

Scottish Oriental Smaller Companies

Exposure to quality Asian small-cap stocks

Scottish Oriental Smaller Companies Trust (SST) is a well-established Asian trust investing in small-cap companies in the region, excluding Japan and Australasia. Following the 2015 division of First State Stewart into two companies, SST comes under the umbrella of FSS Asia and continues to be managed by Wee-Li Hee, working alongside Martin Lau and Scott McNab. Stocks are selected on a bottom-up basis with a focus on quality companies with good long-term growth prospects. The portfolio is conservatively run with a view to preserving/increasing capital rather than outperforming a benchmark.

12 months ending	Share price (%)	NAV (%)	MSCI AC Asia ex-Japan (%)	MSCI AC Asia ex-Japan Small Cap (%)	FTSE All-Share (%)
31/03/12	16.6	6.4	(6.5)	(12.7)	1.4
31/03/13	40.0	37.9	13.0	18.6	16.8
31/03/14	(17.7)	(7.5)	(6.1)	(5.0)	8.8
31/03/15	17.3	19.7	24.7	17.9	6.6
31/03/16	(8.8)	(5.4)	(8.7)	(6.8)	(3.9)

Note: Twelve-month rolling discrete £-adjusted total return performance.

Investment strategy: Quality, long-term investment

Stock selection is bottom up rather than macro driven and, as a result, sector and geographic exposure may vary considerably from the benchmark. The manager seeks to invest in reasonably priced Asian small-cap companies that have strong franchises, solid balance sheets, robust cash flows and where managements' interests are aligned with shareholders. There is a large emphasis on proprietary research and meeting with company management teams is a key part of the research process. Intrinsic values of potential investments are calculated, with a view to being realised over three to five years.

Market outlook: Potential for better performance

Despite the underperformance of Asian markets versus the rest of the world in recent years as a result of strong returns from the US market and macroeconomic issues in the Asian region, including concerns about slowing GDP growth in China, the longer-term outlook of above average economic growth remains intact. Population growth and rising disposable income remain powerful investment themes.

Valuation: Discount wider than historical average

SST's discount has been on a widening trend over the last couple of years as Asia has fallen out of favour with investors. The current share price discount to cum-income NAV of 13.0% compares to the 12-month range of 1.7% to 16.2% and is wider than the average discount over the last one, three, five and 10 years (range of 5.5% to 11.7%). However, it is roughly comparable to its closest peer. The board does not have a formal discount control policy, but has been accelerating the pace of share repurchases. At the current price, the shares are yielding 1.5%.

Investment trusts

14 April 2016

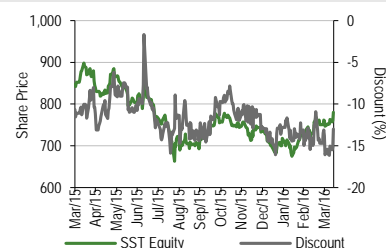
Price 780.5p
Market cap £243m
AUM £305m

NAV* 897.7p
Discount to NAV 13.1%
NAV** 897.1p
Discount to NAV 13.0%

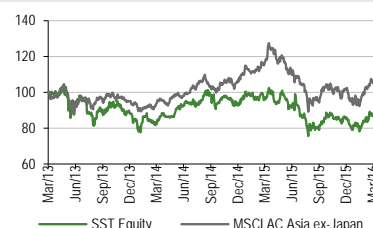
*Excluding income. **Including income. As at 12 April 2016.

Yield 1.5%
Ordinary shares in issue 31.1m
Code SST
Primary exchange LSE
AIC sector Asia Pacific – ex-Japan

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low 898.5p 663.0p
NAV** high/low 998.7p 761.5p

**Including income.

Gearing

Gross* 7.7%
Net cash* 4.5%

*As at 29 February.

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Scottish Oriental Smaller Companies Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance
Investment objective and fund background

Scottish Oriental Smaller Companies Trust's objective is to provide shareholders with long-term capital growth through investment in smaller Asian (excluding Japanese and Australasian) quoted companies. Its assets are invested in a diversified portfolio of securities, substantially in the form of equities. While the manager takes account of cultural, political and economic factors, stock-specific features are the main driver of portfolio selection with the aim of identifying good-quality companies with solid long-term growth prospects.

Recent developments

- 13 April 2016: Results for the six months ended 29 February 2016 – NAV TR of 5.9% compared with 3.1% for MSCI AC Asia ex-Japan index.
- 28 October 2015: Results for the 12 months ended 31 August 2015 – NAV TR of -8.5% compared with -9.1% for MSCI AC Asia ex-Japan index.
- 28 April 2015: Board confirms new management arrangements post Stewart Investors/FSS Asia split on 1 July 2015: Wee-Li Hee to be supported by Scott McNab and Martin Lau.

Forthcoming

AGM	January 2017
Interim results	April 2016
Year end	31 August
Dividend paid	February
Launch date	March 1995
Continuation vote	No

Capital structure

Ongoing charges	1.01% (excl. performance fee)
Net gearing	-4.5%
Annual mgmt fee	0.75%
Performance fee	Yes (see page 7)
Trust life	Indefinite
Loan facilities	£20m at 3.135% (see page 7)

Fund details

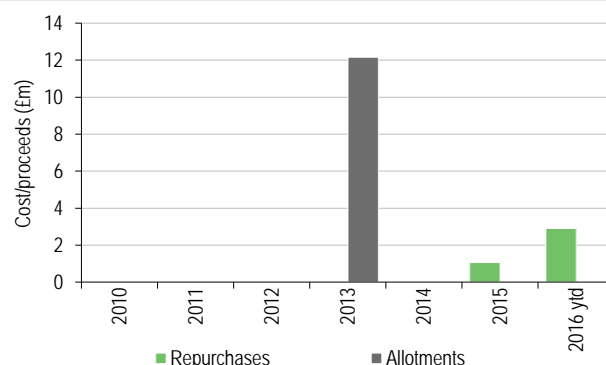
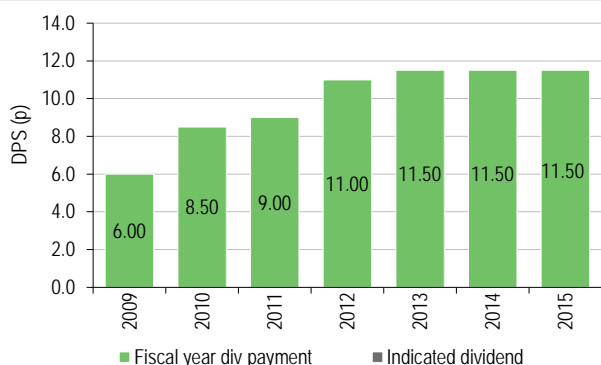
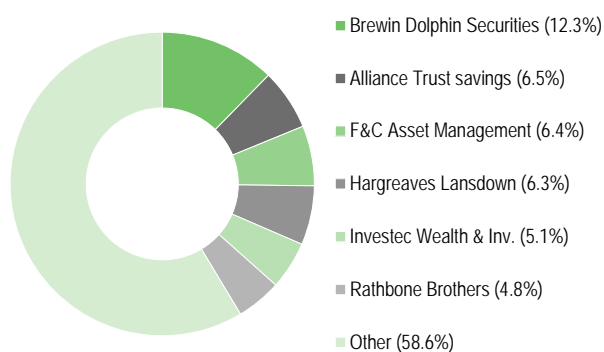
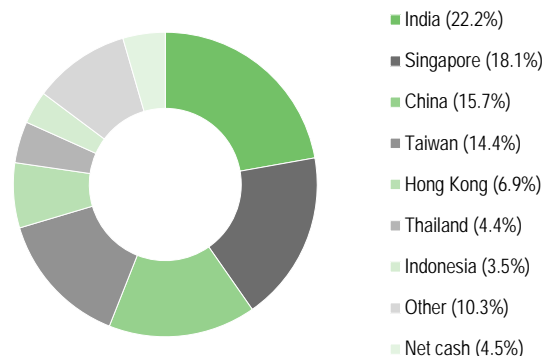
Group	First State Stewart (Asia)
Manager	Wee-Li Hee
Address	10 St Colme Street, Edinburgh, EH3 6AA
Phone	+44 (0) 131 473 2200
Website	www.scottishoriental.co.uk

Dividend policy and history

One annual dividend paid in February. The board intends to at least maintain this level of dividend, using reserves if necessary, unless company distributions fall sharply

Share buyback policy and history

The board has a repurchase authority (14.99%), which can be used where it judges it is necessary to manage the discount.


Shareholder base (as at 13 April 2016)

Geographical allocation of portfolio (as at 29 February 2016)

Top 10 holdings (as at 29 February 2016)

Company	Country	Sector	Portfolio weight %	
			29 February 2016	28 February 2015*
Marico	India	Consumer products	3.0	3.0
Raffles Medical	Singapore	Healthcare services	3.0	N/A
Taiwan FamilyMart	Taiwan	Convenience stores	3.0	2.6
Tong Ren Tang Technologies	China	Traditional medicine	3.0	N/A
Standard Foods	Taiwan	Food products	2.9	N/A
Petra Foods	Singapore	Food products	2.7	2.3
AmorePacific	South Korea	Consumer products	2.6	3.0
Interplex Holdings	Singapore	Industrials	2.4	N/A
Lu Thai Textiles	China	Textiles	2.3	N/A
Towngas China	Hong Kong	Gas distribution	2.2	2.3
Top 10			27.0	25.4

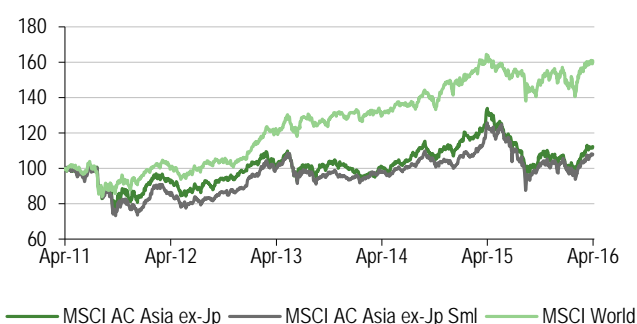
Source: Scottish Oriental Smaller Companies Trust, Edison Investment Research, Morningstar, Thomson. Note: *N/A where not in February 2015 top 10.

Market outlook: Relatively higher economic growth

Over the last five years, Asian markets have lagged the performance of the world index (Exhibit 2, left-hand side). This is due to the strong performance of the US market in recent years (its weighting is now c 60% of the MSCI World index) and more recently due to weakness in the Chinese stock market. The Shanghai Composite index fell by more than 40% between mid-June and late-August 2015, which has affected sentiment in the region; the market has struggled to recover and is now once again around the same level as the late-August low. Reasons for this have included concerns about slower Chinese economic growth, its currency and higher-margin calls for retail investors who had participated in the stock market rally earlier in the year. Despite near-term challenges, the longer-term outlook for investment in Asian equities remains positive. Rising disposable income and infrastructure spending are contributing to higher economic growth in the region versus the rest of the world. In its latest World Economic Outlook, the IMF is projecting GDP growth of 6.4% and 6.3% for 2016 and 2017 in emerging and developing Asia respectively versus 3.2% and 3.5% for world output. Looking at valuations in the region (Exhibit 2, right hand side), both large- and small-cap Asia ex-Japan indices are trading at a discount to the world index on both a forward P/E and price-to-book basis.

Exhibit 2: Indices and valuation

Asia ex-Japan and World indices: total returns over five years



Asia ex-Japan and World valuation metrics

End March	MSCI AC Asia ex-Japan	MSCI AC Asia ex-Japan Small Cap	MSCI World
P/E year forward (x)	12.1	13.1	15.8
Price/book (x)	1.4	1.2	2.1
Dividend yield (%)	2.8	2.5	2.7

Source: Thomson Datastream, MSCI, Edison Investment Research

Fund profile: Long-term view on quality small-caps

The Scottish Oriental Smaller Companies Trust (SST) was launched in March 1995 and invests in small-cap companies in the Asia Pacific region excluding Japan and Australasia. Currently holding c 80 positions, stock selection is bottom up and companies are selected for long-term capital growth. The market cap of portfolio holdings at the time of investment is generally below \$1.5bn, although up to 20% may be in companies between \$1.5-3.0bn. There are no absolute limits for the size of individual stock/sector exposures. Since 2003, the benchmark has been the MSCI AC Asia ex-Japan index. This is not an ideal comparator as it is dominated by larger companies; however, it is the most widely recognised regional index and pre-dates SST's inception in March 1995. The MSCI AC Asia ex-Japan Small Cap index (created in 2007) may also be used for comparative purposes as it covers the relevant markets with the exception of Pakistan and Sri Lanka.

In March 2015, First State Stewart (FSS) announced its intention to split into two teams allowing each to move forward as smaller, flexible businesses: one primarily based in Hong Kong (FSS Asia) and the other in Edinburgh (Stewart Investors) with both teams having their own identity and autonomy. Post separation on 1 July 2015, SST continues to be managed by Wee-Li Hee, part of the FSS Asia team, who is supported by Martin Lau (managing partner) and Scott McNab (senior investment analyst); collectively, they have 40 years' experience at FSS. There is also the ability to

draw on the resources of the rest of the FSS Asia team. Hee and McNab are based in Edinburgh and Lau is based in Hong Kong. The manager reports that the transition into two teams has been smooth, with no client losses or consultant downgrades, and it is very much business as usual; the FSS team is well established and remains well resourced.

The fund manager: Wee-Li Hee

The manager's view: Importance of “sticking to the knitting”

Manager Wee-Li Hee comments that growth is scarce and companies that can deliver predictable growth are trading on relatively expensive valuations. However, in line with SST's strategy of many years, the manager and her team seek investments in quality companies that have the potential to deliver capital growth over the long term. The top 10 holdings in the portfolio are all well known to the team and although they are currently quite expensive, they are continuing to grow and position sizes are likely to be increased following any period of significant share price weakness. It is a tough environment in which to invest so the manager states that it is very important to “stick to the knitting” and focus on quality companies with good franchises, strong balance sheets and cash flows, where managements' interests are aligned with those of shareholders.

Asset allocation

Investment process: Seeking long-term growth potential

SST aims to invest in attractively priced, good-quality companies with solid, long-term growth prospects. Stocks are selected on a bottom-up basis and sector and country weightings are not reflective of the benchmark. There is a strong emphasis on high-quality proprietary research, which includes meeting with company managements; the team conducts more than 800 direct company meetings each year. Conversations include details of the companies' competitive environment, which may lead to further ideas to be researched. Team members gain a deep understanding of companies from looking at their history, rather than relying on financial models. There is not a heavy reliance on sell-side research; one reason is that small-cap Asian companies are not always well covered by analysts. The investment approach focuses on absolute return and is inherently conservative, mindful of capital preservation as well as capital growth. There is a valuation discipline in place, but the team members are not ‘value investors’. A risk team monitors the characteristics of the portfolio including liquidity and exposure to growth versus value, but risk is essentially contained by the focus on well-managed companies with strong balance sheets plus sector and geographic diversification within the portfolio. For each of the quarterly board meetings, the managers provide the directors with detailed information about the portfolio, which gives another level of risk oversight. In line with the long-term focus of the fund, turnover is less than 50% pa.

Current portfolio positioning

There are currently 78 holdings in the portfolio; as at 29 February, the top 10 holdings represented 27.0%. This was a modest increase in concentration versus 25.4% one year ago. The largest position was in Marico, a leading Indian consumer products company. Its key products are the Parachute and Nihar brands of coconut oil haircare (with a combined market share of 57%) and Saffola premium refined edible oil (58% market share). Over the last 10 years sales have grown by more than four times and net income by nearly six times as a result of increased market share, expanded distribution and new product development. After a period of strong performance, the position was recently trimmed to keep it at c 3% of the portfolio.

There have been selected opportunities to add to existing names such as Singamas Container, a manufacturer of shipping containers and related products and logistics provider. The stock fell on concerns about slowing growth in China, resulting in an attractive valuation. The manager knows the company well; it is family owned and she believes that the business is run with passion and integrity.

Exhibit 3: Sector portfolio weightings (%)

	Portfolio 29 February 2016	Portfolio 28 February 2015	MSCI AC Asia ex-Japan weight	Active weight vs benchmark	MSCI AC Asia ex- Japan Small Cap weight	Active weight vs small-cap index
Consumer staples	19.0	17.8	5.8	13.3	5.7	13.3
Consumer disc.	16.1	19.2	8.9	7.2	18.5	-2.4
Industrials	15.2	14.2	8.6	6.6	15.5	-0.3
Info technology	12.3	9.5	23.9	-11.6	18.2	-5.9
Financials	11.8	11.4	30.4	-18.6	19.3	-7.5
Healthcare	8.0	6.2	2.7	5.3	9.1	-1.1
Materials	5.2	7.1	4.5	0.7	8.6	-3.4
Telecom services	3.7	4.2	6.6	-2.9	1.1	2.6
Utilities	3.5	3.5	4.3	-0.8	2.5	1.1
Energy	0.7	2.0	4.2	-3.5	1.5	-0.8
Net cash	4.5	4.9	0.0	4.5	0.0	4.5
	100.0	100.0	100.0	0.0	100.0	0.0

Source: Scottish Oriental Smaller Companies Trust, Edison Investment Research, MSCI. Note: Benchmark is MSCI Asia ex-Japan index and small-cap index is MSCI Asia ex-Japan Small Cap index.

Over the last 12 months the largest changes in sector exposure were a 2.8% increase in information technology and a 3.1% decrease in consumer discretionary, which has outperformed more cyclical sectors. However, both the consumer sectors remain the largest overweights versus the benchmark; the managers feel the best smaller company franchises are still in these sectors.

Exhibit 4: Geographical portfolio weightings (%)

	29 February 2016	28 February 2015	Change	MSCI AC Asia ex-Japan index	Active weight vs index	Trust weight/ index weight
Singapore	18.1	17.0	1.1	5.2	12.9	3.5
India	22.2	25.3	-3.1	9.3	12.9	2.4
Sri Lanka	2.1	2.9	-0.8	0.0	2.1	N/A
Thailand	4.4	3.1	1.3	2.7	1.7	1.6
Philippines	2.1	1.2	0.9	1.7	0.4	1.2
Indonesia	3.5	2.2	1.3	3.4	0.1	1.0
Taiwan	14.4	12.6	1.8	15.0	-0.6	1.0
Malaysia	2.7	3.2	-0.5	4.1	-1.4	0.7
Hong Kong	6.9	7.8	-0.9	12.5	-5.6	0.6
China	15.7	15.0	0.7	28.2	-12.5	0.6
South Korea	3.4	4.8	-1.4	17.9	-14.5	0.2
Net cash	4.5	4.9	-0.4	0.0	4.5	N/A
	100.0	100.0	0.0	100.0	0.0	

Source: Scottish Oriental Smaller Companies Trust, Edison Investment Research. Note: Ranked by active weight, excluding cash.

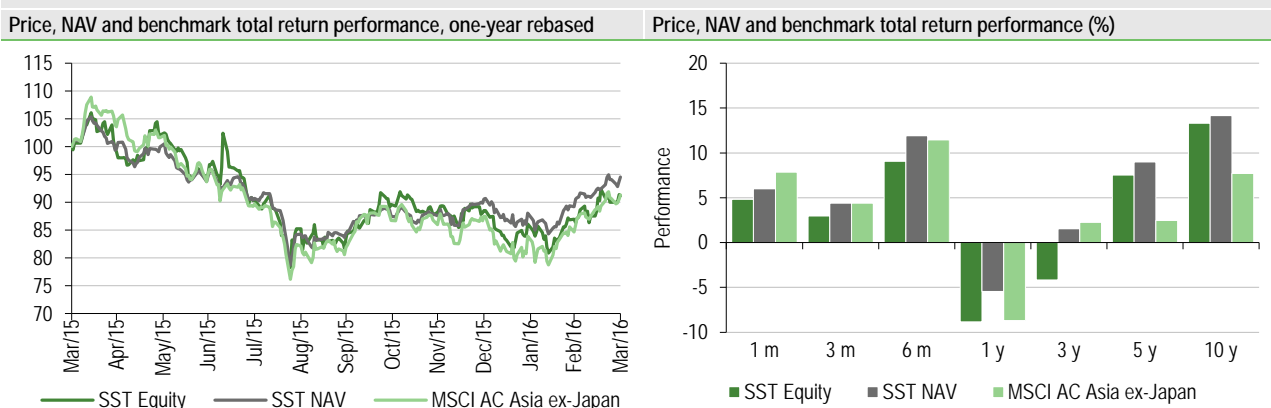
As investments are made for the long term, exposures to individual countries do not vary significantly over time. The largest change over the last year has been a 3.1% reduction in the exposure to India; this is on valuation grounds. However; the manager notes that this is a country where attractive investment opportunities are still available. A recent addition to the portfolio is Mphasis, an IT outsourcing company. It is 60% owned by Hewlett Packard Enterprise, but has been decreasing its dependence on the parent. The company has a good management team and a strong balance sheet with net cash. Its shares trade at a discount to its competitors and there is the potential for the company to be acquired. Singapore is the other large active weight in the portfolio. Exposure here is varied with some domestic and some overseas exposure; the position size should not be viewed as a positive call on the country. The manager considers the combined exposure to Greater China (China, Hong Kong and Taiwan) as their political and economic futures are interlinked. Over the past 12 months, exposure to Greater China has increased by 1.6%, although

SST is still underweight the benchmark by a combined 18.7%. The manager focuses on the companies that have the potential to build longstanding franchises, or have already built them.

Performance: Long and short-term outperformance

The manager comments that smaller companies' share prices often see large moves in periods of market volatility. By investing for the long term, focusing on companies with good management teams and strong balance sheets and cash flows, the manager aims to achieve long-term capital growth. SST has a "distinct, predictable return profile", according to FSS Asia. Since inception on 28 March 1995 to end-December 2015 it has outperformed the MSCI AC Asia-ex Japan index in 59.8% of months (39.1% in months when the market rallied and 83.6% where the market fell).

Exhibit 5: Investment trust performance to 31 March 2016



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

As illustrated in Exhibit 6, SST has outperformed its benchmark MSCI AC Asia ex-Japan benchmark in NAV total return terms over one, five and 10 years. It has also outperformed the more relevant MSCI AC Asia ex-Japan Small Cap index over all periods shown.

Exhibit 6: 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 MSCI AC Asia ex-Japan	(2.8)	(1.4)	(2.2)	(0.2)	(17.6)	27.2	66.0
NAV relative to MSCI AC Asia ex-Japan	(1.7)	(0.0)	0.4	3.6	(2.0)	36.1	78.7
Price relative to MSCI AC Asia ex-Japan Small Cap	(0.6)	2.0	0.3	(2.2)	(15.6)	33.0	64.1
NAV relative to MSCI AC Asia ex-Japan Small Cap	0.5	3.4	2.9	1.5	0.4	42.3	76.6
Price relative to FTSE All-Share	2.8	3.4	5.3	(5.1)	(21.0)	8.9	120.4
NAV relative to FTSE All-Share	4.0	4.8	8.1	(1.6)	(6.0)	16.5	137.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2016. Geometric calculation. All indices in sterling terms.

Exhibit 7: SST NAV total return vs MSCI AC Asia ex-Japan total return over 10 years, rebased to 100



Source: Thomson Datastream, Edison Investment Research

Discount: A widening trend over the last two years

At the current share price, SST's shares are trading at a 13.0% discount to cum-income NAV. This compares to a discount range of 1.7% to 16.2% over the last 12 months and is wider than the average over the last one, three, five and 10 years (range of 5.5% to 11.7%). SST is at a roughly comparable discount to its closest peer, the Aberdeen Asian Smaller Companies Trust.

Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research. Note: Negative values indicate a discount, positive values a premium.

Capital structure and fees

SST is a conventional investment trust with one class of share; there are currently 31.1m shares in issue. The board has no formal discount control mechanism, but will buy back shares opportunistically and issue new shares at a small premium to NAV when advantageous to existing shareholders. During FY15, 0.15m shares were repurchased at an average 14.2% discount to NAV. As shown in Exhibit 1, share repurchases have accelerated year to date in FY16.

While the trust had a net cash position of 4.5% at the end of February, it does have a borrowing facility. It has a £20m sterling-denominated, five-year fixed loan at 3.135% with National Australia Bank, which is due for repayment on 14 August 2019.

FSS Asia receives an annual management fee of 0.75% of net assets, payable quarterly in arrears. In addition a performance fee is payable if the share price total return exceeds that of the benchmark by 10% over a rolling three-year period. The fee is 10% of the excess return and is capped at 1.5% of net assets. In FY15, a performance fee was earned for the sixth year in succession; this increased the ongoing charges from 1.01% to 1.05% of NAV.

Dividend policy and record

In FY15, revenue returns per share increased to 15.58p from 9.59p in the previous year. This was due to a special dividend from Asia Satellite Telecom, which added 6.08p. The board has a desire to increase or maintain the annual dividend, using revenue reserves if necessary, which stood at 22.4p per share at the end of FY15. The 2015 annual dividend of 11.5p was maintained for the third year in succession. At the current share price this represents a dividend yield of 1.5%.

Peer group comparison

Exhibit 9 shows the AIC Asia Pacific ex-Japan investment trusts with a market cap above £50m. It is a group with diverse objectives including income and small-cap specialists, and mandates including and excluding Australasia. SST's NAV total return ranks above the sector-weighted average over one, three, five and 10 years. It is the best performing fund in the group over the last decade. The ongoing charge is lower than average but, unlike most of the peers, a performance fee is payable. The discount is currently one of the widest in the group (although roughly in line with its one small-cap peer Aberdeen Asian Smaller Companies Trust) and the dividend yield is lower than average. In terms of risk-adjusted returns as measured by the Sharpe ratio, SST is in line with the average over one and three years.

Exhibit 9: Selected peer group as at 12 March 2016

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (ex-par)	Net gearing	Yield	Sharpe 1 year (NAV)	Sharpe 3 year (NAV)
Scottish Oriental Smaller Cos	236.4	(7.3)	7.8	56.2	282.3	1.0	Yes	(15.1)	96.0	1.5	(1.0)	(0.0)
Aberdeen Asian Income	306.6	(12.0)	(10.4)	34.2	156.2	1.3	No	(9.6)	111.0	5.3	(1.1)	(0.6)
Aberdeen Asian Smaller	288.5	(7.0)	(4.3)	57.5	251.1	1.5	No	(14.3)	113.0	1.9	(1.3)	(0.5)
Aberdeen New Dawn	184.8	(18.8)	(8.6)	5.6	105.0	1.1	No	(13.5)	112.0	2.5	(1.5)	(0.4)
Asian Total Return Inv Company	148.3	(4.9)	14.8	13.1	110.0	1.1	Yes	(8.3)	106.0	1.6	(0.9)	0.2
Edinburgh Dragon	476.4	(15.7)	(4.7)	12.2	121.9	1.2	No	(12.4)	110.0	1.2	(1.3)	(0.3)
Fidelity Asian Values	176.8	(5.5)	33.4	37.8	171.0	1.4	No	(11.8)	97.0	0.8	(0.7)	0.7
Henderson Far East Income	326.4	(11.2)	0.9	25.4	113.7	1.1	No	(2.9)	103.0	6.7	(0.9)	(0.1)
Invesco Asia	160.1	(8.6)	23.3	30.9	143.7	1.1	No	(10.8)	102.0	2.0	(0.7)	0.5
JPMorgan Asian	207.2	(15.7)	8.7	1.2	76.3	0.9	No	(12.2)	103.0	1.0	(1.1)	0.1
Martin Currie Asia Unconstrained	101.3	(12.3)	(2.0)	13.0	46.2	1.2	No	(13.7)	103.0	2.7	(1.0)	(0.2)
Pacific Assets	243.4	(7.8)	28.1	58.1	134.0	1.3	No	2.1	100.0	1.3	(1.1)	0.6
Pacific Horizon	100.6	(14.6)	9.5	13.1	91.6	1.0	No	(11.2)	88.0	0.2	(1.0)	0.1
Schroder AsiaPacific	457.2	(11.0)	10.5	34.7	143.7	1.1	No	(12.5)	105.0	2.6	(0.9)	0.2
Schroder Oriental Income	442.6	(6.1)	8.5	50.4	170.0	0.9	Yes	(1.4)	109.0	4.3	(0.6)	0.1
Sector weighted average		(10.6)	6.2	32.2	149.0	1.1		(9.3)	105.4	2.7	(1.0)	(0.0)
Rank	8	5	9	3	1	13		15	14	10	7	9

Source: Morningstar, Edison Investment Research. Note: TR = total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are four members on the board of SST; all are non-executive and independent of the manager. Chairman James Ferguson was elected in 2004. The other board members and their year of election are Alexandra Mackesy (2004), Dr Janet Morgan (1995) and Anne West (2010). Interests are aligned as all board members hold shares in SST.

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