

# Foreign & Colonial Investment Trust

## More global income

Foreign & Colonial Investment Trust (FRCL) is one of the largest and most liquid investment trusts. It has a highly diversified portfolio (over 600 companies in 30 countries) and seeks both capital and income growth. Reflecting a strategy to increase global exposure, and to diversify income sources, two new global portfolios were created in January (an income and a funds portfolio) and the benchmark was changed to the FTSE All-World. The portfolio remains overweight the UK, a position the manager is happy to maintain near term. Recent performance is close to the benchmark.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return blended benchmark* (%)	Total return FTSE All-World* (%)	Total return FTSE All-Share* (%)
31/07/10	17.6	19.4	18.3	17.6	19.3
31/07/11	17.1	15.6	14.1	13.5	14.9
31/07/12	0.9	0.5	1.4	2.2	0.4
31/07/13	26.1	26.1	26.2	26.7	24.3

Note: \*Twelve-month rolling discrete performance. FRCL's blended benchmark index is a composite of 40% FTSE All-Share Index and 60% FTSE World ex-UK Index until 31 December 2012 and the FTSE All-World Index thereafter.

## Investment strategy: Asset and liability management

Jeremy Tigue has managed FRCL since 1997. He is responsible for the whole portfolio but concentrates his efforts on the strategic asset allocation of the trust and the management of liabilities (the amount, cost, and FX denomination of borrowings). Selection of the individual investments is delegated to sub-management teams with specific expertise in countries, regions and asset classes. These are mostly sourced from within F&C Asset Management, but external managers are also used when FRCL believes this will enhance performance.

## Outlook: Sentiment improving, valuations average

Global equities have provided a very positive performance over the past year. The FTSE All-World Index has returned 26.7%, in sterling adjusted total return terms, while the MSCI World and FTSE All-Share have returned 28.1% and 24.3% respectively. There is evidence to suggest the global macro outlook is improving, but the recent tick up in volatility is a reminder that considerable uncertainty remains. The manager remains positive on the outlook for global equities over the medium to long term, particularly compared with other asset classes but, given near-term uncertainties, remains comfortable with the defensive positioning of the listed equity portfolio. The current market P/E of the Datastream World Market Index, at 15.6x, is in line with its 10-year average of 15.7x (see page 3).

## Valuation: Discount in line with longer-term averages

The current cum fair discount of 10.2% is in close range of its longer-term averages of 10.3%, 10.4% and 9.9% over one, three and five years respectively, and has moved in the relatively narrow range of 7.6% and 12.9% over the last three years. This offers investors some comfort that they should be able to enter and exit the trust at valuations around this level. The discount is slightly higher than the peer group (7.7%), while the dividend yield is also slightly higher (2.4% vs 2.1%).

## Investment trusts

28 August 2013

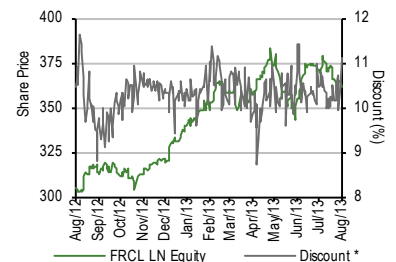
<b>Price</b>	<b>362.00p</b>
<b>Market cap</b>	<b>£2,066m</b>
<b>AUM</b>	<b>£2,610m</b>

NAV*	404.87p
Discount to NAV	9.7%
NAV**	407.18p
Discount to NAV	10.2%
Yield	2.4

\*Adjusted for debt at par value and excluding income, as at 27 August 2013. \*\*Adjusted for debt at market value, including income, as at 27 August 2013.

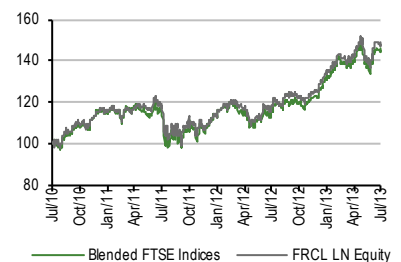
Ordinary shares in issue	570.7m
Code	FRCL
Primary exchange	LSE
AIC sector	Global Growth

## Share price/discount performance



\*Positive values indicate a discount, negative values indicate a premium.

## Three-year cumulative perf. graph



52-week high/low	383.00p	302.60p
NAV* high/low	421.64p	336.81p

\*Adjusted for debt at market value, excluding income.

## Gearing

Gross	13.1%
Net	12.2%

## Analysts

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[Edison profile page](#)

## Exhibit 1: Trust at a glance

### Investment objective and fund background

FRCL's investment objective is long-term growth in capital and income from a portfolio of primarily listed global equities, but also including unlisted investments. FRCL's blended benchmark index is a composite of 40% FTSE All-Share Index and 60% FTSE World ex-UK Index until 31 December 2012 and 100% the FTSE All-World Index thereafter. Gearing and the management of liabilities are important elements of FRCL's strategy.

### Recent developments

1 August 2013: Interim results for the half year ended 30 June 2013 released.

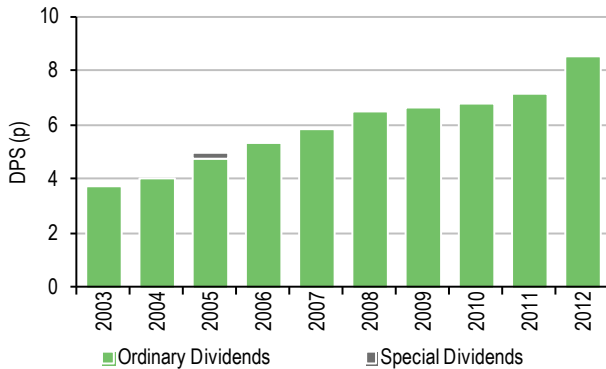
31 July 2013: Francesca Ecsery appointed as a non-executive director of the trust.

28 June 2013: First interim dividend for the year ending 31 December 2013 announced at 2.1p/share.

Forthcoming		Capital structure		Fund details	
AGM	April 2014	Ongoing charges*	0.90%	Group	FCAM/F&C Mgmt
Preliminary results	March 2014	Net gearing	12.2%	Manager	Jeremy Tigue
Year end	31 December	Annual mgmt fee	0.365% of market cap	Address	Exchange House, Primrose Street, London EC2A 2NY
Dividend paid	Quarterly	Performance fee	None	Phone	+44 (0) 800 136 420
Launch date	1868	Trust life	Indefinite	Website	<a href="http://www.foreignandcolonial.com">www.foreignandcolonial.com</a>
Continuation Vote	None	Borrowing facilities	Various – see page 7		

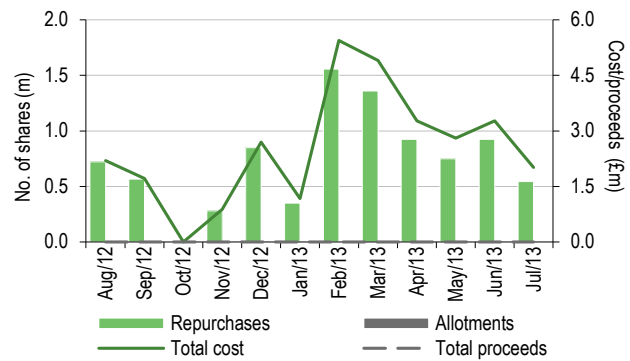
### Dividend policy and history

Dividends are paid quarterly in February, May, August and November.

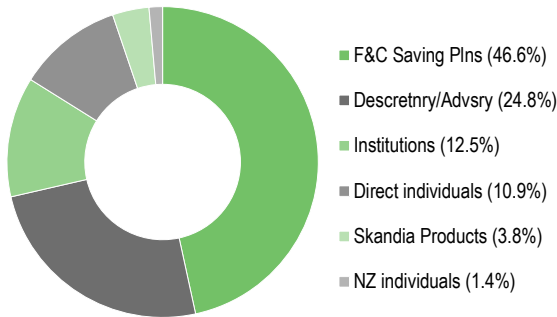


### Share buyback policy and history

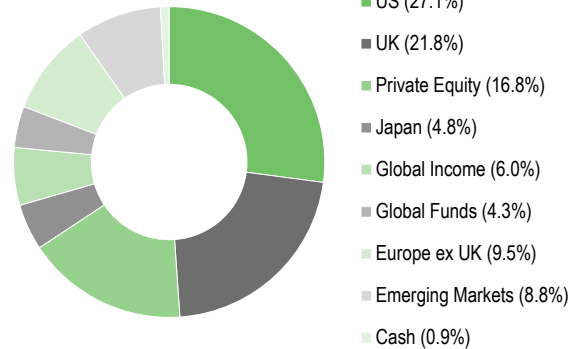
Renewed annually, the trust has authority to purchase up to 14.99%, and allot up to 5% of issued share capital.



### Shareholder base (as at 31 December 2012)



### Distribution of portfolio (as at 30 June 2013)



### Top 10 holdings (as at 30 June 2013)

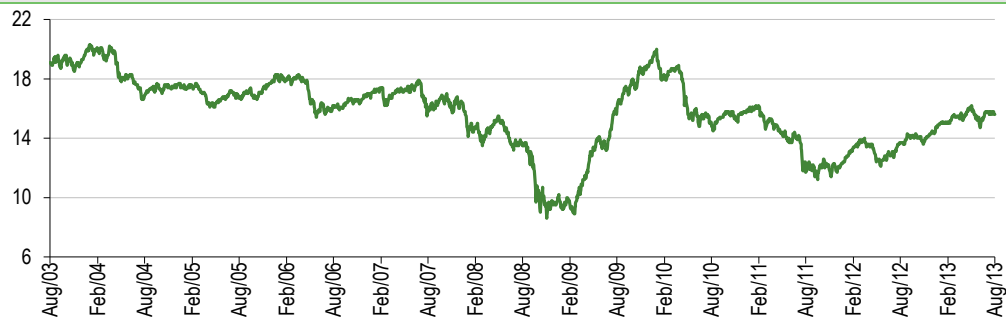
Company	Country	Sector	Portfolio weight %		Active weight %
			30 June 2013	31 December 2012	30 June 2013
Pantheon Europe Fund V	UK/Europe	Private Equity – fund of funds	2.4	2.5	2.4
Harbourvest V Direct Fund	US	Private Equity – direct	2.0	2.1	2.0
Pantheon Europe Fund III	UK/Europe	Private Equity – fund of funds	1.8	2.1	1.8
Doverstreet VII	Global	Private Equity – fund of funds	1.8	1.9	1.8
HSBC	Global	Financials/Banking	1.5	1.8	1.1
GlaxoSmithKline	Global	Large Pharmaceuticals	1.4	1.8	1.4
HarbourVest Buyout Fund VII	US	Private Equity – buy outs	1.3	N/A	1.3
BP	Global	Oil Comps – Integrated	1.3	1.6	1.0
Royal Dutch Shell	Global	Oil Comps – Integrated	1.2	1.9	0.3
HarbourVest Buyout Fund VIII	US	Private Equity – buy outs	1.1		1.1
<b>Top 10</b>			<b>15.8</b>	<b>19.0</b>	
<b>Cash</b>			<b>0.9</b>	<b>1.0</b>	
<b>Borrowings</b>			<b>13.1</b>	<b>15.5</b>	

Source: Foreign & Colonial Investment Trust, Edison Investment Research. Note: \*Ongoing charges include the look through expense of managing the private equity portfolio.

## Outlook: Sentiment improving? Valuations average

Despite very recent market volatility, global equities have provided a positive performance over the past year, with the trust's benchmark, the FTSE All-World Index, up by 12.9% over six months and 26.7% over 12 months. While there is evidence to suggest the global economic outlook is improving, considerable uncertainty remains. More bearish investors can point to low growth in European economies, fiscal deficits in the US, the potential inflationary effects of quantitative easing and falling growth in emerging markets as negative factors for global equities. More bullish investors can point to progress being made in the US economy, signs that Japan may be moving away from its deflationary past, and the ECB's ongoing commitment to support the eurozone as supportive of global equities. While there is variation within markets and regions, in historical terms, average P/E valuations for global equities do not look overstretched (see Exhibit 2). Currently at 15.6x, the average P/E ratio over the past 10 years for the Datastream World Market Index is 15.7x.

**Exhibit 2: Datastream World Market Index P/E over 10 years**



Source: Thomson Datastream

## Fund profile: Large diversified global trust

Launched in 1868, FRCL was the first UK investment trust. Today, its large size has the advantages of providing liquidity and spreading costs, while providing highly diversified exposure to global equities. Its investment objective is to generate long-term growth in both capital and income by investing in a portfolio of primarily listed equities, as well as unlisted securities (via private equity funds), supported by the use of long-term structural gearing. FRCL's current portfolio is differentiated by a relatively high weighting (c 17%) to private equity funds. However, this allocation is falling, and should continue to do so, towards a target of 10%. FRCL and F&C are completely independent legal entities, although FRCL once owned F&C. Jeremy Tigue has been the fund manager since July 1997. He owned 470k shares as at 8 July 2013. Reflecting a strategy to increase global exposure and diversify sources of income, January 2013 saw the introduction of two new sub-portfolios: a global income portfolio (6.0% of the total at the end of June) and a global funds portfolio (4.3% of the total as at the end of June, and used to invest in specialist areas globally). From 1 January the trust's benchmark was also changed from being a composite of 40% FTSE All-Share and 60% FTSE World Ex-UK to 100% FTSE All-World Index.

## The fund manager: Jeremy Tigue

### The manager's view: Investing for income growth

The manager remains broadly positive about global equities over the medium to long term, particularly when compared to other asset classes. Global economic growth, while subdued, remains positive and the corporate sector is generally robust. However, macroeconomic challenges remain, recovery is slow and, with evidence that profits and dividend growth are slowing, the

manager remains comfortable with the defensive positioning of the listed equity portfolio. Following the change in benchmark at the beginning of January, the allocation to the UK, where there has been a focus on income, has been reduced to make way for an increased allocation to global income stocks. However, rather than making wholesale changes, the manager has sought to make adjustments opportunistically, and so the portfolio currently remains substantially overweight the UK, which when coupled with the substantial allocation to private equity, leads to underweights across the remaining regions. The manager does not currently hold any regional or market preferences, noting that in his view none look particularly cheap or expensive, and he expects to continue to increase the allocations to other global regions as the UK allocation is reduced. Given the maturity and diversity of the private equity investments (most were acquired around 2002), the manager expects cash inflows to continue as the underlying funds realise investments. If fund valuations have been sufficiently conservative, there is also the prospect of an uplift to NAV as realisations occur. The manager continues to look at new areas and strategies to support above-benchmark returns with lower volatility, although for the moment he expects to continue reinvesting this cash flow in listed equities (allowing private equity to fall to c 10% of the portfolio over time, perhaps five years). This is expected to support growth in revenue income generation.

## **Asset allocation**

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### **Investment process: Top-down allocation, bottom-up analysis**

FRCL is managed using a predominantly top-down investment style supported by in-house and external specialist sub-managers of geographic sub-portfolios and funds. The manager is supported in his asset allocation decisions by the F&C asset allocation and strategy team, although given the size of the FRCL portfolio, the focus is on medium- to long-term market trends rather than tactical asset allocation or trading. However, FRCL is not passive and over the years has shown itself prepared to make material and significant shifts in its portfolio to gain exposure to anticipated secular investment themes. FRCL employs structural gearing that it believes will enhance shareholder returns over the long term. The level of gearing is varied over time, generally from 0-20% (in May 2007 it was c 5%, c 19% in September 2011, and now c 12%), and the manager seeks to add value by selecting borrowing in a suitable currency. A combination of low interest rates and a weak currency is ideal. Stock selection is left to specialist country/regional sub-managers, the majority of whom are internal to F&C but may also be external, as is the case with the two North American sub-managers and the private equity investments. Recently a total of c 45% was externally managed and this is likely to increase. The decision to employ external sub-managers is based on whether the manager and board believe this is likely to lead to superior performance. The manager does not impose specific sector weighting guidance on the sub-managers, believing this may blur responsibility for decision-making. The majority of the portfolio is made up of larger, more liquid, diversified companies with strong balance sheets within each region.

### **Overview: Diversified global equity exposure**

As at 30 June 2012, FRCL had direct exposure to c 600 direct equity investments. The top 10 account for 9.4% of the portfolio. As illustrated in Exhibit 1, the US accounts for 27.1%, the UK 21.8%, private equity 16.8%, Japan 4.8%, Europe ex-UK 9.5%, emerging markets 8.8% and cash 0.9% of the portfolio. With its significant exposure to private equity funds (c 17%), FRCL's exposure to most major equity markets or regions appears underweight, excluding the UK (see Exhibit 4).

### **Recent activity and current portfolio positioning**

Reflecting the change of benchmark in January, portfolio activity year to date has seen the allocation to the UK, where there has traditionally been a focus on income, reduced to make way for an increased allocation to global equities, particularly income stocks in the global income portfolio. Despite this, FRCL's portfolio remains overweight the UK, and the process of reducing the

UK is expected to continue albeit, on valuation grounds, the manager is relaxed with the current level of holdings. The allocation to Europe has seen little change but there has been an increase in the allocation to the US and other global equities. Private equity has seen a modest reduction in its allocation, partly reflecting strong growth seen elsewhere in the portfolio, as well as realisations that have been reinvested in listed equities. At a sectoral level the portfolio remains overweight financials, industrials and healthcare. Consumer staples, previously an underweight position, and information technology, previously a relatively strong overweight, both now have a broadly neutral allocation. Looking at the direct equity portfolio in isolation, FRCL has a modestly more defensive positioning than its benchmark, with a beta of a little over 0.9.

**Exhibit 3: Sector allocations as at 30 June 2013**

	Portfolio weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/benchmark weight
Financials	27.6	22.7	4.9	1.22
Healthcare	11.0	8.1	2.9	1.36
Industrials	10.7	10.2	0.5	1.04
Consumer staples	11.2	11.0	0.2	1.02
Information technology	9.8	10.1	(0.3)	0.97
Telecommunication services	4.4	5.0	(0.6)	0.88
Materials	5.7	6.7	(1.0)	0.86
Utilities	2.2	3.6	(1.4)	0.61
Energy	8.9	10.4	(1.5)	0.86
Consumer discretionary	7.6	12.2	(4.6)	0.62
Cash	0.9	0.0	0.9	N/A
	<b>100.0</b>	<b>100.0</b>	<b>0.0</b>	

Source: Foreign & Colonial Investment Trust, Edison Investment Research

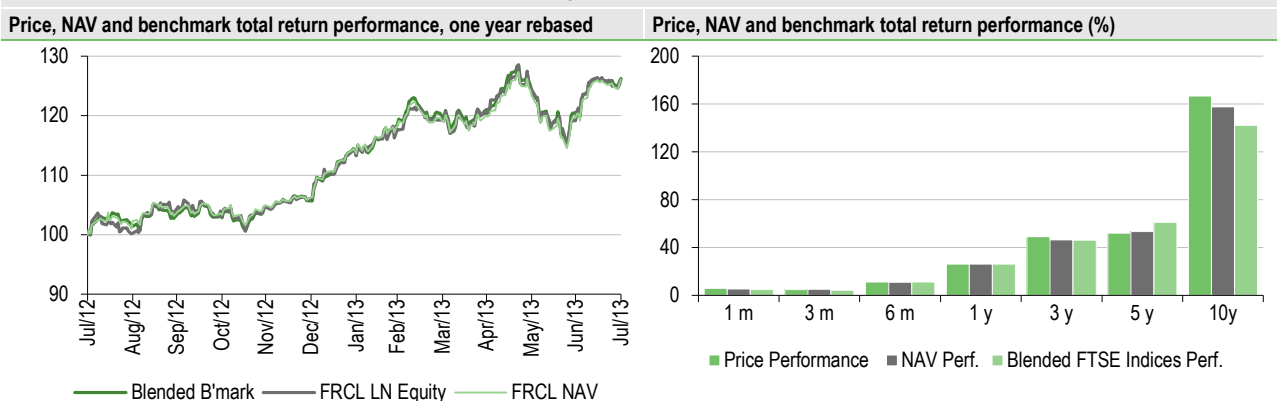
**Exhibit 4: Geographic allocations as at 30 June 2013**

	Portfolio weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/benchmark weight
Private equity	16.8	0.0	16.8	N/A
UK	21.9	6.1	15.8	3.59
Emerging markets	8.8	12.0	(3.2)	0.73
Japan	4.8	8.1	(3.3)	0.59
Other global	10.2	15.2	(5.0)	0.67
Europe Ex-UK	9.5	18.3	(8.8)	0.52
US	27.1	40.3	(13.2)	0.67
Cash	0.9	0.0	0.9	N/A
	<b>100.0</b>	<b>100.0</b>	<b>0.0</b>	

Source: Foreign & Colonial Investment Trust, Edison Investment Research

## Performance: Mild outperformance over 10 years

**Exhibit 5: Investment trust performance to 31 July 2013**



Source: Foreign & Colonial Investment Trust, Thomson Datastream, Edison Investment Research

As Exhibits 5, 6 and 7 illustrate, FRCL's performance has tended to follow that of its blended benchmark index quite closely. As Exhibit 7 also illustrates, the majority of the underperformance over the last five years occurred around the financial crisis. However, during the last four years the

trust has experienced periods of mild outperformance and underperformance, which have been broadly offsetting, although the long-term trend, measured by the 10-year figures, is one of modest outperformance. The relatively low tracking error against the blended benchmark (3.2% over one year) reflects the large number of holdings within the trust and the diversification this brings. As we explain elsewhere, FRCL has not been shy of taking significant strategic positions over the years and the clearest current example is the c 17% weighting to private equity. Exhibit 8 illustrates a performance attribution analysis for FRCL for the six months to 30 June 2013. During this period, asset allocation has been the primary detractor (overweight UK, underweight US and overweight private equity), stock selection has been mildly positive (Europe was particularly positive), while gearing has made the most significant positive contribution.

**Exhibit 6: Share price and NAV total return performance, relative to benchmarks (%), to 31 July 2013**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to blended benchmark <sup>1</sup>	1.0	0.5	0.0	(0.2)	3.0	(9.1)	24.4
NAV relative to blended benchmark <sup>1</sup>	0.5	0.7	(0.4)	(0.1)	0.4	(7.8)	15.4
Price relative to FTSE All-World	0.9	0.0	(1.5)	(0.6)	2.2	(13.7)	26.6
NAV relative to FTSE All-World	0.5	0.2	(1.9)	(0.6)	(0.4)	(12.4)	17.6
Price relative to FTSE All-Share	(1.0)	0.4	2.4	1.8	5.7	(1.2)	23.8
NAV relative to FTSE All-Share	(1.5)	0.6	2.1	1.8	3.1	0.1	14.8

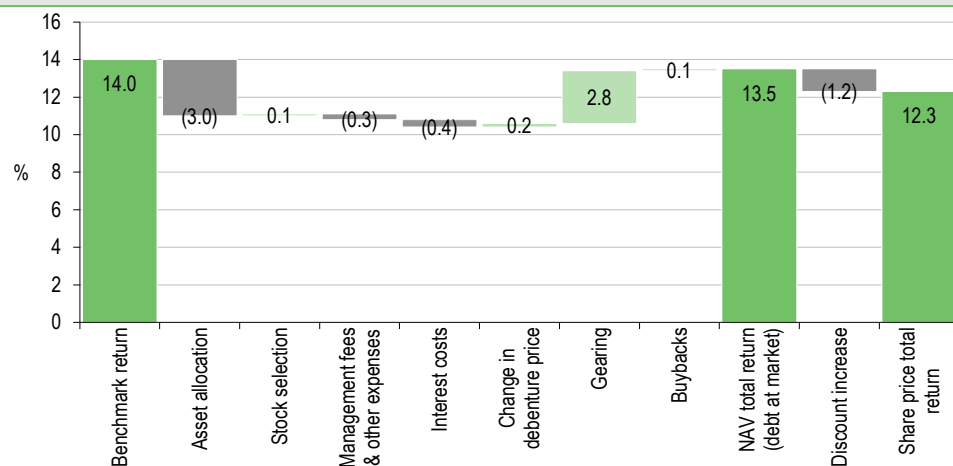
Source: Foreign & Colonial Investment Trust, Thomson Datastream, Edison Investment Research

**Exhibit 7: FRCL NAV total return vs blended benchmark<sup>1</sup> total return, over five years, rebased to 100**



Source: Foreign & Colonial Investment Trust, Thomson Datastream, Bloomberg, Edison Investment Research

**Exhibit 8: Performance attribution – six months to 30 June 2013**



Source: Foreign & Colonial Investment Trust, Thomson Datastream, Bloomberg, Edison Investment Research

## Discount: Close to long-term averages

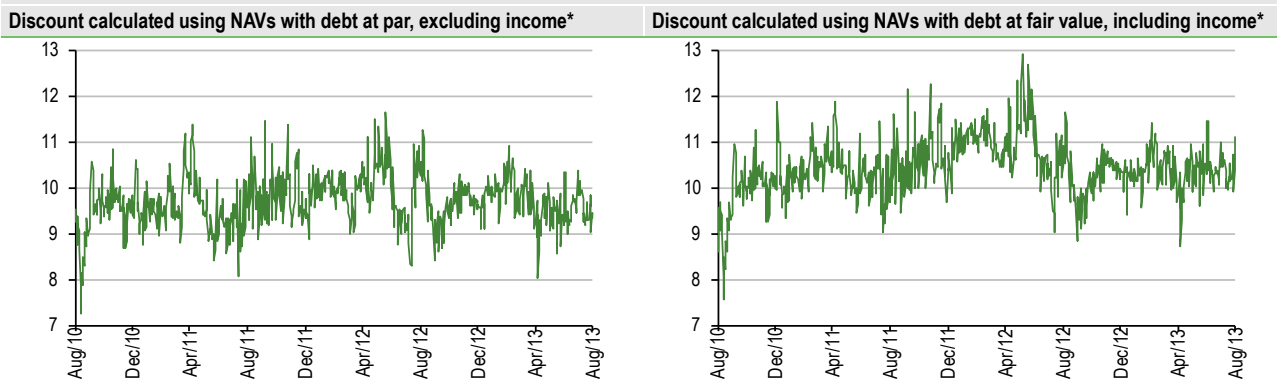
FRCL has had an objective to limit any share price discount to NAV to 10% since 2005. In pursuit of this, it has been active in the market for its own shares and has repurchased 43.5m shares over the

<sup>1</sup> FRCL's blended benchmark index is a composite of 40% FTSE All-Share Index and 60% FTSE World ex-UK Index until 21 December 2012 and the FTSE All-World Index thereafter.



past three years (7.1 % of those outstanding at the beginning of the period). However, buyback activity is down year on year. The year to 31 July 2013 saw 8.8m shares repurchased (at a cost of £30.4m), as illustrated in Exhibit 1, vs 14.7m (costing £44.7m) for the year to 31 July 2012. Exhibit 7 illustrates FRCL's discount during the last three years. The current cum fair discount<sup>2</sup> of 10.2% is in close range of its longer-term averages of 10.3%, 10.4% and 9.9% over one, three and five years respectively, giving investors comfort that they will be able to enter and exit the trust at valuations around this level. Given the significant private equity component within the portfolio (c 17%) it is worth noting that listed discounts tend to be higher (c 25%). However, FRCL is larger and more liquid than most pure listed private equity vehicles, and its portfolio is maturing and entering a phase of cash release and possible realisation gains.

**Exhibit 9: Discount/premium over three years**



Source: Thomson Datastream, Edison Investment Research. Note: \*Positive values indicate a discount; negative values a premium.

## Capital structure: Conventional, moderate gearing

FRCL is a conventional investment trust, having only one class of share in issue, 25p ords. The trust is able to gear up to 20% of net assets, and uses a range of debt instruments for this purpose, including 11.25% debenture stock expiring in 2014 (par value £110m) as well as loan and overdraft facilities (totalling £175m). In addition, FRCL has a seven-year loan, taken out in April 2012, designed to lock in current interest rates on US\$8m and JPY6bn. As at 30 June 2013 FRCL had gross and net gearing of 13.1% and 12.2% respectively. Since 1 January 2011 the manager has received an annual fee of 0.365% pa of the market capitalisation of FRCL, calculated and paid monthly in arrears. The fee is subject to a deduction for any amounts earned from investments made into other F&C vehicles managed, but the manager is reimbursed for fees paid to sub-managers. The investment management agreement can be terminated, by either side, at six months' notice. However, FRCL may give three months' notice in the event of a change in control of the manager. Ongoing charges, which also include the look through expense of managing the private equity portfolio, were 0.90% for the year ended 31 December 2012 (2011: 0.90%). FRCL does not have a fixed life and there is no specific mechanism to wind up the company.

## Dividend policy: Quarterly dividend payments

FRCL moved to making quarterly dividend payments from February 2013. For the year ended 31 December 2012 FRCL paid a total dividend of 8.5p (an increase of 19.7% year-on-year), and has provided investors with 43 consecutive years of uninterrupted dividend growth. The increase for 2012 reflected previously strong growth in dividends from listed investments (+20% in 2011), strong income reserves (18.1p per share at the end of 2012), and the anticipation of future net income growth (from re-investment of private equity cash flows into higher yielding listed equities as well as

<sup>2</sup> Cum Fair premium/discount calculated using NAVs with debt at fair value including current year revenue income.

the maturing of £110m of expensive debt in 2014). In addition, from April 2013, FRCL will no longer incur costs in relation to savings schemes, which should save around £1m pa of expenses charged to revenue. We estimate that remaining income reserves should be c 17p per share at the end of 2013, providing a strong platform to support future dividend development. If we assume a £60m shift from private equity to listed equity this year followed by £20m pa, a refinancing of the 11.25% 2014 debenture at 5%, and a reduction in the income reserve to c 11p per share but allow for no capital appreciation or dividend income growth, FRCL's existing portfolio would support dividend growth of c 5% pa to the end of 2017.

## Peer group comparison

Exhibit 10 provides a peer group comparison for the global growth sector, of which there are 35 constituents (a sample is given below). FRCL is one of the larger trusts in this peer group, and its relatively large allocation to private equity is a distinguishing feature. Within this peer group FRCL ranks 17th over one year, 15th over three years and 21st over five years when considering share price total return. In terms of risk-adjusted returns, FRCL has the eighth highest one-year Sharpe ratio for price, and eighth highest Sharpe ratio for NAV, in its peer group.

**Exhibit 10: Global growth sector, as at 27 August 2013**

Company	Share price total return on £100			Ongoing charges (%)	(Disc)/prem.	Net gearing (100=no gearing)	Five-year dividend growth (%)	Div. yield	Sharpe ratio NAV one year	Sharpe ratio price one year
	One year	Three years	Five years							
Sector average	121.3	143.2	149.1	0.8	(7.7)	105.5	9.4	2.1	1.9	1.7
Foreign & Colonial	120.7	144.6	144.4	0.6	(10.2)	112.0	6.9	2.5	2.4	2.1
Alliance Trust	119.7	147.6	154.9	0.7	(13.9)	111.0	3.9	2.2	2.2	2.1
Bankers	137.1	168.4	169.7	0.5	0.3	104.0	4.6	2.5	2.3	3.6
Edinburgh Worldwide	134.7	154.6	159.7	1.0	(7.9)	110.0	0.0	0.6	1.3	1.4
F&C Global Smaller Companies	137.3	187.9	225.6	0.8	2.2	98.0	5.9	0.8	2.9	2.9
Henderson Global	119.1	124.3	155.1	1.0	(9.5)	100.0	7.4	2.8	2.2	1.4
Independent	131.4	152.6	169.7	0.4	(7.6)	90.0	0.0	1.9	2.5	2.9
JPMorgan Overseas	120.2	124.9	176.3	0.6	(5.9)	110.0	3.3	1.5	1.9	1.9
Martin Currie Global Portfolio	124.1	157.8	151.8	0.8	(1.0)	98.0	2.2	2.5	2.0	1.7

Source: Morningstar

## The board

All directors are non-executive and independent of the investment manager. They are Simon Fraser (chairman), Sarah Arkle, Sir Roger Bone, Stephen Burley, Francesca Ecsery, Jeffrey Hewitt, Christopher Keljik and Nicholas Moakes (directors). Average length of director service is 4.0 years.

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