Witan

WTAN has had a challenging 2020, but a refreshed line-up of managers makes the 7.8% discount potentially attractive...

Update
04 September 2020

Summary

Witan aims to provide investors with a 'one-stop shop' for an actively managed exposure to global equities. The trust invests with a range of third-party managers who select concentrated portfolios. This approach means that shareholders can benefit from diversification and active management, but with less key-man or manager risk.

The selection of these managers is overseen by Witan's executive team. These underlying managers run high conviction portfolios, which means that the trust's overall exposure may be quite different from its benchmark. Managers employ different strategies, with some being highly adaptable, to minimise the need to change them over time. However 2020 has been challenging for investors, and the executive team have made an unusually high number of changes to the portfolio.

These changes represent around a third of the portfolio, and represent the first substantial changes since 2017. Overall these changes significantly reduce the trust's exposure to 'value', while increasing the exposure – and reducing the underweight relative to the benchmark – to the US. It also represents a change in thinking: that global portfolios, rather than geographic specialists, are now more likely to deliver the best results going forward.

Witan employs structural gearing, historically at around 10% of NAV. Over the last six months Witan has been making adjustments to bring interest costs down and increase flexibility. The current gearing at 9% reflects the relatively cautious optimism of the team.

At the current share price, Witan yields 3% and has increased its dividend every consecutive year for 45 years. The board notes that revenue earnings per share in 2020 are likely to be around half of the 2019 level, but that they expect to use reserves so that shareholders will see continued dividend growth in 2020.

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Analyst's View

Witan has a strong track record against global equities since it adopted a manager of managers approach. However 2020 has been a poor year so far for Witan. Our analysis shows that the underperformance was very much concentrated in Q1 and represents a number of one-off factors – see **Performance**. Since then the NAV has seen marginal outperformance of the benchmark, giving grounds for optimism. The board and executive team have made some decisive changes, designed to set the trust back on track towards outperformance once again – as examined in **Portfolio**.

Currently Witan trades at a discount of 7.8%, which is wider than the one year average of 4.4% and the sector weighted average discount currently of 2.9%. Should the trust regain its poise in performance terms, as we discuss under **Discount**, there is potential for the discount to narrow once again.

In the current uncertain outlook for dividend income, the board's statement on Witan's dividend is reassuring. At 3%, based on last year's dividend level, it will likely prove attractive relative to many other income stocks.

For us Witan continues to be one of the more attractive investment vehicles for long-term investors, searching for an actively managed equity global portfolio for both capital appreciation and income. The board remain engaged in protecting discount volatility on the downside. Furthermore, with net assets of £1.7bn, Witan is a long way from being constrained in how many shares it is able to buy back. Yet the current discount remains wider than historic averages and could prove to be an opportune entry point.

BULL
Manager of managers approach means that investors can benefit from a diversified array of concentrated portfolios
Refreshed roster of managers, with an increasingly global approach
A reliable dividend, progressively growing for the past 45 years

BEAR
Witan may lack appeal for investors who want to do their own asset allocation
Poor performance so far in 2020
Gearing can exacerbate the downside

Portfolio

Witan aims to provide investors with a 'one-stop shop' for investors looking for an actively managed exposure to global equities. It has a long heritage, also reflected in it being one of the AIC's dividend heroes, and since 2004 has followed a 'manager of managers' approach. The trust invests with a range of third-party managers who hold concentrated portfolios of their best ideas. This approach means that shareholders can benefit from diversification and active management, but with reduced key-man or manager risk.

Over time Witan's roster of managers is likely to number between eight to 12 at any given time. The selection of these managers is overseen by Witan's executive team lead by Andrew Bell, about which more later. Andrew believes that over short to medium-term time frames there should low turnover in managers. Investment decisions at the underlying level, made through the underlying highly active managers, mean that the trust's exposure will be dynamic and adapt to the investment environment as circumstances change. However 2020 has revealed challenges facing many investors, and Witan's executive team has been making an unusually high number of changes to the manager roster to adapt to the investment environment.

Having changed the trust's benchmark, as of 1st January 2020, to reflect a more international exposure – 85% MSCI ACWI, and 15% MSCI UK Investable Market Index – the executive team decided to make moderate, gradual changes to the portfolio to reflect this, rather than make a rapid switch as of that date. In hindsight Witan was not positioned well for what was to come: considering the portfolio was suddenly significantly underweight the US, and overweight the UK relative to the new benchmark on 1st January. The COVID-19 market selloff has prompted, but also brought forward, some changes to the manager line-up in funds representing around a third of the portfolio. We understand that these changes have been fully implemented at the time of writing, at the end of August 2020.

The graph below shows the reported portfolio allocations to managers as at 30/06/20, but also an illustrative allocation of how the portfolio sits now the agreed changes have been made. The changes come on the back of the executive team's earlier decision to exit their investments with two European managers and a US-based global value manager, with proceeds reallocated to global managers.

In our view Witan certainly qualifies as a potential investment for investors who want an ESG aware manager. We look forward to the specific ESG progress report which the managers have undertaken to include in this year's annual report.

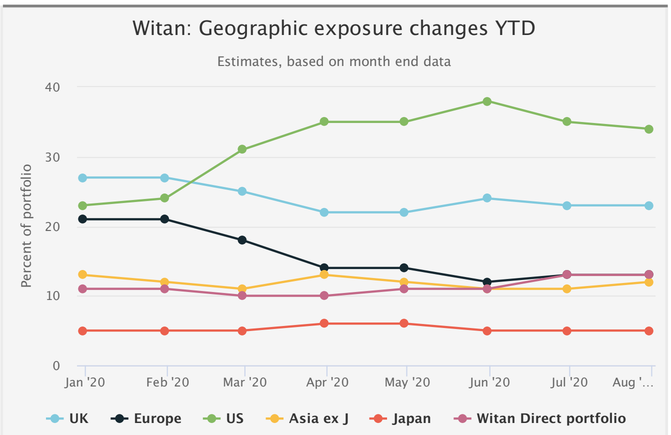
Summary Of Changes To Portfolio Currently In Process

MANAGER	GEOGRAPHIC AREA	STYLE	% AS AT 30-06-20	INDICATIVE % AS AT END OF AUGUST 20	CHANGE %
Veritas Investment Management	Global	Fundamental value, real return objective	20	20.1	0
Lansdowne Partners	Global	Global developed markets	18	18.0	0
Lindsell Train	Global	Long-term Growth	15	14.7	0
Vanguard S&P 500 ETF	US	ETF	10		-10
Witan Direct Holdings	Direct	Specialist funds	10	10.0	0.1
WCM	Global	Quality Growth		9.5	9.5
Artemis	UK	Recovery / Special solutions	7	7.0	0.5
Matthews Asia	Asia	Quality dividend paying companies	6	6.0	-0.3
GQG Partners	Emerging Markets	Quality at a reasonable price	6	6.0	0.1
Jennison Associates	Global	High Growth businesses		4.5	4.5
Latitude Investment Management	Global	Global 'best in class' businesses	3	3.0	-0.1
Heronbridge Investment Management	UK	Long-term value	3	0.0	-2.9
GMO	Climate change	Companies addressing climate change	3	3.0	0.3

Source: Witan, Kepler Partners LLP

The effect of these changes has been to significantly reduce the exposure to 'value' as an investment style, but also increase the exposure – and reduce the underweight relative to the benchmark – to the US. The graph below shows the indicative look-through geographic exposure of the trust, excluding the Witan Direct portfolio, over time. This strategy has brought the trust closer to the benchmark's weighting, although Witan remains underweight the US by 13% relative to the new benchmark, and overweight to the UK (+5%), Europe (+4%) and Asia (+3%).

Fig.1: Geographic Exposure Over Time



Source: Witan

The new managers, both based in the US, represent a belief by Witan that value managers might continue to struggle over the long term. Both WCM and Jennison Associates are global growth managers. WCM has more of a quality growth bias; investing in companies that they believe have growing competitive advantages, strong corporate cultures and solid balance sheets. Jennison on the other hand are more 'growthy', and look for innovative business which are creating structural changes in the industries they operate in. These accounts were funded by the sale of the S&P500 ETF and the closure of the UK mandate managed by Heronbridge Investment Management.

These changes represent significant activity, relative to the history of Witan as a 'manager of managers', and represents a change in thinking that global portfolios rather than geographic specialists are likely to deliver the best results going forward – also reflected in the changed benchmark. As a result in the future the team expect that around two thirds (65%, +/- 5%) of the portfolio will be invested by global managers. Of the remainder 10% (+/- 5%) will be invested by UK focused managers, and 10-15% through "specialist or newly established managers". Latitude Financial (based in London) represents a manager in the 'relatively new' camp. While the GMO strategy is specialist, targeting companies that are expected to benefit from efforts to curb or mitigate the effects of climate change. Other areas the team believe could qualify in this area include biotechnology and information technology. But they are likely to only include areas that the team believe have strong secular growth trends for a number of years.

A unique feature of Witan is that up to 10% is invested through the Witan Direct portfolio, which represents investments made by the executive team in other investment trusts. These trusts are those deemed attractive investments in their own right, usually within a relatively specialist area, and perhaps with a discount kicker if the team get their timing right. One example is the holding in **BlackRock World Mining Trust (BRWM)**, which the team first bought over five years ago and averaged down during 2015. Whilst the discount has not narrowed significantly, the share price performance has been strong with an average 'in price' of around 200p: BRWM currently trades in excess of 400p. **Listed private equity** trusts have formed the backbone of this part of the portfolio for quite some time; held both for the strong returns achievable by the managers, but also for the attractions of discounts narrowing. The team report that they have added to holdings in Princess Private Equity, Apax Global Alpha and BRWM earlier in the year, although the overall allocation within Witan's portfolio is unlikely to ever rise above 10%. In our view this part of the portfolio is a definite differentiator, considering the specific expertise that Andrew Bell and James Hart have in the sector, and gives investors exposure to areas unlikely to be looked at by other multi-manager funds.

Going forward the team believe that they will continue to invest with pragmatic highly active managers, but with less exposure to the stronger stylistic value end of the spectrum. The team will continue to look to identify those that have the capabilities and track record to outperform their relevant benchmarks. Each manager will be expected to run a concentrated portfolio, with investment decisions being made based on fundamental drivers as opposed to short-term trends. Alongside this focused process, the managers need to exhibit talented and accountable leadership, a clear process, high standards of corporate governance (see **ESG section**) and have generally long-term outlooks.

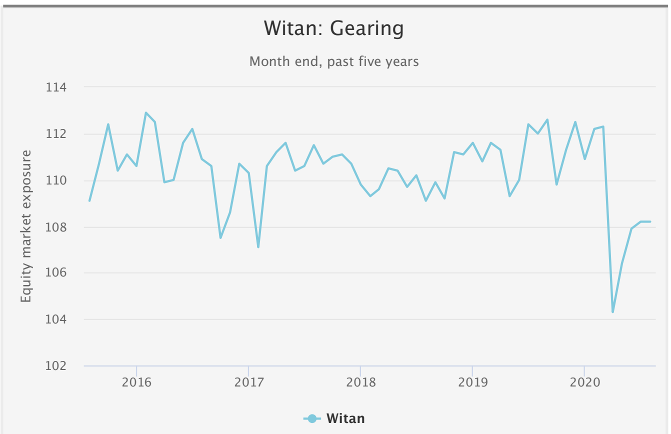
Gearing

Witan employs structural gearing to enhance returns for shareholders, which has historically been at around 10% of NAV. 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. Within these perimeters the level of gearing at any one point is the decision of Chief Executive Andrew Bell, with input from the board.

Gearing was an overall detractor to performance during the first half of 2020. Witan started the year with gearing of 11%, as the graph below shows, but this was reduced to 4% in the exceptionally volatile conditions in March. With the outlook appearing very poor the team withdrew their horns by raising cash levels significantly, to reflect the unusually volatile conditions in the early stages of the lockdown. As markets stabilised and the picture became somewhat clearer, gearing was reapplied.

Simultaneously Witan has been making adjustments to its structural gearing, to bring the interest cost down and increase flexibility. The high coupon 6.125% 2025 secured bond was repaid during May: with an upfront payment of capital and a near equivalent saving in interest costs until 2025, meaning that the net cost is relatively small. As a result Witan now has fixed rate borrowings of £155m, equivalent to 9.2% of NAV, paying a blended interest rate of 3%. On top of this the trust also has £100m of flexible credit facilities to increase gearing if desired. As is the case currently with gearing at 9% reflecting the relatively cautious optimism of the team, Witan holds cash to offset the effects of structural borrowings.

Fig.2: Gearing



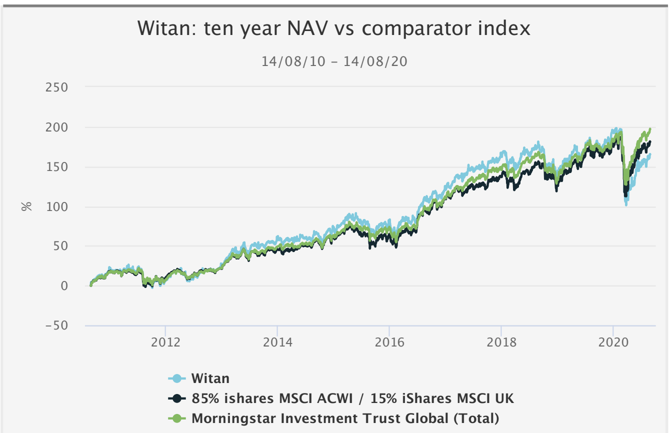
Source: Morningstar

Performance

For a large part of the last ten years, up to August 2020, Witan has achieved its goal of outperforming its composite benchmark, and raising the dividend significantly faster than the rate of inflation. As we discuss in the **Dividend section**, the board remains as resolutely determined to continue to achieve the strong record of dividend growth. However 2020 has seen Witan give back performance. The board and executive team, as is examined in **Portfolio**, have made a number of changes designed to set the trust back on track, towards their aim of outperformance once again.

Illustrating the longer-term performance relative to the benchmark is complicated by Witan's use of a hybrid benchmark, as well as recent changes to it. Historically it has comprised of a blend of five different regional indices, but, as from 1st January 2020, this has been significantly simplified to 85% global (MSCI ACWI) and 15% UK (MSCI UK IMI). The UK weighting reflects the home-bias of the legion of private investors, who have long used Witan as a long-term savings vehicle. However the use of a global index reflects the board and manager's view that the best investment returns will be generated by active managers, with as few top down constraints – as to which geographic region they invest in – as possible. There is no requirement for the portfolio to mirror the benchmark and any change in asset allocation, either directed by Witan's executives or the underlying managers, will be driven by its prospects relative to opportunities globally. In the graph below we illustrate Witan's NAV relative to our estimate of the current blended benchmark, which has only applied since 1st January 2020, and against Morningstar's Global Investment Trust index – representing the weighted average of the peer group's NAV performance. What is clear is that, up until this year, Witan has been ahead of this benchmark but also ahead of peers.

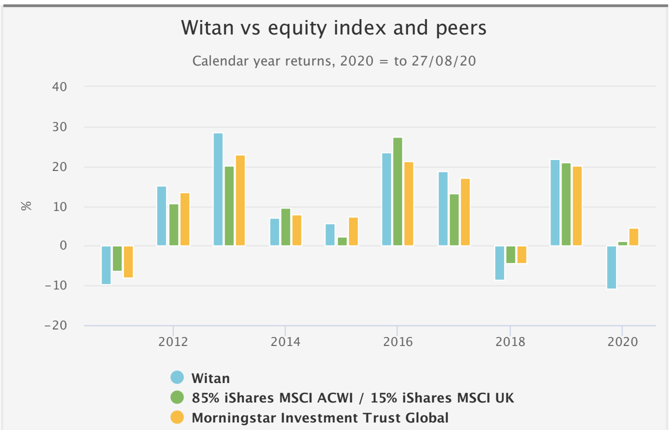
Fig.3: Ten Year Nav Performance



Source: Morningstar, Kepler Partners

As an actively managed portfolio, it is inevitable that Witan will have periods of underperformance as well as outperformance. Over the long term, we believe the

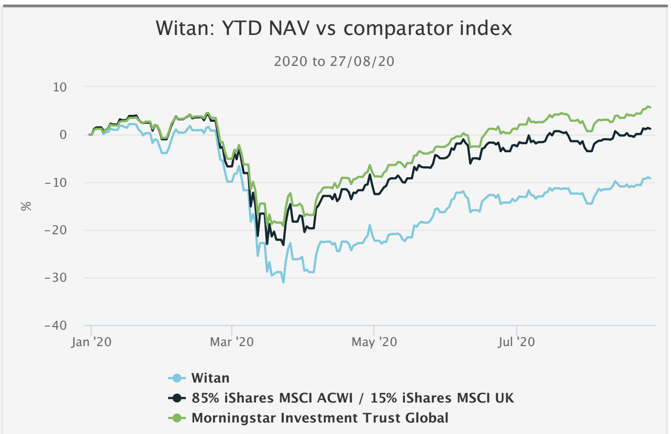
Fig.4: Calendar-Year Nav Returns



Source: Morningstar, new benchmark used for comparison manager of managers approach will ensure that the trust's managers will deliver positive value-add through the cycle. As we discuss below, the underperformance this year has been largely driven by one-off factors. Additionally, in our view, the positive trajectory of relative performance in Q2 shows that nothing is fundamentally broken in how Witan invests shareholder's capital.

As we show above and below, so far 2020 has not been a good year for Witan. However the underperformance is likely to have been exaggerated by the change to the current benchmark, because of the executive team's decision to adjust the roster of managers gradually to reflect it. Much of the underperformance has been confined to a very short period in Q1 2020. Since the start of Q2 we calculate that Witan's NAV is very marginally ahead of the blended benchmark. Over the past five years, up to 27 August 2020, Witan has delivered an NAV total return of 55.7% compared with iShares MSCI ACWI return of 91.1% and the iShares UK ETF return of 13%. The weighted average for the peer group has delivered 80% over the same period. This return is one that reflects the heavier 'growth' bias of a lot of the trusts in the sector over this period, not to mention their unfettered global benchmarks.

Fig.5: 2020 Nav Performance



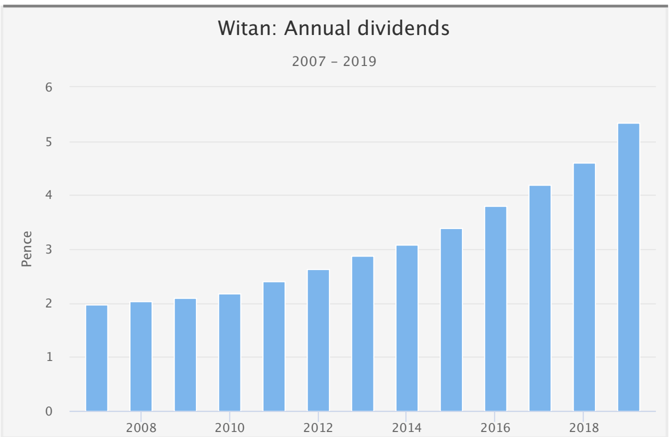
Source: Morningstar, Kepler Partners LLP

Witan's executive team believe that, outside of the tech mega-caps, there are areas of the global equity market which look attractive by long-term measures. They are optimistic that Witan's historic trajectory of outperformance can be recovered and continued, and that they can look forward to the impact of the portfolio changes made during recent months to have an effect. Should the trust regain its poise in terms of performance, as we discuss in the **Discount section**, there is potential for the discount to narrow once again, which would further add to shareholder returns from the current point.

Dividend

At the current share price Witan yields 3%. It is the board's long-standing policy each year to grow the dividend ahead of inflation. In fact Witan has increased its dividend every consecutive year for 45 years. The dividend is paid quarterly in March, June, September and December.

Fig.6: 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

In the recently published (August 2020) interim results, the board note their expectation that revenue earnings per share in 2020 are likely to be around half of the level in 2019, owing to unprecedented cuts in market dividends. Nevertheless they have restated their policy of dividend growth, and have stated they expect 2020 to see a further year of growth in dividends paid.

As of the most recent annual report in December 2019, the trust has revenue reserves of c. £71.1m – which is the equivalent of 1.5x the annual dividend. In the current financial year so far, Witan expects to pay three interim dividends of 1.34p each, with a balancing final payment as yet to be decided by the board. The board have committed to use revenue reserves to support the dividend as much as they need to, but have also noted that capital reserves are potentially available if warranted. At the same time we understand that the board will only use capital reserves to bridge a defined period, before one might reasonably expect the dividend to be covered by income receipts once again, thereby ensuring it is truly sustainable over the ultra-long term.

Management

Witan is internally managed by a team headed by Andrew Bell, who became CEO in 2010 and sits on the board of directors. There are multiple benefits to being self-managed, including the alignment of interests: there is no question of an investment decision being influenced by what is better for a management company, which may be investing in the same or similar assets elsewhere. Another benefit is that employees are wholly focused on Witan's portfolio, which is unlike other investment houses where analysts could be working for multiple clients.

Witan has a multi-manager approach, using a range of third-party managers that are investing in concentrated portfolios. Changes are expected to be relatively infrequent, but, as we discuss in the **Portfolio section**, the executive team can act fast and with conviction if they feel they need to. As at the start of September 2020 there are expected to be ten external managers, including smaller allocations to two specialist or newly established managers, not including the Witan Direct portfolio.

Managers are formally reviewed at least once a year, but are reviewed more frequently than that by the executive team. We understand the intention to be that managers are unlikely to be replaced due to short-term performance relative to their benchmarks. Instead the replacement of managers is more likely to happen in cases of unexplainable performance, investment mandate changes, or changes at the management company. The breadth of experience represented by Witan's nine board members also facilitates this process; with diverse skills being brought to the table from the likes of Ben Rogoff (current Polar Capital Technology fund manager), Paul Yates (ex-CEO of UBS Global Asset Management UK) and Gabrielle Boyle (Senior Fund Manager and Head of Research at Troy Asset Management).

Investment Managers

MANAGER	AREA	STYLE
Artemis	UK	Recovery / special situations
GMO	Climate change	Companies addressing climate change
GQG Partners	Emerging Markets	Quality at a reasonable price
Jennison Associates	Global	High Growth businesses
Lansdowne Partners	Global	Global developed markets
Latitude	Global	Global 'best in class' businesses
Lindsell Train	Global	Long-term Growth
Matthews Asia	Asia	Quality dividend paying companies
Veritas Investment Management	Global	Fundamental value, real return objective
WCM	Global	Quality Growth

Source: Witan

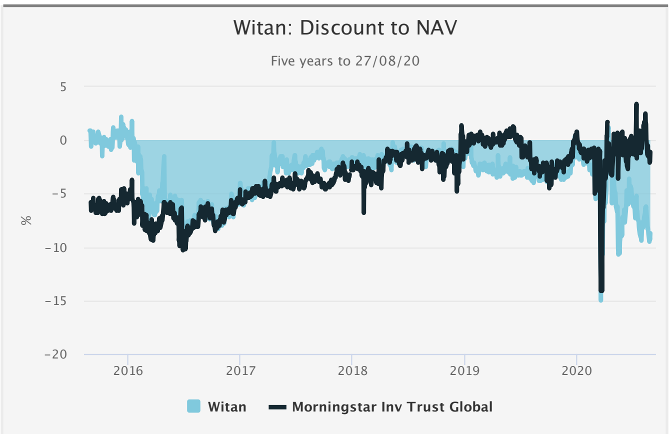
Witan is able to use its large size, including net assets of £1.7bn, to negotiate attractive fees with the managers it has selected. Up to 10% of the portfolio may be invested directly by the executive team in specialist collective funds. These funds may represent undervalued asset categories, or funds viewed as longer-term generators of superior returns – potentially, but not always, with a discount kicker. A further 10-15% may also be allocated in smaller mandates to third-party managers, where Witan believe there is strong potential to add value; which the team view as possible managers for the future or as specialists.

Discount

Over the last five years, Witan has tended to trade at a small discount to NAV. Prior to this year the only exception to this was in 2016, following the placing of shares from the former large shareholder Aviva: but this was a technical issue rather than one related to performance. However, as we discuss in the **Performance section**, Witan suffered in performance terms during the COVID-19 induced selloff in February and March 2020, which (in our view) is the main reason why the discount has not recovered alongside many of its peers. Currently the trust trades at a discount of 7.8%, wider than the one year average of 4.4% and the sector weighted average discount currently of 2.9%.

The board places great emphasis on the importance of the liquidity of the shares. Consequently it closely watches for discount-related issues, and over the past few years has made significant use of share buybacks in order to meet its objective that the shares should trade on a sustainable low discount or premium to NAV. As a result the discount widening led to the board stepping up its market purchases and in six months, up to 30 June 2020, bought back 20.5m shares (2.4% of the total) into treasury, at an average discount of 5.8%. The board continues to buy shares back at the time of writing. In previous years, and in different investment conditions, the board have bought shares back at a considerably narrower level. It therefore

Fig.7: Discount



Source: Morningstar

takes into account market conditions when setting the buyback parameters.

With net assets of £1.7bn, Witan is a long way from being constrained in how many shares it is able to buy back. Therefore, with the board remaining engaged in protecting discount volatility on the downside, the 7.8% discount is wider than historic averages and could prove to be an opportune entry point.

Charges

Witan aims to use its large size to negotiate attractive fees from the underlying managers, which are lower than those available through the publicly available funds that the managers run.

In 2019 the ongoing charges, excluding performance fees, were 0.79%, which is not far from with the peer group's simple average of 0.71%. In 2019 one of the two managers who were eligible for a performance fee earned one so, including these costs, the OCF rose to 0.87%. From the start of 2020 only one manager is eligible for a performance fee, and that manager is not currently entitled to any fee as it is below its high-water mark.

Witan has a KID RIY of 1.69%, including interest and transaction costs, relative to the sector simple average of 1.45%. 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 holdings portfolio.

ESG

Witan's ESG approach is evolving, as is the case with much of the investment world. In February 2020 Witan became a signatory to the UN's Principals of Responsible Investment (PRI). It is also now a requirement that new managers who the team select, also need to be signatories to the UNPRI. All of Witan's existing managers are signatories.

From an engagement perspective, Witan's executive team regularly review the manager's approach to ESG and ask for reports of when ESG breaches occur. The team then look into the detail of any such breaches, whether processes or stock specific, with the aim of making sure that Witan's executive team are fully satisfied that ESG is being properly taken into account, and by implication managers are not just making a 'nod' toward ESG.

As an indication of how Witan's executive team's line of thinking is heading during 2020, Witan has increased its investment in the GMO Climate Change Fund from 1% to 3% of assets. This fund seeks to outperform global equities, by investing in companies benefiting from measures to curb or mitigate the long-term effects of climate change.

In our view Witan certainly qualifies as a potential investment for investors who want an ESG aware manager. We look forward to the specific ESG progress report which the managers have undertaken to include in this year's annual report.

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