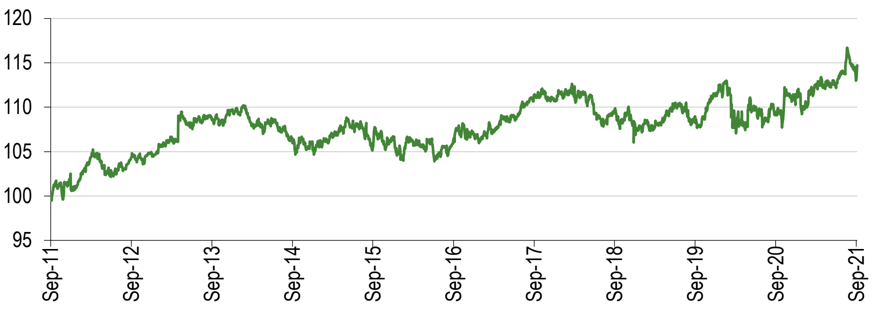
The Brunner Investment Trust

Approaching 50 straight years of higher dividends

Investment trusts
Global equities

The Brunner Investment Trust (BUT) is managed using a team-based approach. Lead manager Matthew Tillett at Allianz Global Investors (AllianzGI) is supported by deputy managers Christian Schneider and Marcus Morris-Eyton. The trust has delivered encouraging outperformance following the Q120 COVID-19 induced sell-off, with the managers continuing to focus on high-quality, reasonably priced growth companies, and employing a long-term investment approach. As shown in the chart below, the trust has a long-term record of outperformance with NAV and share price total returns ahead of the benchmark over the last one, three, five and 10 years.

Long-term NAV outperformance versus the benchmark



Source: Refinitiv, Edison Investment Research

The analyst's view

BUT may be considered as a 'one-stop shop' for global investors with its relatively concentrated portfolio of c 65 high-quality, global listed equities across the market-cap spectrum (c 15% of the fund is in small- and mid-cap stocks); the trust's managers aim to generate both capital and income growth over the long term. Tillett notes that in terms of BUT's post-COVID-19 income recovery, over the course of this year he has regularly had to revise up his bottom-up forecasts for 2021 dividend receipts. There has been a broad-based improvement as suspended payments have been reinstated faster than expected and dividend growth has exceeded expectations; BUT has also received a few special dividends including from Rio Tinto and Stock Spirits. It appears that the trust is now heading towards a position where its dividend can be fully covered, although there are significant revenue reserves if required to build on BUT's 49-year record of consecutive annual dividend growth.

Scope for a higher valuation

BUT's current 12.3% discount to cum-income NAV is towards the narrower end of the 7.3% to 19.3% range over the last 12 months and compares with the 10.6% to 12.5% range of average discounts over the last one, three, five and 10 years. Given the trust's long-term positive performance record and the complete exit of a long-term selling shareholder earlier this year, one could argue that BUT is a high-quality, focused fund that deserves to be afforded a higher valuation.

27 October 2021

Price	**1,020.0p**
Market cap	**£435m**
AUM	**£522m**

NAV*	1,163.1p
Discount to NAV	12.3%

*Including income. At 25 October 2021.

Yield	2.0%
Shares in issue	42.7m
Code	BUT
Primary exchange	LSE
AIC sector	Global

52-week high/low*	1,085.0p	763.0p
NAV** high/low	1,180.4p	857.6p

*A-shares. **Including income.

Gearing

Net gearing at 30 September 2021	7.3%

Fund objective

The Brunner Investment Trust aims to provide growth in capital value and dividends over the long term through investing in a portfolio of global equities. Its benchmark is a composite of 70% All-World ex-UK (£) Index and 30% All-Share Index.

Bull points

- Balanced portfolio of global equities, aiming to generate both capital and income growth.
- Long-term record of outperformance versus its benchmark and 49 consecutive years of higher dividends.
- Scope for a higher valuation.

Bear points

- Medium- and long-term performance lags the averages of its peers in the AIC Global sector.
- Structural gearing of £25m will amplify capital losses in a market sell-off.
- Around 29% of the share base is owned by the Brunner family.

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Edison profile page

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The manager's view: Confident about fund's prospects

Tillett comments that in the first half of 2021, for the most part, macroeconomic data surprised to the upside and was reflected in corporate earnings releases; cyclical companies generally exceeded consensus expectations, and their share prices responded well. However, the manager says that investors are now looking past good news about 2021 earnings and focusing instead on the outlook for 2022 results. As the stock market has rallied, Tillett suggests that good news is already priced in; also, looking at the UK in particular, the economic outlook has deteriorated due to supply chain disruptions and fuel and labour shortages. Policymakers had suggested that inflationary pressure was transitory, but it is now proving to be more long lasting than prior expectations, which has spooked the stock market. The manager expects there to be more cost pressures in 2022 and less economic improvement compared with 2021, where activity bounced back strongly after lockdowns.

The manager says that the more challenging economic backdrop is not having a significant impact on BUT's portfolio construction as he and his team are continuing to invest on a bottom-up basis with a long-term view. Looking out over the next three years, Tillett believes that near-term issues will indeed prove to be transitory. He explains that supply chains are interlinked so the manager is not surprised that current disruptions are widespread, but he believes that the demand/supply imbalances will be worked through even if it takes a year or two. Tillett says that in the short term, inflation and cost pressures pose a risk to corporate earnings; highlighting some recent profit warnings in the UK including online fashion retailers ASOS and Boohoo Group, and engineering manufacturer Melrose Industries; he suggests that going forward there are likely to be further earnings disappointments. Also, the manager comments that coronavirus has placed huge debt burdens on governments. Some of this will be inflated away but there will still be a bill to be paid, which is reflected in rising corporate and personal tax rates. Tillett believes that it is important to monitor what happens in other asset classes such as bonds. So far, the bond market has been relatively calm with bond yields remaining remarkably low given rising inflation rates. He suggests that with some parts of the world having negative real yields, this could prove to be problematic if bond investors decide that they are no longer willing to accept them.

Tillett explains that an inflationary environment should be negative for low-quality companies with no pricing power; these are the businesses that he tends to avoid. The manager says that, in general, value stocks do well in an inflationary environment; however, it is important to remain selective as some value stocks are inexpensive for a reason. This type of environment should be negative for very highly valued companies, as they are likely to experience valuation compression as higher interest rates reduce the present value of their future earnings streams. Tillett believes that firms that should be well positioned are those that are reasonably valued with high-quality business models and pricing power that can operate efficiently in difficult economic environments. These are the types of companies that make up BUT's portfolio; hence the manager is confident in the fund's prospects. The trust's holdings are shares of companies with sustainably high returns on capital operating in businesses with high barriers to entry, so they should be relatively well positioned in an environment of higher input costs and rising prices; these stocks are not exposed to the valuation risk compared with highly valued growth companies. Tillett reemphasises the lack of radical changes in BUT's portfolio as he remains confident about the long-term investment case of investee companies, even if there are shorter-term challenges.

Recent new positions

Tillett has recently introduced some new and different additions to the trust's portfolio. **Jumbo** is a Greek discount retailer listed on the Athens Stock Exchange. It is a market leader, dominant in countries in Southeast Europe: Greece, Cyprus, Bulgaria and Romania. BUT has modest retail exposure due to industry competitive pressures; however, discount retailers have thrived in this environment as they tend to be regional businesses with lowest-cost operator business models. Jumbo offers every day and seasonal products at a c 20–30% discount to its local competition. Discount retailers have performed well, despite the growth in online retailing, as they tend to be very efficient operators and their customers have small basket sizes. The manager has followed Jumbo for a long time; he considers it to be very well managed with a founder CEO that owns around 20% of the company, and the firm has a consistent growth track record. Romania is seen as an important area for Jumbo's future growth as it already has scale in the country, which has a population of c 20 million. Tillett suggests that Romania could generate a similar percentage of Jumbo's revenue as Greece (currently c 45%). The company has a very conservative balance sheet with c 30% cash and the manager was able to initiate a position at an attractive valuation of less than 10x free cash flow yield as Jumbo's business has been affected by COVID-19 in terms of store closures and restrictions in the number of in-store customers.

Unusually, Tillett participated in the initial public offering (IPO) of **Baltic Classifieds Group**; it is a Lithuanian company that is quoted on the London Stock Exchange. The firm operates in Lithuania, Estonia and Latvia with what the manager considers to be a very interesting business model: portals and websites that are similar in terms of market dominance to AutoTrader and Rightmove in the UK. Tillett says that Baltic Classifieds is monetising just a fraction of what these two UK peers are achieving. He says that it is a classic 'winner takes all' business model as an increased number of buyers and sellers on its platforms are beneficial for both the company and its customers. Adding additional services should ensure that the company has sustained pricing power as users become more and more dependent on its offerings; hence the manager believes that Baltic Classifieds has a very attractive long-term growth runway. Generally, Tillett is sceptical about IPOs as he thinks that normally asymmetry favours the sellers rather than the buyers. A company can choose the time to go public and typically wants to list at the highest possible share price. However, the manager said that the Baltic Classifieds IPO was reasonably priced in the middle of the anticipated range and the deal was not overhyped. With a market cap of c £1bn, the company is relatively small and BUT did not receive its full desired allocation in the IPO. As the company's share price has rallied by more than 30% following the listing, the trust only has a modest position, but Tillett would consider adding to the holding if there is a meaningful pullback in the stock.

US-listed **MarketAxess Holdings** is an international financial technology company that operates an electronic trading platform for institutional credit markets. The manager says this company operates in an interesting area, as in equity markets trading is generally electronic due to good levels of liquidity and a relatively small number of securities. He explains that in credit markets liquidity is sparser as companies have multiple fixed income securities with a range of interest rates, maturities and terms. MarketAxess was founded in 2000 by chairman and CEO Richard McVey (the business was formerly part of JPMorgan Chase). Its market share has gradually increased, and it has 15–20% of the US investment-grade credit market. Tillett says that the company is the dominant player in electronic trading of corporate bonds and has significant growth potential. He believes that the 15–20% annual earnings growth achieved over the last decade can continue, and that there is room for MarketAxess to expand into other subsectors such as emerging market or municipal bonds. Its platform allows institutional investors to trade directly with other buy-side firms, which could lead to increased liquidity. The manager says that this 'wall to wall' protocol is fast growing. MarketAxess's shares are highly rated compared with other portfolio companies, but Tillett believes this is warranted given the company's dominant position, growth potential and high levels of profitability.

Performance: Above-benchmark returns over long term

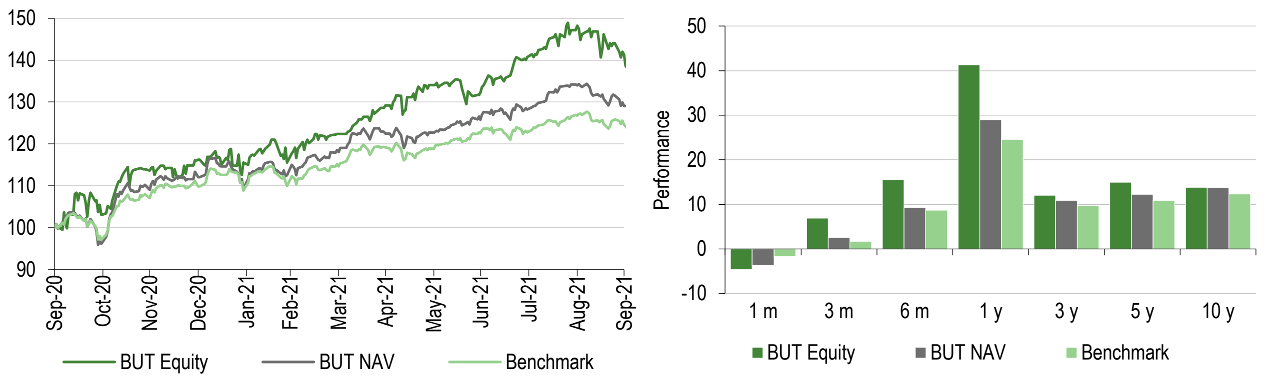
Exhibit 1: Five-year discrete performance data

12 months ending	Share price (%)	NAV* (%)	Benchmark** (%)	CBOE UK All Companies (%)	MSCI All World ex-UK (%)
30/09/17	27.6	19.1	13.9	12.0	15.8
30/09/18	11.7	9.6	11.6	5.9	14.0
30/09/19	8.5	6.3	6.6	2.7	8.1
30/09/20	(8.2)	(0.5)	(0.7)	(17.9)	7.1
30/09/21	41.3	29.0	24.6	28.5	22.6

Source: Refinitiv. Note: All % on a total return basis in pounds sterling. *NAV with debt at market value. **From 22 March 2017, benchmark is 70% All-World ex-UK and 30% All-Share Index.

Exhibit 2: Investment trust performance to 30 September 2021

Price, NAV and benchmark total return performance, one-year rebased | Price, NAV and benchmark total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 3: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to benchmark	(2.9)	5.1	6.2	13.4	6.7	19.7	14.3
NAV relative to benchmark	(2.0)	0.8	0.5	3.5	3.5	6.3	13.1
Price relative to CBOE UK All Companies	(4.0)	4.5	7.1	10.0	29.9	56.1	65.9
NAV relative to CBOE UK All Companies	(3.0)	0.3	1.3	0.4	26.0	38.6	64.3
Price relative to MSCI All World ex-UK	(2.5)	5.4	6.0	15.3	(0.8)	7.1	(6.2)
NAV relative to MSCI All World ex-UK	(1.5)	1.1	0.2	5.2	(3.9)	(4.9)	(7.2)

Source: Refinitiv, Edison Investment Research. Note: Data to end-September 2021. Geometric calculation.

Tillett explains that over the last year the companies that have contributed the most to BUT's performance are dominated by cyclical businesses or those that have benefited from an economic rebound. They include specialist recruitment company SThree, window and door maker Tyman, analytical laboratory instrument manufacturer Agilent Technologies, private equity investor Partners Group and Stock Spirits, which has received a takeover bid. Positions detracting from BUT's returns over the last 12 months are those that are more defensive or are exposed to different business cycles such as Munich Re. In general, the reinsurance pricing cycle is improving, but 2021 will be another year of high catastrophe losses. According to the manager, the company has performed strongly over the long term, is managed well, has a conservative balance sheet and does not pay excessive dividends. Healthcare is BUT's largest sector exposure and in aggregate has detracted from the fund's performance over the last year, as this defensive area has been out of favour with investors; however, stock selection has been good including the trust's holdings in Agilent Technologies and Novo Nordisk.

The Stock Spirits bid was made by a private equity buyer at a c 45% premium to its pre-bid share price. The manager explains that this company is a good example of what he and his team are trying to achieve within their small- and mid-cap holdings, which make up around 15% of the portfolio. He says that Stock Spirits 'punches above its weight' in terms of quality growth and valuation. It is a British alcoholic beverage business operating in Poland, the Czech Republic, Italy, Slovenia and Croatia. Stock Spirits has a dominant position in the Czech Republic and generates EBITDA margins of c 30%. BUT's position was initiated in 2019 and has delivered in terms of earnings growth and share price appreciation. The company has been growing its dividend and has also paid a special dividend this year. Tillett reports that Stock Spirits has returned around 15% of BUT's original investment in dividends and its share price has risen by c 90% since the position was initiated.

Exhibit 3 shows BUT's relative returns; its NAV and share price are ahead of the benchmark over all periods shown, except for September 2021. Tillett explains that there was 'a savage rotation in the stock market' as bond yields rose on inflation fears and energy prices rose, leading to a shift out of growth/quality stocks towards value/cyclical companies. Also, two out of three of BUT's utility stocks came under pressure: Iberdrola was the subject of 'political interference' says the manager and Enel (which has now been sold) is experiencing an increasingly competitive environment, especially for renewable assets. The manager is becoming more cautious on this area of the energy market as asset prices are being bid up, and companies are being hurt by commodity price inflation and are generating low returns. Tillett reports that he 'had made good money' in Enel and the proceeds were redeployed into other higher-yielding positions in BUT's portfolio.

Exhibit 4: NAV total return performance relative to benchmark over three years

Source: Refinitiv, Edison Investment Research

Peer group comparison

There are 17 companies in the AIC Global sector, which we show in Exhibit 5. Tillett suggests that BUT can be considered as one of the 'core' funds in the group given its balanced approach, aiming to generate both capital and income growth. Its quality bias means that the fund is made up of defensive growth companies rather than hyper-growth businesses and it does not have any unlisted positions. Having recently been on a roadshow visiting current and potential BUT shareholders, the manager says that some investors favour this trust compared with other 'core' funds such as Bankers Investment Trust and F&C Investment Trust as there is a higher level of conviction in terms of a much more concentrated portfolio (c 65 stocks) and more small- and mid-cap exposure (currently around 15% of the fund).

BUT's NAV total returns are above average over the last year, ranking third (6.4pp above the mean), and it is broadly in line with the average over the last three years, while lagging over the last five and 10 years. The trust currently has a wider-than-average discount, a competitive ongoing charge and a level of gearing that is modestly above the mean. BUT's 2.0% dividend yield is 20bp higher than the sector average.

Exhibit 5: AIC Global sector at 26 October 2021*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Brunner	435.5	28.1	52.8	69.8	213.6	(12.8)	0.6	No	107	2.0
Alliance Trust	3,218.3	24.1	50.6	78.2	238.8	(5.7)	0.7	No	107	1.4
AVI Global Trust	1,068.5	36.7	53.9	77.4	195.8	(8.3)	0.9	No	105	1.6
Bankers	1,494.3	19.1	48.6	75.4	243.7	(5.2)	0.5	No	107	1.9
Blue Planet Investment Trust	11.9	12.7	(14.5)	(19.3)		(23.5)	4.3	No	125	2.2
EP Global Opportunities	105.9	14.3	7.1	21.8	127.7	(9.5)	1.0	No	100	2.1
F&C Investment Trust	4,651.9	24.7	53.6	79.6	263.3	(9.7)	0.5	No	110	1.4
JPMorgan Elect Managed Growth	293.0	27.2	46.4	71.8	234.6	(4.1)	0.5	No	100	1.5
Keystone Positive Change Inv	210.8	17.9	11.1	9.4	99.9	(3.2)	0.5	No	104	3.3
Lindsell Train	285.0	13.0	56.5	154.5	601.0	19.1	0.8	Yes	100	3.5
Manchester & London	233.0	7.7	53.0	110.7	156.0	(16.7)	0.8	Yes	100	2.4
Martin Currie Global Portfolio	350.7	19.4	75.9	100.4	286.9	(0.5)	0.6	No	106	1.0
Mid Wynd International Inv Trust	493.8	22.2	70.6	100.0	296.2	1.6	0.6	No	100	0.8
Monks	3,244.1	24.7	95.0	141.7	320.6	(5.1)	0.4	No	102	0.1
Scottish Investment Trust	540.6	9.3	4.5	15.0	116.7	(6.3)	0.5	No	108	2.8
Scottish Mortgage	21,152.1	39.9	207.0	334.0	1,002.8	4.9	0.3	No	107	0.2
Witan	1,861.4	27.8	40.3	59.5	225.5	(8.0)	0.8	Yes	110	2.2
Average (17 funds)	**2,332.4**	**21.7**	**53.7**	**87.1**	**288.9**	**(5.5)**	**0.8**		**106**	**1.8**
BUT rank in sector	**10**	**3**	**9**	**12**	**11**	**15**	**10**		**8**	**8**

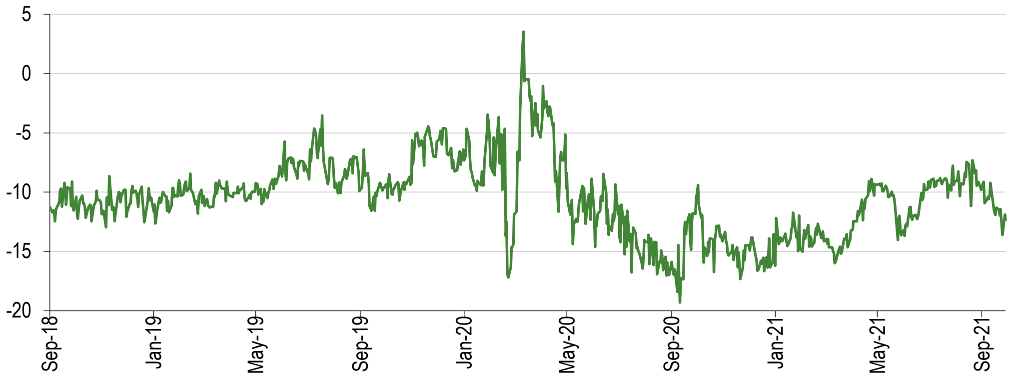
Source: Morningstar, Edison Investment Research. Note: *Performance to 25 October 2021 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Board hopeful for a narrower discount

In April 2021, Aviva, which had been a 20% shareholder in BUT following its acquisition of Friends Provident in 2015, sold its remaining stake. Now this overhang has been removed, the board is hopeful that, over time, BUT will be afforded a higher valuation. While c 29% of the share base is owned by the Brunner family, there are multiple owners, some of whom trade their shares. Over the last 12 months, the trust's average daily trading volume is c 105k shares, which is much higher than an average of c 55k shares over the last three years, and over this period BUT's shareholder base has widened including a greater percentage of holders on retail platforms. This has been helped by AllianzGI's efforts to promote the trust to a wider audience.

BUT is currently trading on a 12.3% discount to cum-income NAV compared with a 7.3% to 19.3% range of discounts over the last 12 months. Over the last one, three, five and 10 years, the trust's average discounts are 12.5%, 10.6%, 11.2% and 12.1% respectively.

Exhibit 6: Share price premium/discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

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