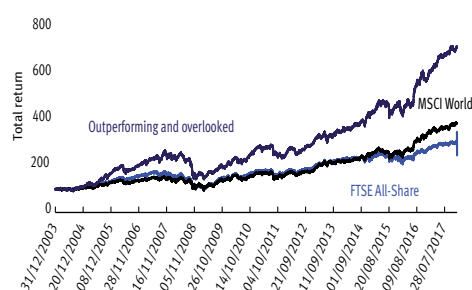




Alpha Investment Trusts: Highlighting sector plays

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.

- The 10-investment trust portfolio generated by the screen this month is showing up good value opportunities in smaller companies and some other interesting niche areas.
- European assets have been flagged, which is interesting as recent economic data has been more upbeat and valuations are suppressed. There is also the prospect of euro-denominated assets benefiting against weaker sterling, as the clock runs down on the UK's latest date of departure from the European Union.
- Another investment fraught with risk, thanks to geo-politics and volatility of resources prices, is Russian equities. The Russian market is consequently one of the cheapest in the world, although intrepid investors may feel the deep value premium on offer is worth the risk with just a modest slice of portfolio funds.
- Talking of deep value, the private equity trust in this month's portfolio is at a discount that reflects a very cheap asset class that is perhaps being unduly punished, thanks to weaker global sentiment and liquidity concerns that, although real, may be worth braving depending on investors' time horizon.

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				Price performance					
							Now	Avg	Low	High	1m	3m	6m	1y	3y	5y
1	JPM Smaller Companies	JMI	£176m	221p	2.4%	-1.6	-15.1%	-12.8%	-8.0%	-17.6%	0.9%	9.4%	9.4%	-10.6%	45.0%	53.8%
2	JPM Russian Securities	JRS	£282m	592p	4.4%	-0.8	-15.8%	-14.8%	-11.7%	-17.7%	5.0%	12.3%	15.9%	20.5%	101.2%	67.4%
4	Electra Private Equity	ELTA	£142m	370p	-	-0.7	-27.8%	-21.4%	-0.9%	-40.6%	4.7%	17.8%	-6.4%	-4.3%	26.0%	86.9%
5	JPM Mid Cap	JMF	£262m	1,105p	2.4%	-1.0	-7.4%	-5.1%	0.7%	-10.1%	1.4%	6.3%	7.5%	-11.1%	24.6%	68.5%
6	Middlefield Canadian Inc Trusts	MCT	£102m	96p	5.3%	-1.2	-15.0%	-12.8%	-4.6%	-17.2%	0.7%	4.5%	2.6%	3.0%	43.0%	14.5%
7	European Assets	EAT	£381m	106p	5.8%	-0.6	-8.1%	-6.6%	-0.3%	-10.5%	0.8%	6.6%	7.3%	-7.8%	23.9%	51.4%
8	JPM Elect – Managed Growth	JPE	£259m	828p	2.1%	-1.3	-2.8%	-2.0%	0.4%	-4.2%	0.0%	3.8%	7.5%	0.8%	47.4%	65.3%
9	Strategic Equity Capital	SEC	£146m	228p	0.4%	-0.1	-15.3%	-15.2%	-9.2%	-18.7%	2.9%	11.0%	9.4%	1.1%	13.4%	49.5%
10	Invesco Perpetual UK SmCos	IPU	£171m	522p	2.8%	0.0	-4.0%	-4.0%	0.4%	-6.9%	2.2%	12.0%	11.7%	3.4%	52.5%	101.2%
11	Independent Investment Trust	IIT	£314m	568p	1.2%	-0.9	-1.5%	5.1%	22.2%	-5.0%	1.3%	4.0%	4.6%	-23.8%	53.2%	131.4%

Winterflood Investment Trusts, as at: 22 May 19

Top 25

Rank	Name	TIDM	Market cap	Price	DY	Z-score	Discount				Price performance					
							Now	Avg	Low	High	1m	3m	6m	1y	3y	5y
1	JPM Smaller Companies	JMI	£176m	221p	2.4%	-1.6	-15.1%	-12.8%	-8.0%	-17.6%	0.9%	9.4%	9.4%	-10.6%	45.0%	53.8%
2	JPM Russian Securities	JRS	£282m	592p	4.4%	-0.8	-15.8%	-14.8%	-11.7%	-17.7%	5.0%	12.3%	15.9%	20.5%	101.2%	67.4%
3	Pershing Square Holdings	PSH	£2,924m	1,350p	0.6%	-1.2	-26.9%	-23.9%	-16.4%	-27.8%	-1.9%	6.1%	20.5%	35.8%	-	-
4	Electra Private Equity	ELTA	£142m	370p	-	-0.7	-27.8%	-21.4%	-0.9%	-40.6%	4.7%	17.8%	-6.4%	-4.3%	26.0%	86.9%
5	JPM Mid Cap	JMF	£262m	1,105p	2.4%	-1.0	-7.4%	-5.1%	0.7%	-10.1%	1.4%	6.3%	7.5%	-11.1%	24.6%	68.5%
6	Middlefield Canadian Inc Trusts	MCT	£102m	96p	5.3%	-1.2	-15.0%	-12.8%	-4.6%	-17.2%	0.7%	4.5%	2.6%	3.0%	43.0%	14.5%
7	European Assets	EAT	£381m	106p	5.8%	-0.6	-8.1%	-6.6%	-0.3%	-10.5%	0.8%	6.6%	7.3%	-7.8%	23.9%	51.4%
8	JPM Elect – Managed Growth	JPE	£259m	828p	2.1%	-1.3	-2.8%	-2.0%	0.4%	-4.2%	0.0%	3.8%	7.5%	0.8%	47.4%	65.3%
9	Strategic Equity Capital	SEC	£146m	228p	0.4%	-0.1	-15.3%	-15.2%	-9.2%	-18.7%	2.9%	11.0%	9.4%	1.1%	13.4%	49.5%
10	Invesco Perpetual UK SmCos	IPU	£171m	522p	2.8%	0.0	-4.0%	-4.0%	0.4%	-6.9%	2.2%	12.0%	11.7%	3.4%	52.5%	101.2%
11	Independent Investment Trust	IIT	£314m	568p	1.2%	-0.9	-1.5%	5.1%	22.2%	-5.0%	1.3%	4.0%	4.6%	-23.8%	53.2%	131.4%
12	Polar Capital Technology	PCT	£1,791m	1,338p	-	0.0	-4.2%	-4.1%	0.8%	-8.0%	0.5%	8.3%	18.0%	7.7%	132.7%	199.6%
13	Keystone	KIT	£218m	1,613p	3.8%	-1.5	-14.5%	-13.1%	-10.1%	-15.3%	0.2%	1.7%	2.9%	-5.7%	10.0%	11.1%
14	Henderson Smaller Cos	HSL	£653m	875p	2.5%	-0.1	-8.0%	-7.9%	-3.8%	-13.7%	-0.9%	6.0%	7.4%	-7.6%	55.4%	88.8%
15	Tetragon Financial Group – US\$	TFG	£932m	13p	5.7%	-1.1	-47.0%	-43.8%	-38.5%	-48.8%	0.0%	2.4%	5.0%	4.7%	50.8%	71.7%
16	Montanaro UK SmCos	MTU	£192m	115p	2.7%	-0.3	-15.5%	-14.5%	-5.9%	-22.6%	-0.1%	4.9%	2.4%	1.6%	34.6%	37.6%
17	Third Point Offshore – US\$	TPOU	£521m	15p	-	-1.1	-23.6%	-20.5%	-13.3%	-26.7%	0.3%	2.1%	6.5%	-12.7%	4.6%	-12.1%
18	Montanaro Euro Smaller Cos	MTE	£159m	953p	0.9%	0.2	-9.1%	-9.5%	-3.2%	-13.8%	0.1%	8.0%	10.2%	9.7%	78.7%	92.8%
19	F&C Investment Trust	FCIT	£3,795m	698p	1.6%	-1.2	-0.7%	0.5%	2.3%	-2.2%	0.9%	1.5%	3.6%	3.1%	70.0%	106.9%
20	TR Property	TRY	£1,312m	414p	3.0%	-0.2	-0.7%	-0.3%	5.8%	-5.2%	4.4%	5.0%	5.8%	3.7%	54.0%	85.3%
21	BlackRock Greater Europe	BRGE	£304m	358p	1.6%	0.2	-3.9%	-4.1%	-0.6%	-7.4%	1.4%	7.8%	11.4%	5.6%	55.9%	60.5%
22	BMO UK High Income – Units	BHIU	£108m	371p	5.4%	-0.7	-9.3%	-7.7%	-1.6%	-12.4%	-0.5%	3.3%	1.1%	-4.6%	21.0%	27.2%
23	Princess Private Equity – Euro #	PEY	£606m	10p	5.6%	0.3	-10.6%	-11.6%	-4.4%	-24.3%	2.2%	7.9%	0.0%	3.2%	51.2%	109.5%
24	JPM Japanese	JFJ	£685m	425p	1.2%	0.5	-8.3%	-9.1%	-4.2%	-13.3%	3.7%	10.0%	5.3%	-6.2%	52.2%	124.8%
24	Marble Point Loan Financing – US\$	MPLF	£133m	1p	9.8%	-1.2	-4.5%	3.8%	17.4%	-6.0%	0.0%	1.2%	-19.6%	-6.8%	-	-

Source: Winterflood Investment Trusts, as at: 22 May 2019

(Methodology and screens by Algy Hall)

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