



BINARY CAPITAL

Investment Management



Long-term investing

Investment Trusts in Wealth Portfolios

Long-termism shapes our relationships and our investments.



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Introduction to Investment Trusts

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This paper outlines our thinking at Binary Capital on investment trusts. Whilst retail investors continue to see their appeal, investment trusts have become less popular with wealth managers and IFAs – often they are not used by such firms. Investment trusts are seen as too traditional, often backwater investments not suitable in the current fast moving and flexible investment world. Robots certainly do not invest in investment trusts.

We seek to change that view and overall narrative. We want to popularise investment trusts, specifically around Discretionary Fund Management (DFM) portfolio solutions. We believe the best investment trusts are highly suitable for all client types, in fact, even more suitable in the current investment climate and the continued evolution of capital allocation moving forward. We like investment trusts.

At Binary Capital, our strict long term and high-conviction investment philosophy aligns well with many investment trusts. We find several reasons why we feel very comfortable investing in investment trusts for clients which we discuss further in this paper.

What are investment trusts?

Investment trusts are closed-ended investment vehicles (effectively plc companies) that have a secondary market for their shares via a listing. There are over 300 listed in the UK.

Why are investment trusts less popular now?

This is down to a range of factors, such as:

- OEICs and UCITS are often pushed by sales and marketing teams towards intermediaries due to business incentives.
- OEICs is a better structure for increasing firm's AUM and therefore investment firms' fees irrespective of fund performance.
- Investment Trusts being increasingly seen as too esoteric and less relevant for client portfolios. There is a lack of proper understanding of investment trusts.
- The historic persistence of discounts (to net asset value) on investment trusts which made them less appealing than daily priced investment instruments.
- The mis-selling and the poor performance of some investment trusts in the past has put off capital allocation into some trusts and often the sector as a whole.

Evolution of Investment Trusts

The first investment trust, the Foreign & Colonial Government Trust (now the Foreign & Colonial investment trust, Ticker: FCIT) was established by Philip Rose in 1868 which was made up of a selection of global & colonial government bonds. Investment trusts have often been labelled as a Victorian invention – a byproduct of the vast wealth of the British Empire at the time, which facilitated investment in new schemes requiring significant financing to begin.

Since then, many investment trusts have evolved particularly out of Edinburgh, Scotland. The wealthy elite, post the Scottish Enlightenment, sought to broaden their investment horizons into the new developing economies. They had the capital and the intelligence to create joint-stock companies and other corporate entities together with the networks to raise sufficient capital to fund the initial investments. This was truly revolutionary thinking at the time. For example, The Scottish American Investment Trust (1873) which raised private capital to fund new developments such as railways or infrastructure, or the Scottish Mortgage Investment Trust (1909) to provide mortgages to rubber plantation owners, secured over the plantation land. Soon after, such specific investment remits were broadened out to include wider range investment opportunities. These investment trusts have evolved in to the billion-dollar size of assets they manage now. Today, many investment trusts are still managed out of Edinburgh.

Over the years investment trusts became more professionally managed. Different investment houses focusing on the professionalism of the board and robustness of corporate governance. Alongside this, alternative strategies developed in such investment trusts: different share classes, preference shares and zero-coupon shares are a few examples.



Edinburgh, Scotland

Changing with the times

The poor performance of many investment trusts through the 1980s and 1990s led to changes of the underlying investment manager and increased board action and intervention. Corporate activism also helped create more efficiency around investment trust management, performance, discount management and independence of the board.

One interesting example around investment trusts management was the focus on Alliance Trust (a very old investment trust managed from Dundee), as a result of a prolonged period of under-performance. Elliot Advisers (a US activist investment firm), took a significant stake in the Trust with a view to improving its performance. They wished for more independence of the board and a change around the investment management strategy. Eventually after various public disagreements the board composition was changed, and the fresh board decided to shift towards a multi-manager investment approach overseen by an investment consultant. Since that 'activist' change, the performance of the Trust has improved, the discount to net assets has narrowed,

and there is better transparency around the whole Trust. Elliot Advisers was successful in effecting change; while other active managers failed in a similar strategy. Investment Trusts are changing.

As technology has become more pervasive in the investment management industry, investment firms themselves have become more sophisticated. As an example, they have been willing to change internal investment teams to make the trusts more efficiently managed and better performing. Technology has also altered how investors can access investment trusts, alongside updated data and information around investment trusts.

Fundamentally we can write in detail around investment trusts strategy and teams, but all of this comes down to performance. Good performing, high quality investment trusts will always do well in the long-term, trade at a premium and have the ability to issue more shares whilst utilising clever borrowing facilities to enhance returns. We seek such opportunities. We explore more of this in this paper.

Examples of fund houses that manage investment trusts:

AberdeenStandard
Investments

Allianz

BAILLIE GIFFORD

Fidelity
INTERNATIONAL


FRANKLIN TEMPLETON
INVESTMENTS

IMPAX Asset
Management


Invesco

Janus Henderson
INVESTORS

J.P.Morgan
Asset Management


JUPITER

LINDSELL TRAIN

MONTANARO
ASSET MANAGEMENT


POLAR
CAPITAL

RUFFER

Schroders

TROY
ASSET MANAGEMENT

May include investment in unlisted equities

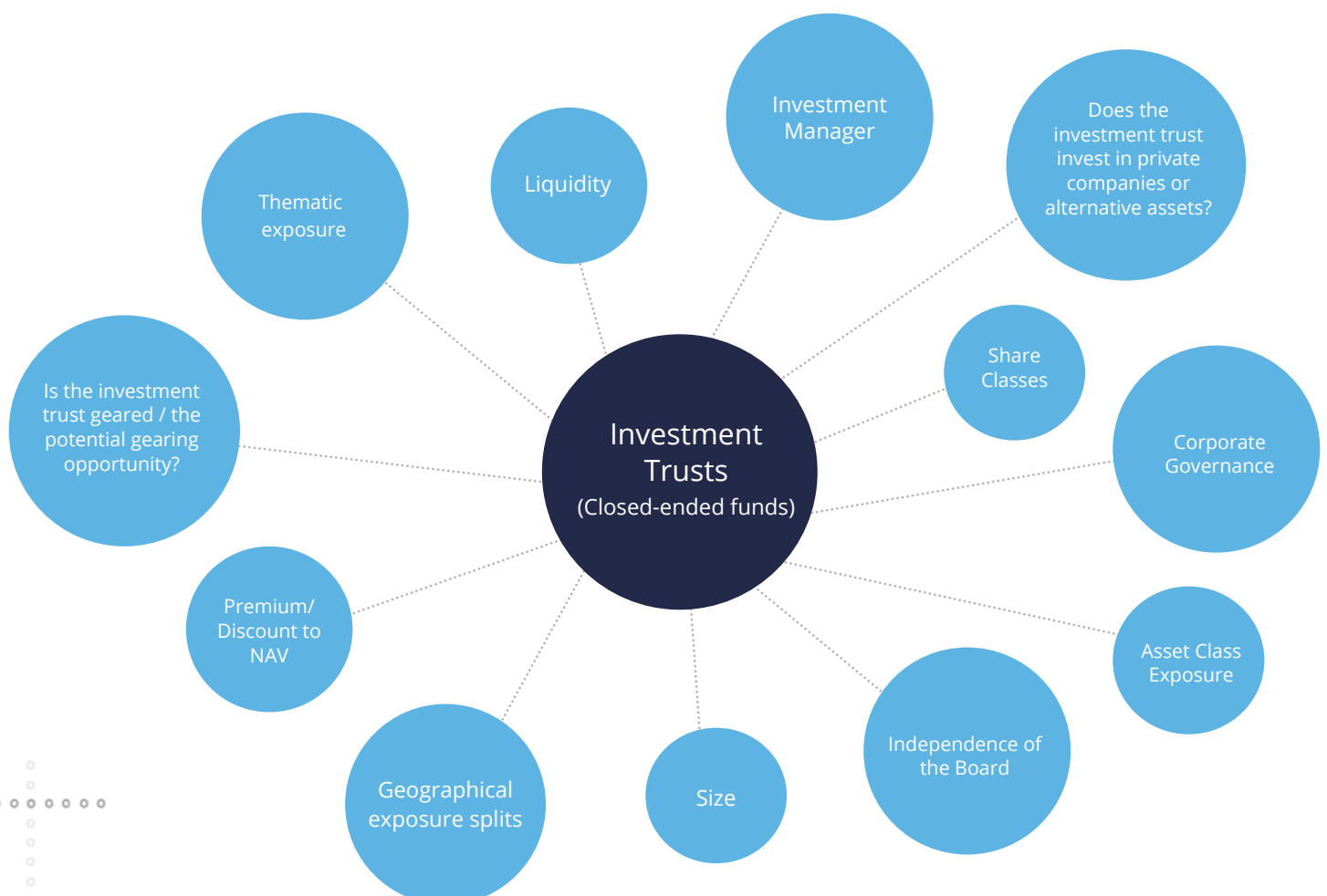
The unlisted or private investment markets are an exciting and growing area of global capital allocation. There is a growing percentage of firms either delaying being listed or those that are not listing at all, instead securing funding through alternative channels such as private equity. This has been a persistent trend in capital markets over the past 10 years.

At BCIM we would never be comfortable buying a UCITS or OEIC that invests in unlisted securities, neither do we invest directly into private equity funds (they tend to be illiquid, opaque and expensive). Using investment trusts we can access exposure to otherwise inaccessible, unlisted investments opportunities. We can therefore avoid the pitfalls that can occur in the investment industry, for example: Woodford Asset Management (WAM) – see later in this document.

More independent oversight

Investment trusts are listed investment companies consisting of a Chairman, an independent board of directors, and so on. The (hopeful) independence of the board and heightened corporate governance holds the investment team and manager to account and scrutiny. The board represent the interests of the shareholders and ensure the trusts objectives are met. If there is sustained under-performance of the investment trust against a pre-determined, relevant benchmark then the board can replace the investment manager or indeed the overall investment house. This ongoing independent scrutiny of the investment managers and their investment strategy should lead to increased transparency and consistency of performance.

What to look out for when investing investment trusts



How can advisers use investment trusts in client portfolios?

Global equity exposure

Nowadays, many funds are structured using a geographical or thematic mandate. This has been a development in the asset management industry over the past 30 years. Many large investment trusts still have large global investment mandates that allow managers the freedom to invest in the best ideas and best companies available. This is a useful exposure if global investment exposure is required.

As with all investment products and strategies, in-depth analysis needs to be undertaken on the strategy and philosophy of the management team behind the product. We have identified some exceptional investment trusts that offer great geographical exposure that is well managed within the closed-ended structure.

Unquoted investment exposure

The investment trust structure provides clients with a liquid vehicle to gain exposure to both liquid and illiquid investment opportunities.

Furthermore, larger investment trusts with an active secondary market offer investors intraday liquidity via a listing. This liquidity option removes the risks of a “run on the fund”, such as what happened at Woodford Investment Management in 2019, and other investment firms previously. The investment industry is littered with investment firms that have had problems with liquidity causing valuation issues, poor performance and ultimately an inability to facilitate the liquidity demands when clients require their capital and wish to exit a fund.

The permanent capital structure of investment trusts is well placed to manage unquoted private investments. There is no need to sell down other liquid investments to manage investment redemptions. The natural supply and demand of the listed shares will reflect how the investments will be managed. There is a natural market in existence, it may not be completely perfect but there is an exchange market.

Alternative asset classes

Other assets that are liquid or illiquid can also be suitable within an investment trust structure. Assets such like commodities, real estate, infrastructure can be suitably placed in investment trusts and managed in a very optimal manner.

Real Estate Investment Trusts (REITs) are a very popular vehicle to manage real estate assets, the illiquid nature of such assets are well placed to be managed in such liquid investment trust structures.



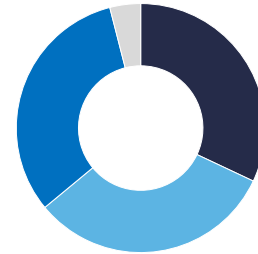
Shenzhen, China

Three Example Portfolio Ideas

The best ideas portfolio

A diversified portfolio aligned with your asset allocation framework and your best investment ideas, including your best ideas from equity focused funds and the investment trust universe. Utilising the unique exposure offered by some investment trusts within a diversified best ideas style portfolio. This approach can be used for all client types and adjusted for risk profiles.

Illustration of a portfolio with various investment vehicles

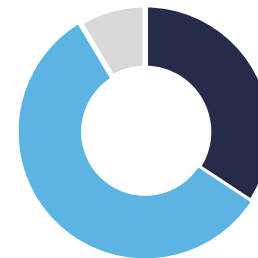


- Investment Trusts
- Funds
- ETFs
- Cash

The high conviction portfolio

A simple but effective portfolio with your highest conviction ideas, from the investment trust space, in combination with core ETFs for any fixed income exposure to maintain alignment with defined risk profiles. Many investment trusts are already diversified in their approach, therefore, overlaying too many funds or trusts dilutes alpha generating return opportunities, leading to a more index-like and passive performance. It is worthwhile considering this approach if you have significant research capabilities. For clients that want a higher chance of outperforming benchmarks and accept the risks of such strategy.

Illustration of a high conviction portfolio built with investment trusts

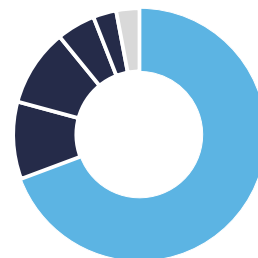


- 5 - 10 Equity Focused Investment Trusts
- 2 - 3 Core Bond ETFs
- Cash

The endowment model portfolio

Build a diversified portfolio that invests in alternative assets using investment trusts. Investment trusts offer a liquid, daily traded investment vehicle for investors looking for exposure to real estate, infrastructure, commodities and more. This is an approach that can be considered for larger clients – institutions and large family offices.

Illustration of an highly diversified portfolio for a client with an adventurous risk profile using investment trusts



- Equities and Bonds
- REITs
- Infrastructure trusts
- VCTs
- Commodity Trusts
- Cash

The Scottish Mortgage Investment Trust

The Scottish Mortgage investment trust (SMT) provides clients with an opportunity to gain active exposure to high growth public and private companies at a low fee of just 0.36%. The managers take a bottom-up, stock picking approach with a high conviction style (the top 30 holdings account for around 80% of total assets).

“ China is now home to an entrepreneurial fury that leads to the creation of great individual businesses.

James Anderson, Head of Global Equities, Baillie Gifford

Strategy and Philosophy

- SMTs long-term growth focus has exposure that is set to benefit from converging narratives such as the growth of China, technology and healthcare.
- SMTs managers have identified quality investments opportunities aligned with these growth themes

Key Portfolio Characteristics

US and China equities: The US and China economic and innovation story plays a big part in the Trust's investment philosophy. Digitalisation is sweeping through the Chinese economy at a rapid rate and China is home to one third of all emerging and digital technology unicorns. The scale of the Chinese market has driven such companies' rapid expansions, dominance and profitability.

Alongside the Chinese investment opportunity, the US exposure is also compelling with investments in companies such as Tesla, Illumina and Amazon. The Trust has made considerable gains in many of these investments but still feels compelled to hold them for the prospects of significant future gains.

Investing in next generation companies: Another important theme in the Trust, is investing in the future, those real winners emerging from key growth sectors. One example of such an investment is Intuitive Surgical, a company developing leading robotics products designed to help in invasive surgery. The company is innovating well across the robotics area as well as the accompanying software inputs. The opportunity to further innovate into more complex surgery treatments is possible in the years ahead.

Investing early: Ordinarily, industry leading private companies would have undertaken an initial public offering. However, as capital is more freely available and less commoditised, privately managed firms can seek out patient capital investors to help with their overall business objectives. SMT are well positioned to take advantage of this trend and can allocate up to 25% of the trust in such future growth opportunities.

Key Information	
Ticker	SMT
Inception	1909
Philosophy	Growth, Long-term, High conviction, Low Turnover, High active share, Asymmetrical investing
Style	Growth
Exposure	Global Equities
Cap focus	Large cap
Cost	0.36%
Invested Gearing	5%



3 Yr. Percentage appreciation of SMT Vs. FTSE World Index

	SMT	Benchmark (FTSE World Index)
5-Year Annualised Return	45.22%	11.03%
5-Year Annualised Volatility	22.23	15.62
5-Year Sharpe Ratio	1.92	1.05

The Scottish Mortgage Investment Trust

(contd...)

Holdings

SMT continues to make strategic investment decisions founded on the belief that the global economy will continue to shift resources further towards Asia. Currently 22% of the trust is invested in China and they have a solid track record of long-standing successful investments; the technology giant Alibaba has provided annualised return of 41.9% since the initial unlisted purchase during 2012. ByteDance the media technology company is privately held and provides leading exposure to social media in China and now more widely. ByteDance is valued at \$100bn+ and is growing at a rapid pace.

In healthcare, SMT is not only invested in global gene sequencing company Illumina but also in private companies such as Grail (now owned by Illumina), Tempus Labs & HeartFlow.

The philosophy of SMT is clear, it is always seeking future growth, genuine inflection growth opportunities to invest in for the long-term.


How can the investment trust be used in portfolios?

Scottish Mortgage is a global investment trust with significant concentrated exposure to the US and Chinese investment markets. The trust is primarily focused on listed investments but as we note earlier in this note the Trust has significant exposure to private investments, primarily investments around the high growth technology and healthcare sectors. The Trust is an excellent vehicle to give portfolios genuine active investment exposure in high growth sectors within a global remit. The low fee within the Trust is another key advantage.

The Trust is volatile, which can be expected due to the underlying nature of the underlying investments. This volatility needs to be managed in any portfolio strategy. The long-term record of the Trust is impressive, the investment strategy and the way the Trust invests is also impressive. The forward-looking nature of the trust is innovative and very different from other investments out there. The significant size of the Trust, c.£20bn should not deter future investment opportunities.

For global equity exposure in a concentrated and low-cost manner the Trust is pretty much unrivalled across peers.

The above is not financial advice. Please review full disclaimer.

Top 5 Listed Holdings	
	<p>Sector: Communication Services Position: (c.6.5%)</p> <p>Operates as a holding company and through its subsidiaries provides social networking, music, web portals, ecommerce, AI and technology solutions to a global customer base.</p>
	<p>Sector: Biotechnology Position: (c.6.1%)</p> <p>Top-ranking developer, manufacturer and marketer of next-generation genetic sequencing tools used by genomic research centers, Pharmaceutical companies, and biotech companies worldwide.</p>
	<p>Sector: Internet / e-commerce Position: (c.5.9%)</p> <p>E-commerce and technology giant. An on-line retail services provider, with focus on artificial intelligence, venture capital and the operation of a global cloud platform – Amazon Web Service.</p>
	<p>Sector: Automotive (EVs) & Technology Position: (c.5.1%)</p> <p>A leader in the sector; designer, manufacturer, and seller of high-performance EVs, EV components, and solar energy generation and energy storage products serving a global client base.</p>
	<p>Sector: Automotive Position: (c.4.8%)</p> <p>Manufacturer and seller of automobiles offering their own range of EVs and parts, as well as the provision of battery charging services.</p>

Top 5 Unlisted (privately managed) Holdings	
	<p>Sector: Financial Services Position: £302m (c.1.7%)</p> <p>An affiliate company of Alibaba Group that owns China's largest digital platform Alipay. Serving over one billion users and 80 million merchants with the aim of supporting the digital transformation of the service industry.</p>
	<p>Sector: Media and Data Position: £230m (c.1.3%)</p> <p>A multinational internet technology company. Operates a range of content platforms that inform, educate, entertain & inspire people globally.</p>
	<p>Sector: Technology & Healthcare Position: £220m (c.1.2%)</p> <p>With the world's largest accessible library of clinical and molecular data along with the use of artificial intelligence, they are making precision medicine a reality. Optimized therapeutic options.</p>
	<p>Sector: Synthetic Biology Position: £180m (c.1.0%)</p> <p>An organism company specializing in genetic engineering to produce bacteria with industrial applications from enzyme discovery in pharmaceuticals to biosecurity.</p>
	<p>Sector: Financial Services Position: £140m (c.0.7%)</p> <p>Payments processing platform offering software and application programming interfaces for e-commerce websites & mobile applications.</p>

Polar Capital Technology

A Trust focused on the ever-disrupting technology sector, which since its launch in 1996 has evolved into a leading global technology investment trust with a market capitalization of over £2bn. Managed by an active investment house, Polar Capital, in London. Polar Capital has significant thematic investing experience, they run financial as well as healthcare investment trusts alongside this technology Trust.

“...technology is not mean reverting, and that value stocks are usually cheap for good reason

Ben Rogoff, Partner, Polar Capital

Strategy and Philosophy

- Disruption is the core theme running through the trust as the managers seek to invest in the digital transformations rapidly changing the way we work and live. The mandate is broad and focused around best-in-class technology companies.
- The Trust is managed in a very traditional manner: fundamental investment research, looking at corporate management very carefully analysing companies from a strategic point of view as well as more globally against their peer group and the potential market opportunity. The Trust is managed by an experienced investment team who understand technological evolution very well and really do look forward to real future trends in technological advancement.

Key Portfolio Characteristics

Investing globally: This is a Trust focused exclusively on technology investments. The majority of investments are positioned in the the US market with the rest allocated to Asia – China is a big focus. The Trust has limited investments in Europe.

Investing in technology: The Trust has broad technology sector focus with software a key area at 30% of the Trust – the top two holdings in the Trust are Microsoft and Alphabet (Google). Despite the high valuation (\$2tr market capitalisation, forward PER 30x) and strong historic share price growth, the Trust has a significant position in Apple, around 8% of the overall portfolio, circa a £310m position.

A diversified approach: The Trust is broadly well diversified with around 100 investments and the top 15 investments account for around 50% of the investments, therefore the trust adopts a core, satellite approach: it is comfortable with its core (top) holdings and thereafter takes on smaller investment positions that could grow exponentially based around their future outlook.

Key Information	
Ticker	PCT
Inception	1996
Philosophy	A focus on long-term capital growth in technology investments
Style	Growth
Exposure	Global Equities
Cap focus	Large cap
Cost	1.0%
Invested Gearing	0%



5 Yr. Percentage appreciation of PCT Vs. DJ Global Technology Index

	PCT	Benchmark DJ Global Tech
5-Year Annualised Return	31.66%	28.88%
5-Year Annualised Volatility	29.38	36.37
5-Year Sharpe Ratio	0.72	0.96

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Polar Capital Technology (contd...)

Holdings

The market capitalization focus of the investment trust is primarily on mega and large cap positions. The Trust does not invest in small cap technology businesses. As a result, the Trust features many common technology names, Apple, Facebook, Amazon.com to name three.

The Trust therefore provides global vanilla technology exposure via the mega and large cap technology plays.

How can the investment trust be used in portfolios?

The Trust has a very good performance record against a competitive benchmark and provides very broad exposure to the key global technological corporates. The Trust is on the expensive side with an overall fee of around 1%, there is also a 10% performance fee in the Trust (paid over an agreed benchmark performance).

We like the global nature of this investment trust, we like the efficient way it is managed and its liquid, large cap exposure in some of the best technological companies in the world. The Trust is increasingly looking at China for renewed technological exposure. We like this focus towards Asia technology.

Historically the Trust has a solid performance record, and we see no reason why this performance will not continue into the future. Notwithstanding cyclical markets, the Trust is well positioned and resilient as market volatility may become heightened. The Trust is a very good long-term play for conviction global technology exposure.

The composition of the trust, the volatile nature of the trust, needs to be carefully noted and managed around any overlap with other US investment trust investments.

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Top 10 Holdings	
	<p>Sector: Tech hardware Position: £310m (c.10.0%) Global consumer hardware player. Strong market share, exceptional margins and growth.</p>
	<p>Sector: Software Position: £260m (c.8.0%) Compelling software innovation especially in the lucrative business marketplace. A leadership position in technology.</p>
	<p>Sector: Software Position: £200m (c.6.0%) A technology giant, with a focus around internet services, artificial intelligence, venture capital and media.</p>
	<p>Sector: Tech Hardware Position: £130m (c.4.0%) A technology consumer brand, a core interest in semiconductors. Strong competitive advantage in mobile phones, especially in Asia. A global market leader.</p>
	<p>Sector: Semiconductors Position: £120m (c.4.0%) Leadership in semiconductors, producing chips for many global technology giants, Apple, Google to name two.</p>
	<p>Sector: Others Position: £100m (c.3.0%) Tencent is a technology conglomerate with investments in China and globally. It reaches into social media, messaging, music and gaming.</p>
	<p>Sector: Interactive Media Position: £80m (c.2.5%) Online global social media is the key to Facebook's success with a reach beyond many other social corporates. Its internet advertising is exceptionally well developed and highly profitable.</p>
	<p>Sector: Internet / e-commerce Position: £80m (c.2.5%) A technology giant, with a focus around internet services, artificial intelligence, venture capital and media content. Exceptional leadership in US and now increasingly global e-commerce.</p>
	<p>Sector: Internet An exceptional foothold in e-commerce in China and expanding regionally, media is also an important business division. Strong growth outlook.</p>
	<p>Sector: Semiconductors Position: £50m (c.1.06%) A global semiconductor corporate with a particular focus in innovating around gaming computing technology.</p>

Closing Remarks

We hope in this paper we have made a compelling case for investment trusts and specifically investment models designed around such products. With our deep expertise in such strategies and direct access to good managers, we at Binary Capital, are well placed to utilise investment trusts across DFM strategies.

By using investment trusts we give clients access to these vehicles and all the advantages and opportunities that we have described in this paper. Models are therefore created with high conviction, good transparency and importantly access to great investment ideas: technology, healthcare and other important sectors. Clients get access to potential portfolio leverage and access to interesting and innovative unquoted investments.

The compelling nature of investment trusts is outlined in this paper and the way we manage money at Binary Capital: long-term, patient, focus with a growth bias is exceptionally well aligned to many leading investment trusts.

We want to bring unique and innovative products into the DFM marketplace. The investment trust strategy is another option in our uniqueness in the DFM marketplace. We can undertake this strategy on a modular or bespoke basis.

We look to add value to clients, fulfill requirements for clients who perhaps do not know the opportunity that investment trusts represents and importantly the opportunity around investment trusts as part of an approach to investing across different risk profiles.

Summary

- Investment trusts are here, they are available, they are resilient investment vehicles.
- There is real innovation in many investment trusts.
- As investment markets and indeed investing in general continues to evolve, many Trusts have genuine compelling investment coverage characteristics that are often ignored.
- A DFM proposition considering investment trusts is an interesting strategy that is worth considering when compared to other DFM strategies.
- The opportunity to create real long-term returns for clients in an investment trust vehicle could be more compelling than an equivalent open-ended structure.
- With specialist knowledge, specialist opportunities emerge.

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