGT's latest KID RIY is 1.25% as at 31/12/2023. The board has removed the additional costs associated with the underlying investments, seeing a big drop from last year, although it remains higher than the peer group's 1.12% simple average KID RIY, according to JPMorgan Cazenove, as of 12/03/2024.

ESG

AGT's investment team fully integrate ESG and sustainability factors throughout the investment process to comprehensively understand each investment's ability to create long-term value. The team at AVI have been enhancing their analytical capabilities, including the development of their proprietary ESG database. Rather than being reliant on third-party data providers, this in-house system deepens the team's understanding of investee companies with their unique approach.

AVI tracks the performance and progress of their portfolio companies against defined ESG metrics. They break down 'E', 'S', and 'G' into distinct subcategories to assess the extent to which ESG risks and opportunities are being managed and highlight areas for improvement. The focus is on building resilience to ESG risks, and the monitoring system helps to identify issues where they can constructively engage with investee companies to take meaningful action to remedy any weaknesses given the significant effect such risks can have on a company's valuation. AVI also boasts a dedicated ESG analyst, Esme Morter, who joined in 2021, which enables AVI to engage with a greater number of portfolio companies and encourage progress on a wider variety of ESG issues.

AGT has a Morningstar sustainability rating of average when compared to its wider global-equity peers. In our view, this reflects the fact that AGT is unlikely to be able to demonstrate superior ESG credentials due to the notoriously poor level of ESG disclosures and complex structures of family-backed holdings companies and pooled investment vehicles which make up a large portion of AGT's holdings. AVI has published its first **ESG Report** detailing its approach and offering insights into how this works in practice.

Disclaimer