Opinion **Investing in funds**

Are investment trusts still relevant?

A year away has taught me a lot about the industry — and I still see opportunities on offer

SIMON EDELSTEN

Since the first was launched in 1868, global investment trusts have been a great way for British savers to invest in equities and bonds around the world © FT montage/Dreamstime

Simon Edelsten 12 HOURS AGO

My first City job was at Grenfell & Colegrave stockbrokers in the mid-1980s. Nobody seemed to be using the early IBM computer, so I had fun typing the green characters of C++ code. Used like an oversized calculator, it could eventually value the investment trust debentures that were traded on the exchange.

Fortunately, the computer priced the debentures a little more accurately than the market makers. As a result, this piece of kit made small profits and kept doing so for many years. We thought we were very sophisticated indeed.

I then did some investment trust broking and deals at BZW before moving into fund management, and run — or co-run — several trusts over the years.

For much of the past 12 months I have been on gardening leave, which has given me space to look at investment trusts as a private investor, completing a 360-degree tour of the industry.

And what have I learned? Since the first — the Foreign & Colonial Trust — was launched in 1868, global investment trusts have been a great way for British savers to invest in equities and bonds around the world. The structure allows some gearing. In other words, managers can borrow cash to buy assets they think will generate a better return than the cost of the loan — a great way to fuel performance when it works. Not so good when it doesn't.

For those less concerned about tech valuations, Scottish Mortgage retains an excellent long-term record

An investment trust is overseen by a board of directors who, at their best, encourage fund managers during gloomy times and calm them down if they become overexcited. But does this model still work in the 21st century?

Perhaps the best way to judge that is to look at performance. The large global equity funds have been excellent over the past five years. The weighted average net asset performance of the group is 71 per cent to the end of September 2024; the performance of the MSCI All-World index is only 64 per cent.

The problem with trusts is that when investors are nervous or uninterested the share price can fall below the value of the assets held. If a trust has assets of, say, £100 and the shares trade at 90 pence, the shares are said to trade at a 10 per cent discount.

This is where we are today. As discounts have widened, the full increase in the value of the underlying assets — known as "net asset value" — has not come through to share prices. In the past five years to the end of September, these have risen by only 60 per cent on a weighted basis.

The short-term performance of the group has not been good either. Net assets have risen by 17 per cent over one year, while the index has risen by 20 per cent. A tracker fund has done a better job — and tracker funds do not suffer from discounts.

Of course, discounts can be attractive if you are a buyer. Less so for holders. Boards have been stalwart in trying to reduce discounts. This is usually done by trusts buying back shares themselves to support demand.

This can seem a thankless task. Until about a year ago, I managed the Mid Wynd International Investment Trust with Alex Illingworth at Artemis. The board has long maintained a 2 per cent discount limit — demonstrating loyalty to existing holders. But holding the line here has led them to buying in a fair amount as investors get to know the new manager (as happened when I first took on the trust).

Keystone, another trust, found it so hard to manage the discount that its board wound it up.

While high discounts seem a permanent risk today, it is not that long ago that many trusts were trading at a premium and issuing new shares. There are still many great performers in this space.

The F&C Investment Trust's performance record has been consistently good, and the current discount of nearly 10 per cent seems unmerited. The AVI Global Trust and the Brunner Investment Trust have also produced very good performances. The former is a "deep value" investor — an investment approach that may suit those who believe Microsoft, Nvidia et al are too highly valued.

For those less concerned about tech valuations, Scottish Mortgage retains an excellent long-term record. However, it has been volatile recently, which has worried many.

In my view, high volatility is a serious issue for trusts, as your investors may not stick with you through the dark times to enjoy the rewards over the long term. I believe boards should discourage investment structures that raise volatility, such as very large individual stock positions, very large unlisted equity holdings or excessive use of gearing.

Over the past year I have invested privately. My largest investment is in the Hansa Investment Company. As the name suggests, its model is the family trading businesses of history and building family wealth over generations. All the same, its five-year record — growing assets by 50 per cent — is not shabby, and the shares have risen 25 per cent this year while still trading on a 38 per cent discount to net asset value.

William Salomon has guided Hansa over the decades. In recent months he has simplified the structure, and it is likely that the trust's main investment, Brazilian port company Wilson Sons, will be sold. This investment represents around 20 per cent of Hansa's assets. A sale would most likely lead Hansa to focus on its holdings in liquid investment funds. A smaller discount is likely to follow.

The past year has seen many British savers choose tracker funds over traditional investment vehicles. This probably accounts for some of the widening of discounts, though another issue has been the misleading way in which trusts were asked to declare their charges — an issue that seems finally to have been resolved.

It is a challenging time for trusts, but over the past century and a half they have seen many of those. Yes, they have to beat off competition from unit trusts, ETFs and, increasingly, active ETFs. But the structure is proven. Recent performance demonstrates it is still relevant. Good managers should continue to attract investors. I think some of those discounts look more like opportunities than warning signs.

Simon Edelsten is chair of the investment committee at Goshawk Asset Management.