Foreign & Colonial Investment Trust

Investment trust review

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Now with quarterly dividends

Investment trusts

Foreign & Colonial Investment Trust (FRCL) is one of the largest and most liquid global equity trusts in the UK, with assets of c £2.5bn. It is highly diversified, with investments in more than 500 companies, across 30 countries. It pursues long-term growth in capital and income. It has a 42-year record of uninterrupted dividend growth and income seems likely to play a larger part in overall returns going forward. In general this reflects the paucity of growth opportunities across markets, but specifically it reflects FRCL's on-going shift from non-yielding private equity investments towards higher yielding listed equities, as well as the prospect of lower funding costs on structural borrowing. Strong income reserves have allowed it to anticipate these portfolio shifts and the interim dividend, paid in September 2012, was rebased upwards by 33%. From February 2013 dividends will be paid quarterly.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return Composite B'mark* (%)	Total return FTSE All-Share* (%)	Total return FTSE World ex-UK* (%)
18/01/2010	35.0	34.0	35.7	40.6	32.3
18/01/2011	17.1	15.7	15.6	15.5	15.7
18/01/2012	(3.7)	(2.6)	(2.5)	(3.3)	(2.0)
18/01/2013	16.0	15.0	13.7	14.1	13.4

Note: *Twelve-month rolling discrete performance. Composite Benchmark index comprises 40% FTSE All-Share Index and 60% FTSE World ex-UK Index.

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). Thereafter, 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 its performance.

Outlook: Self help

The manager is generally positive about global equities over the medium to long term, especially comparing solid yielding equities with bonds. The global economy is still growing, innovation continues, and the corporate sector is generally robust but macroeconomic problems persist and recovery from the financial crisis is slow. In April 2012, FRCL fixed £100m of its debt at a blended rate (3.25%) that is lower than the dividend yields available on listed equity investments. Positive cash flows from maturing private equity investments and the repayment of a historically expensive £100m (11.25%) debenture in 2014 will further support future portfolio income.

Valuation: Discount in line with longer-term averages

The current discount, with debt at market of 10.3% is broadly in line with its longer-term averages of 9.9%, 9.8% and 9.0% over one, three and five years respectively but slightly higher than the AIC peer group (9.1%), whilst the dividend yield is slightly larger (2.5% vs 2.2%).

21 January 2013

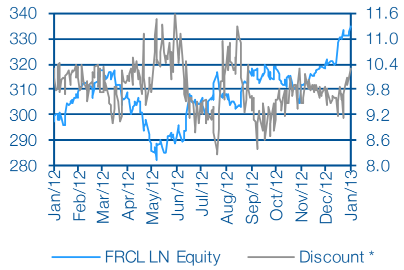
Price	**334.50p**
Market cap	**£1,930m**
AUM	**£2.498m**
NAV*	375.42p
Discount to NAV	10.9%
NAV**	372.92p
Discount to NAV	10.3%
Yield	2.4%

** Adjusted for debt at par value, excluding income, as at 17 January 2012.*

*** Adjusted for debt at market value, excluding income, as at 17 January 2012.*

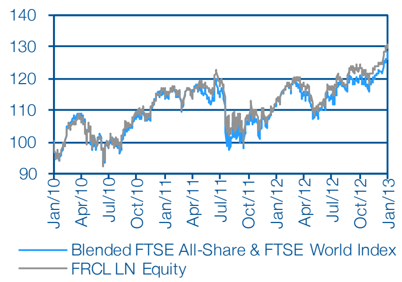
Ordinary shares in issue	577.2m
Code	FRCL
Primary exchange	LSE
AIC Sector	Global Growth

Share price/discount performance



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

Three-year cumulative perf. graph



52-week high/low	334.50p	282.50p
NAV* high/low	372.27p	316.45p

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

Gearing

Gross	16.7%
Net	15.0%

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Edison profile page

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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. The performance benchmark is a composite index comprising of 40% FTSE All-Share Index and 60% FTSE All World Index. Gearing and the management of liabilities is an important element of the strategy.

Developments last quarter

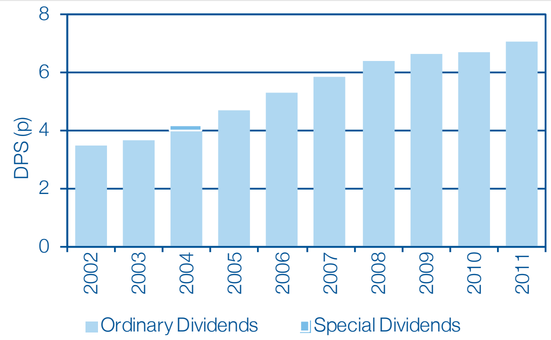
15 January 2012: Month end Portfolio information released.

12 December 2012: Second interim dividend of 2.0p, for year-end 31 December 2012 announced. XD=11 Jan 13, Paid=1 Feb 13.

Forthcoming		Capital structure		Fund details	
AGM	April 2013	Ongoing charges	0.92%	Group	FCAM/F&C Mgmt
Preliminary results	March 2013	Net gearing	15.0%	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		
Launch date	1868	Trust life	Indefinite	Phone	0800 136 420
Wind-up date	None	Loan facilities	See page 7	Website	www.foreignandcolonial.com

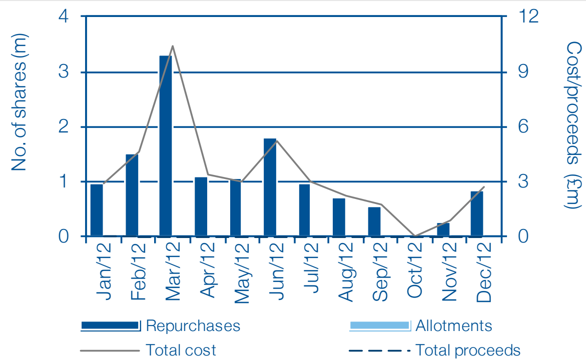
Dividend policy and history

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

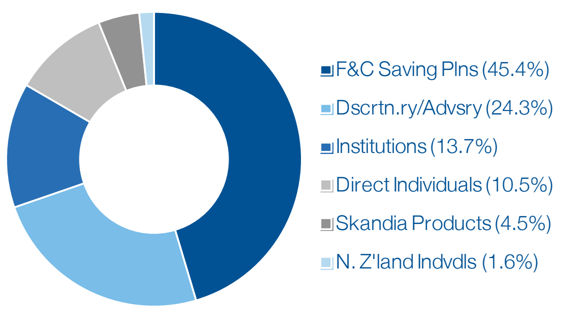


Share buyback policy and history

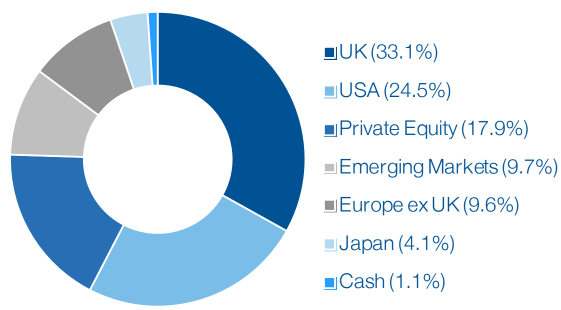
Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 5% of issued share capital.



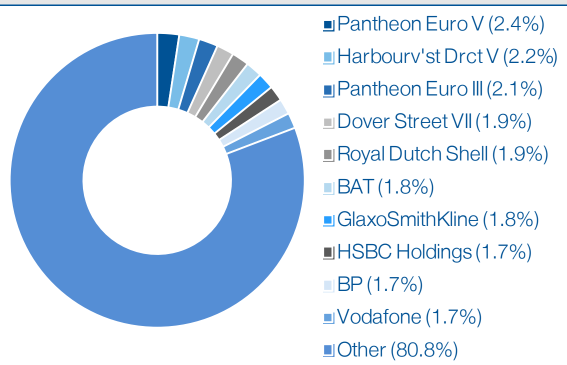
Shareholder base (as at 31 December 2011)



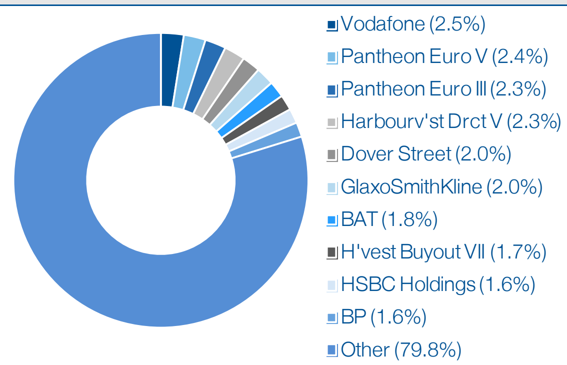
Geographic distribution of portfolio (as at 30 November 2012)



Portfolio composition (as at 30 November 2012)



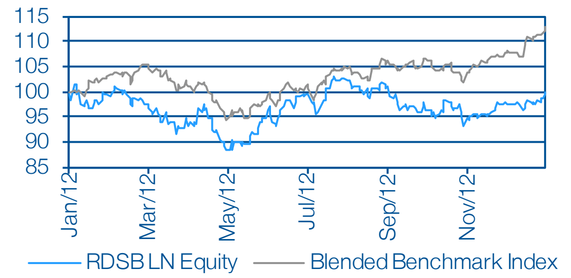
Portfolio composition (as at 31 May 2012)



Source: Foreign & Colonial Investment Trust, Edison Investment Research

Exhibit 2: Top five quoted equity positions at a glance at a glance, as at 30 November 2012

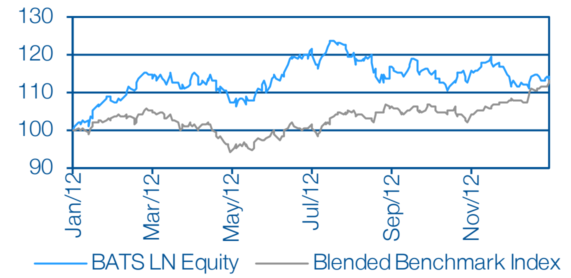
Royal Dutch Shell	Code: RDSB LN	Market cap: £142,625m



Div Yield (trail. 12 months)	4.81%
Industry/Sector	Oil & Gas Producers/Integrated
Listing	LSE, EN Amsterdam, NYSE
Website	www.shell.com

Based in the Netherlands, Shell is a global group of energy and petrochemicals companies that employs 102,000 people in over 100 countries. Shell is revising its business structure into four new main areas: upstream international, upstream Americas, downstream and projects & technology. Shell has proven reserves of 18.1bn barrels of crude, 45,000 service stations worldwide and interests in 25 refineries. The manager considers Shell offers defensive earnings and a good yield.

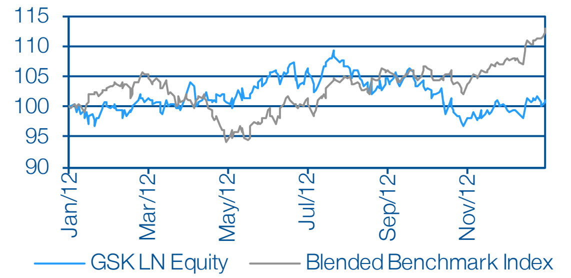
British American Tobacco	Code: BATS LN	Market cap: £61,203m



Div Yield (trail. 12 months)	4.12%
Industry/Sector	Tobacco/Tobacco
Listing	LSE – Premium Listing
Website	www.bat.com

British American Tobacco (BAT) is the world's second largest quoted tobacco company, by market share. It has over 200 brands sold in over 180 countries and 46 factories in 39 countries. Its four main brands are Dunhill, Kent, Lucky Strike and Pall Mall. The manager believes BAT has good management, is very cash generative and has a strong balance sheet. Furthermore, in addition to its defensive earnings, BAT is well positioned to benefit from emerging market growth.

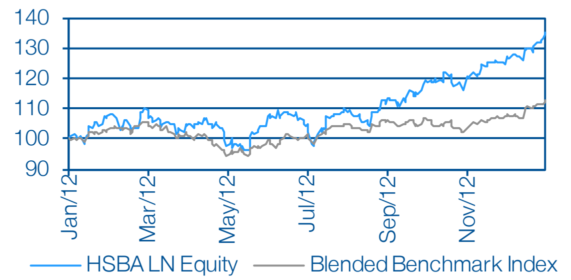
GlaxoSmithKline	Code: GSK LN	Market cap: £67,460m



Div Yield (trail. 12 months)	5.31%
Industry/Sector	Pharmaceuticals & Tech/Pharma
Listing	LSE – Premium Listing
Website	www.gsk.com

Headquartered in the UK, GlaxoSmithKline (GSK) is a global healthcare company engaged in the discovery, development, manufacture and marketing of pharmaceutical and health related consumer products. GSK employs over 97,000 people in over 100 countries. The manager considers that GSK is a strong multinational business that is well managed, cash generative and well financed and that it offers a defensive earnings and a good yield.

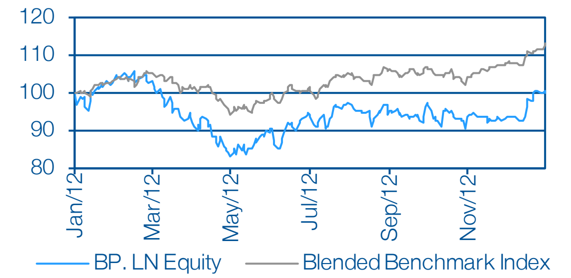
HSBC Holdings	Code: HSBA LN	Market cap: £128,204m



Div Yield (trail. 12 months)	3.75%
Industry/Sector	Banks/Banks
Listing	LSE – Premium Listing
Website	www.hsbc.com

Based in the UK, HSBC is one of the world's largest banking and financial services organisations. It operates in five main geographical areas: Europe, Hong Kong, North America, South America and Asia-Pacific – including the Middle East and Africa. HSBC has 8,500 offices across 86 countries. The manager considers that HSBC is well managed, offers a good yield and is well positioned to benefit from emerging market growth.

BP	Code: BP. LN	Market cap: £88,129m



Div Yield (trail. 12 months)	4.54%
Industry/Sector	Oil & Gas Producers/Integrated
Listing	LSE – Premium Listing
Website	www.bp.com

One of the world's largest integrated oil companies, BP employs 96,000 people in over 100 countries. BP is structured around two main business segments: Exploration and Production, and Refining and Marketing. BP has proven reserves of 18.1bn barrels of crude, 22,600 service stations, interests in 17 refineries and exploration activities in 29 countries. The manager believes BP offers a decent yield and offers good growth prospects.

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

Fund profile: Moderate turnover, medium- to long-term value play

FRCL has a long history; launched in 1868 it was the first ever UK investment trust. In today's world, its large size has the advantage providing liquidity and spreading costs, whilst providing highly diversified exposure to global equities. The 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/private equity, supported by the use of long-term structural gearing. FRCL's current portfolio is differentiated by a relatively high weighting (18%) of private equity investments, although given the maturity of these investments, the weighting is expected to fall as investments are realised. FRCL and F&C are completely independent entities, although FRCL once owned F&C. Jeremy Tigue has been the fund manager since July 1997. He owned 454k shares as at 9 January 2013.

Equity outlook

Since the financial crisis, the usual yield advantage of 10-year government bonds compared to quality blue chip non-financial equities has reversed. Despite generally lower levels of global economic growth than before the financial crisis, if current dividend levels are maintained, it is difficult to see how equities will underperform bonds over the next 10-years. Dividend sustainability, which in general relies on economic growth and corporate profitability, is a key risk to the equity advantage emphasising the importance of stock selection. European equities clearly face headwinds but P/E valuations, despite the recent uplift, are at the lower end of their historic range, the investment universe is broad and many companies have protection from the international scope of their businesses.

The fund manager: Jeremy Tigue

The manager's view: Investing for income growth

The manager is generally positive about global equities over the medium to long term, especially comparing solid yielding equities with bonds. The global economy is still growing, innovation continues, and the corporate sector is generally robust. But macroeconomic problems persist and recovery from the financial crisis is slow. With its significant allocation to private equity funds (c 18%) FRCL's exposure to most major equity markets or regions inevitably appears as underweight, with the exception of emerging markets. However, adjusted for this, the manager does not currently hold strong regional or market preferences, viewing valuations as compressed, and therefore showing few clear anomalies. Within the sub-portfolios, the UK is focused on income, Europe (ex-UK) has recently shifted from a defensive stance towards companies (mainly found in more cyclical sectors) with strong managements and franchises, sound cash flow and attractive valuations, while the US reflects the respective strengths of the two external managers (in growth and in value). The Japanese portfolio, tilted towards growth stocks, has performed well so far during 2012 after a difficult 2011. Given the maturity of the private equity investments (most were acquired around 2002), the manager expects a continued return of cash to FRCL as the underlying funds increasingly realise their investments. If fund valuations have been sufficiently conservative, there is also the prospect of an up-lift to NAV as realisations occur. With the next major trend in investment markets elusive at this stage, the manager expects to reinvest this cash flow in listed equities (allowing private equity to fall to c 10% of the portfolio over time, perhaps five years), which will have the effect of lifting FRCL income, as the private equity investments are non-yielding capital growth investments.

Investment process: Top-down asset 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 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 15%), 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. The decision on whether to employ external sub-managers is simply based on whether the manager and board believe this is likely to lead to superior performance for the company. The manager does not impose specific sector weighting guidance on the sub-managers, in 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

Exhibit 3: Sector allocations, of listed equity portfolio, as at 30 November 2012

	Trust weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/ benchmark weight
Information technology	11.3	5.3	6.0	2.12
Healthcare	9.3	3.5	5.8	2.67
Financials	25.3	22.3	3.0	1.13
Industrials	10.0	7.2	2.8	1.39
Telecommunication services	5.2	5.8	(0.6)	0.89
Utilities	2.5	3.9	(1.4)	0.63
Consumer staples	11.8	15.0	(3.2)	0.79
Energy	10.6	14.1	(3.5)	0.75
Consumer discretionary	7.0	10.9	(3.8)	0.65
Materials	7.0	12.0	(4.9)	0.59
Total	**100.0**	**100.0**	**0.0**	

Source: Foreign & Colonial Investment Trust, Edison Investment Research

Exhibit 4: Geographic allocations as at 30 November 2012

	Trust weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/ benchmark weight
Private Equity	17.9	0.0	17.9	N/A
USA	24.5	15.1	9.4	1.62
Emerging Markets	9.7	6.2	3.5	1.56
Japan	4.1	3.0	1.1	1.37
Europe Ex-UK	9.6	18.1	-8.5	0.53
UK	33.1	48.7	-15.6	0.68
Other	0.0	8.9	-8.9	0.00
Cash	1.1	0.0	1.1	N/A
Total	**100.0**	**100.0**	**0.0**	

Source: Foreign & Colonial Investment Trust, Edison Investment Research

As at 30 November 2012, FRCL had direct exposure to c 520 direct equity investments. The top 10 account for 19.2% of the portfolio. As illustrated in Exhibit 1, the UK account for 33.1%, the US 24.5%, private equity 17.9%, emerging markets 9.7%, Europe Ex-UK 9.6%, Japan 4.1%, and cash 1.1% of the portfolio. With its significant exposure to private equity funds (c 18%) FRCL's exposure to most major equity markets or regions appears underweight (excluding the US emerging markets).

Current portfolio positioning

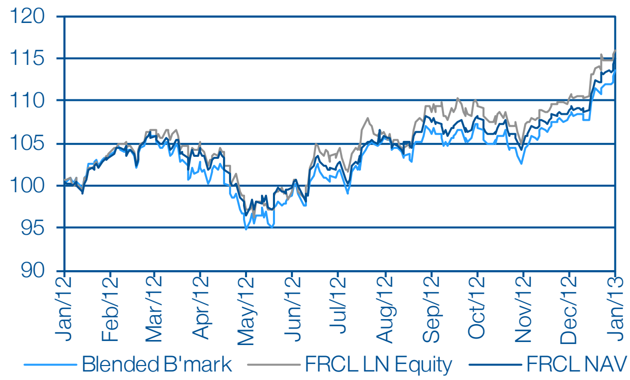
At the sectoral level, there has been little change in relative allocations during the last six months. The largest active weight remains information technology at +6.0%. FRCL also remains overweight healthcare, financials and industrials. Looking at the direct equity portfolio in isolation, FRCL has a more defensive positioning than its benchmark, with a beta of a little over 0.9.

Recent performance: Mild outperformance over the longer term

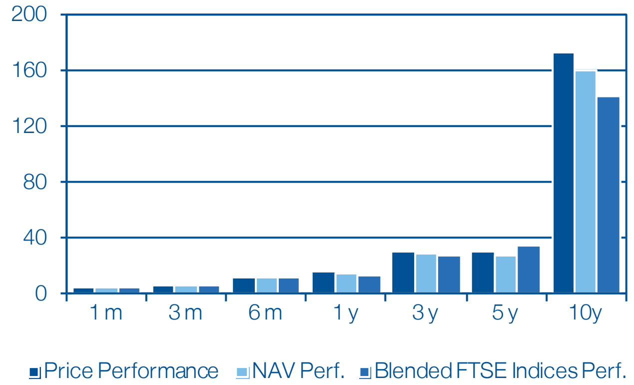
As Exhibits 4 and 5 illustrate, FRCL's performance has tended to follow that of its blended benchmark index quite closely. This reflects a number of off-setting factors within the portfolio rather an attempt to replicate the index performance. As we explain elsewhere, FRCL has not been shy to take significant strategic positions over the years and the clearest current example is the c 20% weighting to private equity. However, the long-term trend, measured by the 10-year figures, is one of mild outperformance.

Exhibit 5: Investment trust performance

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



Price, NAV and benchmark total return performance (%)



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

Exhibit 6: Share price and NAV total return performance (sterling adjusted), relative to benchmarks

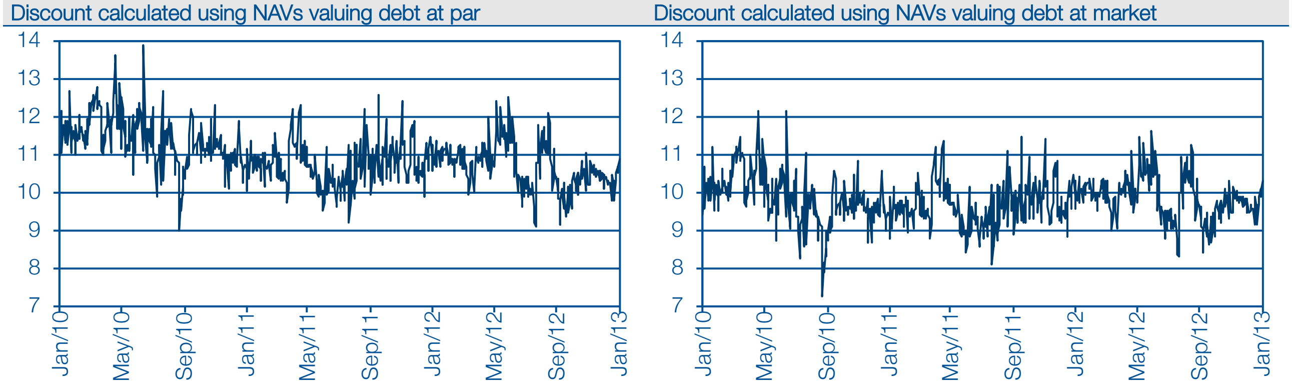
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to Blended benchmark	0.2	(0.1)	(0.3)	2.3	2.7	(5.0)	32.4
NAV relative to Blended benchmark	0.4	0.4	0.2	1.2	1.4	(7.4)	18.7
Price relative to FTSE All-Share Index	1.1	0.6	0.2	1.9	3.4	0.4	25.3
NAV relative to FTSE All-Share Index	1.4	1.1	0.7	0.9	2.1	(1.9)	11.6
Price relative to FTSE World ex-UK	(0.5)	(0.5)	(0.7)	2.6	2.2	(9.2)	37.2
NAV relative to FTSE World ex-UK	(0.3)	(0.1)	(0.2)	1.5	0.9	(11.5)	23.5

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

Discount: Fair value discount close to longer-term averages

In 2005 the FRCL board set a clear objective to limit any share price discount to NAV, to 10%. In pursuit of this, FRCL has an active share repurchase policy and has repurchased c 68m shares (10.6 % of those outstanding at the beginning of the period) over the past three years. Repurchase activity during the last 12 months has seen 12.9m shares repurchased at a cost of £39.5m, as illustrated in Exhibit 1. As Exhibit 8 shows, the discount management strategy has been largely successful over the past three years. In Exhibit 7, the first graph is produced using NAVs with debt valued at par whilst the second chart, which is arguably of more relevance to investors, values debt at market. The current discount, with debt at market value, of 10.3% is marginally above its longer-term averages of 9.9%, 9.8% and 9.0% 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. Although FRCL has a significant private equity content (c 18%) where listed discounts tend to be higher (c 25%), FRCL is a larger and more liquid company than most pure listed private equity vehicles, and its portfolio is maturing and entering a phase of cash release and possible realisation gains.

Exhibit 7: Discount over three years



Source: Thomson Datastream, Edison Investment Research

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 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 November 2012 FRCL had gross and net gearing of 16.7% and 15.0% 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 board reviews F&C's performance each year. The investment management agreement can be terminated, by either side, at six months' notice. FRCL may, however, give three months' notice in the event of a change in control of the manager. The total expense ratio (TER) was 0.50% for the year ended 31 December 2011 (0.54% for the year ended 31 December 2010). Ongoing charges, which also include the look through expense of managing the private equity portfolio was 0.92% for the year ended 31 December 2011. FRCL does not have a fixed life and there is no specific mechanism to wind up the company.

Dividend policy and record: Move to quarterly payments

FRCL recently announced several important changes to its dividend policy. The 2012 interim dividend (paid in September 2012) was increased by 33% and from February 2013, dividends will be paid quarterly, starting with 2p per share. FRCL has a consistent record of dividend growth and appears on track for a 42nd year of uninterrupted dividend growth. The rebasing of the interim dividend reflects continued growth in dividends from listed investments (H112 +8% after +20% in 2011), strong income reserves (18.8p per share at the end of 2011), and the anticipation of future net income growth (from re-investment of private equity maturity cash flows into higher yielding listed equities as well as the maturing of expensive debt in 2014). We estimate that remaining income reserves should be c 14p per share at the end of 2012, providing a strong platform to support future dividend development. If we assume a £20m pa shift from private equity to listed equity (company guidance), a refinancing of the 11.25% 2014 debenture at 5%, and a reduction in the income reserve to c 10p per share but allow for no capital appreciation or dividend growth, FRCL's existing portfolio would support dividend growth c

5% pa to the end of 2017. In terms of expense allocation, transaction costs relating to the purchase and sale of investments and exchange gains/losses are charged to the capital account. Management fees for certain private equity investments are charged 100% to the capital account. Management fees for the non-private equity portfolio and finance costs are charged on a 50:50 split to the revenue and capital accounts respectively. All other costs are charged to the revenue account. This allocation reflects FRCL's investment mandate, which aims to provide both income and capital growth.

Peer group comparison

As Exhibit 8 illustrates, the AIC global growth sector is a comprehensive peer group. There are 29 constituents (a sample is given below). FRCL is one of the larger trusts in this peer group and, when compared to the others, its relatively large allocation to private equity is a distinguishing feature. Within this peer group FRCL ranks 15th over one year, 12th over three years and 18th over five years when considering share price total return.

Exhibit 8: Global growth sector, as at 18 January 2013

Company	Share price total return on £100			Ongoing charges (%)	(Disc)/ prem.	Net gearing (100=no gearing)	Five-year dividend growth (%)	Div. yield
	One year	Three years	Five years					
Sector average	**114.6**	**130.8**	**132.5**	**0.79**	**(9.1)**	**105**	**9.8**	**2.2**
Foreig & Colonial	**116.0**	**130.9**	**129.8**	**0.57**	**(10.7)**	**114**	**5.7**	**2.5**
Alliance Trust	114.8	128.7	135.6	0.64	(14.2)	106	3.8	2.4
Bankers	120.3	140.4	141.7	0.44	(5.3)	104	4.6	2.9
Edinburgh Worldwide	118.4	128.6	131.8	1.03	(12.8)	115	0.0	0.7
F&C Global Smaller Co's	122.4	172.3	208.8	0.81	0.7	101	4.4	0.9
Henderson Global	118.9	119.6	153.8	0.87	(6.1)	96	12.7	2.8
Independent	118.4	133.6	131.1	0.38	(15.0)	93	0.0	2.3
JPMorgan Overseas	110.3	119.8	149.8	0.63	(7.5)	111	3.3	1.7
Martin Currie Global Portfolio	114.0	132.1	135.6	0.82	(4.6)	97	8.5	2.7
RIT Capital Partners	94.3	114.2	115.9	1.28	(7.9)	102	47.6	2.5

Source: Association of Investment Companies

The board

All directors are non-executive and independent of the manager. They are Simon Fraser (chairman), Sarah Arkle, Sir Roger Bone, Stephen Burley, Jeffrey Hewitt, Christopher Keljik and Nicholas Moakes (directors). The average length of board member service is 3.9 years.

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