Investment Trusts: Back in Vogue

Jackie Beard, Director of Investment Trust Research, UK
Agenda

- Qualitative Research
- Key Advantages
- Performance Comparison
- Case Study
Research Staff at Morningstar: Global and Local

- 220 researchers worldwide
- Quantitative methodologies team (PhDs, CFAs, MBAs)
- 120+ equity analysts, 2,000 stocks worldwide
- 70+ fund analysts; 3,000 funds worldwide
  - US: 25 fund analysts; 2,000 funds
  - Australia: 7 analysts; 250 strategies
  - Canada: 7 analysts; 400 funds
  - Europe & Asia: 38 researchers; current coverage of >1,000 funds
  - ETF & Closed-End Team: 12 analysts
Investment Trust Qualitative Research – Why now?

- Fully independent research
- Depth of analytical resources and tools
- Leading provider of closed-end fund data - Morningstar Traded Funds
- Mission – create great products that help investors reach their goals
- Investors come first
Back in Vogue…

► “Investment trusts are the granddaddy of the fund world.” David Budworth, The Times Online, 4 Jan. 2010

► “…The companies are giving shareholders a choice because the more vehicles competing, the better and cheaper they will be…This is a structure which still has its attractions.” Ian Sayers, Director General AIC, Investment Week, 15 Mar 2010

► “Reform will create new opportunities for investment trusts to meet changing consumer needs.” Daniel Godfrey, former Director General AIC) Investment Week, 10 Nov 2008

► “This [financial markets] upheaval has obscured a rapid transformation of the closed-end sector. It has benefitted from a general move away from closet tracking where risk was assessed by reference to volatility compared to, and deviation from, a given benchmark.” Nick Greenwood, CIO, iimia, iimia Investment Trust results 29 Jul 2010
What is an Investment Trust?

Investment Trusts

Listed Equities

Unit Trusts
Key advantages

- Closed to new capital after initial public offering
- Listed on a stock exchange – can be traded intraday
- Fixed number of shares, so price determined by supply and demand
- Board of Directors
- External management contract (usually but not always)
- Ability to use leverage (gearing)
- Discounts
- Structure well suited to illiquid asset classes
- Cost benefits
1. Closed to new capital after initial public offering
2. Can be traded intraday

29 Sep 2008 – US Congress rejects $700bn bank bailout plan

Source: CNN
3. Board of Directors - Edinburgh Investment Trust

Edinburgh Fund Managers

Fidelity

Invesco
4. Gearing - Levels across IT sectors

Source: Morningstar
5. Discounts

London-listed average weighted discount vs FTSE AllShare

Source: Morningstar
5. Discounts - Possible cause of discounts

- Illiquidity of underlying assets
- Discounting future management fees
- Poor past performance
- Lack of board action to keep discount narrow
- Market sentiment towards investment type/sector
5. Discounts - Better Performance, Narrower Discounts?
5. Discounts - Discount control mechanisms

- Fixed wind-up dates
- Fixed wind-up resolution dates
- Discount targets (if breached over specific period, may trigger a continuation vote or tender offer)
- Share buybacks
- Presence of arbitrageurs provides incentive to prevent discount from drifting too wide
6. Suited to illiquid asset classes
Growth of Assets by Sector (London-listed inv. companies)

Source: Morningstar
7. Cost Benefits - Lower Costs, Greater Transparency

Total Expense Ratio: 2009 Fiscal Year

Source: Morningstar

Notes to the Financial Statements continued

### 5. Other expenses

<table>
<thead>
<tr>
<th></th>
<th>2009 £'000</th>
<th>2008 £'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Custody fee</td>
<td>14</td>
<td>21</td>
</tr>
<tr>
<td>Administration fee</td>
<td>127</td>
<td>120</td>
</tr>
<tr>
<td>Auditors’ remuneration:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– audit services</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>– other audit services*</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Directors’ emoluments</td>
<td>91</td>
<td>91</td>
</tr>
<tr>
<td>Registrar’s fee</td>
<td>34</td>
<td>20</td>
</tr>
<tr>
<td>Other administrative costs</td>
<td>169</td>
<td>146</td>
</tr>
<tr>
<td></td>
<td>461</td>
<td>423</td>
</tr>
</tbody>
</table>

The Company’s total expense ratio, calculated as a percentage of average net assets, excluding interest costs and VAT written back, after relief for taxation was: 1.3%

*Other audit services relate to the review of the half yearly financial statements.

Annual Report 31 October 2009
### 7. Cost Benefits - BlackRock New Energy Investment Trust

#### 10. Investments held at fair value through profit or loss

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£’000</td>
<td>£’000</td>
<td>£’000</td>
<td>£’000</td>
</tr>
<tr>
<td>Quoted investments held at fair value through profit or loss</td>
<td>115,740</td>
<td>115,740</td>
<td>91,783</td>
<td>91,783</td>
</tr>
<tr>
<td>Unquoted investments held at fair value through profit or loss</td>
<td>442</td>
<td>557</td>
<td>732</td>
<td>847</td>
</tr>
<tr>
<td></td>
<td>116,182</td>
<td>116,297</td>
<td>92,515</td>
<td>92,630</td>
</tr>
<tr>
<td>Valuation brought forward</td>
<td>92,515</td>
<td>92,630</td>
<td>174,192</td>
<td>174,329</td>
</tr>
<tr>
<td>Investment holdings losses/(gains)</td>
<td>33,023</td>
<td>32,908</td>
<td>[52,557]</td>
<td>[52,694]</td>
</tr>
<tr>
<td>Opening cost of equity investments</td>
<td>125,538</td>
<td>125,538</td>
<td>121,635</td>
<td>121,635</td>
</tr>
<tr>
<td>Additions at cost</td>
<td>32,323</td>
<td>32,323</td>
<td>41,762</td>
<td>41,762</td>
</tr>
<tr>
<td>Disposals</td>
<td>(33,346)</td>
<td>(33,346)</td>
<td>(43,686)</td>
<td>(43,686)</td>
</tr>
<tr>
<td>Realised (losses)/gains</td>
<td>(5,577)</td>
<td>(5,577)</td>
<td>5,827</td>
<td>5,827</td>
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<tr>
<td>Cost carried forward</td>
<td>118,938</td>
<td>118,938</td>
<td>125,538</td>
<td>125,538</td>
</tr>
<tr>
<td>Investment holdings losses</td>
<td>(2,756)</td>
<td>(2,641)</td>
<td>(33,023)</td>
<td>(32,908)</td>
</tr>
<tr>
<td>Closing valuation of equity investments</td>
<td>116,182</td>
<td>116,297</td>
<td>92,515</td>
<td>92,630</td>
</tr>
</tbody>
</table>

During the year, transaction costs of £43,000 were incurred on the acquisition of investments (2008: £38,000). Costs relating to the disposal of investments during the year amounted to £17,000 (2008: £40,000). All transaction costs have been included within the capital reserves.

Annual Report 31 October 2009
7. Cost Benefits - BGF New Energy (SICAV)

<table>
<thead>
<tr>
<th>Class</th>
<th>Management Fee</th>
<th>Distribution Fee</th>
<th>TER</th>
<th>Initial Charge</th>
<th>CDSC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class A</td>
<td>1.75</td>
<td>0.00</td>
<td>2.09</td>
<td>5.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Class B</td>
<td>1.75</td>
<td>1.00</td>
<td>3.09</td>
<td>0.00</td>
<td>4.00 to 0.00</td>
</tr>
<tr>
<td>Class C</td>
<td>1.75</td>
<td>1.25</td>
<td>3.35</td>
<td>0.00</td>
<td>1.00 to 0.00</td>
</tr>
<tr>
<td>Class D</td>
<td>1.00</td>
<td>0.00</td>
<td>1.34</td>
<td>5.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Class E</td>
<td>1.75</td>
<td>0.50</td>
<td>2.59</td>
<td>3.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Class I</td>
<td>1.00</td>
<td>0.00</td>
<td>1.08</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Class J</td>
<td>0.00</td>
<td>0.00</td>
<td>N/A</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Class Q</td>
<td>1.75</td>
<td>1.25</td>
<td>3.35</td>
<td>0.00</td>
<td>4.00 to 0.00</td>
</tr>
<tr>
<td>Class X</td>
<td>0.00</td>
<td>0.00</td>
<td>0.07</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>
Investment Trusts vs OEICs
Annual % compound outperformance 10 yrs to 31-Aug-10

Source: Morningstar
Global Emerging – JPMorgan Emerging Markets

Indexed Line Chart From 01/09/2000 To 31/08/2010

Source: Morningstar
Global Emerging – JPMorgan Emerging Markets

Source: Morningstar
Japan – Schroder Japan Growth/Schroder Tokyo

Indexed Line Chart From 01/09/2000 To 31/08/2010

Past performance is not a guide to future performance. The value of units may go down as well as up.

Source: Morningstar
Japan – Schroder Japan Growth/Schroder Tokyo

£10,000 invested on 31 Aug 2000 to 31 Aug 2010:

- Schroder Tokyo: £9,860
- Schroder Japan Growth NAV: £7,961
- Schroder Japan Growth Mid: £7,582
- TOPIX: £7,271

Source: Morningstar
Some of the new funds launched in 2010

- Aberdeen Latin American Income (£57.2m)
- Fidelity China Special Situations (£460m)
- JP Morgan Brazil (£46.7m)
- JP Morgan Glbl Emerging Markets Income (£104m)
- Polar Capital Glbl Healthcare Growth & Income (£89m)

- YTD inflow through launches (to 30 Sep 10) +£1.88bn
Case Study

- Aberdeen Latin American Income (£57.2m)
- **Fidelity China Special Situations (£460m)**
- JP Morgan Brazil (£46.7m)
- JP Morgan Global Emerging Markets Income (£104m)
- Polar Capital Global Healthcare Growth & Income (£89m)
Case Study: Fidelity China Special Situations

- **People**
  - Asian team of 22 PMs and 31 analysts
  - Based in HK, Seoul, Singapore, Mumbai, Sydney
  - Martha Wang – FF China Focus – Superior rated
  - Experienced investor generally who is familiar with management of closed-end vehicles
  - Invested £2.5m at launch, aligning his interests with his investors’

- **But…**
  - Only committed to 2 years
  - Limited prior experience of investing in China
Case Study: Fidelity China Special Situations

- Parent – Part 1 - FIL
  - Fund line-up spans all asset classes, geographies – aiming to be all things to all investors – but means well-resourced
  - Promotes through ranks – can lead to higher than average manager turnover as they change focus
  - Funds could be cheaper, given scale of AUM (approx £140 bn)
  - Paid 0.5% trail to IFAs who promoted fund, despite being closed-end
  - If no adviser involved, Fidelity keeps the 0.5% trail – firm putting its own and advisers’ interests above those of investors
Case Study: Fidelity China Special Situations

- Parent – Part 2 – Board of Directors of Trust
  - 5 non-execs
  - 1 is director of another trust
  - 1 is director of FIL
  - 4 own shares in the trust
# Case Study: Fidelity China Special Situations

**Director Biography:**

**Bull, Nicholas**

**CA**

**Listed Company Directorships:**
- Fidelity China Special Situations PLC (Non-Executive Director)

**Non Listed Company Directorships:**
- Smith's Corporate Advisory Ltd (ch)

**Career:**
- 2010 - to date, Fidelity China Special Situations PLC (dir*)
  - Morgan Grenfell Society Generale
  - ASN AMRO

**Professional Qualifications:**
- CA

**Education:**
- University of Exeter

**Activities:**
- The Conran Foundation; The Great River Race; Council of the University of Exeter (mem)

**Personal:**
- 1/1/1953, Age 67
- Gender: Male

Source: Morningstar
Case Study: Fidelity China Special Situations

Process

- What do we know from Fidelity Special Sits?
- Contrarian with value bias
- Searches down market-cap scale
- Uses analysts extensively
- Tail in portfolio but capacity limit of $1bn
- Driven by bottom-up fundamentals but macro aware
- Will it work in China where many individuals trade daily?
Case Study: Fidelity China Special Situations

- Price
  - Under the Management Agreement the Investment Manager has agreed to provide investment management services for an **annual fee equal to 1.5% of the NAV**.
  - In addition, the Investment Manager is entitled to an annual **Performance Fee of 15%** of any change in NAV attributable to performance which is **more than 2% above the returns on the MSCI China Index** subject to a maximum Performance Fee payable in any year equal to 1.5% of the arithmetic mean of the value of assets with valuation calculated at the end of each month during the year.
  - **Any outperformance above this cap will be carried forward.**
  - If the Company underperforms, such underperformance must be made good before any further Performance Fee becomes payable.

Source: FCSS Prospectus
Case Study: Fidelity China Special Situations

- Corporate Structure
  - Discount control mechanism
  - Wind-up policy
  - Borrowing restrictions
  - Debt
Case Study: Fidelity China Special Situations

Source: Morningstar

Legend:
- Fidelity China Special Ordinary Share FCSS/LON Price
- Fidelity China Special Ordinary Share FCSS/LON Ex-Income NavParDil
Case Study: Fidelity China Special Sits v JPM China

Source: Morningstar
Potential Roles in Portfolio

- Specialist asset class or sector
- Alternative source of income generation
- Broad diversification as ISA investment
Summary

- Key attributes
- Cost benefits
- Greater transparency for investors
- Understand both fund and company structure
- Know where risks lie