Witan

Witan continues to adapt to a changing investment environment...

Update
08 December 2021

Summary

Witan offers investors a highly efficient way of getting exposure to global equities, with all the benefits of active management but with few of the disadvantages. The highly diversified portfolio has little key man risk thanks to the multi-manager approach and is different to other global trusts thanks to the in-house executive team, which is fully aligned with Witan's shareholders.

The portfolio is designed relatively simply and sees the majority of the trust's assets invested with 'core' managers (c. 75%) and the balance using 'specialist' teams. Currently, there are eight main underlying managers, as well as other smaller exposures, including a number of investment trusts. Reflecting the long-term investment approach, changing allocations between managers is expected to be infrequent, although as we discuss in **Portfolio**, October has seen some activity in this regard.

Since the adoption of the current 'manager of managers' approach, Witan has outperformed its benchmark and delivered dividend growth well ahead of inflation. The period since the pandemic has presented challenges, but the executive team were quick to address the changed outlook, and the performance has directly benefitted from their actions. The underlying portfolio is currently well balanced, with exposure to companies with enduring cash-flows, higher growth companies, and undervalued, cyclical businesses. This helps explain the decent relative **Performance** over the last 12 months despite a changeable market environment.

Notwithstanding the pressures felt by many trusts, Witan's board increased the 2020 **Dividend** by 1.9%, taking the ten-year compounded growth to 9.6% annualised. We expect to hear confirmation on the dividend for the current financial year in March 2022. Witan currently yields 2.3% on a historic basis.

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Analyst's View

Witan's team was wrong-footed by the pandemic, and performance suffered. However, they were quick to confront the new reality, and with changes to the manager roster having been made the resulting portfolio is, in our view, better equipped to deliver for shareholders in this new environment. This demonstrates the advantages Witan has over most other global funds, in that there is little key man risk, and changes to the manager set-up can be made relatively easily. This enables the trust to continue to adapt to a changing investment environment over the coming decades.

As highlighted in **Portfolio** and **ESG**, the executive team are already adapting their approach so that investors will benefit from the significant opportunities presented by the shift to a low carbon economy and the world's net-zero ambitions. Although the bald statistics don't show it, we continue to believe Witan qualifies as a potential investment for investors who want a responsible, ESG aware manager.

Witan's discount took a knock from the pandemic, from which it has so far not recovered. Whilst Witan is never likely to be the strongest performer over a short time frame – particularly if a narrow style finds favour over another – over the long-term, outperformance has historically come through. We believe we could see the discount narrow over time, but over the short term, the board continues to protect discount volatility on the downside. As such, Witan is a strong potential candidate for any long-term equity investor.

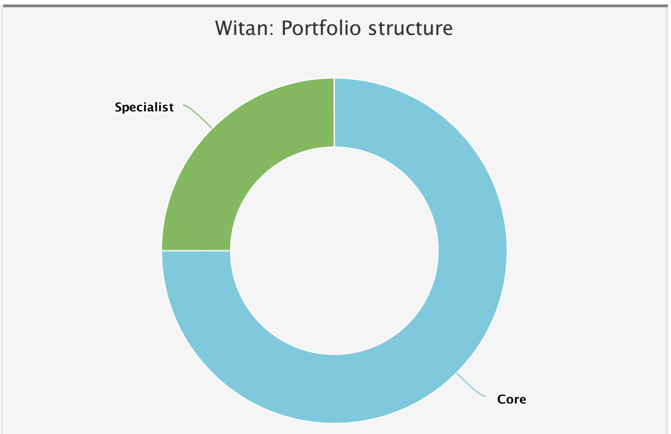
BULL
'Manager of managers' approach offers diversified exposure within a clear portfolio structure
Majority of global managers complemented by specialists means portfolio is likely to be differentiated to other global trusts
A reliable dividend, progressively growing for the past 46 years

BEAR
Higher exposure to UK than global peers, means this could weigh on relative performance
Poor performance in H1 2020 means long term track record was affected
Gearing can exacerbate the downside, as was the case in 2020

Portfolio

Witan offers investors a highly efficient way of getting exposure to global equities, in a manner that offers the benefits of active management but with few of the disadvantages. The portfolio structure results in a highly diversified portfolio and no key man risk through the multi-manager approach. Witan is different to other global trusts in that it has an in-house executive team that monitor the existing roster of investment managers, as well as make suggestions to the board of potential changes. The executive team are 100% focused on Witan, providing full alignment between them and Witan's shareholders. The portfolio is designed relatively simply, around a loose framework that sees the majority of the trust's assets invested with 'core' managers and the balance using 'specialist' teams. We draw distinctions between the two further below. Almost all of the trust's assets are invested through segregated accounts, with each manager providing the executive team with full transparency and detailed information on voting and engagement activities (see **ESG**).

Fig.1: Portfolio Structure



Source: Witan

Within the core managers, the significant majority (c. 65% of total assets, +/- 5%) are expected to be global managers with a range of styles. Reflecting the fact that Witan has a large body of UK retail investors, 10% (+/- 5%) of total assets within the core portfolio are expected to be UK managers. The benchmark also reflects this, with an 85% weighting to the MSCI ACWI and 15% to the MSCI UK Investable Market Index. Within the core portfolio, managers are selected to provide a range of different approaches and styles, ensuring that the portfolio as a whole is never overly exposed to one sector, style or theme.

The specialist manager allocation, of around 25% of the total assets, is expected to deliver potentially superior growth through specialist regional or sectoral expertise. Within this allocation, the executive team can also invest in other investment trusts. It is through the specialist section of the portfolio that the team get exposure to emerging markets, a climate change strategy, private equity and life sciences. The executive team also aim to find newly established managers, perhaps with innovative or differentiated processes, which will fit within the specialist allocation.

Each of the managers awarded a mandate by Witan is given a large amount of freedom to invest as they see fit. However, the segregated accounts through which Witan invests gives the executive team a huge amount of transparency on holdings and activity. They select managers who have high conviction and also demonstrate that ESG is fully integrated into their processes. The executive team continuously monitor investment activity and are able to have continuous dialogue with managers on their investment choices. Manager changes are expected to be relatively rare, reflecting Witan's long-term investment, but changes do happen. 2020 was a relatively active period (see our profile covering this period), but the recent factsheet also highlighted more activity.

Summary Of Manager Exposure

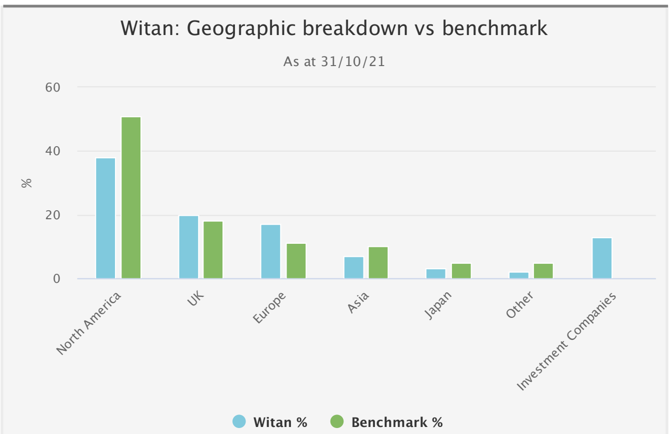
MANAGER	GEOGRAPHIC AREA	STYLE	% AS AT 31/10/2021
Lansdowne Partners	Core - Global	Global developed markets	20
Veritas Investment Management	Core - Global	Fundamental value, real return objective	18
Lindsell Train	Core - Global	Long-term growth	15
WCM	Core - Global	Quality growth	11
Jennison	Core - Global	High growth businesses	6
Artemis	Core - UK	Recovery / Special	6
SPECIALIST			
Witan Direct Holdings	Direct	Specialist funds	11
GQG Partners	Emerging Markets	Quality at a reasonable price	6
GMO	Climate change	Companies addressing climate change	5
Unquoted Funds	Specialist funds	Lansdowne, Lindenwood	2

Source: Witan

Over October 2021, Witan added £20m to the GMO Climate Change strategy, which now represents 5% of the portfolio and has been a constituent since 2019. The manager aims to deliver high total returns by investing in companies that are positioned to benefit from efforts to curb or mitigate the effects of climate change. Other additions included £20m to the Lansdowne Opportunities Fund, which invests in listed and unlisted opportunities arising from Lansdowne's long-standing involvement with the intellectual property spinouts from the UK's leading universities. This investment follows an allocation of capital to another specialist unquoted fund (Lindenwood) in July. Both funds reside in a newly established sub-category of "unquoted funds" within the broader Specialist portfolio. Together Lindenwood and Lansdowne Opportunities account for approximately 1.7% of Witan's overall portfolio. These new investments were funded by a small redemption from the Lansdowne global equity mandate and selling the S&P500 ETF. Witan also redeemed from a small portfolio managed since 2018 by Latitude Asset Management.

When combined, the portfolio can be seen to have wide-ranging exposure to equities across the globe. However, aside from the UK exposure, there are no predefined allocations between geographies, in that they are essentially determined by the underlying managers – especially those who invest globally. Given the portfolio is not managed to benchmark weightings, it is likely exposures will deviate from those of the benchmark, sometimes quite significantly – as is the case today, which we show in the chart below. Witan's active share of 78% shows us that the portfolio is very different to the benchmark. As we discuss in **Performance**, the trust's underweight to the US is likely to be a contributory factor to the recent underperformance of the benchmark. Over time, we would expect that with highly active managers underpinning the strategy, Witan's exposure will be dynamic and adapt to the investment environment as circumstances change.

Fig.2: Geographic Exposure Vs Benchmark



Source: Witan

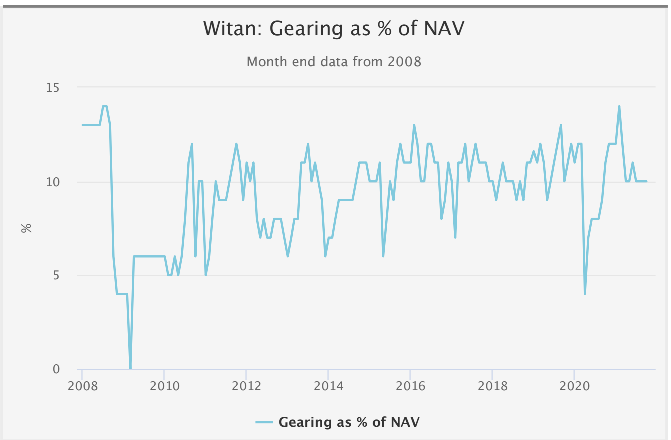
The executive team have a mandate to invest up to 10% of the portfolio directly into other investment trusts which complement the rest of the portfolio. This adds extra reach within the portfolio and an opportunity to add returns and alpha. The team have long experience of investing in investment trusts, but whilst the discount opportunity may be part of the attraction, it is mainly the underlying assets or the manager that the team are harnessing by investing in any trust. Long-running holdings include Syncona (a life sciences investor), Apax Global Alpha and Princess Private Equity (private equity), Schroder Real Estate, BlackRock World Mining and VH Global Sustainable Energy.

Gearing

Witan's board and executive team both share the view that gearing can enhance long term returns for shareholders. The executive team view 10% as a neutral level of gearing, and it is the board's long-standing policy not to allow gearing to rise to more than 20%, other than temporarily and in exceptional circumstances. As the chart below shows, the gearing level has typically fluctuated between 6% and 12% of NAV. Gearing has two 'costs' – the interest cost and the impact on returns over any period. Over time, the cost of gearing has come down as Witan has repaid historic and relatively high-cost borrowing as loans have matured. This means that the fixed borrowings (totalling £155m in total) now have a blended average cost of only 3%. In addition, Witan has more flexible short-term borrowing facilities, which currently amount to £83m and bring the overall blended cost of borrowings down to 2.2%. In terms of the impact on returns – the other potential cost – gearing exaggerates positive and negative moves, and so over the short term, it can reduce or enhance returns. Over the past ten calendar years, gearing has added to returns in seven of them and detracted in three.

To the extent that the executive team want to reduce gearing below the level of the fixed borrowings, they either raise cash from portfolios or sell index futures – both of which reduce the effective equity exposure of the trust. This was the case in Q1 2020 when the trust's gearing rose to c. 15% as a result of the decline in the asset value following the pandemic induced market selloff. The outlook at the time was very unclear, and the underlying managers were experiencing highly volatile equity markets, which prompted the executive team, with the support of the board, to reduce effective gearing to 4% in mid-March to protect capital until the outlook became clearer. When market conditions had returned somewhat to normal, gearing was re-applied to allow the fund to participate in much of the equity market recovery.

Fig.3: Gearing

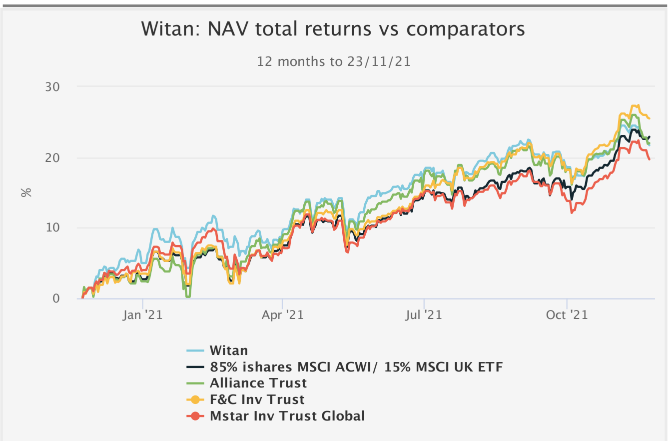


Source: Witan

Performance

Witan's portfolio is actively managed, with each underlying manager investing without heed to benchmarks and aiming to deliver strong risk-adjusted returns. When combined, as we discuss in **Portfolio**, Witan has an active share of 78%, although each individual manager is likely to have even higher scores. Stock-picking is therefore likely to drive performance, but the executive team aim to combine managers to provide a range of styles. All of this means that over various time frames, the trust may underperform, but over longer time frames, the managers aim to deliver outperformance. The graph below shows that over the past 12 months, the trust has had a good run of performance over a period that has seen a very changeable environment with the extremes of value and growth taking turns to lead month by month.

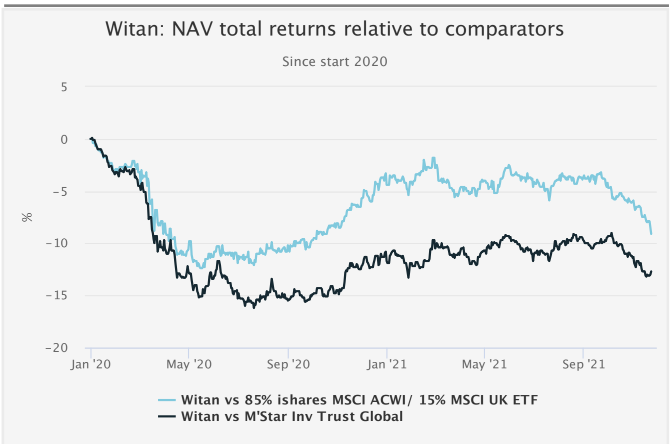
Fig.4: Past 12 Months NAV Performance



Source: Morningstar, Kepler Partners LLP
Past performance is not a reliable indicator of future results.

Whilst the past 12 months has seen a strong performance in absolute terms and relative to the sector, 2020 was unarguably a poor year for the trust on a relative basis. Witan was positioned for continued economic expansion at the start of 2020, and so the impact of COVID-19 on markets hit the NAV hard. The executive team made some decisive changes to the portfolio after the pandemic hit, which meant that since the start of H2 2020 and into Q1 2021, Witan had a good period of outperformance of the benchmark and peers. This shows up in the graph below, with an upward sloping line indicating a period of outperformance and downward representing underperformance. More latterly, the compounders and quality industrials in the portfolio have lagged – exacerbated by renewed lockdown fears. The portfolio, whilst not at all deep-value biased, still has a fair degree of cyclical exposure. Additionally, the trust's underweight to the US is likely to have been a contributory factor to the recent underperformance of the benchmark, given the relative strength of US equity markets and the US Dollar.

Fig.5: 2020 And 2021 YTD NAV Performance

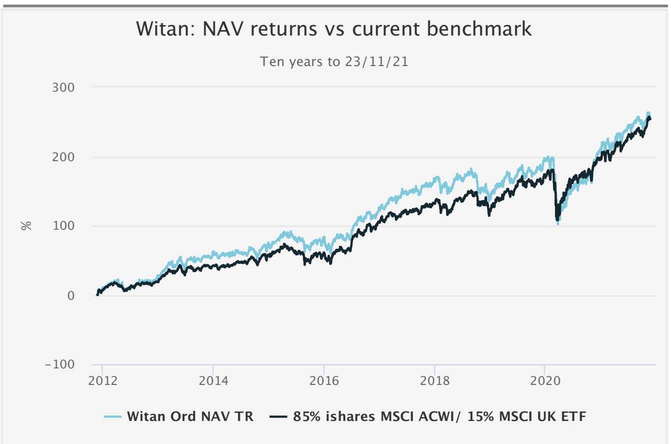


Source: Morningstar, Kepler Partners LLP
Past performance is not a reliable indicator of future results.

Over the long term (ten years to 31/10/2021), Witan's approach has delivered NAV TR outperformance of its composite benchmark of 24.7pp Over time this benchmark has changed, with the current 85% MSCI ACWI and 15% MSCI UK having been adopted at the start of 2020. The graph below shows performance against this new benchmark, which shows the NAV total return broadly in-line with the benchmark over the past ten years, reflecting a historically higher weighting to the UK and other non-US regions compared to the current benchmark over this time. Over five years, largely as a result of the poor start to 2020, Witan is c. 6% behind its composite benchmark.

In our view, one of the advantages that Witan has when compared to other global trusts is the ability (and willingness when circumstances warrant it) of the executive team to make changes quickly and easily to the manager roster. Over time, the executive team have employed a greater proportion of global managers, each of which has few geographic or sector restrictions. At the same time, the team expect to benefit from specialists from the 25% of the portfolio reserved for them. Witan's approach, in our opinion, means that a manager is only ever a contributor to the track record and also means it is far easier to rotate the manager roster to keep up with market events and expectations or take in new, emerging opportunities. Over time, we think this should ensure that outperformance over the benchmark is more consistent than peers.

Fig.6: NAV Performance



Source: Morningstar, Kepler Partners

Past performance is not a reliable indicator of future results.

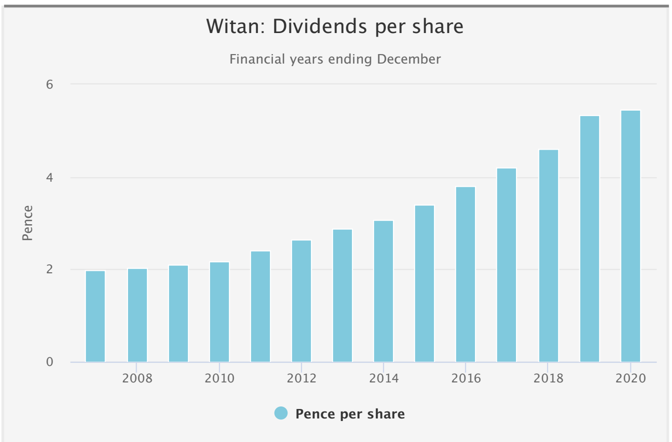
Dividend

Witan is a good example of a trust which has used the structural advantages of investment trusts to deliver a progressive dividend to shareholders over many years. In fact, the dividend has been increased every year for the past 46 years, putting it firmly in the ranks of the **AIC's dividend heroes**. The Board's policy remains to grow the dividend each year ahead of inflation, which in some years sees revenue reserves used to support the dividend. 2020 was just one of these years, but despite the pressures inflicted on the trust's revenues by the pandemic, the board still increased the dividend by 1.9%, taking the ten-year annualised compound growth to 9.6%.

Revenue reserves now represent 1.2x the full-year dividend, a strong level of cover. However, the board has also signalled that capital reserves are potentially available if warranted, illustrating that they have plenty of latitude to continue to support dividends into the future. We note that the board have stated they will only use capital reserves to bridge a shortfall until one might reasonably expect the dividend to be fully covered by income receipts once again, thereby ensuring it is truly sustainable over the ultra-long term. In our view, the level of reserves and the board's stated intent continue to provide shareholders with plenty of confidence in the trajectory of the dividend into the future. We expect to hear confirmation on the dividend for the current financial year in March 2022.

At the current share price, Witan yields 2.3% on a historic basis. Interim dividends are paid quarterly in June, September and December, with a final balancing payment for the financial year ending December, paid in March. The March dividend payment reflects the difference between the three quarterly dividends already paid, and the payment decided for the full year.

Fig.7: Dividends



Source: Witan, Comparative figures prior to 28 May 2019 have been restated due to the five-for-1 share split on 28 May 2019

Past performance is not a reliable guide to future returns

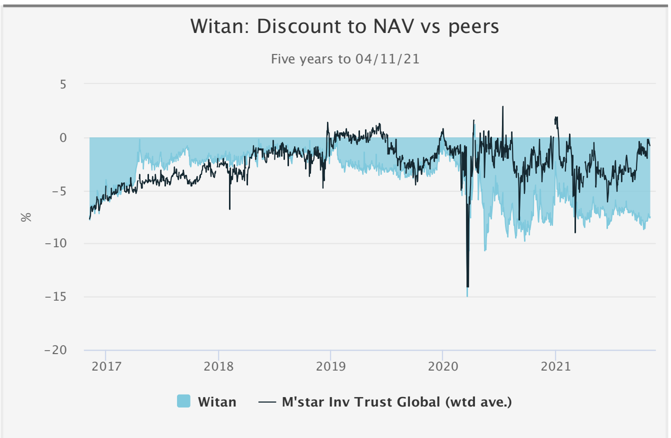
Management

Witan has a multi-manager approach, using a range of third-party managers that invest through highly active, concentrated portfolios. In total, Witan currently has eight underlying managers as well as other smaller exposures including a number of investment trusts – see **Portfolio** for more details. The selection of managers and overall asset allocation is overseen by Witan's executive team led by Andrew Bell (who became CEO in 2010 and sits on the board of directors) and supported by James Hart. In selecting managers, the executive team aim to narrow down the field of potential new managers if the decision has been made to change any, and then propose to the board those that they are happy to have in the portfolio. The board then participates in an interview process and, in consultation with the executive team, decides on appointments. WTW is retained as a consultant to provide supplementary support, but the process is driven very much by Andrew and his team, with input from the board. Members of the board have extensive investment management experience and are, in our opinion, in a strong position to make informed choices. This is a key difference to Global sector peer Alliance Trust, which employs WTW to manage the selection process on a fully discretionary basis.

Discount

To coin a storied phrase, over the past five years, Witan's discount has been 'a game of two halves'. In the years prior to the pandemic, the discount was on a narrowing trend and traded at a premium to peers. For a long period, it had hovered around the 2% level – which we would view as insignificant in the grand scheme of things (average discount from November 2017 to end March 2020 was 2.7%). In our view, Witan's discount was narrow because of strong performance as well as recognition of the attractive features of the trust's set up as a long-term savings vehicle. As the graph below shows, the market sell-off in Q1 2021 appears to have dented investor appetite for the trust from buyers, given that the shares have traded not only on a significantly wider discount (average of 6.8% from April 2020 to November 2021) but also on a very meaningful discount relative to the AIC Global peer group.

Fig.8: Discount

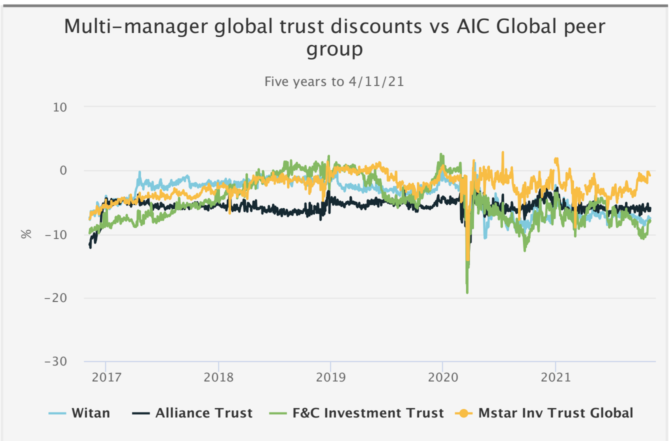


Source: Morningstar

The derating of Witan's shares has also been shared by F&C Investment Trust, which has a multi-manager approach, illustrated in the graph below. Having traded broadly in-line (and sometimes at a premium) to the broader peer group of global investment trusts, all three trusts with multi-manager approaches have traded at discounts to their peer group since Q1 2020. In our view, this is perplexing given over the same period, investor flows into global equities have increased. In our view, for long term savers or investors, the attractions of a diversified stock-picking approach like Witan's have become more attractive, not less.

The board's objective is that the shares should trade on a sustainable low discount or premium to NAV, and it is, therefore, active in the market in buying shares back when it sees fit. As a result of the discount widening, the board has made a significant number of buybacks over the financial year, approaching 6% of the shares in issue so far. With the board engaged in protecting discount volatility on the downside, the current discount of c. 7% continues to appear a potentially attractive entry point.

Fig.9: Peer Group Discounts



Source: Morningstar

Charges

Witan has an OCF of 0.78%, with management fees payable to the roster of underlying managers amounting to 0.52%, with the balance made up of other expenses of running the trust. Witan uses its large size as a negotiating factor with managers to enable it to pay less than the publicly available funds that these managers run. Only one of the managers is paid a performance fee, which constituted 0.04% of NAV over 2020 and meaning that the OCF, including performance fees, last year was 0.82%.

The ex performance fee OCF of 0.78% compares with the simple average of the AIC Global peer group of 0.63%. Witan has a KID RIY of 1.73%, including interest and transaction costs, relative to the sector simple average of 1.33%. Historic performance fees of 0.03% are included in Witan's figure. It is worth noting that calculation methodologies can vary and that this figure also includes the look-through KID RIY figures of the private equity funds held in the direct holding's portfolio, not to mention the cost of Witan's gearing, which over time has been additive to returns net of costs.

ESG

Sustainability is ascending the agenda for many investors, and Witan is no exception. The executive team seek to incorporate ESG and sustainability into their portfolio in two ways. Firstly, the executive team are making investments directly into themes that reflect their observation that reaching net-zero is key to the long-term sustainability of the planet. Witan has had exposure to GMO's Climate Change strategy (to which it recently added exposure), as well as the listed VH Global Sustainable

Energy. Alongside this, the team indirectly influence the portfolio by only allocating to managers who they believe are properly considering ESG issues in their analysis of investments. All of Witan's managers are signatories to the UNPRI.

With both these approaches – direct and indirect - rather than being exclusionary, the executive team believe a more practical and real-world approach is required. The portfolio contains a number of clean energy companies, but the team also expect to own companies that may not 'score' well on backward-looking ESG metrics but are an integral part of the solution to whichever issue is being addressed. These companies produce materials, components or technologies which are essential to the transition to net-zero. Some holdings which fall into this category include BlackRock World Mining Investment Trust, Freeport-McMoRan, ArcelorMittal, Safran and Smurfit Kappa. These companies are significant contributors to the portfolio's current carbon footprint, and the executive team, therefore, look for evidence of long-term positive impact and that ongoing engagement is leading to improvements in operational efficiency and social awareness.

Witan sees itself as a responsible investor and believes that "investing in well-managed companies with sustainable, growing businesses is the foundation for achieving good returns for shareholders as well as for a better future for the planet and its people". As such, Witan became a signatory to the UN's Principles of Responsible Investment (PRI) in February 2020, and all of Witan's underlying managers are also signatories to the UNPRI.

According to Morningstar, Witan's current portfolio (on a look-through basis) scores "below average" on their Sustainability Rating when compared to the "Global Equity Large Cap" peer group, albeit on only 93% of the portfolio having been covered by Morningstar's analysis. In our view, this score does no justice to the clear efforts the team are making to ensure that the portfolio is invested in companies that are behaving responsibly and encourages managers to engage with companies that fall short on Environmental, Social or Governance issues. As such, we continue to believe Witan qualifies as a potential investment for investors who want a responsible, ESG aware manager, although it is unlikely to qualify for sustainability purists.

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