EDISON

The North American Income Trust

Above-average yield from a concentrated portfolio

Investment trusts

The North American Income Trust (NAIT) is a concentrated portfolio of primarily US large-cap stocks. Manager Fran Radano selects companies on the basis of their quality, value and income. The trust is benchmarked against the S&P 500 Index, but is also referenced against the Russell 1000 Value Index as it better reflects the investment mandate and income objective. Prior to May 2012, the trust was an index fund tracking the total return of the S&P 500 Index. NAIT has a progressive distribution policy (dividends have compounded at a 19.2% annual rate over the last three years) and since the change in objective has regularly added to revenue reserves.

12 months ending	Share price (%)	NAV (%)	S&P 500 (%)	Russell 1000 Value (%)	FTSE All-Share (%)
31/03/12	7.9	8.5	8.9	5.1	1.4
31/03/13	20.4	14.5	19.9	25.0	16.8
31/03/14	1.5	3.7	11.0	10.7	8.8
31/03/15	12.7	18.4	26.6	22.8	6.6
31/03/16	5.7	7.5	5.1	1.7	(3.9)

Note: Twelve-month rolling discrete £-adjusted total return performance.

Investment strategy: Quality stock selection

The investment objective is to provide above-average income and long-term capital growth from a concentrated portfolio. The majority of holdings are US equities, although Canadian equities, bonds and options may also be held. Stocks are selected based on their durable business models, cash flow generation, capital allocation policies and attractive valuations. Regular meetings with companies form a fundamental part of the Aberdeen investment process. The dividend yield of the portfolio is around 1.5x that of the benchmark. As a result of recent stock market volatility, the manager and his team have been able to find some good-quality companies at an attractive price and yield.

Market outlook: Attractive relative yield vs bonds

Despite heightened stock market volatility as investors have focused on monetary policy, slowing global growth, weak commodity prices and other macroeconomic issues, there is the potential for an improvement in US corporate earnings. Disposable income is being boosted by lower gasoline prices and higher levels of employment and there are indications that there may be a bottoming in demand at the industrial level. In addition, the yield spread between US equities and bonds is towards the high end of the historic range.

Valuation: Discount on widening trend

The current share price discount to cum-income NAV of 11.4% compares to a range of 4.8% to 13.5% over the past 12 months. It is wider than the average of the last three, five and 10 years (range of 4.1% to 5.7%). There is no formal discount control policy in place, but the board has been actively repurchasing shares since mid-2014. The trust has a progressive dividend policy with an above-average yield. At the current share price, the dividend yield is 3.6%.

26 April 2016

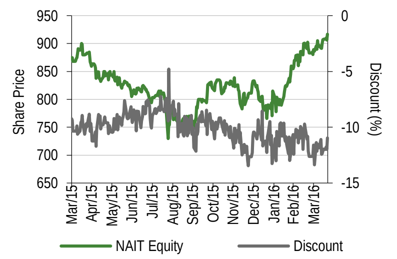
Price	**905p**
Market cap	**£264m**
AUM	**£336m**

NAV*	999.6p
Discount to NAV	9.5%
NAV**	1,021.2p
Discount to NAV	11.4%

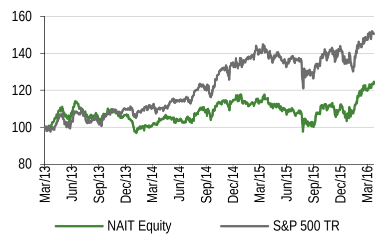
*Excluding income. **Including income. As at 22 April 2016.

Yield	3.6%
Ordinary shares in issue	29.1m
Code	NAIT
Primary exchange	LSE
AIC sector	North America

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low	917.0p	730.0p
NAV* high/low	1,032.4p	792.8p

*Including income.

Gearing

Net*	12.1%
Net (excluding cash held against option positions)*	13.7%

*As at 31 March 2016.

Analysts

Mel Jenner +44 (0)20 3077 5720

Sarah Godfrey +44 (0)20 3681 2519

investmenttrusts@edisongroup.com

Edison profile page

The North American Income Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

The North American Income Trust's objective is to provide investors with above-average dividend income and long-term capital growth through active management of a portfolio consisting predominantly of equities in the benchmark S&P 500 Index. The board also benchmarks the trust against the Russell 1000 Value Index. The investment objective was changed on 29 May 2012 from being an index fund tracking the capital and income of the S&P 500 Index.

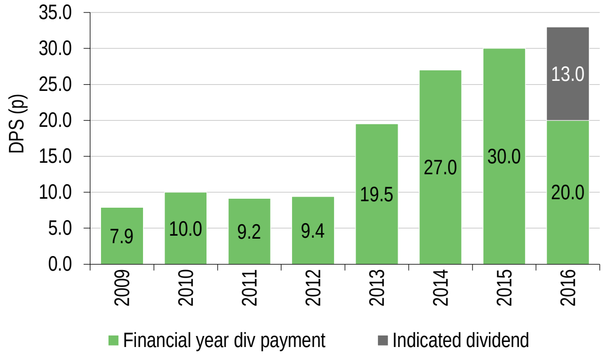
Recent developments

- 24 March 2016: Annual report for 12 months ending 31 January. NAV TR +3.2% vs benchmark TR 5.2%. Share price -2.0%.
- 24 March 2016: Recommendation of final dividend of 13.0p vs 11.5p in prior year.
- 14 January 2016: Announcement of third interim dividend of 7.0p vs 6.5p in prior year.

Forthcoming		Capital structure		Fund details	
AGM	May 2016	Ongoing charges	1.03%	Group	Aberdeen Asset Managers
Interim results	September 2016	Gearing	13.7%	Manager	Fran Radano
Year end	31 January	Annual mgmt fee	0.8%	Address	Bow Bells House, 1 Bread Street, London, EC4M 9HH
Dividend paid	Feb, May, Aug, Nov	Performance fee	None		
Launch date	November 1902	Trust life	Indefinite	Phone	0500 00 00 40
Continuation vote	Every three years, next at 2018 AGM.	Loan facilities	£45m (see page 11)	Website	www.northamericanincome.co.uk

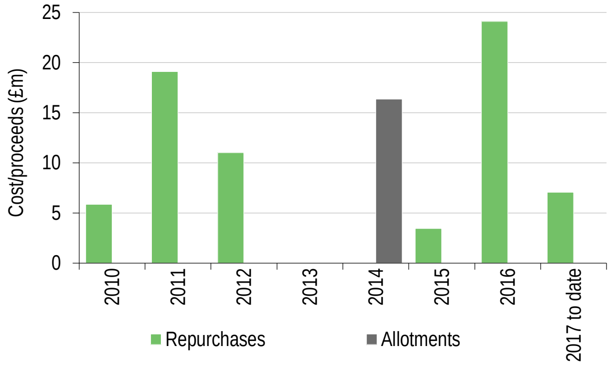
Dividend policy and history

NAIT has a progressive distribution policy. Dividends are paid four times a year in February, May, August and November.

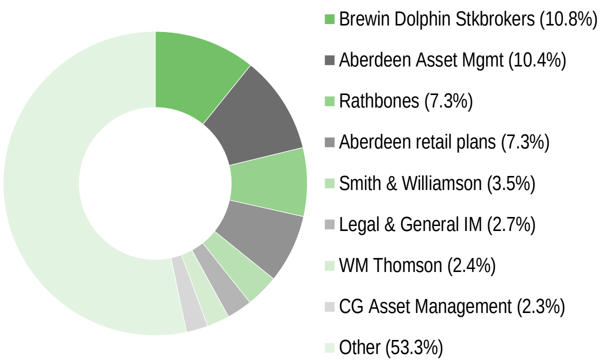


Share buyback policy and history (by financial year)

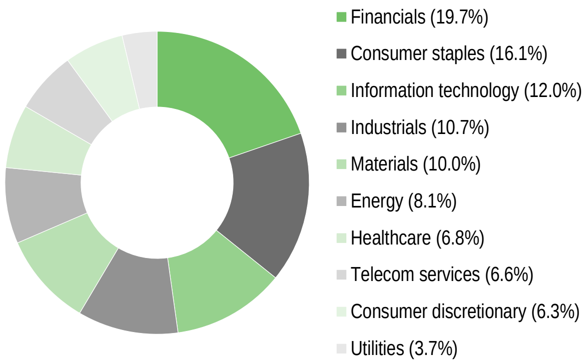
There is an annually renewed authority to buy back up to 14.99% and allot up to 10% of issued share capital.



Shareholder base (as at 31 March 2016)



Portfolio exposure by sector (as at 31 March 2016)



Top 10 holdings (as at 31 March 2016)

			Portfolio weight %	
Company	Country of listing	Sector	31 March 2016	31 March 2015*
Philip Morris International	US	Consumer staples	4.1	3.3
Molson Coors Brewing	US	Consumer staples	4.0	N/A
Dow Chemical	US	Materials	3.5	N/A
Microsoft	US	Information technology	3.5	3.5
Rockwell Automation	US	Industrials	3.5	N/A
CME	US	Financials	3.4	N/A
Verizon Communications	US	Telecommunication Services	3.4	3.5
Lockheed Martin	US	Industrials	3.3	N/A
PepsiCo	US	Consumer staples	3.0	N/A
Chevron	US	Energy	3.0	N/A
Top 10			34.7	32.6

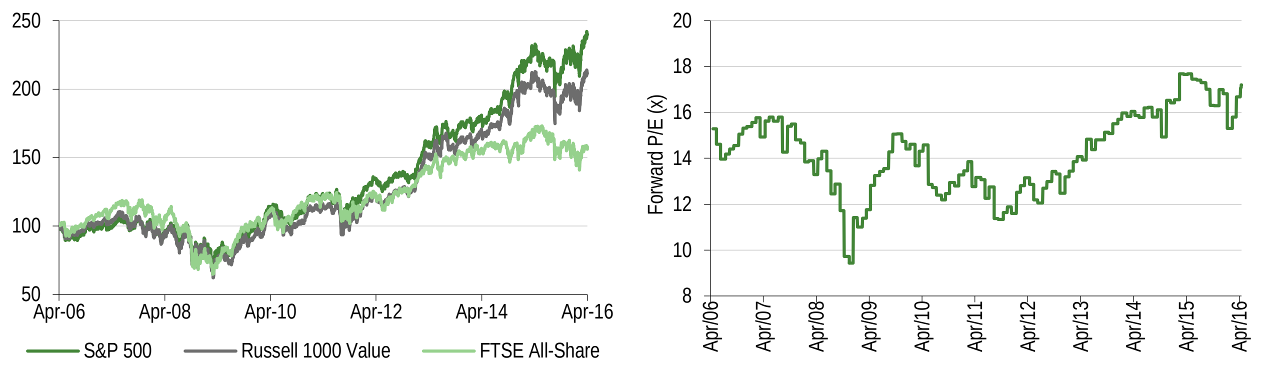
Source: The North American Income Trust, Edison Investment Research, Bloomberg, Morningstar, Thomson. Note: *N/A where not in the March 2015 top 10.

Market outlook: Potential for improving fundamentals

To set the context, Exhibit 2 (left-hand side) shows the performance of the S&P 500 and Russell 1000 Value indices over the last 10 years, rebased to 100. For comparison, the FTSE All-Share Index is also shown. Since the end of 2013, the outperformance of the S&P 500 Index is particularly marked; reasons include having greater exposure to high-growth stocks that have done particularly well, such as online retailer Amazon, whose share price rallied by 118% in 2015, and IT company Apple, which has risen significantly over the last few years to become the largest company in the world. In contrast the FTSE All-Share Index has a higher weighting to resource stocks that have been negatively affected by weak commodity prices. As a result of the outperformance, the valuation of the US market as measured by the US Datastream Index is close to its 10-year high (Exhibit 2, right-hand side).

Exhibit 2: Market performance and valuation over 10 years

Performance of indices | Valuation of US Datastream Index



Source: Thomson Datastream, Edison Investment Research. Note: Data to 21 April 2016.

Despite the 12-month forward price to earnings (P/E) multiple of the market and the price to book value being above the 10-year average (Exhibit 3), there are divergences by sector; an investment style focused on valuation allows pockets of overvaluation to be avoided. The dividend yield is above the 10-year average and there are some companies with higher-than-average yields that are still increasing their dividends. The return on equity remains below average; having improved since the depths of the financial crisis, it has dipped lower since the end of 2014, so there is potential for a further recovery as the economy improves.

Exhibit 3: Valuation of US market

	Last	High	Low	10-year average	Last as % of average
P/E 12 months forward (x)	17.2	17.7	9.4	14.2	121
Price to book (x)	2.8	3.1	1.3	2.4	118
Dividend yield (%)	2.1	3.5	1.6	2.0	104
Return on equity (%)	11.7	17.9	3.8	13.3	88

Source: Thomson Datastream, Edison Investment Research. Note: As at 21 April 2016.

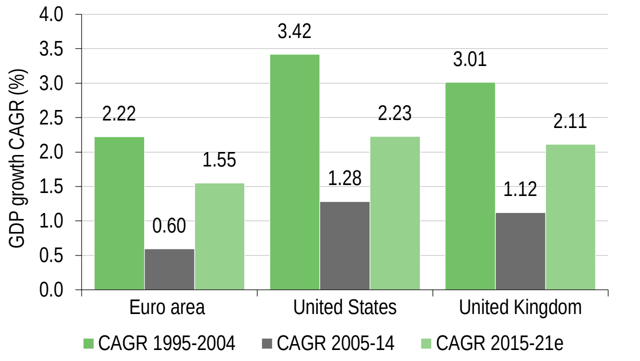
The US stock market, along with other global markets, has experienced a period of heightened volatility over the last several months. Investor concerns have included uncertainty about US monetary policy. During 2015, the timing of the first interest rate hike was a major topic of discussion. The Federal Reserve (Fed) increased the Fed Funds rate in December, the first hike since 2006. This is in contrast to other central banks, which are continuing to ease monetary policy. However, since December, US interest rates have been on hold; minutes from the latest Fed meeting referenced that “sharp, though temporary, deterioration in global financial conditions earlier this year had not been fully resolved”. Slowing economic growth in China and concerns about devaluation of its currency, along with significant weakness in commodity prices, have also contributed to stock market volatility.

However, there are reasons to be optimistic about the outlook for US equities. Exhibit 4 (left-hand side), illustrates the relative attractiveness of equities versus bonds from a yield perspective (although the yield on the US equity market is lower than the majority of other developed markets). In the US, the yield spread is near the top end of its 10-year range. From a top-down perspective, International Monetary Fund GDP growth estimates still suggest higher output from the US versus other advanced economies (Exhibit 4, right-hand side). Domestic inflation remains low and unemployment is the lowest in more than seven years, which is good for consumers.

Exhibit 4: Dividend yield premium and GDP growth

Dividend yield versus 10-year government bond yield (%)

IMF GDP growth outlook



Source: Thomson Datastream, Edison Investment Research, IMF

At the corporate level, following a period of negative earnings revisions, industrial companies are talking more positively about the outlook for underlying demand. In several areas of the market, despite the low growth environment, cash generation is healthy and dividend growth continues, especially in the IT, financials and consumer staples sectors. For investors looking to participate in US equities, a fund with an above-average yield, focused on valuation, investing in quality companies for long-term capital growth may hold appeal.

Fund profile: Above-average income and capital growth

The North American Income Trust (NAIT) was launched in 1902. In 2012, the investment strategy was changed from an index fund tracking the S&P 500 Index (the Edinburgh US Tracker Trust, which was acquired by Aberdeen in 2003), to an investment objective aiming to provide above-average dividend income and long-term capital growth, primarily from investing in S&P 500 companies. The benchmark remains the S&P 500 Index, but in 2015, the board decided to include the Russell 1000 Value Index as an additional reference benchmark as it better reflects NAIT's mandate and income objective.

Companies considered for investment are selected for their disciplined and balanced capital allocation policies and good prospects for sustainable dividend growth. The focus is on durable business models, with sufficient cash flow generated to fund future business development and return a sizeable amount of earnings to shareholders. The portfolio will typically have 35-45 stock holdings and 10-15 bond holdings. Up to 20% of gross assets may be invested in fixed income assets, which includes non-investment grade debt. Any single investment may not exceed 10% of the portfolio at the time of investment. There are no restrictions regarding the minimum or maximum market capitalisation of portfolio holdings or the size of sector or country weightings. Gearing of up to 20% of net assets is permitted. Derivative investments of up to 20% of the portfolio are allowed for efficient portfolio management, hedging and investment purposes.

The manager of the trust is Fran Radano (senior investment manager). He took over management in 2015 following the departure of Paul Atkinson, who was head of Aberdeen's North American Equities team based in Philadelphia; he left the company after 18 years to relocate his family to

Europe. Radano is overseen by Ralph Bassett (head of North American equities). Continuity of management has ensued as Radano has spent 16 years of his 22-year career at Aberdeen (or companies that were eventually acquired by Aberdeen) and has worked on the NAIT portfolio since the change in mandate in 2012. Bassett has spent 10 of his 11 years' industry experience with the company.

Within Aberdeen, the investment approach is very much team based; the manager spends a lot of time discussing ideas with his colleagues. Senior members provide leadership and there is a strong culture of growing in-house talent. The North American equity team of 13 investment management professionals have between four and 26 years of investment experience. Since late 2007, it has been a fairly stable team; Atkinson was the first senior person to leave. Team members are all generalists, although some of the senior employees have sector specialisms; Radano had focused on consumer companies for several years earlier in his career. Sector-specific experience is viewed as being most helpful in periods of market stress.

The fund manager: Fran Radano

The manager's view: Investment opportunities available

The manager notes the volatility in the market over the last several months surrounding speculation regarding the Fed's monetary policy, concerns about slowing growth in China and the weakness in oil and other commodity prices. Despite the uneven level of economic growth in the US, with a slowdown in the third and fourth quarters of 2015 due to a reduction in consumer spending and lower non-residential fixed investments and exports (as a result of the strength of the dollar), the outlook is not for recession but is a reflection of slower global growth. This is consistent with what US companies are seeing in their businesses.

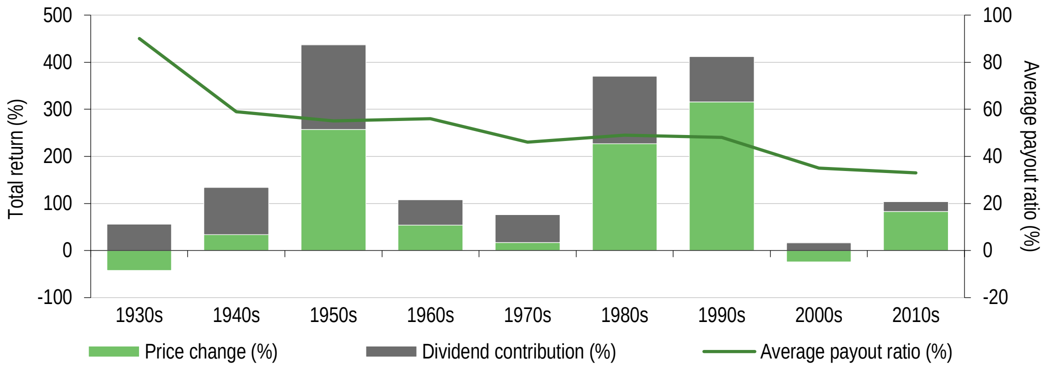
The manager expects that the higher volatility in the markets will continue as macroeconomic issues remain prevalent. The correction in the stock markets in early 2016 would be more typical in a recessionary environment rather than when monetary policy is tightening as a result of an improving economy. However, the manager comments that this is not a typical business cycle, as central banks' monetary policy is not aligned. This is proving problematic for exporters and foreign economies due to strength in the dollar. In addition, low commodity prices are putting pressure on some companies' earnings, especially those that are highly leveraged.

Radano comments that to have confidence in current valuations, he must first have conviction in company fundamentals. He sees Fed policy as the biggest risk in terms of a strong dollar and its impact on trade and international economies. A further risk is whether the current macroeconomic issues mean a reduction in corporate and consumer activity. If these risks can be contained, then he views the outlook for the domestic economy as reasonably healthy based on low unemployment and inflation.

The manager feels that there are now more investment opportunities available than there have been for some time. He has taken advantage of individual share price weakness to add positions that were unfairly hit from perceived energy/industrial exposure such as Genuine Parts (automotive parts), which has a strong franchise, a competent management team and a consistent share repurchase programme; Rockwell Automation (industrial automation), with high barriers to entry and returns on capital with a solid distribution policy split between dividends and share repurchases; and Union Pacific (railroads), operating in an industry that the team knows well – the company is considered by the manager to be best-in-class.

With regards to dividends, the manager highlights the importance of dividend payment and reinvestment to total return; over the decades since the 1920s, c 50% of the average total return of the S&P 500 Index has been from dividends.

Exhibit 5: Dividend contribution to total return and average payout ratios over decades



Source: The North American Income Trust, Edison Investment Research

Payout ratios have drifted lower over time (Exhibit 5), partly as a result of there being more growth companies in existence, which pay low or zero dividends, and partly because companies are using cash for share repurchases rather than dividends. He notes that since the global financial crisis, dividend growth has been rapid and is moderating to more closely match growth in earnings. During FY16, over 80% of portfolio holdings raised their dividends with a weighted increase of c 7%, which was noticeably lower than in recent years. However, within the portfolio, there were some double-digit dividend increases such as Cisco and Microsoft (IT), BlackRock, Regions Financial and Wells Fargo (financials) and Dow Chemical and Praxair (basic industries). Since the change in investment strategy in 2012, NAIT's investments have grown dividends at a compound annual growth rate of c 12% and more than 97% of holdings have raised their dividends over this period.

Ahead of first quarter earnings announcements, the manager comments that results from energy companies should continue to be weak. The outlook for the rest of the market is in the mid to high single-digit range in constant currency terms and broadly flat in reported terms. Due to the strength of the dollar, reported earnings have been coming in a lot lower than constant currency earnings. The effect is expected to become more muted. Recent meetings with companies have indicated that within the industrial sector, activity is showing signs of bottoming. Earnings estimates have been beaten down, so some suggestion of recovery is encouraging. There is modest increasing demand within the consumer discretionary sector as a result of lower gasoline prices and lower unemployment.

Considering the political environment, the manager notes that following the recent change in tax inversion rules, which led to the Pfizer takeover of Allergan being aborted, M&A activity is likely to be more muted. There have been delays to capex as a result of the rules regarding repatriation of funds. The clampdown on tax inversions should come with a better ability to repatriate foreign earnings. Some companies have billions of dollars abroad, which would be taxed twice if brought back home. Any change would be positive for dividend paying companies, as some are taking on debt to fund capex; it is cheaper to borrow at low interest rates than face a higher tax bill from repatriation of cash. Some of NAIT's portfolio companies have cash abroad, so should benefit if the repatriation rules are changed.

Asset allocation

Investment process: Focus on quality, valuation and yield

NAIT follows the Aberdeen process, which is a quality-driven, bottom-up investment approach, rather than focusing on top-down macroeconomic factors, with a view to investing in quality companies that generate above-average income and long-term capital growth. Quality is determined with reference to the business strategy, whether the management team is deemed credible, how strong the financial metrics are and the level of corporate governance. Having screened the universe, only those companies that meet the quality criteria are subjected to a valuation-based discipline. Valuation measures considered are P/E, price to cash flow, price to book, return on equity and dividend yield.

The resulting portfolio is concentrated, holding c 50 positions (c 40 stocks and c 10 bonds) excluding options and the dividend yield of the portfolio is typically 1.5x that of the benchmark. Meeting with companies is a fundamental element of the Aberdeen investment process. The manager does not invest in any company that he or his team has not visited. Contact with the management of portfolio companies occurs at least annually and may be up to four times a year. Sometimes companies are bought that may not yet meet all the quality criteria, but turnaround and deep value situations are generally avoided. Since the change of manager in 2015 there have not been wholesale changes to the portfolio; there are slight differences at the margin, but it is still the Aberdeen ‘Quality and Value’ process.

The manager is benchmark aware, but portfolio construction is not driven by index weightings. Risk is managed via adequate diversification of the portfolio. In addition a risk team provides independent monitoring of the trust and utilises Aberdeen’s operational risk management system known as SWORD.

Radano has been somewhat more proactive in adding to favoured positions than the prior manager and is willing to hold a wider range of position sizes (c 1.4-4.3% vs 1.7-3.2% under the prior manager). As a result of investing for the long term, portfolio turnover is relatively low, but is amplified by the use of options. Options are mainly used as a way to purchase a company’s shares at the desired price. There are typically five option positions within the portfolio; two-thirds short put options and one-third covered calls. The manager feels that options make sense as a way to purchase more volatile names such as those found in more cyclical sectors.

Investment in corporate bonds provides diversification and additional yield in a relatively benign default environment. The positions are selected by in-house fixed income specialists. Although 20% is the maximum permitted level of bond investment, the percentage has only ever reached c 15% and is currently around 4%.

Current portfolio positioning

As shown in Exhibit 6, the structure of the portfolio was essentially maintained over the last 12 months; the majority consists of US equities. At the end of March 2016, bonds represented 3.8% of the portfolio, down from 5.4% a year ago. Some positions have been sold following refinancing deals that made the coupons less attractive. At the end of FY16 (end of January 2016), the average credit rating was BB, the average current yield on the bond portfolio was 6.55% and the duration moved up over the year from 3.5 to 4.3 years.

Exhibit 6: Portfolio breakdown by geography, asset class and option positions

	End-March 2016	End-March 2015	Change
US (%)	89.3	89.2	0.1
Canada (%)	8.8	8.5	0.3
Cash for investment (%)	0.5	0.3	0.2
Cash held against options (%)	1.4	2.0	-0.6
	100.0	100.0	
Equities (%)	96.2	94.6	1.6
Fixed income (%)	3.8	5.4	-1.6
	100.0	100.0	
Number of option positions	4	5	-1
Equity sleeve optionised (%)	2.71	4.01	-1.30

Source: The North American Income Trust, Edison Investment Research

At the end of March, the top 10 positions represented 34.7% of the portfolio; this was a modest increase in concentration versus 32.6% at the end of March 2015. Three companies were common to each list. The current top two positions are both consumer staple companies: Philip Morris (tobacco) and Molson Coors (beverages); given the low volatility nature of the sector, the manager is comfortable holding larger position sizes.

Historically, the highest yielding sectors in the market are utilities, telecoms and consumer staples. Aberdeen as an investment house favours global brands, hence the larger overweight in consumer staples versus telecoms or utilities. The manager argues that utilities have little pricing power and are constrained by geography; often they have high yields but little dividend growth. NAIT currently owns two utilities (CMS Energy and WEC Energy, both of which have a history of growing dividends), two telecoms (Verizon, the second largest telecom company in the US, and TELUS, the second largest wireless carrier in Canada) and two REITs (Digital Realty Trust and Ventas). Typically, an income fund would have a much larger weighting in these three sectors.

Exhibit 7: Portfolio sector exposure vs S&P 500 index (%)

	Portfolio end-March 2016	Portfolio end-March 2015	Change	Index weight*	Active weight vs index	Trust weight/ index weight
Financials	19.7	13.1	6.6	15.6	4.1	1.3
Consumer staples	16.1	16.3	-0.2	10.4	5.7	1.5
Information technology	12.0	7.3	4.7	20.8	-8.8	0.6
Industrials	10.7	10.1	0.6	10.1	0.6	1.1
Materials	10.0	11.5	-1.5	2.8	7.2	3.6
Energy	8.1	12.2	-4.1	6.8	1.3	1.2
Healthcare	6.8	8.2	-1.4	14.3	-7.5	0.5
Telecommunication services	6.6	6.3	0.3	2.8	3.8	2.4
Consumer discretionary	6.3	9.9	-3.6	12.9	-6.6	0.5
Utilities	3.7	5.1	-1.4	3.4	0.3	1.1
	100.0	100.0				

Source: The North American Income Trust, Edison Investment Research. Note: *May not add up to 100% due to rounding.

The largest overweight by sector is materials, although the absolute weighting of c 10% is modest. Holdings include a position in Dow Chemical, which has good pricing power and is less exposed to low commodity prices than some materials companies. Sonoco, a packaging company, is arguably more of a consumer-led business. Another portfolio holding in the materials sector is Nucor, a best-in-class mini-mill rather than a more cyclically challenged integrated steel company. It has strong cash flow and a good dividend yield.

Over the last 12 months, the largest increases on a sector basis have been to financials and IT. Within financials new positions were initiated in regional banks M&T Bank and Regions Financial. This followed multiple visits with the companies and investments were made on the basis of positive long-term outlooks, dividend growth prospects and reasonable valuations. In our view, a rising interest rate environment should be favourable for banks' net interest margins. NAIT is structurally underweight the IT sector versus the S&P 500 Index, but is more in line with the Russell 1000 Value Index, as it does not hold the high-growth names such as Alphabet (the holding company name for Google) and Facebook. A new position was taken in Texas Instruments, a global semiconductor company with strong assets, a diverse client base and multiple drivers of growth. The company consistently returns cash to shareholders. In 2015 it boosted dividends by 12%, marking the 12th consecutive year of dividend increases, and authorised a $7.5bn share repurchase programme.

The largest reductions in sector exposure were in energy and consumer discretionary. Within energy the exposure has shrunk due to the underperformance of the sector. In addition, NAIT has been consolidating its exposure into higher-quality names, including a sale of the remaining position in Exxon Mobil and a reduction in the ConocoPhillips holding with proceeds reinvested into Chevron. Within the oil service sector there has been a switch out of National-Oilwell Varco and into Schlumberger. National-Oilwell has dominant market shares in its energy equipment and services businesses, but is leveraged to deepwater drilling and exploration activity, which is currently being curtailed due to the weak oil price. Schlumberger is widely held within Aberdeen managed funds and has continued to invest during the downcycle, therefore putting the company in a stronger position when the industry rebounds. Within the industry, there is a significant amount of M&A in progress and so the oil services sector should be more of a duopoly in the future. Schlumberger has recently completed its merger with Cameron International, which will result in the industry's first complete drilling and production system offering, and Halliburton (the other major player) is in the process of trying to acquire Baker Hughes. The reduction in consumer discretionary exposure included the sale of Mattel. The business remains structurally challenged and the manager viewed the dividend as being unsustainable.

The Russell 1000 Value Index has a much larger weighting in financials (the S&P weighting in this industry is quite low in a global context). The financial weighting in the portfolio has recently been increased due to an improving economic environment but in a concentrated portfolio it is unlikely that more than one or two global banks will be held. NAIT currently favours Wells Fargo, which has lower capital markets exposure than its peers and hence generates more consistent results.

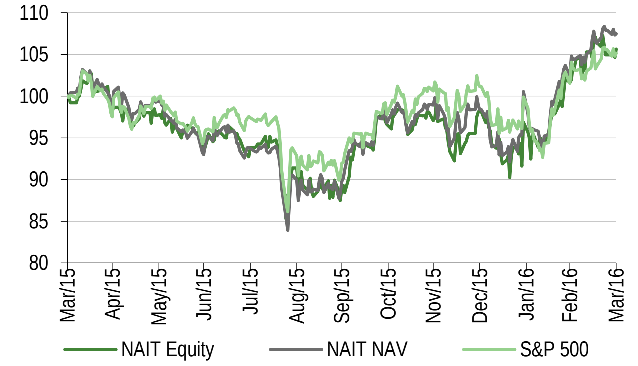
Performance: Improving near-term results

In FY16 (the year ending 31 January 2016), NAV total return was 3.2% in sterling terms, which compared to the benchmark S&P total return in sterling terms of 5.2%; the Russell 1000 Value Index returned 0.6%. Performance was stronger in the second half of the period and the manager comments that since the end of the financial year, in a period of continued volatility in the stock markets, relative performance has been improving. NAIT underperformed the S&P 500 Index over FY16 as a result of growth outperforming value; there were strong returns from stocks such as Facebook and Amazon that the trust cannot own due to their low/no dividend yield.

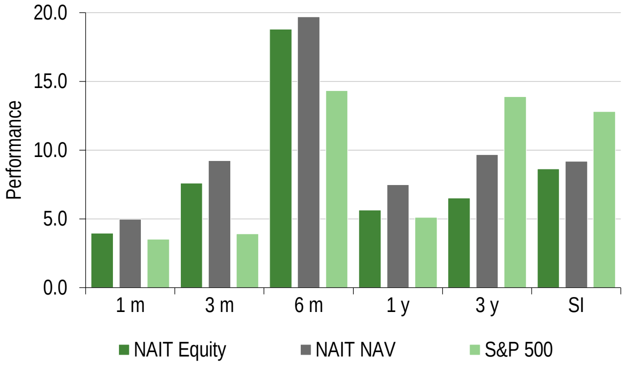
During FY16 the outperformance versus the Russell 1000 Value Index was primarily as a result of stock selection, mainly in the industrials, financials and consumer staples sectors. Overweight positions in consumer staples and telecoms also added to performance. On a stock-specific basis, positions in Molson Coors (beverages), Microsoft (IT) and Dow Chemical (chemicals) were positive contributors. These companies posted good operational results and were involved in M&A, such as Molson Coors assuming full ownership of Miller Coors (from a 42% stake) and Dow Chemical announcing a merger of equals with rival DuPont. The largest detractors to performance were an overweight position in materials and an underweight position in healthcare. Stock selection within materials was also negative; the holding in Potash detracted from performance because of significant weakness in fertiliser prices. Office products retailer Staples saw declining revenues despite better margins due to weakness in overseas operations as a result of the strong dollar. There are also ongoing regulatory hurdles regarding its pending merger with Office Depot.

Exhibit 8: Investment trust performance to 31 March 2016

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three year and SI (since inception) figures annualised. SI refers to the change in strategy at end-May 2012.

As shown in Exhibit 9, NAIT's NAV total return has outperformed both the S&P 500 and Russell 1000 Value indices over one year and shorter time periods. For reference for UK investors, the trust has outperformed the FTSE All-Share Index over all the time periods shown.

Exhibit 9: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Since 31 May 2012
Price relative to S&P 500	0.4	3.5	3.9	0.5	(18.2)	(17.1)
NAV relative to S&P 500	1.4	5.1	4.7	2.2	(10.7)	(15.0)
Price relative to Russell 1000 Value	0.0	3.3	5.0	3.9	(12.5)	(15.3)
NAV relative to Russell 1000 Value	1.0	4.8	5.8	5.7	(4.6)	(13.1)
Price relative to FTSE All-Share	2.0	8.1	14.8	10.0	8.5	8.1
NAV relative to FTSE All-Share	3.0	9.7	15.6	11.9	18.4	10.9

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2015. Geometric calculation.

NAIT's defensive portfolio outperformed the soft market in August and September 2015 and also during the weakness in January 2016. The trust has continued to perform well this year, which the manager views as encouraging. There has been a broad-based recovery within the portfolio such as in the top two holdings of Molson Coors and Philip Morris International; the latter had been penalised in a strong dollar environment because all of its business is overseas.

Exhibit 10 shows NAIT's NAV total return versus the benchmark over the last three years. To put this in context, over this period value stocks have underperformed growth stocks. The total return of the Russell 1000 Value Index has trailed the total return of the Russell 1000 Growth Index by c 15%. Relative outperformance for NAIT since the start of 2016 may indicate a return to favour for value stocks.

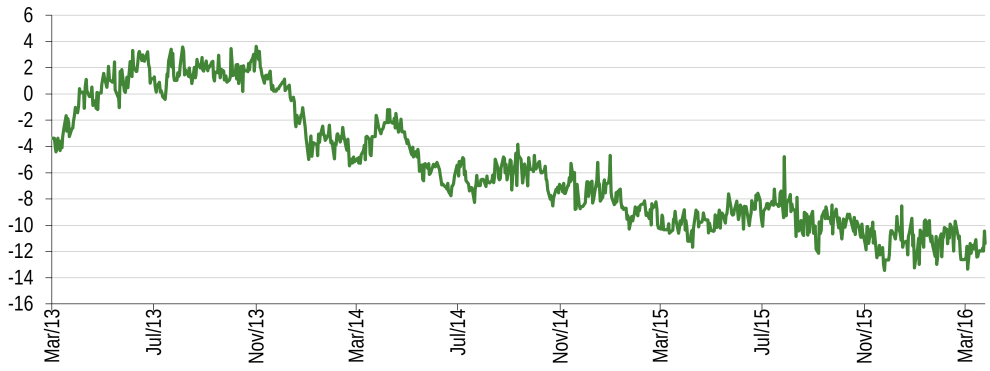
Exhibit 10: NAIT NAV total return vs S&P 500 over three years, rebased to 100

Source: Thomson Datastream, Edison Investment Research

Discount: Widening trend since end-2013

At 22 April 2016, NAIT's share price was trading at an 11.4% discount to cum-income NAV. This compares to a range of 4.8% to 13.5% over the last 12 months. Over the last three, five and 10 years, the average discount has been in a range of 4.1% to 5.7%. There is no formal discount control policy but the board will consider buying back shares when the discount exceeds 5% for a significant period of time. During FY16, 2.9 million shares were repurchased at a cost of £24.5m (versus 0.4m shares for £3.5m in the prior year). Share repurchases are continuing in the current financial year. To date, 0.85m shares have been bought at a cost of £7.06m.

Exhibit 11: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research. Note: Negative values indicate a discount, positive values a premium.

Capital structure and fees

NAIT is a conventional investment trust with one class of share; there are currently 29.1m shares outstanding. It has a £45m borrowing facility with State Street. £30m was fixed in July 2014 for three years at a rate of 2.18% and was fully drawn down. The remaining balance of £15m revolving credit has a rate of 0.9% over Libor; currently, £7m is drawn. Gearing is employed on a strategic rather than a tactical basis. The average level is c 10%, within a range of 8-14%, dependent on the amount of cash needed to cover put options. The annual management fee is 0.8%, payable quarterly; the fee is allocated 30% to revenue and 70% to capital. There is no performance fee payable. In FY16, the ongoing charge was 1.03%, which was in line with the prior year.

Dividend policy and record

NAIT has a progressive distribution policy. Typically the quarterly dividend is raised in the third quarter and a final special dividend has been paid (announced for FY16) in each of the last four years. In FY16, the revenue return per ordinary share rose from 32.71p to 35.74p, an increase of 9.3%. The directors have recommended payment of a final dividend of 13p, which would bring the annual dividend payment to 33.0p, a 10% increase over the prior year. A balance of £1.2m will be added to the revenue reserve, which will provide flexibility for future years.

Since the change in investment mandate in 2012, revenue reserves have increased each year; the revenue reserve of 15.8p at the end of January compares to 5.4p four years ago. Over this period the annual dividend has increased from 9.4p to 33.0p. Over the last three full years that the revised investment strategy has been in place, dividends have grown at a compound annual rate of 19.2%.

At the end of FY16 corporate bonds represented 4.5% of total assets, which was the lowest level since the change in investment objective. They provided 7.3% of total income, which compared to 9.5% in the prior year. Option premiums of £2.8m were 18.8% of total income versus 21.7% the year before. The manager stresses that bond income and option premiums are secondary sources and that dividends will remain the main source of income.

Peer group comparison

NAIT is part of the AIC North America sector, a small group of closed-end funds with different investment objectives. There are two funds that invest primarily in Canadian equities and four funds have an income mandate (NAIT, BlackRock North American, Canadian General Investments and Middlefield Canadian Income); NAIT has a shorter stock list than the peer-group average. Looking at NAV total return, it has outperformed the average over one and five years and ranks second out of three funds over 10 years. In terms of risk-adjusted returns, as measured by the Sharpe ratio, NAIT is above average over both one and three years. The ex-par discount is narrower than average; the ongoing charge is in line and like most of the funds in the sector, there is no performance fee. Gearing is roughly in line with the sector average and as befits a trust with an income mandate, the dividend yield is higher.

Exhibit 12: Selected peer group as at 21 April 2016

% unless stated	Market Cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing Charge	Perf. fee	Net gearing	Dividend yield (%)
The North American Income Trust	265.4	7.6	33.9	70.6	101.6	0.2	0.7	(8.5)	1.0	No	112	3.4
BlackRock North American	86.5	6.7	32.7	-	-	0.1	0.7	(4.3)	1.3	No	100	3.4
Canadian General Investments	360.3	(9.6)	7.5	2.5	33.8	(0.9)	(0.0)	(29.4)	1.6	No	118	3.6
Gabelli Value Plus+ Trust	96.6	3.9	-	-	-	(0.1)	(0.3)	(6.7)	0.9	No	100	0.0
JPMorgan American	795.3	3.3	52.4	84.8	143.3	(0.1)	1.0	(3.0)	0.6	Yes	110	1.3
Middlefield Canadian Income	86.3	(7.3)	3.1	5.4	-	(1.1)	(0.2)	(15.7)	0.9	No	100	6.3
Weighted average		0.9	35.4	58.1	107.7	(0.3)	0.6	(10.4)	1.0		110	2.5
Rank	3	1	2	2	2	1	2	4	3		2	4

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown 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 total assets less cash and equivalents as a percentage of net assets.

The board

There are four members on the board at NAIT; they are all independent of the manager. Chairman James Ferguson was appointed in March 2002. He is a former chairman and director of Stewart Ivory and a former deputy chairman of the AIC. Guy Crawford is the senior independent director and was appointed in March 2004; he has more than 30 years' experience in investment management and is a chartered accountant. He was the former senior investment manager of Caledonia Investments and served 12 years on the AIC Tax Committee. Archie Hunter was appointed in September 2003; he too is a chartered accountant. He is a former president of the Institute of Chartered Accountants of Scotland and former managing partner of KPMG Scotland. The most recently appointed board member is Susan Rice, who is a chartered banker and joined the board in March 2015. Susan became the first woman to head a UK clearing bank as chief executive and then chairman of Lloyds TSB Scotland. She is currently president of the Scottish Council for Development and Industry, chair of the Scottish Fiscal Commission, vice chair of Scotland's 2020 Climate Change Group and a non-executive director of J Sainsbury and Big Society Capital.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place,
88 Phillip Street, Sydney
NSW 2000, Australia

Wellington +64 (0)4 8948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand