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MIGO Opportunities

MIGO's managers say there are too many great opportunities to fit them all in the portfolio...

Update
11 July 2024

Overview

MIGO Opportunities (MIGO) is designed to exploit the broad range of opportunities in the closed-ended fund universe, which boasts a huge range of specialised strategies with strong NAV stories as well as technical opportunities that often show up via wide discounts.

Managers Nick Greenwood and Charlotte Cuthbertson look predominantly for funds trading on a wide discount to NAV, where they see a clear catalyst to that discount closing. They will at times also buy portfolios trading on narrower discounts if the NAV story is particularly strong and under-appreciated. However, currently, the main theme in the portfolio is deep discounts, with the sector exceptionally cheap versus history—it has only really been cheaper in the immediate aftermath of the 2007/2008 great financial crisis.

The largest ten holdings are trading on an average discount of 32% (see **Portfolio section**). This would imply a 47% average return should they all return to trading at par, before considering any NAV gains. It is worth stressing real life is likely to be messier than this, and not all positions will be held until the discount closes, so this is no type of return projection, but simply an illustration of the extreme valuation opportunity out there, which Nick and Charlotte tell us makes them feel like "kids in a sweet shop". They have a small net gearing position for the first time in years as a result of the number of opportunities they are finding.

MIGO's shares, themselves, trade at a **Discount** of 2.4% at the time of writing. The board has a vigorous buyback programme which has kept the discount close to NAV in recent years. MIGO is now managed by AVI rather than Premier Miton, although the management team and investment process have remained identical (see **Management**).

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Analyst's View

There are two reasons we think this is likely to prove a great long-term entry point into the investment trust sector as a whole. First, the likelihood that interest rates have peaked in the US and UK means that pressure has been relieved on the valuation of equities, listed and unlisted, while investors are likely to be looking to put cash to work rather than building up more. Secondly, wide discounts across the sector and the consensus that rates are not going to be cut fast are leading boards to cut to the chase and use all the levers they have to unlock value. Wind-ups, mergers, and tender offers are a regular occurrence, and the cheapness of the investment trust sector has encouraged value-seekers and activists to get involved, including prominent US hedge fund managers.

All this plays into the hands of Nick and Charlotte, who tell us their main problem at the moment is choosing between the huge number of attractive opportunities. MIGO offers a good way for investors to access a broad range of trusts across the space in sectors it would be hard to research individually for a non-specialist. This is all Nick and Charlotte do, however, and so they have the time and experience to get into the weeds with all the idiosyncratic investment companies on the London market. We think it could easily complement a portfolio with a more conventional asset allocation or serve as a one-stop shop for access to the deep discount stories in the sector for those investors with little investment trust exposure already.

BULL
Exceptionally wide discounts across the sector have created a rare opportunity
Specialist team devoted to the sector, now with more resources behind them at AVI
Eclectic portfolio offering access to specialist areas to which many investors won't have exposure

BEAR
Structurally higher interest rates could lead to discounts remaining persistent in many areas
Corporate activity is unpredictable and may disappoint in significant individual positions
Low market cap may mean liquidity is limited

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Portfolio

MIGO Opportunities (MIGO) has a diverse portfolio, with Nick and Charlotte able to invest pretty much anywhere and selecting opportunities based on their underlying attractions rather than with a rough asset or regional allocation in mind. The managers do have an eye for risk management though and consider their look-through positioning carefully. This means they can at times take a position in a basket of funds investing in a certain theme when they see a common catalyst to value realisation, and at other times be selective in which fund they invest in for a certain theme to avoid taking on more exposure. An example of the first trade would be the significant allocation to private equity trusts in the current portfolio. Nick and Charlotte view essentially the whole sector as strikingly cheap, while having great potential to deliver NAV returns, and have invested across a number of funds. An example of the second sort of positioning would be Vietnam, where they prefer one position in VinaCapital Vietnam Opportunity Fund (VOF), reflecting the relative size of the opportunity they see in the Vietnam sector and the amount of risk they want to devote to it. VOF is the largest position in the fund at present, as the table below illustrates, although private equity trust Oakley (OCI), along with other private equity trusts such as NB Private Equity Partners (NBPE), make up a larger allocation.

Top Ten Holdings

HOLDING	WEIGHT (%)	DISCOUNT (%)
VinaCapital Vietnam Opportunities	6.3	-19
Baker Steel Resources Trust	4.7	-31
Oakley Capital Investments	4.5	-28
JPMorgan India Trust	4.0	-17
Tufton Oceanic Assets	3.9	-19
Georgia Capital PLC	3.6	-58
Aquila European Renewables	3.4	-25
Geiger Counter	3.2	-27
Real Estate Investors	3.2	-42
Phoenix Spree Deutschland	3.1	-56
Weighted Average Discount	-	**-32.2**

Source: MIGO, as at 31/05/2024

Both positions illustrate the sort of technical opportunity that Nick and Charlotte look for, where a strong NAV story is coupled with a supply and demand issue which has led to wide discounts emerging. In the case of PE, there are a few technical reasons the trusts are trading at deep discounts; a key one centres on costs. PE typically has performance fees (or carried interest) and uses a significant amount of debt in its investment strategy which has a cost in interest. Both of these have had to be reported in official cost disclosures, which has caused many professional investors to pull back from the sector so as not to have to report them as look-through costs to their own clients. Yet the regulations forcing these cost disclosures are under review, with the government having instructed the FCA to look at changing them to ensure investment companies are not being unfavourably treated and permitting investment companies more leeway in the meantime. This could be exactly the sort of catalyst that could see investors come back into the sector, and indeed discounts have narrowed over the past year slightly, which may reflect an early hint of this move.

In the case of Vietnam, on the other hand, Nick and Charlotte argue there is too much capital in the sector, with a lot of money having been raised many years ago when Vietnam was the flavour of the month. They expect capital to be returned to shareholders via buybacks, tender offers, or wind-ups, which should over time see a balance between supply and demand and therefore discounts closing. VOF they view as a high-quality option with good exposure to private companies that they like, and so it is their preferred vehicle for this trade. Additionally, they think Vietnamese equities look very attractive in light of its strong economic growth and good trading links with China and the US.

Private equity has also been affected by a wariness about the valuation of unlisted assets in the light of a higher interest rate environment. This also led to wide discounts opening up in the growth capital sector. These are trusts which invest in minority interests in unlisted companies. Schiehallion (MNTN) and Chrysalis (CHRY) are examples that are held within the MIGO portfolio and have performed strongly over the past year (see **Performance section**). MNTN had risen c. 50% by the end of March since the managers bought it in Q4 2023. They have added to this space over the past couple of years, arguing that the market was being indiscriminate in how it treated unlisted assets, and the discounts didn't reflect the profitability within the portfolios, purely treating them all as blue sky ideas.

They have also added to trusts in the various alternative sectors over the same time frame, taking advantage of discounts that opened up as interest rates rose rapidly. These are typically "YieldCos", which were viewed as bond proxies. As rates on bonds rise, they become relatively unattractive. Nick and Charlotte view this as an opportunity: either rates fall and discounts should narrow, or capital will be taken out of the sector as investors vote to receive it back in the form of buybacks, tender offers, or wind-ups.

There is plenty of such corporate activity around at the moment. In part, this is a consequence of a high-interest-rate environment which has changed the economics of

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investment and led to major shifts in asset allocations. Another factor is the consolidation of wealth management businesses which means that there are fewer investors who can invest in smaller funds. This is compelling the smaller funds to merge or liquidate. Nick describes this as a "perfect storm", given how the technical factors (including cost issues referred to above) and economic issues have aligned.

As an example, MIGO will benefit from the decision by Tufton Oceanic Assets (SHIP) to wind down over the next few years, in light of a stubborn discount. SHIP sold two vessels above carrying value in January, a possible indication the NAV is fairly valued and implying therefore that total returns from its wind-up process should be attractive. Another fund in wind-up that MIGO owns is Real Estate Investors REIT, a midlands-focussed property fund. It is trading at a c. 40% discount at the time of writing, which would imply a gain of 33% on investment in the shares, even if the portfolio was sold 10% below carrying value. In the interim, the yield is 7.5%, and Nick and Charlotte expect handsome gains from the sale process.

Nick and Charlotte expect the top ten holding Phoenix Spree Deutschland (PSDL) to fail a continuation vote next year. PSDL owns a portfolio of German residential property. While this market is falling at the time of writing, the discount of the shares to NAV is almost 50%, implying good gains from any wind-up process, even considering the impact of the high levels of debt. The managers also own abrdn Property Income (API), a diversified UK commercial property REIT on a 29% discount to NAV which has proposed a managed wind-down to shareholders.

The managers can agitate for the return of capital themselves and have done so on occasion. In Q4 2023, Nick joined fund management company AVI, bringing the fund with him from his previous employer. AVI has plenty of expertise and experience in activism, running a number of strategies in which it is the key lever. We think this could strengthen Nick and Charlotte's hand in the future, and should provide greater resources, ideas, and heft in scenarios as they come up.

Fundamentally though, the strategy is about looking for mis-pricing, where the NAV has a strong story. Currently, the portfolio is benefitting from a position in UK micro caps, where there are a handful of funds investing in an illiquid and out-of-favour space. Nick and Charlotte hold Rockwood Strategic (RKW) amongst other funds, despite the fact that RKW has been trading on a premium for some time. They view the discounted valuations on the underlying attractive enough to hold close to par. Similarly, uranium is a theme that has been played over a few years by companies that have traded close to or above par for periods of time. Nick and Charlotte have owned Yellow Cake (YCA) which offers exposure to the physical commodity and Geiger Counter (GCL) which invests in the miners.

As it is a relatively small fund at present (c. £87m gross assets as of the end of May), the managers can take meaningful positions in the smaller and less liquid funds in the market, which are often the more specialised. Geiger has a market cap of just £72m at the time of writing, and it is far from the smallest. Baker Steel Resources (BSRT) has a market cap of c. £59m.

On a look-through basis, the current portfolio has c. 53% invested in quoted equity, 14% in private equity, and around 31% in alternatives. The exposure to alternatives and private equity, as well as the uncorrelated nature of the eclectic portfolios, have contributed to a relatively low NAV volatility over five years: 12.4% compared to 20.4% for the MSCI ACWI or 14.5% for the FTSE All Share. However, many of these funds report infrequent NAVs, and this will mechanically bias the volatility downwards. Nonetheless, we think it speaks to the benefits of diversification and the attractive risk-adjusted returns that can be achieved by taking advantage of deep discounts. Buying on a deep discount should in theory reduce the likelihood of further discount widening, as cheapness itself attracts buyers, while wind-ups and other corporate activities are idiosyncratic events which are not dependent on general market movements and can bring uncorrelated returns. That said, given how wide discounts are on the current holdings, we would expect the best returns to come when risk appetite returns to markets, at which point there could be a double whammy effect from rising NAVs and closing discounts across the board.

Gearing

We think the sharp rise in gearing since December 2023 speaks volumes about how attractive Nick and Charlotte view the current opportunity set in the closed-ended fund space. As the chart below illustrates, it has been rare for managers to be geared at all in recent years, with an average net cash position of 7.5% over the past five years. Gearing is taken through a revolving credit facility of £5m on which the trust pays SONIA plus 1.45%, and the strategy is to use it as a source of cash when the managers have more ideas they want to buy than sell—i.e. rather than as an overall call on the market to be invested across the portfolio. It is worth noting that many of the underlying holdings are themselves geared, and sometimes significantly so. As such, Nick and Charlotte consider their look-through gearing as a risk factor. The investment policy officially restricts gearing at the top level to a maximum of 20% of NAV at the time of borrowing.

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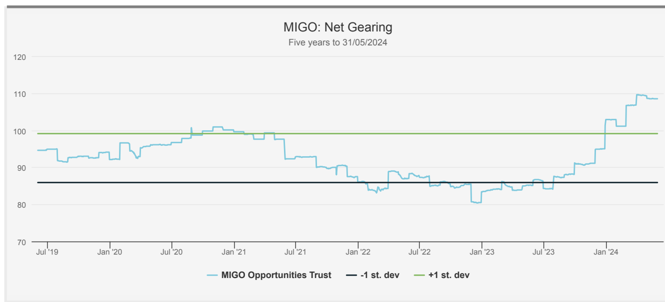
Fig.1: Net Gearing

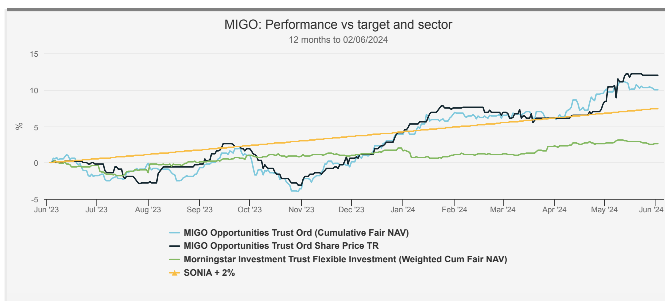


Source: Morningstar

Performance

MIGO has delivered strong performance since November last year, shortly after we reported in our last note that Nick views the investment trust sector as representing a "once-in-a-lifetime opportunity". At the time of writing, the NAV per share is up c. 14% since the end of October and the share price c. 15%.

Fig.2: One-Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.

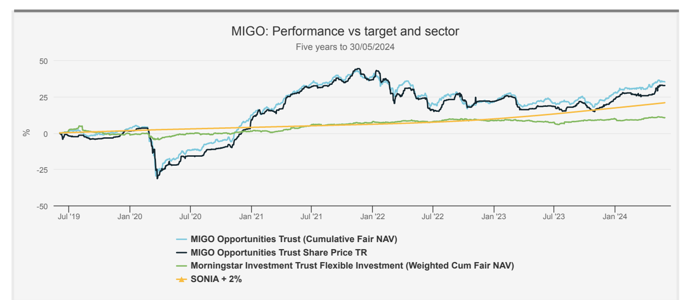
One major contributor was the uranium position, with uranium rallying hard at the start of 2024. Nick and Charlotte responded by cutting their positions into strength. Other good NAV stories have included UK micro-cap specialists Rockwood Strategic (RKW) and River & Mercantile UK Micro Cap (RMMC). The Indian holdings also saw good NAV gains in the first quarter. There have been contributions from narrowing discounts too. Schiehallion has seen its discount narrow dramatically from c. 60% in October to nearer 20% at the time of writing, as the shares have more than doubled in price. Chrysalis (CHRY) saw a similar level of discount narrowing, although some of that has since been given back. Riverstone Energy has also seen a dramatic narrowing of its discount, and excellent shareholder returns, due to stock-specific issues: the board announced a major tender offer which saw buyers.

The diversity of the drivers behind this success story is typical of MIGO's portfolio: Schiehallion and Chrysalis were largely rate expectation stories, RSE a corporate action story and the NAV stories were also very different across the trusts mentioned. On the other hand, the fate of Georgia Capital over the period highlights the risks in some of the idiosyncratic opportunities Nick and Charlotte look for and the importance of the managers remaining diversified. Georgia Capital performed strongly over most of the period before the eruption of civil unrest in Georgia amidst concerns about a pro-Russian government taking the country out of the Western orbit hit the shares hard. Phoenix Spree Deustchland, which owns residential property in Germany, has also suffered over the period as the market it invests in, the German condominium market, struggled under the pressure of higher interest rates.

MIGO's formal target is to outperform SONIA plus 2% over the long term. SONIA is an interbank lending rate closely linked to the Bank of England base rate, and so this target represents the potential yield from a high interest savings account. We also think it is informative to look at MIGO's returns versus equity markets, as by investing in listed funds it has significant equity beta in its NAV and comparable volatility. While the period since the end of October has been good for MIGO, its returns have been similar to the 14% returned by the FTSE All Share.

Over the long run, MIGO has handsomely outperformed its benchmark. As the chart below illustrates, over five years the NAV total return has been 35.1%, while we calculate SONIA plus 2% compounded would equate to returns of c. 21%. MIGO has outperformed the return to the UK equity market, with the FTSE All Share up 33.1% over the period. It could be argued that global indices are interesting comparators too, given the underlying NAV opportunities are global, even if the companies are listed in the UK. Global equities have delivered returns of 73.2%, boosted by the success of US tech stocks. A similar pattern emerges over the much longer run: MIGO has delivered returns well ahead of its benchmark over the decade and has outperformed the FTSE too (much more so than over five years), while global equities have outperformed. MIGO's NAV total return in the ten years to the end of May was 117% compared to 36.3% to its benchmark and 77.6% for the FTSE All Share. The MSCI ACWI was up by 200%.

Fig.3: Five-Year Performance



Source: Morningstar

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The narrowing of discounts is one of the opportunities that MIGO is designed to capture, but equally widening discounts are a risk factor to be borne in mind. Discounts widened across the investment trust sector in 2022 and 2023 as markets digested the implications of higher interest rates. These make yielding vehicles in the alternatives space less attractive, while they also raise the investment hurdle for any risky asset. In 2022, MIGO saw its worst year for some time, with losses of 12.7% on a NAV basis. However, while 2023 started badly, the trust finished it with a 5.1% gain thanks to the sharp rally in Q4. MIGO's best years in the last ten have been 2016, 2017, and 2021. In each year, markets saw relatively high animal spirits and delivered strong returns, but MIGO outperformed UK equities, looking at all-cap, mid-cap, and small-cap indices. In our view, the most favourable environment for the trust is likely to be in an environment in which rates are being cut, or are low, while the economy escapes a serious recession. This looks like a realistic outcome over the coming months and years, and so we think the trust could be poised to perform very well once again.

As noted, MIGO is a relatively volatile strategy, although it has tended to be less volatile than its closest peers. Over five years, the NAV volatility has been 12.4%. This is considerably lower than CT Global Managed Portfolio Growth (CMPG) and CT Global Managed Portfolio Income (CMPI), which have delivered annualised volatility of 19-20%. We would attribute this to Nick and Charlotte's greater focus on discounts and the portfolio being much more exposed to niche asset classes which are often less correlated to one another.

Dividend

MIGO's objective is to generate capital growth for shareholders, and the board's policy is to only pay out a dividend if required to retain investment trust status, which by regulation is 85% of any net income for the year. Investment management fees and other expenses are charged first against the income account, reducing the chance of a dividend being payable.

However, a dividend of 3p was paid for the financial year ending 30/04/2023, equating to a historical yield of 0.83% at the time of writing, only the second to be paid in the history of the trust. Income for the year rose as Nick and Charlotte invested in high-yielding alternatives which fell onto wide discounts in the light of rising interest rates, while management fees were lower as market capitalisation fell.

Management

MIGO is managed by Nick Greenwood and Charlotte Cuthbertson. Nick has managed the portfolio since it launched in 2004, and he was joined by Charlotte as co-manager in 2017. In March 2023, Nick resigned from the previous fund manager, Premier Miton. The board reviewed the management arrangements, consulted with shareholders and decided to appoint Asset Value Investors. In July, Charlotte joined AVI and in December, AVI took over the management contract and Nick joined AVI.

As a result, there should be total continuity in management style and approach, with the same personnel employed to run the same strategy. There is also the potential for collaboration with Nick and Charlotte's new colleagues, as AVI already invests in closed-ended funds in a number of strategies. While Nick and Charlotte retain full control of the portfolio, they are able to discuss ideas with a number of personnel at AVI who also look for discount opportunities in the sector.

Nick began his career in private client stock broking and was a founder member of Christows stockbroking operation in 1991. He joined the Christows Investment Trust team setting up their London office in 1995 and became lead manager in November 1997. Charlotte has eight years' experience in the finance industry, with the last seven years specialising in investment trusts and working with Nick. Prior to AVI, she worked at Tyndall Investment Management and Premier Miton.

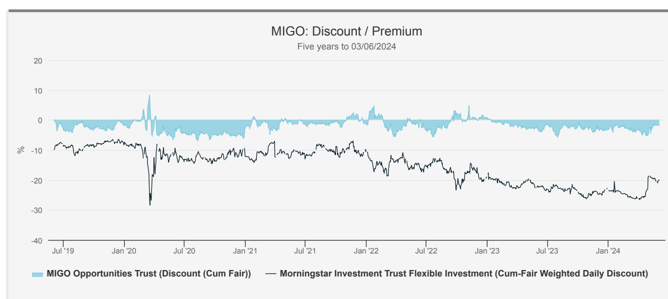
Discount

MIGO's board has a 'robust' discount management policy and aims to be proactive in managing the premium or discount. It notes that buying the trust's shares when they are on a discount is particularly attractive given the high average discount on the underlying portfolio (32% on the top ten at the time of writing). As the chart below illustrates, the board has generally managed to keep the discount narrower than 5% in recent years. In the brief periods the shares have traded at a premium, it has issued new shares to reduce this premium and lower the effect of fixed costs by spreading them over a larger capital base.

More commonly, however, the shares have traded at a discount. In particular, during 2023, when investors navigated high interest rates and fears of recession, the discount was persistent. The board responded with substantial buybacks over the year and also stepped in decisively when Nick Greenwood resigned from the trust's former manager in March. On a net basis, we calculate the board has spent c. £17.5m on shares over the past five

years, repurchasing 5.6m (again net), which compares to a current market capitalisation of £81m and shares in issue of 22.5m.

Fig.4: Discount



Source: Morningstar

MIGO also offers a realisation option to shareholders every three years, at the discretion of the board, and in the interims published in December 2023 stated it would offer such an opportunity in 2024.

Charges

MIGO's latest ongoing charges figure (OCF) is 1.6%, as of 30/10/2024. Included in MIGO's OCF is an annual management fee of 0.65%, based on the market capitalisation of the trust. We think that charging the management fee to market cap rather than net assets helps align managers' and shareholders' interests by incentivising the manager to close the discount. We note the OCF has ticked up over the past year thanks to substantial buybacks reducing the number of shares in issue.

There has been a debate ongoing about whether costs reported to investors should include the OCFs of investment trusts held as investments. MIGO's OCF and KID RIY figures (of 1.9%) both don't include these figures, and this appears to be the direction in which the new regulation is heading. It is important to bear this in mind when making comparisons though: some vehicles buying investment trusts may still be reporting these in their OCFs.

Looking at some reasonable comparators in the closed-ended universe, MIGO's charges are higher than those of CT Global Managed Portfolio, which invests in portfolios of investment trusts and has two share classes with OCFs of 1.07% and 1.17%. They are slightly higher too than AVI Global, which invests in trusts as well as directly in equities and has an OCF of 1.27%. In these cases, underlying OCFs have been excluded.

ESG

ESG matters including climate change are frequently discussed in meetings with portfolio companies and are also part of the risk assessment when deciding on whether an investment should be made. In particular, Nick and Charlotte are aware that trusts perceived to be falling behind on ESG and climate change matters could see their shares trade at wider discounts than peers. It is therefore an important part of the risk assessment when looking at possible investments. That said, the portfolio is highly diverse, and Nick and Charlotte will look for all sorts of ideas, including those in sectors or with special situations which might be considered to have a poor ESG profile at first glance. The trust does not have a rating from Morningstar for sustainability.

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