Investment Trust
N E W S L E T T E R

MARCH 2007

ISA SELECTIONS

As usual in our March newsletter, our thoughts and analysis turn towards trusts for your ISAs, whether you are investing at the end of the 2006/07 tax year or at the start of the 2007/08 tax year. This year some investors may feel reluctant to commit fresh money to the markets in these choppy market conditions, but our intention is to look beyond the short-term: we can see no reason why you should not invest as usual. We'll start with a review of our selections from last year. Our first recommendation was **Perpetual Income & Growth Investment Trust** subscription shares. These are quasi-warrants that you can put in an ISA, and it seemed sensible to us to use your ISA allowance for an investment which could deliver substantial capital gains. In this case the subscription shares have moved up from 52.5p to 69p to record a gain of 31.4%. This sounds good, but the gain was more than 50% a fortnight ago. These subscription shares are volatile, and if you believe that markets will rebound from their current setback, these may still be worth considering for a bounce. Our sister newsletter Warrants Alert considers the subscription shares to be attractive on a technical basis at this level.

Our second selection last year was **Glasgow Income Trust,** which has performed satisfactorily, we think. The trust's shares have risen by 9.3% to 103.25p and holders have collected a good yield (currently 5%) as well. Over the last year the trust is ranked first in the small UK high income sector by net asset value performance, so we are content that we have chosen a good reliable trust. The trust is currently overweight in industrials and consumer services, and underweight in oil & gas, health care, and telecoms.

Finally from last year, **Polar Capital Technology** was our higher risk choice. A fortnight ago the holding was in profit, but now the shares have fallen back to 235.25p, recording a loss of 6.1% over the year. This is disappointing, not least because our ISA selections have been very good at avoiding losses over the years. Whilst accepting the trust has not produced the returns we were hoping for, we think it could yet have a good run, and do not believe that this would be the right time to sell out. We rate the shares a HOLD, although we can now see the argument for a switch into **Finsbury Technology** (see news round-up).

For what it is worth, market commentators have been falling over themselves to play down the impact of the recent negative news from China and the US. The prevailing opinion is that the drop in global equity markets is more of an opportunity than a crisis. To some degree this is reassuring, but this does not feel like a time to take huge risks with ISA selections. Whether or not the current market correction is finished or not, investors have been reminded of the risks of equity investment. From this point on, the continuation of the bull market will not be taken for granted. With this in mind, our first selection for this year is a trust which has proven its quality over a long period of time, in all market conditions. It is a trust which we have no hesitation in recommending – again. Long-time sub-

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scribers will probably know it well. **British Empire Securities & General Trust** is a star trust, and you can buy it now on a less than stellar rating.

British Empire is a £770m trust which can trace its roots back to 1889. It aims for capital growth through a focused portfolio of investments, particularly in companies whose share prices stand at a discount to estimated underlying net asset value. Over five years the trust has grown its net assets by 133.3% - roughly twice the sector average – and is ranked top of the global growth sector. Over three years it is also first, out of 29 trusts. Now for the catch. Over one year the trust is ranked 24th out of 30 trusts, with a muted gain of just 3.3%. What is the explanation?

Quite simply, the manager John Pennink has been cautious about markets and has maintained a comparatively high level of liquidity. And when he has invested, it has been with the risks as well as the potential rewards in mind. He summarises this neatly in the trust's latest monthly factsheet, in which he explains "while we have been cautious of fully embracing the bull case for stocks, we have managed to find some investments that we think give us some upside and, at the same time have strong asset backing that could, hopefully, limit the downside in case of a setback." If we compare the performance of British Empire against the FTSE All-Share Index, this caution is evident – the trust has lagged behind the rise in the index over the last six months in particular.

Until the last fortnight, that is. The trust's assets have not fallen as far as the wider market, but we do note that the shares appear to have been caught up in the general mêlée. As a result they are available on a debt-adjusted discount of 3.9%. This compares very favourably to the average premium of 3.3% on which the shares have traded over the last year, and suggests to us that this might not be a bad entry point.

A look through the trust's top ten holdings throws up a mix of the familiar and the not so familiar. **Alliance Trust** was British Empire's second largest holding at the end of January, **and Electra Private Equity** also features on the list. Alongside these well-known names though we find less familar names such as Sofina, Paris Orléans, and Lundbergforetagen. The manager casts his net wide in the search for value, and has the ability to research areas entirely unknown to retail investors. So that you know, these three companies mentioned are all holding companies operating in Europe. Sofina is a Belgian holding company and is the investment vehicle of the Boël family. The family controls the company via two listed companies and a web of private companies, giving them a stake in Sofina of around 50%. Sofina's investment portfolio is approximately EU3.5bn in size and is invested primarily in large listed companies in Belgium and France including Richemont, Suez, Danone, Colruyt and Total. At the time of British Empire's last annual report, Sofina was trading at a wide discount to net asset value of approximately 27%. John Pennink said he believed there was potential for the discount to narrow if the company were to consider share buybacks and a simplification of the ownership structure. Paris Orléans is the holding company of the French branch of the Rothschild family. L E Lundbergforetagen AB is a Swedish holding company which invests in several sectors, real estate and forestry being the primary ones.

For an ISA holding, intended to be kept for the medium to long term, we think British Empire at 435.25p is a good choice. The trust is sensibly managed, with considerable skill, and has in the past provided strong returns without undue risk.

The British Empire ISA is available from the managers, Asset Value Investors. It is administered by Halifax Share Dealing. The charges include £30 initial charge, 0.5% per annum, and £20+VAT for stock withdrawals. For details please call 0845 850 0181 or visit www.british-empire.co.uk.

For income, we wanted to choose something different this year. With the expansion of the investment trust sector into all kinds of different realms has come a much greater variety in the sources of income. As a way of diversifying, we can see it makes sense for investors to consider an income source away from mainstream equity markets. This year we were also looking for an income paid gross, which is beneficial for ISA investors not having to pay tax on dividends. We toyed with the idea of the specialist **CQS Rig Finance Fund,** which invests in bonds issued to finance the construction of oil rigs. The trust offers an enticingly high yield, but is in its early stages (it floated in December) and perhaps too exotic for many portfolios. We also considered **HSBC Infrastructure Company.** We believe that whilst there is a buzz around this theme at present, it is more than just a fad, and that demand for infrastructure assets is likely to be sustained. It is hard to recommend the trust on a 6.5% premium to net asset value though, and we think that whilst the 5.2% yield is attractive, there is very little scope for capital gain from the current share price of 111p. Investors are probably better off applying for new issues in the sector. Moving on to other assets, we examined other trusts such as **Merrill Lynch Commodities Income,** which offers a yield of 4.3% but where we think there is some risk to capital, and **Kenmore European Industrial Property,** where the yield of 5.2% is counterbalanced by a 12% premium to asset value.

Finally we decided on the £90m **Invesco Leveraged High Yield Fund** as our income selection. This trust, managed by Paul Read and Paul Causer, offers an apparently very high yield of 9.4%, it generates its returns from bonds rather than equities, and it is domiciled in Jersey (allowing it to pay dividends gross), so it meets all of our criteria. Let's take a closer look. The trust was launched in 1999 to take advantage of opportunities in the growing European corporate bond market, and now seeks to achieve a high level of

income from high yielding corporate and government bonds. The trust may also invest in equities and other instruments that the manager considers appropriate. The trust says it seeks to balance the attraction of high yield securities with the need for protection of capital and to manage volatility. The trust employs leverage (borrowings) in its investment policy.

In practice, the trust, which has provided a good yield together with a rising share price, is invested in a range of corporate bonds, with roughly half of the assets in Europe, 30% in the UK, and 20% in the Americas. It uses gearing with flexible borrowing which is currently around 60%. For the last four years the trust has declared a dividend of 10p per year, and we would expect the same amount again this year. With the shares at 106.5p (having just gone ex-dividend for the interim), on a modest 2% premium to net assets, this implies a yield of 9.4%. Clearly we would have to expect some risk to capital from a yield this high, but this trust has managed to maintain its capital value successfully over the last few years. Five years ago the share price was 21.5p, which adjusted for a 5-for-1 consolidation, equates to 107.5p now. In other words, the return has come entirely from the dividends, with the capital value being maintained in absolute (not real) terms. If this suits you, we think this trust is worth considering – particularly if you are nervous about equity markets. We do know that there is demand for the shares – the trust is currently expanding through an issue of up to 27.5m shares, and seems to issue shares quite regularly.

You can invest through the Invesco Perpetual Maxi ISA (this trust forms part of the 'Series 2' offering). This ISA carries a 1% charge on all purchases and sales, plus a 1% annual management fee and a £50 charge for withdrawals. Details are available from www.invescoperpetual.co.uk or on 0800 085 8677.

As our higher risk choice this year we are opting for **Baillie Gifford Japan**. We are attracted to the trust by a confluence of three factors: (i) the poor performance of Japanese trusts last year may imply a cyclical opportunity now; (ii) Baillie Gifford Japan has a strong long-term record; and (iii) the recovery in the Japanese economy is ongoing, with a pause in growth and the market now again offering a possible window of opportunity. Explaining each of these points in turn, investors in Japan can certainly feel assured that they would not be investing at the top of a fashionable cycle. Japan was the worst place to have been invested in investment trusts in 2006, and has not made much progress in 2007 either, having suffered heavy falls over the last fortnight. The Nikkei 225 Index started 2006 at 16,111 and currently stands at 16,764 – just 4% higher. Over one year Baillie Gifford Japan does not have an inspiring record, with the assets down 10% and the trust ranked fourth out of six in its sector. Over the longer term though the trust has done well, with an 82% jump in assets over five years. Over both three and five years the trust is top of the sector, so we think it will come good again.

Japanese stocks have been particularly weak during the market correction because it was partly triggered by concerns over possible weakness in the US economy. Alan Greenspan – still influential in spite of his retirement from public office – warned that the current phase of US economic growth may be coming to an end. This spooked Tokyo because many leading Japanese companies are heavily reliant on exports, particularly to the US. Some 63% of Toyota's sales were overseas in 2006, and 70% of Sony's sales. Many commentators are expecting growth in the Japanese economy to slow, especially as its most-watched leading index of future economic activity is signalling a slowdown. The leading index was 35% in January. A number below 50 indicates the economy will cool in three to six months. That may happen, but few observers expect a problematic or drastic reversal in the economic recovery. The corporate sector remains strong, and Japan's largest companies increased capital spending 16.8% from a year earlier in the last quarter, the fastest pace in at least four years. Profits rose for the 18th straight quarter, extending the longest streak of growth in 36 years.

Investing now requires two elements of faith, we think: faith that the Japanese economic recovery will stumble but not fail; and faith that Baillie Gifford Japan will recover its pre-eminent position in the sector. Neither is guaranteed, but we think the odds favour both, and that you can buy in at a good price now. For medium-term investors we recommend the shares. At 234.5p Baillie Gifford Japan shares are trading on a small discount to assets of 1.1%.

The Baillie Gifford ISA is available with no initial charge or dealing commission, and a flat rate management fee of £30 (+VAT) per year. Telephone 0800 027 0133 or visit www.bgisas.com for details.

NEW ISSUES

F&C Event Driven Fund

There is no doubt about the prime theme in the new issue market this month. We are seeing more hedge fund launches to swell what is already a reasonably large sector with £1.8bn of assets. The most surprising in many ways, although it has been well flagged, is that F&C is planning to launch a new fund of hedge funds. The launch, which F&C says combines its investment trust pedigree with the expertise of its dedicated fund of hedge funds business, will deepen F&C's drive into specialist areas and complement the extension of its closed-end investment range in recent years into areas such as commercial property and private equity funds of funds. The new trust will be called **the F&C Event Driven Fund.** We understand that it will be listed on the main market in London some time in the second quarter of 2007, and that it

already has capital commitments of £85m prior to its fund raising exercise. The underlying portfolio will invest in between 20 and 40 hedge funds selected and monitored by F&C Partners, the group's dedicated fund of hedge funds business. The funds will be drawn from the 'event driven' category of the hedge fund industry which is estimated to account for around 40% of the entire hedge fund universe. Event driven hedge funds encompass a wide range of investment strategies and styles but broadly target companies which require a catalyst for change such as a significant corporate event (merger, demerger); the resolution of a major problem (bankruptcy, re-financing or balance sheet restructuring) and other forms of activism.

The F&C Event Driven Fund will target a return of 8%-12% per annum net of fees with a target volatility of 5%-8%. The F&C Event Driven Fund will not employ gearing other than for the purposes of managing liquidity in recognition of the fact that the underlying hedge funds will use leverage. Commenting on the plans, Mike Woodward, head of investment trusts at F&C, said "the first investment trust launched almost 140-years ago, Foreign & Colonial, was without doubt a radical innovation in that it provided investors with access to investment opportunities that had not hitherto been readily accessible except to the very wealthy. The F&C Event Driven Fund will follow in that same mould, by providing an opportunity to achieve exposure to an increasingly significant class of investment, hedge funds, but through a diversified portfolio based on rigorous specialist selection and with shares in a closed-end company that will be traded on the London Stock Exchange." More details when we have them.

BH Macro Limited

BH Macro Limited is a major new hedge fund launch which is coming to the market this month. As is common for new launches, the company is structured as a closed-end limited liability investment company, registered in Guernsey. Less common is the status of this trust as a 'feeder fund' to invest its assets in the Brevan Howard Master Fund, an existing US$11.3bn fund which seeks consistent long-term appreciation through active leveraged trading and investment on a global basis. It is predominantly exposed to global fixed income and foreign exchange markets.

The listing documents for this trust are amongst the most voluminous we have seen, with 25 pages on risk factors alone. We will try to distil the facts as concisely as we can. The trust is due to start conditional dealings on 9th March, and is aiming for up to EU1.5bn from an issue of shares in euros, in sterling, and in dollars. The sterling shares are being offered at £10 each. The funds, apart from working capital requirements of EU2m, will all be invested directly into the Brevan Howard Master Fund. This is currently closed to additional new or unconnected investments. The fact that the master fund is huge, and closed, indicates that it must have a good track record. Since inception in April 2003 the managers say it has avoided any prolonged period of negative performance, and they point to unaudited annualised returns of 10.56% from launch to 31st October 2006. The Master Fund employs an investment process which primarily uses a combination of macro (economic change and monetary policy) and relative value (market inefficiencies) strategies. By asset class, at 31st October, the fund comprised 55% developed markets fixed income, 19% foreign exchange, 15% emerging markets, 8% equities, and 3% commodities.

The Brevan Howard Master Fund is managed by a team at Brevan Howard Asset Management. The team includes Alan Howard, the chief investment officer. He worked for Credit Suisse First Boston from 1997 to 2002 as a managing director and global head of proprietary trading in the bank's Developed Markets Rates Division. The team has a great deal of collective experience, and seems highly regarded, but without much more in-depth knowledge of the hedge fund industry it seems very difficult to gauge whether they have an outstanding record. We have other reservations too. This fund is the first to list under controversial new 'light touch' regulations which allow foreign funds to list under less onerous rules than for UK funds. These mean, for example, that the fund is not required to comply with a number of corporate governance rules, nor rules requiring an adequate spread of investment risk, nor rules governing the requirement that the directors and investment manager have sufficient experience. We understand as well that the fund is unlikely to reach its fund-raising target, hampered by market conditions. Press reports indicate that the fund may raise around EU800m. For now, we are not certain that this fund is suitable for private investors – there are just too many grey spots for us.

Gottex Market Neutral Trust Limited

Here is another new name for the investment trust sector. Gottex Market Neutral Trust is a new Guernsey registered, closed-ended investment company whose investments will be managed by Gottex Fund Management. The trust is seeking to raise up to £200m. The shares will be traded on the London Stock Exchange, in sterling. The investment objective of the trust will be to generate consistent returns over the medium-term with low beta to major equity and fixed income market indices. The returns are expected to be associated with a low degree of risk. Gottex will have a global focus and will seek to achieve the investment objective through investment in hedge funds, each of which must be independently market neutral in that they substantially hedge out any direct exposure to major equity and bond market movements.

These underlying funds in which the trust will invest are expected to pursue primarily market neutral implementations of strategies that fall within the relative value, event driven and hedged equities

styles. Initially, it is intended that Gottex will invest in at least 30 underlying funds. We understand that Gottex has been running a US$4.6bn fund with a similar style – although more diversified – since 1999. Over the period from inception to 31st January 2007, this fund has generated a sterling annualised return on its ungeared shares of approximately 9.62%. This compares to a sterling annualised return of -0.05% on the FTSE 100 (total return) and 4.84% on the Lehman Sterling Gilts Index (total return) over the same period. Even more impressive, perhaps, than the overall returns is the consistency. Based on the average monthly returns for the ungeared sterling shares in the same period, the fund had 87 up months and 5 down months compared to the FTSE 100 (total return) which had 53 up months and 39 down months and the Lehman Sterling Gilts Index (total return) which had 59 up months and 33 down months.

The Gottex Group has been in existence since 1992 and at the end of January had US$7.2bn under management. It operates from offices located in Lausanne, London, Boston, New York, Luxembourg and Hong Kong. The manager will receive an annual fee of 1% plus a performance fee on top, which looks quite generous to us. The costs of the issue will be limited to 1.75% of the gross proceeds of the issue, so the initial net asset value will be at least 98.25p. There is a placing plus an offer for subscription with a minimum investment of £2000 which closes on 21st March; dealings are scheduled to begin on 29th March.

Finally, we have also heard that an asset management group called Fortune also intends to list an investment trust company – called the **Market Wizards Fund** - that invests in a range of hedge funds. The trust will invest in a range of hedge funds offered through a seven-year-old programme, which was launched by Fortune's investment director Jack Schwager. It aims to offer investors transparency and liquidity through careful selection of both managers and strategies. The fund will be incorporated in Guernsey as a closed-ended investment company. The net proceeds of the proposed placing and offer for subscription of the company's shares will be invested into an existing portfolio of managed accounts currently held within a Bermuda-registered trust, Market Wizards Fund Bermuda.

STOCKBROKERS' RESEARCH

Dresdner Kleinwort issued a detailed research note on **Merrill Lynch World Mining** on 16th February. The broker downgraded the shares from buy to hold, at 461p, with what we must say was impressive timing. The shares are lower now following the growth concerns in China and the subsequent knock-on effect across commodity markets. The brokers thought that something like this might happen – the research indicated a tactical opportunity rather than any more fundamental concerns over the quality of the trust. The note says that the trust's manager has added significant value over the long term, liquidity is good, the company has genuine sub-contraction value and that Dresdner regard it as a core holding within a diversified portfolio. "However", the note continues, "given the seasonal nature of returns, we believe there may be an opportunity for the more tactical investor to take advantage of forthcoming weakness, which is typically short and very sharp."

The trust recently announced its results for 2006, which were impressive, both in absolute and relative terms. The undiluted net asset value total return was 32.9%, compared to 21.8% for the benchmark. Over the past five years, the compound net asset value total return is 35.8%, significantly ahead of 25% and 8.5% compound returns for the benchmark and FTSE All Share, respectively. The manager believes the global economy is likely to remain strong, albeit with lower growth levels than 2006, with China the most important demand side factor. Despite a slowdown in the global economy, most industrial commodity supply/demand balances should remain favourable this year; project delays and escalating capital funding requirements for new green field mines have resulted in a slower-than-expected response by the supply side to higher prices. The manager believes that while earnings momentum may slow, there is scope for modest multiple expansion, with many key holdings now trading at attractive levels after de-rating last year, when prices failed to keep up with strong earnings growth; Dresdner strategists have recently highlighted that the forward P/E of the mining sector is the lowest in both the UK and Europe.

That's the comforting medium-term outlook. In the short-term, however, Dresdner say that the "seasonal nature of returns represents a tactical opportunity." They explain that a spring sell-off has become a feature in this sector: they point to price falls of 27% (2006), 13% (2005) and 23% (2004). They also explain that second quarter returns have disappointed – over five years the average net asset value and price return is -0.5% and -1.1% during the second quarter, and during the past seven years, 78% of total asset growth has come in the second half of each year, with 57% in the last quarter.

Prospect Epicure J-REIT, the specialist trust which invests in Japanese property, has enjoyed a terrific start to 2007. The shares have risen from just under 100p in mid-January to 121.5p now. But has this sudden rise been justified? It has been justified, yes, by the rise in Japanese REITs, but we share the concerns of Dresdner Kleinwort's trust team, who have just issued a 'sell' note on the trust. They wonder whether this sector is exhibiting bubble characteristics. They say that "whilst acknowledging the attractive yield and current discount, the recent performance of the underlying asset class is a cause for concern. Any change in sentiment/risk appetite could prompt a sharp reversal, and given the focus on smaller companies, portfolio concentration and current gearing levels, any price falls could be as dramatic as recent gains. With the shares having achieved

their annual total return target in less than a month, we favour a more defensive stance." To explain a little further, the company aims for an annual total return of 20%, which the shares and the asset value have already achieved since launch in November. Dresdner suggest there are signs of NASDAQ-style irrational exuberance in the Japanese real estate sector. Abnormally low interest rates are being used as justification for exceptionally high valuations and the result has been a parabolic ascent, similar to that described by the NASDAQ composite between 1996 and 2000. The Japanese REIT index has moved well away from its 200 day moving average, and we do think these gains will be hard to maintain, let alone build upon. We would err on the side of caution and listen to Dresdner's informed analysis. SELL.

UBS met **Jupiter European Opportunities** manager Alex Darwall recently. After eight years as an investment analyst, Alex joined Jupiter in 1995. In 1999, he became the fund manager for Jupiter European Trust which rolled over into the Jupiter European Opportunities Trust in late 2000. UBS say that he has a significant (and growing) personal stake in the fund. The trust invests in West European companies with a "long only, hedge fund" mentality. Alex likes to invest with a bottom-up approach and prefers individual companies which he sees as benefiting from long term secular/structural trends and with strong, proprietary advantages. The fund is not constructed on a regional or sector allocation basis. Alex sees globalisation as a major theme but he avoids basing his investment decision on anticipated short term macro trends (such as the oil prices, currencies and interest rates). The fund is "fashion neutral" and each investment must fulfil all of the following three criteria: (i) strong business model – resulting in sustainable competitive advantage (eg pricing power); (ii) strong management teams – experienced, honest and open management; and (iii) insight or "edge" on the company – a sense that he is ahead of consensus/market on a company valuation.

The portfolio is highly concentrated with the top ten holdings accounting for around 63% of assets. The trust is generally biased towards mid-cap stocks, has gearing of around 17%, and is moist heavily exposed to France (39%), UK (21%), Netherlands (17%), and Denmark (14%). The largest UK holding is in Carphone Warehouse, at just over 5% of assets. Over the last 12 months, NAV (total return) grew by 18.9%, outperforming the FTSE Europe ex UK by around 4%. The manager remains optimistic about the outlook. He thinks that European emerging markets offer exciting prospects but prefers to invest in Western European companies that stand to benefit from this trend, as there is greater accountability and transparency. Companies with superior application of available technology and building a sustainable advantage should offer best returns and globalisation will catalyse their growth. He sees recent performance in commodity stocks as impressive but is concerned that this will eventually change when capacity catches up. Alex believes market developments suit his consistent, long-term investment approach. UBS conclude that "the fund is on our list of 'preferred' stocks. We like Alex's high conviction approach and his focus on Continental Europe fits in with the UBS strategist's overweight stance on Continental Europe (recently added to). Trading on a 3% discount to NAV, the stock is not obviously cheap but we feel it offers investors a consistent long term performer with a highly focused mentality."

WINS issued a note on **Scottish American** (commonly known as SAINTS) on 15th February. The note says that SAINTS has been turned around since its move to Baillie Gifford at the start of 2004. The trust has since outperformed its benchmark, and the dividend, which is fully covered, has grown significantly. The fund's net yield is currently 2.9%. Patrick Edwardson, a Baillie Gifford partner, is the fund's overall manager and he is also responsible for stock selection in the UK equity portfolio. The UK equity portfolio (57% of the overall portfolio) has a target yield of 20% over the All-Share Index. It includes around 50 stocks with selection based on the UK team's model portfolio, adjusted for the income constraint. It is overweight the banking sector, with holdings including Barclays and Royal Bank of Scotland, while underweight oil & gas, utilities and mid cap stocks. There are two overseas equity portfolios (28% of assets): the main overseas equity portfolio has no income constraint and is run by Craig Collins, part of Baillie Gifford's Global Equity Desk. This portfolio of around 35 stocks is closely in line with the non-UK element of Edinburgh Worldwide. Patrick Edwardson, with Baillie Gifford's regional equity teams, is responsible for a focused portfolio of higher yielding overseas stocks, delivering a yield of 4%. The fixed income portfolio is managed by Ken Barker, while Matthew Oakeshott of OLIM is responsible for the direct property portfolio.

The trust has a long-term debenture in issue which provides potential gearing equivalent to 24% of net assets. Three years ago, the debt was mainly invested in property and corporate bonds. However, strong dividend growth has helped to alleviate the fund's yield constraint and has given greater flexibility in asset allocation. As a result, the bond portfolio has been reduced over the past few years with the proceeds reinvested in equities. Equity exposure is currently 104%, reflecting the manager's cautious outlook on the global economy. Going forward, the manager's intention is that around half of the equity portfolio be invested in overseas equities split equally between the higher yielding and the global growth portfolios. The trust's UK commercial property portfolio has a value of £43.7m (11.7% of net assets). There are 16 holdings, principally in the leisure and retail sectors, which provide a rental yield of 5.8%. After a period of strong performance, the manager believes that significant capital uplifts are unlikely going forward and given yield compression, has therefore decided to reduce exposure to between £30m and £35m.

WINS say "we believe that SAINTS offers some value on its current discount of around 9% with debt at fair value, and if the per-

formance record is maintained there should be scope for a rerating. We expect steady dividend growth and believe that SAINTS is attractive compared with funds in the UK income growth sector, as well as its global income growth peers. Consequently, we are recommending SAINTS to investors who are seeking a combination of steady dividend increases and long-term capital growth."

Teather & Greenwood has highlighted **Baring Emerging Europe** as a fund to watch. On a discount of around 12% compared with a 12-month average of 7.7% the broker says the trust is "great value for both long and short-term players – particularly when set against this vehicle's long-term credentials in terms of adding shareholder value."

After the market dislocation, Cazenove provided an update on its views on 2nd March. It said one of the notable relative changes is that the discount on **Aberdeen Asian Smaller Companies** has widened from 2.3% to 5.9%, whilst **Scottish Oriental Smaller Companies** has remained on a similar discount of 4.2%. Cazenove continues to prefer the latter. The broker says that during periods of market volatility, discounts can be difficult to accurately measure and the market moves quickly, but the discount figures still may provide useful indications of buying opportunities given the strong fundamentals for global equities. Cazenove noted that **Merrill Lynch World Mining** (outperform) "looks even cheaper than usual at 13.8%"; **Templeton Emerging Markets** (outperform) – "under great shareholder pressure to reduce the discount and improve performance – is on a 10.5% discount"; and **Jupiter European Opportunities** (outperform) – whose discount moved out to 3.6% (from 0.7%) – "offers good value as well."

Panmure Gordon commented in detail on **Aurora Russia** in its daily note on 27th February. Aurora Russia raised £70.5m (net of expenses) in March 2006, which was less than initially targeted. Panmure says that clearly there are disadvantages in terms of liquidity of a sub-£100m market cap, but raising a smaller amount that can be efficiently invested without compromising quality will probably ultimately result in better shareholder returns, and obviously there is no reason why a fresh capital raising couldn't be executed once the initial portfolio begins to bear fruit. Aurora will invest in private equity stakes in small to mid-sized Russian growth companies, either as a start-up or as part of an expansion capital funding. The sector focus is on financials, business and consumer services, with a typical investment size being £5m-15m. Exits are expected to occur after two to four years via the usual routes of trade sales, IPO or MBO. Aurora's management has a track record of building and selling businesses in these sectors.

Looking at Aurora's current investments, Panmure started with Unistream, where the trust provided US$20m of expansion capital for 26% equity stake. Unistream is a spin-off from the Uniastrum banking group, and is a leading money transfer agency in Russia. A large immigrant population has, according to the Central Bank of Russia, seen the market grow by 56% between 2003 and 2005. Unistream had turnover of US$750m in 2005, US$1.85bn in 2006, and expects, according to its chief executive, to turnover around US$4bn in 2007. Revenues grew by 200% in 2005 and by almost 300% in 2006. Panmure cannot resist the temptation to scribble some back-of-the-envelope calculations to reach a potential revenue of US$240m, and sounds cautiously positive on the company. Next up is Kreditmart, where Aurora invested £12.5m of start-up capital for a 100% equity stake, 15% of which is reserved for a staff option plan. Kreditmart is a start-up business that will broker financial services products such as residential mortgages, home improvement/ equity loans, consumer and car loans and insurance. It plans to roll out 10 outlets in 2007 across seven regions while building a mortgage loan book. Aurora director James Cook has built a similar consumer finance business in the past while at GE Consumer Finance and he will be chairman of the new business. Third and finally, there is OSG Records Management, for which Aurora provided US$9.4m in expansion capital for a 37% (fully-diluted) equity stake. OSG RM is the market leader in Russia for providing secure document storage, security and destruction facilities. Up until recently, the bulk of its business has come from multinationals, but the growth element of the business is now being driven by local Russian companies.

Aurora has around 60%, or around £40m, of cash remaining and anticipates deploying this in three or more further investments within 18 months of listing, which would mean by autumn 2007. Panmure says it does not want to sound too starry-eyed, as this is a private equity fund listed on AIM investing into Russian small and medium-size enterprises which as yet has invested less than half its cash. The broker concludes "you'd have to therefore expect a j-curve effect on the share price, and indeed the first part of this, the fall below issue price, has indeed occurred. Given the growth rates we are being presented with, you could reasonably expect the j-curve to play out over a less protracted period than for a similar vehicle operating in a more developed market like the UK. With low turnover, you'd need patience to build a stake, but it's easy to see how the share price could run away once a re-valuation event took place in a year or 18 months time."

NEWS ROUND-UP

British Assets Trust has confirmed a management change, which does not come as a great surprise. In the trust's final results, announced in November, the chairman said "the board is disappointed with the poor stock selection this year and has been assured that the managers are addressing this issue. In particular, the board has been advised that the managers are looking to

strengthen their UK team. It is hoped this will result in improved performance in this important part of the overall portfolio." Sure enough, the board has now agreed with F&C that the trust's UK portfolio will be managed by the London-based F&C UK equities team, headed by Peter Lees. We'll see if this change gives the trust a much-needed boost.

It is fairly rare for managers to talk down the prospects for their sector, so it was refreshing to read the frank remarks which accompanied the results from **European Assets Trust** on 6th March. The statement said that earnings growth has been strong, and that companies, official forecasting institutes, and independent commentators are all positive on 2007. "Nevertheless", the statement warns, "your board believes that some measure of caution is warranted. After five years of sharply rising share prices, valuations for small and medium-sized companies look high both in absolute terms and relative to likely future earnings growth." The trust says too that recent share price reaction to unexpected earnings numbers has been extreme, a possible sign that low volatility which has hitherto supported the asset class may be on the rise. Accordingly, the managers have positioned the portfolio cautiously, focusing on companies with a demonstrable earnings record and with sustainable high returns on shareholders' capital.

The £80m **F&C UK Select Trust,** has been outperforming its benchmark and successfully narrowing its discount to asset value. On 14th December 2006 shareholders voted in favour of the trust's continuation, but a new condition has now been added. In the event that the trust is unable to increase its net assets through the issue of new shares by at least £25m before 31st October 2007, the board will provide shareholders with a further opportunity to vote on the continuation of the trust before the end of 2007. In terms of outlook the chairman is cautiously optimistic about the year ahead.

Changes at **Finsbury Technology Trust** could spark a re-rating. Back in November the board of the trust said that it was reviewing the trust's longer term investment management and administrative arrangements. From the start of January, Michael Bourne, who had managed the trust's portfolio since 1995, ceased to have principal responsibility for the day-to-day management of the portfolio. Following a 'beauty parade', the board has chosen RCM, part of Allianz Global Investors, as the new manager. You may remember that RCM was thwarted in its attempts to launch a new technology trust last year when the market turned down. RCM has a good record from its US based technology team over the past ten years. The new manager has assets under management of £77.6bn including US$2.6bn in global technology mandates and £1.3bn assets under management in a range of investment trusts. Walter Price and Huachen Chen are the co-lead portfolio managers of the RCM global technology team and will jointly manage the trust's portfolio. The pair have managed technology portfolios together since 1990. Walter and Huachen are based in San Francisco and are supported by two portfolio analysts as well as five US technology analysts, three technology analysts based in Europe and one based in Asia. The change should become effective next month.

The trust's investment objective and policy - investing principally in the equity securities of quoted technology companies on a worldwide basis – will remain unchanged. However, it is expected that when the new manager assumes responsibility, the portfolio will be rebalanced to reflect RCM's views on current markets, trends and investment opportunities. At present this would result in a significantly higher initial weighting in larger capitalisation securities and a reduced allocation to the UK and Europe. The board intends that the Company's name should be changed to the 'RCM Technology Trust PLC' and intends to put a resolution to shareholders at the forthcoming AGM accordingly. We think this is good news for Finsbury Technology, and note that the trust, on a 7.8% discount at 216.5p, trades on a significantly lower rating than Polar Capital Technology (1.8% discount). This could well change once the new management is installed. We can remember being keen on the idea of the RCM trust last year, so we certainly welcome this backdoor arrival.

Gartmore European shareholders have seen off the attempt by the arbitrageur Carrousel Capital to gain seats on the board. The board now intends to renew its proposal to put forward a tender offer at close to NAV for the benefit of shareholders that want to realise their investment. Separately, **Gartmore Growth Opportunities** raised £29.6m from its 'C' share offer.

SVM Asset Management has launched the SVM Savings Scheme for Children to enable parents and grandparents to invest in two of its investment trusts, **SVM Global Fund** and **SVM UK Active Fund,** from as little as £25 a month. For more details of the SVM Savings Scheme for Children call 0800 019 9440 or visit www.svmonline.co.uk.

The next issue of Investment Trust Newsletter is published on Saturday 14th April.

EARLY 2007 GAINS WIPED OUT BY SHARP MARKET FALLS

The FTSE 350 Equity Investment Instruments Index is down 170.9 points (-2.92%) to 5689.8 since the last newsletter.