

Foreign & Colonial Investment Trust

Happy birthday, F&C Investment Trust

Foreign & Colonial Investment Trust (FRCL) is the oldest investment trust and is celebrating its 150th anniversary. Dividends have been paid every year since the fund was launched and 2017 marked the 47th consecutive annual increase. The board has proposed a subtle change in the name of the trust to F&C Investment Trust and this will be voted on at the April 2018 AGM. FRCL offers investors a diversified 'one-stop-shop' for investment in both listed and unlisted global equities. The trust had a strong set of results in FY17, with most of its underlying strategies outperforming their respective benchmarks. In terms of NAV and share price total return, FRCL is outperforming its benchmark over one, three and five years (its share price is also outperforming over 10 years).

12 months ending	Share price (%)	NAV (%)	FTSE All-World (%)	FTSE All-Share (%)	FTSE World ex-UK (%)
28/02/14	10.6	8.5	7.4	13.3	8.4
28/02/15	22.4	16.7	17.5	5.6	18.2
29/02/16	(3.5)	(0.9)	(2.1)	(7.3)	(0.9)
28/02/17	34.2	33.2	37.7	22.8	38.4
28/02/18	17.0	11.6	7.8	4.4	7.6

Source: Thomson Datastream. Note: All % on a total return basis in GBP.

Investment strategy: Global equity 'one-stop-shop'

FRCL invests in a range of strategies that are managed either internally or by third parties: regional (US growth, US value, Europe, UK and Japan); global (income, smaller companies and multi-manager); and private equity (funds and direct). The trust offers investors very broad exposure; as a result of direct, fund and private equity positions, FRCL has around 500 holdings. Gearing of up to 20% of NAV is permitted; it was 7.0% at end-February 2018.

Market outlook: Share valuations higher than average

Following a period of above-average equity returns in recent years, on a forward P/E multiple basis, global equities are trading above their 10-year averages. The US is looking particularly expensive, while other regions, such as Japan, are trading at more reasonable valuations. In an environment of higher stock market volatility, which has been in evidence so far in 2018, investors may prefer to consider a diversified global fund that also offers private equity exposure; private equity has provided higher returns than listed equity over the very long term.

Valuation: Discount in a narrowing range

FRCL's share price discount to cum-income NAV has been in a narrowing trend since mid-2016, from c 14% to the current level of 3.3%. This compares with the average discounts of the last one, three, five and 10 years (range of 5.9% to 9.2%). The board has announced that it will no longer target a discount below 7.5%, but will continue to repurchase shares, in normal market conditions, if the discount widens significantly. Shares may be issued if FRCL trades at a consistent premium. The trust has a distinguished dividend history: annual distributions have increased over the last 47 consecutive years and its current dividend yield is 1.6%.

Investment trusts

19 March 2018

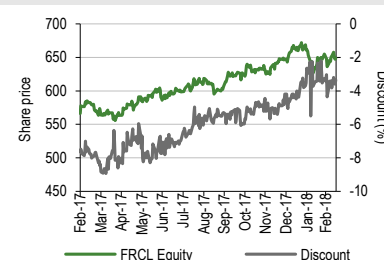
Price 649.0p
Market cap £3,519m
AUM £3,854m

NAV* 666.3p
Discount to NAV 2.6%
NAV** 671.5p
Discount to NAV 3.3%

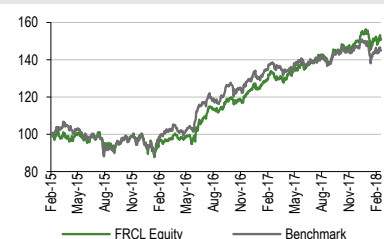
*Excluding income. **Including income. As at 15 March 2018.

Yield 1.6%
Ordinary shares in issue 542.2m
Code FRCL
Primary exchange LSE
AIC sector Global
Benchmark FTSE All-World

Share price/discount performance



Three-year performance vs index



52-week high/low 672.0p 555.5p
NAV** high/low 697.3p 600.7p

**Including income.

Gearing

Gross* 7.0%
Net* 7.0%

*As at 28 February 2018.

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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 is the FTSE All-World Index.

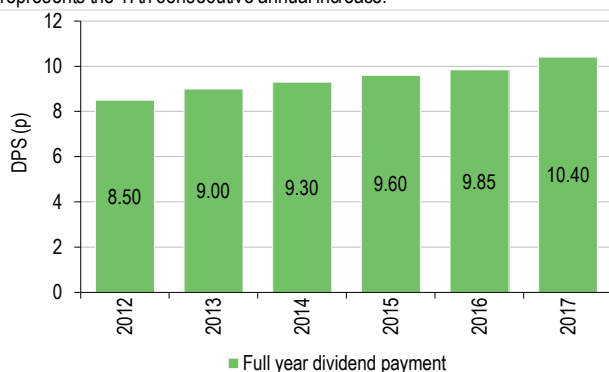
Recent developments

- 14 March 2018: Announcement of issuance of £75m of 2.92% 30-year, fixed-rate senior unsecured private placement notes (funding date in May 2018).
- 7 March 2018: 12-month results ending 31 December 2017. NAV TR +16.9% versus benchmark TR +13.8%. Share price TR +21.0%. Announcement of fourth interim dividend of 2.7p (in line with prior year).
- 8 December 2017: Announcement of third interim dividend of 2.7p (+10.2% year-on-year).
- 20 September 2017: Announcement of second interim dividend of 2.5p (+6.4% year-on-year).

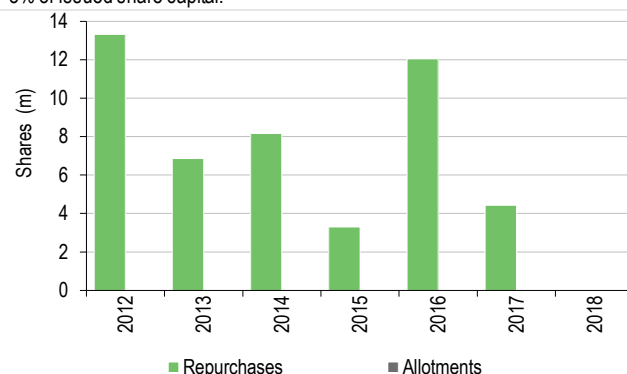
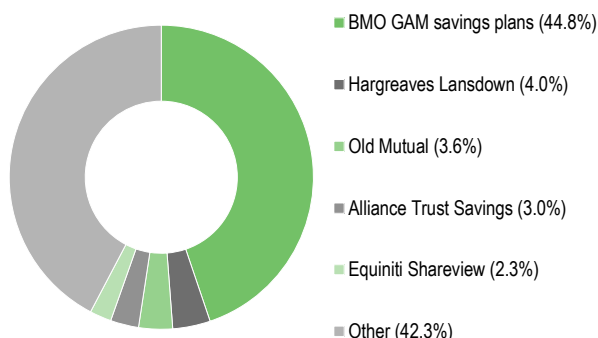
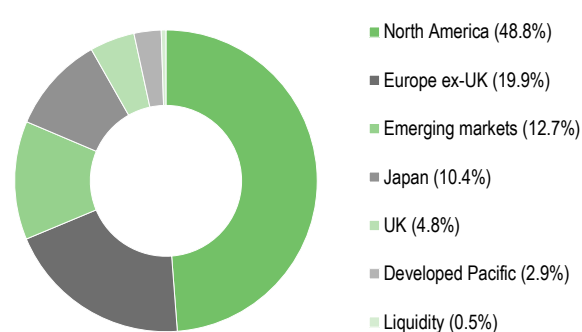
Forthcoming		Capital structure		Fund details	
AGM	April 2018	Ongoing charges	0.79%	Group	BMO Global Asset Mgmt (BMO)
Interim results	July 2018	Net gearing	7.0%	Manager	Paul Niven
Year end	31 December	Annual mgmt fee	0.365%	Address	Exchange House, Primrose Street London EC2A 2NY
Dividend paid	Feb, May, Aug, Nov	Performance fee	None	Phone	+44 (0)800 136 420
Launch date	March 1868	Trust life	Indefinite	Website	www.foreignandcolonial.com
Continuation vote	None	Loan facilities	Various – see page 7		

Dividend policy and history (financial years)

FRCL pays dividends quarterly. The announced 2017 total dividend of 10.4p represents the 47th consecutive annual increase.


Share buyback policy and history (financial years)

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


Shareholder base (as at 9 March 2018)

Strategy allocation (including private equity, as at 28 February 2018)

Top 10 holdings (as at 28 February 2018)

Company	Country	Sector	Portfolio weight %	
			28 February 2018	28 February 2017*
Amazon	US	Consumer services	1.9	1.4
Microsoft	US	Technology	1.5	1.1
Alphabet**	US	Technology	1.1	1.1
UnitedHealth	US	Healthcare	1.0	1.2
Facebook	US	Technology	0.9	0.8
Anthem	US	Healthcare	0.9	N/A
Utilico Emerging Markets	UK	Financials	0.8	0.9
JPMorgan Chase	US	Financials	0.8	N/A
Pantheon Europe Fund V	UK/Europe	Private equity	0.7	1.1
Booking Holdings***	US	Consumer services	0.7	0.8
Top 10			10.3	

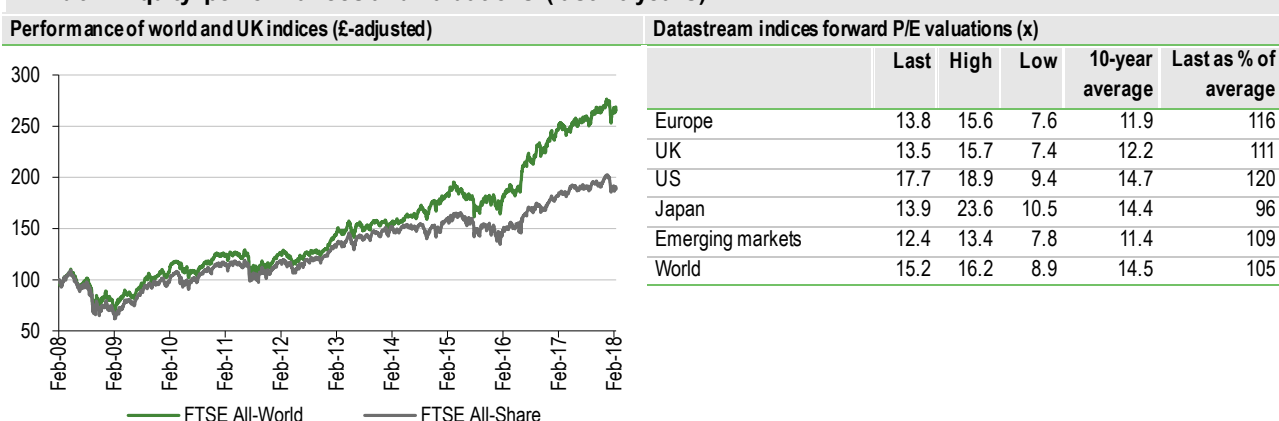
Source: Foreign & Colonial Investment Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in February 2017 top 10. **Formerly known as Google. ***Formerly known as Priceline.

Market outlook: Equity valuations above average

Exhibit 2 (LHS) shows the performance of global and UK equities (in sterling terms) over the last 10 years. Since stock market lows in 2009, following the global financial crisis, investors in overseas equities have been rewarded with higher total returns than investors in UK shares; this is partly due to sterling weakness over the period.

While equity markets so far in 2018 have been more volatile, following below-average levels of volatility in 2017, equity valuations are generally above long-term averages. Based on forward P/E multiples, both world and emerging market stocks are trading above their averages over the last 10 years. This is led by the US, which is trading at a 20% premium to its 10-year average forward P/E. With this valuation backdrop, investors seeking equity exposure may wish to consider a fund with a broad remit, including exposure to private equity, and allocations to regions where valuations are more favourable compared to history, such as Japan.

Exhibit 2: Equity performances and valuations (last 10 years)



Source: Thomson Datastream, Edison Investment Research. Note: Data as at 15 March 2018.

Fund profile: World's oldest collective investment fund

Launched in 1868, FRCL is now celebrating its 150th birthday and is the oldest investment trust. It began with assets of £588,300 and the trust has grown substantially since then: assets under management currently stand at c £3.9bn. Data from Newlands Fund Research suggests that if £100 had been invested when the trust was launched, at end-December 2017, the investment would have been worth £12m. FRCL originally invested in government bonds, but by 1965, 95% of the portfolio was held in equities, and the trust has been investing in private equity since 1942. The board has proposed a subtle change in the name of FRCL: subject to shareholder approval at the April 2018 AGM, at some time in the future, the trust may be renamed as F&C Investment Trust.

FRCL has low manager turnover: Paul Niven is just the third manager of the trust since 1969, and there have only been 11 managers in 150 years. Niven seeks long-term growth in capital and income, and attractive risk-adjusted returns from a globally diversified portfolio of listed equities and unlisted securities including private equity. The trust is benchmarked against the FTSE All-World index. There are no sector or geographic limits for publicly listed equities. A maximum 5% of the portfolio (at the time of acquisition) may be invested in unlisted (excluding private equity) investments, and this requires board approval prior to purchase. Long-term private equity exposure above 20% would require shareholder approval. At the time of acquisition, no individual holding should exceed 10%, and the maximum permitted investment in funds managed by BMO Global Asset Management is 5%, and is subject to board approval. Gearing in either sterling or foreign currencies is allowed, up to a maximum 20% of NAV; at end-February 2018, net gearing was 7.0%.

The trust has a distinguished dividend history: dividends have been paid every year since launch, and have increased for the last 47 consecutive years. FRCL has more than 100,000 investors, of which more than 90% are retail shareholders.

The fund manager: Paul Niven

The manager's view: Bull market has further to run

While equities have enjoyed a long bull run, Niven believes that they can still move higher, given positive underlying fundamentals as a result of an improving global economy, which is feeding into higher corporate earnings. Earnings multiples have expanded, but the manager does not think that they have reached a point of excess. He believes that an economic downturn could be required to bring the bull run in equities to an end, which could be signalled by an inverted yield curve, where short-term borrowing rates exceed long-term rates. Other potential risks for equity returns are higher inflation or central bank monetary policy missteps. So far, the manager believes that inflation is "not too hot and not too cold", but there are signs of wage acceleration in the US, which need to be monitored carefully.

Niven believes that the higher levels of stock market volatility experienced during 2018 to date will continue, as credit spreads start to widen from historically low levels. He expects a higher dispersion of equity returns versus history and believes that growth stocks, including technology, should continue to outperform, along with financial stocks, which should benefit from higher bond yields. He sees less chance of other cyclical sectors outperforming.

Asset allocation

Investment process: One-stop-shop for global equity exposure

FRCL's portfolio is diversified by geography and sector. Niven is benchmark-aware, but he does not follow the FTSE All-World index allocations. FRCL comprises strategies from both BMO's specialist teams and third-party managers (see Exhibit 3), which are regularly reviewed.

The manager remains committed to private equity investment, which is undertaken on a focused and opportunistic basis. In 2017, there was £30m in new direct commitments, which was a mixture of co-investments and primary investments. The percentage invested via HarbourVest and Pantheon funds of funds is reducing over time, as the investments are maturing. Niven says that FRCL's diversification strategy is key (including having both listed and private equity exposure), both to reduce risk and also help to limit volatility of investment returns.

Current portfolio positioning

FRCL's top 10 positions are shown in Exhibit 1. At end-February 2018, they represented 10.3% of the portfolio, which was broadly in line with end-February 2017. Within the top three are holdings in Amazon and Alphabet (the parent of Google). These are members of the group of five US technology-based companies known under the acronym FAANGs, which have delivered very strong returns in recent years. Examples of the trust's diversified nature include two other top 10 positions: Utilico Emerging Markets (a UK-listed company primarily invested in cash-generative infrastructure, utility and related assets); and Pantheon Europe Fund V (a private equity fund focused on the UK and Europe). FRCL's strategy allocations are shown in Exhibit 3. Most of the strategies have high active shares (a measure of how a portfolio differs from an index, with 100% representing no commonality and 0% full index replication). While the UK strategy active share is lower than the other strategies, it has increased from 52% at end-June 2017.

Exhibit 3: FRCL strategy allocations (as at 31 December 2017)

Strategy	Primary manager	Approach	% allocated	Holdings	Active share (%)**
Regional					
US growth	T. Rowe Price	Growth	17.0	119	78
US value	Barrow, Hanley, Mewhinney & Strauss	Value	15.5	46	80
Europe	BMO Global Asset Management	Fundamental quality value	13.2	40	84
UK	BMO Global Asset Management	Quality growth	4.3	25	62
Japan	BMO Global Asset Management	Quality GARP*	8.5	54	75
Emerging markets	LGM	Long-term quality	11.1	38	96
Global					
Income	BMO Global Asset Management	Systematic income GARP*	10.6	57	90
Smaller companies	BMO Global Asset Management	Core quality growth	4.4	82	99
Multi-manager	BMO Global Asset Management	Fund of funds	7.8	23	68
Private equity					
Funds	HarbourVest/Pantheon	Fund of funds	5.0	16	N/A
Direct	BMO Global Asset Management	Direct	1.3	13	N/A

Source: Foreign & Colonial Investment Trust, Edison Investment Research. Note: *GARP is growth at a reasonable price. **Active share is a measure of how a portfolio differs from an index (0% is full index replication and 100% is no overlap with the benchmark).

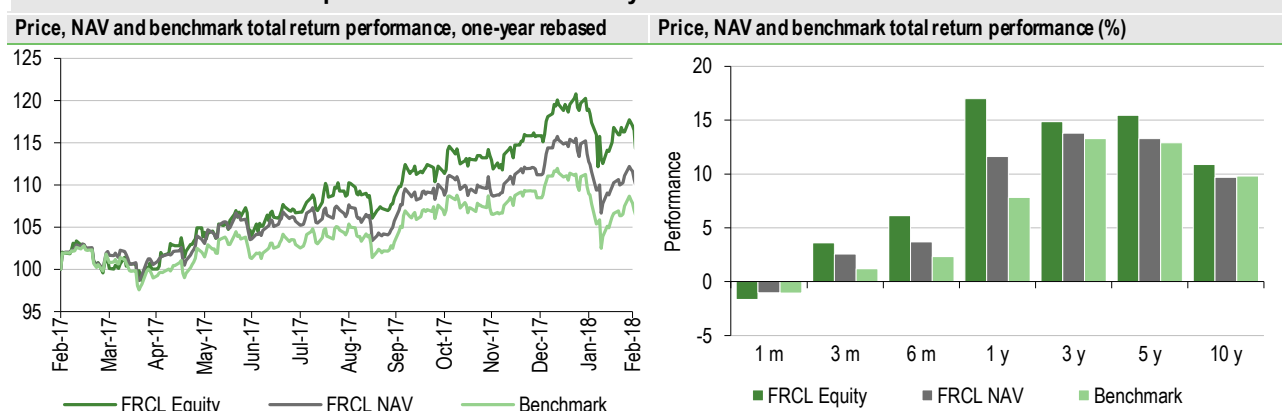
Exhibit 4 shows FRCL look-through geographic exposure is broadly similar to when we published our last report in [September 2017](#), although there is a reduced underweight exposure to North America and the UK is now modestly under rather than overweight the benchmark, as the manager is finding better investment opportunities elsewhere. He believes that Brexit negotiations and their implications could act as an overhang to UK equity performance for months, if not years.

Exhibit 4: Geographic weightings (including private equity, % unless stated)

	Portfolio end-Feb 2018	Portfolio end-Feb 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
North America	48.8	47.3	1.5	54.3	(5.5)	0.9
Europe ex-UK	19.9	18.1	1.8	14.8	5.1	1.3
Emerging markets	12.7	11.9	0.8	10.3	2.4	1.2
Japan	10.4	10.1	0.3	8.7	1.7	1.2
UK	4.8	8.1	(3.3)	5.8	(1.0)	0.8
Developed Pacific	2.9	2.7	0.2	5.9	(3.0)	0.5
Liquidity	0.5	1.8	(1.3)	0.0	0.5	N/A
	100.0	100.0		100.0		

Source: Foreign & Colonial Investment Trust, Edison Investment Research

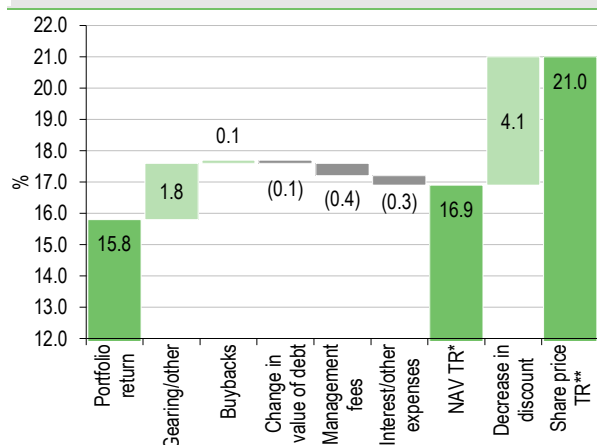
Performance: Strong set of 2017 results

Exhibit 5: Investment trust performance to 28 February 2018


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

FRCL has recently released its 2017 results; the NAV and share price total returns of 16.9% and 21.0%, respectively, were meaningfully ahead of the benchmark's 13.8% total return. Most

strategies beat their respective performance benchmarks, led by North America and Europe ex-UK. Emerging market returns were broadly in line with the benchmark, despite under-exposure to China and technology stocks, which performed strongly over the period. The UK strategy underperformed. Private equity returns lagged listed equity returns in 2017, but continue to exceed them over the longer term. In absolute terms, the strategies with the highest total returns in 2017 were emerging markets (+25.6%) and Europe ex-UK (+19.3%). The waterfall chart in Exhibit 6 breaks down FRCL's 2017 performance attribution in more detail. The 16.9% NAV total return was primarily due to an above-average portfolio return, plus a modest positive effect from gearing. Strong demand for FRCL's shares meant that the recent narrowing of the discount led to the share price total return exceeding the NAV total return.

Exhibit 6: Performance attribution in 2017


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

Exhibit 7: NAV total return performance relative to benchmark over three years


Source: Thomson Datastream, Edison Investment Research.

Exhibit 8 shows FRCL's relative returns. Following a strong performance over the past 12 months, the trust is now outperforming its benchmark in both NAV and share-price terms over one, three and five years, the share price is also ahead of the blended benchmark over 10 years, while the NAV is modestly lower. It is interesting to note FRCL's outperformance versus the FTSE All-Share over all periods shown, particularly over the longer time periods. The manager says that the allocation move in recent years, towards lower UK and higher overseas exposure, has definitely been the correct decision.

Exhibit 8: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to blended benchmark*	(0.6)	2.4	3.7	8.5	4.3	11.8	10.0
NAV relative to blended benchmark*	0.0	1.3	1.3	3.5	1.4	1.7	(1.1)
Price relative to FTSE All-World	(0.6)	2.4	3.7	8.5	4.3	11.8	5.5
NAV relative to FTSE All-World	0.0	1.3	1.3	3.5	1.4	1.7	(5.1)
Price relative to FTSE All-Share	1.7	4.2	7.1	12.1	27.6	44.4	47.7
NAV relative to FTSE All-Share	2.3	3.2	4.6	6.9	24.0	31.3	32.8
Price relative to FTSE World ex-UK	(0.9)	2.5	3.6	8.7	2.7	8.5	0.9
NAV relative to FTSE World ex-UK	(0.2)	1.4	1.2	3.7	(0.1)	(1.3)	(9.2)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-February 2018. Geometric calculation. *Benchmark prior to 1 January 2013 was a composite of 40% FTSE All-Share and 60% FTSE World ex-UK indices (now FTSE All-World index).

Discount: Fixed discount target removed

FRCL's discount has been in a narrowing trend since mid-2016 and the 4.3% discount at the end of 2017 was the lowest year-end level for more than 20 years. The trust's current 3.3% share price discount to cum-income NAV compares to a range over the past 12 months of 2.2% to 8.9% and the range of average discounts over the last one, three, five and 10 years of 5.9% to 9.2%.

In recent years, FRCL has had a target in place, aiming to keep the discount below 7.5%. However, the board has announced that this target will be removed, although the board will continue to repurchase shares, in normal market conditions, if the discount widens significantly. The board aspires for FRCL's shares to trade close to NAV. Shares may be issued if the trust trades at a consistent 1% or higher premium. During 2017, 4.4m shares were repurchased (less than 1% of shares outstanding) at around a 5% discount.

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



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

FRCL is a conventional investment trust with one class of share. There are currently 542.2m ordinary shares in issue, with a further 19.6m held in treasury. Gearing of up to 20% of NAV is permitted. Since 2012, it has varied between 7% and 14%, and at end-February 2018, net gearing was at the low end of this range. FRCL has a range of debt facilities totalling £296m, diversified by currency, lender and maturity profile: a £50m 1.12% revolving credit facility expiring in 2018; ¥6.6bn at 2.50% and \$80m at 4.00% maturing in 2019; €72m at 1.69% in 2022; £25m at 2.80% in 2028; £50m at 3.16% in 2031 and a £0.6m 4.25% perpetual debenture. The trust's average cost of debt has come down considerably, from 7.1% at end-2013 to the current level of 2.5%. This is the result of some refinancing and the maturity of a longstanding 11.25% debenture. On 14 March 2018, FRCL announced the issuance of £75m of 2.92% 30-year fixed-rate senior unsecured private placement notes, for which the funding date will be in May 2018. The trust is planning for the future by increasing fixed-rate, long-dated, sterling-denominated financing at an attractive interest rate. Following the transaction, the weighted average interest on all structural borrowings will be c 2.8%.

BMO Global Asset Management is paid an annual management fee of 0.365% of market cap, and FRCL also pays direct fees to its external managers. The ongoing charges have remained around 0.8% for the last three years.

Dividend policy and record

FRCL has proposed a final 2017 dividend of 2.70p, which would mean a total annual distribution of 10.40p. This is 5.6% higher than the 9.85p total 2016 dividend and represents the 47th year of consecutive dividend increases (a dividend has been paid every year since FRCL was launched).

In 2017, the net revenue return was 11.67p, which was 10.4% higher than 10.57p in 2016. This means that the 2017 dividend is more than 1.1x covered. The net revenue return has increased in each of the last four years, despite the shift from UK to overseas equities, which had been expected to create a revenue challenge. There have been benefits from underlying income growth (including

special dividends, which were £2.7m in 2017 versus £4.4m in 2016), reduced interest costs and cash flow from private equity investments. The board is committed to increasing the dividend in real terms (ie at a rate higher than the level of UK inflation). FRCL's current dividend yield is 1.6%.

Peer group comparison

Exhibit 10 shows the 13 trusts in the AIC Global sector with less than 25% invested in the UK. With a market cap of c £3.5bn, FRCL is the second largest. Its NAV total returns are above average over 10 years, broadly in line over three and five years, while lagging over one year. FRCL's discount is below average, as is its ongoing charge. The trust has an above-average level of gearing and its dividend yield is in line with the selected peer group average.

Exhibit 10: Selected peer group as at 15 March 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Foreign & Colonial Investment Trust	3,518.8	7.9	44.2	80.6	166.9	(2.5)	0.8	No	107	1.6
Alliance Trust	2,520.2	6.8	44.4	71.0	151.6	(5.8)	0.5	No	102	1.8
British Empire	820.7	6.1	42.8	54.7	114.5	(11.3)	0.9	No	105	1.7
Caledonia Investments	1,527.0	3.1	26.5	62.3	99.7	(15.4)	1.1	No	100	2.0
Edinburgh Worldwide	409.5	32.0	62.4	120.5	227.8	1.3	0.9	No	105	0.0
EP Global Opportunities	130.9	4.9	34.6	67.6	146.6	(6.9)	1.0	No	100	1.8
Hansa Trust class 'A'	234.6	8.3	23.4	38.8	69.3	(28.4)	1.1	No	100	1.6
Lazard World Trust Fund	136.8	9.6	40.2	70.9	100.7	(4.9)	1.4	Yes	100	3.5
Majedie Investments	148.6	0.1	28.8	63.3	23.1	(12.0)	1.1	No	111	3.5
Martin Currie Global Portfolio	217.5	2.3	36.9	69.2	134.1	(0.8)	0.7	Yes	100	1.8
Mid Wynd International	169.6	11.3	48.9	95.1	194.0	2.8	0.7	No	100	1.0
Monks	1,740.9	19.9	63.7	94.3	141.4	2.7	0.6	No	105	0.2
Scottish Mortgage	6,586.1	34.9	88.5	178.9	337.4	(1.9)	0.4	No	103	0.6
Average	1,397.0	11.3	45.0	82.1	146.7	(6.4)	0.9		103	1.6
FRCL rank in sector (13 trusts)	2	7	6	5	4	6	8		2	9

Source: Morningstar, Edison Investment Research. Note: *Performance as at 14 March 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are eight directors on FRCL's board; all are non-executive and independent of the manager. Chairman Simon Fraser was elected to the board in September 2009 and assumed his current role in May 2010. The senior independent director is Sir Roger Bone, who was appointed in March 2008. The other six directors and their dates of appointment are: Jeffrey Hewitt (September 2010), Sarah Arkle and Nicholas Moakes (both March 2011), Francesca Ecsery (August 2013), Edward Knapp (July 2016) and Beatrice Hollond (September 2017).

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