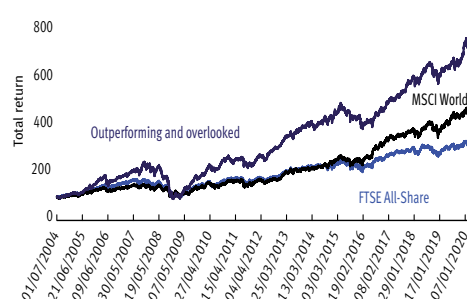




Alpha Investment Trusts: Bargains for uncertain times

The investment trust sector is wonderfully diverse. Our screen compares the best value closed-end funds, whatever their investment mandate, and identifies those with the best growth prospects. We screen for our top 25 trusts and select an automated portfolio of 10

Outperforming and overlooked trusts



Source: Thomson Datastream

Screen methodology:

To fairly compare investment trusts with different remits and capital structures, we assess funds' value relative to their historic mean premium/discount. Three-month share price momentum indicates market sentiment towards the funds. Next, a composite value-momentum ranking is arrived at using hedge fund manager Joel Greenblatt's 'Magic Formula' two-factor model. Our tables show the top 25 investment trusts and a portfolio of 10 investment trusts subject to additional selection criteria.

■ Our value and momentum-ranked Investment Trust screen has picked up on recovery bargains in Europe and Asia this month. Several of the companies in our 10-stock portfolio combine double-digit share price momentum, with discounts to their net asset value (NAV) that are wide in absolute terms and by historic standards.

■ Healthcare and biotechnology are areas that have seen widespread interest in the era of coronavirus, but even though **Polar Capital Global Healthcare (PCGH)** and **Biotech Growth (BIOG)** have enjoyed a three-month share price momentum of 28 per cent and 53 per cent, respectively, discounts to the value of portfolios they hold are relatively large thanks to NAV growth.

■ European trusts are prominent in this month's screen and if the European Union succeeds with its proposed €750bn recovery fund and the injection of further liquidity into its financial system (the European Central Bank is lending to banks at negative rates) helps shore up confidence, then this could be an interesting theme for UK investors to play through investment trusts.

JN

Analyst: Algy Hall
algy.hall@ft.com

Alpha Production Editor: Sameera Hai Baig

Making fair comparison in the richly diverse investment trust sector

Valuation metrics for trusts are very limited relative to those for other equities, with the key measure of value being the discount or premium a trust's shares trade at, compared with its net asset value (NAV) per share. However, the average historic discount of individual trusts is strongly influenced by the assets they invest in and past performance, along with multiple other factors such as the trust's structure and the level of 'gearing' it employs to enhance returns. So, while one trust trading at a 10 per cent discount to NAV may look achingly cheap against its history, another trust trading at the same discount may be considered eye-wateringly expensive.

Meanwhile, an assessment of the underlying quality of an investment trust also depends on many factors that are often unique to the trust concerned. Screens are ill-suited to providing a nuanced analysis and direct comparisons between trusts with different characteristics can be misleading.

However, we have found that a useful screen can be created by focusing on two 'high-level' factors that researchers have shown to be predictive of future share price performance: 'value' and 'momentum'. Based on 14-year back-testing of the screen (the period over which we have been able to source reliable historic data), this strategy has produced a 619 per cent cumulative total return or 482 per cent if an annual dealing charge is included for the presumed yearly reshuffles of the portfolio. Over the same period, a 50:50 split between the FTSE All-Share and the MSCI World indices has produced a 250 per cent total return (see graph on page 1). This data is based on annual reshuffles of 10-stock portfolios like the one on page 5, which applies the rules listed on page 4.

How the screen works

The screen uses the following two criteria:

Value: To hunt for value, this screen looks at a trust's premium or discount compared with its own one-year historic average. A statistical measure known as the Z-score is used to do this which produces a standardised score based on where the premium or discount sits compared with its historic range (the score measures how many standard deviations the current valuation is from the mean average). A negative Z-score suggests a trust is cheap relative to its own historic standards (the larger the negative score the cheaper). A positive score suggests a trust is expensive. Because each trust has its current valuation compared with its own valuation history rather than that of other trusts, the Z-score can be used to make comparisons between trusts with very disparate valuation characteristics.

Momentum: The other factor the screen looks at is recent share price performance. There is a huge body of research that has found rising share prices tend to beget more of the same. Specifically, the screen wants to see strong share price performance over three months. The fact that the screen looks at price and not NAV performance means some credence is given to the wider market view of a trust's prospects. For example, if sentiment has been improving towards a trust, thereby narrowing its discount over the three months, this will create stronger momentum which means a more favourable ranking from the screen. Scepticism implied by a widening discount will, by contrast, act as a headwind to price performance. That said, the overall objective when combining momentum with value is to find promising performance trends that the market has not yet fully priced in.

Bringing it all together

To assess both factors together, the screen uses the ranking method employed by hedge fund manager Joel Greenblatt in his two-factor 'magic formula' (the magic formula uses different inputs). The method simply ranks both factors and then adds the rankings together to find the trusts with the most attractive combined ranking.

The top 25 ranking trusts are presented in the table on page 5, while a portfolio of 10 trusts is published in the table on page 5 based on the following rules:

The 10-stock portfolio rules

- Market capitalisation must be more than £100m.
- No tracker or hedge funds.
- No more than half the portfolio (five out of 10 shares) should be in funds with a niche theme. 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. I also regard Asian smaller companies trusts as niche, but not Asian generalists.
- No more than half the portfolio (five out of 10 shares) should be mainstream funds 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.

10-trust portfolio

Rank	Name	TIDM	Market cap	Price	DY	Z-score	Discount to NAV			Share price performance						
							Now	Avg	Low	High	1m	3m	6m	1y	3y	5y
1	TR European Growth	TRG	£418m	834p	2.7%	-1.6	-17.9%	-13.6%	-6.0%	-22.1%	13.8%	43.8%	-12.9%	0.0%	-16.2%	48.2%
2	BlackRock Greater Europe	BRGE	£336m	399p	1.5%	-1.5	-6.7%	-3.6%	1.5%	-13.1%	13.2%	39.8%	1.0%	9.4%	30.3%	76.4%
3	Henderson Eurotrust	HNE	£253m	1,195p	2.6%	-1.4	-12.7%	-9.8%	-4.6%	-20.9%	13.8%	41.6%	1.3%	10.4%	8.6%	52.9%
4	JPM Japan SmCos	JPS	£233m	427p	4.2%	-1.4	-14.1%	-10.2%	-5.4%	-25.1%	7.0%	40.0%	-1.6%	14.2%	24.2%	85.2%
5	Oryx Int. Growth	OIG	£117m	825p	–	-1.9	-30.0%	-24.2%	-17.7%	-32.2%	0.0%	28.9%	-12.7%	6.5%	14.6%	60.2%
6	Polar Capital Global Healthcare	PCGH	£283m	234p	0.9%	-1.7	-11.8%	-8.3%	-3.2%	-21.9%	-3.5%	28.0%	1.5%	10.6%	13.3%	41.2%
7	Biotech Growth Trust	BIOG	£451m	1,150p	–	-1.0	-10.5%	-8.2%	0.2%	-19.7%	1.6%	53.3%	25.8%	58.8%	58.0%	44.0%
8	JPM Smaller Cos	JMI	£172m	220p	2.5%	-1.0	-14.5%	-9.8%	0.4%	-27.6%	11.0%	46.2%	-26.9%	2.4%	33.6%	44.8%
9	Schroder Asian Total Return	ATR	£343m	351p	1.9%	-1.8	-3.5%	1.1%	5.6%	-16.3%	6.2%	25.4%	-3.0%	0.3%	21.1%	92.5%
10	Henderson European Focus	HEFT	£257m	1,195p	2.6%	-1.4	-11.6%	-9.2%	-3.3%	-16.0%	9.4%	32.8%	-9.3%	1.2%	-6.0%	30.1%

Source: Winterflood Securities

Top 25

Rank	Name	TIDM	Market Cap	Price	DY	Z Score	Discount to NAV				Share price performance					
							Now	Avg	Low	High	1m	3m	6m	1y	3y	5y
1	TR European Growth	TRG	£418m	834p	2.7%	-1.6	-17.9%	-13.6%	-6.0%	-22.1%	13.8%	43.8%	-12.9%	0.0%	-16.2%	48.2%
2	BlackRock Greater Europe	BRGE	£336m	399p	1.5%	-1.5	-6.7%	-3.6%	1.5%	-13.1%	13.2%	39.8%	1.0%	9.4%	30.3%	76.4%
3	Henderson Eurotrust	HNE	£253m	1,195p	2.6%	-1.4	-12.7%	-9.8%	-4.6%	-20.9%	13.8%	41.6%	1.3%	10.4%	8.6%	52.9%
4	JPM Japan SmCos	JPS	£233m	427p	4.2%	-1.4	-14.1%	-10.2%	-5.4%	-25.1%	7.0%	40.0%	-1.6%	14.2%	24.2%	85.2%
5	Oryx Int. Growth	OIG	£117m	825p	–	-1.9	-30.0%	-24.2%	-17.7%	-32.2%	0.0%	28.9%	-12.7%	6.5%	14.6%	60.2%
6	Polar Capital Global Healthcare	PCGH	£283m	234p	0.9%	-1.7	-11.8%	-8.3%	-3.2%	-21.9%	-3.5%	28.0%	1.5%	10.6%	13.3%	41.2%
7	Biotech Growth Trust	BIOG	£451m	1,150p	–	-1.0	-10.5%	-8.2%	0.2%	-19.7%	1.6%	53.3%	25.8%	58.8%	58.0%	44.0%
8	JPM Smaller Cos	JMI	£172m	220p	2.5%	-1.0	-14.5%	-9.8%	0.4%	-27.6%	11.0%	46.2%	-26.9%	2.4%	33.6%	44.8%
9	Schroder Asian Total Return	ATR	£343m	351p	1.9%	-1.8	-3.5%	1.1%	5.6%	-16.3%	6.2%	25.4%	-3.0%	0.3%	21.1%	92.5%
10	Henderson European Focus	HEFT	£257m	1,195p	2.6%	-1.4	-11.6%	-9.2%	-3.3%	-16.0%	9.4%	32.8%	-9.3%	1.2%	-6.0%	30.1%
11	Jupiter US Smaller Cos	JUS	£124m	947p	–	-1.2	-13.6%	-10.0%	-5.6%	-21.2%	16.6%	35.3%	-15.1%	-8.5%	14.5%	40.9%
12	JPM Euro Smaller Cos	JESC	£539m	338p	2.0%	-1.0	-15.6%	-13.1%	-9.5%	-24.1%	11.9%	39.1%	-10.3%	-5.5%	-7.0%	50.3%
13	Baillie Gifford Japan	BGFD	£716m	780p	0.5%	-1.0	-4.7%	-1.5%	4.7%	-12.2%	8.9%	40.3%	-5.8%	-0.7%	14.5%	73.6%
14	Herald	HRI	£968m	1,450p	–	-0.9	-17.7%	-15.1%	-5.3%	-28.8%	9.9%	41.9%	-3.6%	9.0%	49.6%	101.4%
15	European Assets	EAT	£342m	95p	6.5%	-1.1	-10.7%	-8.2%	-3.6%	-23.5%	7.2%	35.7%	-12.0%	-9.9%	-11.9%	20.4%
16	JPM China Growth & Income	JCGI	£298m	410p	1.4%	-1.0	-13.7%	-10.6%	-0.6%	-19.1%	6.5%	38.1%	21.7%	57.9%	71.2%	119.1%
17	Invesco Perpetual UK SmCos	IPU	£139m	412p	4.5%	-2.1	-12.3%	-2.7%	4.0%	-16.3%	8.1%	20.8%	-33.1%	-19.1%	-1.4%	32.5%
18	BlackRock Frontiers	BRFI	£233m	96p	6.3%	-1.7	-5.4%	0.3%	9.0%	-8.1%	9.2%	22.7%	-25.7%	-25.2%	-25.1%	0.8%
18	Schroder Japan Gwth	SJG	£216m	173p	2.7%	-1.2	-14.9%	-12.4%	-8.8%	-23.7%	5.2%	29.1%	-12.4%	-2.6%	-6.6%	19.3%
20	Standard Life UK Smaller Cos	SLS	£486m	486p	1.8%	-1.1	-8.3%	-5.0%	5.4%	-15.6%	11.2%	33.9%	-19.0%	-0.8%	18.3%	72.6%
21	F&C Investment Trust	FCIT	£3,730m	688p	1.7%	-0.8	-6.5%	-3.8%	2.2%	-19.5%	7.5%	39.0%	-8.8%	0.2%	21.3%	71.6%
21	Pollen Steet Secured Lending	PSSL	£529m	716p	6.7%	-0.7	-24.2%	-17.4%	-6.5%	-54.4%	10.8%	46.7%	-13.5%	-9.3%	-5.9%	-11.4%
21	TR Property	TRY	£1,142m	360p	3.9%	-1.6	-9.5%	-1.0%	6.5%	-28.2%	20.6%	22.9%	-24.5%	-10.6%	13.1%	41.0%
24	City Merchants High Yield	CMHY	£176m	173p	5.8%	-1.2	-3.7%	1.0%	4.1%	-20.9%	3.0%	32.1%	-11.3%	-3.2%	1.9%	19.4%
25	Baillie Gifford Shin Nippon	BGS	£519m	186p	–	-0.6	-3.5%	-1.5%	6.4%	-17.2%	12.2%	66.2%	0.9%	2.3%	33.2%	147.1%

Source: Winterflood Securities

(Methodology and screens by Algy Hall)

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