Martin Currie Asia Unconstrained Trust

Disciplined investment in Asian growth

Investment trusts

17 February 2016

Martin Currie Asia Unconstrained Trust (MCP) does not have a traditional Asia ex-Japan benchmark, but aims to achieve returns commensurate with GDP growth in the region. The manager's Asia Long-Term Unconstrained (ALTU) strategy was launched in July 2008 and adopted by MCP in July 2014. Since inception, the strategy has tended to capture most of the upside in rising markets, while outperforming in falling markets. The portfolio is focused, with 20-30 holdings that have all undergone a rigorous selection process, including an in-depth forensic accounting report and a corporate governance review.

12 months ending	Total share price return (%)	Total NAV return (%)	Blended benchmark* (%)	MSCI AC Asia ex-Japan (%)	GDP growth Asia ex-Japan (%)
31/01/12	(3.8)	(1.9)	(6.2)	(5.8)	21.5
31/01/13	11.4	10.4	12.2	12.1	17.1
31/01/14	(1.8)	(6.2)	(2.2)	(6.8)	12.7
31/01/15	14.7	17.0	12.3	24.1	8.8
31/01/16	(16.3)	(14.8)	7.9	(13.1)	7.9

Source: Thomson Datastream, MCP, IMF, Edison Investment Research. Note: 12-month rolling discrete total return performance, all in £ terms. *Blended benchmark is MSCI AC Asia Pacific Index (Japan fixed at 40%) until 30 June 2008, MSCI AC Asia Pacific Index from 1 July 2008 to 30 June 2011, MSCI AC Asia Pacific Index (Japan fixed at 25%) from 1 July 2011 to 10 July 2014, and three-year rolling nominal Asian GDP growth from 11 July 2014.

Investment strategy: Asia Long-Term Unconstrained

MCP adopted the ALTU strategy in July 2014, aiming to generate total returns in line with Asia ex-Japan nominal GDP growth. MCP is a long-only concentrated fund with a portfolio of 20-30 stocks. The stock selection process is rigorous, starting with a screen for return on capital, stability of returns over time and growth in cash flow. The track record of potential investments is analysed, growth drivers assessed, a forensic accounting report prepared and a review of corporate governance undertaken. The focus is on long-term investment; hence portfolio turnover is relatively low.

Market outlook: Higher relative growth

Despite recent downward revisions to global growth expectations and concerns over China's economy, the outlook for growth in Asia ex-Japan remains favourable compared with developed markets and the rest of the world. The recent de-rating in the region has left the forward P/E at a discount to the world index of nearly 20%, towards the bottom end of the five-year range, arguably discounting a further weakening in the environment and potentially signalling a valuation opportunity on a longer-term view.

Valuation: Recent widening of discount

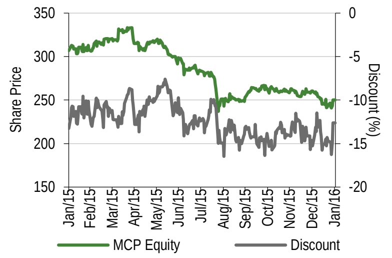
Having been in a narrowing trend in recent years, the discount has widened since mid-2015 as the regional stock markets have de-rated. The current discount is wider than the three- and five-year averages and above the peer group average. However, the dividend yield of 3.1% is the highest of the non-income mandated trusts in the peer group. On average, dividends have grown by 15% pa since 2010.

Price	**243.5p**
Market cap	**£91.0m**
AUM	**£105.6m**
NAV*	282.59p
Discount to NAV	13.8%
NAV**	286.34p
Discount to NAV	15.0%

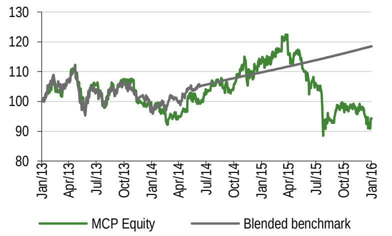
*Excluding income. **Including income. Price at close 31/1/16 NAV at 29/1/16.

Yield	3.1%
Ordinary shares in issue	37.4m
Code	MCP
Primary exchange	LSE
AIC sector	Asia Pacific – ex-Japan

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low	333.5p	237.0p
NAV** high/low	378.0p	278.8p

**Including income.

Gearing

Gross*	4.7%
Net*	3.7%

*As at 31 January 2016.

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Edison profile page

Martin Currie Asia Unconstrained Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

Martin Currie Asia Unconstrained Trust aims to achieve returns commensurate with Asia ex-Japan nominal GDP growth, unconstrained by an equity benchmark, over a long-term time horizon from a concentrated portfolio of 20-30 stocks. Before its change of investment objective in July 2014, it invested in a pan-Asian portfolio with a benchmark of MSCI AC Asia Pacific (Japan fixed at 25%).

Recent developments

- 12 November 2015: Half-yearly report for six months to 30 September – NAV TR -19.2%.
- 11 November 2015: Martin Shenfield is appointed to the board as a non-executive director.
- 31 July 2015: Name change from Martin Currie Pacific Trust to Martin Currie Unconstrained Trust.

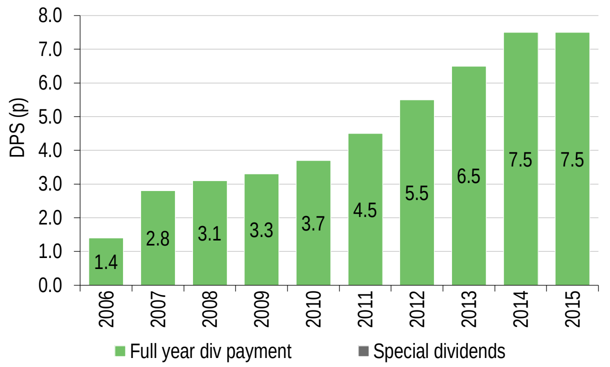
Forthcoming		Capital structure		Fund details	
AGM	July 2016	Ongoing charges	FY15 1.2% (see page 7)	Group	Martin Currie Investment Management
Preliminary results	May 2016	Gearing	4.7% (gross)	Managers	Andrew Graham
Year end	31 March	Annual mgmt fee	Tiered, 0.60-0.75% of net assets	Address	Saltire Court, 20 Castle Terrace, Edinburgh EH1 2ES
Dividend paid	December and August	Performance fee	None		
Launch date	1985	Trust life	Indefinite	Phone	0131 229 5252
Continuation vote	Three-year, next in 2018	Loan facilities	£5m	Website	www.martincurriepacific.com

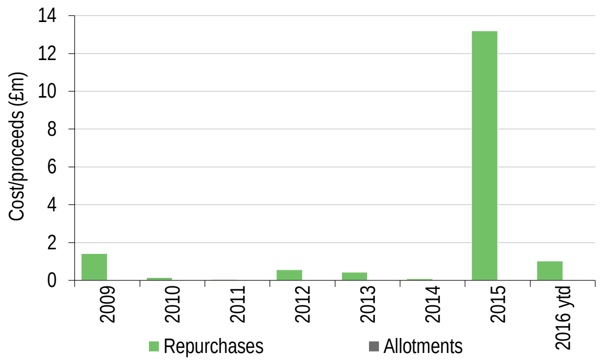
Dividend policy and history

MCP has a progressive dividend policy and has paid interim and final dividends since FY14. The average annual dividend growth rate since 2010 is 15%.

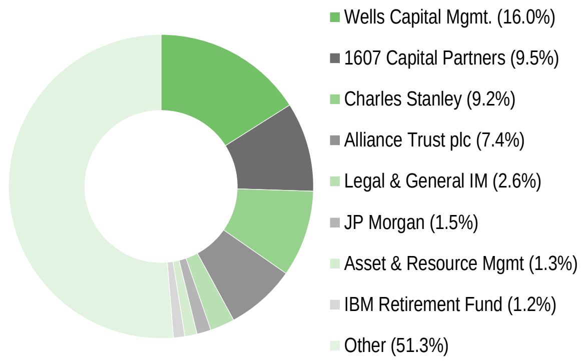
Share buyback policy and history

MCP is authorised to repurchase up to 14.99% and allot up to 5% of its ordinary shares. A tender offer for 10% of the issued shares was made in July 2014.

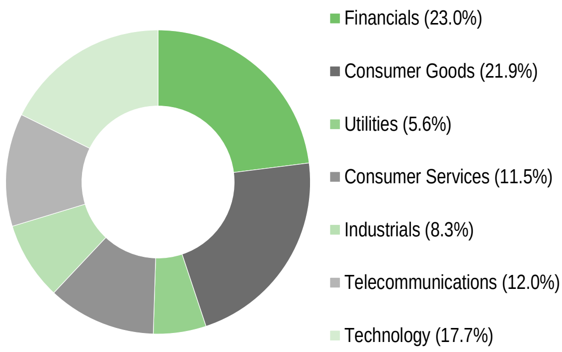




Shareholder base (as at 11 January 2016)



Portfolio exposure by market cap (as at 30 September 2015)



Top 10 holdings (as at 31 January 2016)

			Portfolio weight %	
Company	Country of listing	Sector	31 January 2016	31 January 2015*
AIA	Hong Kong	Insurance	8.2	6.8
Infosys	India	Software & services	6.8	5.1
Taiwan Semiconductor	Taiwan	Semiconductors & equipment	6.6	4.7
China Mobile	China	Telecom services	6.3	5.6
Tata Consultancy Services	India	IT services	5.6	4.1
HSBC	Hong Kong	Banks	5.2	4.5
Jardine Matheson	Hong Kong	Conglomerate	4.7	4.2
Samsung Electronics	South Korea	Tech hardware & equipment	4.5	4.4
Hero MotoCorp	India	Automotive	4.5	N/A
Johnson Electric	Hong Kong	Automotive	4.4	4
Top 10			56.8	

Source: Martin Currie Asia Unconstrained Trust, Edison Investment Research, Morningstar, Thomson. Note: *N/A where not in January 2015 top 10.

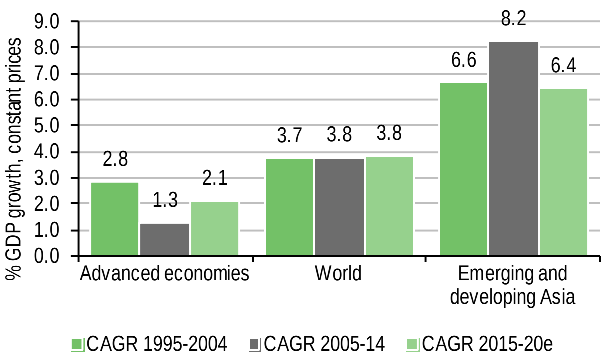
Market outlook: Potential for outperformance

Despite concerns over developments in China's economy and a downward trend in growth expectations, GDP growth forecasts for emerging and developing Asia remain much higher than those for advanced economies and the world as a whole (Exhibit 2, left-hand side). As Asian markets have become more mature, the diversity of growth drivers has increased; they include Asian consumption growth as a result of rising disposable incomes, low household debt and low unemployment, growth in trade and financial services and infrastructure spending. Valuation in the region is attractive on a comparative basis; following the P/E multiple contraction from mid-2015, the Datastream Asia ex-Japan index forward multiple now stands at a c 20% discount to the world index, very near the low end of the five-year range.

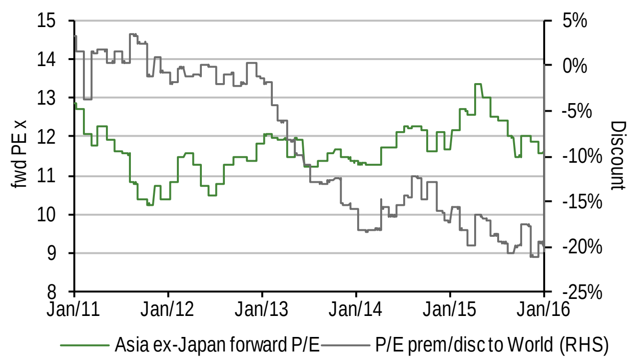
For investors attracted by current valuations but concerned by increased volatility in recent months, the focused strategy employed at MCP aiming to capture regional GDP growth could be appealing.

Exhibit 2: Emerging Asia vs advanced and world markets – GDP growth and valuation metrics

GDP growth rates – emerging Asia vs advanced economies and world



DS Asia ex-Japan vs DS World valuation comparison



Source: IMF October 2015 WEO, Thomson Datastream, Edison Investment Research

Fund profile: Disciplined long-term strategy

MCP was launched in 1985. It was initially benchmarked (see table on page 1), but in July 2014 it adopted Martin Currie's Asia ALTU strategy. ALTU was developed to capture the benefits and mitigate the risks of investing in Asia and accounts for a significant £1.4bn of Martin Currie's assets under management. Since the launch of ALTU, its performance between October 2008 and November 2015 has been 12.3% pa and turnover has been c 11% pa. ALTU aims to provide returns commensurate with nominal Asia ex-Japan GDP growth (on a rolling three-year basis). The unconstrained approach means that stock selection is based on fundamentals, not with reference to a benchmark. Investments are made on a long-term view with the low turnover helping to reduce costs and, when successful, allowing the positive effects of compounding returns from good businesses to accrue to shareholders.

MCP is managed by Martin Currie's Asia investment team, headed by Andrew Graham. The team developed the ALTU strategy and also runs relative-return portfolios. Martin Currie Investment Management specialises in overseas equities, with 52% of its assets (ex-Martin Currie Australia) in Asia Pacific ex-Japan. Since October 2014, Martin Currie has been a wholly-owned subsidiary of US-based Legg Mason, but has retained operational and investment autonomy.

The fund managers: Andrew Graham and team

The manager's view: Long-term dynamics remain positive

Andrew Graham notes that although the Asian stock markets have been weak, companies with strong fundamentals have outperformed the broader market. Over the last year, eight 'forensic tests' on companies that screened positively have been undertaken. So far, no new positions have been initiated, either because the team is awaiting specific company developments or because the valuations of the potential investments have not been attractive.

The Asia ex-Japan market valuation is more interesting following the recent sell-off, trading at a P/E of c 11.5x, which is at the low end of its historical range. However, on an equal rather than a cap-weighted basis, the market is trading around 15x, which is in line with the long-term average. High-growth companies are still trading at high multiples versus history, as investors are willing to pay up for perceived growth in a low-growth environment.

Graham still sees the long-term secular dynamics in the region as positive. Most businesses in which MCP is invested are doing "reasonably well". Although stock market enthusiasm for these waxes and wanes, the "economics of the portfolio remain reasonably robust".

The team of seven managers/analysts has an active research agenda, focusing on monitoring existing holdings and generating new ideas. Recent portfolio activity has involved recycling funds from profit taking in the portfolio. The market sell-off in August 2015 led to an increase in activity. Over the last 12 months, the largest portfolio additions have been to Hero MotoCorp, Samsonite and Tata Consultancy Services.

MCP invests for the long term. In illustrating this, Graham notes that Genting, which is primarily a gaming operator, has been among the weaker performers in the portfolio over the last year. In addition to some cyclical effects, trading has been held back as the company updates the Genting Highlands resort in Malaysia, but the returns on this investment should flow through as the work is completed. While it does not offer an essential service, Genting is viewed as having a sustainable competitive advantage, has a loyal customer base and should benefit as leisure spending grows with disposable income in the Asian region. Genting's return on capital is currently depressed, but there is net cash on the balance sheet and excess cash is returned to shareholders.

Asset allocation

Investment process: Asia Long-Term Unconstrained (ALTU)

A c 1,100-strong Asia stock universe is screened for companies with a track record of positive returns over the cost of capital, stability of returns and growth in cash flow. This leads to an investable universe of around 200 companies. Selection draws on the team's knowledge of the businesses, built in part through more than 500 company visits a year. In-depth evaluation focuses on analysing the track record of the potential investment to identify sustainable growth, the competitive position and the strategic direction. Corporate governance history is assessed and a forensic accounting review is undertaken, which involves outsourcing a detailed 40- to 60-page 'accounting diagnostics report'. Long-term cash returns and growth are modelled and an intrinsic value vs the current market value is estimated.

Over the last quarter, 47 potential new investments have been investigated. It is deemed very important to keep monitoring new ideas to ensure that the portfolio does not remain static. Potential investments are rejected if the company has an unproven business model, MCP managers struggle to understand the business, there is excess competition in the industries in which it operates, the company has a weak competitive position, management capital allocation is poor or valuation is prohibitive. As a result, many ideas are rejected early on.

The manager does not set specific share price targets, instead employing a more holistic approach. The team starts by solving for the current share price and then flexing the assumptions required to gain a sense of potential under or overvaluation. MCP is disciplined with regard to valuation; as a stock becomes expensive the position will be trimmed and may eventually be sold. Other reasons for selling a position are if there is a structural change in the business that has a negative impact on its long-term potential, there is a breach of good corporate governance or other investments offer significantly superior potential.

Individual portfolio holdings are limited to 10% and the maximum position that can be invested in a single company is 10%. Risk is diversified via country, sector and maturity of the businesses and is mitigated by due diligence on potential investments.

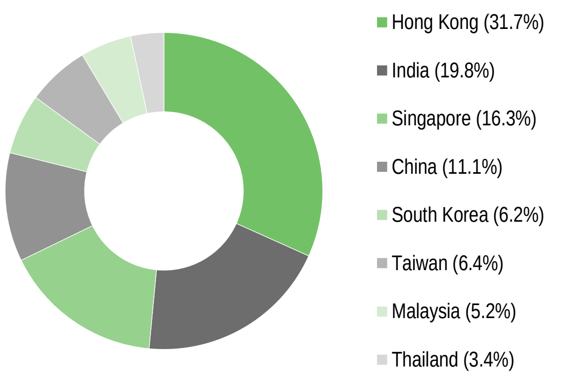
Current portfolio positioning

The portfolio is relatively concentrated, with 27 holdings versus a peer group average of 67. MCP has an unconstrained strategy and no benchmark and as part of its monitoring, the manager considers correlations between holdings. The average long-term pairwise correlation over 42 months to 11 September 2015 of 0.2 is low. In the depths of the financial crisis it only spiked to 0.5 and saw a smaller increase in August 2015.

The top 10 holdings accounted for 56.8% of the portfolio at end January 2016 compared with 47.3% at end January 2015. Nine of the top 10 holdings were held at end January 2015. Although concentrated, the portfolio is diversified by sector and country (see Exhibits 1 and 3).

Over the last 12 months, exposure has been added to Hong Kong and India. The manager had been cautious on India, believing that the market was expensive and expectations were high following the election of Modi. However, exposure to the country has been raised for stock-specific reasons. For example, the position in Hero MotoCorp has been increased as a result of valuation and an improvement in market share. MCP added to the holding in Tata Consultancy Services, a play on global IT outsourcing, which the manager believes has many years of growth to come. The number of customers generating at least $100m revenue for Tata has risen from seven to 34 since FY08; illustrating the increasing scale of spending in this area.

Exhibit 3: Portfolio exposure at 31 January 2016



Source: Martin Currie Asia Unconstrained Trust, Edison Investment Research

Exhibit 4: Portfolio characteristics

	MCP portfolio	MSCI AC Asia ex-Japan index
Price/earnings* (x)	13.8	12.0
Price/book (x)	1.9	1.4
Yield (%)	3.2	3.5
EV/EBIT (x)	12.4	13.3
EV/EBITDA (x)	8.4	7.7
Net debt/(cash) to equity (x)	(19.9)	29.4
Return on equity* (x)	13.7	11.9

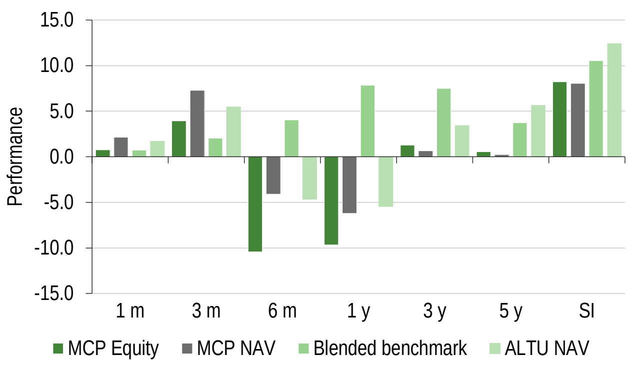
Source: Martin Currie and UBS PAS, 30 November 2015. Note: *Indicates consensus.

Given MCP's focus on higher-quality companies, valuation multiples are generally higher than those of the MSCI AC Asia ex-Japan index (Exhibit 4). Portfolio companies have above-average returns on equity and significantly lower gearing (on average they hold net cash) than the index.

Performance: Lower volatility versus the market

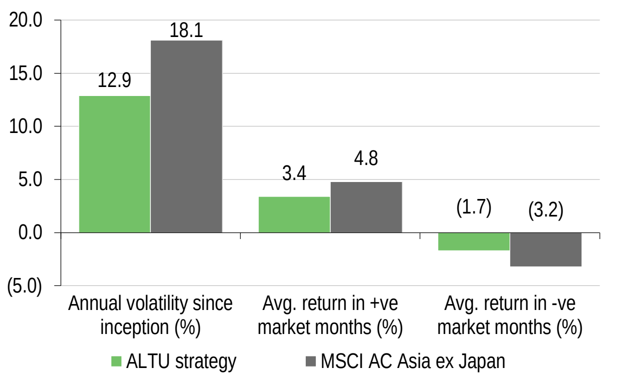
With a move to the ALTU strategy in July 2014, longer-term performance data for MCP are of limited relevance. Looking at ALTU's longer-term performance data from 31 October 2008 to 30 November 2015, relative to the MSCI AC Asia ex-Japan index (Exhibit 6), annual volatility of returns was lower. In addition, more than 70% of market performance has been achieved in months where there was an upward move in the market, while in months where the market declined the ALTU decline was roughly half that of the market.

Exhibit 5: MCP vs blended benchmark and ALTU NAV



Source: Thomson Datastream, Martin Currie Asia Unconstrained Trust. Note: Three- and five-year and since inception (SI) performance is annualised.

Exhibit 6: ALTU NAV volatility and upside/downside participation to 30 November 2015



Source: Martin Currie Asia Unconstrained Trust. Note: ALTU strategy inception date is 31 October 2008.

Exhibit 7 shows that the ALTU strategy has outperformed MCP NAV over periods of three years and more, while it also outperformed the MSCI AC Asia ex-Japan index over three and five years. Reflecting a particularly difficult period of relative performance for Asian stock markets, ALTU (and MCP) have lagged Asia ex-Japan three-year rolling GDP growth over periods greater than three months.

Exhibit 7: Comparing MCP and ALTU total return performance with indices and Asia ex-Japan growth (%)

	One month	Three months	Six months	One year	Three years	Five years	SI
MCP Equity	0.8	4.0	-10.4	-9.7	3.9	2.9	76.2
MCP NAV	2.2	7.3	-4.1	-6.2	2.0	1.2	74.4
ALTU strategy NAV	1.7	5.5	-4.7	-5.5	10.8	31.7	131.8
Blended benchmark	0.7	2.0	4.1	7.9	24.2	20.2	105.4
MSCI AC Asia ex-Japan	1.7	6.8	-7.9	-3.6	9.1	7.0	139.6
MSCI World	0.4	8.6	3.3	5.5	47.7	57.5	133.5
GDP Asia ex-Japan	0.7	2.0	4.1	7.9	33.2	90.3	184.4

Source: Thomson Datastream, Edison Investment Research. Note: Data to end December 2015. Geometric calculation. SI = since ALTU strategy inception date, 31 October 2008.

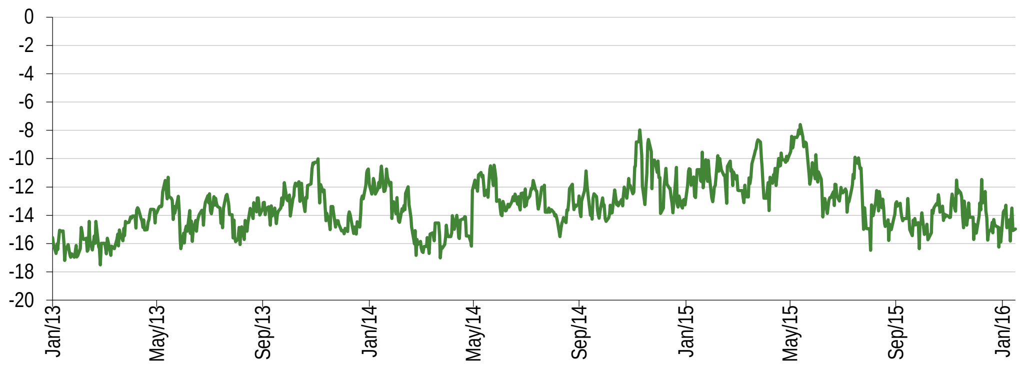
Discount: Recent widening of the discount

At 16 February, MCP shares traded at a 15.0% discount to cum-income net asset value. This is wider than the one, three and five year averages (12.5%,13.3% and 14.6% respectively). The recent modest widening trend (Exhibit 8) presumably reflects cautious current sentiment towards the Asian region.

MCP does not have a formal discount management policy; the board believes that this is not suitable for a smaller trust, but believes that, over time, the adoption of the ALTU strategy should lead to improved performance and a narrowing of the discount. The trust is authorised to buy back up to 14.99% and allot up to 5% of the shares in issue, as well as reissuing shares from treasury.

The latest share repurchase was on 1 February 2016, when 49,543 shares were purchased at 251.59p (to be held in treasury).

Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

MCP is a conventional investment trust with one class of share. There are 37.4m shares in issue, with a further 2.1m in treasury. On 27 October 2015, the board entered into a £10m loan facility with Royal Bank of Scotland, which expires on 30 September 2018. Terms were 0.75% over LIBOR. Under the agreement £5m was drawn down on 5 November 2015. Gearing is effectively viewed as structural, rather than a means to time the market, and has the potential to enhance the return and the dividend-paying capability of the trust. Cash at 31 January 2016 was 1.0% of the portfolio, down from 7.5% at January 2015, as in recent months the proceeds of the Hindustan Unilever sale have been reinvested in existing portfolio positions.

In January 2014, a new fee structure was introduced, with MCP paying management fees of 0.75% pa of net assets up to £150m and 0.60% pa above £150m. Ongoing charges in FY15 were 1.2%. The trust is subject to a three-yearly continuation vote, with the next vote due in 2018.

Dividend policy

The board recognises the importance of income to shareholders, but to reflect the new mandate to invest in companies positioned for growth and the consequent reduction in revenue reserves, it notes that shareholders should not expect the level of dividend increases seen in earlier years. For FY15, the dividend was unchanged at 7.5p. In the half-year to 30 September 2015 the revenue return was 5.62p, which exceeded the 4.82p earned in the whole of FY15. The board has said that it will explore options to increase the level of dividend, which has grown at an average annual rate of 15% since 2010. At the current price of 243.5p, the yield is 3.1% based on the FY15 dividend.

Peer group comparison

Exhibit 9 shows a comparison of MCP versus a peer group of members in the AIC Asia Pacific ex-Japan sector with a track record of more than 10 years. It is currently the smallest trust in the group. MCP's NAV total return performance over one, three, five and 10 years is below the peer group average. However, longer-term historic performance is less relevant following the change in investment strategy in July 2014.

In terms of risk-adjusted returns, MCP's Sharpe ratios are somewhat below the peer group averages over one and three years. Ongoing charges are modestly above the average, but there is no performance fee. Net gearing is in line with the peer group average of 3.8%, which has risen from 2.0% since the last report was published in May 2015. Within the group, MCP has the highest dividend yield if the three income trusts are excluded from the comparison.

Exhibit 9: Asia pacific ex-Japan peer group as at 31 January 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 (%)
Martin Currie Asia Uncon.	94.9	(14.5)	(6.1)	1.7	43.0	(1.7)	(0.5)	(12.6)	1.2		104.0	3.0
Aberdeen Asian Income	278.3	(15.0)	(12.0)	26.0	143.0	(1.8)	(0.8)	(10.5)	1.3		109.0	5.9
Aberdeen Asian Smaller	266.6	(13.0)	(2.1)	45.9	252.0	(2.1)	(0.5)	(13.7)	1.5		112.0	2.1
Aberdeen New Dawn	169.0	(20.2)	(15.5)	(3.1)	95.1	(2.0)	(0.8)	(12.6)	1.1		114.0	2.7
Asian Total Return Inv. Co.	143.7	(5.2)	4.0	6.5	106.6	(1.0)	(0.2)	(4.1)	1.1	Yes	101.0	1.6
Edinburgh Dragon	431.3	(16.9)	(10.4)	5.4	114.0	(1.7)	(0.6)	(12.5)	1.2		111.0	1.3
Fidelity Asian Values	159.3	(2.4)	24.6	23.7	153.0	(0.6)	0.4	(11.5)	1.4		98.0	0.8
Henderson Far East Income	313.3	(12.1)	(3.0)	15.5	107.5	(1.3)	(0.4)	0.3	1.1		105.0	7.0
Invesco Asia	145.4	(9.7)	10.8	21.8	136.8	(1.0)	0.0	(10.9)	1.1		102.0	2.2
JPMorgan Asian	187.5	(14.6)	(0.8)	(4.6)	67.3	(1.3)	(0.2)	(12.4)	0.9		108.0	1.1
Pacific Assets	221.6	(6.5)	24.9	49.7	134.6	(1.2)	0.4	(0.9)	1.3		100.0	1.4
Pacific Horizon	95.6	(14.0)	1.7	6.6	107.0	(1.2)	(0.2)	(13.3)	1.0		89.0	0.2
Schroder Asia Pacific	421.0	(10.8)	3.0	26.0	143.8	(1.2)	(0.2)	(12.2)	1.1		103.0	2.8
Schroder Oriental Income	407.2	(6.9)	7.8	43.8	174.7	(1.0)	(0.1)	(1.9)	0.9	Yes	105.0	4.6
Scottish Oriental Smaller Cos.	221.4	(9.6)	8.2	43.8	280.1	(1.3)	(0.1)	(13.3)	1.0	Yes	96.0	1.6
Average	237.1	(11.4)	2.3	20.6	137.2	(1.4)	(0.2)	(9.5)	1.1		103.8	2.6

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

MCP has five directors. Harry Wells was appointed in 2003 and became chairman in July 2014, following the retirement of Patrick Gifford. He has more than 38 years' investment experience. He is a director of the Establishment Investment Trust and has recently joined Deer Creek Advisors as an associate. Gregory Shenkman (senior independent director) and Peter Edwards were appointed in 2007, while Anja Balfour joined the board in 2012. The newest member of the board is Martin Shenfield, who was appointed in November 2015 and has 35 years' experience in managing institutional and retail funds and holds several senior management positions.

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