A guide to investment trusts
What are investment trusts?

Investment trusts are part of the family of collective investments that includes unit trusts, open-ended investment companies (OEICS) and exchange-traded funds.

By buying shares in these investment companies, which invest in a diversified pool of assets, you can spread your risk and access investment opportunities many of which you probably would not or could not find on your own.

Investors

You buy one or more shares in an investment trust

A fund manager will run the trust and invest in a wide range of assets. You get diversification via a single product.
How an investment trust works

Investment trusts are companies in their own right, quoted on the London Stock Exchange with independent boards of directors. They have a closed-ended structure, which means there is a fixed number of shares in issue, so for every buyer there has to be a seller.

This structure can be an advantage. Unlike in the open-ended sector, an investment trust does not expand or contract in size depending on fund inflows and outflows.

Many fund managers take a long term view with their investments. Their goal is to manage portfolios effectively in both good and bad market conditions.

Unit trusts and OEICS will have to keep investing when new money flows into their funds. They will have to sell some holdings if investors decide to exit. In contrast, investment trusts aren’t exposed to inflows and outflows of money.

How do you research investment trusts?

Each investment trust will publish a list of its top 10 holdings and explain its investment style in a consumer-friendly fact sheet. You can find this information on our website by visiting www.youinvest.co.uk/shares/investment-trusts or by visiting the fund manager’s own website.

Some investment trusts will explicitly invest in income-generating assets like companies with generous dividend yields or fixed income products like corporate bonds. They will collect the income paid by the underlying assets and distribute most of the cash to shareholders as dividend payments, either monthly, quarterly, half-yearly or annually.

Other investment trusts will be focused on growth. This means investing in assets, most likely individual company shares, that the manager believes will grow in value — and therefore lift the value of the investment trust in time.

You may also find investment trusts that focus on specific geographic areas or certain industry sectors.

The Investment trust area on the AJ Bell Youinvest website lists the most recent popular investment trust purchases amongst AJ Bell Youinvest customers. You can access research reports on these investment trusts from an independent research company Investment Trust Intelligence.

The website also has a quick rank tool and more advanced search tools which allow you to search for investment trusts from different managers or by sector and provides detailed information on each investment trust including current price, past performance, net asset value and investment objective.
What are the benefits of investment trusts?

1. Access to a broad range of assets through a single product
   They are a great way to help diversify your portfolio. Some people don’t have the time or the inclination to look for multiple stocks ideas, so using an investment trust or fund is more convenient way of investing. You let an experienced fund manager do the hard work in picking assets in exchange for an annual fee.

   There are cost benefits from being part of a collective as the total cost of the fund manager’s time and effort is spread across all investors. This helps to keep fees lower than if you were the only person paying someone to run your investments.

2. Dividend smoothing
   Investment trusts are allowed to stash away up to 15% of their income each year in their revenue reserves. Essentially it is putting money away for a rainy day. It provides back-up money to sustain dividend payments during tougher stock market or economic conditions, a process known as dividend smoothing.

   Many of the oldest and biggest investment companies continue to increase dividend payments year after year, partially because of this flexibility when it comes to having cash in reserve.

   The Association of Investment Companies has highlighted 19 investment trusts that have increased their dividends every year for 20 years or more. Of these, 10 investment trusts boast a track record of more than 40 years of consecutive dividends hikes. These include City of London, Bankers Investment Trusts and Alliance Trust each with 49 years of consecutive annual dividend growth.

3. Cost benefits
   You will incur 10 sets of dealings costs when buying 10 individual shares. An investment trust will only come with a single dealing cost associated with your purchase, but potentially give you access to 10 or more companies in the underlying portfolio.

   You will still have to pay an annual management fee to the fund manager, but this can be worthwhile to benefit from their expertise and time.

4. Opportunity to invest in a portfolio of companies at a lower price than buying each one individually
   Investment trusts often trade below the value of their net assets. We explain why in a separate section of this guide. Please note that investment trusts can also trade at a premium to their net assets, so there is a risk you are paying more than they are worth via the individual stock route.

5. Easy to buy and sell
   Investment trusts trade on the London Stock Exchange in exactly the same way as individual company shares.

   You can see their price at any time of the day and deal at any point when the market is open.

   In comparison, unit trusts and OEICS are only priced once a day. Anyone buying the latter types of funds are likely to have to wait until the next day for the trade to take place. The order would be executed at the following day’s price and you would be committing to an investment without knowing the cost.
Can you explain what trading at a discount or premium to NAV means?

Rather than being inextricably linked to the value of the underlying portfolio, share prices of investment trusts are driven by the market. If demand is high, the shares may trade at a premium to their net asset value (NAV) but if demand is low, they are likely to trade at a discount.

While this quirk can create an element of volatility, it also means there is an opportunity for value-hungry investors. Since many investment trusts trade at a discount to the value of their underlying assets, you can in theory pay 80p for a share worth £1. In order to realise this value, the discount has to narrow from the level at which you buy in and there is a risk it could widen further.

Investment trust boards are aware of the negative impression big discounts can create and frequently carry out share buy backs in order to narrow or maintain discounts to NAV.

Investment trusts make regular announcements to the stock market titled ‘net asset value’ (NAV), which you can see on websites such as www.investegate.co.uk.

How to calculate if an investment trust trades at a discount or premium

To better understand how the discount/premium to NAV works, let’s create a hypothetical investment trust called Big Stocks Trust plc.

It owns 500,000 shares in food seller Domino’s Pizza – trading at 896p; 100,000 shares in self-storage provider Big Yellow – trading at 753p; and 900,000 shares in gold miner Centamin – trading at 116.7p. The trust has no debt and 1 million shares in issue.

If you do the maths, you can work out the net asset value per share:

- Domino's Pizza = 500,000 x 896p = £4,480,000
- Big Yellow = 100,000 x 753p = £753,000
- Centamin = 900,000 x 116.7p = £1,050,300

Net asset value per share = £6,283,300 ÷ 1,000,000 (shares in issue) = 628.33p

Now let’s look at the trading price for shares in Big Stocks Trust which is 599p. It means you can buy 628.33p of underlying assets for 599p, representing a 4.7% discount. You can calculate the discount as follows: ((628.33-599)/628.33)*100.

This is a simplified version of calculating discount/premium to NAV. In reality it is much harder to calculate due to additional factors about how products are run and the frequency of information being published.
Reasons behind large discounts to net asset value

There are five main reasons why investment trusts trade at a discount to underlying net asset value.

1. The portfolio contains lots of underlying assets with high levels of debt.
2. Investment trusts can trade at a big discount if investors have no faith about the ability to sell underlying assets.
3. The same applies if investors don’t believe the fund manager has the right skills to grow the trust.
4. A sector might be out of fashion and investors believe the fund manager may lose interest, not be able to generate value from the trust, or not be able to sell any of the underlying assets, hence a big discount.
5. Market disbelief in the stated net asset value figure. In particular, this can apply to stakes in private companies where valuations are often based on previous fundraisings and where there is doubt that future fundraisings will be done at the same or higher valuation levels.

What does it mean when an investment trust uses gearing?

Investment trusts can borrow money to make additional investments. This is known as gearing. The fund manager hopes to make enough money to cover both the costs of servicing the debt and making a profit on top. Gearing is good and bad. It offers the chance to boost an investment trust’s profit but also increases the risks. Not every investment trust uses gearing; most only use modest levels.
# How do investment trusts differ to other funds?

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<thead>
<tr>
<th>INVESTMENT TRUSTS</th>
<th>EXCHANGE-TRADED FUNDS</th>
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<tbody>
<tr>
<td>Closed-ended structure</td>
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<td>Price indirectly linked to net asset value and driven by market demand. The price can vary dramatically from the net asset value.</td>
<td>Dual priced with bid-offer spreads, with price linked to net asset value. Price also affected by market demand (but arbitrage helps keep the price close to the net asset value).</td>
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<td>Actively managed</td>
<td>Either passive or actively managed</td>
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<td>Generally lower fees</td>
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<td>Tends to invest directly in underlying assets, but can use derivatives to support investment strategy</td>
<td>Can invest directly in underlying assets or use derivative contracts to get synthetic replication of a specific index in order to support investment strategy</td>
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<td>Unlike other types of funds, investment trusts can hold back up to 15% of the income generated by underlying investments each year to create a pot of money to fund dividends in more leaner years.</td>
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Source: AJ Bell Media, Vanguard
How do you deal in investment trusts through AJ Bell Youinvest?

Investment trusts can be bought and sold in the exactly the same way as individual company shares. A full list of available products via All Bell Youinvest can be found at https://www.youinvest.co.uk/research-tools/quickrank/it where you can also get information on price performance.

You can buy investment trusts through a SIPP, a Stocks and shares ISA, a Lifetime ISA or a Dealing account. They trade on the London Stock Exchange and their prices are driven by market demand.

What are the costs of buying and owning an investment trust?

The cost of buying an investment trust through AJ Bell Youinvest is the same as an individual company share.

There is an additional charge which is the fee payable to the fund manager and this is built into the price. To find this charge, look for the phrase ‘Total Expense Ratio’ or ‘Ongoing Charges’. These state how much you should reasonably expect to pay as an investor from one year to next and include all professional, management, audit and custody fees.

This charge does not include performance fees, as these can vary depending on how well or badly a fund performs. Many investment trusts don't charge a performance fee.

Can anyone buy investment trusts?

In general, yes. The only exception is investment trusts classified as 'complex investment instruments' such as Marwyn Value Investors. These might have a sophisticated structure and/or complex performance related charging; they might also have indirect ownership of underlying shares. These products are seen as carrying an increased amount of risk.

You will be asked to fill in an application to invest in complex instruments and provide evidence that you are a sophisticated investor in order to be allowed to invest in these restricted products.