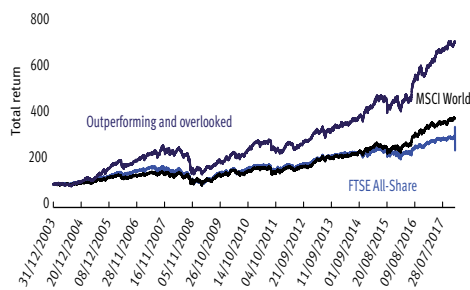




## Alpha Investment Trusts: Highlighting sector plays

*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 – 14 years to 31 Dec 2017



Source: Bloomberg

#### 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.

■ This month's screen highlights investment trusts that trade on discounts to net asset value (NAV) and could turn out to be rebound plays, should some of the headwinds facing the global economy start to reduce.

■ These include **JP Morgan Chinese (JMC)**, which has outperformed the MSCI China index and may benefit if trade talks with the US progress.

■ Japanese stocks have already had a strong 2019 and two Japan-focussed trusts – **Fidelity Japan (FJV)** and **CC Japan Income & Growth (CCJI)** – are included in the top 10 portfolio.

■ Hopes of a possible Brexit breakthrough – although at the time of writing Parliament remains a tricky hurdle – will be a boost for domestically-focused UK companies. Conversely, larger companies may see their shares re-rate if the pound jumps against the US dollar. The discount to NAV of some of the investment trusts in our list that include blue-chip dollar-earners could be seen as providing a margin of safety.

JN

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### **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				Price price performance					
							Now	Avg	Low	High	1m	3m	6m	1y	3y	5y
1	Phoenix Spree Deutschland	PSDL	£313m	311p	1.4%	-1.3	-29.8%	-14.2%	0.3%	-36.5%	9.1%	8.7%	-14.3%	-9.3%	45.7%	-
2	Temple Bar	TMPL	£873m	1,306p	3.9%	-1.2	-5.4%	-3.7%	-1.0%	-6.6%	4.7%	3.8%	-3.4%	13.2%	30.5%	38.9%
3	JPM Chinese	JMC	£220m	302p	1.2%	-1.1	-13.2%	-11.4%	-5.1%	-14.8%	-5.6%	3.6%	0.3%	32.6%	45.1%	95.5%
4	Ceiba Investments	CBA	£112m	81p	6.1%	-0.9	-26.7%	-20.2%	0.0%	-29.5%	3.9%	3.9%	-16.1%	-28.1%	-	-
5	Fidelity Japan Trust	FJV	£207m	155p	-	-0.7	-11.0%	-9.6%	-2.7%	-13.8%	-0.6%	4.2%	9.0%	2.7%	53.5%	139.4%
6	CC Japan Income & Growth	CCJI	£207m	154p	2.5%	-0.7	-0.2%	2.1%	11.1%	-5.3%	1.2%	3.5%	4.4%	0.6%	34.4%	-
9	Artemis Alpha Trust	ATS	£112m	282p	1.8%	-2.1	-20.7%	-17.0%	-13.5%	-21.4%	2.0%	-1.4%	-1.8%	-5.2%	24.4%	14.8%
12	Independent Inv. Trust	IIT	£289m	527p	1.5%	-0.1	-1.8%	-1.3%	14.8%	-8.3%	2.1%	4.2%	-6.1%	-17.4%	39.9%	112.3%
15	Perpetual Income & Gwth	PLI	£691m	311p	4.7%	-1.1	-12.9%	-11.5%	-8.0%	-14.7%	1.8%	-1.1%	-7.0%	-3.0%	-4.7%	5.9%
16	Henderson High Income	HHI	£219m	171p	5.7%	-1.3	-6.1%	-3.5%	0.6%	-7.7%	-1.7%	-1.5%	-2.3%	7.4%	8.5%	37.6%

Winterflood Investment Trusts, as at: 17 October 2019

## 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	Phoenix Spree Deutschland	PSDL	£313m	311p	1.4%	-1.3	-29.8%	-14.2%	0.3%	-36.5%	9.1%	8.7%	-14.3%	-9.3%	45.7%	-
2	Temple Bar	TMPL	£873m	1,306p	3.9%	-1.2	-5.4%	-3.7%	-1.0%	-6.6%	4.7%	3.8%	-3.4%	13.2%	30.5%	38.9%
3	JPM Chinese	JMC	£220m	302p	1.2%	-1.1	-13.2%	-11.4%	-5.1%	-14.8%	-5.6%	3.6%	0.3%	32.6%	45.1%	95.5%
4	Ceiba Investments	CBA	£112m	81p	6.1%	-0.9	-26.7%	-20.2%	0.0%	-29.5%	3.9%	3.9%	-16.1%	-28.1%	-	-
5	Fidelity Japan Trust	FJV	£207m	155p	-	-0.7	-11.0%	-9.6%	-2.7%	-13.8%	-0.6%	4.2%	9.0%	2.7%	53.5%	139.4%
6	CC Japan Income & Growth	CCJI	£207m	154p	2.5%	-0.7	-0.2%	2.1%	11.1%	-5.3%	1.2%	3.5%	4.4%	0.6%	34.4%	-
7	Triple Point Social Housing	SOHO	£324m	92p	1.1%	-0.2	-9.5%	-7.6%	6.3%	-26.6%	4.5%	11.1%	-1.9%	-7.1%	-	-
8	BMO Real Estate Investments	BREI	£204m	85p	5.9%	-0.7	-19.4%	-16.4%	-7.2%	-24.5%	0.7%	1.9%	-10.2%	-6.2%	1.9%	24.0%
9	Artemis Alpha Trust	ATS	£112m	282p	1.8%	-2.1	-20.7%	-17.0%	-13.5%	-21.4%	2.0%	-1.4%	-1.8%	-5.2%	24.4%	14.8%
10	Schroder Japan Gwth #	SJG	£238m	191p	2.5%	-0.8	-11.2%	-9.3%	-2.4%	-13.7%	0.0%	0.5%	2.1%	-7.1%	14.4%	75.0%
11	Civitas Social Housing	CSH	£542m	87p	6.1%	-0.6	-18.7%	-12.6%	6.3%	-27.5%	2.8%	1.2%	2.6%	-13.9%	-	-
12	Independent Inv. Trust	IIT	£289m	527p	1.5%	-0.1	-1.8%	-1.3%	14.8%	-8.3%	2.1%	4.2%	-6.1%	-17.4%	39.9%	112.3%
12	ICG-Longbow Snr Sec Prop Debt	LBOW	£117m	97p	6.2%	-1.8	-0.4%	1.5%	4.5%	-2.4%	-2.5%	-2.0%	-3.5%	-0.5%	12.6%	28.6%
12	Princess Private Equity - Euro	PEY	£576m	10p	5.9%	-0.7	-17.4%	-14.9%	-5.8%	-24.3%	0.2%	0.2%	-0.6%	7.3%	34.2%	77.2%
15	Perpetual Income & Gwth	PLI	£691m	311p	4.7%	-1.1	-12.9%	-11.5%	-8.0%	-14.7%	1.8%	-1.1%	-7.0%	-3.0%	-4.7%	5.9%
16	Henderson High Income	HHI	£219m	171p	5.7%	-1.3	-6.1%	-3.5%	0.6%	-7.7%	-1.7%	-1.5%	-2.3%	7.4%	8.5%	37.6%
17	JPM Mid Cap	JMF	£271m	1,143p	2.6%	0.1	-6.6%	-7.0%	0.7%	-11.3%	0.7%	7.8%	5.3%	14.0%	36.8%	89.6%
17	Ruffer Invmt Co	RICA	£398m	220p	0.8%	-0.4	-3.6%	-2.7%	3.2%	-7.2%	-3.1%	1.4%	4.3%	-2.3%	-0.3%	19.1%
19	Invesco Income Gwth	IVI	£158m	271p	4.3%	-0.6	-14.1%	-13.5%	-10.6%	-16.3%	-0.2%	0.0%	-1.3%	8.7%	10.9%	28.2%
19	NB Private Equity	NBPE	£540m	1,108p	4.0%	-1.2	-26.2%	-22.2%	-15.6%	-29.6%	-2.9%	-1.6%	1.6%	6.7%	30.5%	99.8%
21	CVC Credit Partners Euro Opps - €	CCPE	£110m	1p	5.6%	-1.1	-2.3%	0.0%	4.3%	-4.6%	-0.5%	-1.5%	-6.6%	-6.5%	15.1%	21.4%
22	Keystone	KIT	£212m	1,570p	3.5%	-1.3	-16.5%	-14.2%	-10.1%	-18.5%	-0.3%	-1.9%	-2.9%	3.3%	6.1%	13.4%
23	Standard Life Private Equity	SLPE	£553m	360p	3.5%	0.0	-17.7%	-17.6%	-5.9%	-25.0%	2.6%	2.7%	-1.2%	10.8%	46.3%	107.0%
24	HgCapital Trust	HGT	£914m	227p	2.1%	0.1	-5.0%	-5.7%	3.4%	-17.2%	-0.4%	4.1%	6.3%	19.0%	72.2%	160.6%
24	ICG Enterprise	ICGT	£627m	910p	2.4%	0.1	-20.5%	-20.8%	-15.2%	-27.1%	4.4%	4.1%	6.3%	8.8%	51.3%	89.7%
26	Diverse Income Trust	DIVI	£334m	88p	4.2%	-0.6	-3.0%	-1.1%	5.4%	-9.5%	-3.5%	-0.5%	-7.2%	-8.5%	10.8%	42.3%
27	Edinburgh IT	EDIN	£1,096m	599p	4.7%	-0.1	-9.6%	-9.3%	-5.5%	-15.1%	2.9%	1.7%	-7.3%	-2.8%	-4.2%	25.1%
28	Herald	HRI	£865m	1,280p	-	-0.7	-16.3%	-15.0%	-10.7%	-19.4%	-2.4%	-1.1%	-1.7%	4.1%	48.8%	115.5%
28	Tetragon Financial Group - US\$	TFG	£917m	12p	5.9%	-0.7	-47.6%	-46.5%	-42.4%	-49.1%	0.0%	-1.2%	-2.8%	5.2%	31.7%	59.8%
30	Aberdeen Diversified Inc & Growth	ADIG	£347m	108p	5.0%	-1.4	-13.1%	-7.5%	-0.7%	-16.1%	1.2%	-2.5%	-6.7%	-9.6%	16.4%	11.1%

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*(Methodology and screens by Algy Hall)*

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