Finsbury Growth & Income Trust

A short stock list with a long investment horizon

Investment trusts

Finsbury Growth & Income Trust (FGT) is a concentrated portfolio of mainly UK stocks chosen for their enduring quality and total return potential. Manager Nick Train takes a very long-term view and has made no new purchases or full exits in the past year, although significant share issuance has allowed him to top up holdings in certain stocks. While not targeting a high income, the trust increased its dividend by 7.6% in FY14. Performance has been strong and FGT is ranked first for NAV total return over five and 10 years in the AIC's UK Equity Income sector.

12 months ending	FGT share price (%)	FGT NAV (%)	FTSE All-Share Index (%)	FTSE 350 Index (%)	MSCI World Index (%)
31/12/11	4.1	3.8	(3.5)	(3.2)	(4.3)
31/12/12	25.4	23.6	12.3	12.0	11.4
31/12/13	35.1	35.1	20.8	20.5	25.0
31/12/14	5.9	6.9	1.2	1.2	12.1

Source: Thomson Datastream. Note: Total return basis.

Strategy: Compounding quality over the long term

Manager Nick Train aims to buy quality stocks that can grow and compound returns over time, which feeds into a very long-term holding period and low turnover. He uses fundamental analysis to identify companies that are undervalued relative to their long-term investment prospects. Train favours stocks with global market-leading consumer brands and those that will benefit from developments in digital technology, and the FGT portfolio is concentrated in just four sectors: consumer goods and services, technology and financials.

Market outlook: Reasons to be cheerful?

UK stock market returns in 2014 were lacklustre (+1.2% for the FTSE All-Share and FTSE 350 in total return terms) and 2015 has begun in a similarly uncertain vein, with the FTSE 100 down 2.7% in the first two weeks of the year. Investors are concerned about the implementation of QE in Europe and the implications for economic growth of falling inflation (or deflation) and the lower oil price. However, all these factors could also be viewed as positives in another light, highlighting that the die is not yet cast for markets in the year ahead. In such situations, a mix of quality cyclical and defensive stocks could provide an interesting each-way bet.

Valuation: Demand drives premium and issuance

Strong demand for FGT's shares has seen it trade consistently at a premium, with 15.8m shares issued over the 12 months to 20 January 2015, raising an extra £80.9m. At 20 January the shares stood at a 1.3% premium to cum-income net asset value, not far from its highest point in the past year (1.6% in mid-June). The shares have only traded below par value on 26 days in the past 12 months. Over one and three years the shares have traded at an average premium of 0.5% and 0.6% respectively. The board of FGT will buy back shares if the discount reaches 5%, and new shares are issued if there are unfulfilled buy orders in the market.

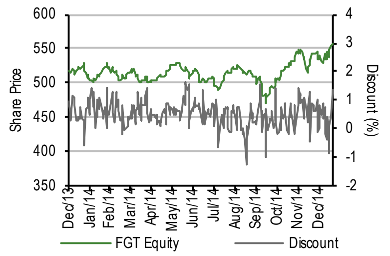
22 January 2015

Price	**558.0p**
Market cap*	**£579.3m**
AUM	**£594.6m**
NAV*	549.0p
Premium to NAV	1.6%
NAV**	550.6p
Premium to NAV	1.3%
Yield	2.0%

*Excluding income. **Including income. Data at 20 January 2015.

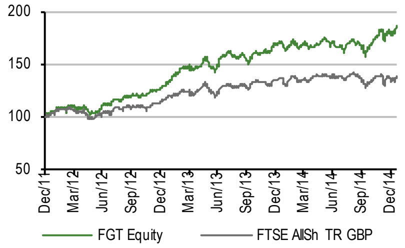
Ordinary shares in issue	103.8m
Code	FGT
Primary exchange	LSE
AIC sector	UK Equity Income

Share price/discount performance*



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

Three-year cumulative perf. graph



52-week high/low	558.0p	470.3p
NAV* high/low	550.6p	474.6p

*Adjusted for debt at market value, including income.

Gearing

Gross	5.0%
Net	5.0%

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Edison profile page

Exhibit 1: Finsbury Growth & Income Trust at a glance

Investment objective and fund background

FGT's investment objective is to achieve capital and income growth and provide shareholders with a total return above that of the FTSE All-Share Index. It invests principally in the securities of UK-quoted companies, but up to a maximum of 20% can be invested in non-UK-quoted companies at acquisition. FTSE 100 companies normally represent 50-100% of the portfolio, with at least 70% usually invested in FTSE 350 companies.

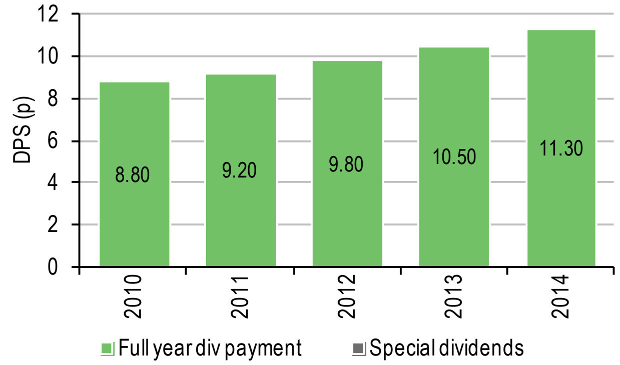
Recent developments

- 8 December 2014: Annual results published for the year ended 30 September. NAV TR +8.9% compared with +6.1% for FTSE All-Share.
- 30 October 2014: Additional market maker, Investec Securities, appointed to facilitate placing of new shares, bringing number of market makers to six.

Forthcoming		Capital structure		Fund details	
AGM	February 2015	Ongoing charges	0.8%	AIFM	Frostrow Capital LLP
Half-year results	May 2015	Net gearing	5.0%	Portfolio manager	Lindsell Train
Year end	30 September	Annual mgmt fee	£70k + 0.6% market cap	Address	25 Southampton Buildings, London, WC2A 1AL, UK
Dividend paid	May, October	Performance fee	None (see page 7)		
Launch date	January 1926	Trust life	Indefinite	Phone	+44 (0)20 3008 4910
Continuation vote	None	Loan facilities	Up to £50m revolving	Website	www.finsburygt.com

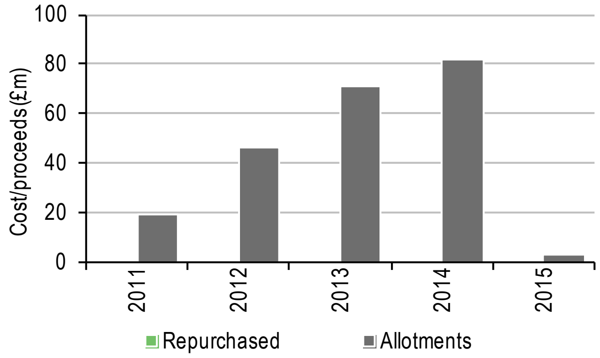
Dividend policy and history

Two dividends annually, paid in May and October. The dividend is expected to rise over the longer term.

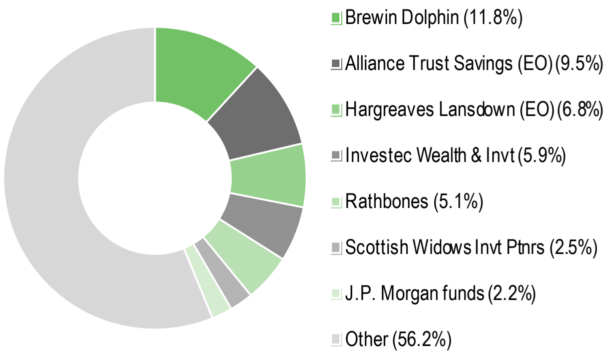


Share buyback policy and history

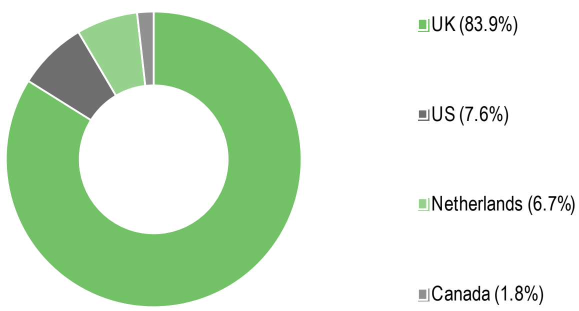
Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 10% of issued share capital.



Shareholder base (as at 9 December 2014)



Distribution of portfolio (as at 30 November 2014)



Top 10 holdings (as at 31 December 2014)

Company	Country	Sector	Portfolio weight % 31 December 2014	Portfolio weight % 31 December 2013*
Unilever	UK	Consumer Goods	8.7	8.5
Diageo	UK	Consumer Goods	8.1	8.6
Reed Elsevier	UK	Consumer Services	7.7	5.7
Pearson	UK	Consumer Services	6.5	7.8
London Stock Exchange	UK	Financials	6.4	5.5
Heineken	Netherlands	Consumer Goods	6.3	6.5
Sage Group	UK	Technology	5.9	N/A
Burberry Group	UK	Consumer Goods	5.7	N/A
Schroders	UK	Financials	5.1	5.6
Daily Mail & General Trust	UK	Consumer Services	4.7	6.1
Top 10 (% of portfolio)			**65.1**	**64.9**

Source: Finsbury Growth & Income Trust, Edison Investment Research, Morningstar, Bloomberg. Note: *N/A where not in top 10 at 31 December 2013.

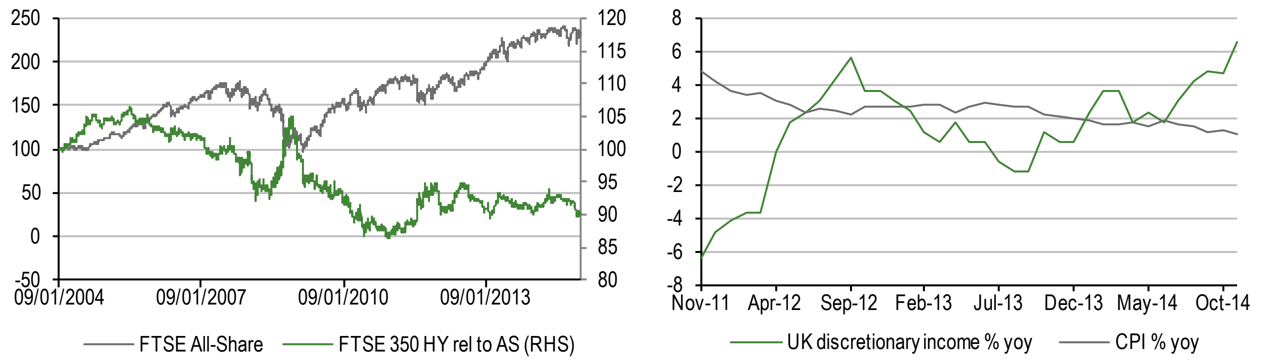
Outlook: Is bad news good news in disguise?

After a year in which the UK stock market struggled to advance, 2015 has begun in similarly uncertain fashion, with investors worried about the falling oil price, stalling economic growth, imminent quantitative easing in Europe and the spectre of deflation. But sentiment can turn quickly and many of these factors could come to be seen as positives rather than negatives (see 'The manager's view' section for Nick Train's take on the benefits of a falling oil price). Consumer stocks could gain from lower price inflation leading to higher disposable incomes (right-hand chart below).

The left-hand chart in Exhibit 2 shows FTSE All-Share Index total returns (grey line) and the performance of the more defensive FTSE 350 Higher Yield Index relative to the All-Share (green line) over 10 years. An inverse relationship can be observed: when the overall index falls (as in the financial crisis of 2008/09) the defensive stocks perform relatively better, whereas in strongly rising markets such as 2012-13, the defensive stocks do relatively worse. While FGT's portfolio has little in common with the High Yield Index, its mix of more defensive-type stocks like consumer staples, and more market-sensitive companies such as asset managers and technology stocks could provide an interesting each-way bet in uncertain times.

Exhibit 2: FTSE 350 Higher Yield vs FTSE All-Share and UK household income vs inflation

FTSE 350 HY relative to FTSE All-Share total returns, indexed to 100 | **UK household disposable income and CPI inflation, % change year-on-year**



Source: Thomson Datastream, Asda income tracker, Office for National Statistics.

Fund profile: Long-term, total return focus

Finsbury Growth & Income Trust (FGT), launched in 1926, has been managed since October 2000 by Nick Train of Lindsell Train Investment Management, a boutique he co-founded with ex-GT colleague Michael Lindsell. The pair are ultra-long term investors in the mould of Warren Buffett, aiming to "buy great stocks and hold them forever". FGT has a concentrated portfolio of mainly UK stocks. While it sits in the AIC's UK Equity Income sector, its focus is on total return rather than high yield. Strong demand has seen the trust grow significantly in size over recent years.

The fund manager: Nick Train

The manager's view: Falling oil is a huge short-term dividend

Train sees the sharp fall in the oil price as one of the major shorter-term macro drivers. FGT has no holdings in oil companies and is more exposed to sectors that are likely to benefit from a lower oil price. "A falling oil price is an enormous dividend for a company like Unilever," he says. Oil and oil derivatives are a significant part of its cost base, so lower oil price means lower costs, feeding into rising profits. "The lower oil price also puts billions of dollars, or rupees, or pesos in the pockets of consumers, so it is a big positive event for a globally orientated consumer company," Train adds.

A more enduring portfolio theme is the disruptive and transformative impact of technology. Every existing and potential holding is assessed in the context of digital technology, which the manager says has power to destroy some business models while creating new opportunities. Hargreaves Lansdown, which has grown its online investment platform assets from £6bn to £50bn in 10 years, and DMGT, whose Mailonline website has brought content to a far larger audience than a newspaper could achieve, illustrate how ‘analogue’ industries (financial services, media) can embrace the digital age. However, some areas are safer from adverse technological impact: as Train notes in the FGT annual report, you cannot get digitally drunk or eat virtual chocolate. He continues to back consumer staples stocks with global brands, such as Diageo (Guinness), Mondelez (Cadbury’s) and Heineken.

As a concentrated portfolio of stocks held over the very long term, FGT’s exposures diverge widely from the market and at times relative returns will be as much about what it does not hold as what it does. Train owns no healthcare stocks, which performed very well in 2014. While some names in this area show traits Train values, such as globally leading brands and disruptive technologies, he dislikes the uncertainty as to which drugs or compounds will drive future returns. Similarly, while he correctly called the start of a huge bull market in commodities in 2006/07, he had and continues to have no exposure to the sector, which was among the worst performers in 2014. “There are sectors where we have understanding and value to add, and those where we don’t,” says Train.

After six consecutive years of outperformance of the index, Train counsels that at some point a bad year in relative terms is almost inevitable, although in line with his long-term philosophy he would not change his approach in response to market fluctuations.

Asset allocation

Investment process: Looking for enduring quality

FGT is a concentrated (25-30 stock) portfolio of mainly UK companies. Influenced by long-term value investors like Warren Buffett, Sir John Templeton and Peter Lynch, manager Nick Train aims to buy quality stocks that can grow and compound over time. Turnover is extremely low, with no new stocks added since 2011 and only one full exit in the past two years. Train uses fundamental analysis to identify companies that are undervalued versus their long-term prospects. While FGT is a member of the AIC’s UK Equity Income sector, total return potential is a more important factor than dividend yield. Train focuses on quality stocks with strong brands and enduring intellectual property. The manager favours companies with predictable cash flows, and says this is more important than whether a firm has some debt on its balance sheet, although he adds that none of the stocks he owns is excessively levered.

Current portfolio positioning

At 30 November 2014 FGT held 24 quoted companies, plus a small position in convertible stock of Celtic FC, and a 0.2% stake in unquoted Frostrow Capital, which provides administration, company secretarial, marketing and alternative investment fund manager (AIFM) services to FGT and other trusts. With the exception of these and a 0.7% holding in Lindsell Train IT, position sizes range from 1.1% to 8.8% of the portfolio, with 15 holdings having weightings above 3%. At 30 November, 58% of the portfolio was in FTSE 100 stocks, with 75.4% in FTSE 350 stocks (c 81% if Daily Mail & General Trust and Young & Co are included; both are big enough to appear in the index, but are excluded because their stock is non-voting). A further 16.1% was in overseas-listed stocks.

Relative to the FTSE All-Share benchmark, FGT is underweight FTSE 100, which accounted for 81.3% of the All-Share Index at 30 November, although including the overseas stocks (all of which are large enough to be in the FTSE 100 if they were UK-listed), the large-cap underweight is more marginal. Average market capitalisation for FGT holdings is £10bn (£6.9bn for UK stocks only); this is some way below the £16.7bn average size of FTSE 100 stocks, and substantially below the

£70.7bn average for the 10 largest stocks in the index. FGT holds only one true UK 'mega-cap', Diageo, the eighth-largest stock in the FTSE 100 with a market cap of £46.6bn at 30 November.

Exhibit 3: Sector allocations as at 31 December 2014

	Portfolio weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/ benchmark weight
Consumer Goods	40.7	14.5	26.2	2.8
Consumer Services	27.5	11.3	16.2	2.4
Technology	10.6	1.5	9.1	7.0
Utilities	0.0	4.0	-4.0	0.0
Financials	21.2	25.6	-4.4	0.8
Telecommunications	0.0	4.9	-4.9	0.0
Basic Materials	0.0	7.2	-7.2	0.0
Healthcare	0.0	8.5	-8.5	0.0
Industrials	0.0	9.8	-9.8	0.0
Oil & Gas	0.0	12.7	-12.7	0.0
	100.0	**100.0**	**0.0**	

Source: Finsbury Growth & Income Trust, FTSE, Edison Investment Research. Ranked by active weight.

FGT's focus on strong consumer brands, technology-enabled companies (including media) and 'stock market proxies' (largely asset managers and investment-focused service providers such as Hargreaves Lansdown) means its portfolio is exposed to only four of the 10 market sectors in the All-Share Index (Exhibit 3). The largest overweights are to consumer goods and services and the largest underweights are to oil and gas and industrials, although in relative terms technology, at seven times the index weighting, is the biggest overweight.

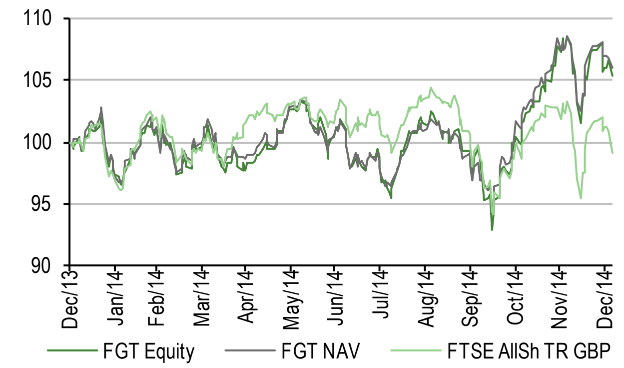
While no new holdings have been bought in the past three years, Train has significantly increased his weighting in Burberry, a rare consumer discretionary stock in a portfolio otherwise dominated by staples. As well as having a leading global brand, Burberry scores well for its use of technology, with innovative ordering systems allowing stores to carry less stock. Money from new share issuance has enabled Train to build the Burberry position without making any material reductions elsewhere.

One stock that has performed less well recently is online investment broker Hargreaves Lansdown (HL), down 25% in CY14. Train has topped up his position on price weakness, and says the reforms to pensions in the UK (essentially removing the obligation to buy an annuity at retirement) will be a significant positive for HL, whose customers value its high service standards even though it may not be the lowest-cost provider. The manager says that while operating margins will come down from their current 70%+ level over the next decade, the opportunities for HL to build its asset base are huge, as few if any players in the same space are currently in a position to take it on.

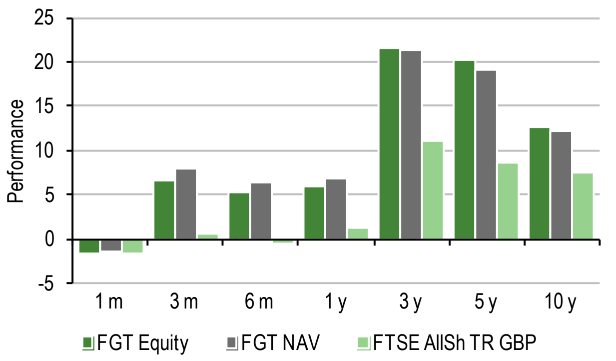
Performance: Longstanding record of outperformance

Exhibit 4: Investment trust performance to 31 December 2014

Price, NAV and benchmark total return perf, one year rebased



Price, NAV and benchmark total return performance (%)*



Source: Thomson Datastream, Edison Investment Research. Note: *Three, five and 10 years annualised.

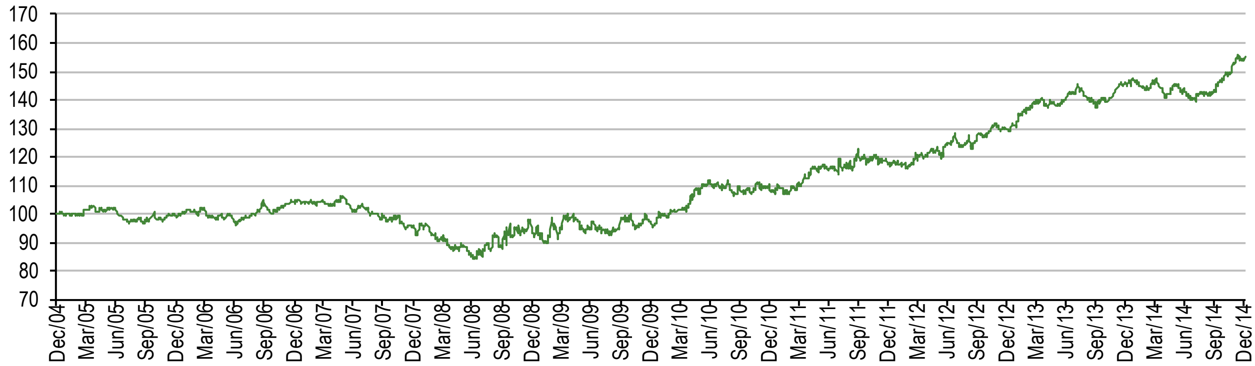
The summer of 2014 saw a spell of relative underperformance for FGT, but following a widespread sell-off in September/October, the trust recovered well and finished the year ahead of its FTSE All-Share benchmark in both share price and NAV terms over almost every period shown in Exhibits 4 and 5 (the pre-Christmas sell-off caused marginal underperformance in share price terms during December). FGT has also outperformed the FTSE 350 Index (a measure of the UK market excluding smaller companies) over all periods. Over periods of one year and less it has tended to lag the global market (Exhibit 5), largely owing to strong performance in the US, which makes up around half of the MSCI World. However, over longer periods it has comfortably beaten this index too. Exhibit 6 shows FGT's longer-term trend of steady outperformance versus the FTSE All-Share Index; where there have been periods of relative weakness, these have tended to be brief.

Exhibit 5: Share price and NAV total return performance relative to benchmarks (%) to 31 December 2014

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-Share	(0.1)	6.0	5.8	4.7	30.7	65.6	59.1
NAV relative to FTSE All-Share	0.2	7.2	6.8	5.7	30.1	57.6	53.7
Price relative to FTSE 350 Index	0.0	6.0	5.8	4.7	31.4	66.3	58.7
NAV relative to FTSE 350 Index	0.3	7.2	6.8	5.7	30.7	58.2	53.3
Price relative to MSCI World Index	(0.5)	1.4	(3.0)	(5.5)	14.9	45.3	41.5
NAV relative to MSCI World Index	(0.2)	2.6	(2.0)	(4.6)	14.4	38.2	36.7

Source: Thomson Datastream, Edison Investment Research. Note: Geometric calculation.

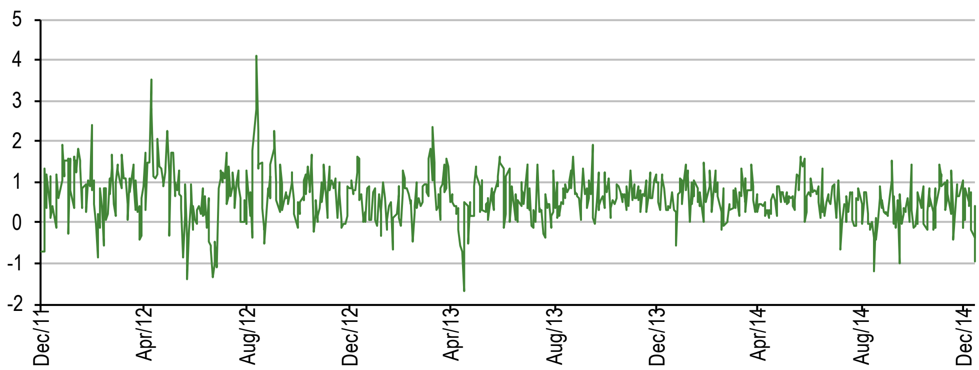
Exhibit 6: FGT NAV total return vs FTSE All-Share total return, over 10 years, rebased to 100



Source: Thomson Datastream, Edison Investment Research

Discount: Strong demand sees continued issuance

Exhibit 7: Discount/premium to cum-income NAV over three years



Source: Thomson Datastream, Edison Investment Research. Note: Discount with debt at fair value, including income.

Demand for FGT shares has continued to be strong and over the 12 months to 20 January the shares traded at an average 0.5% premium to net asset value (0.6% over three years), ending the period at a premium to cum-income net asset value of 1.3%. The trust has an active discount control mechanism and will buy back shares into treasury if the discount reaches 5% or more. If there are unfulfilled buy orders it will issue new shares at a small premium to meet demand. Each year the trust seeks authority to buy back up to 14.99% and allot up to 10% of issued share capital. If the 10% level is exceeded (as it has been in recent years), further authority can be sought. In the 12 months to 20 January 2015, FGT issued 15.8m new shares, raising £80.9m. There are currently no shares held in treasury.

Capital structure and fees

FGT is a conventionally structured investment trust, with 103.8m ordinary shares in issue at 20 January 2014 (+17.6% over 12 months). Gearing is via a £30m three-year revolving multicurrency facility with Scotiabank, with the ability to draw a further £20m if needed. At the 30 September 2014 year-end, £23.1m was drawn, equivalent to net gearing of 4.0%. FGT's gearing policy states that gearing should not exceed 25% of net assets. If all the available gearing were drawn (including the additional £20m) the maximum achievable gearing based on 30 September net assets is 10.1%. However, it is unlikely that gearing will increase materially from current levels (other than in exceptional circumstances to fund a substantial new purchase); Train views a level of c 5% on such a concentrated portfolio as a bullish position.

Portfolio manager Lindsell Train receives an annual management fee of 0.45% of FGT's market capitalisation, calculated monthly and payable monthly in arrears. Frostrow Capital is the alternative investment fund manager (AIFM) under the AIFM Directive, and provides company secretarial, administration and marketing services. Frostrow receives an annual fee of £70,000 plus 0.15% of FGT's market capitalisation, also calculated and paid monthly. During the 2014 financial year the trust's performance fee mechanism was scrapped. No performance fee had been paid since 2007. An increasing number of trusts view performance fees as inappropriate in the post-Retail Distribution Review[1] environment, and only five out of 24 UK Equity Income trusts now have such fee arrangements.

Dividend policy and record

Dividends are paid twice a year, in May and October. While not a high income trust (its yield is among the lowest in the UK Equity Income peer group, reflecting its focus on growth as well as income), FGT has a progressive dividend policy, and has raised dividends by an average of 5.7% a year over the past five years. (A fall in the dividend between 2009 and 2010 was principally a result of government intervention to prevent Lloyds Bank paying its own dividends.) The total dividend of 11.3p per share for FY14 was 7.6% higher than the 2013 dividend, and was fully covered by income. The board of FGT has considered quarterly payment of dividends, but has concluded that paying two interim dividends remains the most appropriate and cost-effective strategy, particularly as most portfolio companies pay their own dividends twice a year.

Several of FGT's portfolio holdings increased dividends by more than 10% during 2014 and in July Train estimated the underlying dividend growth for the portfolio at c 8.5%, similar to FGT's own dividend growth for the year. New money (through the issuance of shares) has been allocated to the areas where Train sees the best total return opportunities rather than the highest dividends.

[1] The Retail Distribution Review, implemented in January 2014, aimed to remove commission bias in the recommendations of independent financial advisers by requiring advice costs to be explicit, rather than rolled up in fund fees. In theory this should place investment trusts, which have never paid commission, on an equal footing with open-ended funds, which previously levied an initial charge that included payment for financial advice. Performance fees are rare in open-ended funds and removing them from investment trusts allows for easier comparison of the overall cost of ownership.

Peer group comparison

The AIC's' UK Equity Income sector contains 24 funds; Exhibit 8 below shows the 12 with market capitalisations in excess of £200m. FGT is the fifth-largest fund in the sector. Its strong performance record is evident: in NAV total return terms it is first overall over five years, second over three years and sixth over one year (third among the group of larger trusts). Its risk-adjusted return as measured by the Sharpe ratio is above average over both one and three years. High-income strategies are much in demand and many UK Equity Income trusts (14 of 24) trade at a premium to NAV; FGT's 0.9% premium at 14 January is above the 0.3% weighted average. FGT has the lowest yield in the sector. Gearing is towards the lower end of the range, while charges are average.

Exhibit 8: UK Equity Income investment trusts

% unless stated	Market cap (£m)	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	Discount (-) /premium	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
Finsbury Growth & Income	**562.0**	**5.2**	**76.1**	**136.9**	**0.8**	**No**	**0.9**	**105.0**	**2.1**	**1.0**	**1.7**
City of London	1,135.2	3.0	49.5	77.4	0.4	No	2.1	108.0	4.0	0.9	1.4
Diverse Income Trust	313.7	-1.0	88.1	--	1.3	No	2.9	96.0	2.9	0.6	2.5
Dunedin Income Growth	389.6	0.2	37.4	59.0	0.6	No	-2.9	108.0	4.4	0.4	1.0
Edinburgh Investment	1,277.8	12.1	54.5	99.2	0.7	No	0.8	114.0	3.6	1.4	1.4
F&C Capital & Income	238.2	-3.7	32.2	43.9	0.7	No	2.9	107.0	3.9	0.3	1.1
JPMorgan Claverhouse	323.0	-2.0	48.8	59.4	0.7	Yes	-3.0	118.0	3.4	0.6	1.3
Lowland	342.9	-5.4	65.2	121.9	0.6	Yes	-2.6	114.0	2.8	0.1	1.5
Merchants Trust	502.3	-4.7	41.3	60.0	0.6	No	0.3	119.0	5.2	0.2	1.1
Murray Income Trust	509.7	-0.4	37.3	60.4	0.7	No	-0.5	106.0	4.2	0.4	1.1
Perpetual Income & Growth	930.4	7.6	70.7	106.8	0.9	Yes	1.3	116.0	3.1	1.4	2.0
Temple Bar	777.7	-3.7	47.9	68.4	0.5	No	1.7	97.0	3.3	0.2	1.5
Weighted average (24 funds)		**2.7**	**54.0**	**83.9**	**0.8**	**0.0**	**0.3**	**111.6**	**3.6**	**0.8**	**1.5**
FGT rank out of 24	**5**	**6**	**2**	**1**	**13**		**11**	**18**	**24**	**5**	**3**

Source: Morningstar, 14 January 2015, Edison Investment Research. Note: Excludes trusts with less than £200m market cap. TR = NAV total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show 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 shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds.

The board

FGT has five non-executive directors. Anthony Townsend joined the board in 2005 and became chairman in 2008. Vanessa Renwick and John Allard have both been directors since October 2000, when Lindsell Train became the investment manager. David Hunt has been on the board since 2006, while Neil Collins was appointed in early 2008. The directors have backgrounds in investment management, accountancy, marketing and journalism, and stand for re-election annually.

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