Lies, damned lies, and statistics

The impact of the pandemic in 2020, and interest rates in 2022, will have a profound effect on performance data in March this year...

Update
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We're rapidly approaching that time of year when investors start thinking about ISA investments, and while everyone is familiar with the disclaimers about past performance not being a reliable indicator of future returns, for many of us past performance is certainly one element taken into account when making investment decisions.

This year, the performance tables around the end of March are going to feature two events that continue to dominate the investment landscape, both of which will dramatically alter the way performance tables appear. First, the pandemic, which in late March 2020 saw markets bottom out after significant falls. That means that the starting point for five-year performance is, in the next few weeks, going to be rebased lower dramatically and the five-year numbers for virtually all investment trusts are therefore going to look significantly better than they do now. Secondly, market response to interest rate rises in 2022 really began in March 2022, and this is going to reshape the three-year performance figures. Five and three years are, as we know, the main performance periods that industry data defaults to and they are heavily scrutinised by investors.

One can use that knowledge in a few ways. The simplest, which is what most of us should be doing, is to acknowledge that this shake-up is about to occur and allow for it in any analysis of performance. Next, a more complex thought is that this knowledge may help explain other investors' behaviour. As we will see in some examples below, the effect on performance tables is quite striking and it's not hard to imagine it turning some people's heads. Could this influence discounts?

Many years ago, anticipating what performance tables would be like in a month or two's time was a trading strategy regularly employed by some investors. We think that the way trading and flows in and out of investment trusts work these days makes this less likely, but we can't say for sure. Furthermore, the analysis might help us learn a little bit more about the different trusts and investing more generally. The pandemic was a highly correlated event where investment trusts, and really all risk asset classes, fell as one. In contrast, the interest rate event saw a dispersion of returns. Again, both these facts have been heavily referenced in performance commentary over the years, so they won't be startling insights. But as we approach the twin anniversaries it's helpful just to mark the calendar and remember what happened.

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For those for whom these events were their first encounter with a big market fall, we suggest they make a note, as in the years to come these events will be a big element of what we call 'experience' and for those who have seen it all before, it's useful to reflect that actually, no we haven't seen it all before, as the nature of these two events was very different to anything else. Either way, it's helpful to take a moment to remember, as it's one thing to see it on a chart, it's another thing to have been there at the time.

With the above out of the way, let's focus on some examples. What we don't want to do is weigh readers down with a deep analysis that implies that any of what follows is complex. It isn't, and here's a chart that explains everything else we are going to look at. This is the NAV total return of the Morningstar Europe peer group for the five years beginning in January 2020. We can see that big dip in markets in March and the two straight lines help illustrate the dramatic shift that is about to occur at this starting point for five-year performance numbers.

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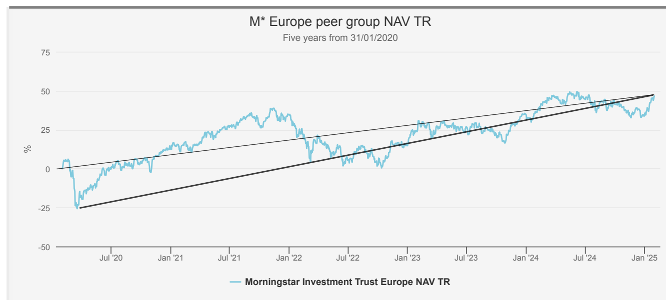
Fig.1: Five-Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.

The thicker of the two straight black lines above covers a period of 58 months to the end of January 2025, so if we just assume that between the end of January and the end of March 2025, markets don't move up or down very much, we can use that period to estimate what five-year performance tables will look like by the end of March. The table below does that for the underlying trusts in the Europe peer group. The first column labelled 'Pre-Pandemic' is the actual five-year return to the end of January 2025. The second, 'Pandemic' is the 58-month period that starts at the low point. We've added a further column 'Post-Pandemic' which takes its start point at the end of April 2020. This gives us a further idea of what five-year performance tables will look like by late Spring 2025, although of course the further we project into the future, the greater the probability of events upending that analysis become. We've chosen Europe as it's a reasonably sized peer group of trusts with, broadly, the same equity growth strategy. We hope the individual managers can forgive us for that statement, but it's a fair generalisation in this context. And, as we will see later, there are some notable differences between the trusts in this group. To be strictly accurate, our 58-month period actually begins on 20/03/2020. Not all markets bottomed on exactly the same day, but this date is a reasonable approximation.

The fact that the Pandemic column above shows higher figures across the board won't come as a surprise. It's easy to forget though that lowering the starting point by even a little bit can have such a powerful effect on percentage gains. If something halves in value, that's a 50% fall, whereas to get back to the starting point requires a 100% increase. That is such a simple piece of mathematics that it can be easy to forget, and this writer has seen experienced analysts and fund managers tripped up by it. As we note above, while we don't know exactly what effect these numbers might have on investor behaviour, it's not hard to imagine some of those very high, greater than 100% numbers above, catching some investors' eye. As the third column shows, the air rapidly comes out of those numbers as markets quite quickly bounced back during 2020.

Enduringly, the most popular investment trust sector is UK Equity Income and the next table performs exactly the same exercise for that sector. Again, it's a striking reminder of how lowering the start point has a dramatic effect on subsequent percentage gains.

Europe Five-Year Projected Performance

	TICKER	PRE-PANDEMIC 01/02/2020 31/01/2025 NAV TR (CUMULATIVE)	PANDEMIC 20/03/2020 31/01/2025 NAV TR (CUMULATIVE)	POST-PANDEMIC 30/04/2020 31/01/2025 NAV TR (CUMULATIVE)
Baillie Gifford European Growth	BGEU	24	54	26
BlackRock Greater Europe	BRGE	66	118	81
European Opportunities Trust	EOT	12	59	29
Fidelity European Trust	FEV	69	107	81
Henderson European Trust	HET	68	119	83
JPMorgan European Growth & Income	JEGI	73	135	99

Source: Morningstar

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UK Equity Income Five-Year Projected Performance

	TICKER	PRE-PANDEMIC 01/02/2020 31/01/2025 NAV TR (CUMULATIVE)	PANDEMIC 20/03/2020 31/01/2025 NAV TR (CUMULATIVE)	POST-PANDEMIC 30/04/2020 31/01/2025 NAV TR (CUMULATIVE)
Finsbury Growth & Income	FGT	29	61	42
BlackRock Income and Growth	BRIG	34	92	59

Merchants Trust	MRCH	44	154	89
Edinburgh Investment	EDIN	54	132	95
Diverse Income Trust	DIVI	26	74	39
CT UK High Income	CHI	27	98	54
Chelverton UK Dividend Trust	SDV	0	157	68
CT UK Capital and Income	CTUK	22	108	58
abrdn Equity Income Trust	AEI	11	93	48
British & American	BAF	40	66	55
Schroder Income Growth	SCF	32	103	64
JPMorgan Claverhouse	JCH	30	108	71
Dunedin Income Growth	DIG	28	80	45
Murray Income Trust	MUT	27	80	46
City of London	CTY	40	105	69
Temple Bar	TMPL	36	169	113
Shires Income	SHRS	26	96	51
Lowland	LWI	23	109	69
Law Debenture Corporation	LWDB	67	149	109

Source: Morningstar

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Finally, the next table repeats the exercise for the three Asian sectors of smaller companies, income strategies, and growth strategies, with the three groups shaded to distinguish them. Again, the first two columns show that there were very few places to hide in that period, as every trust has a higher 'Pandemic' performance number. The third column though hints that some trusts may have had a better time since then and we'll come on to that when we look at the impact of interest rates next.

Asia Five-Year Projected Performance

ASIA	TICKER	PRE-PANDEMIC 01/02/2020 31/01/2025 NAV TR (CUMULATIVE)	PANDEMIC 20/03/2020 31/01/2025 NAV TR (CUMULATIVE)	POST-PANDEMIC 30/04/2020 31/01/2025 NAV TR (CUMULATIVE)
abrdn Asia Focus plc	AAS	64	112	93
Fidelity Asian Values	FAS	65	117	91
Scottish Oriental Smaller Cos	SST	65	101	100
abrdn Asian Income Fund	AAIF	44	85	63
Henderson Far East Income	HFEL	6	31	14
Invesco Asia	IAT	51	91	63
JPMorgan Asia Growth & Income	JAGI	32	52	36
Schroder Oriental Income	SOI	51	93	67
Pacific Assets	PAC	52	77	70
Asia Dragon	DGN	11	32	19
Schroder AsiaPacific	SDP	39	63	45
Schroder Asian Total Return Inv. Company	ATR	59	94	67
Pacific Horizon	PHI	98	144	94

Source: Morningstar

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The next table uses the same format to look at how the interest rate anniversary will change the three-year performance of the European trusts. Again, focussing on the first two columns, the first one is actually three years and one month (i.e. 37 months), and the second is 34 months, timed more or less at the point markets peaked before rising interest rates took their toll. We can see here that the three trusts that we might describe as being more defensively positioned at the time, **Fidelity European Trust (FEV)**, **Henderson European Trust (HET)**, and **JPMorgan European Growth & Income (JEGI)**, did not see quite the same dramatic rebasing of their performance as a result of interest rate hikes. Although we would not describe any of these as thoroughly value-orientated, the latter two took on more value positions around this time, which performed better, and the first, FEV, tends to favour lower beta defensive stocks which again, performed better in 2022 than the index.

But here's the point, one could easily slip into looking at the table above and think that it was sending a signal that those three trusts mentioned above are in some way 'better'. But because we know the context of this chart, we can say that some performed better than others because of their inherent characteristics. Understanding that **BlackRock Greater Europe (BRGE)**, which has a very notable longer-term track record, performs better in some circumstances might help an investor choose it, or lead an investor to **Baillie Gifford European Growth (BGEU)** for its very considerable recovery potential in some of the higher growth names, or to **European Opportunities (EOT)** for a return to its outstanding twenty-year track record.

Strikingly, it's a very different story for the UK Equity Income sector as the table below shows. Many of the stalwarts of this sector, taking **City of London (CTY)** as an example, show very little effect from the interest rate-hiking cycle, with the before, during, and after performance figures all much the same. To our point above about 'experience', one thing to take away from this is that certain asset classes are interest rate sensitive in a fairly obvious way, property and infrastructure being good examples, but sensitivity in equities is more complex. If high-growth companies are achieving very high valuations based on earnings far in the future, then a small change in interest rates can have a dramatic impact, whereas companies with very reliable earnings today, which trade at lower valuations, may weather interest rates much better, even if one might think that because they have a dividend yield, they might be more vulnerable.

These more reliable companies tend to be the backbone of all the trusts below and thus weathered the cycle better. That's not to say that some share prices haven't suffered, and thus discounts have developed, but again, looking at performance through this lens might help an investor gain confidence that those discounts are an opportunity rather than a warning sign. Coming right up to date, a trust such as **CT UK Capital & Income (CTUK)** has currently positioned itself to avoid very specific interest rate changes in future, such as those the manager perceives within UK high street banks and instead is looking for value and specialist financials further down the market-cap spectrum, which again shows that this sector is perhaps less sensitive that a superficial analysis might imply.

Europe Three-Year Projected Performance

	TICKER	PRE-INTEREST RATES 01/01/2022 31/01/2025 NAV TR (CUMULATIVE)	INTEREST RATES 31/03/2022 31/01/2025 NAV TR (CUMULATIVE)	POST-INTEREST RATES 30/06/2022 31/01/2025 NAV TR (CUMULATIVE)
Baillie Gifford European Growth	BEGU	-26	-4	18
BlackRock Greater Europe	BRGE	-2	19	43
European Opportunities Trust	EOT	6	13	23
Fidelity European Trust	FEV	24	31	39
Henderson European Trust	HET	25	33	43
JPMorgan European Growth & Income	JEGI	27	36	46

Source: Morningstar

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UK Equity Income Three-Year Projected Performance

	TICKER	PRE-INTEREST RATES 01/01/2022 31/01/2025 NAV TR (CUMULATIVE)	INTEREST RATES 31/03/2022 31/01/2025 NAV TR (CUMULATIVE)	POST-INTEREST RATES 30/06/2022 31/01/2025 NAV TR (CUMULATIVE)
abrdn Equity Income Trust	AEI	10	8	13
BlackRock Income and Growth	BRIG	25	24	28

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British & American	BAF	45	124	67
Chelverton UK Dividend Trust	SDV	-16	-6	4
City of London	CTY	32	28	29
CT UK Capital and Income	CTUK	13	18	23
CT UK High Income	CHI	21	28	30
Diverse Income Trust	DIVI	-1	3	8
Dunedin Income Growth	DIG	13	20	26
Edinburgh Investment	EDIN	38	37	43
Finsbury Growth & Income	FGT	14	23	30
JPMorgan Claverhouse	JCH	18	22	31
Law Debenture Corporation	LWDB	28	25	30
Lowland	LWI	14	16	24
Merchants Trust	MRCH	22	18	21
Murray Income Trust	MUT	11	15	21
Schroder Income Growth	SCF	24	18	22
Shires Income	SHRS	14	15	22
Temple Bar	TMPL	42	40	45

Source: Morningstar
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Returning to our last sample set, the Asian trusts, the next table repeats the interest rate analysis. What we know already is that Asian companies arrived in the rate-hiking cycle with relatively low debt and far fewer of the high-valuation companies that fell so far in Europe, and the US. This is particularly the case with smaller companies, as noted to us by the managers of both **abrdn Asia Focus (AAS)** and **Fidelity Asian Values (FAS)**, and their domestic earnings focus also helped shield them from the shock of rising rates. The table below clearly shows that there is very little effect from the start of the rate-hiking cycle on the performance of these trusts.

Asia Three-Year Performance

ASIA	TICKER	PRE-INTEREST RATES 01/01/2022 31/01/2025 NAV TR (CUMULATIVE)	INTEREST RATES 31/03/2022 31/01/2025 NAV TR (CUMULATIVE)	POST-INTEREST RATES 30/06/2022 31/01/2025 NAV TR (CUMULATIVE)
abrdn Asia Focus plc	AAS	15	20	26
Fidelity Asian Values	FAS	20	21	19
Scottish Oriental Smaller Cos	SST	38	45	44
abrdn Asian Income Fund	AAIF	12	11	18
Henderson Far East Income	HFEL	4	-1	5
Invesco Asia	IAT	13	14	11
JPMorgan Asia Growth & Income	JAGI	7	11	12
Schroder Oriental Income	SOI	22	17	23
Pacific Assets	PAC	8	18	18
Asia Dragon	DGN	-12	-5	-3
Schroder AsiaPacific	SDP	3	8	13
Schroder Asian Total Return	ATR	9	16	28
Pacific Horizon	PHI	-13	-5	3

Source: Morningstar
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Conclusion

At its simplest level, the analysis above just goes to show, in possibly too much detail, that it's good to know what was happening around the start date of any performance analysis, as a few weeks, either way, can make a huge difference to what the data looks like. This is about to happen and investors with a date in their diary for some homework on ISA investments may wish to ensure they take a snapshot of performance tables before the big impact of the pandemic tilts the numbers and look at the two alongside each other. Another version of this note could have been at least twice the length and included tables for every sector, but we've chosen some examples where first, the sectors are of a good size and provide a spread of examples and second don't all march to the same tune and thus provide us with different responses to interest rates, if not the pandemic.

It also helps to show that not all big events are made the same, and while interest rate hikes have cast a long shadow over many asset classes, the impact on equities varies according to which economies they face, what their balance sheets look like, and what their starting valuation was. There is no special reason why these anniversaries require investors to take any particular action, but as we note above, they both form part of our investing experience and sometimes it's just helpful to look back on events. Not a guide to the future, then, but perhaps helpful in guiding how we as investors respond to future events.

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