Never Gonna Give You Up

We argue rising activism means now is not the time to throw in the towel...

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Analysts:
Thomas McMahon
+44 (0)203 795 0070

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Saba has come back for another attempt at extracting value from its closed-ended fund holdings. It was hard to see their rationale for picking the first **seven trusts they targeted unless** it was simply that they thought the high retail shareholder ownership meant many investors wouldn't vote, increasing their chances of winning. This was a miscalculation if so, with all votes being convincingly lost. Their second, smaller selection of targets seems to be united by their fairly straightforward, vanilla strategies. All own long-only equity portfolios focussed on major developed markets, which is perhaps why Saba feels it justifiable to claim that they would be good candidates for converting into open-ended funds.

For those that haven't yet seen their proposals, they are that the companies wind up and offer rollovers into open-ended equivalents, with the alternative of a cash exit. These four are **Middlefield Canadian Income (MCT)**, **Schroder UK Mid Cap (SCP)**, **CQS Natural Resources Growth & Income (CYN)**, and **European Smaller Companies Trust (ESCT)**. Saba has requisitioned shareholder meetings to vote on their proposals and will require other shareholders to vote with them to win. We think investors would lose out in all these cases if the funds did go open-ended, but that doesn't mean that all activism in the sector is unhelpful.

Saba's proposals

We should note first that Saba has temporarily withdrawn its proposals on ESCT and MCT and is in discussion with the board on the next steps. We still feel inclined to point out that ESCT has outperformed the open-ended equivalent fund run by Ollie Beckett for Janus Henderson pretty consistently. Over ten years, the share price returns are ahead of the returns for the fund, and the NAV returns only very marginally below. In more recent years, the outperformance has been considerable, with five-year annualised NAV total returns of 10.8% versus 8.8% per annum. The trust also makes liberal use of the ability to take on gearing, and when packaging that with the discount, the long-term potential for share price returns looks pretty attractive to us. We suspect that the outcome of Saba's discussions may be the facilitation of their exit while the closed-ended fund remains intact.

The case for SCP is equally as strong. Ten-year returns have been ahead of the index, although returns more recently have been poorer than the equivalent fund. Gearing will have had an effect in difficult markets but adds to the recovery potential—SCP is ahead of the index and its open-ended equivalent over the past year as markets have rallied. In our view, the discount adds to the attraction of the trust at this point.

CYN and MCT don't have open-ended sister funds. They do, however, both make good use of the closed-ended fund structure to gear up, with 8% and 13% respectively. (MCT is a Jersey-incorporated cell company but shares some of the same important characteristics as an investment trust.) This ability to gear would be lost in conversion to an open-ended fund.

CYN also uses the closed-ended structure to take positions in the smaller and less liquid companies in the mining space. Investing in less liquid securities is riskier in the open-ended structure, as managers can more easily become forced sellers or at least see the less liquid positions grow to larger as a proportion of the portfolio than they would wish if they see sustained outflows. ETFs also struggle to give exposure to these companies, particularly in the mining sector where they can be pretty illiquid and volatile.

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MCT, meanwhile, is an income fund and uses the flexibility of its structure to smooth dividends by building up reserves. It was thereby able to hold its dividend through the pandemic, even as revenue earnings fell during lockdowns. This ability would be lost in conversion to an open-ended fund, significantly reducing its attraction as an income diversifier.

Ultimately, though it is for investors to decide whether these companies still match their objectives. Saba has over 29% of the shares of three of them and just over 11% of SCP. They will need to persuade their fellow shareholders that they are better off in an open-ended fund or taking the cash.

In our view, this is just about the worst time to convert a closed-ended equity fund into an open-ended one. Wide discounts represent opportunity, and the opportunity has opened up because sentiment towards the underlying equity markets is going through a cyclical low. Investors need to decide if the 10 or 11% that could be gained from the closing of the discount to NAV less costs is more attractive than the performance potential of the trusts over a long holding period. In a rising market, if gearing, remaining fully invested and being freer with stock selection can add 2% a year over the returns of the market, then over five years, investors will make that 10 or 11% anyway, along with the returns of the underlying market. So, over a decent holding period, investors don't even need the discount to narrow to achieve these extra returns.

However, if the market rises for five years then the discount will likely close too, meaning there is another 10% or so on the table. We think the evidence of the first round of votes is that the average retail investment trust investor is investing for the long term and won't be interested in the short-term gains Saba's proposals offer. Indeed, Saba might not themselves be satisfied with these gains if they weren't reportedly highly leveraged, meaning that they will make much more than that 10–11% on the discount closing.

Saba will argue that the discount would go even wider if they were to sell their shares into the market—in other words, that their buying has meant the discount is narrower than it would otherwise be. This is possible, but untestable, so there's not much to discuss. It is true, in any case, that Saba's presence creates an issue that has to be resolved. They don't want to own these trusts over the next five to ten years like, presumably, the other investors, so one way or another they will have to be offered an exit to avoid selling down their stake weighing on the discount. It seems likely, therefore, that big tender offers which allow Saba to sell close to NAV will be on the table before too long.

Alternative assets

We are generally fairly relaxed about discounts, particularly in equity trusts, as it is still possible to make very good returns if a discount persists while NAV performance is good. However, when discounts start to get beyond the 20% mark, the pressure on boards to take action is typically very strong, and when it comes to alternative assets, a wide discount can be a more serious problem. It can signal the market thinks the valuation of the assets is wrong, or it can mean that the investors who would want to own the assets don't want to own them through an investment trust. In the case of **BBGI Global Infrastructure (BBGI)**, it was clearly the latter case, with the Ontario Teachers' Pension Plan buying the portfolio at a premium to NAV, let alone to the deeply discounted share price.

In our note on **MIGO Opportunities (MIGO)**, published last week, we discussed the view of managers Nick Greenwood and Charlotte Cuthbertson that activism would soon enter the alternatives space. As if by magic, Friday saw the publication of a prospectus for an investment trust that it appears is going to do just that. Christopher Mills and Robert Naylor have raised £54m for Achilles Investment Company, a vehicle to take stakes in closed-ended funds and unlock value by working with boards. The prospectus does not state the focus will be alternatives, but media reports suggest it will. In any case, we expect their approach will be less confrontational than Saba's, which is likely to work better in Britain. The limited market capitalisation at launch also implies this; it means the stakes taken are likely to be small meaning cooperation with other shareholders will likely be required. In our view, this is much more likely to lead to good results for investors than Saba's confrontational campaigns which have so far been focussed on removing trusts entirely from the sector.

With the infrastructure sector trading on a weighted average discount of 20% and the renewable infrastructure sector 34%, the gains to be made from the discounts are much more attractive than is the case with the equity trusts, so it would make sense for activists to take aim here. For those who don't have exposure, this might be a good time to be looking for value here, particularly if corporate activity and activism are going to feature more.

In particular, we think that **The Renewables Infrastructure Group (TRIG)** and **Greencoat UK Wind (UKW)** look good value after a recent sell-off. There seem to be many institutional buyers withdrawing from the market for renewable infrastructure at the moment, such as BP, which may be weighing on sentiment. There have also been modest hits to NAV from assumptions about power prices and, in the case of UKW, lower assumptions of future wind

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speeds. But operationally, both portfolios are performing well and throwing off enough cash to offer yields of 10% (TRIG) and 9.3% (UKW). These are higher than the expected average returns from equity markets, all thanks to the excessive discounts of 37% and 26%.

In our view, trusts such as TRIG and UKW with high-quality, institutional-scale assets are unlikely to prove long-term value traps given the high quality of the underlying assets. In the medium term, we are transitioning to low-carbon energy, and so the assets should continue to be valuable. Meanwhile, boards are taking action and buying back huge amounts of shares. UKW has just completed a £100m buyback programme and we may see another announced at the full-year results which are due this week. TRIG has announced it will be increasing the scale and pace of the buyback programme from £50m to £150m. It may be there aren't enough investors who want to own these assets in the investment trust structure to keep the shares trading close to par, but this is something that engagement and activism can tackle. There are plenty of solutions that fall short of winding up the structure or selling the whole portfolio.

It seems unlikely to us that the infrastructure sectors will follow the path of listed private equity, which has traded on wide discounts for a number of years. PE trusts were arguably slow to take significant action to close their discounts, although boards have increasingly been active over the past year or so with some aggressive buyback programmes. The infrastructure sectors seem to have grasped the nettle sooner, and the threat of activist shareholders is likely to sharpen the focus. PE and growth capital remain areas of great conviction for **AVI Global (AGT)**, as we discuss in our **latest note**, published last week. AGT's managers continue to engage with **HarbourVest Global Private Equity (HVPE)**, for example, leading to several changes, including doubling the amount of cash realised from the trust's portfolio that will be allocated to the distribution pool, which is expected to be used for share buybacks. AVI estimates that, if distributions meet the forecast, HVPE could repurchase c. 9% of its shares at the current share price. The board has also announced a switch to investing directly in underlying third-party funds, as well as a continuation vote at the AGM in mid-2026.

Nick Greenwood and Charlotte Cuthbertson of MIGO are now managing MIGO for AVI. They can now work in concert with Joe Bauernfreund, Tom Treanor, and the team on a few cross-shareholdings. One of these is **Chrysalis (CHRY)**, which sits in the AIC Growth Capital sector and invests in unlisted businesses. CHRY has a meaty capital allocation policy, having decided to return the first £100m of cash made from sales in buybacks. Over the last quarterly reporting period, buybacks contributed 2.6p per share to a return of 15.36p (11%). Holding Klarna is expected to IPO shortly, and its stake is valued at £144m in the latest update. With the IPO forecast to come in at or above the current valuation of the business, it seems likely that there will be a major distribution of capital in the coming months. CHRY shares trade on a 36% discount to NAV, even after a share price return of 18.6% over the past year.

Conclusions

In our view, discounts generally represent opportunity rather than failure. This is particularly the case in the equity sectors, where there is the possibility for either beta or alpha and indeed for some judiciously applied gearing, to deliver multiples of the discount in a single good year. We think Saba's proposals to roll four trusts into open-ended equivalents would be a disappointing outcome for most shareholders, who stand to gain more over the long run thanks to the benefits of the investment trust sector, and who aren't levered in their exposure to the closing discount as Saba reportedly is. However, boards can't be complacent, and when it comes to discounts over 20% and persistent discounts on trusts owning alternative assets, there is a greater case for radical action. Investors like AVI are already making good headway with a collaborative approach to unlocking value. The recent share price falls in the infrastructure sectors have certainly led to many investors questioning their holdings, judging by our virtual mailbag. We think there's plenty of value to be unlocked for shareholders at these levels. For those who aren't involved, it may be a good time to take exposure, while existing shareholders need to be careful of selling at just the wrong time.

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