Engagement Policy Annual Report 2020

This report summarises our engagement activity in 2020 as shareholders of investment trusts (and investment companies) on behalf of our clients.

2020 was a particularly challenging year for investment trusts and investment companies (hereafter referred to only as investment trusts). At the beginning of the year, discounts across the universe had reached historically quite narrow levels. The onset of the pandemic caused huge disruption to the financial services industry and investment trusts were some of the worst affected traded securities.

Specifically the sudden need for all employees to work from home played havoc with market-making activities. Particularly for less liquid investment trusts, this resulted in liquidity drying up and mid prices collapsing as a result of a) sudden and uncoordinated selling from some investors (in relatively small size) and b) market-makers reducing their bid prices to extremely low levels. This resulted in a two-week period of extraordinary volatility at the beginning of March.

Coming out of this turmoil, many investment trust prices did not recover – despite their net asset values (NAVs) remaining stable. This was particularly true in the property and alternative fixed income areas. Hawksmoor believed increased engagement with Boards was necessary and the HFM team began an intensive period of engagement.

First, we engaged with the managers (investment advisers) of the portfolios to reaffirm that we could trust the latest published NAVs. Then, particularly where share prices had not recovered and large discounts to NAV had appeared, we engaged with the Boards of those trusts. It was important to establish whether Boards were willing to use their powers and tools at their disposal to improve shareholder returns.

In general, we were disappointed with the engagement. Our response was as follows:

Where Boards showed no realisation of the extent of the issues, and refused to proactively do anything to improve the situation, we divested.

Where Boards showed a willingness to listen to our ideas, consider them, and potentially take action in the future, we remained invested.

Where Boards shared our concerns and were already in the process of acting, or where the situation was clearly temporary, we increased our position.

In the main, far too many Boards fell into the first two categories and did not show enough proactivity in looking after shareholder interests. We therefore extended our engagement to the industry body (the AIC) and to the broking community. We organised a call with the AIC to express our concerns. This resulted in Ben Conway being invited to present at the AIC's annual conference for investment companies to an audience of Board directors. We also held talks with the sales and corporate advisory teams at all of our brokers to ensure they were correctly advising their clients (i.e. the Boards).

Finally, we remain open to encouraging our peer shareholders across the industry to proactively vote (e.g. via the press). Voter turnout is still too low. HFM voted all our proxies in the year.

Outside of the circumstances surrounding the pandemic we engaged with Boards in the normal course of business as we always do. We were particularly heavily engaged (and still are) with one Real Estate Investment Trust (REIT), which has seen the need for us to use activism. This action included successfully bringing together other shareholders and ultimately removing the chairman and ensuring a change of investment policy was not enacted. As a reminder, as per our engagement policy, when we enter an investment we do so since we support existing management. i.e. activism is not something we aim to use when invest. However, where low cost divestment is not possible (e.g. because we are too large a shareholder) we will be activist in the pursuit of maximising shareholder returns for our investors.

We are also involved in ongoing discussions with the Board of another investment company, where we previously successfully encouraged a buyback program and insider buying of the shares.

Our earlier engagement with brokers has continued – particularly around the subject of initial public offerings (IPOs). We are increasingly reluctant to participate in the IPOs of investment trusts where shareholder protections are not put in place. As a result of our engagement brokers have been advising Boards to give shareholders more concessions at IPO, as well as advising Boards of existing trusts to consider capital allocation policy and even continuation of the trust.

It remains our view that investment trusts and investment companies are excellent ways of accessing less liquid asset classes. However governance standards of these trusts and companies is highly variable and it is our responsibility to engage appropriately to ensure a greater likelihood of strong shareholder returns. Meanwhile on the rare occasions where quick and low cost divestment is not possible, we will employ activism to achieve the best outcome for our investors. 2020 showed all of these principles at work.

Please note we do not publicise the trusts we have engaged with or are in engagement with. Please contact Hawksmoor for more information.