Witan

A solid period of outperformance means WTAN is back in business...

Summary

Update
07 June 2021

Witan offers investors an actively managed but diversified exposure to global equities. Since the adoption of the current 'manager of managers' approach the trust has outperformed its benchmark and delivered dividend growth well ahead of inflation. In our opinion, Witan provides the benefits of active management but with reduced key-man or manager risk.

Underlying managers are chosen by Witan's executive team to complement each other, but not necessarily to provide exposure to all 'styles' of investing. However, the overall structure of the portfolio is designed to have 'core' managers representing around 75% of the **Portfolio**. Within this, 65% is allocated to global managers and around 10% (+/- 5%) are expected to be specifically UK-focussed managers (broadly reflecting the UK component of the benchmark). The remaining specialist portfolio of 25% represents managers who the team believe have the potential to deliver superior growth through regional or sectoral expertise, but also can include direct holdings in other collective funds and trusts.

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 and led to the **Discount** widening. The executive team made some decisive changes to the portfolio. Currently, we think the underlying portfolio is well balanced, with exposure to companies with enduring cash-flows, higher growth companies, and undervalued, cyclical businesses. This helps explain the good 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. Witan currently yields 2.3% on an historic basis.

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Analyst's View

Witan had been making strong progress as an attractive way for investors to get a diversified exposure to global equities, reflected in good performance and a narrow discount prior to 2020. As was the case for many trusts, Witan was wrong-footed by the pandemic and performance suffered. However, with gearing now built back up (10% as at 30/04/2021) and the roster of managers performing strongly, we think Witan is back in business.

The changes made during 2020 can be seen as having future-proofed the manager roster in our opinion, evidenced by the fact that, despite a strong performance from value and more cyclical stocks over the past six months, the NAV has outperformed the benchmark for ten out of the past 12 months, and by c. 15% over that period.

Witan's nimble approach led by the executive team means it is relatively easy to rotate the manager roster to keep up with market events, expectations or take in new, emerging opportunities. One such example is the team's interest in sustainable investment as a way to generate excess returns, which we would expect to see grow as a proportion of the portfolio as time goes on.

Witan trades at a discount of 6.5%, wider than the five-year average of 4% and the current sector weighted average discount of 2.8%. Now that Witan is delivering outperformance again, we believe we could see the discount narrow. With the board engaged in protecting discount volatility on the downside, the current discount may prove an attractive entry point.

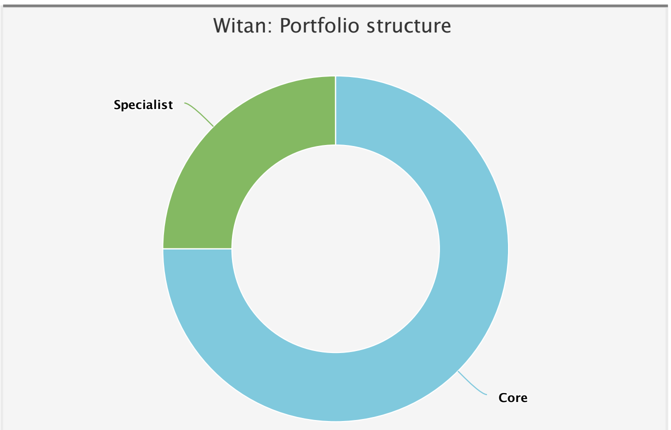
BULL
Manager of managers' approach offers diversified exposure within a clear portfolio structure
Refreshed roster of managers, with an increasingly global approach
A reliable dividend, progressively growing for the past 46 years

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 an actively managed, but diversified, exposure to global equities. The current 'manager of managers' approach was adopted in 2004, in which the trust uses its large scale to access a range of third-party managers at institutional fee rates. Since the adoption of this approach, the trust has outperformed its benchmark by 69% (source: Witan, as at end of May 2021) and delivered dividend growth ahead of inflation. At the start of 2020, Witan's board changed the benchmark from a blend of five different regional indices to a new simpler combination of 85% MSCI ACWI, and 15% MSCI UK Investable Market Index. The overall structure of the portfolio is designed to have a relatively loose framework as shown below, with 'core' managers representing around 75% of the portfolio. Within this around 10% (+/- 5%) are expected to be specifically UK-focussed managers (reflecting the UK component of the benchmark) and 65% global managers with a range of styles. The specialist portfolio of 25% represents managers whom the executive team believe have the potential to deliver superior growth through regional or sectoral expertise, but also can include direct holdings in other collective funds and trusts selected by the Witan investment team.

Fig.1: Portfolio Structure



Source: Witan

The change in the benchmark we refer to above was designed to reflect a more international exposure and a view that global managers, with their broader opportunity set, were more likely to perform better. The benchmark change meant that at a stroke, Witan saw a significant increase in the underweight exposure to the US. At the start of 2020, when the change occurred, Witan's executive team under CEO Andrew Bell judged that the market environment favoured making steady changes to the line-up of managers to reflect the new benchmark as time progressed. But as things turned out, the underweight to the US cost the trust dearly in relative performance terms when the pandemic hit equity markets and US equity markets outperformed (see **Performance section**).

As we will discuss later, Witan pressed ahead with the anticipated changes to the geographic weightings and line-up of managers, which were enacted by the end of August 2020, once the extreme volatility of Q1 2020 had subsided. Witan's underlying manager roster is likely to typically number between eight to 12 at any given time, and the current line-up can be seen in the table below. Each manager invests in a relatively concentrated portfolio of their best ideas, oversight of which is managed by the executive team. This approach, in our opinion, gives shareholders diversification and the benefits of active management, but with reduced key-man or manager risk. The managers are chosen to complement each other, but not necessarily to provide exposure to all 'styles' of investing. Over time the executive team expect most changes to the underlying portfolio to be made by the underlying managers, and only occasionally through management changes of their own. For example, the changes made in 2020 reflected the first change in the manager line-up since 2017.

Summary Of Manager Exposure

MANAGER	GEOGRAPHIC AREA	STYLE	% AS AT 30/04/2021
Lansdowne Partners	Global	Global developed markets	21
Veritas Investment Management	Global	Fundamental value, real return objective	18
Lindsell Train	Global	Long-term growth	14
Witan Direct Holdings	Direct	Specialist funds	11
WCM	Global	Quality growth	10
Artemis	UK	Recovery / Special solutions	7
GQG Partners	Emerging Markets	Quality at a reasonable price	6
Jennison	Global	High growth businesses	5
GMO	Climate change	Companies addressing climate change	3
Latitude Investment Management	Global	Global 'best in class' businesses	3
S&P 500 ETF	US	Tracker	3

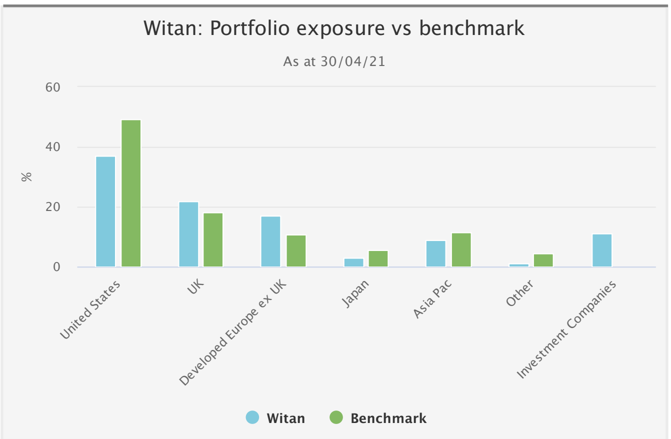
Source: Witan

Most of the managers in the portfolio have been a constituent of Witan's portfolio for many years. WCM and Jennison are the new entrants, having become part of the portfolio in August 2020, and were funded by exiting investments with two European managers, a UK manager, and a US-based global value manager. As time has progressed, the executive team have been drip feeding more capital to these new, higher growth focused, managers to bring them up towards 'full' weight. An additional, more recent change has seen an Asian manager exit with coverage of the region now provided by Global and Emerging Market managers. In addition, an S&P 500 ETF was purchased in March 2021. This is part of the stepping stone approach that the executive team have used to make swift asset allocation changes before allocating to a manager. In this case, the team wished to further reduce Witan's underweight to the US – itself a result of the global managers in the portfolio finding opportunities elsewhere. The executive team believe that, with the leadership of the US market having waned and the upcoming fiscal stimulus likely to deliver strong economic growth over the short term, it makes sense for the trust to add exposure here.

The selection of managers and overall asset allocation is overseen by Witan's executive team led by Andrew Bell 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. As we discuss in the **Management section**, 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.

Another difference between Witan and Alliance Trust can be seen in the graph below, which shows Witan's allocations relative to its benchmark. Allocations between geographies are determined by the executive team and by the underlying managers – especially those who invest globally. The portfolio isn't managed to benchmark weightings, which means that it is likely exposures will deviate from those of the benchmark, sometimes quite significantly – as is the case today. The over and underweight exposures are exaggerated by the executive team's allocation to other investment trusts (which we examine below). This part of the portfolio has 'look through' exposure to private (and some public) companies primarily domiciled (or listed) in the US, UK & Europe. That said, the underlying holdings are quite idiosyncratic, and so cannot be viewed as a market proxy. As such, we would expect Witan to have a higher tracking-error when compared to global equities than Alliance Trust. Witan's active share of 76% shows us that the portfolio is very different to the benchmark.

Fig.2: Geographic Exposure



Source: Witan

As we note above, change in benchmark and the COVID-19 market selloff prompted a radical change to the manager line-up, in total representing around a third of portfolio funds. Having an adaptable, 'manager of managers' approach enabled this, but overall we would reiterate that Witan is expected to have low turnover in managers over the medium to long term. Investment decisions at the underlying level, made through the underlying, highly active, managers, should mean that the trust's exposure will be dynamic and adapt to the investment environment as circumstances change. The changes the executive team made during 2020 can be seen as having future proofed the line-up in our opinion, evidenced by the fact that, despite a strong performance from value and more cyclical stocks over the past six months, the portfolio as a whole has been outperforming the benchmark for ten out of the past 12 months (see **Performance section**).

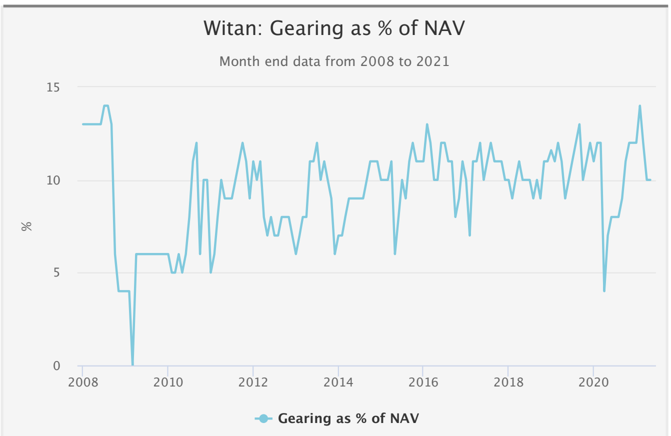
The executive team have a mandate to invest up to 10% of the portfolio directly into other investment trusts which complement the rest of the portfolio. In our view this adds an extra dimension to the proposition, given that they have long experience of investing in investment trusts. The motivation of investing in trusts is for exposure to the underlying assets or management team, rather than as a discount opportunity (although this can add to the attraction, it is not a pre-requisite). Holdings in this part of the portfolio include Syncona (a life sciences investor), Apax Global Alpha, Electra and Princess Private Equity (private equity) and BlackRock World Mining (which has been a very strong contributor of late). As we have noted elsewhere, private equity trusts have delivered strong returns relative to global equities during 2020, with momentum seemingly continuing into 2021 so far. Earlier this year, the team invested in a new trust to launch, VH Global Sustainable Energy, which aims to generate attractive returns from the development phase of renewable energy assets. This echoes a wider theme the executive team are keen to explore and invest more capital to – which has also seen them invest in GMO's Climate Change Fund.

Gearing

Witan's board and executive team believe that gearing can enhance long term returns for shareholders. As a result the gearing level has typically fluctuated between 6% and 12% of NAV, illustrated in the graph below. We understand that, over the past ten years gearing has contributed in seven of them. The trust employs fixed rate, structural gearing, and to any extent that the executive team want to lower gearing they either raise cash from portfolios or sell index futures – both of which reduce the effective equity exposure of the trust. 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.

Over time, the cost of Witan's borrowing has come down, as older more expensive tranches of debt have rolled off. Witan now has fixed rate borrowings of £155m, equivalent to c. 7.8% of NAV, paying a blended interest rate of 3%. On top of this the trust also has £1,250m of flexible credit facilities to increase gearing if desired. Currently, as at 30/04/2021, Witan is 10% geared. As the graph below shows, when equity markets fell precipitously during Q1 2020, the trust's gearing rose to c. 15% as a result of the decline in the asset value. 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

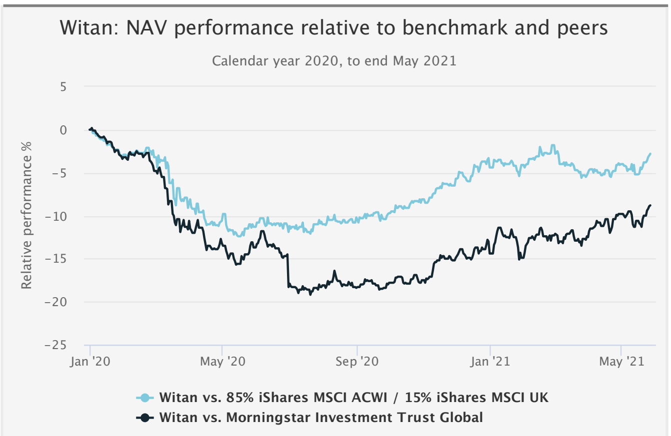
Witan was positioned for continued economic expansion at the start of 2020, and so the impact of COVID-19 on markets hit the NAV hard and also led to the discount widening. The underperformance relative to the benchmark was compounded by the recent change of the benchmark at the start of 2020, which meant that Witan was very underweight the US equity market at a time when the US market outperformed other geographies, and this made relative performance look worse. The executive team made some decisive changes to the portfolio, which have already shown up in the relative performance numbers in the graph below (a downward sloping line indicates underperformance, and upward a period of outperformance). At the time of writing (early June 2021) Witan has now outperformed the benchmark for ten of the past 12 months. As we discuss in the **Discount section**, having been derated as a result of poor performance during Q1 2020, we think this should give investors hope that the discount could narrow once again.

As we illustrate in the graph below, since the start of H2 2020, Witan has been outperforming the benchmark and peers. In our view, it is notable that the trust has seen continued outperformance from November when 'value' as an investment style had a strong recovery., Witan has continued to perform strongly relative to the benchmark – and even more so against peers – since then. This comes despite the new managers, WCM and Jennison Associates, both being global 'growth' managers. WCM has a quality growth bias; investing in companies that it believes have growing competitive advantages, strong corporate cultures and solid balance sheets. Jennison on the other hand is more 'growthy', and looks for innovative business which are creating structural changes in the industries they operate in. Witan's initial positions were a 'less than full' allocation, which the team have been adding to since the first investment.

Overall, the bulk of the portfolio is invested in good 'quality' businesses. It has an underweight position towards deep 'value', but is also underweight to mega-cap 'growth' stocks. In our view this positioning somewhere near the 'middle' of the growth/value spectrum perhaps explains the good relative performance in 2021 so far. In any event, there remains plenty of exposure to cyclicality in the portfolio through the likes of Lansdowne and Artemis, who are style-agnostic but have been positioned towards recovery plays. Relative to the benchmark, the portfolio is currently c. 3% overweight to growth, c. 11% underweight to value and c. 8% overweight to companies which occupy the middle ground.

In our view, the graph above illustrates the attractions of Witan's adaptable, 'manager of managers' approach. Over the short term, investment decisions at the underlying level are made through a group of highly active managers, which means investors experience dynamic stock-picking processes that adapt to the investment environment as circumstances change. However, when circumstances warrant it, the executive team can quickly and easily make changes to the manager roster. In 2020 some of these changes had been predetermined following the change in benchmark, but others were a reaction to the unique circumstances of the year. The executive team believe that they have now future-proofed the portfolio by making these changes and employing a greater proportion of global managers who have 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.

Fig.4: 2020 & 2021 YTD Nav Performance



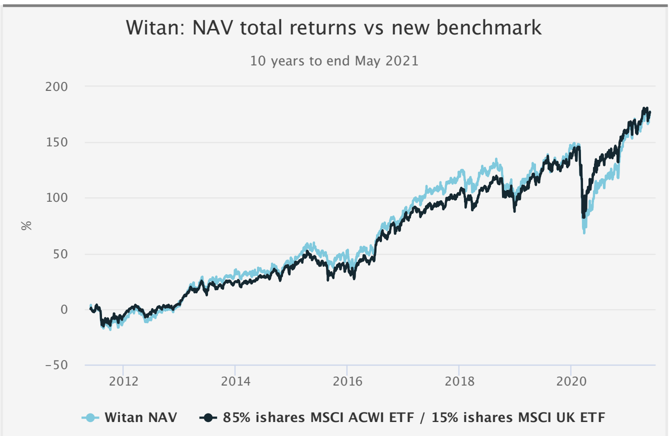
Source: Morningstar, Kepler Partners LLP

Past performance is not a reliable indicator of future returns

Witan's formal objectives are to outperform its benchmark and raise the dividend significantly faster than the rate of inflation. Despite the difficult background for equity income and the trust's dividend receipts this year we understand that the board remains determined to continue to build on the strong record of dividend growth, as we discuss in the **Dividend section**. Over the long term (ten years to 31/05/2021), Witan has delivered outperformance of its composite benchmark of 20.4%. The graph below shows performance against the current benchmark, which shows the NAV total return broadly in-line with the benchmark over this period, 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. 2.8% behind its benchmark.

As an actively managed portfolio, Witan's NAV performance is expected to deviate from that of the benchmark. As such, Witan will have periods of underperformance as well as outperformance. Whilst aiming to have a low turnover of managers, the executive team are not wedded to one manager whose track record the trust relies on. 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.5: Ten Year NAV Performance



Source: Morningstar, Kepler Partners LLP

Past performance is not a reliable indicator of future returns

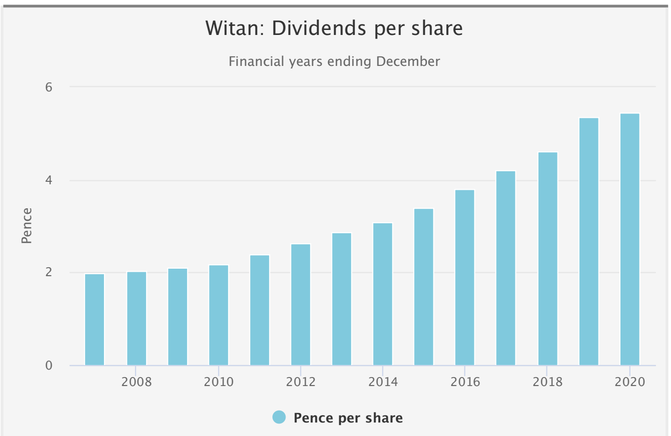
Dividend

Witan has a wide retail investor following, and the board is focussed on continuing the trust's 46 years of consecutive dividend increases. As we note in the **Performance section**, growing the dividend ahead of inflation is one of the formal objectives of the trust. 2020 was a challenge for the trust, as was the case for many other dividend payers. However, notwithstanding these pressures, Witan's board increased the 2020 dividend by 1.9%, taking the ten-year compounded growth to 9.6% annualised. Witan is a member of the **AIC's group of Dividend Heroes**, representing trusts which have grown their dividends for more than 20 years in a row.

Last year, a proportion of the dividend was met by the trust's revenue reserves, which we understand now represent 1.2x the full year dividend, a strong level of cover. The board has committed to use revenue reserves to support the dividend as much as necessary, and 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 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 should give shareholders reassurance about the reliance of the dividend in the years ahead.

At the current share price Witan yields 2.3% on an 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 will reflect the difference between the three quarterly dividends already paid, and the payment decided for the full year.

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

Past performance is not a reliable guide of future returns

Management

Witan is internally managed by a team headed by Andrew Bell, who became CEO in 2010 and sits on the board of directors. We would comment that 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 in other vehicles. Another benefit, in our opinion, is that employees are wholly focussed 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. 2020 was a case in point, and the team made some significant changes which mean there are now ten external managers. Witan retains WTW as a consultant, who helps the executive team to monitor the roster of managers, and provide intelligence on other potential managers.

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. If a change is to be made, then the board has ultimate responsibility – advised by the executive team. The breadth of experience represented by Witan's eight board members facilitates this process; with diverse skills being brought to the table from the likes of Ben Rogoff (current Polar Capital Technology Trust 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). Andrew Ross (previously chairman of Cazenove Capital Management) became Chairman in April 2020, and Rachel Beagles (Chairman of the AIC) was appointed as a director in July 2020.

Witan is able to use its large size (gross assets of £2.2bn) 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 to specialist third-party managers, where Witan believes there is strong potential to add value or to managers which the team view as possible managers for the future. On occasion, as we discuss in the **Portfolio section**, the executive team will invest in an ETF or index futures if they believe that the overall portfolio will benefit from an asset allocation which is different from the one produced by the third-party managers' stock selection. Currently Witan has a 3% allocation to an S&P 500 ETF for this reason.

Manager Geography & Style

MANAGER	GEOGRAPHIC AREA	STYLE
Artemis	UK	Recovery / Special solutions
GMO	Climate change	Companies addressing climate change
GQG Partners	Emerging Markets	Quality at a reasonable price
Jennison	Global	High growth businesses
Lansdowne	Global	Global developed markets
Latitude Investment Management	Global	Global 'best in class' businesses
Lindsell Train	Global	Long-term growth
S&P 500 ETF	US	Tracker
Veritas Investment Management	Global	Fundamental value, real return objective
WCM	Global	Quality growth

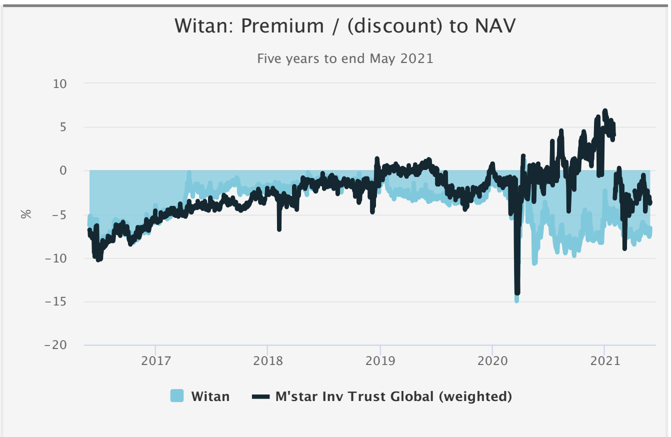
Source: Witan

Discount

As the graph below highlights, Witan's discount had narrowed in the years prior to 2020. However, Witan's underperformance during Q1 preceded the discount widening out considerably, and it has not yet recovered its previous level. Currently the trust trades at a discount of 6.5%, wider than the five-year average of 4% and the current sector weighted average discount of 2.8%.

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 past twelve months. We note that Witan has net assets of over £2bn, and so has economies of scale that can be maintained for quite some time. However, our view is that the changes to the manager roster which came into effect in summer 2020 have future proofed the portfolio and, as seen in the relative performance since then, now that Witan is delivering outperformance again, should see the discount narrow. With the board engaged in protecting discount volatility on the downside, the current discount may prove an attractive entry point.

Fig.7: Discount



Source: Morningstar

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 2020 the ongoing charges, excluding performance fees, were 0.78%, which is not far from the peer group's simple average of 0.63% which typically have only one manager and therefore higher 'key man' risk. Only one of the managers in the roster has a performance fee arrangement. During 2020, this manager was eligible for a performance fee which meant that including these costs, the OCF rose to 0.82%.

Witan has a KID RIY of 1.73%, including interest and transaction costs, relative to the sector simple average of 1.28%. 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 holdings portfolio, not to mention the cost of gearing which over time has been additive to returns net of costs.

ESG

Witan's ESG approach is two pronged and continues to evolve. Fundamentally, 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". This informs the executive team's approach. From a top-down perspective, Witan became a signatory to the UN's Principals of Responsible Investment (PRI) in February 2020, and we understand that all of Witan's underlying managers are also signatories to the UNPRI. The executive team regularly review and ensure that each of their managers is taking into account ESG issues in their analysis of investments. In the most recent report and accounts from Witan, the trust provides several examples where the underlying managers have incorporated ESG in their investment decision making process. **Click this link to download a PDF version**.

From a bottom-up perspective, the executive team believe that many of the drivers underpinning ESG are likely to be profitable investment areas for years to come. In this way, Witan has a 3% allocation to the GMO Climate Change Fund, as well as a new direct investment in a new investment trust called VH Global Sustainable Energy, which aims to generate attractive returns from the development phase of renewable energy assets. We understand that the executive team are actively looking to invest in more sustainable investment opportunities as time goes on.

According to Morningstar, Witan's current portfolio (on a look through basis) has achieved a Morningstar Low Carbon Designation and scores an "average" on their Sustainability Rating, when compared to the "Global Equity Large Cap" peer group, albeit on only 94% of the portfolio having been covered by Morningstar's analysis. In our view 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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