

# THE IMPORTANCE OF INVESTMENT TRUSTS

DECEMBER 2016



As well as investing in “open-ended” funds (such as unit trusts and OEICs, which allow daily inflows and outflows), the Hawksmoor Funds also invest in “closed-ended” funds, also known as investment trusts. These vehicles give a manager a fixed amount of cash to invest, which is raised via an Initial Public Offering (IPO). This portfolio is valued on a regular basis, but is owned via the investment trust structure, which itself is traded like any other listed company shares. This means that the market’s valuation of the investment trust can diverge (both positively and negatively) from its valuation of the portfolio resulting in the trust trading at a premium or discount to the implied valuation of the underlying portfolio.

The closed-ended nature of investment trusts allows fund managers to invest in more illiquid assets than he or she might otherwise be able to invest in via an open-ended fund as there are no inflows that might dilute or outflows that might disrupt the make-up of the portfolio. This enables us to gain access to a far wider pool of investment opportunities within our two funds of funds, Vanbrugh and Distribution. In turn, this gives us access to asset classes that might behave very differently from, and are valued more cheaply than equities and bonds that are typically held in open-ended funds. Owning assets that perform in different ways at different times (i.e. that have low or negative correlation) assists greatly with portfolio construction. If we only owned assets that always acted in the same way, we would have a portfolio that potentially could suffer much larger swings in value than would otherwise be the case. By owning cheap assets that behave differently we can dampen these swings in value without sacrificing performance. Over recent years the performance of traditional assets such as bonds and equities have become far more positively correlated and so being able to access different asset classes via investment trusts has materially improved our performance relative to much larger funds of funds that only invest in open-ended funds.

We can also exploit inefficiencies in investment trusts and the fact that they trade at premia and discounts to our advantage. We often purchase them at a discount (effectively buying a pound worth of assets for less) and hope to sell them at a narrower discount or even a premium. This return is in addition to the underlying return we receive from the portfolio’s gain in value.

The types of assets we hold via investment trusts include loans, private equity, property, asset-backed securities and more illiquid parts of global equity markets (such as “Frontier Markets”). It would be a mistake to think that these investments necessarily involve taking extra risk. Quite the opposite can be true. Consider private equity as a case in point. The two words often conjure up images of greedy financiers charging high fees and ruining the companies they invest in. While the run up to the 2007-2008 crisis did undoubtedly uncover some unhealthy practices by poorly-run private equity companies, these proved to be the exceptions rather than the rule. Indeed, if run properly, private equity plays a vital role in any capitalist society by giving life blood (capital) to early-stage and strongly growing companies that might otherwise struggle to get established and achieve their potential. Such companies can go on to be the consumer favourites of the future, providing exciting technological advancement and making crucial advancements in fields such as biotechnology with accompanying improvements to the treatment of human illness. We have long held exposure to such private equity funds and have managed to acquire them on significant discounts via the investment trust space. Further, the companies owned within these portfolios have, on average, delivered far superior earnings growth to those available on the publicly-traded equity markets. Of late, the weakness in the pound has encouraged overseas buyers to opportunistically purchase cheap sterling assets. Private equity investment trusts have been an area of particular interest to these buyers and recently a takeover bid for one of these trusts from a US company has focused attention on the whole asset class. In addition to strongly performing portfolios, our investments in this area have consequently benefitted from narrowing discounts and resulted in them being one of the world’s best performing areas in 2016.

An investment in one of Hawksmoor’s Funds gives you access to a whole array of attractive asset classes that you might not otherwise be able to invest in thanks to our specialist expertise in investment trusts which, among other positive attributes, has led to both Funds being among the best performers in their sectors – both over the long-term and over the past year.

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