Dream team

Our analysts review how their fund picks for 2024 have done...

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Kepler Trust Intelligence

It's been a good year for investors so far, certainly for those who were willing to invest in equities despite the cloudy outlook. Thinking back to the end of 2023, there was plenty of trepidation about the health of the major economies and whether we were about to see a severe recession caused by the delayed impact of rate hikes. High cash rates saw big inflows into money market funds in December and January, according to IA statistics, in flagrant contravention of our **warnings** that the outlook for equities was better than for cash. But those who increased their equity exposure will generally have done better. It is therefore nice to report that our team picks for 2024 are a sea of green, although there is a wide spread of absolute and relative returns. Each year we ask our team members to pick a trust to do well in share price terms over the coming year, and the table below shows how this year's selections have done. If there is a general trend we could pick out, it might be that larger companies have generally done better than smaller ones, although the top performer in the list contravenes this rule. You can read the original reasons for the **picks here**, but below our analysts review how their trust has done so far and how they rate its prospects for the rest of the year.

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PERFORMANCE OF TEAM'S PICKS

TRUST PICK	ANALYST	COMPARATOR	NAV TOTAL RETURN (%)	SP TOTAL RETURN (%)	EXCESS RETURN ON NAV (%)
Rockwood Strategic	Jo Groves	FTSE Small Cap Ex Invest Trust	24.2	27.6	10.1
Brunner	Nicholas Todd	FTSE All World	8.9	17.4	-3.7
CC Japan Income & Growth	Josef Licsauer	FTSE Japan	13.9	11.8	5.6
Shires Income	Ryan Lightfoot-Aminoff	FTSE All Share	11.9	10.8	1.5
European Smaller Companies	Alan Ray	FTSE Europe Small Cap ex UK	4.8	10.3	0.1
Brown Advisory US Smaller Companies	Thomas McMahon	Russell 2000	2.2	5.2	-3.2
NB Private Equity Partners	William Heathcoat Amory		2.9	2.7	
Bellevue Healthcare	Pascal Dowling	FTSE AW Ind/Health Care	3.0	1.7	-10.2

Source: Morningstar, 01/01/2024 - 17/08/2024
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Jo Groves – Rockwood Strategic (RKW)

Without wishing to tempt fate (and risk having to eat a large slice of humble pie come December), there's a certain satisfaction in leading the KTI pack as we head into the home straight for 2024. My pick was UK small-cap specialist **Rockwood Strategic (RKW)** which has rewarded investors with a year-to-date share price return of 28%.

We've been banging the drum of UK equities for a while and there's nothing quite like putting your money (or office kudos) where your mouth is. My choice was predicated on the compelling valuations of UK small-caps, given the MSCI UK index was trading on a trailing price-earnings ratio of 11.3x, less than half the 23.9x of its MSCI US peer (and a fair whack below its historic average).

Despite the recent bounce in UK equities pushing the price-earnings ratio up to 12.7x, the discount remains largely intact with the MSCI US index heading up to 26.3x (as of 31/07/2024). It's not entirely surprising that some UK fund managers have described this as a 'once-in-a-decade' opportunity to snag a bargain.

So, what's been driving performance? After a long spell in the doldrums, UK small-caps are finally showing signs of recovery, with the FTSE Small Cap Index up by almost 10% this year (as of 19/08/2024) on the back of the improving macroeconomic backdrop. Inflation fell to its target level (at last), the Bank of England cut base rates (ahead of the Fed), and consumer and business confidence are at their highest levels in almost two years. And let's not forget that our general election is done and dusted whilst the US faces several more months of speculation on that front.

Whilst a rising tide lifts all boats, manager Richard Staveley has significantly outperformed both the FTSE Small Cap and AIM benchmark indices. Richard runs a concentrated portfolio, enabling a private-equity style approach towards encouraging boards to unlock value which creates a tailwind for returns.

One of the standout performers is Filtronic, a communications specialist based in County Durham. The company's share price has been on a blistering year-to-date run, rising by more than 220% (as of 19/08/2024), eclipsing the 160% odd gain of stock market darling, NVIDIA. Filtronic also enjoyed some stardust of its own, recently announcing a partnership with Elon Musk's Space X, and small business loan provider Funding Circle chipped in with a year-to-date share price increase of 165%.

Thanks to its track record of outperformance, it's worth noting that Rockwood is one of the few UK small-cap trusts to trade on a premium which has proved a kicker to share price returns (and prompted a further issue of shares), Looking ahead, a resumption of M&A activity in the small-cap sector could drive returns in the second half of the year. With the macroeconomic gloom lifting and UK small-caps continuing to trade at attractive valuations, I'm hopeful that Rockwood will finish the year strongly.

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Ryan Lightfoot-Aminoff – Brunner (BUT)

The Olympic medals table is usually ranked by a country's gold medal count. The US, never one not to be an exception, ranks the table by total medals, a metric that conveniently puts them a clear first. The UK used the traditional gold ranking method, but after slipping to seventh (behind the French and the Aussies no less) many media outlets decided that the total medal count was a better metric in 2024, resulting in the UK actually coming third. Which it did, clearly.

These statistical gymnastics can also put our recently departed colleague Nicholas Todd's pick of **Brunner (BUT)** in two different lights. On the one hand, the trust's NAV return to 17/08/2024 was 8.9%, ranking him a distant fourth, however, share price returns—which are what we officially use as the ranking metric—were an impressive 17.4%, taking Nick to second place overall.

Much of this has come as a result of the trust's discount closing, from around 10% at the turn of the year to close to par now. This has been particularly impressive considering the board has not undertaken any share buybacks, instead focussing on raising the trust's profile and highlighting its qualities to attract shareholders, such as the flexible and pragmatic approach, and the impressive 52 years of dividend growth track record.

This approach by managers Julian Bishop and Christian Schneider has delivered strong, consistent outperformance of BUT's composite benchmark over a number of years regardless of the prevailing market investment style. This seems to have been recognised and appreciated by

its shareholder base, leading to an impressive rerating. The managers have benefitted from their holdings in the tech sector, such as Microsoft and TSMC, as well as financials which benefitted from the higher interest rate environment. We believe this is a good demonstration of the managers' pragmatic approach as these two asset classes are typically considered opposite ends of the spectrum style-wise, but by being flexible, Julian and Christian have benefitted from both sectors.

Reassuringly, this was very much in line with Nick's thought process, aiming to pick a trust with balanced consistency that can offer superior returns without having to shoot for the stars. Based on BUT's strong showing so far this year, his reasoning seems to be pretty on target.

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Joe Licsauer – CC Japan Income & Growth (CCJI)

August 5, 2024 , marked a significant downturn in global stock markets, amid fears of a faster-than-expected slowdown in the US economy. Japan's Nikkei 225 index took a notable hit, closing more than 12% down, its largest fall since Black Monday in 1987. Investors were rattled by the Bank of Japan's decision to raise interest rates for the first time in 17 years, whilst the Federal Reserve held steady. The rate hike caused the yen to surge against the US dollar, making Japanese exports less competitive and prompting investors to unwind carry trades, where they had borrowed in Japan's low-interest environment to invest in higher-yielding US assets.

This news meant that my Japanese investment trust pick for 2024 - **CC Japan Income & Growth (CCJI)** - took a hit, erasing much of its strong first-half-year performance. However, these volatile market swings occur and the challenge for investors in these situations is resisting those initial knee-jerk reactions. Simply waiting one day, in this example, would have completely changed the narrative. If your broadband went down for the day and you decided to watch all three Lord of the Rings films (extended edition) twice, totalling just over 24 hours, you may not have even noticed the movement in the market. Within 24 hours, Japan's stock market and CCJI both rebounded 10%.

Richard Aston, CCJI's manager, argues the structural long-term drivers in Japan will be more significant for investors than short-term currency gyrations. As such, he remains focussed on the long term, targeting high-quality, attractively valued companies, and emphasising opportunities arising from Japan's improving dividend culture, seeking companies committed to enhancing shareholder value. This approach sets CCJI apart from most others in the sector, which tend to pursue higher-growth-focussed strategies.

Despite concerns of another false start, I think Japan still presents opportunities, supported by the number of underlying factors driving the Nikkei's ascension this year. Japan, unlike many other nations, is welcoming positive inflation, which has allowed companies to exert their pricing power for the first time in years. It's also benefiting from increased demand given investors antipathy towards China. Additionally, the country's decade-long corporate governance push, perhaps the most significant driver of opportunity, has led to material improvements at the stock level. With around 1,600 companies still below P/B and ROE requirements, I think there could still be a significant runway for growth, suggesting Japan might be in the early stages of a multi-year opportunity.

Richard's extensive experience, honed over two decades of investing in Japan, positions him well to capitalise on these factors and uncover less well-known alpha opportunities. His differentiated strategy and strength in stock picking have helped the trust perform well since launch (to 17/08/2024), delivering NAV total returns of 159.9% and a share price return of 137.3%, versus Japan's stock market rise of 102.7%.

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Ryan Lightfoot-Aminoff – Shires Income (SHRS)

Once again, my pick has landed me almost exactly in the middle of the pack relative to my peers, similar to my inaugural effort in 2023. However, the trust I picked for 2024, **Shires Income (SHRS)**, has achieved double-

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digit share price returns of 10.8% representing an outperformance of the benchmark of 1.5 percentage points, which I believe is a very satisfactory result.

My reasoning for picking SHRS was based on its diversified portfolio which could offer resilience in a number of market conditions. The trust has an equity income mandate which I believe can offer resilience should the challenging market conditions of 2023 persist, whilst also having a reasonable allocation to small- and mid-cap companies that could provide upside potential should macro conditions improve. Finally, the managers also invest in preference shares which not only offer a higher yield which could support total returns but could also be a potential beneficiary of interest rate cuts.

Many of these factors have been supportive of total returns. Smaller companies have had a good year so far, bouncing back after some challenging periods, and the Bank of England have begun cutting interest rates, albeit not quite at the scale that was hoped for at the beginning of the year, but nonetheless improving the relative attractiveness of income-generating assets.

One expectation I had that hasn't been fulfilled is the narrowing of the discount. When making SHRS my pick, I noted the 8% discount could be an opportunity. Even with its double-digit returns, the share price has underperformed the NAV which has risen an impressive 11.9%. This has meant the discount has widened to c. 10%. I believe this represents even more of an opportunity for the second half of the year.

The outlook for the UK has markedly improved since January, with the country beginning a new chapter from a political point of view, as well as seeing encouraging economic data coming through, such as first quarter GDP being the joint highest of the G7. Despite this, valuations of the UK stock market remain low, particularly in small- and medium-sized companies. As we have heard from a number of trusts that specialise in the space, particularly at our **recent small-cap event**, valuations at these levels rarely last long, and are often followed by strong recoveries over the next 12 and 24 months. This may not come in time for me to top the charts amongst my esteemed colleagues come year-end, but I believe this tailwind will continue to support returns as we move into the last third of the year.

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Alan Ray – European Small Companies (ESCT)

Whilst the rollercoaster of H1 2024 has been quite exciting in some respects, I struggle a bit to read much into seven or eight months of performance, other than to say, well, at least it's moving in the right direction. I did very recently meet Ollie Beckett, the manager of **European Smaller Companies (ESCT)**, for an update for a forthcoming note. In summary, all the factors that led me to highlight this trust for 2024 remain in place, but as Ollie Beckett said, they've just moved to the right a bit (as in, along the x-axis of time, rather than politically...). Like UK smaller companies, and for that matter smaller companies elsewhere, one of the big draws is that the asset class is unloved and on a valuation discount to large-caps. It's not entirely unfair that a higher rate environment would cause such an anomaly as the thinking goes that smaller companies may be less robust or have fewer financing options than larger companies, so a big rise in rates can't be good news. In an era of higher rates, and I think we can now call it an era, it becomes very enticing to start dreaming of the moment that rates start to fall, and easy to forget that when the moment comes it's not necessarily as a response to good news. As such the resurgence of assets that are generally considered to respond well to falling inflation and rates, such as smaller companies, can be delayed as investors recalibrate their enthusiasm. That wall of worry turns out to be just a bit higher than we hoped for. Ollie made a very interesting point during our meeting. He has participated in a few IPOs recently, and part of his thinking is that private equity firms need the IPO market to re-awaken and so the first wave of IPOs are very likely to be 'priced to go'. I'm sure private equity wouldn't use that phrase, but it's an entirely plausible argument that Ollie thinks has been borne out by the performance of the IPOs he's taken. It also remains the case that within a large and under-researched universe, there are opportunities to buy good companies that have continued to trade well, companies that are going through a transformation, or companies that are in the early stages of a significant growth phase.

Overall then, I think the case for ESCT, and its asset class remains strong. No one would have been sacked this year for buying the S&P 500, but at some point, the very narrow range of stocks driving the market must broaden and investors' confidence will rise sufficiently to allocate to smaller companies, which could lead to a very powerful recovery.

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Alan joined Kepler in October 2022. He has worked in the investment funds industry for over 25 years. The first half of his career was as an investment trust analyst, leading a highly-rated sell-side research team. More recently he has worked in corporate advisory and investment banking roles, with a focus on alternative asset classes.

Thomas McMahon – Brown Advisory US Smaller Companies (BASC)

My thesis behind picking **Brown Advisory US Smaller Companies (BASC)** was that a rally in US large-caps would broaden out into the small-caps in 2024. I thought that inflation would come down and rates could be cut, without crashing the US economy. I thought in this positive environment for equity markets, investors would start to put money back into cheaper small-caps, noting the more positive outlook for earnings and more attractive valuations.

Inflation has been a little slower to come down than I anticipated, and so interest rate cuts have been pushed back. It now looks likely that September will see the first cut. I don't think the picture has really changed: we have seen the US economy slowing, but stronger than expected which means inflation has been a little higher than expected, and so the cutting cycle is likely to be slow and not in response to a sharply deteriorating situation. I still think this environment should be good for high-quality small-caps, once the market has absorbed the first cut.

Additionally, I think the sharp correction in large-cap tech stocks seen over July and August could be a sign that the move in this sector has been and gone. Whilst NVIDIA has bounced since its August lows, it is still just below all-time highs, and Apple, Microsoft, and Meta also took a large hit. To my mind, this indicates that investors are nervous and looking for opportunities to sell and bank gains. NVIDIA earnings tomorrow could be a deal-breaker though—good results and perhaps the large-cap rally has some more legs?

In any case, I still like the outlook for BASC. Valuations remain much more attractive in small-caps rather than large-caps, whilst they have historically performed well in periods of high but declining inflation. I would interpret the narrowing discount this year as investors recognising the value in the market, but notably, it is still 8.5%. In my opinion, this is a discount that could revert quickly should momentum shift.

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Thomas is Head of Investment Companies Research and joined Kepler in April 2018. Previously he was senior analyst at FE Invest, where he was responsible for fund selection for a range of model portfolios. He covered all asset classes over time, but has particular experience with emerging markets and fixed income as well as UK smaller companies funds. He has a degree in Philosophy from Warwick University and is a CFA charterholder.

William Heathcoat Amory – NB Private Equity Partners (NBPE)

Before I get to my stock pick for 2024, may I briefly note the share price turnaround of my pick for both 2022 and 2023, Hipgnosis Songs. The share price return in 2024 has shown an impressive recovery, with the shares now delisted pending the acquisition by Blackstone, having delivered a c. 62% return YTD. In my view, this highlights the advantages of the closed-end structure, in having independent boards who can take the initiative and fight for the best value for shareholders. Once it was clear that M&A was going to be the endgame for SONG, the board composition changed considerably, and the new board performed extremely well in navigating a complex bidding situation.

My pick for 2024 was **NB Private Equity Partners (NBPE)**. The thesis was that the discount had the potential to narrow, driven by NAV progress. In terms of the latter, I expected interest rate headwinds to become tailwinds over the year, based on the expectation that interest rates in the US would start to fall. I anticipated that deal activity would increase from the muted levels of the last couple of years driving realisations from the increasingly mature portfolio. Secondly, lower interest rates may help underpin valuations at the margin.

As 2024 has transpired, rates have not fallen in the US so far, although expectations are still there that rate cuts are in the offing. As such, whilst there has been plenty of activity, including a notable step up in realisations and sales from quoted holdings (as of 30/06/2024, NBPE had achieved $126m of realisations, compared to $171m for the whole of 2023), NAV progress has been perhaps a little disappointing. The NAV total return (to 30/06/2024) is so far -0.8%. Underneath this, private investments have delivered NAV total returns of 2.4%, offset by quoted holdings declining in value and the effect of foreign exchange.

The share price total return has been positive at [+4%], reflecting a narrowing of the discount to NAV to c. 22%. In our view, the potential for NBPE to deliver strong returns in both NAV and share price terms remains strong. Private equity managers create value in a repeatable process over cycles, and NBPE is a great way to access this talent. NBPE will be repaying its zero dividend preference shares which mature soon. Once this has been achieved, surplus capital over the steady stream of dividends that NBPE already pays may be channelled towards buybacks.

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Pascal Dowling – Bellevue Healthcare (BBH)

According to the FCA—and what they say goes around here—the minimum period one should have in mind when making an investment is five years. With that in mind, the weak performance so far of **Bellevue Healthcare (BBH)**, which was David Kimberley's pick for 2024, should be of little concern.

Given that David left us earlier this year to launch a startup of his own, I thought I would step in to defend his honour because I am convinced that biotech and healthcare is well overdue its day in the sun.

Populations all over the world getting older, fatter, sicker, and richer, and the pace of technological innovation is increasing all the time as better technology leads to faster results—which for my money makes biotech and healthcare one of the best long-term growth stories in town.

This is slippery talk though, given that—apart from acting as a kind of village pillory to which the loser in this annual ritual can be strapped before being pelted with rotten vegetables—the whole point of this series is for one of us to pick the best-performing trust 'this year'.

Against that short-term backdrop, biotech and healthcare stocks continue to have a frustratingly tough time, and BBH has not been immune to these woes. The trust's woes are compounded by its focus on companies lower down the market-cap scale. The development of drugs and healthcare technology takes time and money, and in an environment where the cost of money is higher, that is not good news for companies which need debt to fund that development; smaller companies are more reliant on debt than large ones.

The good news is that with rates likely to fall in the coming months and most commentators pointing to a relatively easy landing for the US economy, that negative pressure is likely to ease. Q4 of last year may make for an interesting portent when small- and mid-caps across the sector rallied sharply as consensus formed that the peak of US interest rates had been reached.

As the first US rate cut was pushed back again and again, these relative gains have been given up, but the heat returned this summer as Powell hinted at a September rate cut. With the pendulum for healthcare so far in the wrong direction, the swing when it comes to the right one, could be impressive.

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Pascal is a partner at Kepler Partners LLP and launched Kepler Trust Intelligence when he joined Kepler in 2015. Prior to this he managed FE Trustnet, one of the UK's largest investment research websites, for ten years. In a former life Pascal was a financial journalist and he has written extensively about investment trusts and other investments for the trade and national press.

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