Quarterly report | Investment Companies

8 July 2015

Second Quarter of 2015

QuotedData news

This is the second quarterly report we have published. Q2 2015 might have been a fraught one for markets, as Chinese stocks boomed and bust and GREXIT edged ever closer, but it was a good time for the investment companies sector with around 90 funds expanding during the period, adding a net £2.4bn of assets.

New research

We published two big research pieces in the period. The first, on Japan, was entitled "Is Japan on the road to recovery? We interviewed a number of managers investing in the sector to find out what they thought about the Japanese government's efforts to revitalise the Japanese economy (the third largest in the world after the US and China). We also published a note on a hot topic, "The importance of income – Where to find it?", that looked at some of the options available within the investment companies sector for investors looking for alternative homes for their cash now that bank deposit rates are so low. If you missed either of these they are available on our website.

In this issue

Performance Data – two Chinese funds top the tables despite that market's boom and bust

Money in and out of the sector – the largest new issue in the sector ever

Significant rating changes – evaporating premiums on a couple of stocks

Major news stories – Alliance Trust beefs up its savings business after compromising with Elliott Advisers

Income – the highest yielding investment companies based on current year forecasts

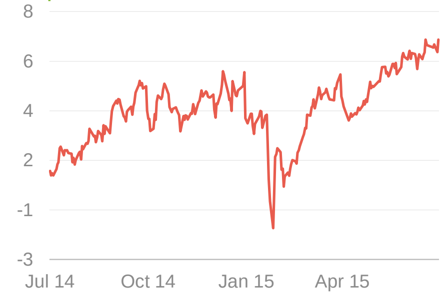
All investment companies average discount

Time period 01/07/2014 to 30/06/2015

Over the 12 months to the end of June 2015, the average discount across the whole of the investment company market moved within a range of c9% to c12% - over the past quarter there has been a narrowing of discounts.

Renewable Energy average discount

Time period 01/07/2014 to 30/06/2015



One of the sectors that has seen a noticeable increase in premiums over the past year is renewable energy where the highest rated stock, Bluefield Solar Income, traded on an 8.3% premium at the end of June

More information about the funds mentioned in this report is available on our website. If you are reading this online, there are links embedded in the document that will take you through to the relevant webpage.

Performance Data

UK smaller companies funds feature quite prevalently in the lists on the back of a decisive election result in the UK and some funds close to the end of their lives made significant progress during the quarter for stock specific reasons.

- **ARC Capital**'s impressive performance this quarter was the result of it winning a couple of court cases. This fund is close to the end of its life and its shares have been suspended from trading while it finalises its accounts for 2014.
- **PME Africa**, **Trading Emissions** and **European Real Estate** are similarly working to liquidate their investments. PME finalised the sale of most of its rail business during the quarter and European Real Estate managed to get vacant possession of one of its three remaining properties and extract a dilapidation payment from the tenant.
- **Aseana Property** will now join the ranks of those funds liquidating their portfolios. Shareholders have approved a three year timescale for this endeavour.
- Many of the UK small cap. funds are geared as a result of their capital structure but **Strategic Equity Capital** deserves special mention as its performance came without the use of leverage and this extends its performance lead over other UK smaller companies funds. This has made it popular with investors and it now trades at an 8% premium.
- **Lindsell Train's** premium, now 21.6%, is starting to look excessive.
- **Fidelity China** has given up much of its recent performance as domestic Chinese stocks have had a swift reversal of fortune and are now in bear market territory.
- **Marwyn** has been benefitting as entertainment One, its largest investment, is hitting new share price highs.

Figure 1: Best performing funds in price terms in Q2

	%
ARC Capital	+56.3
PME African Infrastructure	+46.8
Trading Emissions	+29.0
Aseana Property	+26.9
Strategic Equity Capital	+21.3
Lindsell Train	+17.3
Rights & Issues Income shares	+16.4
Acorn Income	+15.3
BlackRock Smaller Companies	+15.1
European Real Estate	+14.6

Source: Morningstar

Figure 2: Best performing funds in NAV terms in Q2

	%
Fidelity China Special Situations	+11.2
Marwyn Value	+10.8
Acorn Income	+10.5
BlackRock Smaller Companies	+10.2
Rights & Issues Income shares	+10.0
Small Companies Dividend	+9.7
British & American	+9.5
Invesco Perpetual UK Smaller	+9.3
Aberforth Geared Income	+9.2
Strategic Equity Capital	+8.8

Source: Morningstar

On the negative side, looking at figures 3 and 4, once again a number of very small funds that are close to the end of their life show up in the tables. Commodities funds struggled again and so did some Asian funds as investors grew more nervous about the possible effect of US rate rises on the region and slowing Chinese growth.

- Highly geared property fund, **Invista European**, has sold some property but at discounts to last valuation and it is getting closer to negative NAV territory.
- **Tau Capital** is closer to selling off its last investment but may have to inject cash into it before it can complete the transaction.

- **Duke Royalty** is the new name for Praetorian Resources. Shareholders approved a change of direction for this commodity fund, it will now buy royalty streams from cash strapped, asset-light but intellectual property rich companies.
- One of the court cases **Juridica** had funded was lost and this took $29.7m off its NAV.
- **Ukraine Opportunity** was thinking of a change of remit, no surprise maybe given the country's situation but shareholders voted against almost all resolutions put forward at its AGM, the board has changed and it has a new Chairman.
- **Nimrod Sea Assets** has been affected by the oil price slide, one of the companies it leased a vessel to is in administration.
- **Dolphin Capital** is exposed to Greece but it did say that it has just €1.5m in Greek bank accounts, most of its Euro cash is outside the country.

Figure 3: Worst performing funds in price terms in Q2

	%
Invista European Real Estate	-50.0
Tejoori	-45.3
Tau Capital	-33.4
Duke Royalty (Praetorian)	-26.4
Origo Partners	-25.0
Juridica	-23.4
Ukraine Opportunity	-23.1
Nimrod Sea Assets	-21.2
Aurora Russia	-18.9
Alpha Pyrenees	-16.9

Source: Morningstar

Figure 4: Worst performing funds in NAV terms in Q2

	%
Duke Royalty (Praetorian)	-43.7
Ottoman Fund	-34.6
Dolphin Capital	-21.6
Juridica	-15.7
Geiger Counter	-14.9
BlueCrest Blue Trend GBP	-13.5
Symphony International	-13.3
Schroder Global Real Estate	-12.5
Aberdeen New Thai	-11.0
Martin Currie Pacific	-9.6

Source: Morningstar

Money in and out of the sector

On our numbers, we think the sector expanded by about £2.4bn over the quarter, taking in close to £2.9bn and handing back just over £450m. What seems interesting to us is that many of the funds raising money are not designed to throw off high levels of income, suggesting that investors are as attracted by capital growth stories at the moment as high yield investments.

Coming in:

Woodford Patient Capital Trust was the largest ever new issue in the sector, a remarkable feat for Neil Woodford's new management company. The fund's net asset value has edged up to 102p since launch but the shares are trading at more than a 10% premium to this level, reflecting the excitement around this new issue. The fund is distinctive for having no base management fee, instead the manager hopes to earn money from performance fees generated by the fund.

Toro invests in asset backed and structured debt. It raised close to €340m from investors at launch. Apax Global Alpha raised €300m of fresh capital from investors. It invests in funds managed by private equity firm, Apax. The fund had some pre-existing investors and has about £640m of assets. Amedeo Air Four Plus is, like the three Doric Nimrod Air funds, investing in Airbus A380s which it then leases to Emirates. This quarter also saw the expansion of another fund specialising in this area as DP Aircraft raised money to buy Boeing Dreamliners which it the leased to Thai Airways.

Oakley Capital is another private equity fund. It, GCP Student Living and Scottish Mortgage are all funds that have been around for a while but have proved popular with investors and are raising money.

Ranger Direct Lending was the third fund in the fast-expanding online lending sector to launch after P2P Global and VPC Speciality Lending. Another fund is on the way in the form of GLI Alternative Finance Limited.

Phoenix Spree Deutschland, like Apax Global Alpha, is a fund that has been around for a while but has only just been listed on a stock market. It specialises in investing in residential property in Berlin. This was an area of the market that was popular in the early 2000s but, as many of these funds were highly leveraged, ran into trouble in the credit crisis.

AEW UK REIT is another property company. Its focus though is on smaller commercial properties in the UK. The rationale is that there is less competition for properties that are too small for the major institutional investors and so these are more attractively priced.

Going out:

Around a third of all the money handed back in the quarter came from SVG Capital as it bought back both its shares and its convertible debt. It has had a lot of success in recent months in selling off some of its largest investments, recently announcing the sale of fashion brand, New Look, for instance.

Emerging markets funds have not been doing too well recently as growth has slowed or gone into reverse in big countries like Brazil, Russia and China. This probably accounts for the shrinkage of Templeton Emerging. China though saw its domestic stock market boom and bust during the quarter. Investors in Fidelity China seem to have been taking profits throughout this process which seems quite healthy to us. Dale Nicholls, the fund's manager, outlines the case for investing in the country in our latest economic and political roundup. Shareholders in Biotech Growth and Worldwide Healthcare seem to have also been taking profits. Again, Sam Isaly of Orbimed, manager of the latter, explains why he thinks that sector has further to run in the economic and political roundup. Cayenne is, like SVG, buying back both its ordinary shares and its convertibles. It is gradually selling off its portfolio.

The other three funds are just looking to manage their discounts. BlackRock Income Strategies is maybe a surprising name on the list as it hoped to be expanding as investors took advantage of the freedom to invest their pension pots in assets other than annuities.

Figure 5: Funds raising capital in Q2 2015

	£m
Woodford Patient Capital	800.0
Toro	250.7
Apax Global Alpha	217.0
Amedeo Air Four Plus	202.0
Ranger Direct Lending	135.0
Oakley Capital	130.0
GCP Student Living	120.0
Phoenix Spree Deutschland	105.0
AEW UK REIT	100.5
Scottish Mortgage	c80.0

Source: Morningstar, QuotedData

Figure 6: Funds returning capital in Q2 2015

	£m
SVG Capital	94.2
SVG Capital 8.25% Convertible	61.6
Templeton Emerging Markets	21.3
Fidelity China Special Situations	19.9
JPMorgan American	11.5
Biotech Growth	11.1
BH Macro	10.4
Worldwide Healthcare	9.9
Cayenne 3.25% Convertible	8.5
BlackRock Income Strategies	8.4

Source: Morningstar, QuotedData

Significant rating changes

Good results from Lindsell Train helped propel it onto a higher premium but we would always caution investors against buying funds on very high premiums. There is a good illustration of the dangers of this in Figure 8 as Nimrod Sea Assets fell to a discount from a 10% premium as the falling oil price affected its portfolio.

We have included a couple of new issues in the lists. Woodford Patient Capital has moved to a high premium, reflecting investors' high hopes for good performance. However, one fear might be that this takes time to manifest itself and investors lose faith. Woodford Patient Capital does maintain quite a good track record for the sector of new issues trading above or close to asset value. There is always an exception to the rule though and Phoenix Spree Deutschland has bucked the trend (see Figure 8).

The demand for yield has helped push Scottish American, GCP Student Living and 3i Infrastructure onto higher ratings but it is probably high capital growth from Strategic Equity Capital that is attracting new investors to that trust.

A few funds that had been trading on high premiums issued more stock during the quarter or promised to and this might have depressed their share price. These include DP Aircraft One, P2p Global and Tritax. Doric Nimrod Air Three might not have raised more money but Amedeo Air Four plus was launched with the same remit.

Figure 7: More expensive relative to NAV - notable changes to discount (-ve) or premium (+ve)

	31/03/15 %	30/06/15 %
Lindsell Train	+5.8	+22.0
Duke Royalty	-49.0	-33.5
Scottish American	-4.2	+8.1
Geiger Counter	-23.4	-11.3
GCP Student Living	-3.6	+8.5
Woodford Patient Capital	n/a	+11.4
Strategic Equity Capital	-5.0	+5.8
3i infrastructure	+6.9	+16.0
JZ Capital Partners	-42.9	-34.6
Fidelity Special Values	-9.6	-1.7

Source: Morningstar

Figure 8: Less expensive relative to NAV - notable changes to discount (-ve) or premium (+ve)

	31/03/15 %	30/06/15 %
Nimrod Sea Assets	+10.0	-8.7
Phoenix Spree Deutschland	n/a	-12.4
Baker Steel Resources	-29.0	-39.7
DP Aircraft One	+16.2	+5.7
Juridica	+12.3	+1.9
City Natural Resources	-15.0	-24.6
P2P Global	+14.1	+5.3
Tritax Big Box REIT	+10.5	+3.6
SVG Capital	-14.5	-20.8
Doric Nimrod Air Three	+22.5	+16.2

Source: Morningstar

Major news stories

Portfolio developments

- **Nimrod Sea Assets** bought a 50% stake in a multi-role support vessel but later acknowledged the impact of the weak oil price on its portfolio and said one investment was in administration
- **Graphite Enterprise** sold the National Fostering Agency for £11.9m adding 0.5% to NAV.
- **International Public Partnerships** paid £14.3m for an extra 40% of Lewisham schools project and invested in an offshore transmission project

- **Next Energy Solar** bought a number of solar power plants including Glebe Farm and Hawkers Farm.
- **Riverstone Energy** is contributing $167m to Texas based oil and gas company, Three Rivers Natural Resource Holdings III LLC and invested in Carrier Energy II
- **JZ Capital Partners** bought two Miami properties and a US telecom tower business
- **Alliance Trust** bought Stocktrade
- **SVG** said New Look had been sold
- **DP Aircraft One** bought two planes for Thai Airways
- **Renewables Infrastructure** said it was in talks to buy six wind farms from Fred Olsen
- **Caledonia** bought Seven investment management
- **Oakley Capital** sold Verivox
- **Hg Capital** sold SimonsVoss

Corporate News

- **Aseana Properties**' shareholders approved an orderly realisation of its assets over the next three years.
- **Alliance Trust** reached an 11th hour compromise with Elliott Advisers prior to its AGM on 30th April 2015.
- Shareholders in **Ukraine Opportunities** voted against most AGM resolutions
- **Fidelity Special Values** has adopted a formal DCM with the aim of keeping the discount in single figures.
- **JZ Capital** will borrow money rather than issue CULS to repay its Zero Dividend Preference Shares
- **Praetorian Resources** unveiled plans to become a royalty finance company, **Duke Royalty**
- **Capital Gearing** said it would adopt a zero discount policy
- **Dexion Absolute** is mulling focusing on early stage funds
- **Invesco Property Income** plans to wind up

Managers

- **BlackRock Greater Europe** is scrapping its performance fee from 1 September 2015. The base management fee will increase to 0.85% (previously 0.7%).
- **JPMorgan Asia's** manager, Ted Pulling is moving to the US and relinquishing his role as the trusts' manager.
- **Aberforth Geared Income** cut its base management fee
- **Aberforth Smaller Companies** introduced a tiered management fee
- **Capital Gearing** said it would introduced a tiered fee
- **Dolphin Capital** introduced an incentive fee to encourage the sale of non-core assets
- **JPMorgan Emerging** scrapped its performance fee

Income

This quarter we are publishing a list of the highest yielding investment companies based on forecast dividends. We are using Morningstar's figures for this. Figure 9 shows the list of highest yielding funds at the end of June 2015. We have tried to exclude from this list funds that are shrinking deliberately by handing back capital to shareholders.

Figure 9: Highest yielding investment companies (data at 30/6/15)

	Yield
Jupiter Dividend & Growth	15.7
Carador Income Fund	12.0
New City Energy	11.7
M&G High Income	10.0
Ranger Direct Lending	9.4
British & American	8.9
Fair Oaks Income	8.8
DP Aircraft One	8.5
Doric Nimrod Air One	8.4
Amedeo Air Four Plus	7.9
Blackstone / GSO Loan Financing.	7.9
Doric Nimrod Air Three	7.8
BlackRock Commodities Inc	7.6
Doric Nimrod Air Two	7.5
VPC Speciality Lending	7.4
Aberdeen Latin American Income	7.4
CQS New City High Yield	7.3
BlackRock World Mining	7.3
MedicX	7.3
SQN Asset Finance	7.0

Source: Morningstar

Jupiter Dividend & Growth is a split capital company that will wind up in November 2017. The way its structure works (it has a combination of ordinary income shares, common shares and zero dividend preference shares), its ordinary income shares have almost no net asset value right now but are entitled to a disproportionate share of the income generated by the company. M&G High Income is a similar story. Here we show the forecast yield on its income and growth units (comprising an income share and a capital share).

Carador Income invests in the lower tranches of CLOs (see our website for a detailed explanation). Its investment style leads it to earn quite a bit of income but this is often offset by capital losses, reducing the overall return that investors earn. Fair Oaks Income and Blackstone / GSO Loan Financing are similar funds.

New City Energy invests in companies involved in exploration, development and production of energy, and related service companies. The fall in the oil price and other commodities has hit it hard and its share price has more than halved over the past year. To date though it has managed to maintain its dividend, hence its high yield. BlackRock Commodities Income and BlackRock World Mining have been similarly affected though in Commodities Income's case its share price decline has been less dramatic.

Ranger Direct Lending and VPC Speciality Lending are two relatively new investment companies that are investing in loans originated on online platforms. These yields are based on forecasts made in their prospectuses that assumed the funds were fully invested but, in practice, it can takes a little time to deploy capital raised in new issues.

British American's ordinary shareholders benefit from the presence of a convertible security in its capital structure which boosts the dividend but makes its net asset value more volatile.

DP Aircraft One, the three Doric Nimrod funds and Amedeo Air Four Plus are leasing planes. It is hard to tell what the resale value of these planes will be when the leases come to the end of their life. This resale value will have a big impact on their final net asset values and will determine whether these funds generate capital growth or losses.

MedicX's dividend was only covered 54% by its income last year so, at the moment, it is one of the funds boosting its income through capital distributions.

QuotedData

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IMPORTANT INFORMATION