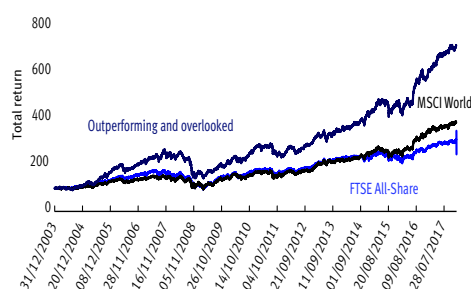




Alpha Investment Trusts: A diverse world of opportunities

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.

■ Our portfolio of 10 investment trusts, from the companies that topped our magic formula trust screen, includes eight new entries this month, with the selections offering interesting diversity in themes and regional exposure.

■ Healthcare and Biotech are represented by **BB Healthcare (BBH)** and **Biotech Growth Trust (BIOG)**, respectively.

■ Trusts with more general holdings in global equities, that scored well in the screen, also offered interesting options. **Martin Currie Global Portfolio (MNP)** has exposure to computers (12 per cent), internet companies (7 per cent), insurance (7 per cent) and banks (6 per cent). Its notable holdings include 4 per cent in **Apple (AAPL)**, but it is not overly exposed to companies like **Netflix (NFLX)** and especially **Facebook (FB)**, whose earnings disappointed investors recently.

■ **Alliance Trust (ATST)** is another global equities trust whose big tech exposure is skewed towards the better performers among the so-called FAANGs – they only had 1.4 per cent in Facebook, but 2.3 per cent in **Alphabet (GOOGL)**, the holding company for Google, and 1.5 per cent in **Amazon (AMZN)**.

■ For investments, lower down the market capitalisation scale, **Montanaro Euro Smaller Companies (MTE)** and **JP Morgan US Smaller Companies (JUSC)** are two trusts that offer interesting regional exposures.

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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				Share price performance					
							Now	Avg	Low	High	1-mth	3-mth	6-mth	1-yr	3-yr	5-yr
1	BB Healthcare	BBH	£365m	133p	3.0%	-2.0	-2.4%	1.5%	6.6%	-4.3%	1.9%	22.6%	12.2%	15.0%	-	-
2	Biotech Growth Trust	BIOG	£455m	820p	-	-1.6	-8.8%	-5.2%	0.8%	-11.2%	7.9%	18.8%	1.7%	0.3%	-6.3%	96.6%
3	Martin Currie Global Portfolio	MNP	£224m	253p	1.7%	-2.2	-1.5%	-0.2%	1.8%	-3.3%	2.4%	8.1%	2.9%	9.1%	49.6%	72.5%
5	Hansa Trust "A"	HANA	£166m	1,035p	1.6%	-3.1	-32.5%	-28.4%	-25.6%	-32.1%	5.1%	5.9%	2.0%	15.0%	30.4%	49.7%
6	JPM US Smaller Cos	JUSC	£179m	313p	0.8%	-1.4	-5.1%	-1.5%	4.2%	-6.6%	0.3%	12.2%	6.5%	17.0%	77.4%	104.4%
7	Alliance Trust	ATST	£2,619m	771p	1.3%	-1.7	-6.7%	-5.7%	-3.8%	-7.4%	3.8%	7.7%	1.3%	9.1%	67.3%	95.8%
8	Fidelity Euro Values	FEV	£967m	234p	1.9%	-1.1	-10.5%	-8.3%	-4.7%	-12.1%	7.1%	10.9%	2.2%	7.4%	37.7%	75.0%
9	Middlefield Canadian Inc Trusts	MCT	£104m	98p	5.2%	-1.9	-14.2%	-11.2%	-7.3%	-15.6%	2.8%	5.4%	-2.0%	-0.1%	30.3%	19.4%
10	Montanaro Euro Smaller Cos	MTE	£151m	900p	0.9%	-1.0	-12.1%	-10.3%	-5.4%	-15.0%	0.6%	11.8%	5.9%	14.3%	76.2%	99.0%
11	North Atlantic SmCos	NAS	£430m	2,980p	-	-0.7	-21.9%	-20.0%	-15.1%	-27.1%	3.5%	12.7%	3.5%	14.6%	47.4%	100.3%

Winterflood Investment Trusts, as at 27 July 2018

Top 25

Rank	Name	TIDM	Market cap	Price	DY	Z-score	Discount to NAV				Share price performance					
							Now	Avg	Low	High	1-mth	3-mth	6-mth	1-yr	3-yr	5-yr
1	BB Healthcare	BBH	£365m	133p	3.0%	-2.0	-2.4%	1.5%	6.6%	-4.3%	1.9%	22.6%	12.2%	15.0%	-	-
2	Biotech Growth Trust	BIOG	£455m	820p	-	-1.6	-8.8%	-5.2%	0.8%	-11.2%	7.9%	18.8%	1.7%	0.3%	-6.3%	96.6%
3	Martin Currie Global Portfolio	MNP	£224m	253p	1.7%	-2.2	-1.5%	-0.2%	1.8%	-3.3%	2.4%	8.1%	2.9%	9.1%	49.6%	72.5%
4	Polar Capital Global Healthcare	PCGH	£260m	212p	0.9%	-1.4	-7.5%	-3.4%	3.3%	-10.0%	2.4%	13.7%	3.4%	2.2%	20.9%	52.4%
5	Hansa Trust "A"	HANA	£166m	1,035p	1.6%	-3.1	-32.5%	-28.4%	-25.6%	-32.1%	5.1%	5.9%	2.0%	15.0%	30.4%	49.7%
6	JPM US Smaller Cos	JUSC	£179m	313p	0.8%	-1.4	-5.1%	-1.5%	4.2%	-6.6%	0.3%	12.2%	6.5%	17.0%	77.4%	104.4%
7	Alliance Trust	ATST	£2,619m	771p	1.3%	-1.7	-6.7%	-5.7%	-3.8%	-7.4%	3.8%	7.7%	1.3%	9.1%	67.3%	95.8%
8	Fidelity Euro Values	FEV	£967m	234p	1.9%	-1.1	-10.5%	-8.3%	-4.7%	-12.1%	7.1%	10.9%	2.2%	7.4%	37.7%	75.0%
9	Middlefield Canadian Inc Trusts	MCT	£104m	98p	5.2%	-1.9	-14.2%	-11.2%	-7.3%	-15.6%	2.8%	5.4%	-2.0%	-0.1%	30.3%	19.4%
10	Montanaro Euro Smaller Cos	MTE	£151m	900p	0.9%	-1.0	-12.1%	-10.3%	-5.4%	-15.0%	0.6%	11.8%	5.9%	14.3%	76.2%	99.0%
11	North Atlantic SmCos	NAS	£430m	2,980p	-	-0.7	-21.9%	-20.0%	-15.1%	-27.1%	3.5%	12.7%	3.5%	14.6%	47.4%	100.3%
12	F&C Global Smaller Cos	FCS	£851m	1,425p	1.0%	-1.5	-2.2%	0.0%	2.8%	-4.0%	0.4%	6.0%	2.2%	9.9%	47.1%	86.0%
13	Polar Capital Technology	PCT	£1,769m	1,322p	-	-0.5	-1.6%	-0.8%	3.9%	-5.7%	5.8%	17.0%	13.2%	26.8%	120.3%	204.3%
14	Pershing Square Holdings	PSH	£2,322m	1,156p	-	-0.3	-22.0%	-21.4%	-16.4%	-26.6%	4.7%	24.3%	13.3%	7.9%	-	-
15	Gabelli Value Plus+	GVP	£128m	129p	0.5%	-0.8	-8.1%	-6.3%	-1.3%	-11.8%	-1.2%	8.4%	-4.5%	-0.9%	30.0%	-
16	Murray Income	MUT	£526m	790p	4.5%	-1.7	-8.5%	-7.2%	-4.9%	-8.7%	1.2%	4.5%	-0.8%	4.0%	29.1%	26.3%
17	Crystal Amber	CRS	£224m	230p	2.2%	-0.7	-5.8%	-3.0%	10.7%	-11.8%	5.5%	9.0%	10.6%	24.3%	49.8%	-
18	JPM Russian Securities	JRS	£261m	522p	1.2%	-0.9	-15.1%	-13.9%	-8.7%	-16.3%	3.2%	7.2%	-6.3%	19.7%	82.7%	21.9%
18	R&M UK Micro Cap	RMCM	£107m	205p	-	-0.3	-5.2%	-3.0%	16.9%	-15.4%	5.7%	15.8%	-11.6%	18.2%	89.1%	-
20	Aberdeen New India	ANII	£276m	468p	-	-1.4	-15.0%	-12.6%	-8.2%	-16.0%	4.1%	5.1%	0.4%	-1.2%	38.1%	108.9%
21	Marwyn Value Investors	MVI	£103m	145p	5.7%	-0.3	-30.2%	-29.3%	-23.5%	-36.7%	-0.7%	12.0%	-8.8%	-6.4%	-30.6%	-
22	Secs Trust of Scot	STS	£187m	173p	3.5%	-0.9	-6.2%	-5.5%	-1.8%	-6.9%	3.0%	6.1%	-1.4%	7.3%	44.9%	36.1%
23	Scottish IT	SCIN	£683m	876p	2.8%	-1.1	-11.2%	-10.4%	-8.5%	-12.3%	1.5%	5.4%	1.2%	11.1%	50.9%	72.0%
23	Dunedin Income Growth	DIG	£385m	259p	4.8%	-2.5	-11.7%	-9.8%	-7.7%	-11.7%	1.6%	2.0%	-2.3%	2.4%	20.2%	20.0%
25	BlackRock Greater Europe	BRGE	£308m	357p	1.5%	-0.4	-4.4%	-3.9%	-0.5%	-6.8%	3.0%	8.0%	5.5%	14.7%	50.1%	74.7%

Winterflood Investment Trusts, as at 27 July 2018

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