

# Foreign & Colonial Investment Trust

## Global growth in capital and income

Foreign & Colonial Investment Trust (FRCL) is a large, globally diversified fund investing directly and through funds in listed and private equity; external managers are used for some strategies. Performance in 2015 was strong and to the end of February 2016, NAV total returns were ahead of the benchmark over one, three, five and 10 years. A narrowing of the discount in 2015 added to share price total returns. The announced 2015 dividend of 9.6p represents the 45th consecutive annual increase.

12 months ending	Total share price return (%)	Total NAV return (%)	Blended benchmark (%)	FTSE All-World (%)	FTSE All-Share (%)	FTSE World ex-UK (%)
29/02/12	1.9	1.4	1.0	0.7	1.5	0.5
28/02/13	17.4	17.3	16.6	15.7	14.1	16.5
28/02/14	10.6	8.5	7.4	7.4	13.3	8.4
28/02/15	22.4	16.7	17.5	17.5	5.6	18.2
29/02/16	(3.5)	(0.9)	(2.1)	(2.1)	(7.3)	(0.9)

Note: Twelve-month rolling discrete total return performance. FRCL's benchmark prior to 1 January 2013 was a composite of 40% FTSE All-Share index and 60% FTSE World ex-UK index and thereafter is the FTSE All-World index.

## Investment strategy: Focus on growth assets

Manager Paul Niven's views on asset allocation, risk and the use of gearing form the basis of FRCL's portfolio, informed by the wider views of BMO Group managers. Sector and geographic exposure is not driven by benchmark index allocations. Although at the end of February 2016 the portfolio had more than 520 holdings, there is exposure to thousands of companies via fund and private equity investments. Historically, private equity has been managed by two external managers, HarbourVest and Pantheon, but these investments are maturing and in future investments in this asset class are more likely to be sourced internally.

## Market outlook: Attractive equity yield premium

Despite the Datastream world index 12-month forward P/E valuation being above the 10-year average, other valuation measures are looking more attractive. Comparing the yield of UK equities to 10-year government bond yields also highlights the relative attractiveness of equities. Global growth estimates, while reduced, do not indicate a recession and central bank monetary policies remain accommodative. Given the volatile stock market performance to date in 2016, despite macroeconomic uncertainties, there is the potential for an improvement in investor sentiment.

## Valuation: Active discount control strategy

The board aspires that the shares trade at or close to NAV. As part of the strategy to narrow the discount, in May 2015 the discount ceiling above which shares are repurchased was lowered from 10.0% to 7.5%. The current share price discount to cum income NAV is narrower than the averages of the last three and five years. FRCL has a longstanding history of dividend increases; the current yield of 2.2% is above the average of the selected peer group of investment trusts with a market cap of more than £100m and less than 25% of assets invested in the UK.

## Investment trusts

15 March 2016

**Price** 427.8p  
**Market cap** £2,378m  
**AUM** £2,914m

NAV\* 471.9p  
Discount to NAV 9.3%  
NAV\*\* 474.9p  
Discount to NAV 9.9%

\*Excluding income. \*\*Including income as at 11 March 2016.

Yield 2.2%

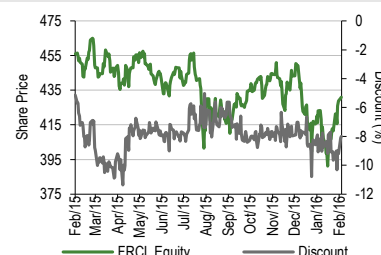
Ordinary shares in issue 555.8m

Code FRCL

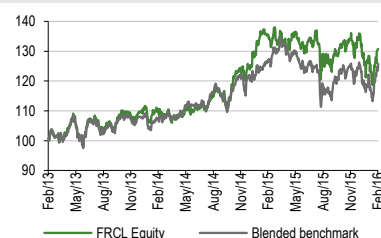
Primary exchange LSE

AIC sector Global

## Share price/discount performance



## Three-year cumulative perf. graph



52-week high/low 465.0p 391.2p

NAV\*\* high/low 508.5p 430.8p

\*\*Including income.

## Gearing

Gross\* 10.0%

Net\* 10.0%

\*As at 31 January 2016.

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**Exhibit 1: Trust at a glance**
**Investment objective and fund background**

FRCL's investment objective is to secure long-term growth in capital and income through investing primarily in an internationally diversified portfolio of listed equities, as well as unlisted securities and private equity, with the use of gearing. FRCL's benchmark index is the FTSE All-World Index.

**Recent developments**

- 8 March 2016: Annual results for the year ended 31 December 2015. NAV TR +7.5% vs 4.0% for the FTSE All-World index. Share price TR +9.0%.
- 8 March 2016: Announcement that senior independent director Christopher Keljik will retire following the next AGM.
- 9 December 2015: Third interim dividend of 2.3p declared. Total annual dividend expected to be 9.6p.

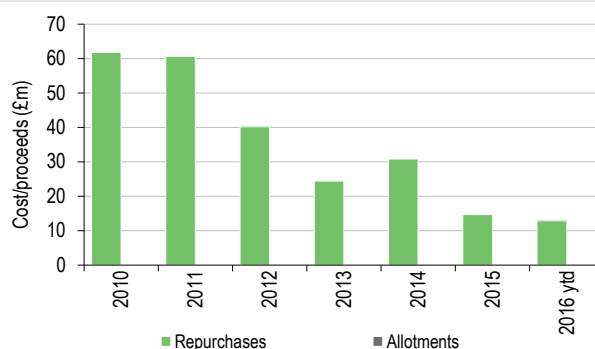
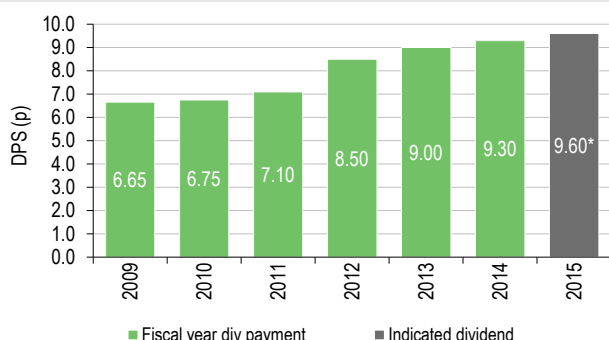
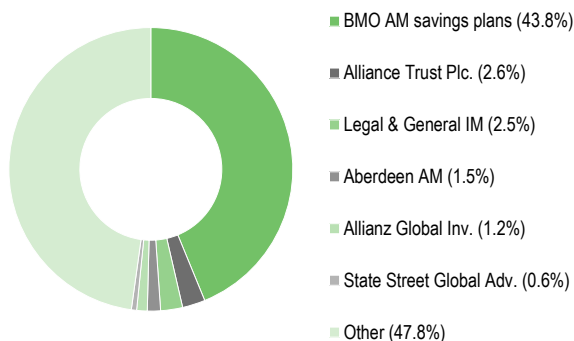
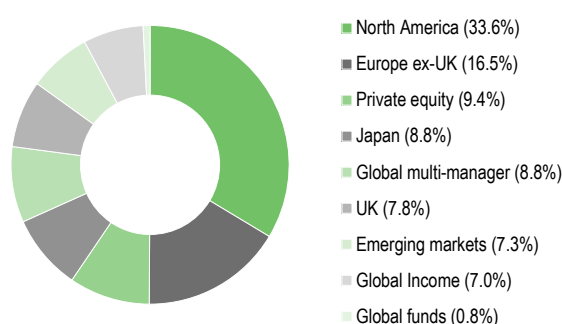
Forthcoming		Capital structure		Fund details	
AGM	April 2016	Ongoing charges	0.80% (at 31 December 2015)	Group	BMO Global Asset Mgmt (BMO)
Interim results	July 2016	Gearing	10.0%	Manager	Paul Niven
Year end	31 December	Annual mgmt fee	0.365%	Address	Exchange House, Primrose Street, London EC2A 2NY
Dividend paid	Feb, May, Aug, Nov	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	Loan facilities	Various – see page 7		

**Dividend policy and history**

FRCL pays dividends quarterly. Note: \*The 2015 total dividend of 9.6p represents the 45th consecutive annual increase.

**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 2 March 2016)**

**Strategy allocation (as at 31 December 2015)**

**Top 10 holdings (as at 31 January 2016)**

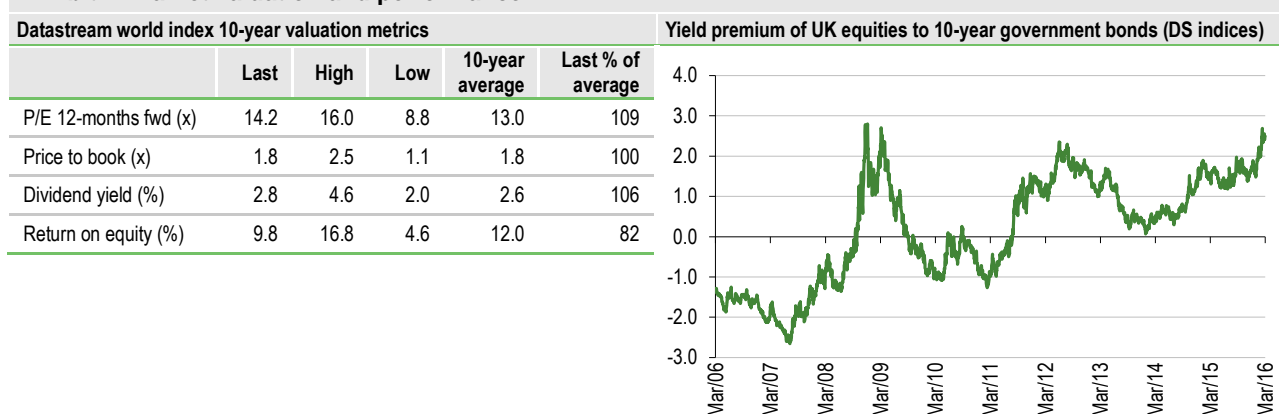
Company	Country/region	Industry	Portfolio weighting (%)	
			31 January 2016	31 January 2015*
Pantheon Europe Fund V	UK/Europe	Private equity	1.5	1.7
Alphabet	US	Technology	1.1	N/A
UnitedHealth	US	Healthcare	1.1	N/A
Microsoft	US	Technology	1.1	N/A
Amazon	US	Online retail	1.1	N/A
Roche	Europe	Healthcare	0.9	N/A
Novartis	Europe	Healthcare	0.9	1.0
HarbourVest Partners Ventures VIII Fund	US	Private equity	0.9	1.0
HarbourVest Partners VIII Buyout Fund	US	Private equity	0.9	N/A
Utilico Emerging Markets	UK	Utilities	0.9	0.9
<b>Top 10</b>			<b>10.4</b>	<b>N/A</b>

Source: Foreign & Colonial Investment Trust, Edison Investment Research, Morningstar, Thomson. Note: \*N/A = were not in January 2015's top 10.

## Market outlook: Equities look relatively attractive

Looking at Exhibit 2 (left-hand side) the valuations of the Datastream world index vs history, equities do not look immediately compelling. The forward P/E multiple at 14.2x is below the 10-year high of 16.0x, but is 9% above its 10-year average. However, the price-to-book multiple, which can be viewed as a more stable valuation measure, is in line with the 10-year average. In addition, the dividend yield is attractive vs history and returns on equity are improving from the low levels seen in the depth of the global financial crisis. Exhibit 2 (right-hand side) illustrates the relative attractiveness of equities vs bonds from a yield perspective. In the UK, the dividend yield is currently 250bp higher than the 10-year government bond yield.

**Exhibit 2: Market valuation and performance**



Source: Thomson Datastream, Edison Investment Research. Note: As at 1 March 2016.

Notwithstanding the volatile to start to 2016 in global financial markets due to investor concerns about slowing global growth and macroeconomic issues, forecasts are for continuing economic improvement. In the IMF's latest World Economic Outlook, despite reducing forecasts for world output in both 2016 and 2017 by 0.2%, estimates are for 2.1% GDP growth for both years in advanced economies vs 1.9% in 2015. GDP growth in emerging markets and developing economies is forecast to accelerate to 4.3% year-on-year in 2016 and 4.7% in 2017 vs 4.0% growth in 2015. Global monetary policy remains accommodative; the ECB and Bank of Japan are continuing to ease and following a period of softer economic data in the US, expectations for a further interest rate hike have been delayed. In this period of low, but moderately improving economic growth and low interest rates, a diversified portfolio focused on both capital return and income may be viewed as attractive by investors.

## Fund profile: Focus on capital return and rising income

Foreign & Colonial Investment Trust (FRCL) is the oldest investment trust in the UK, launched in 1868. It aims to provide both capital and income growth from a diversified equity portfolio that includes investment in private equity. Dividends have increased annually for the last 45 years. FRCL typically remains fully invested. There are no geography or industry sector exposure limits for publicly listed securities; up to 10% of the portfolio can be invested in private equity and a maximum 5% (excluding private equity) can be invested in unquoted securities. No single investment may exceed 10% and there is a 5% limit on the combined value of investment funds managed by the F&C Group. Derivatives may be used to enhance income or for efficient portfolio management.

Since 1 January 2013, FRCL's benchmark has been the FTSE All-World index, reflecting a reduction in exposure to the UK and portfolio allocation more in line with the global index. Prior to this the benchmark was a composite of 40% FTSE All-Share index and 60% FTSE World ex-UK

index. The portfolio has undergone significant repositioning since the change in investment manager in July 2014, when Paul Niven (BMO's head of multi-asset investment) took over from Jeremy Tigue, who retired having managed the trust for 17 years. FRCL has a broad shareholder base, including more than 100,000 private investors.

## **The fund manager: Paul Niven**

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### **The manager's view: Stock market rotation expected**

Manager Paul Niven highlighted the FY15 outperformance of FRCL vs its benchmark. Most of the underlying strategies added to performance, such as North America, where the US T Rowe Price growth strategy returned 10%, outperforming the S&P 500 Index and growth indices. Allocations were increased to Japan and Europe, contributing to performance. Private equity was a strong contributor, returning 13.9% in 2015 and generating more than £129m of cash. The weighting has fallen to 9.4% of the portfolio and the manager suggests future exposure is likely to range between 5% and 15% depending on the relative attractiveness of the asset class. When private equity valuations are high and prospective returns are lower than historically, a lower allocation would be desirable. Third-party funds-of-funds were previously invested via HarbourVest and Pantheon (who were paid £4.6m in fees in 2015), but the manager says future private equity investment is likely to be managed internally via primary and secondary investment as well as possible co-investment. This will result in a smaller number of underlying investments and will afford FRCL greater control and lower costs. The manager will have control over the geography and type of investment and will work with the internal team to source them.

Gearing was increased to gain equity exposure in August 2015 during a period of market stress, and decreased in December. The manager is relatively cautious on the economic outlook and notes that gearing has not been significantly increased during the stock market volatility in 2016 as he views the environment as less benign compared to six to eight months ago. He explains that stock markets are driven by corporate cash flows/earnings/dividends and investor risk appetite. Earnings are declining, which is less supportive for equities; negative earnings revisions are not limited to the resource sectors. Profit margins in the US have peaked and are starting to decline from elevated levels. The manager expects pressure from wage gains and higher interest rates. He believes that other regions of the world will outperform the US this year despite elevated macroeconomic risks and that 2016 will be a more difficult year for investors. There has already been rotation in the market, as emerging markets are starting to perform better, along with resource stocks. The manager is looking for the growth/value trade in the US to reverse; in the last three years growth stocks have outperformed value names (measured by the Russell 2000 and S&P 500 growth and value indices).

## **Asset allocation**

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### **Investment process: Diversified global investment strategies**

FRCL's portfolio is large and diversified and is structured based on the manager's views on asset allocation, risk and the use of gearing. The objective is long-term growth in capital and income. Investments are primarily in public and private equity given the belief that equities provide the best returns over the longer term. The trust aims to provide market exposure rather than focusing on absolute returns and tactical allocations may be made to address short-term opportunities or threats. The manager is benchmark aware, but the portfolio is not required to follow benchmark allocations; an obvious example is FRCL's exposure to private equity.

Allocations are made across five regional and three global (including private equity) strategies, with in-house or external manager selection driven by balancing expected return with cost. However, since the acquisition by BMO in 2014, in-house resources are increasingly being used. US small-cap exposure was historically via the Jupiter US Smaller Companies IT (previously a BMO trust), but is now managed internally as part of a global small-cap strategy. There is a Global Equity Income portfolio run by BMO's Erik Rubingh and a Global Multi-Manager portfolio run by BMO's Rob Burdett and Gary Potter. Exposure to externally managed funds via a 'global funds' portfolio has been reduced; the remaining holdings have been re-allocated into the relevant geographical portfolios.

## Current portfolio positioning

At the end of February 2016, FRCL had 523 holdings, with the top 10 representing c 10% of the portfolio. Within this there are private equity holdings and fund exposure, so the actual number of companies invested in runs into the thousands. Looking at the sector exposure (excluding private equity), the largest changes in 2015 were an increase in consumer goods and a reduction in oil & gas. The highest overweight position is in consumer services.

**Exhibit 3: Portfolio sector exposure (excluding private equity)**

	Portfolio end- December 2015 (%)	Portfolio end- December 2014 (%)	Change (%)	Index weight (%)	Active weight vs index	Trust weight/ index weight
Financials	21.6	23.0	-1.4	22.4	-0.8	1.0
Consumer services	15.3	14.8	0.5	11.3	4.0	1.4
Consumer goods	13.8	10.8	3.0	13.9	-0.1	1.0
Healthcare	13.5	12.4	1.1	11.7	1.8	1.2
Industrials	13.0	14.2	-1.2	12.1	0.9	1.1
Technology	10.7	10.9	-0.2	11.4	-0.7	0.9
Basic materials	5.0	4.3	0.7	4.2	0.8	1.2
Oil & gas	3.3	5.4	-2.1	6.2	-2.9	0.5
Telecommunications	2.5	2.6	-0.1	3.6	-1.1	0.7
Utilities	1.3	1.6	-0.3	3.2	-1.9	0.4
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: Foreign & Colonial IT, Edison Investment Research, FTSE.

As shown in Exhibit 4, on a look-through basis, over the last 12 months the largest geographic changes have been increased exposure to Japan and decreased exposure to North America. The largest overweight exposure is to Europe ex-UK. Following a prolonged period of outperformance, exposure to the US T Rowe Price growth strategy has recently been reduced.

**Exhibit 4: Geographical weightings (including private equity) vs benchmark**

	Portfolio end- January 2016 (%)	Portfolio end- January 2015 (%)	Change (%)	Index weight (%)	Active weight vs index	Trust weight/ index weight
North America	42.3	44.9	-2.6	55.2	-12.9	0.8
Europe ex-UK	22.6	21.9	0.7	15.6	7.0	1.4
Japan	10.0	6.3	3.7	8.6	1.4	1.2
Emerging markets	10.2	10.5	-0.3	8.1	2.1	1.3
UK	10.3	11.3	-1.0	6.9	3.4	1.5
Developed Pacific	3.0	4.3	-1.3	5.6	-2.6	0.5
Cash	1.6	0.8	0.8	0.0	1.6	N/A
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

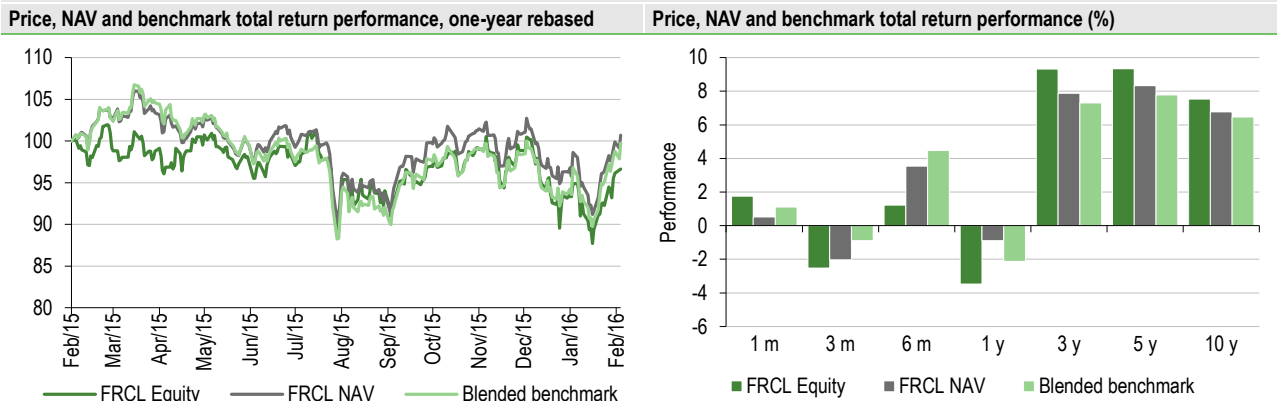
Source: Foreign & Colonial IT, Edison Investment Research, FTSE. Note: Look-through exposure.

## Performance: Outperformance vs the benchmark

As shown in Exhibit 5, FRCL has outperformed its benchmark over one, three, five and 10 years. The narrowing discount has resulted in outperformance of the share price vs the NAV over three, five and 10 years. The trust has also outperformed the FTSE All-Share index over all periods shown excluding the last month. For the year ended 31 December 2015, FRCL's NAV total return was 7.5%, which was 350bp higher than the 4.0% returned by the benchmark FTSE All-World index.

The share price rose by 9.0%, narrowing the discount. The outperformance was primarily a result of stock selection, although asset allocation also contributed to performance. There were modest share repurchases, which had a small positive contribution and the effect of gearing was positive (shown in Exhibit 7).

**Exhibit 5: Investment trust performance to 29 February 2016**



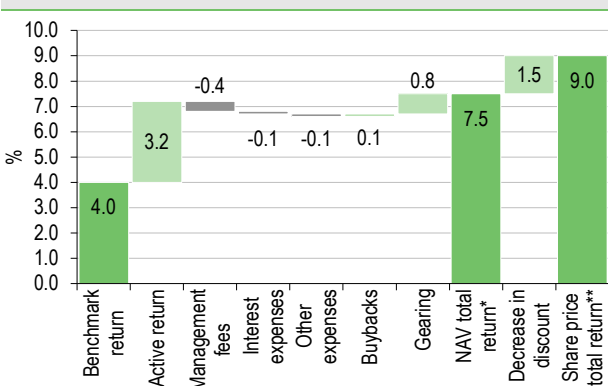
Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

**Exhibit 6: Share price and NAV total return performance, vs indices (percentage points)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to blended benchmark	0.6	(1.6)	(3.1)	(1.4)	5.8	7.5	10.4
NAV relative to blended benchmark	(0.6)	(1.1)	(0.9)	1.3	1.6	2.7	2.7
Price relative to FTSE All-World	0.6	(1.6)	(3.1)	(1.4)	5.8	8.5	8.3
NAV relative to FTSE All-World	(0.6)	(1.1)	(0.9)	1.3	1.6	3.6	0.8
Price relative to FTSE All-Share	0.9	1.1	2.5	4.1	17.9	21.8	28.2
NAV relative to FTSE All-Share	(0.3)	1.6	4.8	6.9	13.2	16.3	19.4
Price relative to FTSE World ex-UK	0.5	(2.0)	(3.8)	(2.6)	2.9	5.1	5.9
NAV relative to FTSE World ex-UK	(0.7)	(1.5)	(1.6)	0.1	(1.1)	0.4	(1.4)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-February 2016. Geometric calculation.

**Exhibit 7: Performance attribution in 2015**



Source: Foreign & Colonial Investment Trust, Edison Investment Research. Note: \*Debt at market value, \*\* dividends reinvested.

**Exhibit 8: NAV performance relative to benchmark\***



Source: Thomson Datastream, Edison Investment Research. Note: Total return performance over five years. \*Benchmark prior to 1 January 2013 was a composite of 40% FTSE All-Share index and 60% FTSE World. It is now the FTSE All World index.

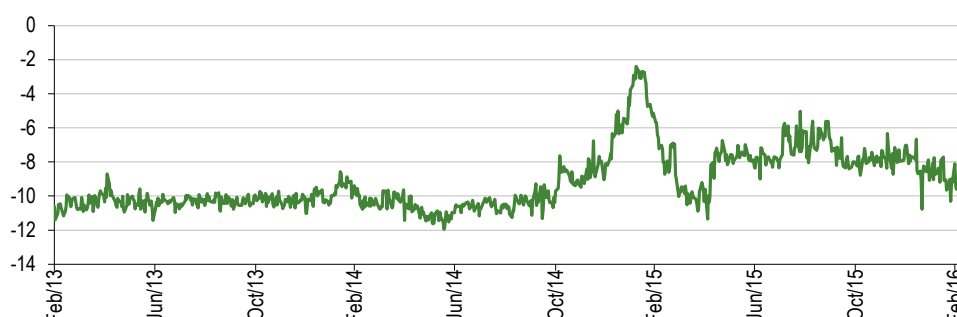
## Discount: Narrower average discount over last year

FRCL has an active policy to manage the share price discount to net asset value by purchasing shares. In May 2015 the discount ceiling above which shares are repurchased was lowered from 10.0% to 7.5%. This is a step towards the board's aspiration of the shares trading at or close to NAV. FRCL also has the ability to issue shares when there is a premium. The year 2015 saw the lowest level of repurchases since the policy was introduced in 1999. The current share price



discount of 9.9% to cum-income NAV is above the average 7.9% over the last 12 months (range of 5.0% to 11.4%). The change in the discount policy has helped to reduce the average discount; over the last three and five years the discount has averaged 9.2% and 9.7%, respectively.

#### Exhibit 9: Share price premium/discount to NAV (including income) over three years (%)



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

## Capital structure and fees

FRCL is a conventional investment trust with 555.8m shares in issue with a further 6.0m shares held in treasury. The trust uses gearing to enhance returns, which currently stands at 10%. Over the last 10 years, gearing has been in a range of 5% to 19%; it was 8.6% at the end of 2015. Short or long-term borrowings can be taken out in sterling or foreign currencies up to a total of 20% of shareholder's funds. Borrowing costs have been reduced following the maturity of the long-standing debenture at the end of 2014. A £50m, equivalent seven-year euro loan was taken out in July 2015 at a rate of 1.69% to take advantage of the low interest rate environment. At the end of 2015, around half of total borrowings were short dated with current interest rates between 0.27% and 0.70%. Shorter-term borrowings will be used more actively in terms of currency views, while the currency of structural borrowings will be more closely related to the underlying asset mix. The current blended cost of borrowing is c 1.6%.

FRCL pays a management fee of 0.365% of its market cap to BMO with direct fees also paid to external managers. The manager suggests that the fee structure is competitive, especially for a trust where some of the management is outsourced. In 2015, the ongoing charge was reduced from 0.87% to 0.80%.

## Dividend policy and record

Dividends form an important part of shareholder returns and have been increased every year since 1970; they have more than doubled in each of the last four decades. The board recognises the importance of a rising income stream in real terms and has committed to another rise in the dividend in 2016. Since the beginning of 2013 dividends are paid quarterly, previously twice a year. The board has stated that it would like the dividend to be fully covered by revenue income (0.9x in 2015), which rose by 25% year-on-year; however, there is no fixed timeline for full coverage. At the end of December 2015, the revenue reserve was nearly 1.5x the dividends paid in the year. The 9.6p dividend proposed for 2015 is a 3.2% year-on-year increase and the current dividend yield is 2.2%.

## Peer group comparison

The selected peer group shown in Exhibit 8 are members of the AIC's Global sector with a market cap of more than £100m and less than 25% of their assets invested in the UK. FRCL's NAV total return performance is ahead of the peer-group average over one, three, five and 10 years; ranking first over one year and second over both three and five years. In terms of risk-adjusted returns, it is in line with the peer-group average over one year and modestly above over three years. The discount is moderately wider and the ongoing charge is slightly above the peer average. There is no performance fee. Gearing is above the group average and the dividend yield is also higher.

**Exhibit 10: Selected peer group as at 14 March 2016**

Percentage 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 (%)
Foreign & Colonial Invest. Trust	2,377.9	(0.9)	25.5	49.2	92.4	(1.0)	0.6	(9.9)	0.8	No	109.0	2.2
Alliance Trust Ord	2,573.5	(1.5)	18.8	38.9	67.1	(0.9)	0.3	(10.9)	0.7	No	112.0	2.9
EP Global Opportunities Ord	111.6	(5.2)	19.8	34.1	63.9	(1.3)	0.4	(3.7)	1.1	No	100.0	1.5
Henderson Global Trust Ord	137.7	(6.5)	12.9	27.1	92.8	(1.4)	0.2	(10.0)	0.9	No	97.0	2.7
JPMorgan Overseas Ord	257.1	(6.7)	20.9	33.5	96.7	(1.1)	0.4	(8.6)	0.7	Yes	108.0	1.6
Martin Currie Global Portfolio Ord	179.7	(2.0)	23.0	47.9	92.8	(0.9)	0.5	0.1	0.7	Yes	100.0	2.3
Monks Ord	872.8	(5.4)	14.1	18.3	56.6	(1.1)	0.2	(12.1)	0.6	No	108.0	1.0
Scottish Mortgage Ord	3,209.6	(2.3)	46.5	69.5	151.6	(0.7)	0.8	(5.6)	0.5	No	112.0	1.2
<b>Simple average</b>		<b>(3.8)</b>	<b>22.7</b>	<b>39.8</b>	<b>89.2</b>	<b>(1.0)</b>	<b>0.4</b>	<b>(7.6)</b>	<b>0.7</b>		<b>105.8</b>	<b>1.9</b>
<b>Rank</b>	<b>3</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>5</b>	<b>4</b>	<b>2</b>	<b>4</b>	<b>3</b>		<b>3</b>	<b>4</b>

Source: Morningstar, Edison Investment Research. Note: Performance data to 29 February 2016. 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 eight members of the board, all are independent non-executive directors. Chairman Simon Fraser became a director in 2009 and was appointed chairman in 2010. Senior independent director Christopher Keljik was appointed in 2005. The other six directors with their year of appointment are: Sir Roger Bone and Stephen Burley (2008), Jeffrey Hewitt (2010), Sarah Arkle and Nicholas Moakes (2011) and Francesca Ecsery (2013). The board is very diverse; the directors have backgrounds in asset management and a range of industries.

On 8 March 2016, it was announced that Christopher Keljik will be retiring from the board following the next AGM. The search for his replacement is currently being undertaken via an online resource, leading to a broader selection of candidates. Sir Roger Bone will become senior independent director.

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