Weathering storms and building trust

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In recent years, the UK investment trust sector has found itself navigating through challenging times. Changes in regulations and the overall economic environment have made things tough. But despite these challenges, it's important to remember why investment trusts are valuable, especially in terms of diversification and accessing long-term investment opportunities ordinarily not available to individual investors.

Back in 2022, the sector started seeing a significant number of institutional and retail investors pulling out, driven by regulatory changes that had widespread implications. A key issue was the interpretation of EU rules concerning the reporting of 'ongoing costs,' which significantly impacted investment trusts in the UK.

Unlike open-ended funds, where fees are deducted from investors' holdings, investment trusts are set up differently and operate on a closed-ended structure. This means that operational costs are already embedded in the share price, leading to a discrepancy in how ongoing costs are perceived by investors. Retail investors may be misled into believing they are paying yearly ongoing costs, while institutional investors, like ourselves, face the burden of aggregating costs, making their funds appear more expensive than they truly are.

As a result of these headwinds, UK investment trusts continue to offer significant value, especially with recent governmental actions to attempt to resolve issues surrounding cost disclosure rules as seen in the Autumn Statement, but which proved insufficient to overcome the problem. Their closed-ended structure makes them well-suited for long-term institutional investment in illiquid assets, offering diversification and exposure to a wide range of investment opportunities that may be inaccessible to individual investors.

Furthermore, recent market conditions have presented compelling opportunities for investors. Wider discounts and attractive yields have emerged, providing an entry point for those willing to weather the storm. Despite challenges posed by rising interest and discount rates, indications of stabilisation and potential market shifts suggest a more optimistic outlook for investment trusts.

The average investment company discount is reflective of market sentiment and investor demand. By the end of October 2023, the average discount reached 17%, marking its widest level since the financial crisis, although it has since recovered. [1]Recent research from the Association of Investment Companies (AIC) suggests that investing when the average investment trust discount exceeds 10% could lead to significantly better returns over the subsequent five years. The AIC's analysis of investment trust returns since 2008 shows that when the average discount exceeded 10%, the average investment trust generated a return of 89.3% over the following five years.

Amidst these challenges and opportunities, it is essential to emphasise the importance of true diversification in investment portfolios. Relying on traditional allocations to stocks and bonds just isn't enough anymore. Alternative investments, including property, private equity, infrastructure, and specialist financials, offer non-correlated returns that can enhance portfolio resilience and mitigate risk.

We believe that integrating specialist assets such as real estate investment trusts (REITs), infrastructure, private equity, and specialist financials creates a widely diversified portfolio. While not easily readily accessible to the wider market, having over two decades of expertise enables us to search a wider arena, easing the burden for individual investors. Real assets typically exhibit a moderate-to-low correlation with equities and financial assets, providing strong diversification benefits. Investment trusts offer exposure to these real asset vehicles that often escape traditional avenues due to underlying asset illiquidity. The combination of these assets with traditional investments like equities and bonds holds several attractions for investors. They deliver solid investment returns and tend to operate independently of market fluctuations. However, investing in these areas also comes with risks of their own and our approach emphasises thorough research and expertise.

As the saying goes, "You can lead a horse to water, but you can't make it drink." It means that you can show people the opportunities, but they have to be willing to take them. That's true for investors too. UK investment trusts might be facing some tough challenges, but we remain advocates of their vital roles in multi-asset portfolios.

Source:[1]https://www.theaic.co.uk/aic/news/press-releases/double-digit-investment-trust-discounts-can-mean-higher-returns-over

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