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How do you solve a problem like Korea?

Concentration is rising, but trusts have the tools to take advantage.

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Like Glenn Close in *Fatal Attraction*, we are prone to listing the reasons we love investment trusts, in the dark, at 3am, in a whisper. But just so they never, ever forget, the key reason is the fuller freedom the structure gives active managers to be truly active. However, this is a double-edged sword. You don't need to be Jean-Paul Sartre to recognise that freedom is invigorating, but also frightening. I think boards and managers could be braver in using some of their freedom.

Managers in the Asia and emerging markets sectors have been rewarded this year for taking a bold stance on the tech leaders TSMC, Samsung and SK Hynix. For example, [Fidelity Emerging Markets \(FEML\)](#), which is overweight the two largest companies in the MSCI EM Index, TSMC and SK Hynix, has returned 33.6% versus an MSCI EM return of 22%. While many funds have a hard or soft position limit of 10%, managers Nick Price and Chris Tennant held a 16.9% position in TSMC as of the end of July, meaning they were overweight the 15.5% position in the benchmark. Meanwhile, [Pacific Horizon \(PHI\)](#) is the top performer in the Asia Pacific sector and held 13.8% in TSMC at the end of August. While this was underweight the 16.9% in its benchmark (the MSCI AC Asia ex Japan Index), it is well over the 10% limit many funds stick to. Meanwhile, PHI held 12.6% in Samsung, well ahead of the 9% in the benchmark as well as the 10% mark.

UCITS funds are restricted to 10% in a single position, but trusts are not. It may seem prudent to follow the UCITS rules, but the rules are completely inconsistent. This is shown by the fact that passive funds are excluded from the concentration rules entirely. So, it is 'safe' to hold 16.9% in TSMC, if it is in an ETF, but unacceptably 'risky' to hold 10.1% in Samsung, if it is in an active fund. This makes total sense if you are a bureaucrat, but then bureaucrats also think importing oil from the other side of the world is greener than drilling it here.

The issue of concentration is most important in Asia and emerging markets (although some will be interested to know

the MSCI Serbia Index has a 100% weight in Dunav ad Beograd). TSMC makes up 55% of the MSCI Taiwan, and Samsung 39% of the MSCI Korea. This cascades into the high weights in the regional benchmarks. However, concentration is high across many markets, with successive revolutions in the global technology space a key driver. Alphabet makes up 44% of the world communication services sector, Amazon 28% of the consumer discretionary sector and Nvidia 16% of the information technology sector, creating issues for thematic or sector strategies. If we expand our analysis to look at the weight of the five largest stocks, the IT sector has a 52% weight, emerging Asia a 39% weight and China a 32% weight, to pick just a few examples. The US, where commentators warn concentration is rising, looks relatively diversified, with 27%, just behind India, and only 7.7% in the largest stock, Nvidia.

One way of approaching this issue is to hope it goes away. Historically, much of the outperformance of active funds has come from small and mid-cap companies, and active funds have tended to do better against all-cap indices when these smaller segments have outperformed. It must be tempting to stick to near benchmark-weights in the large caps, look for opportunities lower down and wait for the cycle to turn, particularly for managers who also manage UCITS funds and therefore spend much of their day with one hand tied behind their backs.

I think it is dangerous to take this attitude. AI is going to revolutionise most workplaces, and has started in many of them, underneath the surface. While the current winners may not remain on top, the market is truly global, meaning the leading stocks are likely to be capable of delivering the sort of earnings growth small and mid-caps have historically. Making the right call on these companies is going to continue to be critical, and the right call is highly unlikely to be consistently underweighting them.

Moreover, the investment trust structure offers managers a way to take advantage of this situation and strike a blow back against the shift to passive. Look at how [Baillie Gifford US Growth \(USA\)](#) was able to let its position in SpaceX rise to over 15% of the portfolio before the IPO. Investing in private companies is one differentiator, but the ability to back the biggest companies in the world with conviction is another, and simply not an option UCITS funds can take. In this light, we find Saba's latest attempt to take control of USA regrettable: the trust utilises the investment trust structure to the full to give investors an option hard to find elsewhere, and very

different from a passive fund. Shareholders have to vote if they want to support the current board and ensure there is no strategy change, as we discussed in a [recent update](#).

Markets are constantly changing, and investors need to adapt to survive. Investment trusts have the tools to deal with the extreme concentration we are seeing develop, and make money by overweighting as well as underweighting the megacaps. I hope to see more boldness from managers in the future; it could be what keeps money flowing into active funds instead of passive. And if I don't, well, say goodbye to the bunny.

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