AcenciA Debt Strategies

Performance continues, discount persists

Investment trusts

AcenciA Debt Strategies (ACD), a closed-ended investment company, provides exposure to a focused range of predominantly debt-oriented strategies, particularly distressed debt, via a portfolio of carefully selected hedge funds. Performance continues to be positive in 2013 (+6.4% January to May), as it has in every year except 2008, with low volatility compared with equities (S&P 500) or high-yield US debt. Continuation of the fund beyond 2014 will require unanimous support from shareholders, which appears unlikely. A closing of the c 12% discount to NAV over the next 19 months would alone equate to a c 7.8% share price annual return, with dividends targeted to add a further 4% pa.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return S&P Comp GBP* (%)	MI/BoA High Yield Index GBP* (%)
31/05/10	42.8	19.5	34.9	45.5
31/05/11	19.0	9.2	10.6	4.2
31/05/12	-7.8	0.7	6.5	10.5
31/05/13	28.7	10.9	29.2	16.6

Note: *Twelve-month rolling discrete performance.

Distressed debt focus

ACD invests in a portfolio of predominantly debt-oriented hedge funds. The majority of investments are to underlying managers with very strong track records, whose funds are either closed to new investment or otherwise difficult to access. It has traditionally focused on stressed corporate situations globally, but primarily in the US. Most of ACD's underlying managers pursue multiple debt investment strategies, giving flexibility to adjust to market opportunities as they arise; European assets have increased further to c 30% of the total (31 December 2012: c 25%).

Diverse, continuing opportunities

In the US, underlying managers continue to find opportunities in shorter-duration, high-yield debt (benefiting from repayment at par upon refinancing), in the debt of companies in the later stages of the liquidation process and RMBS. The increasing European investment has been focused on opportunities from local governments disposing of assets to improve their balance sheets, and banks doing likewise to improve their capital positions. The managers have also undertaken opportunistic trading, taking both long and short positions in European sovereign debt.

Low-volatility performance and amortising discount

ACD trades at a c 11% discount to NAV despite a consistent, low-volatility performance and a yield in excess of 4%. A capital return or share buy-backs are possible in the near-term, while continuation beyond December 2014 requires unanimous support from shareholders. A full or partial wind-up and closing of the c 11% discount to NAV over the next 19 months would alone equate to a c 7.8% share price annual return, with dividends targeted to add a further 4% pa. We believe any risks to this from portfolio illiquidity are minimal.

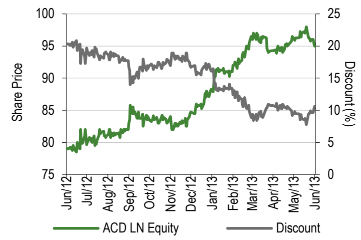
25 June 2013

Price	**95.5p**
Market cap*	**£112m**
AUM	**£124m**
NAV per share	108.06p
Discount to NAV	11.6%
Yield*	3.73%

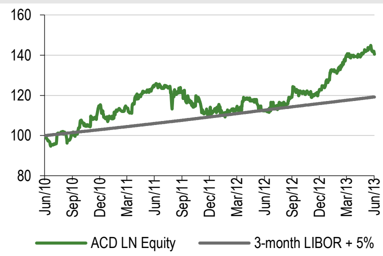
*Based on 2012 aggregated dividends declared.

Ordinary shares in issue	117.1m
Code	ACD
Primary exchange	LSE
AIC sector	Hedge funds

Share price/discount performance



Three-year cumulative performance graph



52-week high/low	98.00p	78.50p
NAV* high/low	107.37p	97.39p

*Adjusted for debt at market value, excluding income.

Gearing

Gross	0.0%
Net cash	4.2%

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Edison profile page

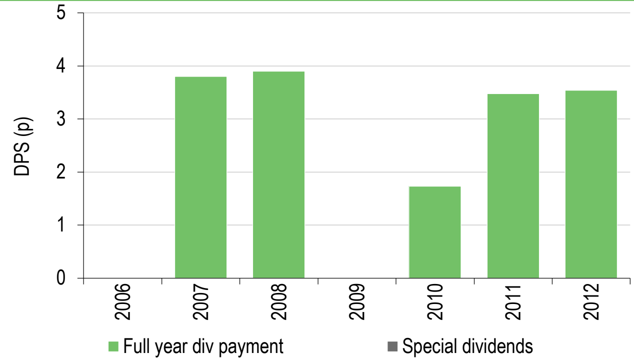
AcenciA Debt Strategies Limited is a research client of Edison Investment Research Limited

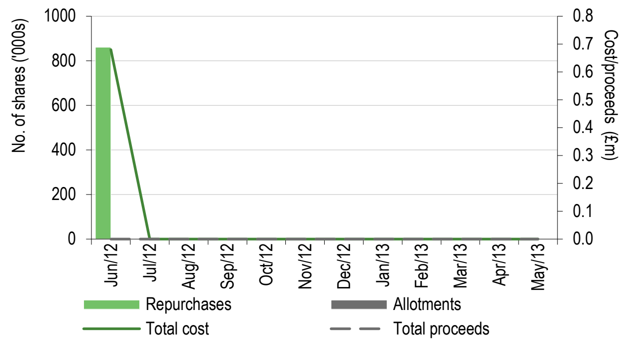
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
ACD invests in an actively managed portfolio of mainly debt-oriented hedge funds and targets annual returns in excess of three-month LIBOR plus 5% over a rolling three-year period, and annual standard deviation of under 5%. The annual management fee is 1% and the manager is entitled to a performance fee of 10% in excess of a 3% hurdle rate and subject to a high water mark (103.38p at 31 December 2013).	13 June 2013: Preliminary May 2013 NAV. 31 May 2013: Purchase of stock by investment adviser (Sandalwood), taking stake to 4.14%.

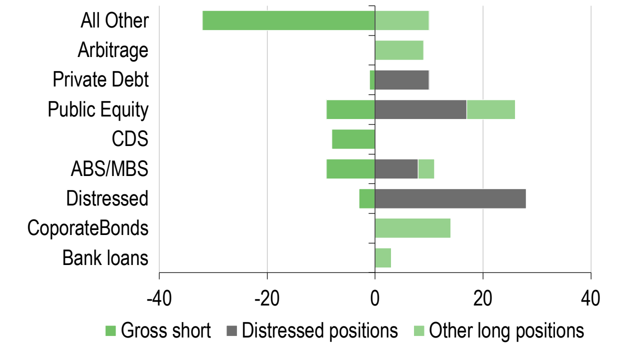
Forthcoming		Capital structure		Fund details	
AGM	April 2014	Ongoing charges	0.75%	Group	Saltus Fund Management
Preliminary results	August 2013e	Net cash	4.2%	Manager	Saltus Partners LLP
Year end	31 December	Annual mgmt fee	1%	Address	72 New Bond Street
Dividend paid	Semi annual	Performance fee	As above		London, W1S 1RR
Launch date	November 2005	Trust life	Indefinite	Phone	+44 (0)20 7499 0200
Wind-up date	Vote September 2014	Loan facilities	35% NAV cap	Website	www.acencia.co.uk

Dividend policy and history	Share buyback and history
ACD seeks to pay annual dividends totalling 3.5% of the company's NAV by way of six-monthly interim and final dividend payments.	Renewed annually, the company has authority to purchase up to 14.99%, and allot up to 10% of issued share capital.

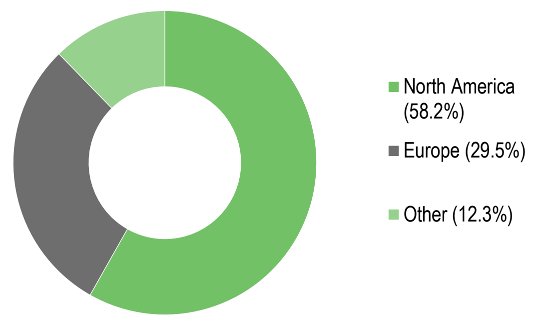




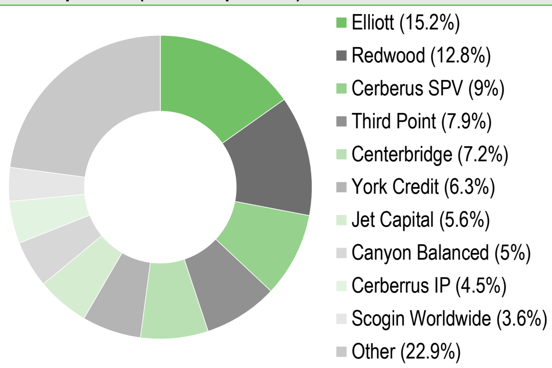
Exposure by investment type (as at 30 April 2013)



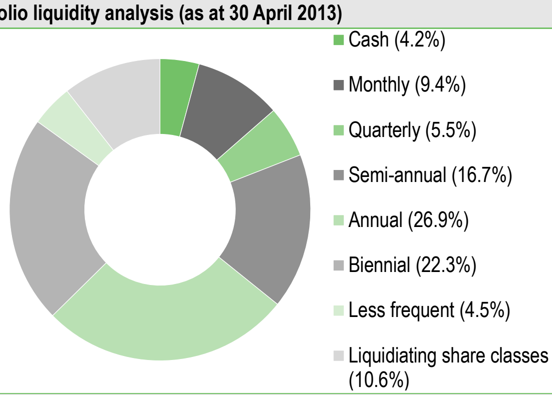
Geographic distribution (as at 30 April 2013)



Portfolio composition (as at 30 April 2013)



Portfolio liquidity analysis (as at 30 April 2013)



Source: AcenciA Debt Strategies

Fund profile

ACD is a Guernsey-domiciled, authorised, closed-ended investment company managed by the Saltus Fund Management group and advised by Sandalwood Securities. It offers exposure to a focused range of predominantly debt-oriented strategies, particularly distressed debt, via a fund of carefully selected hedge funds, the majority of which are closed to new business and would therefore not be accessible to investors. ACD's manager expects market and economic conditions to present attractive investment opportunities for debt managers over the next two to three years. The investment objective is to generate attractive returns with low volatility. This target return is officially defined as an annualised return in excess of three-month LIBOR plus 5% over a rolling three-year period (while maintaining an annual standard deviation of less than 5%), although it should be recognised that this was set before the onset of the financial crisis, which has suppressed official interest rates. In the year to 31 May 2013, NAV (based on provisional estimates of the May NAV) total return was 10.9% and it has been positive in every calendar year with the exception of 2008, when financial markets collapsed after the Lehman failure.

For a longer description and analysis of ACD, please see our January 2013 report.

Diversified debt-oriented strategies via hedge fund portfolio

ACD invests in a portfolio of hedge funds that give exposure to an actively managed and diversified range of predominantly debt-oriented investment strategies and a diverse range of underlying asset classes. These include bank loans, corporate bonds, distressed debt, asset-backed securities (ABS), mortgage-backed securities (MBS) credit default swaps (CDS), private debt and public equity. Stressed and distressed US corporate situations have traditionally been the most significant element in the portfolio.

Underlying investment strategies

The ACD portfolio is managed by Saltus Fund Management and the investment adviser is Sandalwood Securities, with more than $1bn of funds under management. We believe Sandalwood has been a very significant factor in ACD's performance, providing key advice on portfolio composition, particularly for the selection of hedge funds. Its strong industry relationships have also helped ACD access chosen funds that may not otherwise have been available to it. The portfolio is concentrated, with 10 liquid hedge fund positions (on a look through basis) accounting for 56% of the portfolio and c 70% of the portfolio adjusted for liquidating positions and cash (see below). The majority of these funds are no longer open to new investment, which means that ACD offers investors exposure to managers that it would be impossible to access directly.

Most of the portfolio consists of debt-oriented strategies that can be divided into three broad areas:

- **Event-driven investments.** In this case the fund manager looks for opportunities that will be created by significant events such as a bankruptcy, or a business reorganising or recapitalising. Distressed debt investment is an example.
- **Asset-backed investments.** This is where the fund manager invests in debt instruments that are secured against the assets of the issuer, which may often be worth significantly more than the debt itself. Examples would be fund managers investing in collateralised loans and securities, senior bank debt and distressed securities.
- **Relative-value investments.** This is where the fund manager buys one investment but sells another in the hope of benefiting from diverging values in the two. Examples would be fund managers undertaking capital structure arbitrage or convertible bond arbitrage.

Recent investment focus

The percentage of the fund invested in Europe has continued to increase (to c 30% from c 25% in December 2012) as the underlying managers find opportunities from local governments disposing of assets to improve their balance sheets and banks doing likewise to improve their capital positions. The managers have also undertaken opportunistic trading, taking both long and short positions, in European sovereign debt. Within US investments, the managers have continued to invest in shorter duration high-yield debt (benefiting from repayment at par upon refinancing) as well as the debt of companies in the later stages of the liquidation process. RMBS investments have continued to perform well, with an improving housing market supporting the managers' view that undervaluation remains.

2013 returns have been steadily positive

Exhibit 2 shows the monthly, unaudited sterling return for the fund. Monthly returns have continued positively through 2013 ytd, despite continued volatility in markets. In fact, excluding the extreme months around the Lehman crisis, what is noticeable is the relative lack of volatility in the fund return for what might be seen by some as a relatively high risk/return, volatile underlying investment class. In the 108 months from January 1997 to December 2005 Sandalwood Debt Fund B, a fund managed by the investment adviser with a similar investment approach to ACD, had just three months of negative returns and in all but one month, the monthly return was -0.6% to 1.8%. For an analysis of the fund volatility in greater detail see our January 2013 report.

Exhibit 2: ACD monthly NAV returns in sterling

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ytd
2013	1.6%	0.8%	1.4%	0.7%	1.7%*								6.4%
2012	1.3%	1.2%	1.1%	0.1%	(0.1%)	(0.0%)	0.7%	1.6%	0.9%	0.6%	0.6%	1.6%	9.9%
2011	1.4%	1.3%	(0.7%)	2.3%	0.2%	(0.4%)	0.5%	(1.7%)	(1.6%)	0.3%	(0.0%)	0.4%	1.7%
2010	1.2%	0.2%	3.8%	1.0%	(0.7%)	(0.3%)	0.4%	(0.1%)	1%	0.8%	0.0%	1.8%	9.3%
2009	2.8%	(1.9%)	0.1%	3.8%	2.7%	1.9%	2.4%	2.7%	2.5%	1.3%	1.3%	1.5%	23.0%
2008	(2.0%)	0.0%	(1.2%)	0.9%	1.1%	(0.3%)	(2.1%)	(0.6%)	(5.1%)	(9.8%)	(8.6%)	(8.8%)	(31.6%)
2007	1.2%	(2.6%)	3.5%	2.2%	1.2%	0.5%	(0.2%)	(1.1%)	0.7%	0.8%	(0.5%)	0.2%	6.0%
2006	1.6%	0.2%	1%	1.2%	0.3%	0.1%	0.2%	0.2%	0.5%	1.6%	1.2%	1.1%	9.6%
2005												1.4%	7.2%

Source: AcenciA Debt Strategies

Limited life of the fund

An EGM in September 2011 overwhelmingly supported the continuation of the fund but also approved a 'hard' continuation vote in late 2014, which will see the company wound up if any single shareholder votes for this. Moreover, shareholders voted in favour of a 20% return of capital in 2013 if the shares trade at a "persistent" discount of more than 10% in the six months to 30 June 2013. The EGM resolution stated:

In addition, if in the six month period to 30 June 2013, the company's Shares have persistently traded at an average discount of greater than 10 per cent. to its prevailing NAV per share, the board will seek to return capital in respect of up to 20% of the company's shares in issue (as at 30 June 2013) as soon as reasonably practicable. The precise method of this return of capital will be determined at the discretion of the board at the time, based on their assessment of the most effective means of managing the discount but subject always, inter alia, to applicable law, regulation and cash being readily available for such purpose.

Exhibit 3: Discount ex income at par over three years

Source: AcenciA Debt Strategies

As Exhibit 3 shows, the discount has been narrowing over the past 12 months (currently 10.6%), and has at times dipped below 10% in recent months. Clearly, the discount has not been persistently in excess of 10% during the half year to date, making a capital return in 2013 less likely although still possible. We would expect the board to take account of shareholder views rather than be dogmatic in deciding whether or not to return capital, but note the ability to resume share buy-backs (see below) as an alternative way to manage the remaining discount.

Given the ongoing opportunities identified by ACD and its underlying managers, and the fact that many of those managers are closed to new investment in their funds, we continue to think it is possible that some shareholders may request that some form of continuation share class be made available when it comes to the 2014 continuation vote, perhaps continuing the investment horizon to 2016. This would allow those current investors who wish to liquidate the opportunity to do so, while giving investors the option to maintain the current underlying manager exposure.

ACD has shareholder approval for share repurchases (up to 14.99% of the issued capital) but has not made use of this facility since June 2012. We believe that management will be conscious of the need to balance the liquidity of the fund (4.2% cash at 30 April, 2013 as per Exhibit 1) with its desire to manage the discount. We note that the investment adviser, Sandalwood Securities has increased its holding in ACD shares on a number of occasions in recent months. In aggregate it has acquired 542,000 shares, increasing its stake from 3.84% at the beginning of 2013 to 4.30% currently. In January 2013, the President of Sandalwood acquired 210,000 shares in his personal capacity, increasing his stake to c 1.05m shares (0.9%) and on 20 June 2013 the company was notified that the chairman (Mr Le Pelley) had acquired a further 300,000 shares (taking his holding to 0.77%).

Liquidity of the fund continues to improve

Since the 2011 EGM, ACD has been managed in the anticipation that the fund will be wound up at the end of 2014. It is expected that it will be possible to liquidate and distribute substantially all of the assets during the first quarter of 2015. Some smaller amounts, such as audit hold-back balances, may not be immediately available for timing reasons, and there will be some direct expenses associated with liquidation, although we expect these to have a minimal impact on NAV (less than 0.5%). However, barring these, we see any residual illiquid positions as the main obstacle to a full realisation of NAV or immediate distribution of proceeds.

For hedge fund investments there is typically an initial lock-up period, after which redemption can occur at regular intervals (the frequency of which is defined by the original contract terms). As shown in Exhibit 1, around 89% (31 December 2012 87%) of ACD's portfolio is now subject to varying agreed notice periods, ranging from one month to a small amount that requires more than two years' notice. The balance of the portfolio (10.9% vs 12.9% at 31 December 2012 and more than 20% two to three years ago) is in liquidating assets. These are investments in funds where

ACD has submitted a redemption request but where the manager is unable to raise enough liquidity from the underlying fund holdings to honour the request in full, in a timely manner. As the pool of liquidating assets continues to shrink, the manager anticipates that by year-end 2013, substantially all of these investments will have gone. We do not believe these less liquid assets pose any material threat to shareholders being able to realise substantially all of the NAV in cash upon liquidation of all or part of the fund. By way of illustration, should there be, for example, 5% of the portfolio invested in liquidating assets at the end of 2014, and should it require a 25% discount to shift this in the secondary market, then the overall impact on realisable NAV would be relatively small (5% x 25% or 1.25%). Hence, we do not see the liquidating assets as an obstacle to the gradual unwinding of the remaining c 11% discount to NAV over the next two years.

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