

## INVESTMENT COMPANIES ADD SPICE TO PORTFOLIOS WITH EXPOSURE TO UNQUOTED COMPANIES

Investment companies have a closed-ended structure which allows them to invest in a wider range of investments, including unquoted companies which are often referred to as private equity. These are the shares of private companies that are not traded on a recognised public stock exchange. Some investors who want to solely invest in unquoted companies may consider an investment company in the Private Equity sector, whereas investors who want some exposure to unquoted companies can invest through a variety of investment companies in different sectors.

**Annabel Brodie-Smith, Communications Director of the Association of Investment Companies** said: “The closed-ended structure of investment companies makes them suitable for investing in illiquid assets such as unquoted companies. Investors may be interested in the opportunities that some access to fast-growing unquoted companies within a wider portfolio of investments can bring. A number of investment companies offer investors some exposure to unquoted companies, which can add spice to their portfolio.”

### **Global investment companies with exposure to unquoted companies**

The AIC Global sector is the largest investment company sector by total assets, with over £26bn assets under management\*. The average Global sector investment company has returned 22% over the year to 31 October 2017. Whilst investment companies in this sector focus on achieving long-term growth mainly through investing in global equities, a number also invest a percentage of assets in unquoted companies. Interestingly, last year, shareholders of **Scottish Mortgage Investment Trust** approved the decision for the company to hold up to 25% of assets in unquoted companies.

Commenting on their unquoted exposure, **Catharine Flood, Client Service Director, Scottish Mortgage Investment Trust** said: “There are only a few businesses in the world with the potential to become truly great companies. Those that succeed generate the lions’ share of the long-term returns. The flexibility to be able to invest in a company if it fits the Scottish Mortgage investment philosophy, regardless of its corporate structure, is absolutely critical to generating returns for our shareholders.

“In recent years some of the most innovative companies have chosen to stay private for longer, making them hard for many investors to reach. The reputation and scale of Scottish Mortgage are critical factors in enabling us to access such opportunities.

“Our long-term approach enables us to provide supportive investment capital to help these businesses grow, whilst ensuring all participants share similar timeframes when making decisions. Our scale allows us to make meaningful initial investments, build on our holdings in further rounds and then participate at scale in any subsequent public offering, if appropriate.

“Whilst acknowledging we may be wrong on the individual cases, how else can investors access companies like Spotify, Airbnb, Meituan (Internet Plus) and Grail within a low cost global investment vehicle?”

**Foreign & Colonial Investment Trust** has had varying exposure to unquoted companies for decades and made their first major investments in unquoted companies in the 1940s. Foreign & Colonial’s current unquoted exposure is 7%. **Paul Niven, Manager of Foreign & Colonial Investment Trust** said: “Foreign & Colonial has a long history of investing into private equity investments as we believe that strong long-term returns can be derived from this area. Including an element of unquoted investments alongside our quoted portfolio enables us to take advantage of the ‘illiquidity premium’ that a private equity investment can provide. Indeed, our experience over many years has demonstrated the benefits of accessing private market opportunities.

“Furthermore, as an investment company, our closed-ended structure enables us to take a long-term perspective on investments such as less liquid assets and this provides an additional diversifier within a broad portfolio such as Foreign & Colonial.”

At the 30 September 2017, **Caledonia** reported 31% unquoted exposure. **William Wyatt, CEO of Caledonia**, said: “Caledonia operates a global, balanced portfolio with roughly 50% of its £1.8bn Net Asset Value in direct invested unquoted businesses and private equity funds. We believe the balance of both unquoted and quoted investments provides market risk mitigation and helps mitigate overall value volatility inherent in purely quoted markets.”

**British Empire Trust** has approximately 20% unquoted exposure and **Joe Bauernfreund, Manager**, said: “British Empire currently has about 20% of its NAV invested in listed private equity funds. We are value investors, and one of the clearest areas of value across the closed-end fund universe has been in the listed private equity sector. Many of these funds were running over-leveraged balance sheets with excessive commitments in the run-up to the

financial crisis; rights issues and forced secondary sales hit NAVs hard and led to widening discounts. The wide discounts were even more appealing given the attractive earnings growth being generated by underlying companies, while the carrying values compared favourably to public markets.

“Our exposure to the sector has reduced as discounts have narrowed, but we still see opportunities on a more selective basis with compelling upside expected from some fast growing private equity portfolios such as JPEL Private Equity.”

There are two investment companies in the Global sector, the **Lindsell Train Investment Trust** and **Majedie Investments**, whose unquoted exposure reflects a sole investment in their respective asset management companies. Lindsell Train’s unquoted exposure has grown to 40% since it first invested in Lindsell Train Ltd on the firm’s inception in 2001, and Majedie has 27% unquoted exposure through its investment in Majedie Asset Management, which it seeded in 2003.

#### **Flexible Investment with exposure to unquoted companies**

Furthermore, it’s not just investment companies in the Global sector that have exposure to unquoted equities. The Flexible Investment sector also has companies with unquoted allocations in it, including **Tetragon Financial Group**, which has 20% exposure and **Henderson Alternative Strategies Trust**, which has 29% exposure.

**Peter Webster, Assistant Fund Manager at Janus Henderson Investors who works alongside Ian Barrass and James de Bunsen at Henderson Alternative Strategies Trust**, said: “Over the longer term it is evident that smaller companies exhibit higher earnings and revenues growth rates and as such have a tendency to outperform larger capitalisation stocks over the long term. This is one of the key arguments for investing in private equity, traditionally these are smaller businesses that have high growth potential and deliver greater returns to investors.”

#### **Country Specialists: Asia Pacific with exposure to unquoted companies**

For those interested in unquoted exposure further afield, this is also available. **Fidelity China Special Situations**, for example, currently has 4% unquoted exposure with the ability to invest up to 10%.

**Dale Nicholls, Manager of Fidelity China Special Situations** said: “While there is significant opportunity in listed companies focused on China across a range of stock markets, there is a great deal of activity and innovation in exciting companies that have not reached the listing

stage. Following last year's shareholder vote, the company now has the ability to hold up to 10% in unlisted companies, and I see this ability to gain exposure to a broader subsection of the entrepreneurial activity in China as a key strength of the company."

### **What kind of unquoted companies do they invest in?**

#### **Global**

**William Wyatt, CEO of Caledonia** said: "We invest in established unquoted businesses with proven management teams operating with a significant presence in their marketplace. Such businesses offer our shareholders exposure to off-market investments at a relatively early stage in their development, where partnership with our long-term equity offers the opportunity to build the business to its next stage at a pace which optimises longer term value.

"Recent examples in the portfolio include Park Holidays (fixed site caravans) sold in January 2017 at 2.9 times money invested after a successful period of building the scale of its operations. Liberation Group (brewing and pubs) is a similarly cash-generative, asset-backed business acquired in September 2016."

#### **Country Specialists: Asia Pacific**

**Dale Nicholls, Manager of Fidelity China Special Situations** said: "At the end of the last financial year there were four unlisted holdings representing around 4% of the portfolio. Firstly, Xiaoju Kuaizhi ('Didi Chuxing'), the leading ride-sharing player in China, cemented their dominance in the acquisition of Uber China last year. The second one is China Internet Plus Holdings (formerly 'Meituan'), the leader in China in so-called offline-to-online services. The third is Shanghai Yiguo E-commerce ('Yiguo') a leading fresh food e-commerce company, which aims to create a 'farm-to-table' e-commerce platform. It is the exclusive operator of the fresh food segment on Alibaba's T-Mall Supermarket and both Alibaba and its management team are strategic investors.

"Since the end of the financial reporting period, the company has added a fourth unlisted position in Aurora Mobile Limited ('Jiguang'), a leading app developer service provider and big data platform in China."

#### **Flexible Investments**

**Paddy Dear, principal of Tetragon Financial Group** said: "Tetragon is a closed-end investment company that invests in a broad range of alternative assets. One of these investments is TFG Asset Management, through which Tetragon has exposure to private equity in a number of alternative asset management businesses. This represents approximately 20% of Tetragon's NAV. We do this by identifying attractive asset classes and investment strategies

for Tetragon's capital; then seeking high-quality managers, specialists, through whom to invest in these asset classes or strategies. Where sensible, we look to own a portion of these asset management companies with which we invest, alongside their management teams. In aggregate, these private equity investments are TFG Asset Management."

**Peter Webster, Assistant Fund Manager at Janus Henderson Investors who works alongside Ian Barrass and James de Bunsen at Henderson Alternative Strategies Trust,** said: "We are cautious over committing capital to traditional private equity limited partnerships that traditionally have 10 year lives. We get access to private equities in two ways that we believe negates this issue. First, we invest in listed private equity companies such as HarbourVest Global Private Equity Ltd. HarbourVest is a well-diversified portfolio by geography, strategy and commitment stage. Our exposure to funds such as HarbourVest aims to take advantage of the positive backdrop for private equity as an asset class.

"Our second private equity investment strategy is to back specialist teams. We have a position in Mantra Secondary Opportunities. This fund aims to take advantage of unlisted private equity funds that are approaching the end of their lives."

**ENDS**

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**Notes to editors**

1. \* Global sector assets under management correct as at 30 September 2017.
2. Share price total return data is to 31 October 2017 based on the last official close price at the month end, on a % share price total return basis. No expenses taken into account. Source: AIC using Morningstar.
3. The Association of Investment Companies (AIC) was founded in 1932 to represent the interests of the investment trust industry – the oldest form of collective investment. Today, the AIC represents a broad range of closed-ended investment companies, incorporating investment trusts and other closed-ended investment companies and VCTs. The AIC's members believe that the industry is best served if it is united and speaks with one voice. The AIC's mission statement is to help members add value for shareholders over the longer term. The AIC has 351 members and the industry has total assets of approximately £171 billion.
4. Disclaimer: The information contained in this press release does not constitute investment advice or personal recommendation and it is not an invitation or inducement to engage in investment activity. You should seek independent financial and, if appropriate, legal advice as to the suitability of any investment decision. Past performance is not a guide to future performance. The value of investment company shares, and the income from them, can fall as well as rise. You may not get back the full amount invested and, in some cases, nothing at all.