

# Pacific Horizon

## Investor in Asian growth

Pacific Horizon (PHI) is unashamedly a growth fund and its Asia-focused portfolio has significant overweight exposures to technology and biotechnology. However, it would appear that, investors are shying away from Asia because of weak Chinese growth and are seeking safety in defensive stocks for the same reason. Perhaps it is not surprising that PHI has underperformed both its comparative index and its peer group, and its discount has widened. PHI is a fund that may be out of fashion but could perform well in an environment where investors are less risk averse.

The manager believes that PHI is invested in some of the most dynamic and exciting companies in Asia and beyond. He thinks many of us underestimate the pace of technological change, the potential for this to transform many established business models and the potential for Asian companies to create their own intellectual property.

## Asia ex Japan growth stocks

Investment objective: PHI invests in the Asia-Pacific region (excluding Japan) and in the Indian sub-continent, in order to achieve capital growth. The company is prepared to move freely between the markets of the region as opportunities for growth vary. The portfolio will normally consist entirely of quoted securities.

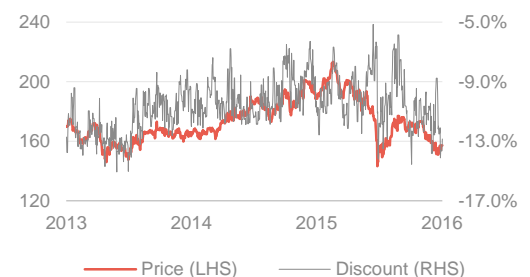
Year ended	Share price total return (%)	NAV total return (%)	MSCI AC Asia Ex-Japan TR. (%)	MSCI AC World total return (%)
29/02/12	6.1	5.7	3.8	0.3
28/02/13	3.9	9.2	11.4	15.0
28/02/14	(1.3)	(3.5)	(9.6)	7.0
28/02/15	14.4	14.6	20.8	16.6
29/02/16	(16.4)	(14.7)	(11.8)	(2.8)

Source: Morningstar, Marten & Co

<b>Sector</b>	Asia ex Japan
<b>Ticker</b>	PHI LN
<b>Comparative index</b>	MSCI AC Asia x Jp
<b>Base currency</b>	GBP
<b>Price</b>	172.75
<b>NAV</b>	192.05
<b>Premium/(discount)</b>	(10.0%)
<b>Yield %</b>	0.2

## Share price and discount

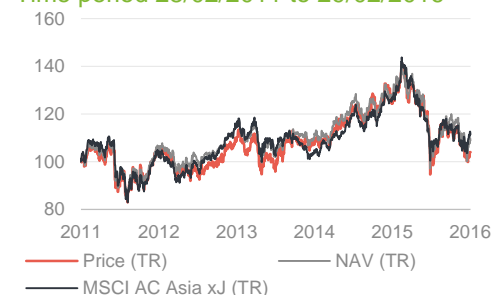
Time period 28/02/2013 to 29/02/2016



Source: Morningstar, Marten & Co

## Performance over five years

Time period 28/02/2011 to 29/02/2016



Source: Morningstar, Marten & Co

<b>Domicile</b>	UK
<b>Inception date</b>	September 1989
<b>Manager</b>	Ewan Markson-Brown
<b>Market cap (GBP)</b>	98m
<b>Shares outstanding</b>	60,124,411
<b>Daily vol. (1 yr avg)</b>	78,199 shares
<b>Net cash</b>	1%

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## Fund profile

A unique approach focused on growth companies

The manager has been in place for only two years

You can access the fund's website at <https://www.bailliegifford.com/individual-investors/funds/pacific-horizon-investment-trust/>

A stock-picking fund, active share 85%

Pacific Horizon is an Asia ex Japan fund that specialises in investing in growth companies. Baillie Gifford & Co Ltd, the manager of the fund, is a long-term growth investor and, as we explain below, it believes there is a significant long-term opportunity to outperform markets over the long-term using this approach. Baillie Gifford believe PHI and its open-ended sister fund, Baillie Gifford Pacific, are unique; there are no other funds taking the same approach, listed or otherwise.

Ewan Markson-Brown (Ewan or the manager) has day-to-day responsibility for the management of PHI. He took over the management of the portfolio on 18 March 2014 (from Mike Gush) and, over the period that he has been running the fund, Asia and emerging markets have been experiencing difficulties. Two years, in the context of the manager's long term approach to managing the portfolio, is insufficient time to judge whether the investment thesis is working.

## About the manager

Baillie Gifford has about 100 investment professionals based in its Edinburgh office. It is structured as a partnership and encourages a collegiate approach to managing money, although it allows its portfolio managers the freedom to have the final say about their portfolios. It manages about £120bn. Baillie Gifford had £23.7bn invested in Emerging Market equities at the end of December 2015. The Emerging Markets Desk had £8.2bn of this. 75% of the firm-wide and Emerging Market desk money is in Asia Pacific. PHI and the Baillie Gifford Pacific Fund (its open-ended equivalent) have combined total assets of roughly £400m.

Ewan joined Baillie Gifford in 2013 from PIMCO where he had been a senior vice-president in its emerging markets team. Prior to that he was managing Asian funds at Newton.

Ewan says he is by nature "big picture" (thinking about the trends that are driving markets and the political and economic environment) and thematic considerations are always in the back of his mind but he thinks you only really get to see the big picture by looking bottom up at individual companies. This is very much a stock-picking fund and the portfolio bears very little resemblance to the fund's MSCI All Country Asia ex Japan Index comparative index (the active share, a measure of how different or otherwise a portfolio is from a benchmark, at 29/02/16 was 85% – meaning that 85% of the portfolio is not represented either to the same degree or at all in the index). Ewan spends most of his time meeting companies and undertaking stock specific research.

Ewan is assisted with the management of the fund by Roderick Snell who has a degree in Medical Biology. Roderick has been at Baillie Gifford since 2006 and has managed the Baillie Gifford Pacific Fund since 2010 and has been deputy portfolio manager of Pacific Horizon since September 2013.

## Managers' view

Asian companies are creating intellectual property in a period of rapid technological change

Many of us in the West have a perception that Asia is better at exploiting intellectual property than creating it. However, in certain sectors this just is not true. Ewan thinks we are going through one of the most rapid periods of technological change in human history, especially in sectors such as communications, manufacturing and biotech.

Deflation is one consequence of technological change

In the past, emerging market economies were late adopters of technological change but today they are often at the forefront. Examples of this phenomenon include the smartphone revolution, where emerging market telecoms companies, unburdened by legacy infrastructure, can more easily embrace cutting-edge technology, leapfrogging their developed world counterparts. There is evidence of this in the high growth in data usage in emerging markets as they see a rapid take-up in the use of smartphones. Ewan also pointed to the considerable growth of the solar energy market in India in a market that is struggling to build coal power plants. He sees this as at least a decade-long trend.

Loss of confidence in central banks is a big risk to markets

On the downside, some established companies are in trouble as new entrants disrupt their markets. Ewan says that one side-effect of rapid technological change is deflation (falling prices), but this is not all bad, however, as it boosts consumers' disposable income (as the basket of things they typically buy costs less). Ewan thinks the domestic Asian consumer is doing ok.

However, the central bank response to deflation has been inadequate in Ewan's view. He says we are coming to the end of central bank credibility. Ewan believes quantitative easing (commonly known as QE, where central banks buy assets from banks, in theory freeing up capital that they can lend to businesses) has been a failure in terms of stimulating growth and he thinks it just perpetuates deflation. How investors deal with a loss of confidence in central banks could pose the biggest risk to global markets.

In an environment like this, markets will be volatile. This underpins one tenet of Ewan's investment approach – avoid companies that might need to raise cash to fund their growth as they might be having to raise money at a time when markets are not prepared to hand it over.

## Investment philosophy and process

### The underlying approach

Markets are inefficient at pricing long-term growth

Baillie Gifford believes markets are inefficient at pricing long-term growth, especially over a time horizon of three to five years, and this creates an opportunity to earn alpha (performance above and beyond what you would earn by just buying an index). For this reason, they aim to encourage a culture of long-term thinking within the firm. Baillie Gifford believes there is persistence of good company management, business models and stock prices. This translates into a culture of sticking with the winners.

Research is home grown or specially commissioned and is focused on the long term

The team do a lot of the research themselves but will also often commission research from local research teams, academics and industry experts. Baillie Gifford also subjects some companies to forensic analysis, using the services of investigative journalists and forensic accountants. When it is talking to companies, the

conversations with their management teams focus on the long-term prospects of the business.

All the money is managed from Baillie Gifford's Edinburgh office. Ewan believes that managing the money this way, rather than having regionally based teams, helps the team keep a sensible detachment from short-term "noise". He is convinced that teams that are split across two or more locations do not function well. Ewan is able to draw on the resources of the whole investment team when analysing companies and can sit in on meetings with companies outside his geographic remit. This is especially beneficial when he is trying to figure out how his companies stack up against competitors based in other markets.

Ideas are reviewed by the team but the portfolio manager has the final say

Each member of the team is assigned a geographical focus for research and these responsibilities are rotated every 18 months. Investment ideas are presented to the group but the lead portfolio manager makes the final decision. Ewan spends four to five weeks each year in Asia. Currently, his special geographic responsibility is India and he will be going there this year. He has recently returned from Korea (where the portfolio has exposure to a number of biotech companies – see page 9) and is thinking of visiting Vietnam (because he thinks it might be an interesting market at the moment) and Indonesia (a big market that has not been doing so well recently).

The open-ended fund (OEIC) and PHI are run in parallel with some exceptions. However, while Ewan is lead portfolio manager on this fund, he is co-manager of the OEIC with Roderick Snell. This does introduce one small element of differentiation between the two portfolios. More significant differences arise because of the need to keep the OEIC's portfolio relatively liquid. There is an internal limit of holding no more than 12 days' volume in any stock across the whole firm but within this constraint, PHI is freer to hold more illiquid investments than the OEIC. The OEIC has ended up with more of a large cap. bias as result – PHI has more exposure to small cap. names. There is considerable crossover in the stocks in the portfolio albeit the individual weightings may differ (53 holdings in common accounting for 74% of Baillie Gifford Pacific Fund and 80% of PHI). PHI, unlike the OEIC, also has the option of using gearing.

A mid cap bias

There is a mid cap bias to PHI's portfolio. This reflects Ewan's belief that smaller companies grow faster than larger ones, albeit their share prices tend to be more volatile. He also subscribes to the view that smaller companies tend to be less well-researched which means they are more likely to be mispriced.

## Building the portfolio

With over 6,000 stocks in PHI's universe to choose from and a target portfolio size of between 40 and 120 stocks, Ewan looks to focus on those that are beneficiaries of positive trends such as demographic shifts (how populations are ageing) or technological change.

Companies growing earnings and cash flow faster than market averages

Ewan is looking for companies that are capable of growing earnings and cash flow faster than market averages. He wants companies to exhibit some or all of the following qualities: good management teams, barriers to entry, positive cash flow, self-funded growth (he wants to avoid companies that need to keep coming back to the market for cash) and a high return on invested capital (ROIC) of around double the market rate. Companies with blue-sky (unproven) technology are interesting to him if they are fully funded through to positive cash flow.

Looking for 15% per annum top line and bottom line

### compound growth over five years

A typical investment should be capable of at least delivering growth in both its top and bottom line of 15% per annum over five years (this translates into a doubling over that period). The managers do not set target prices for stocks. Ewan is mindful of valuations, aiming to at least capture a company's earnings growth on the assumption that the price/earnings (P/E) multiple in five years or so, when he is looking to sell, will be at least as high as it is when he makes the investment. There is a problem if you buy on a high P/E multiple, the business case works out but the P/E multiple declines – you might end up not making any money. As an example of this, Ewan would not buy most consumer staples stocks today because he believes that, in a desperate search for companies with stable revenues, investors have bid up valuation multiples to unsustainable levels.

The research process is flexible and can be carried out quickly if necessary – for an IPO for example. Ewan will always have met the management before investing and the investment case will always be discussed internally. In addition he or a member of the team may have produced a brief report, an internal model, a cash flow projection and/or an extensive internal research note on the company. He will at times canvas analysts and external research providers for their opinion as well.

### No benchmark hugging and no geographic or sector limits

Baillie Gifford is an active investor and does not hold stocks because they are large constituents of any benchmark. Consequently there are few limits on country or sector weightings imposed on managers. The initial size of a position will reflect the strength of the manager's conviction of the potential risks and rewards of the investment. One of the guiding principles of investing at Baillie Gifford is to run the winners (reflecting the belief in the persistency of good business models). However, PHI has an upper limit of 15% exposure to any one stock. Ewan looks at the shape of the overall portfolio to ensure that he does not have too many companies exposed to similar thematic dynamics.

PHI's investment remit allows the manager to use derivatives to control risk and to alter the portfolio's exposure to markets. In practice, Ewan is not undertaking such activity. The managers have no plans to use hedging to alter the portfolio's currency exposure.

## Sell discipline

### Sell if you lose faith in management

Loss of faith in a company's management is an instant trigger for a sale. Ewan cites the example of Justdial, an Indian search-engine company, which Baillie Gifford thought could be an Indian Alibaba – at one point it was 2.5% of PHI's portfolio. After Justdial experienced delays in rolling out its search product, Ewan became concerned when he could not get access to talk to the underlying management of the business. He sold PHI's position and subsequently Justdial announced it had parted company with its Chief Technology Officer, its shares dived.

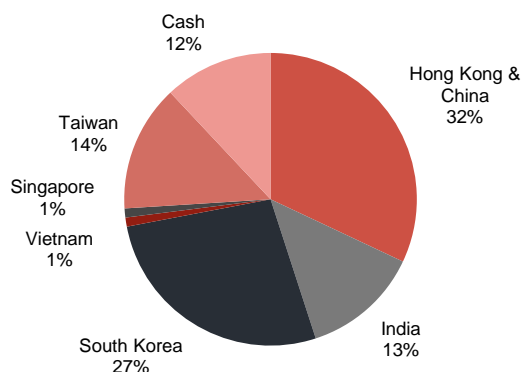
### Sell if the business model is not working

Ewan will also sell if he feels the business model is not working. One example of this is Hindalco which he acquired last year in the belief that aluminium use in the US automotive market would rise over time. However a change to Chinese production of aluminium caused him to sell the position swiftly.

Portfolio turnover on PHI was 50% in the last accounting year. This was pushed higher by the tender (see page 13 for more on this topic) and by their gearing activity (discussed on page 14). Turnover for the year before was 30% and the normal rate of turnover on the portfolio is about 25%, consistent with his three-to-five year investment horizon.

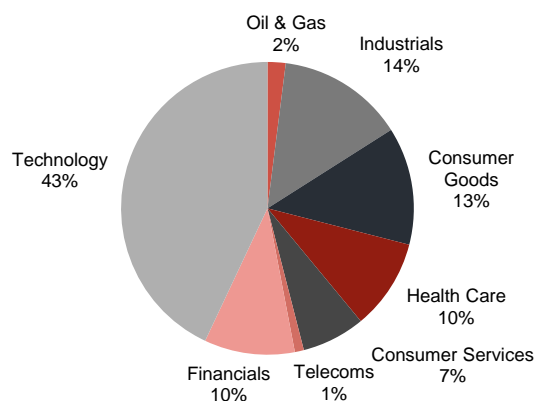
## Asset allocation

Figure 1: Geographic allocation as at 29/02/16



Source: Baillie Gifford

Figure 2: Industry sector allocation as at 31/01/16



Source: Baillie Gifford

The manager says that the portfolio's geographic weights are largely a consequence of his choice of companies. The portfolio has no weighting to the ASEAN countries of Thailand, Malaysia, Indonesia and the Philippines and, relative to the comparative index, quite overweight positions in South Korea and India.

Looking at Figure 2, almost half the fund is in technology and there is also a large weighting to healthcare (biotech). The manager says that back in 2003, this fund would have held a lot of basic materials stocks because there was growth in this sector but today it has no exposure. It is a similar story for the oil & gas sector where the portfolio is now quite underweight.

PHI is only overweight financial stocks in India

The biggest underweight relative to the benchmark is to the financials sector. PHI is only overweight financials in India. Ewan says there is a low probability of him buying banks for the fund at the moment. He will revisit the decision once bank's problems with non-performing loans have been addressed and their balance sheets rebuilt.

One large stock underweight the portfolio has within financials (which has been costly in terms of relative performance recently) is to AIA, the insurance company. Ewan thought it was attractively valued when it came to the market at IPO and he bought it and sold it at a profit. Today though, he thinks it is expensive and is not convinced its earnings are sustainable. There is no allocation to utilities companies in the portfolio. Generally, Ewan does not see them as growth companies and therefore they do not feature in the fund. The same is true of incumbent telecoms businesses.



## Largest holdings

Figure 3: 10 largest holdings as at 29 February 2016

Stock	% of total assets 29/02/16	% of total assets 31/07/15	% Change	Sector	Business focus	Country
Tencent	7.9	6.5	1.4	Technology	Internet	China
Baidu	4.1	3.8	0.3	Technology	Internet search	China
Alibaba	3.1	3.3	(0.2)	Technology	E-commerce	China
Naver	3.0	2.2	0.8	Technology	Internet	India
Hon Hai Precision	2.7	2.9	(0.2)	Technology	Manufacturing	Taiwan
JD.com	2.3	2.1	0.2	Technology	Online sales	China
Advantech	1.9	1.8	0.1	Technology	Computer Manufacturer	Taiwan
Reliance Industries	1.9	0.0	1.9	Oil & Gas	Energy	India
China Life Insurance	1.8	2.3	(0.5)	Financials	Life Insurance	Taiwan
Mahindra & Mahindra	1.8	1.9	(0.1)	Industrials	Conglomerate	India
<b>Total</b>	<b>30.5</b>	<b>26.8</b>	<b>3.7</b>			

Source: Baillie Gifford and Marten & Co

## Tencent

There were 64 holdings in the portfolio at the end of February 2016. The largest position then, at 7.9%, was Tencent, the Chinese company whose businesses encompass messaging, online gaming and social networking. Although there is a limit of 15% exposure to any one stock, the manager says it is unlikely that we will see a position of that size on the portfolio soon. Ewan trimmed the Tencent position when it hit 9.5% of the fund. Baidu is China's leading internet search-engine and Naver occupies a similar position to it in Korea. Naver also has a popular instant messaging app in Japan. Alibaba is China's largest e-commerce platform.

These big internet plays in the portfolio are also held by Baillie Gifford's global teams. The belief is that, in the long term, these are "winner takes all" markets and Baillie Gifford is convinced it is backing the ultimate leaders. Generally, Ewan thinks it will be easier for social networking businesses to make money from advertising than search engine companies, in the long-term, as they can access more targeted audiences.

Ewan says that he continues to be happy holding a large position in Tencent. He thinks it can deliver earnings growth, even in difficult economic environments, and he is comfortable that it can achieve growth of at least 15% per annum compounded.

## Hon Hai Precision Industries

The manager says that not every business PHI holds would be perceived as a cutting-edge technology company; he says that sometimes its most interesting activities are buried deeper within the business. A good example of this, in his view, is Hon Hai Precision Industries, the largest manufacturer of PCs in the world. This is a mature business trading on 8 times earnings. He says that it generates substantial amounts of cash and has a strong balance sheet but its core business is no longer growing. Hon Hai has been investing in automating its production lines and developing the robotic expertise in-house to enable it to do this. Ewan believes there is actually the prospect of a substantial business selling robots to third parties. Hon Hai has already done a tie up with SoftBank where it produced a limited run of a robot called Pepper. Hon Hai is also investing in autonomous vehicles and Ewan thinks it



could emerge as a leading player in this market. He sees the potential for this company to trade on a much higher multiple than it does today.

Ewan sees Hon Hai as an ideal stock for the portfolio in these difficult markets where steady cash flow is prized. PHI holds some other stocks with similar stories but these are a small part of the portfolio.

### ■ Viomed/Korean biotech

Viomed, which lies just outside the top ten holdings, is a Korean biotech stock, which Ewan says has already made PHI 4 times its money and, whilst he is not a fan of old-style pharmaceutical companies, he does like biotech. Ewan is able to draw on the expertise of his deputy manager and Douglas Brodie (head of Baillie Gifford's Global Discovery team who has a DPhil in Molecular Immunology) in this sector. Viomed, which is developing, amongst other things, treatments for cardiovascular disease, is one of a number of Korean biotech stocks that Ewan has bought for the portfolio. Of the 10 stocks he holds, he does not expect all of them to work but believes the rewards from the successful companies will far outweigh the cost of the failures.

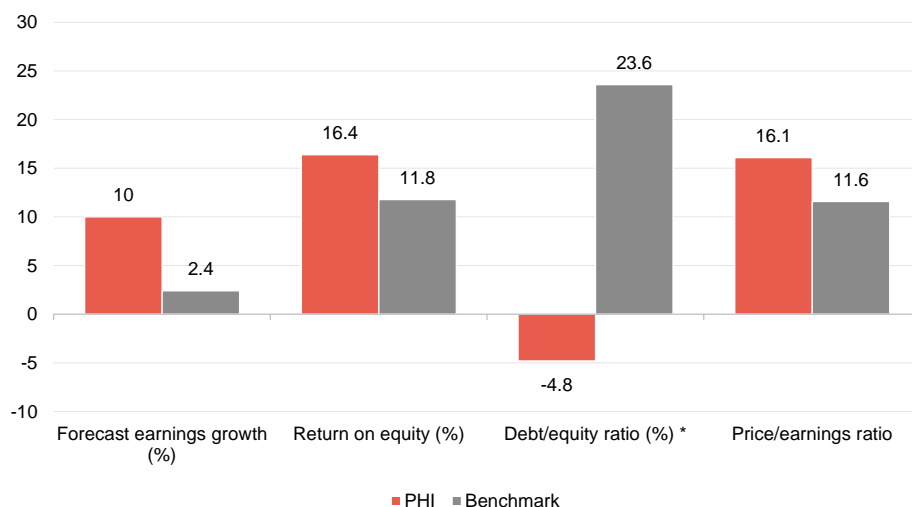
The Korean biotech sector is evidence of home-grown intellectual property in Asia

The manager believes that the Korean biotech sector is a good example of Asian companies exploiting home-grown intellectual property (see page 4 for further discussion.) In Korea, the government decided that it wanted to encourage the growth of the biotech industry and so now covers half of all R&D costs for these companies. The manager says that Korean companies are developing new therapies on the back of the revolutions that have taken place in the fields of stem cell research and genetics and that there is a similar situation in Taiwan.

The forecast earnings growth of PHI's portfolio is higher than the market and it is generating higher ROE

Figure 4 illustrates that the companies within the PHI's portfolio are, on average, expected to grow faster than the market and generate a high ROE. Arguably reflecting Ewan's focus on companies that have the resources to fund their own growth, the companies in PHI's portfolio have, on average, net cash on their balance sheets. The price/earnings ratio is higher for PHI's portfolio than the broader market but the managers believe that, even with the underperformance of growth stocks in recent times, it is still necessary to pay a higher multiple of earnings than the market average to secure faster growth. The manager says that his focus is on ensuring that these companies are trading at the same or higher multiples when it comes to sell them or the earnings growth more than compensates for any de-rating.

Figure 4: Portfolio characteristics as at 31/01/16

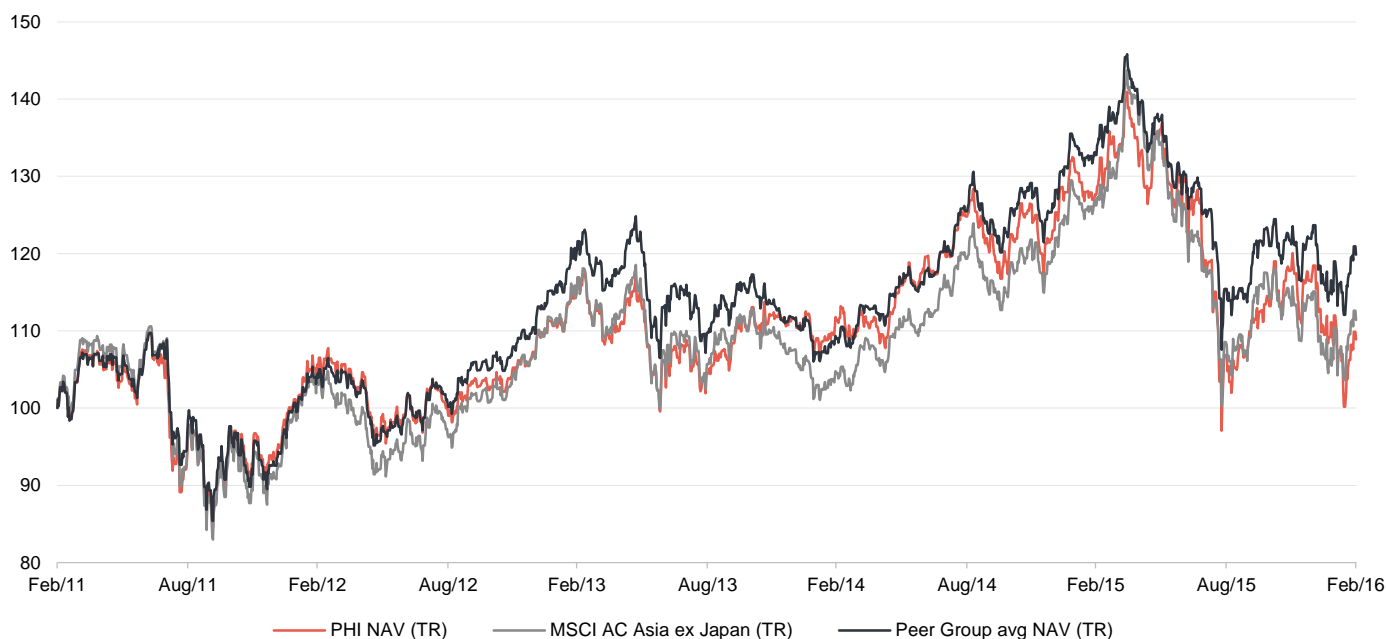


Source: Pacific Horizon Investment Trust (from UBS), \* Debt/equity ratio excludes financials

## Performance

Figure 5 shows that PHI's peer group (defined on page 11) has, on average, outperformed the MSCI AC Asia ex Japan Index over the past five years. PHI, however, has underperformed it, although not by much, as the numbers in Figure 6 show.

Figure 5: PHI NAV performance compared to benchmark and peer group to end February 2016



Source: Morningstar, Marten & Co

Figure 6: Cumulative performance over periods ending 29 February 2016

	3 months (%)	6 months (%)	1 year (%)	18/3/2014 to date (%)	3 years (%)	5 years (%)
Pacific Horizon NAV (TR)	(7.7)	1.9	(14.7)	(0.5)	(5.6)	8.9
MSCI AC Asia ex Japan (TR)	(1.6)	3.0	(11.8)	8.1	(3.7)	11.4
MSCI AC World Index (TR)	(1.0)	4.3	(2.8)	14.1	21.4	40.0
Peer group avg. NAV (TR)	(1.1)	3.8	(9.7)	10.9	(0.5)	19.8

Source: Morningstar, Marten &amp; Co

The manager believes that, somewhat disappointingly, the period since he took up the reins and the preceding few years have not been suited to his investment approach and, over that period, PHI has lagged its benchmark by 8.6% and the average of its peer group by 11.4%. On the plus side, Ewan says being underweight the oil & gas sector and not holding any basic materials stocks has helped performance relative to the benchmark. He says that there is also good news in that the Korean biotech stocks have not sold off recently in line with the rest of the global biotech sector; Ewan thinks this might be because they do not feature in many international investors' portfolios.

However, the manager believes that, in recent years the market has obsessed on companies with certainty of earnings rather than companies which have promise but uncertain earnings (those that are the focus of PHI's portfolio). He says that PHI's performance has suffered from having an underweight exposure to ASEAN stocks, not having gearing in the good times but introducing an element of gearing just before the market turned and from not holding defensive stocks now (as Ewan thinks defensive stocks are expensive).

PHI is not geared (utilising borrowings) at the moment. Ewan feels that the ability to gear is one of the strengths of the closed-end structure and when he took over the management of the fund, was concerned that PHI had not been using its gearing. Following discussions, the board agreed to increase the upper gearing limit to 10% in April 2015. At the time, Ewan thought China's growth problems might have been easing but as the events of August 2015's demonstrated, this decision proved to be premature. The manager says that the gearing was removed immediately and that this decisive action prevented further losses. However, the gearing did cost the fund 2.4% in performance in 2015.

## Peer group comparison

You can access up to date information on the peer group on our website  
<http://quoteddata.com/sector/asia-pacific-excluding-japan/>

The peer group shown in Figure 7 comprises all the funds in the AIC's Asia ex Japan sector excluding those focused on smaller companies or on income.

The successive tenders have shrunk PHI to the point where it is now the second smallest fund in the peer group, although it still has a £104m market cap. PHI's discount is middle of the pack. Given its strong focus on growth stocks it may not come as a surprise that PHI offers the lowest yield of the funds in this group (though all of these lag some way behind the Asian income funds). Despite being one of the smaller funds, PHI's ongoing charges ratio is the second lowest of the peer group.

Figure 7: Fund of fund sub sector comparison table (data as at 18/03/16 except performance)

	Market cap GBPm	Discount (%)	Yield (%)	Ongoing charge (%)	NAV total return performance to 29/02/16		
					1 year (%)	3 years (%)	10 years (%)
<b>Pacific Horizon</b>	104	(10.0)	0.2	1.02	(14.7)	(5.6)	8.9
Aberdeen New Dawn	183	(14.0)	2.5	1.09	(19.2)	(18.5)	2.2
Asian Total Return	151	(8.1)	1.6	1.05	(1.9)	4.0	17.5
Edinburgh Dragon	475	(11.0)	1.2	1.15	(16.2)	(14.9)	9.9
Fidelity Asian Values	174	(10.6)	0.8	1.42	(1.0)	20.1	34.8
Invesco Asia	158	(10.9)	2.0	1.10	(9.2)	6.0	26.3
JPMorgan Asian	206	(10.4)	1.2	0.82	(12.9)	(4.8)	2.4
Martin Currie Asia Unc.	100	(14.7)	2.8	1.17	(0.5)	(9.4)	4.8
Pacific Assets	232	(1.5)	1.3	1.25	(5.4)	18.8	58.6
Schroder Asia Pacific	453	(11.4)	1.6	1.05	(8.3)	(0.1)	33.2

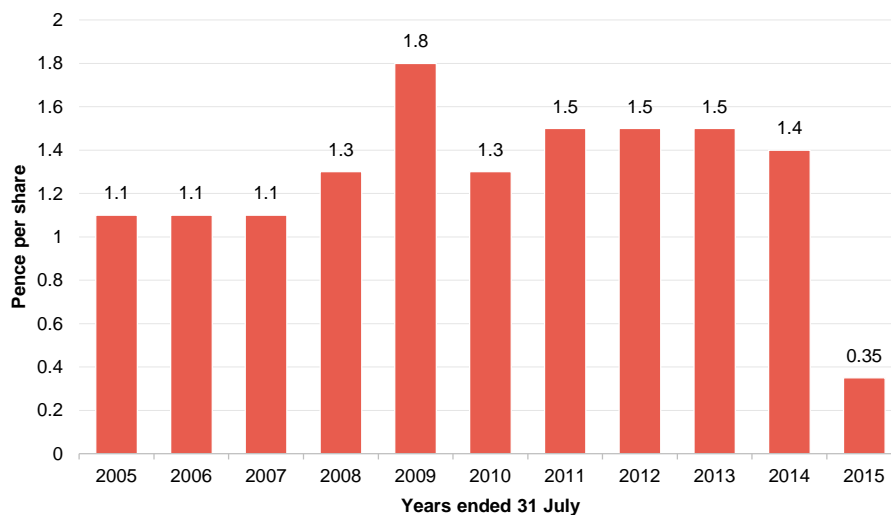
Source: Morningstar, Marten &amp; Co

PHI's ongoing charges ratio is the second lowest in its peer group

Looking at the performance figures, all the funds in the peer group have lost money over the year to the end of February 2016. PHI outperformed the two Aberdeen funds over this period but lagged the other funds. The managers say that, with increased volatility, the market has tended to seek the "safety" of defensive stocks and this has not suited PHI's investment approach. They say it is a trend that has persisted for several years now and this has dragged down PHI's long-term numbers.

## Dividend

Figure 8: 10 years of dividend history



Source: Pacific Horizon Investment Trust, Marten &amp; Co

PHI's primary objective is to generate capital growth. It pays one dividend annually in November and the amount of the dividend tends to reflect the level of earnings in the relevant period. PHI's registrar offers a dividend reinvestment plan.

According to the manager, the fall in the dividend in the accounting year that ended 31 July 2015 reflected a shift within the portfolio into companies exhibiting higher growth characteristics.

## Discount

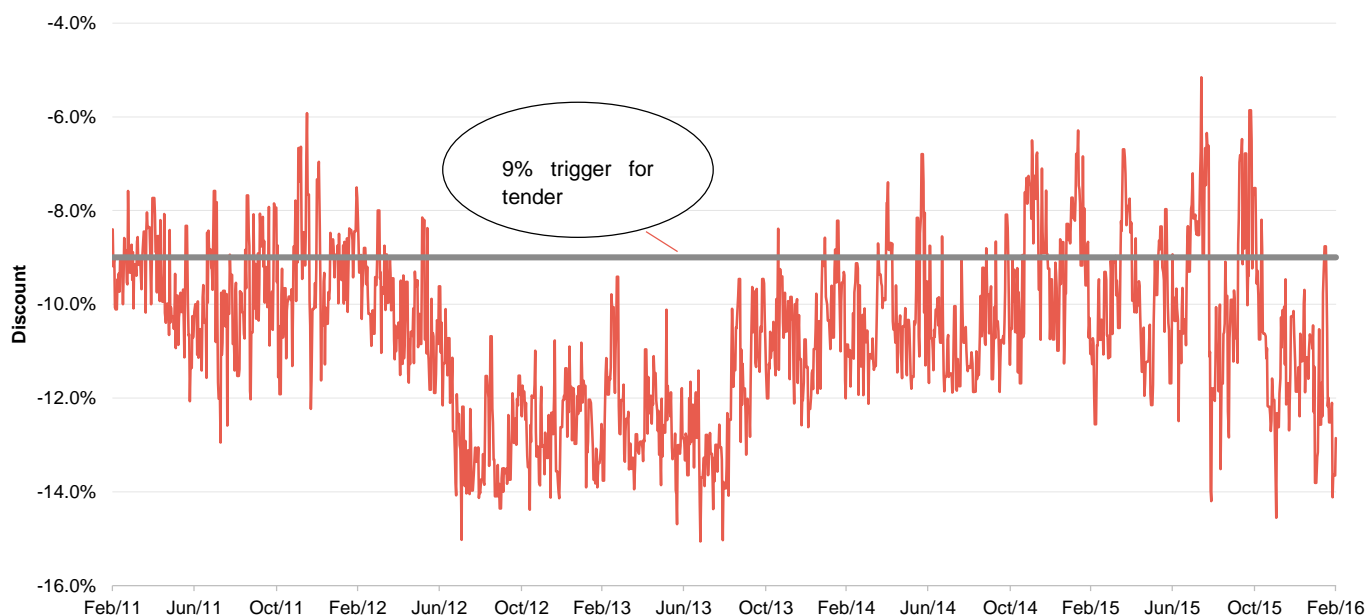
PHI's discount has moved in a reasonably narrow band (about 5% to 15%) over the past five years, aided by the company's share buy-back activity. Today it stands at 10.0%.

### Biannual tender offers

As one way of tackling its discount, in addition to share buy-backs, PHI uses biannual tender offers for up to 5% of the company's shares at a 2% discount to NAV, less costs. These are held, at the board's discretion, in the event that the discount averaged more than 9% during the six month periods to 31 January and 31 July. Shares tendered in excess of the limit set by the directors in respect of a particular tender offer are scaled back pro rata in proportion to the excess amount tendered.

The tenders and buy-backs have reduced the size of the fund by 23% over the past five years (in terms of numbers of shares in issue.) However, the managers think that if markets start to favour Ewan's style again, there is a realistic chance that good investment performance will lead to greater demand for the trust's shares, the discount will narrow and the fund could start to grow again.

Figure 9: PHI discount over the past five years to 29 February 2016



Source: Morningstar and Marten & Co

## Fees and costs

The annual management fee is 0.95% on the first £50m of net assets and 0.65% on the balance. Management fees are calculated on a quarterly basis. The managers may terminate the management agreement on six months' notice and the company may terminate it on three months' notice. There is no performance fee.

The ongoing charges ratio for the accounting year ended 31 July 2015 was 1.02% (barely changed from the year before when it was 1.01%).

## Capital structure and trust life

PHI has one class of share capital. There are 60,124,411 ordinary shares in issue. Each year, the company asks for shareholders permission for the authority to buy back up to 14.99% of its shares at a discount to NAV. It also asks for permission to issue up to 10% of its issued share capital at a premium to NAV.

The company has also obtained shareholder approval to implement, at the board's discretion, a biannual tender offer (see Discount section for more details).

PHI has an unlimited life. Shareholders are given the opportunity to vote on the continuation of the company every five years. The next vote will be at the Annual General Meeting of the company, to be held in 2016.

PHI's year end is 31 July and it holds its AGMs in October or November.

## Gearing

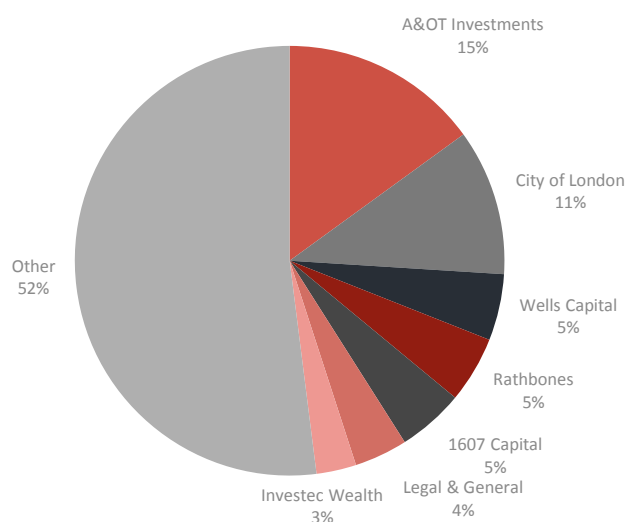
There is formally a maximum limit on borrowings of 50% of shareholders' funds but, in practice, PHI says that these should be less than 25% of shareholders' funds. In reality, PHI has only used borrowings in three of the past 10 years and has not come close to that 25% limit at any point over this time. Currently the fund has no borrowings.

PHI has a £10 million one-year, uncommitted, unsecured revolving credit facility with BNY Mellon and a one-year £14 million unsecured multi-currency revolving credit facility with The Royal Bank of Scotland.

## Largest shareholders

Figure 10 shows the largest shareholders in PHI as they were at 31 July 2015. A&OT Investments, the largest shareholder, is a private family wealth office.

**Figure 10: Largest shareholders**



Source: Pacific Horizon Investment Trust, Marten & Co

## Board

All of the directors are non-executive and considered to be independent of the investment manager. Jean Matterson has been on the Board for 13 years and Douglas McDougall was the joint senior partner and chief investment officer of Baillie Gifford & Co between 1989 and 1999 but has been retired for some time. The board believes both are independent in character and judgement. Douglas McDougall does not sit on the audit committee.

Figure 11: The Board

Director	Position	Appointed	Length of service (years)	Annual fee (GBP)	Shareholding
Jean Matterson	Chairman	2003	13	30,000	157,168
Edward Creasy	Chmn. Audit Committee and Senior Independent Director	2010	6	22,500	16,400
Douglas McDougall OBE	Director	1992	24	20,000	823,853
Elisabeth Scott	Director	2011	5	20,000	6,103

Source: Pacific Horizon Investment Trust, Marten & Co

Jean Matterson and Douglas McDougall both stand for re-election annually, reflecting their length of service on the board and Douglas McDougall's directorship of another Baillie Gifford investment trust (Monks).

There is a limit of £150,000 for the aggregate of fees paid to directors, which forms part of the company's articles of association. Shareholders would have to vote to approve any change in this limit.



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