Acencia Debt Strategies

Investment trust review

Edison investment research

Low volatility earnings enhanced by capital return

Acencia Debt Strategies (ACD), a closed-ended investment company, offers exposure to a focused range of predominantly debt-oriented strategies, particularly distressed debt, via a portfolio of carefully selected hedge funds. It gives exposure to some underlying managers with very strong track records, whose funds are either closed to new investment or otherwise difficult to access. Performance has been positive in every year except 2008 and has been achieved with lower volatility than the S&P500 or high yield US debt. 2012 NAV total return was c 9.7% and expected dividends represent a yield of c 4%. 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 23 months would alone equate to a c 6% 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 (%)	ML/BoA High Yield Index*(%)
31/12/09	59.9	22.9	12.6	44.0
31/12/10	14.5	7.4	18.7	17.7
31/12/11	4.7	1.6	2.9	3.4
31/12/12	10.0	11.6	10.9	13.9

Note: *Twelve-month rolling discrete performance.

Investment strategy: Distressed debt focus

ACD invests in a portfolio of predominantly debt-oriented hedge funds. 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 and we have seen some further diversification into European assets over the past year.

Sector outlook: Ongoing opportunities

The US corporate sector is generally in good health, but market conditions are far from uniform and the weakest end of the credit markets continues to generate some opportunities for distressed funds. ACD has also invested increasingly in funds involved in mortgage-backed securities taking advantage of ongoing dislocation in that huge debt market where intrinsic value is perhaps being overlooked by poor sentiment. Europe's slow growth and the need for banks to de-lever should also provide attractive investment opportunities over the next two to three years and again has been an increasing part of the portfolio, reaching c 25% in November 2012.

Valuation: Unfair discount with trigger for it to reduce

ACD trades at a c 12% discount to NAV, wider than most peers despite a consistent, low-volatility performance and yield in excess of 4%. A 20% capital return is possible in 2013 if the discount fails to narrow sufficiently and continuation beyond December 2014 requires unanimous support from shareholders.

Investment trusts

29 January 2013

Price	91.00p
Market cap	£106.6m
AUM	£120.9m
NAV per share*	103.24p
Discount to NAV	11.9%

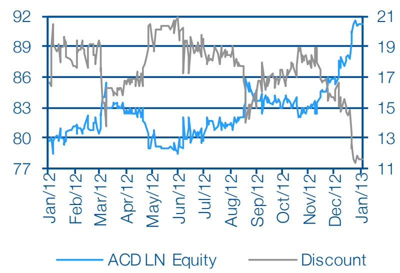
*Company est NAV as at 31 December 2012.

Yield	3.92%**

**Interim dividend of 1.73p annualised.

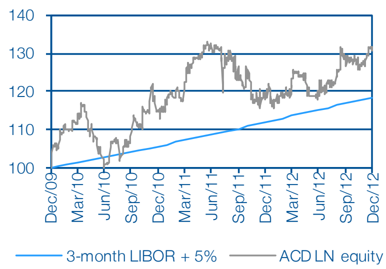
Ordinary shares in issue	117.1m
Code	ACD
Primary exchange	LSE
AIC sector	Hedge funds

Share price/discount performance



* Positive values indicate a discount; negative values indicate a premium.

Three-year cumulative performance



52-week high/low	91.00p	78.50p
NAV* high/low	103.24p	95.67p

* Adjusted for debt at market value, excluding income.

Gearing

Gross	0%
Net	0%

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Edison profile page

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

Exhibit 1: Company at a glance

Investment objective and fund background

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% subject to a 3% hurdle rate and high water mark (102.77p at 30 June 2012).

Developments last quarter

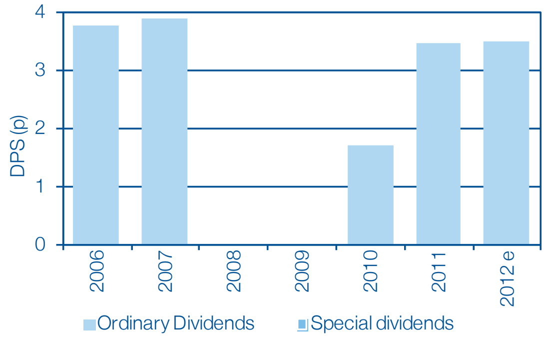
14 January 2013: Estimated December 2012 NAV released.

11 January 2013: President of investment adviser, Sandalwood Sec, acquires shares.

Forthcoming		Capital structure		Fund details	
AGM	April 2013	Ongoing charge	0.75%	Group	Saltus Fund Management
Preliminary results	March 2013	Net gearing	Nil	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

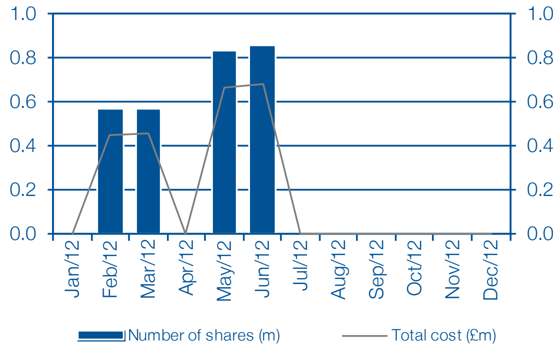
Dividend policy and history

ACD seeks to pay annual dividends totalling 3.5% of the company's NAV by way of six-monthly interim and final dividend payments.

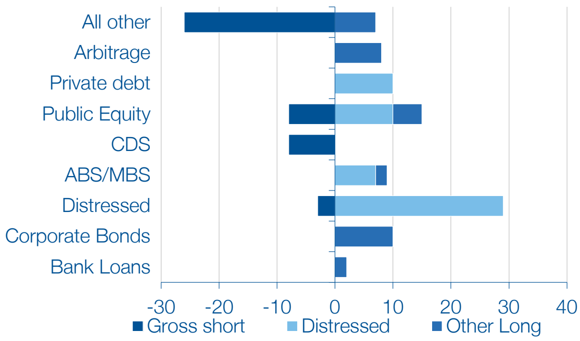


Share buyback policy and history

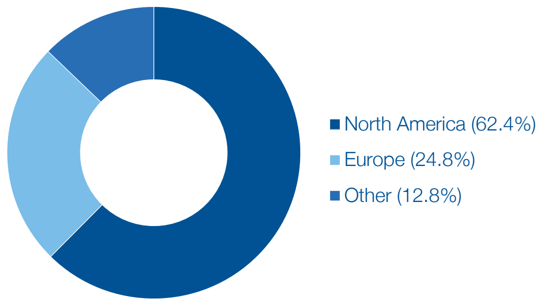
Renewed annually, the company has authority to purchase up to 14.99%, and allot up to 10% of issued share capital.



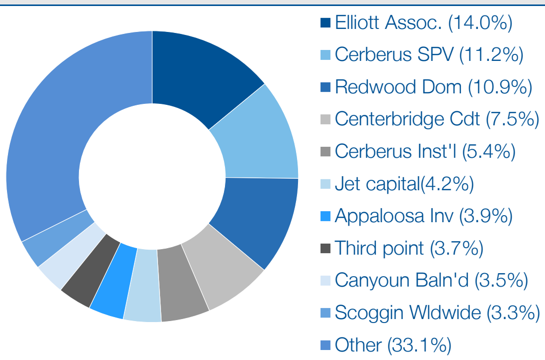
Exposure by investment type (as at 30 Nov 2012)



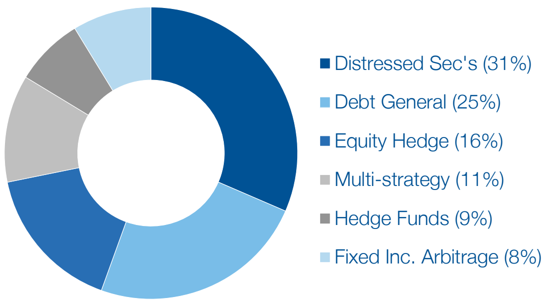
Geographic distribution of portfolio (as at 30 Nov 2012)



Portfolio composition (as at 30 Nov 2012)



Strategy allocation (as at 30 Nov 2012)



Source: ACD, Edison Investment Research

Fund profile

Summary

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 on-set of the financial crisis, which has suppressed official interest rates. In the most recent year to 31 December 2012, NAV (based on provisional estimates of the December NAV) total return was 9.7% and it has been positive in every year with the exception of 2008, when financial markets collapsed after the Lehman failure.

The 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 continuous discount of more than 10% in the six months to 30 June 2013. The current c 12% discount is slightly narrower than the 2012 average of c 18%. If the capital return goes ahead it should cause the discount to NAV to narrow in the short term, and a winding-up would largely remove the discount altogether, by the end of 2014. A full amortisation of the discount alone over a two year period to 31 December 2014 is equivalent to a c 6% annualised return before expected dividends, targeted at 3.5% of NAV pa (or 4% of the current price).

Given the on-going 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 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 vote, perhaps to 2016. This would allow those current investors who wish to liquidate the opportunity to do so whilst giving investors the option to maintain the current underlying manager exposure.

Exhibit 2 shows the monthly, unaudited sterling return for the fund. Excluding the extreme months around the Lehman's 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%. We analyse the fund volatility in greater detail on page 9.

Exhibit 2: ACD monthly returns in sterling

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2005												1.4%	1.4%
2006	1.6%	0.2%	1.0%	1.2%	0.3%	0.1%	0.2%	0.2%	0.5%	1.6%	1.2%	1.1%	9.6%
2007	1.2%	0.9%	0.0%	2.2%	1.2%	0.5%	(0.2%)	(1.1%)	0.7%	0.8%	(0.5%)	0.2%	6.0%
2008	(2.0%)	(0.2%)	(1.1%)	1.0%	1.0%	(0.2%)	(2.2%)	(0.6%)	(5.1%)	(9.8%)	(8.6%)	(8.8%)	(31.7%)
2009	2.8%	(1.9%)	0.1%	3.8%	2.7%	1.9%	2.4%	2.7%	2.5%	1.3%	1.3%	1.4%	22.9%
2010	1.2%	0.2%	3.8%	1.0%	(0.7%)	(0.3%)	0.4%	(0.1%)	1.0%	0.8%	0.0%	1.7%	9.3%
2011	1.4%	1.3%	1.0%	0.6%	0.2%	(0.4%)	0.5%	(1.7%)	(1.6%)	0.3%	0.0%	0.4%	1.7%
2012	1.3%	1.2%	1.1%	0.1%	(0.1%)	0.0%	0.7%	1.6%	0.9%	0.6%	0.6%	*1.5%	*9.7%

Source: ACD. Note: *December performance based on preliminary ACD NAV estimates.

Diversified debt-oriented strategies via hedge fund portfolio

ACD invests in a portfolio of hedge funds that gives exposure to an actively managed and diversified range of predominantly debt-oriented investment strategies and a diverse range of underlying asset classes including 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.

Exhibit 3: Summary of top 10 liquid managers

Fund	Weight	AUM ($)	Leverage	New investment	Strategy	Overview
Elliott	14.0%	16.4bn	Immaterial	Closed	MSE	Trading activities are an opportunistic mix of hedges, arbitrages, value-added positions, control or activist positions, and other uncorrelated activities with the largest area of capital deployment event arbitrage.
Redwood	10.9%	3.3bn	Immaterial	Closed	MSC	The primary focus is on investments in the debt securities of leveraged or financially distressed companies.
Centerbridge	7.5%	6.0bn	None	Closed	MSC	The two primary areas of investment are: 1) non-control distressed securities; and 2) undervalued credit investments such as leveraged loans, high yield bonds, specialty financing and structured products.
Jet Capital	4.2%	2.5bn	Immaterial	Open	MSC	The primary focus is on investments in the debt securities of leveraged or financially distressed companies.
Appaloosa	3.9%	7.8bn	Modest	Closed	MSE	Invests in high yield bonds, bank loans to highly leveraged companies, sovereign debt, and other debt and equity securities, including securities of financially distressed companies.
Third Point	3.7%	2.6bn	Immaterial	Closed	MSE	Seeks to identify event-driven situations in which it can take either a long or a short investment position with an identified near- or long-term catalyst that would unlock value.
Canyon Balanced Fund	3.5%	1.0bn	None	Open	MSE	Pursues both value and event-driven investment strategies through equities, high yield bonds, bank debt, and more recently, structured credit.
Scoggin Worldwide	3.3%	150m	Immaterial	Open	MSC	The primary focus is bank debt.
Thoroughbred	3.1%	4.9bn	Modest	Closed	MSC	Makes event-driven distressed investments as well as value long trades on an unlevered basis. It also opportunistically invests in asset-backed credit and equities.
York Credit Opportunity	1.5%	3.9bn	Immaterial	Open	D	York focuses on global distressed opportunities, particularly in corporate restructuring, targeting both performing and non-performing securities.

Source: ACD. *Note: MSE is multi-strategy event-driven, MSC is multi-strategy credit, D is distressed.

Underlying investment strategies

The ACD portfolio is managed by the Saltus Fund Management group, a London-based and FSA regulated investment manager specialising in multi-asset manager, multi asset-class investment. The investment adviser used by Saltus is SEC registered 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 accounting for 56% of the portfolio (see Exhibit 3) and c 70% of the portfolio adjusted for liquidating positions and cash (see page 10 for an explanation of liquidating positions).

Exhibit 3 also shows which of these funds are open to new investment, and those, the majority, that are not. A distinctive feature of ACD is that it offers investors exposure to managers that it would be impossible to access directly. Top-performing hedge fund managers, as many of these are in a position to choose when they accept new funds for investment and can often afford to be selective. Strong industry relationships can therefore be clearly advantageous.

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, and 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.

The diversification of ACD's portfolio by manager and strategy is key to managing overall risk and volatility, but at the manager level there are a number of factors that influence the scale of opportunity and returns available.

- **Purchase below intrinsic value.** There are often sellers who are forced to sell by regulatory, sentiment, strategic or financial considerations at prices well below intrinsic value. In particular the financial crisis has seen most banks re-evaluate what is core as well as see the weakest corporates face the greatest financial pressures. That environment offers good opportunities for distressed and special situations investing, especially for those managers with the financial resources, skills and patience to wait for the best opportunities.
- **Catalyst.** There is a specific anticipated future event that should act as trigger to crystallise unwarranted market discounts to intrinsic value. For ACD many of its underlying investments are in the securities of companies that have either filed for bankruptcy protection or are likely to do so.
- **Security.** The debt is generally secured, backed by identifiable assets, and senior to (ie paid out before) equity interests. This is helps to limit volatility, although returns obviously fluctuate over time. Achieving the best return in a corporate restructuring requires skill and managing different stakeholders can achieve markedly different returns. It is critical to be able to identify in each situation which level of liability (eg equity vs mezzanine vs senior vs unsecured) is the most mis-priced for its specific probability of repayment.
- **Liquidity.** The target securities are often characterised by illiquid trading, and adverse general market sentiment overriding the specific risk attached to that security.

Investment policy

ACD has an actively managed portfolio of predominantly debt-oriented hedge funds. To gain the desired exposure to the chosen underlying hedge fund managers, ACD will invest directly into that hedge fund or indirectly via other funds of funds. The number of core underlying hedge fund managers in which ACD is ultimately invested is typically around 20. To gain access to chosen fund managers ACD primarily invests through funds that are managed or advised by Sandalwood but it does not pay management or performance fees on those underlying vehicles, avoiding the double-layering of fees that characterise typical funds of funds. The portfolio is constructed within certain parameters, including:

- no more than 15% of NAV may be invested in any one underlying hedge fund;
- no more than 20% of NAV in aggregate may be invested in funds managed by a single hedge fund manager; and
- no structural or long-term borrowing, and short-term borrowing for liquidity purposes limited to 35% of NAV.

Capital structure, buybacks and dividends

ACD was launched in November 2005 when it raised a net £42.6m and listed in Dublin on the Irish Stock Exchange. In June 2006, a further £62.6m was raised through the issue of C shares. In February 2007, with the shares trading at a premium to NAV due to strong secondary interest by investors, a further £86.7m was raised through a second C share issue. ACD joined the official list of the London Stock Exchange, becoming a constituent of the FTSE All-Share Index in December 2010.

In the aftermath of the financial crisis, the discount to NAV remained persistently wide despite continuing share buybacks (including an enhanced share buyback programme). In the past two and half years, through this and normal buybacks, ACD has bought back a total of £37.2m of shares compared with its current market capitalisation of under £100m. In H112 the buyback was 2.98m shares at discounts to NAV of 17.9% to 20.3% for a total consideration of £2.4m. Authorisation to repurchase up to 14.99% of the share capital was renewed at the April 2012 AGM. Ahead of the possible 20% return of capital (see below), there have been no share repurchases since June 2012.

In September 2011, shareholders were given the opportunity to consider whether to wind up the company. 76% of shareholders voted, with 91% of those voting against winding up the company and 99% supporting the board's continuation proposals. The board proposed that ACD be given more time to benefit from a diverse set of nearer-term opportunities in the distressed debt arena, thrown up by the continued fall-out from the financial crisis. The board made a commitment that by the end of 2014 shareholders would be given another opportunity to vote on winding up the company, and this would be carried if any single shareholder voted in favour. Moreover, to provide intermediate relief against a persistent discount to NAV, if, during the six months to 30 June 2013, the shares have traded at a continuous discount of more than 10% (currently c 14%), the board will seek to return up to 20% of the share capital.

ACD returned to dividends in 2010 after a two-year break, paying a final dividend of 1.73p, 2011 3.48p and H112 1.73p. Its policy is to seek to pay annual dividends totalling 3.5% of NAV by way of six-monthly interim and final dividend payments.

Currency exposure

The underlying investments held by ACD are predominantly US dollar-denominated, reflecting the size of the US market and the fact that the market in distressed debt is more developed in the US than in the somewhat more fragmented European markets. In contrast, ACD's share capital is sterlingdenominated, and so the company has a policy of seeking to hedge the exchange rate risk through rolling short-term forward foreign exchange contracts (derivatives are not used for speculative purposes).

The board

All the directors are non-executives.

- Jim Le Pelley (chairman) was called to the Bar in England in 1971 was a partner of Le Pelley & Tostevin from 1972 until 1999, becoming senior partner in 1977 and has served on the board of ACD since its flotation in November 2005. He is chairman of UK Select Trust.
- Richard Battey (chairman of the audit committee) is a non-executive director of a number of closed-ended investment funds. He is a chartered accountant and spent most of his career with the Schroder Group, latterly as director of a number of companies involved in banking, investment management, insurance, trusts and private equity.
- William Scott holds a number of other non-executive directorships. With over 20 years' experience of the investment funds industry, he acts as a consultant to offshore investment organisations. He has served on the board of the company since its flotation in November 2005.

Investment strategy and opportunities

Investment managers' outlook

In a continuing challenging macro environment, the future investment prospects for ACD can be divided between the factors that will influence the existing underlying portfolio of assets and the factors that will create new opportunities, generally in mis-priced risk.

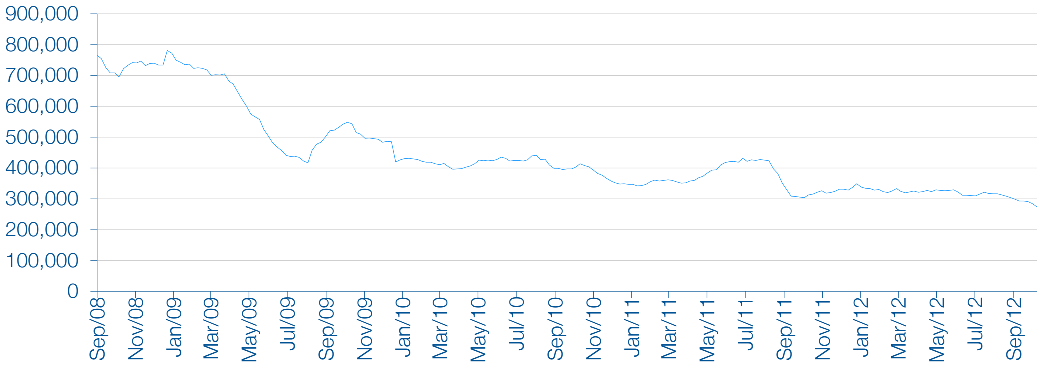
Global economic growth remains sluggish and continued accommodative interest rate policies are compressing yield/return profiles for a vast majority of financial assets and creating a shortage of long-dated products offering attractive yields. ACD believes the contracting supply and escalating need for yield should provide fertile ground for its underlying multi-strategy credit managers, who have a bias towards complex assets at the higher end of the spread spectrum.

ACD sees particular opportunities in the following areas:

- Corporate liquidations and stressed/distressed credit
  Within a generally healthy corporate sector where the stronger companies have been able to use the period of low interest rates to re-finance and extend the maturity of their borrowings, ACD's hedge fund managers continue to identify opportunities. One of these opportunities is the maturing of several previous large-scale bankruptcies, a point at which investors have greater clarity about the likely liquidation proceeds and how these will be distributed. ACD also sees opportunity in certain short-duration, high-yield corporate debt resulting from post-financial crisis corporate refinancing at high interest rates, with just two to three years remaining to maturity. ACD expects the combination of high yield and short duration will make these bonds far more stable than more recently issued, lower-coupon, longer-duration bonds.
- Residential and commercial mortgage-backed securities
  Some of ACD's underlying managers remain significantly focused on residential mortgage-backed securities (RMBS) portfolios built up in 2009-2010, which are producing good returns in a more stable economic and housing market environment that they perceive to still be undervalued. They anticipate yield profiles in the low- to mid-teens, even under weak fundamental scenarios and in some cases they believe that total returns in excess of 20% are possible, even without an improvement in the housing market. The shrinking supply of this type of paper is a factor cited by

the managers. RMBS securities outstanding will be reduced by $175bn a year over the next two years in a $1.1tn market where there is virtually no new issuance. Shrinking supply should support pricing. Additionally, the managers believe these assets are being purchased at deeply discounted prices and provide positive exposure to reflation (economic improvement) and inflation, which will likely be economic themes in the not-too-distant future.

Exhibit 4: Outstanding asset-backed commercial paper ($m)



Source: Federal Reserve

- **Activism and corporate events**
  Pockets of poor corporate governance and inefficient capital allocation provide opportunities for managers to create value by driving change. As the corporate sector has moved from crisis mode to a more forward looking stance which must recognise the continuing relative scarcity of capital resources as the global financial system continues to de-lever this should continue to be the case.
- **European corporate credit**
  The European banks still need to de-lever their balance sheets and improve capital ratios. This will require further shedding of under-performing assets and other capital intensive holdings. Combined with the weak European growth outlook this should provide opportunities for event-driven investment strategies, benefitting from corporate restructuring, for example, and asset-backed investment strategies where assets can be bought at prices below intrinsic value from forced sellers.

ACD performance and peer group comparisons

ACD performance

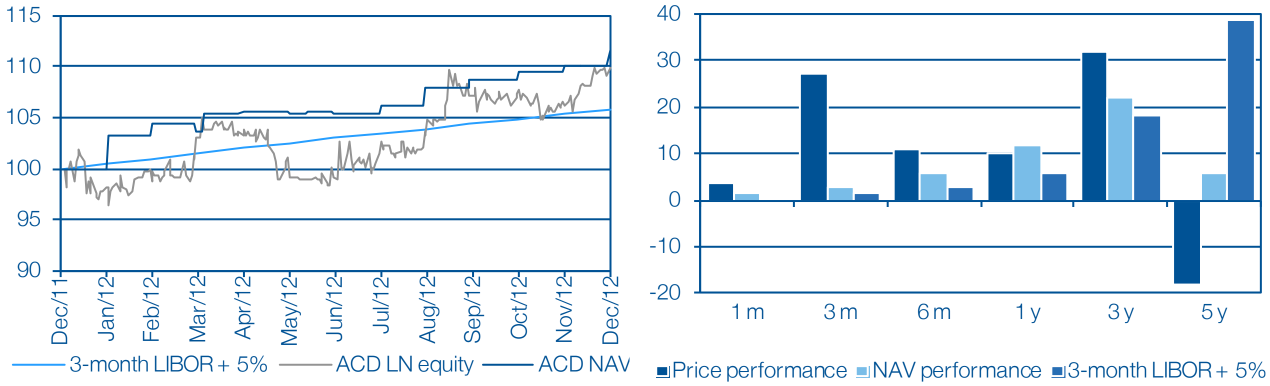
As noted in Exhibit 5, ACD has recovered strongly from the financial crisis that marred 2008 and after a quiet 2011 has again delivered good returns in 2012 (7.5% to end October). The target return of three-month LIBOR plus 5% has become a more challenging target in the low interest rate environment prevailing since the financial crisis, but it has been achieved over three years, albeit a period that includes a sharp recovery in asset prices during 2009.

The monthly return data in Exhibit 5 shows that, with the exception of the extreme months surrounding the Lehman's crisis, there is an observable lack of volatility in the fund NAV return, for what many may perceive as a relatively high risk/return, volatile underlying investment class.

During 2012, the manager notes that ACD's annual return benefited from underlying hedge fund manager strategies to exploit opportunities created by the Lehman Brothers liquidation process, continued recovery in mortgage-backed securities, and European opportunities in Greece (government debt) and Spain (covered bonds and provincial debt).

Exhibit 5: Investment company performance

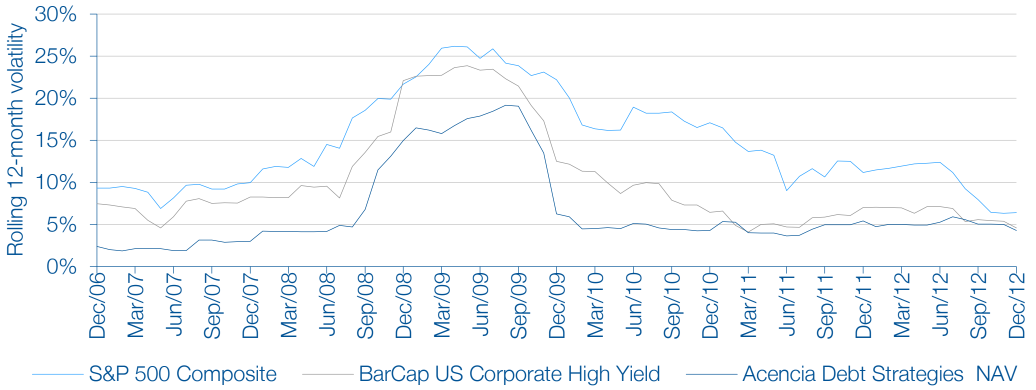
Price, NAV and benchmark total return perf, one-year rebased | Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research

Looking at the NAV volatility more closely (in Exhibit 6), it can be seen that the rolling 12-month volatility of ACD's NAV has consistently been lower than the volatility of both the S&P and the Barclays High Yield debt index, although the gap has recently narrowed.

Exhibit 6: Rolling 12-month volatility ACD NAV compared with S&P and HY in total return terms



Source: Edison Investment Research, Morningstar

Peer comparison

Exhibit 7: Comparison of selected listed fund of hedge funds, credit hedge funds, and other credit funds

	NAV total return			Discount to NAV
30 December 2012	1 year	3 years	5 years	
Acencia Debt Strategies	11.6	21.9	2.3	(16.7)
Credit hedge funds				
Ashmore Global Opp GBP	(7.1)	(6.0)	(18.2)	(31.1)
BH Credit Catalysts GBP	14.9			(5.1)
CQS Diversified GBP	11.6			(7.7)
NB Distressed Debt	6.4			(6.7)
Signet Global Fixed Income GBP	3.1	5.4	(1.9)	(41.2)
Third Point Offshore GBP	22.0	65.9	38.0	(19.9)
Credit hedge fund average	8.5	21.7	6.0	(18.6)
Fund of hedge funds				
Absolute Return Trust GBP	1.5	(1.1)	(1.1)	(16.1)
Alternative Inv. Strategies	7.2	6.8	(7.3)	(13.9)
Dexion Absolute GBP	6.5	6.2	2.3	(13.5)
Dexion Trading	0.9	3.5	10.2	(12.2)
Thames River Hedge+ GBP	5.5	(4.2)	(12.1)	(7.9)
Fund of funds average	4.3	2.3	(1.6)	(12.7)
Other credit funds				
Carador Income Fund USD	54.2	176.4		1.1
Greenwich Loan Income Fund	13.7	118.9	30.3	5.4
HarbourVest Senior Loans Euro	3.0			(7.0)
NB Global Floating Rat Inc GBP	11.8			0.8
Other credit fund average	20.7	147.6	30.3	0.1

Source: Morningstar

In Exhibit 7 we show the NAV total return performance over one, three and five years for a range of credit hedge funds, other, more diversified funds of hedge funds and more plain vanilla credit funds.

Compared with other hedge funds of funds, ACD is the best performing over one and three years and is ahead of the average over five years. Compared with other credit hedge funds, there is less longer-term data. ACD is above average over one year and in second position over three years.

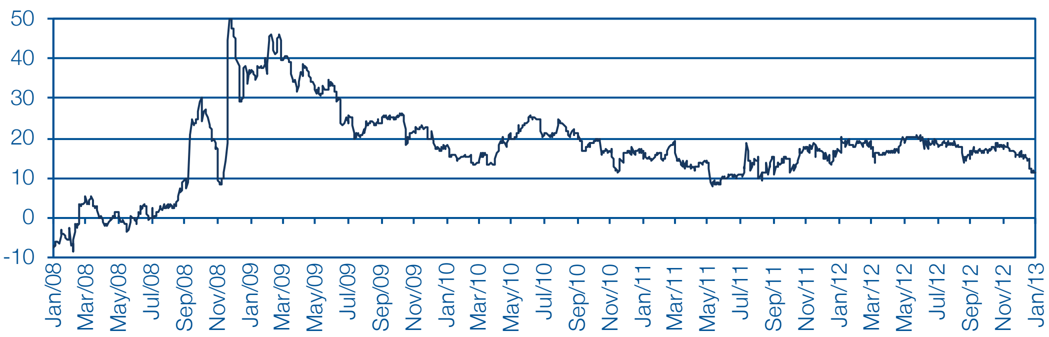
Performance of the other credit funds shown is dominated by the performance of CLO invested funds like Carador and GLIF over the last three years. CLO credit structures have benefitted from the very low level of corporate defaults during this period and favourable funding rates arranged on pre-financial crisis terms.

Taking ACD's overall consistent performance with low volatility, its large discount to NAV looks harsh. We discuss the discount in the following section and then look at the potential to realise NAV in a likely December 2014 winding-up.

Discount to NAV

As Exhibit 8 illustrates, ACD's shares traded at a premium to NAV for much of the period from launch until August 2008. But as the credit crunch approached its most frightening stages (Lehman Brothers filed for bankruptcy on 15 September 2008) and investor fears of a complete collapse of the financial system grew, ACD moved to a significant discount and reached an all-time high of 49.9% in December 2008. The discount has tightened substantially since the peak, supported by improved investor sentiment as well as ACD's investment and operational performance, capital management measures (including substantial share buybacks and resumed dividend payments). The discount fell to c 10% in Q311 but has since widened again (currently c 12%) despite the board's commitment to a 'hard' winding-up vote in 2014 and capital return in 2013 if discount conditions are met.

Exhibit 8: Discount over five years (%)

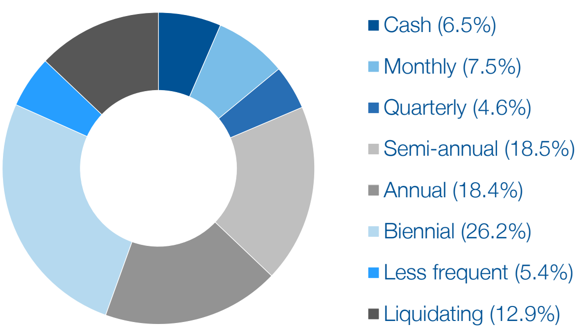


Source: Thomson Datastream, Edison Investment Research

Liquidity analysis and realisation potential from winding-up

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.

Exhibit 9: ACD portfolio liquidity analysis as at 30 November 2012



Source: Acencia Debt Strategies

Hedge funds are relatively illiquid instruments. There is typically an initial lock-up period and, following this, redemption can only occur at regular intervals and after enough notice has been given. 87% of

ACD's portfolio is 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 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. The pool of liquidating assets has been steadily shrinking (from more than 20% two years ago) and should continue to do so. The manager expects that by year-end 2013, substantially all of these investments will have gone. Meanwhile, as well as returning cash, the actual recent performance of the liquidating assets has been good, giving material comfort on their carrying values. During 2012, the weighted average return on liquidating assets was more than 2% ahead of the overall ACD portfolio return. By way of illustration, should there be, say, 5% of the portfolio invested in liquidating assets at the end of 2014, and should it require, say, 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 unwind of the c 14% discount to NAV over the next two years.

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