

Investors Chronicle

Discount [investment trust] sale now on!

Algy Hall, 25th March 2010

Not many years ago, the activities of so-called 'trustbusters' was one of the dominant influences on the investment trust sector. The modus operandi of such activist investors is to build a large stake in a trust that is trading at a substantial discount to net asset value (NAV) in order to try and force the board to return money to shareholders at closer to NAV by winding the trust up, forcing a tender offer, or some similar activity. Over recent years, though, there has been a period of quiet from activists.

However, with the relative stabilisation of the market, this year is witnessing some noteworthy attempts by activists to launch new funds. **Laxey Partners**, once the scourge of the investment trust world, is considering setting up a fund in cahoots with Paris-based arbitrageur **Albion**. Meanwhile a firm called **Nimrod Capital** has also been sounding investors out about a fund provisionally named Damille, which would principally target Aim-traded closed-end funds.

The prospect of two new funds hardly suggests a return to the heady days of trust-busting activity, but it does highlight the perennial allure of buying investments trusts at a discount to their wind-up value. There is certainly good money to be made from the effect of narrowing discounts, as the stellar performance of private equity investment trusts since the market bottomed out in March has proved. However, playing the discount game can also be a treacherous activity.

Cheap for a reason

Despite the potential interest from activists, share price discounts in mainstream investment trust sectors have remained relatively stable during the market ructions of the past few years. And there is currently little reason to regard discounts as particularly wide. Somewhat ironically, it's the success of trustbusters in the past that has helped underpin discounts. In order to stave off activist attacks many trusts introduced discount control mechanisms, such as regular tenders at an agreed discount to the share price, and boards have become more proactive in addressing underperformance.

And where discounts are wide, it's dangerous to rule out their predictive quality. The recent widening of the discount on top-performing trust **BlackRock World Mining** to 17 per cent, for example, is a great buying opportunity for commodity bulls who believe a strong market is set to continue. But for those investors spooked by the recent withdrawal of stimulus in China and the potential effect on demand for commodities, such a discount will look entirely justified. Moreover, discounts normally persist and widen if anticipated NAV falls come through. Discounts can also reflect particular problems in certain sectors, such as the illiquidity of the constituents of the smaller company investment trust sector.

Even where discounts are widely considered attractive, the value on offer is academic if they persist. Indeed, the current 19 per cent share price discount to NAV on the £2.2bn **Alliance Trust** looks eye-catching but the catalyst needed to narrow it still appears illusive. Even a recent large NAV-enhancing buy back of shares from a big shareholder can be interpreted as an attempt to keep the shares out of the hands of potentially more-activist investors that may try and upset the status quo.

Discounts in play

However, the investment trust sector still throws up discounts that present discernable opportunities and there are a number of situations investors can look out for. A change of manager can often be used to address the discount problem. We [recently highlighted the case of European Investment Trust](#), for example. The trust has a new manager with a reputation for outperforming the benchmark, yet the trust trades on the widest discount in the sector, 19 per cent. At least in part, this seems to be down to share selling from a large stake held by a saving scheme operated by the previous fund manager. Of course the discount could persist, but on balance it looks like the situation should rectify itself as selling pressure eases over time.

A starker situation exists at the moment with a UK smaller companies investment trust, **Framlington Innovative Growth**. The board has announced that the trust will be wound up if it had not outperformed its benchmark in the three years to the end of June 2010. So far, according to Datastream data, it is lagging 2 per cent behind and the 17 per cent discount could start to look interesting the closer we get to the fateful date.

Conventional continuation votes are also a potential source of interest. Charles Stanley analyst Stephen Peters highlights **Strategic Equity Capital**, which takes stakes in quoted companies alongside a larger activist investment fund run by private-equity specialist SVG. A continuation vote and strategic review is due to take place late this year and one of the trust's major shareholders, Fortelus, has previously attempted to force a wind up, so things could get quite interesting, especially given the 23 per cent discount on offer.

Lapsed promises to shareholders about narrowing discounts also provide a source of potential opportunity. Many trust's boards have temporarily suspended their commitments to discount targets due to the exceptional circumstances in the market. But it looks as though the time could be coming for them to act to prove their promises were of substance. Our [recent tip on Biotechnology International Trust](#) was in some part in recognition of the trust's commitment to an 8 per cent share price discount to NAV compared with the current reality of a 23 per cent discount.

However, a wide discount on its own is never going to be a sound reason for an investment. Underlying belief in the asset class being targeted by a trust and the manager's ability are always going to be fundamental.

Name	Price p	Discount to NAV %	Disc. avg. %	Disc. low %	Disc. high %
BlackRock Smaller Cos	311	-22.8	-19.9	-13.5	-24.7
International Biotech	137	-22.5	-19.6	-12.1	-23.7
Montanaro UK Sm Cos	231	-21.5	-17.1	-9.5	-23.7
Albany	254.5	-20.4	-16.4	-6.8	-22.4
Aberdeen New Thai	190	-20.0	-14.7	-8.5	-21.9
JPM Mid Cap	375	-19.4	-13.8	-5.9	-20.4
Throgmorton Trust	126.75	-19.2	-16.5	-11.1	-21.3
Alliance Trust	340.4	-18.8	-15.7	-9.9	-20.5
Baillie Gifford Japan	173.25	-18.8	-16.2	-11.1	-20.8
European Investment Tst	538	-18.2	-14.1	-8.3	-18.5
UK Select Trust	128.25	-17.1	-11.7	-6.6	-17.9
Dunedin Smaller Cos	102.5	-17.0	-14.1	-6.1	-18.9
Electric & General	381.5	-16.6	-12.8	-6.8	-17.0
Bankers	381	-15.2	-10.8	-3.2	-16.2
Lowland	616	-13.2	-4.0	6.7	-14.3
JPM Indian	400.1	-11.7	-4.0	1.2	-12.7
JPM Asian	197.8	-11.3	-8.5	-4.9	-12.6
Fidelity Special Values	537	-11.2	-4.8	2.6	-12.3
Pacific Horizon	150	-11.0	-7.5	-2.7	-11.6
Invesco Asia	135.25	-10.9	-7.8	-3.4	-12.0

Name	Price p	Discount to NAV %	Disc. avg. %	Disc. low %	Disc. high %
JPM Emg Mkts	522	-9.4	-7.1	-3.0	-10.2
Schroder Income Gwth	180	-8.2	-4.2	2.6	-9.0
Finsbury Growth & Inc	257	-6.2	-4.2	0.4	-6.6
City Merchants High Yld	157.5	-3.9	3.9	13.3	-3.9

Source: Winterflood Securities - trusts listed are trading on a discount of 10 per cent or less of the year discount high
