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Investment Trusts

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Tacit strategies have exposure to investment trusts due to their inherent benefits over other investment vehicles such as open ended funds. Having had many questions over the past years about why we choose to hold an investment trust over other investments, this week we consider their advantages to UK investors:

1. A Fixed pool of assets

A 'closed-end' investment trust issues a fixed number of shares. This means the portfolio managers always know how much capital they have to manage and do not need to worry about immediate liquidity in the fund in order to meet investor redemptions. This lack of liquidity constraints has three benefits:

- the fund can hold illiquid investments such as real assets, emerging market securities or smaller company stocks;
- the manager can take a very long-term view on their investment strategy and only needs to buy/sell investments when the time is right;
- there is no need to hold excess cash in the portfolio to meet investor redemptions.

The closed-end structure also means that investor panic cannot force a fund to sell high-quality assets simply to meet investor demands for their cash. During periods of market turmoil, although investment trusts can trade at discounts to their underlying value they cannot be crippled by high investor outflows.

2. Gearing

Compared to other types of fund, investment trusts also have far greater freedom to 'gear' – in other words, to borrow money to invest in order to enhance shareholder returns. Being able to borrow capital to invest can have a significant positive impact on performance but will also increase shorter term volatility remember.

3. Income control

The corporate structure of an investment trust gives it the ability to manage its income. Whereas authorised open-ended investment vehicles are obliged to distribute all of their income, an investment trust can retain up to 15% of its annual income as reserves. This can potentially be used to supplement dividends in future years, helping to ensure a steady income is paid to shareholders whatever the business environment. Scottish Mortgage for example has increased its dividend for 28 consecutive years.

In the current environment of heightened volatility, we place a premium on the first of these three benefits as open end funds will have more volatile inflows and outflows which will impact their returns. An investment trust may trade at a discount to its net asset value but it allows the underlying manager freedom to manage the portfolio without being forced to sell his best investments when investors get jittery. This ultimately leads to better performance, especially if you can buy them at discounts to their asset value as is currently the case.

performance is not a guide to future results, and the value of investments can go down as well as up.