Investors' Chronicle | Alpha

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Alpha investment trust report

25 October 2022

Bargain hunting in India and the eurozone

Britain's vulnerability has been laid bare by the shellacking of sterling and UK government bonds when the short-lived Truss-Kwarteng fiscal plan caused a ruckus in financial markets. Although there are many worldwide problems, the value of international diversification has been starkly reiterated and investors must think global.

Value in Europe and Indian growth

Tragedy in Ukraine has meant a different set of challenges for the two regions we're focussing on today. In the case of continental Europe, the energy crisis is likely to lead to a painful recession, especially as the efforts of the European Central Bank (ECB) to head off core inflation (i.e. elements not directly the result of rising energy and food prices) are likely to exacerbate pain going into a downturn. That does mean, however, that there may be some value opportunities for investment trust managers to exploit.

In some respects, Europe's loss has been India's gain. Prime Minister Narendra Modi is a Hindu nationalist who cares little for the suffering of Ukrainians. Western sanctions against Vladimir Putin's regime are just an opportunity for India to buy energy from Russia at distressed prices. Modi may be a controversial figure at home and abroad, but he is proving adept at balancing India's interests between ensuring energy supplies and leveraging its strategic importance (India is Asia's natural counterweight to China) to avoid repercussions for doing so.

Longer term, the global energy transition will be key to the fortunes of both regions. Europe must apply pragmatism as it seeks to reduce fossil fuel use. For India, as a country that is enormously vulnerable to climate change, an acknowledgement that it must balance the speed and sustainability of its development will be crucial.

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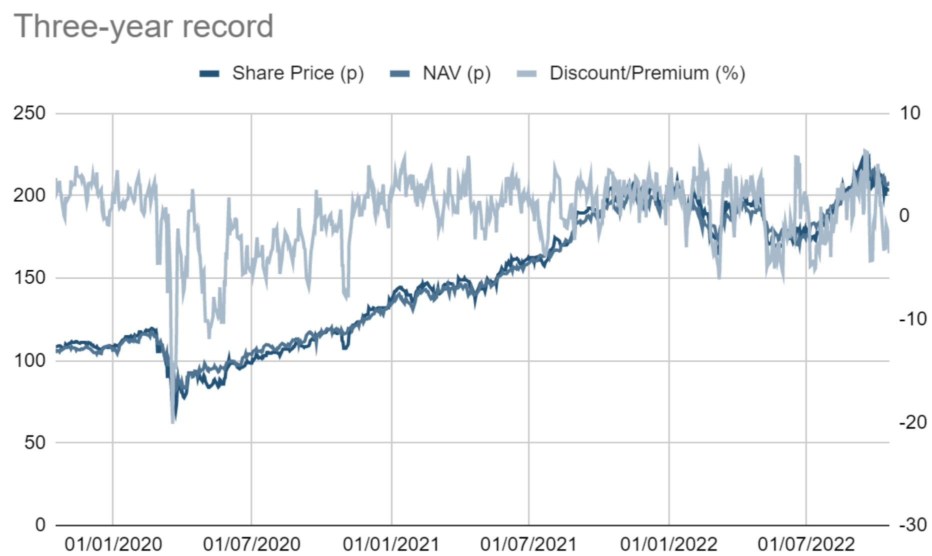
Ashoka India Equity (AIE)

Name	**TIDM**	**Mkt Cap**	**Price**	**DY**	**Gearing**
Ashoka India Equity	AIE	£222m	202p	-	1%
Discount to NAV					
Z-Score	**Now**	**Avg.**	**Low**	**High**	
-1.4	-3.10%	0.80%	6.40%	-6.10%	
Share Price Performance					
1m	**3m**	**6m**	**1y**	**3y**	**5y**
-1.00%	9.80%	3.10%	1.50%	86.20%	-

Source: Winterflood Investment Trusts



Source: Morningstar

When the Alpha Investment Trust report last covered **Ashoka India Equity (AIE)** in September 2021, the size of the three-year management performance charge, which had just fallen due, was its least appealing feature. That was, however, compensation for excellent performance versus its benchmark since the company floated in mid-2018.

AIE charges investors an ongoing charge to cover running costs that they calculate as having been 0.32 per cent of the moving average of net assets for the six months to the end of September. By the Association of Investment Companies (AIC) methodology, the annualised charge has been around 0.5 per cent.

What is rather novel is the way the trust compensates its investment manager. There is no fixed fee, instead there is the three-year charge next due in 2024, which although hefty for the 2018-21 period, is entirely predicated on beating the MSCI India IMI sterling benchmark.

Nothing was accrued for provision of the performance fee in the company's financial year just ended (June 2022), but the fee for 2021-24 will be calculated at a rate of 30 per cent of the excess returns between AIE's adjusted net asset value (NAV) per share on 30 June 2024 and the benchmark over the performance period, adjusted for the weighted average number of ordinary shares is issue over the term. The fee is capped at 12 per cent of the time-weighted average of the fund NAV over the term.

With £7.9mn paid for 2018-20 the deal is certainly lucrative for the managers when they do well. But the fees for that period were paid in the form of new shares in AIE, with 50 per cent locked-in for the 2021-24 period, so as to continue aligning the interests of the manager with shareholders.

The investment managers are Acorn Asset Management Ltd, which is domiciled in Mauritius and is wholly owned by White Oak Capital Partners Pte, Singapore. While 'White Oak Singapore' owns Acorn, the investment advisor to the manager is 'White Oak India', aka White Oak Capital Management Consultants LLP, which is a Mumbai-based boutique firm set up by Mr Prashant Khemka.

Prior to forming White Oak Capital Management Consultants in 2017, Khemka was Chief Investment Officer (CIO) and Lead Portfolio Manager of India equity and global emerging markets equity at Goldman Sachs Asset Management.

It's the expertise of the Mumbai advisory firm that has given AIE's managers the edge in becoming a stand-out performer in the India sector. The team of India analysts are compensated based on their stock picks' contribution to the fund NAV growth, which is a strong motivation to find winners.

Being cynical, an instinctive worry might be that this pushes analysts to hunt out smaller and less liquid companies. In July, the company did change its investment policy to allow the investment manager to expand the number of holdings in the portfolio, but if there is a concern about quality or liquidity then this can be assuaged by a rigorous stock selection process.

Using a cash-flow analysis framework designed by Khemka, the focus is on businesses that don't just generate profits, but have a strong cash position after accounting for capital expenditures and financing costs. As it should be, corporate governance is taken seriously, with Kepler investment trust research analysts reporting that the investment managers undertake more than 3,000 meetings a year with company boards and managers.

Although 2022 has been a volatile year for the share price, the three-year trailing share price total return of 85 per cent is impressive and the fact that the trust has been trading around discount levels in recent months could be a buying opportunity for investors sold on India's growth story.

The NAV was up 5.4 per cent in 2022 up to the end of September, which trailed the fund's benchmark slightly (8.8 per cent), although since launch the fund NAV's compound annual growth rate (CAGR) was 19.6 versus 13.1 per cent. In the fund's 2021-22 financial year, NAV returns were 9.6 per cent versus 7.2 per cent for the MSCI India IMI.

The investment managers noted key contributors to 2021-2 NAV performance, including Laxmi Organic Industries, a specialty chemicals company; Persistent Systems (2.6 per cent of the portfolio), which is an IT services provider with a strong presence in healthcare, life sciences and financial services; and ICICI Bank (the biggest position at 6.8 per cent), which given the under-penetration of credit in India, is a company they argue has a "long runway for growth".

Top holdings

Name	% Port
ICICI Bank Ltd	6.8
Infosys Ltd	5.6
Cholamandalam Investment and Finance Co Ltd	4
Titan Co Ltd	3.6
Asian Paints Ltd	3.1
Maruti Suzuki India Ltd	3
Cipla Ltd	2.6
Persistent Systems Ltd	2.6
HDFC Bank Ltd	2.5
Nestle India Ltd	2.5
Total	36

Source: Morningstar

Investments that in the last financial year detracted from overall performance included Truecaller - an ID verifications service technology company, which the managers argue has further scope to monetise its user base through ad impressions, although the company's shares lost value in the wider tech sell-off this year. Also down in 2021-22 were Metropolis Healthcare, a clinical diagnostics company that has disappointed with its execution of a key government contract; and Cartrade, which now faces more intense competition domestically in the spaces for business-to-business vehicle auctions and classified digital auto ads.

Going forward, early indicators are that Indian inflation is beginning to ease, but as in the wider world, the trade-off will be a slowdown in economic output. Year-on-year CPI increased to 7.4 per cent for September, but with wholesale price inflation (WPI) down from 12.41 per cent in August, to 10.7 per cent (which was below forecasts).

India's central bank had been proactive in raising interest rates (now 5.9 per cent), but at its last meeting maintained guidance it expects full-year inflation to be 6.7 per cent for 2023. Growth expectations were revised down, however, from 7.2 per cent to 7 per cent.

Manufacturing PMI has gently declined between July (56.4) and August (56.2) but fell by slightly more, to 55.1, in September. Perhaps most tellingly, the quarter-on-quarter business optimism index has dropped from 96.6 in July, to 69.9 in October.

Despite the long-term tailwinds for India, which include its well-educated middle class, a favourable demographic profile and benefitting from many western companies' desire to pivot from China. However, India clearly won't be immune to global recession.

For AIE specifically, the challenge will be maintaining its NAV outperformance now the fund is achieving scale. The greater flexibility afforded by the updated investment mandate should support this, although liquidity risk and position size in mid-sized and smaller companies must be managed carefully.

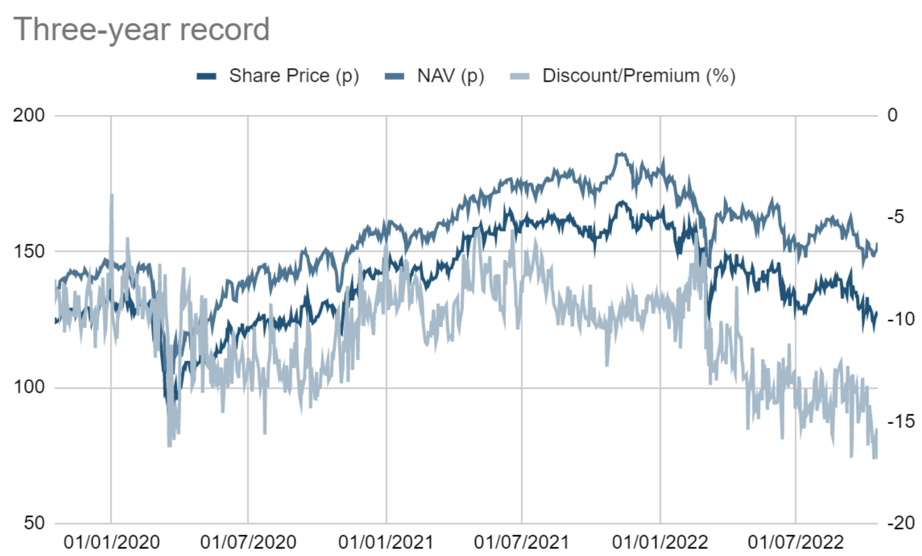
The recession risk should not be understated, but the emphasis on balance sheet strength and bottom-up stock selection could also mean the NAV proves it can outperform its benchmark in an economic downturn.

In any case, this trust should not be a core holding for a balanced portfolio. For a long-term exposure to one of the world's most exciting regions (and one that is poorly represented in most broad emerging market indices), it is a worthwhile satellite holding.

Henderson European Focus

Name	TIDM	Mkt Cap	Price	DY	Gearing
Henderson European Focus	HEFT	£277m	130p	2.70%	4%
Discount to NAV					
Z-Score	**Now**	**Avg.**	**Low**	**High**	
-1.8	-14.20%	-10.40%	-5.30%	-14.90%	
Share Price Performance					
1m	**3m**	**6m**	**1y**	**3y**	**5y**
0.80%	-2.30%	-9.70%	-14.50%	10.70%	3.60%

Source: Winterflood Investment Trusts



Source: Morningstar

Henderson European Focus Trust (HEFT) has been somewhat contrarian in the era of Environment Social and Governance (ESG) investing. With its exposure to blue chip oil and gas companies and cement manufacturers, the portfolio would be shunned by dark green purists, but is a pragmatic reflection of the world today, particularly given Europe's energy crisis.

Portfolio managers John Benett (who is Henderson's director of European equities) and Tom O'Hara are mandated by the company to maximise total return (capital growth and dividends) by investing in a portfolio of European-listed equities. Although the trust is benchmarked against the FTSE

World Europe ex-UK index, it does invest in UK-listed companies like **Shell (SHEL)**, which is its largest holding, and **BP (BP.)**.

Oil majors are certainly a theme for the trust, with French firm **TotalEnergies (FR:TTE)** also a prominent holding. Fossil fuel companies are more vulnerable than most to controversy, not only thanks to issues around emissions but also due to the sensitivities in the geographies where they or partner firms operate. France24 has [reported on allegations]() involving companies Total has owned shares in being complicit in helping Russia's war effort in Ukraine. Total has vigorously denied this and described the allegations as "outrageous and defamatory."

That aside, focusing on the environmental strand of ESG and Total, BP and Shell are three of the more progressive companies. Pressure groups will rightly hold them to task about their transition commitments but this accountability, along with the investments they make, distinguishes the European oil majors. There is a powerful argument that raw exclusion policies just sidelines production to dirtier competitors and that staying invested in firms engaged in change is far more impactful overall in reducing carbon emissions.

Name	% Port
Shell PLC	5.7
Novo Nordisk A/S Class B	4.9
UPM-Kymmene Oyj	4.5
Holcim Ltd	4.5
ASR Nederland NV	4.2
TotalEnergies SE	4
Nestle SA	4
LVMH Moet Hennessy Louis Vuitton SE	3.8
BP PLC	3.6
Roche Holding AG	3.2
Total	42

Source: Morningstar

Other investments demonstrate that the managers have an eye on the importance and opportunities around sustainability. Finnish forestry, biofuels and paper company **UPM-Kymmene Oyj (FIN:UPM)** is a top five holding, as is Swiss sustainable construction materials firm **Holcim (SWX:HOLN)**, with each being 4.5 per cent of the portfolio. Although Holcim makes cement, it tries to lead in greening the carbon intensive, but essential, material.

Healthcare and pharmaceutical firms are also a big part of the portfolio with Denmark's **Novo Nordisk (DEN:NOVO)** and Switzerland's **Roche (SWX:ROG)** major holdings.

Tracking the FTSE World Europe ex-UK index, HEFT had as of 30.09.2022 seen the total return of its portfolio, the net asset value, outperform the benchmark over six months (by 0.9 per cent), three years (6 per cent), five years (4.2 per cent) and 10 years (42.2 per cent). Over one year there has been a 0.3 per cent underperformance.

Considering the share price total returns (with dividends reinvested) gives a better picture of the returns investors would have made. This demonstrates how, despite the skill of the managers which is proven by NAV performance, the structure of investment trusts leaves investors exposed to the effects of discount widening in times of market volatility, as the shares sell off by more and take longer to recover than underlying NAV.

Over six months the total shareholder return has lagged the benchmark by 2.8 per cent; over 12 months by 5.5 per cent; over three years by 2.4 per cent; and over five years by 13 per cent. Over 10 years the TSR has beaten the benchmark by 44.2 per cent.

Observationally, that's something of a quirk. It might suggest the preference UK investors had for other regions such as North America and Asia Pacific when making overseas equity allocations in the second half of the decade, thanks to the perception that the eurozone struggles with growth.

It also suggests that discount management is an issue for HEFT as, although discounts to NAV are buying opportunities, when they are persistent it isn't good for returns. Narrowing the discount has been a focus of the trust's board as a wide discount is an impediment to issuing new shares (doing so at a discount would have a more dilutive effect on the value of existing equity) and growing the company.

Retail investor interest is seen as key to narrowing that gap, which is why the company actioned a 10:1 share split in January to help make the shares more marketable in smaller blocks. Addressing investors' environmental concerns is also important to selling the fund and the extensive ESG report published this year, helps make the case.

It's a nuanced argument, as European policy makers have found to their cost in the energy crisis. The fact that Holcim is a major carbon contributor to the portfolio needs to be weighed against the fact cement is essential to fix all those wind turbines that Europe needs.

Less subtle are the challenges for the eurozone, with the disjointed politics of the region having made it difficult for the European Central Bank (ECB) to act swiftly to rein in inflationary monetary policy. The lag now means the ECB could

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well be forced to tighten policy just as many parts of the continent are going into recession.

This dynamic is an undeniable headwind, so good stock selection and a long-term view will be important for investors in the region. Both of these facets appear evident in the approach of the investment managers, but the HEFT board could well continue to have just as great a challenge in managing the trust's discount.

Last week's tables from the full Alpha Investment Trust report

10-trust portfolio

								Discount to NAV				Share price performance					
Rank	Name	TIDM	Mkt cap	Price	Gearing	DY	Z-score	Now	Avg	Low	High	1m	3m	6m	1y	3y	5y
1	BlackRock Latin American	BRLA	£111m	378p	6%	5.7%	-2.2	-13.3%	-6.3%	3.6%	-13.3%	-2.1%	10.0%	-12.5%	19.3%	-2.3%	0.0%
2	Ashoka India Equity	AIE	£221m	201p	1%	-	-1.8	-4.2%	0.9%	6.4%	-6.1%	-11.1%	13.4%	3.1%	-2.0%	85.3%	-
3	JPM Indian	JII	£613m	808p	1%	-	-1.9	-22.3%	-18.9%	-14.7%	-23.7%	-3.8%	5.2%	3.6%	-3.8%	9.5%	7.0%
6	Riverstone Energy	RSE	£307m	590p	-1%	-	-1.9	-55.3%	-42.8%	-28.0%	-55.9%	-13.5%	3.5%	-7.5%	21.0%	14.1%	-52.8%
7	Personal Assets	PNL	£1,826m	473p	-5%	1.2%	-2.7	-0.1%	1.1%	2.5%	-1.1%	-2.3%	-2.0%	-5.2%	-2.2%	17.7%	23.8%
8	Harmony Energy Income	HEIT	£234m	112p	0%	-	-2.1	-4.1%	2.7%	10.9%	-9.2%	-6.3%	0.2%	2.5%	-	-	-
14	Henderson European Focus	HEFT	£271m	128p	4%	2.8%	-2.5	-15.3%	-10.4%	-5.3%	-15.3%	-5.6%	-2.7%	-12.1%	-16.9%	10.1%	1.0%
20	Henderson Eurotrust #	HNE	£231m	109p	3%	3.5%	-2.8	-17.0%	-11.3%	-6.4%	-17.0%	-6.4%	-5.2%	-13.5%	-25.8%	1.2%	2.7%
28	JPM Global Growth & Inc.	JGGI	£1,248m	413p	3%	3.7%	-1.8	-2.5%	1.3%	7.6%	-5.4%	-1.1%	-1.9%	-9.1%	-3.6%	40.3%	55.5%
33	Baillie Gifford US Growth	USA	£504m	165p	6%	-	-1.2	-16.7%	-9.1%	3.4%	-20.5%	-5.0%	1.6%	-25.4%	-50.7%	29.1%	-

Source: Winterflood Investment Trusts, as at 19 October 2022

Top 25

								Discount to NAV				Share price performance					
Rank	Name	TIDM	Mkt cap	Price	Gearing	DY	Z-score	Now	Avg	Low	High	1m	3m	6m	1y	3y	5y
1	BlackRock Latin American	BRLA	£111m	378p	6%	5.7%	-2.2	-13.3%	-6.3%	3.6%	-13.3%	-2.1%	10.0%	-12.5%	19.3%	-2.3%	0.0%
2	Ashoka India Equity	AIE	£221m	201p	1%	-	-1.8	-4.2%	0.9%	6.4%	-6.1%	-11.1%	13.4%	3.1%	-2.0%	85.3%	-
3	JPM Indian	JII	£613m	808p	1%	-	-1.9	-22.3%	-18.9%	-14.7%	-23.7%	-3.8%	5.2%	3.6%	-3.8%	9.5%	7.0%
4	Aberdeen New India	ANII	£317m	554p	7%	-	-1.9	-22.8%	-17.6%	-12.4%	-23.4%	-8.6%	3.4%	-2.8%	-13.0%	14.0%	21.8%
5	Riverstone Energy	RSE	£307m	590p	-1%	-	-1.9	-55.3%	-42.8%	-28.0%	-55.9%	-13.5%	3.5%	-7.5%	21.0%	14.1%	-52.8%
6	Personal Assets	PNL	£1,826m	473p	-5%	1.2%	-2.7	-0.1%	1.1%	2.5%	-1.1%	-2.3%	-2.0%	-5.2%	-2.2%	17.7%	23.8%
7	Harmony Energy Income	HEIT	£234m	112p	0%	-	-2.1	-4.1%	2.7%	10.9%	-9.2%	-6.3%	0.2%	2.5%	-	-	-
8	Polar Capital Global Financials	PCFT	£454m	139p	1%	3.2%	-1.7	-10.4%	-2.1%	5.9%	-12.7%	-5.4%	2.1%	-14.3%	-18.8%	12.1%	16.5%
9	Fidelity Japan Trust	FJV	£201m	155p	21%	-	-1.9	-11.5%	-7.0%	-1.3%	-13.2%	-3.1%	0.5%	-9.6%	-35.3%	-0.3%	14.0%
9	India Capital Growth	IGC	£115m	119p	-1%	-	-1.3	-16.7%	-12.7%	-3.5%	-20.0%	-6.1%	15.5%	8.4%	-7.6%	65.6%	16.1%
11	VPC Specialty Lending	VSL	£214m	77p	-1%	10.4%	-1.5	-26.6%	-21.6%	-14.3%	-29.6%	-3.8%	2.7%	-12.5%	-3.7%	36.2%	63.8%
12	Baillie Gifford Shin Nippon	BGS	£462m	147p	16%	-	-1.5	-8.6%	-3.6%	2.9%	-11.1%	-5.8%	2.7%	-7.0%	-36.4%	-14.0%	-3.6%
13	Henderson European Focus	HEFT	£271m	128p	4%	2.8%	-2.5	-15.3%	-10.4%	-5.3%	-15.3%	-5.6%	-2.7%	-12.1%	-16.9%	10.1%	1.0%
13	Mobius Investment Trust	MMIT	£127m	117p	0%	0.3%	-1.9	-6.4%	-1.3%	3.7%	-9.5%	-9.7%	-0.4%	-19.5%	-22.2%	41.0%	-
15	HgCapital Trust	HGT	£1,627m	356p	-5%	2.1%	-1.2	-20.7%	-9.6%	5.7%	-29.3%	-5.2%	8.4%	-19.0%	-5.6%	66.2%	132.0%
16	Pershing Square Holdings	PSH	£5,179m	2,670p	9%	1.3%	-1.3	-34.8%	-30.7%	-24.1%	-39.7%	-6.0%	4.1%	-8.9%	-7.0%	87.2%	178.1%
17	NB Global Monthly Income	NBMI	£164m	74p	-5%	7.2%	-2.0	-8.8%	-5.5%	-1.4%	-10.8%	-5.9%	-1.9%	-15.4%	-13.6%	-1.9%	2.6%
18	Pantheon International	PIN	£1,315m	248p	-9%	-	-1.5	-48.3%	-32.5%	-14.7%	-51.7%	-5.5%	1.0%	-20.8%	-17.9%	7.4%	29.7%
19	Apax Global Alpha	APAX	£835m	170p	-10%	7.1%	-1.2	-28.6%	-20.7%	-5.1%	-34.1%	4.3%	4.7%	-14.1%	-16.3%	26.1%	52.7%
20	Henderson Eurotrust	HNE	£231m	109p	3%	3.5%	-2.8	-17.0%	-11.3%	-6.4%	-17.0%	-6.4%	-5.2%	-13.5%	-25.8%	1.2%	2.7%
21	Utilico Emerging Markets	UEM	£428m	209p	4%	3.8%	-1.3	-13.0%	-11.4%	-7.4%	-14.4%	-5.0%	2.5%	-5.4%	0.0%	0.5%	10.4%
22	BlackRock Energy & Resources	BERI	£159m	118p	4%	3.7%	-1.0	-6.6%	-2.1%	10.1%	-11.6%	-9.2%	16.3%	-14.2%	18.9%	101.9%	104.5%
23	HarbourVest Global PrivEq	HVPE	£1,819m	2,300p	-7%	-	-1.0	-44.1%	-32.5%	-15.0%	-49.6%	11.1%	15.0%	-10.7%	-7.1%	34.7%	77.2%
24	Bluefield Solar Income Fund	BSIF	£770m	126p	0%	6.5%	-2.5	-8.7%	3.0%	10.4%	-13.0%	-12.8%	-4.2%	-4.9%	8.7%	16.2%	49.3%
25	HydrogenOne Capital Growth	HGEN	£109m	84p	0%	-	-1.7	-13.2%	5.5%	25.2%	-13.9%	-9.1%	-1.0%	-16.2%	-24.8%	-	-

Winterflood Investment Trusts, as at 19 October 2022

Appendix: Screening rules

The central idea behind the Alpha strategy is to look for trusts displaying an advantageous mix of value and momentum.

To fairly compare investment trusts with different remits and capital structures, the screen assesses trusts' value relative to their one-year average premium/discount.

This is done using a standardised measure called the Z-score (the number of "standard deviations" the premium/discount is from the mean average). A Z-score can be considered to be pretty cheap when it gets below -1 and extremely cheap at or below -2.

Three-month share price momentum is used as an indicator of sentiment towards trusts and their recent investment success.

The tables in this report show the top 25 investment trusts based on a combined ranking of Z-score and momentum. The 10-stock portfolio, which is what this report focuses on, represents the highest ranking trusts that meet the following portfolio rules:

- Market capitalisation must be more than £100mn.
- No tracker or hedge funds.
- No more than half the portfolio (five out of 10 shares) should have "niche" themes, and no more than two trusts should have the same niche. Trusts defined as niche are those focused on non-mainstream asset classes or sub-sectors, such as private equity, debt, technology and biotechnology; and those focused on single countries (excluding the UK and US) or high-risk economic regions such as emerging markets. We also regard trusts targeting smaller Asian companies as niche, but not generalist Asian equity trusts.
- No more than half the portfolio (five out of 10 shares) should be mainstream trusts of the same type. This rule does not apply to global funds, but it does to other mainstream themes such as trusts investing in the UK (large and small companies), Europe, the US or Asia.
- All trusts must trade at a discount to NAV.

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