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David Kempton: Inflation-linked bonds I'm buying and growth trusts I'm holding

Rising yields and falling prices of government bonds (or gilts) tempt our experienced investor, who retains a portfolio of investment trusts for long-term growth.

BY **DAVID KEMPTON**

In late July I wrote about my [international stock selections](#) chosen from the [Citywire Elite Companies Ratings](#) which highlight global companies backed by the world's best investors, across a wide range of industries, and how they rate against their peers. Using my own valuation methods, I invested in 12 companies to form an international direct equity portfolio.

Gratifyingly the portfolio was up 6% in two weeks, but then the last month has seen global markets turn negative with this portfolio disappointingly down 1% while world indices have fallen about 3% and the FTSE All-Share retreated 4.7%.

Adding bonds

Last week the yield on ten-year gilts topped 4.75%, their highest since mid-2008, while five-year US treasuries hit a 16-year high in anticipation of interest rates remaining higher for longer.

But the US economy remains strong with the S&P 500 hitting a high on 25 July, only to fall back in the last weeks – shaken by the rapidly deteriorating situation in China, the world’s second-biggest economy, with companies going bust, property mostly unsellable and youth unemployment above 20% – while a demographic time bomb threatens the next generation.

In this scenario, even as a naturally keen growth international equity investor, I have run scared into my highest-ever holding in bonds, now forming the significant majority of my core portfolio.

I hold short-dated gilts with a low coupon. In these illustrated yields, I want it to be almost entirely capital gain, which has zero capital gains tax on gilts, and not interest income, on which I would pay my marginal tax rate.

I use the excellent abbreviated gilts list in Saturday’s Financial Times from which I chose my current holdings:

- Treasury 0.125% 2024, redemption yield 5.06%.
- Treasury 0.125% 2026, redemption yield 4.78%.
- Treasury 0.5% 2029, redemption yield 4.62%.

Or buy the excellent [AXA Global Short Duration Bond Fund](#), which invests 35% UK, 65% international, yields 3.65% and has returned 2.4% in one year.

A fund manager colleague has bought Index-Linked Treasury 0.125% 2048 to protect a chunk of his capital against the next 25 years of inflation. Optimistic, I thought, at age 59 and it’s not for me – I like to keep flexibility but I can see his point, as do many others.

I might be more tempted by the 2028 and 2041 but if you do fancy a 'linker' go to the [Index-Linked Gilts page](#) on the UK Debt Management Office website, Google the Table, choose your time span and tell your broker.

Partly as a currency hedge, I bought **iShares US Treasury Bond ETF** which tracks an index composed of 147 US Bonds of 1-30 years with an expense ratio of 0.05%, yielding 4.24%.

CGAM Dollar Fund looks significantly the best way to diversify some money into index-linked dollar bonds with its impressive managed performance, but the minimum holding is £100,000, while a smaller holding can be bought in iShares \$ TIPS UCITS ETF giving flexible inflation protection as it tracks an index composed of US inflation-linked government bonds on an expense ratio of 0.10% yielding 2.43%.

Trusts for growth

My other conviction is that UK small companies offer terrific current value, especially in high discount investment trusts, neglected by global investors who view the UK as firmly on the back foot, for reasons that don't need rehashing here. It seems irrational for a company to have more than half its revenue in US or Asia yet be valued on a UK p/e of 10 compared to a US of 20.

Unsurprisingly, UK companies are floating across the Atlantic, as US and other overseas buyers snap up our commercial 'jewels'.

The UK market values are well illustrated by the growth in indices.

Index	YTD	One year
DAX	11.90%	13.70%
CAC 40	10.70%	9.25%
Nikkei 225	20.50%	8.70%
Nasdaq Composite	27%	2.50%
S&P 500	13.80%	2%
Dow Jones	4.00%	1.50%
FTSE 100	-2.50%	-3.70%
SSE Composite	1.40%	-4.40%
Hang Seng	-9.25%	-9.2%
FTSE 250	-4%	-10.10%
FTSE AIM All-Share	-11.90%	-20.80%

The poor UK investor has been fighting market sentiment and AIM stands out here as the big global loser.

The global price-earnings ratios are also illuminating – using a forward P/E for the benchmark index of each country shows US and India trade on 20 times earnings, Australia 15, Canada, France, Germany, Japan all on multiples of about 13, with UK and China both on about 10.

The UK accounted for 10% of world indices in the 1990s but now stands at only 4%, while the US markets have doubled – unsurprising as the FTSE 100 is mostly old economy stocks rather than Amazon, Nvidia, Apple etc.

The seven largest US stocks are up 58% this year and their combined value exceeds the total of all UK, China, Japan and France listed companies.

Let me tell you about the investment trusts I hold.

The UK market valuation looks extremely low compared to other developed world indices and in the UK smaller companies sector I bought **Rockwood Strategic (RKW)**, the smallest of the renowned Christopher Mills Harwood stable at only £50m NAV with a [tightly focused portfolio](#) of 18 holdings. On a discount of 7%, the performance is exceptional with six months, one-year and three-year growth at -1%, 34%, 89%.

Oakley Capital Investments (OCI) provides investors with long-term appreciation in a diversified portfolio of [private mid-market UK and European](#) companies. On a discount of 31%, performance over six months, one year, three years is -2.9%, 9.4% and 88%.

These are my only UK-invested funds and I go back to my well-rehearsed doctrine that I want to live in the UK but my money can invest anywhere.

In today's unstable world, I have sought to buy into sectors and countries which should offer some growth and stability amidst all the turmoil.

Healthcare and technology must qualify for constant growth potential, and I have bought **Polar Capital Global Healthcare Trust (PCGT)** which aims to achieve long-term growth in a diversified healthcare industry portfolio. With 66% US, on a discount of 7%, the performance over six months, one year, three years is -5%, -1.5%, 34%.

Allianz Technology Trust (ATT) invests in [global technology companies](#), currently 94% US, on an 11% discount with six-month, one-year and three-year performance at 9%, -4% and 3.5%.

These two funds have currently performed well in their sectors but do illustrate that recent times have been very hard for the ambitious investor.

The regions of the world offering the best combination of growth and stability are probably Australia, India, Singapore, US/Canada and the Gulf.

I have invested in **India Capital Growth (IGC)** predominantly holding mid and small-cap Indian companies with a performance over six months, one year, three years of 17%, 24%, 115% well demonstrating the [current attractions of the sub-continent](#) – now the world's fifth-biggest economy ahead of the sixth-placed UK.

Canadian General Investments (CGI) is invested 76% Canada, 23% US. The Canadian market should be a beneficiary of the global economic growth expected in the medium term already showing form on the six-month, one-year, three-year total returns of 4%, 4%, 42% and on an extraordinary 34% discount.

JP Morgan American (JAM) covers all the US big hitters where I wanted to maintain some holding, while covering the S&P 500. Performance looks about the [current best of the US trusts](#) with six-month, one-year and three-years at 6%, -2% and 57%.

Rather than buy wind and solar funds I prefer to cover those sectors with **Impax Environmental Markets (IEM)**. Although performance has suffered along with the ESG markets last year, it's a long-term hold for me to benefit from the focus on more efficient services of [energy, water, waste, pollution and resource management](#) of food and forestry. It's a £1.1bn trust on a 5% discount invested 48% US, 37% Europe and 12% Asia.

The £98m **Gulf Investment Fund (GIF)** invests in one of the more stable regions covering the Gulf States and Saudi Arabia and has generated remarkable performance with six-month, one-year and three-year returns of 19%, 12% and 133%. Having devoted 10 years of my working life to Saudi I make no further comment here but would refer you to David Stevenson's [excellent article](#) earlier this month.

I have ventured into buying **Blackrock Frontiers (BRFI)**, designed to achieve long-term capital growth by investing in companies operating in [less developed countries](#) outside the MSCI World index including, Brazil, China, India, Korea, Mexico, Russia, South Africa, and Taiwan (almost a BRICS fund of current topical interest). Capitalised at £270m on an 8% discount, the performance is impressive against market trends with 3%, 14% and 72% total returns over six months, one and three years.