Witan

2023 has, so far, seen a return to outperformance, but the discount remains wide by historical standards…

Update
19 July 2023

Overview

Witan Investment Trust (WTAN) is a simple-to-understand one-stop shop for investors wanting an intelligently put-together global equity exposure. By allocating to a range of different managers, WTAN's in-house executive team look to provide an all-weather exposure, capable of good performance through the cycle. For some time now, WTAN has been managed with a strong emphasis on responsible investment (see **ESG section**).

Underlying investment decisions for WTAN are taken by a roster of third-party investment managers (see **Portfolio section**), each running a segregated account. This enables continuous dialogue with underlying managers, enabling the executive team to monitor performance, not to mention progress towards WTAN being 100%-invested in sustainable businesses by 2030 or earlier. The executive team aim for WTAN to be a long-term partner for managers, but the team do trim or add to allocations or, less often, make wholesale changes.

Within the core manager line-up, WTAN has 10% (+/-5%) invested in UK managers, reflecting the UK bias of WTAN's retail investors. WTAN's benchmark is a composite of 85% of the MSCI ACWI Index and 15% of the MSCI UK Investable Market Index. This differs from WTAN's multi-manager investment trust peers, which have purely global equity benchmarks. Approximately 25% of the portfolio is invested within the specialist managers and strategies, aiming to add to risk-adjusted returns through superior and often uncorrelated returns. When combined, WTAN's portfolio is highly diversified and the active share is high, standing at 79%, as at 30/06/2023.

Investors in WTAN should expect the trust to be geared, with 10% seen as a neutral level. WTAN has now delivered 48 years of consecutive dividend increases. This puts it firmly amongst the leaders of the AIC's 'Dividend Heroes' and the shares yield 2.6%.

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Analyst's View

WTAN's in-house executive team is aligned fully with shareholders and their considered and thoughtful approach to allocating capital is exemplified by their approach to sustainable investing (see **ESG section**). That said, a high active share means that the portfolio can behave very differently to the benchmark and peers, and the NAV may well underperform at times. Whilst WTAN has outperformed over one and three years, it has struggled over a five-year period thanks to several one-off factors (see **Performance section**) that have hindered relative performance against benchmarks. That said, the comparison with the AIC Global peer group is perhaps more indicative. On this basis, WTAN's NAV has delivered a reasonable degree of outperformance of the peer group's weighted average return.

Gearing and WTAN's unique portfolio set-up tends to expose investors to slightly higher volatility than global equities' ETFs. The trust's underperformance during 2022 does not, in our view, signify any fundamental issues with Witan's process or manager line-up, and the NAV performance so far during 2023 gives cause for optimism. As such, for investors willing to take a long-term view, WTAN represents a unique one-stop shop for global equity investors and the discount of 9.2% is considerably wider than the five-year average of 5.8%. With the board remaining committed to reducing the discount over time, evidenced by buyback activity continuing, investors may see the current discount as an opportunity..

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 compared to other global trusts
A reliable dividend, progressively growing for the past 48 years

BEAR
Structurally higher exposure to UK than many global peers means this could influence relative performance
Poor performance in H1 2020 and H1 2022 means long-term track record has been affected
Gearing can exacerbate the downside

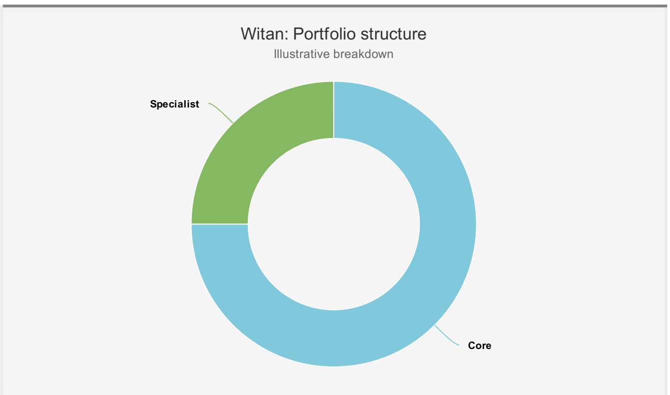
Portfolio

The managers of Witan (WTAN) have constructed the trust as a simple-to-understand, one-stop shop for investors wanting an intelligently put-together global equity exposure. By allocating to a range of different managers, the executive team who run the trust, of which more below, look to provide an all-weather exposure capable of good performance through the cycle. Despite its great age, the trust having been launched in 1909 and now with a 48-year track record of unbroken dividend increases (see **Dividend**), WTAN is at the forefront of developments within the investment management industry. For some time now, it has been managed with a strong emphasis on responsible investment (see **ESG section** for more detail).

The executive team, comprising Andrew Bell, James Hart and the independent board, select and monitor a roster of third-party investment managers. Each of these runs a segregated account for WTAN, providing transparency on holdings and activity to the team. This enables them to have a continuous dialogue with the management teams, and monitor performance, as well as follow the progress of each manager towards being 100%-invested in sustainable businesses by 2030 or earlier. The team aim to be a long-term partner for the managers they invest with. That said, the team do make changes periodically, either trimming or adding within the existing line-up, or making wholesale changes.

The overall framework of the multi-manager strategy is to invest around 75% of the trust's assets with core managers and 25% with specialist managers. Within the core managers, the team expect to have around 10% (+/-5%) invested in UK managers, reflecting the UK bias of the many retail investors who make up the majority of WTAN's share register. WTAN's benchmark is a composite of 85% of the MSCI ACWI Index and 15% of the MSCI UK Investable Market Index. This differs from WTAN's multi-manager investment trust peers, such as Alliance Trust (ATST) and F&C Investment Trust (FCIT), which have purely global-equity benchmarks. Within the specialist manager allocation, the executive team aim to provide exposure to attractive investment opportunities which fall outside the remit of most mainstream fund managers. In particular, the specialist portfolio aims to add to risk-adjusted returns through superior, and often uncorrelated, returns.

Fig.1: Portfolio Structure

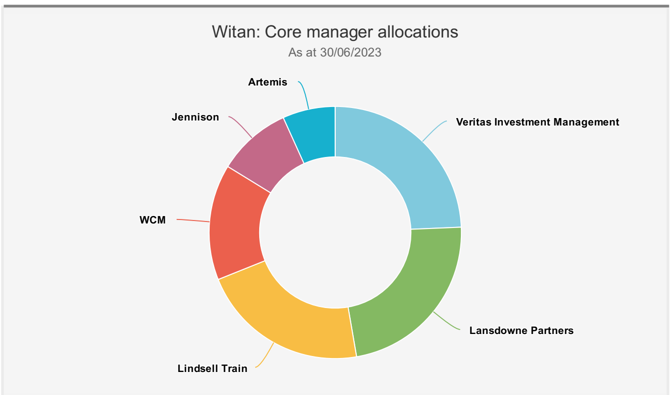


Source: Witan, as at 30/06/2023

We show below the current breakdown of the core portfolio. Each of the managers, other than Artemis, which represents the UK exposure, invests globally. These investments are predominantly in high-quality large and mid-sized companies. Managers are selected for the long term, to provide a range of different approaches and styles. The most recent additions to the core manager line-up were Jennison and WCM, made during 2020. Both are growth managers, so recognising that valuations were relatively extended in their areas of the market, the executive team did not at the time allocate a full weighting to each. Subsequently, they have allocated more capital. Jennison, in particular, had a challenging time during 2022. However, the team continued to build up exposure, a decision which has been more than justified by Jennison's strong outperformance during 2023.

Artemis provide a significant part of the UK exposure, although we understand that global managers have been taking advantage of lower valuations by adding to exposure to the UK market. Lansdowne, in particular, are very bullish on their UK companies, which they see as being at historically low valuations. WTAN's overall 18% exposure to UK equities represents a marginal overweight compared to the composite benchmark and a significant overweight relative to peers, such as ATST and FCIT. Artemis tend to favour mid-cap companies and have had an underweight exposure to the oil and gas sector. Both of these factors have meant that they struggled in performance terms in 2022, although their performance in 2023 has been more encouraging.

Fig.2: Core Managers



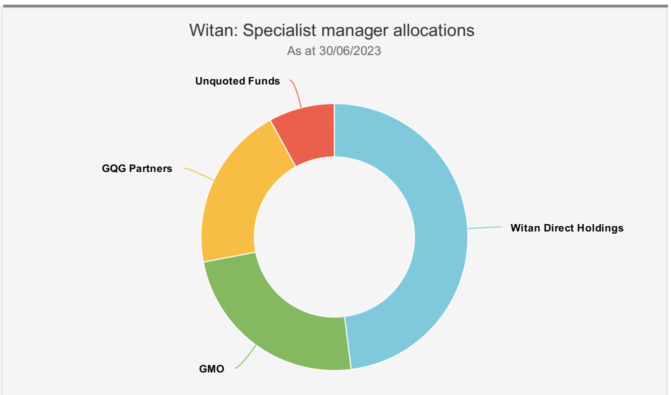
Source: Witan

The specialist manager allocation can be seen in the chart below. Within this allocation, the executive team may invest up to 15% of NAV in funds and other investment trusts. These are principally chosen because of their underlying exposure, but discounts can also be part of the investment thesis. That said, the widening out of discounts can mean a headwind for WTAN during periods of risk aversion, such as we have seen over the past 12 months or so. This has led to the contribution to returns from investment trust exposures reducing over the short term. However, the team remain confident, not only in the long-term prospects for their exposures, but also that over time, discounts will narrow once again.

Currently, WTAN's specialist allocation includes exposure to emerging markets (GQG Partners), a climate change strategy (GMO), private equity, commercial property and life sciences. Private equity exposure is represented by three listed private equity trusts, namely Apax Global Alpha, Princess Private Equity and HarbourVest Global Private Equity. The team continue to look favourably on the asset class and see the wider discounts that trusts in the sector are trading at as an opportunity. The team note that within the private equity exposures, they are not materially exposed to highly leveraged buyouts or venture-type investments that still need significant funding.

Within life sciences, the team have a long-running holding in Syncona, an exposure which was significantly reduced when the shares were trading at a significant premium to NAV in 2021. The Witan team remain favourably disposed to the sector, particularly given the low valuations that public markets ascribe to life science companies. They note with interest that Syncona recently took Applied Genetic Technologies Corporation, a previously Nasdaq-listed company, private. Elsewhere, WTAN holds an equally weighted S&P Biotech ETF, representing a view on quoted company valuations in the sector, and Biotech Growth Trust (BIOG).

Fig.3: Specialist Managers



Source: Witan

In our view, Witan's specialist portfolio exposure illustrates the benefit of having an in-house team who are focussed solely on WTAN, as a client, and are thinking for the long term. Volatility in markets always presents opportunities and the executive team have their finger on the pulse in being able to deploy capital when they see the potential to add positively to returns or spread risks. In **our last note**, we discussed the quick thinking that allowed the team to twice invest and then book significant capital gains from the significant sell-off and then recovery of UK government bonds during the Truss/Kwarteng debacle. With discounts across the trust sector having widened, the Witan team can add to holdings in the sector if the risk/return profile is considered to be better than is available in the equity market.

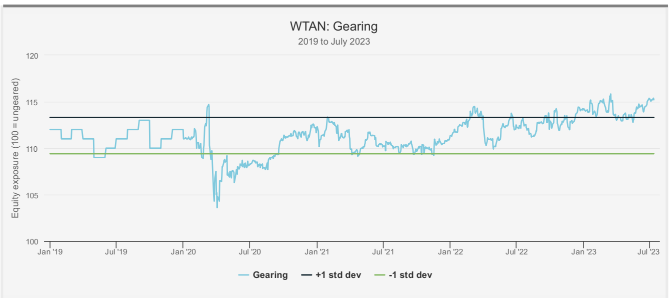
When combined, WTAN's portfolio is highly diversified and the active share is high, standing at 79%, as at 30/06/2023. Geographically, WTAN has a 38% exposure to the US, an underweight relative to the benchmark, which has over 50% US exposure. Meanwhile, 21% is invested in Europe, representing a significant overweight. A high active share means that the portfolio can behave very differently to the benchmark and peers. As such, WTAN offers investors a highly efficient way of gaining an actively managed exposure to global equities. The portfolio is very different to that of global equity ETFs and offers the potential to outperform through active management, but with no key-man risk, given the multi-manager approach. That said, **Gearing** and the unique portfolio set-up does tend to expose investors to slightly higher volatility than global equities' ETFs, as we illustrate in the **Performance section**. For investors willing to take a long-term view, WTAN represents a unique one-stop shop for global equity investors.

Gearing

In the graph below, we show that investors in WTAN should expect the trust to be geared at most points during the cycle. Indeed, the board and executive team believe that it will add to returns over the long term, although it clearly increases volatility and can impinge on returns in negative years for equity markets, given the fact that gearing amplifies losses as much as it enhances gains. Over the long run, the executive team views 10% as a neutral level of gearing, but the precise level is determined by the executive team under powers delegated by the board. The graph below shows the pattern since the start of 2019, which illustrates that gearing has, generally, remained within a relatively narrow band. We understand that the executive team will not invest to take gearing over 15%. 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.

Over time, WTAN's cost of gearing has fallen, as it repaid high-cost borrowing when loans matured. In the context of recent rises in interest rates, this activity looks extremely well timed. WTAN's fixed borrowings, totalling £155m and representing c. 10% of net assets, now have a blended average cost of only 3% and are fixed for an average of around 25 years. As such, WTAN's borrowings can be seen as highly attractive and will have certainly added to the NAV, with debt marked to market value in the last 12 months. As at 30/06/2023, WTAN was 15.3% geared, implying that it had also drawn down some of its flexible short-term borrowing facilities. WTAN has a maximum total facility of £150m available, at a margin over the interbank SONIA rate. With the BoE base rate currently at 5%, this portion of borrowing costs a little over 5.5%. The executive team believe that equity will deliver returns in excess of this level, but gearing may be reduced by either raising cash from portfolios or, in exceptional circumstances, selling index futures. Both approaches reduce the effective equity exposure of the trust.

Fig.4: Gearing



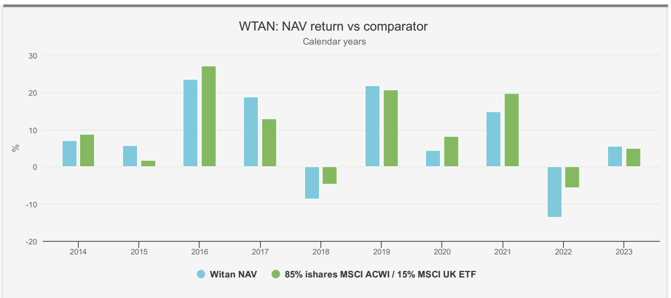
Source: Witan, Kepler Partners

Over the past ten financial years, gearing has added to returns in seven of them and detracted in three. In our view, borrowing capital to invest is a feature that investment trusts can use to potentially enhance returns. This can be seen as an advantage for long-term investors over open-ended funds, which cannot borrow and tend to hold a proportion of cash at all times.

Performance

As we highlight in the **Portfolio section**, the unique way in which the WTAN portfolio is put together ensures that risks are spread. Investors have a diversified exposure to global equities, which offers the potential for the trust to perform well at any point through the cycle. That said, WTAN has a relatively high active share, of 79%. With relatively unconstrained core managers, as well as a portfolio of complementary specialist exposures, we would expect that at times, the NAV will not closely track that of the benchmark. Since January 2020, the composite benchmark has comprised 85% of the MSCI ACWI Index and 15% of the MSCI UK Investable Market Index. The board's aim is that WTAN should outperform its benchmark on a NAV basis, i.e. after all fees and costs, by 2% per annum over the long term. Unfortunately, over ten years to the end of June 2023, WTAN is 7.1% behind the blended composite benchmark. This is a reflection of changes made to the benchmark over time, as twice in the last three years, WTAN has experienced short periods of underperformance relative to the benchmark. Both these episodes were highly unusual periods for equity markets. Performance during 2020 is a good example, when the NAV underperformed in the initial stages of the pandemic sell-off, given that WTAN was positioned for continued economic expansion. This meant that the impact of Covid-19 on markets hit the NAV hard. In 2022, Russia's invasion of Ukraine came at a time when the portfolio was, again, positioned for economic growth. This was a very challenging period for active managers generally, so it is good news that relative performance so far during 2023 sees WTAN ahead of the benchmark. As at 30/06/2023, Witan's NAV total return of 8.8% is 1.6% ahead of the benchmark's 7.2% return.

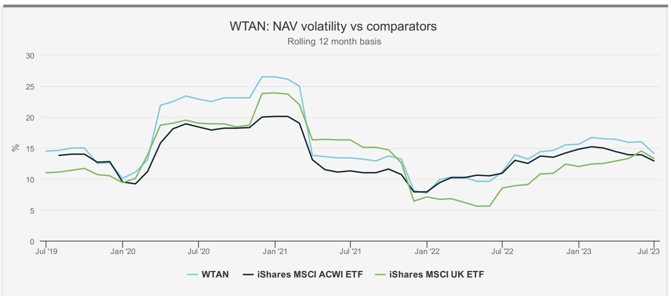
Fig.5: NAV Performance



Source: Morningstar, Kepler Partners. NB: 2023 represents performance to 11/07/2023.
Past performance is not a reliable indicator of future results.

The graph above illustrates that as an actively managed strategy, the NAV tends not to follow closely the returns of the benchmark. Our analysis suggests that WTAN's NAV tends to be consistently more volatile than world equities and the UK equity market, which we show in the graph below. We attribute this not only to the fact that the trust tends to be consistently run with gearing, but also the effect of having a highly actively managed portfolio. A small extra effect may be felt due to the exposure to other investment trusts. Over time, the managers tell us, this has added c. 2% annually to NAV returns. Over the short term,

Fig.6: NAV Volatility

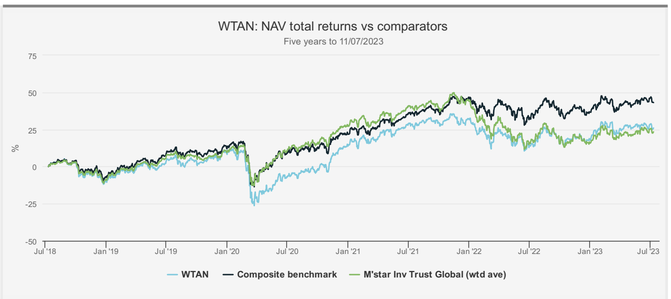


Source: Morningstar
Past performance is not a reliable indicator of future results.

however, they likely add to volatility, given the propensity for discounts to widen out during periods of market volatility, such as is the situation currently.

In the graph below, we show the five-year NAV performance compared to our estimate of the current benchmark. WTAN's underperformance relative to this benchmark is c. 17% over five years but, as we discuss above, much of this underperformance is a result of one-offs. In our view, the comparison with the AIC Global peer group weighted average is more indicative. On this basis, WTAN's NAV returns of 26% compares to the peer group average of 23.4%; a reasonable degree of outperformance. This, as well as the strong relative performance so far this calendar year, means the trust's underperformance during 2022 does not, in our view, signify any fundamental issues with Witan's process or manager line-up.

Fig.7: NAV Performance



Source: Morningstar, Kepler Partners

Past performance is not a reliable indicator of future results.

Dividend

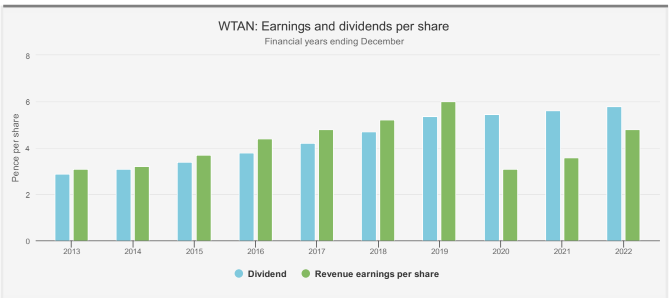
WTAN's dividend is one of its salient features for investors, but not necessarily in terms of its extent, with the current dividend yield being 2.6%. Rather, more that it has now delivered 48 years of consecutive dividend increases. This puts it firmly amongst the leaders of the AIC's 'Dividend Heroes', which gives investors a reasonable degree of confidence that dividend growth in the future will continue to be a feature. The board's policy is to grow the dividend ahead of inflation each year, which in some years sees revenue reserves used to support the dividend. As the graph below shows, the board has been supporting the dividend with revenue reserves since the 2020 financial year. 2020 was impacted significantly by Covid, of course, but in January 2020, WTAN changed its benchmark. This prompted changes to the portfolio, which in any event meant a lower-yielding portfolio.

Progress in rebuilding the earnings' profile of the trust since then has been impressive and, over 2022, the EPS grew by 35%. Part of this was a result of shifts in the portfolio, with underlying managers selling out of unprofitable, non-dividend-paying stocks, and in part due to strong earnings growth from dividend-paying constituents. At the time of the 2022 results, the board stated that it anticipates dividend cover improving in coming years, alongside continued annual dividend growth. As at 31/12/2022, revenue reserves stood at 0.8x the full-year dividend, providing plenty of firepower for the board to continue to support the dividend as earnings recover.

Over the past ten years, dividend growth has averaged 8.2% per annum, compared with a 2.7% per annum rise in UK CPI. The graph below shows that the pace of increase has moderated, whilst the dividend has been uncovered. Until the dividend is once again covered, we would expect relatively modest increases in the dividend. However, we would hope that once covered, WTAN could once again match or exceed inflation.

Interim dividends are paid quarterly in June, September and December, with a final balancing payment for the financial year, ending December, paid in March. At the current share price, WTAN yields 2.6% on an historical basis. This compares positively with the simple average yield of its peers, i.e. 1.9%, according to JPMorgan Cazenove. WTAN's track record of dividend increases and the extent of WTAN's reserves should, in our view, give confidence to investors about the long-term dividend trajectory into the future.

Fig.8: Dividends



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

Management

The managers of WTAN employ a multi-manager approach, using a range of third-party managers who invest through highly-active, concentrated portfolios. In total, WTAN currently has eight underlying managers, as well as other smaller exposures, including a number of investment trusts – see the **Portfolio section** for more details. The selection of managers, and overall asset allocation, is overseen by WTAN's executive team, led by Andrew Bell. He became CEO in 2010 and sits on the board of directors, and is supported by James Hart.

When selecting managers, the executive team aim to narrow down the field of potential new managers if the decision has been made to change any. Then they propose to the board those that they would be happy to have in the portfolio. Subsequently, the board participates in an interview process and, in consultation with the executive team, decides on appointments.

Willis Towers Watson (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 (ATST), which employs WTW to manage the selection process on a fully discretionary basis. This independent decision-making process allows the managers of WTAN to choose from the widest possible range of managers, as it is rarely constrained by managers' capacity limitations or other issues facing larger institutional investors.

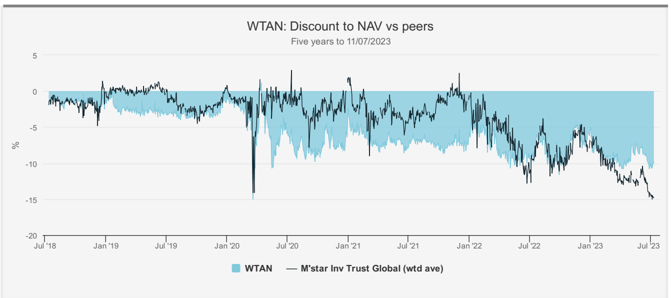
Discount

During 2016 and 2017, WTAN was trading at a premium to NAV and was issuing shares. The graph below shows that, since then, WTAN's shares have suffered a progressive derating. However, from trading at a discount to the peer group average, it is now trading at a premium to the weighted average. The board has a target of maintaining the share price at a 'sustainable low discount or a premium' and they have been very active in buying shares back. Certainly, investor appetites now for global trusts are very far from what they were back in 2020, so it is credit to the board that it has continued to buy shares back. The fact that WTAN now trades at a premium to the average of the peer group is perhaps a mark of the board's success. Over the longer term, we understand it remains the board's ambition to see the shares trade at a narrower discount over time.

In stemming the discount, the board has been very active in buying shares back. For the last financial year, the board bought back 58.2 million shares, representing 7.9% of the total at the start of the year, at an average 7.8% discount to NAV. This activity resulted in an uplift to NAV of £10.9 million, or 1.6p per share. For perspective, this sum exceeds the investment management fees paid to WTAN's external managers, offsetting the majority of the trust's ongoing charges in the last financial year. The board has continued to repurchase shares this year, which in the same way as last year will be additive to NAV.

At the time of writing, the discount to NAV stands at 9.2%, which is considerably wider than the five-year average of 5.8%. With the board remaining committed to reducing the discount over time, as evidenced by buyback activity continuing, longer-term investors may continue to see the current level of the discount as an opportunity. That said, the peer group average discount, on a simple and weighted basis, is currently wider than that of WTAN. Over the short term, there are no guarantees that the discount will not widen further if investor appetites become yet more cautious. In the medium term, we believe that if confidence returns to markets, WTAN's unique attractions could see the discount narrow once again on a sustained basis, providing a useful accelerant to NAV returns.

Fig.9: Discount



Source: Morningstar

Charges

WTAN had an OCF of 0.77% for the last financial year, ending 30/12/2022, with the weighted average of management fees payable to the roster of underlying managers at 0.51%. The balance is made up of the other expenses of running the trust, including the executive team. Witan does not charge an additional management fee. Witan's team's aim is to use its large size of assets under management as a negotiating factor with managers, enabling it to pay less than the publicly available funds that these managers run. The base fee rates for managers in place at the end of 2021 ranged from 0.28% to 0.65% per annum. The team negotiated a 15% reduction in fee for one of the incumbent managers during the year and the team actively engages with managers on an ongoing basis to ensure the lowest possible rates are charged. Most of the fee structures incorporate a taper, whereby the average fee rate reduces as the portfolio grows. The board aims to reduce costs over time. In 2021, the OCF was reduced by 9%, but we imagine the decline in the asset base, as a result of investment performance during 2022 and buybacks (see **Discount section**), has resulted in the OCF increasing during 2022. Only one of the managers is paid a performance fee, which was not triggered during 2022.

The OCF of 0.77% compares with the simple average of the AIC Global peer group of 0.76%. WTAN has a KID RIY of 1.9%, as at 16/05/2023. It is worth noting that calculation methodologies can vary and that this figure also includes the look-through KID RIY figure, i.e. 0.42%, of the specialist trusts held in the direct holdings' portfolio, although NAV and share price performance of these trusts is clearly net of these costs.

In our view, whilst higher than those of many single manager trusts, WTAN's OCF is not out of line with what one might expect for a multi-manager trust, which clearly has significantly lower key-man risks and very significant portfolio diversification. Also, it is worth noting that the contribution from buyback activity continues to be additive to WTAN's NAV. For example, during the last financial year, buybacks added 1.6p to NAV, whilst costs overall detracted 2.1p. Whilst the contribution from buybacks is unlikely to be sustained year on year, shareholders have, effectively, had a meaningful dent taken out of WTAN's overall costs as a result of the board's buyback activities.

ESG

As we highlighted in the **Portfolio section**, for some time now, WTAN has been managed with a strong emphasis on responsible investment. The managers seek to set the trust's stall out to be aligned with investors who care about the challenges we all face in terms of living more sustainable lives, whilst minimising our contribution to climate change. One of the distinguishing features of WTAN is its in-house executive team (see **Management section**), who have a sole focus and unconflicted mandate to pursue whatever is in WTAN's shareholders' best interests. WTAN's board and executive team believe that businesses that are well-run, incorporate resilient business practices and have sustainable cash flows will perform better than companies which are at risk of disruption, litigation, regulation or loss of business because of poor ESG practices.

As a result, Witan is taking active steps to embrace ESG, but as one might expect from having an in-house team, WTAN's approach towards embedding ESG is entirely unique and bespoke. WTAN itself became a signatory to the Net Zero Asset Managers (NZAM) initiative in early 2022, but it has also set a target to have a portfolio which consists entirely of sustainable businesses by 2030. This does not impose blanket exclusions on the underlying managers, but seeks to identify where companies are failing to take action to become more sustainable businesses over time. WTAN engages with its managers on a regular basis on ESG and other investment matters. In turn, they are encouraged to engage with companies which fall short of ESG expectations. Managers who do not take these responsibilities seriously will be unlikely to manage money on behalf of WTAN shareholders. Four out of eight delegated managers have committed to the NZAM, and all of WTAN's delegated managers are signatories to the UNPRI.

In understanding how each portfolio company is interpreting and integrating ESG considerations into their management process, WTAN's executive team created a detailed questionnaire on each sub-portfolio for the respective managers to complete. This survey generated valuable insights for the team into how each of the managers, as well as underlying portfolio companies, approach ESG issues. It also created a baseline from which WTAN's sustainability performance can be measured. The full explanation of the approach and the initial results of last year's survey can be found in the detailed responsible investment policy section of the annual report, which can be found **here**.

Underpinning everything is a practical and real-world application of ESG ideas, and the team aim to focus primarily on where the team and the underlying managers can have the biggest positive impact: the characteristics of investment portfolios and engagement with the companies within them. The approach is adaptable and underpinned by the belief that capital allocation and engagement have a more positive long-term impact than an exclusionary approach. The executive team recognise that key to their success will be engaging with their external fund managers, who manage 85% of the portfolio. Not only is it their role to invest WTAN's capital, but they must also identify any issues at investee companies and engage accordingly. As the ultimate allocator of capital to businesses, WTAN can help accelerate the transition to a more sustainable economy and, ultimately, improve returns for investors.

WTAN's executive team also have direct responsibility for elements of the portfolio, and sustainability considerations are also shaping these parts of the portfolio. For example, WTAN is invested in GMO's Climate Change strategy, as well as the listed VH Global Sustainable Energy. According to Morningstar, WTAN's portfolio scores 'average' on their Sustainability Rating when compared to the Global Equity Large Cap peer group. This score excludes the investment trust portfolio, most of which is not rated by Morningstar. In our view, this score does no justice to the clear efforts that the team are making to ensure that the portfolio is invested in companies which are behaving responsibly, and their encouragement for managers to engage with companies that fall short on Environmental, Social or Governance issues. As such, we continue to believe that WTAN 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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