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Investment Trust Watch: ‘buy’ HICL Infrastructure

By **Gavin Lumsden** / 13 Jul, 2017

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An expectation that global interest rates will rise – or at the very least the Bank of England will reverse its post-Brexit vote cut to 0.25% – has weakened the share prices of many ‘bond proxy’ income funds, most notably **HICL Infrastructure** (HICL).

Analysts have turned positive on the UK’s biggest listed social infrastructure fund with Iain Scouller at Stifel last week upgrading it to ‘buy’ from ‘hold’ after its shares fell below the 165p price at which it issued £268 million of new shares last month.

This was the third oversubscribed share issue in ten months in which HICL has raised a total of £640 million, boosting its market value to £2.9 billion.

Update: another share issue could be on the way after HICL announced on Friday it was part of a consortium buying the HS1 railway from other infrastructure investors.

Winterfloods Securities this week added HICL to its model portfolio saying 'following the significant contraction of its premium over the past few weeks we believe that its current share price offers an attractive entry point.'

Shares in the popular Guernsey-based investment company, which is managed by Harry Seekings of InfraRed Capital Partners, have fallen 5% in the past month as UK government bonds, or gilts, slid and their yields rose to price in a possible rate move either next month or early autumn.

Although not a big decline it was enough to let out some of the hot air around HICL with the premium on the shares tumbling from 19% over net asset value to under 8% at yesterday's close.

This compares to a one-year average premium of nearly 15% and gives it a Z-score of -1.6 which, while not enough to put it in Numis Securities' list of 'cheap' trusts (see below), does make it the least dear in its subsector.

Just to recap, a Z-score is a measure used by analysts to put a premium or discount on an investment trust into the context of its previous 12 months. Roughly speaking, an investment company or trust with a Z-score of -2 or below is 'cheap', while a score of 2 or more is viewed as expensive.

Investors have got used to paying up for the reliable dividends from infrastructure funds, which earn government-backed, index-linked revenues from running facilities for schools, roads, prisons and hospitals.

However, this demand has encouraged the companies to follow HICL's example and issue a lot of new shares, which coupled with unease over the impact of higher interest rates and inflation, and the fact that their yields of just over 4% were not as high as previously, caused them to partly de-rate.

BBGI (BBGI) is currently the dearest with shares in the £691 million fund standing on a 12.6% premium to NAV although a Z-score of -0.2 indicates the recent weakening

in the rating. **International Public Partnerships** (INPP) on a 10% premium and a Z-score of -0.3 follows with **3i Infrastructure** (3IN), a £2 billion rival sitting on a 14.8% premium, merits a -0.7 Z-score.

The only one close to HICL in terms of a low Z-score is **John Laing Infrastructure** (JLIF) on -1.2 and a premium of 8.9%, down from its one-year average of 13%. It is the sector's highest yielder at 5.2%, according to Numis data.

Interest rate 'cushion'

How worried should investors be to infrastructure funds' sensitivity to gilt yields which have jumped from 0.93% to 1.24% since 14 June? Scouller noted a similar sell-off last year when interest rate expectations also rose on the back of the improving global economy.

However, the analyst believes the funds have an inbuilt 'cushion' to their valuation and could see gilt yields rise to 3.5% before there is a 'significant impact' on their portfolios.

With the Federal Reserve's Janet Yellen yesterday stressing that only a few hikes were necessary to normalise US interest rates, the outlook is possibly not too alarming.

Nevertheless, as Alastair Mundy, manager of UK equity income trust **Temple Bar** (TMPL), points out, the relatively immature, high-yielding sectors of infrastructure and renewable energy - where premium-rated investment companies have also issued lots of new shares - have entered new territory as they encounter interest rates rises for the first time.

Noting investors' bullishness towards the 'uncorrelated' charms of infrastructure investments which don't move in step with stock markets, the veteran value investor says in his latest fund commentary that 'the history of popular, highly rated, "alternative" investment companies is not propitious. It will be interesting to see if this record can be broken.'

Shares in the £850 million Temple Bar trade on a 5% discount to asset value, so it is only fair to point out that Mundy could do with diverting some income investors to his cheaper wares.

Turning to our first table of 'cheap' trusts, the theme of higher gilt yields is also evident in the number of proeprty and debt trusts trading on lower than usual valuations.

'Cheap' trusts	Share price premium (-discount) to net asset value %	12-month average premium (- discount) %	Z-score
Ashmore Global Opportunities - £ (AGOL)	-30.5	-23.0	-2.7
Masawara (MASA)	-36.0	-31.9	-2.7
AEW UK Long Lease REIT (AEWL)	0.9	1.6	-2.6
Qatar Investment Fund (QIF)	-22.9	-16.0	-2.6
JPMorgan Global Emerging Markets Income (JEMI)	-6.6	-3.0	-2.5
NB Distressed Debt - Extended Life (NBDX)	-13.8	-8.1	-2.5
Sanditon Investment (SIT)	-2.5	1.0	-2.2
PRS REIT (PRSR)	4.5	6.1	-2.2
Civitas Social Housing (CSH)	3.2	7.7	-2.2
SQN Asset Finance Income (SQN)	5.7	12.7	-2.1
Ranger Direct Lending (RDL)	-26.7	-13.6	-2.1
SQN Asset Finance Income C (SQNX)	2.1	6.2	-2.0
Investment Company (INV)	-12.5	-5.5	-2.0
Ashmore Global Opportunities - US$ (AGOU)	-38.7	-29.8	-1.9
Juridica Investments (JIL)	-56.9	-28.1	-1.8

Source: Numis Securities 12/7/17

Stock market newbie **AEW UK Long Lease Reit** (real estate investment trust) has seen its small premium moderate since it floated, as have other recent big hitters in social housing, **Civitas**, and private rental accommodation, **PRS Reit**.

Meanwhile, debt funds have either seen their discounts widen, as in **NB Distressed Debt** and **Ranger Direct Lending**, or their premiums narrow, as with **SQN Asset Finance Income**.

Investment Company, a small, bond-heavy fund under the watch of Miton's smaller company maestro Gervais Williams, has also entered bargain territory with a -2 Z-score after its discount widened beyond its one-year average.

It is joined by **JPMorgan Global Emerging Market Income**, whose discount has doubled from its 12-month average of 3%.

Away from interest rates, **Qatar Investment Fund** remains in bargain territory with the discount on the single country fund widening to 23% following the country's growing dispute with its neighbours.

And it is three years since ex-Cazenove fund managers Tim Russell and Chris Rice founded **Sanditon** (SIT) and brought over former colleague Julie Dean. A 3% advance in net asset value since launch may not be the absolute return investors were seeking and shares in the £50 million trust have dropped to their first discount, 2.5% below NAV.

'Expensive' trusts	Share price premium (-discount) to net asset value %	12-month average premium (- discount) %	Z-score
Invesco Perpetual UK Smaller Cos (IPU)	-0.7	-5.5	2.9
Syncona (SYNC)	24.0	5.7	2.9
Qannas Investments (QIL)	4.9	-2.3	2.8
Pacific Horizon (PHI)	-7.2	-11.3	2.7
British & American (BAF)	95.5	61.0	2.7
LMS Capital (LMS)	-24.2	-36.5	2.6

'Expensive' trusts	Share price premium (- discount) to net asset value %	12-month average premium (- discount) %	Z-score
Miton Global Opportunities (MIGO)	0.3	-5.5	2.6
Gresham House Strategic (GHS)	-18.2	-24.2	2.6
LXB Retail Properties (LXB)	-2.4	-26.9	2.5
Fidelity Japanese Values (FJV)	-9.4	-15.3	2.5
BlackRock Throgmorton Trust (THRG)	-14.5	-18.1	2.4
Honeycomb IT (HONY)	17.5	5.3	2.3
Highbridge Multi Strategy (HMSF)	-0.8	-5.2	2.3
Kennedy Wilson Europe Real Estate (KWE)	-4.4	-16.1	2.3
Aberdeen Private Equity (APEF)	-10.2	-22.8	2.2

Source: Numis Securities 12/7/17

Disappearing discounts

Finally, turning to our second table (below), I should note the remarkable achievement by two investment trusts in removing their discounts.

Invesco Perpetual UK Smaller Companies sits at the top of our 'expensive' list with a 2.9 Z-score reflecting the virtual eradication of its discount. At yesterday's close the share price of 493.8p stood just 0.7% below its estimated NAV per share of 497p. Not bad for a trust that traded 30% below asset value in the 2008 financial crisis and which sits in a sector where the average discount is 12%. IPU's re-rating has gathered strength in recent years in response to improved performance from manager Jonathan Brown, a decision to pay dividends from capital and to allow investors a three-yearly exit close to NAV. The trust now yields 3.5%, the highest of its peers.

Could we see **Miton Global Opportunities** issue new shares? With a market value of £65 million, it certainly could do with bulking up and with the shares trading on their first, admittedly small, premium of 0.3% and a 2.6 Z-score, it may be able to do so.

It's quite a turnaround for a trust whose manager Nick Greenwood specialises in buying undervalued trusts and investment companies and whose own shares traded at around 10% below asset value for many years. Similar to IPU, a board decision to allow investors a regular opportunity to sell their shares close to their asset value helped re-rate the trust, which has also enjoyed a Brexit boost from the fall in the pound and a marketing push by investment companies group Frostrow.

Lastly, a quick word on **Syncona**. Last week we reported how shares in the health sciences fund had soared 26% since emerging from the merger with the former Battle Against Cancer trust in December. The good news from its portfolio keeps coming and the shares gained another 4% this week, with the premium expanding tp 24% from 20%.