EDISON

Martin Currie Pacific Trust

Unconstrained approach to Asian growth

Investment trusts

Martin Currie Pacific Trust (MCP) has undergone a transformation from a relative return, pan-Asia-Pacific strategy to an unconstrained mandate focused on providing long-term returns commensurate with nominal GDP growth in Asia (ex-Japan). It is the only UK retail fund offering exposure to Martin Currie's Asia Long-Term Unconstrained (ALTU) investment process, which seeks to identify the region's 20-30 most sustainable businesses using an in-depth forensic accounting approach. If the ALTU strategy can maintain its strong performance record, then MCP investors also stand to benefit from a narrowing of the discount, which is probably still influenced by the trust's lacklustre performance under its previous approach.

12 months ending	Share price (%)	NAV (%)	Blended benchmark* (%)	MSCI AC Asia ex-Japan (%)	GDP Asia ex-Japan (%)
30/09/11	(2.4)	(6.5)	(8.9)	(13.3)	14.9
30/09/12	8.2	11.9	11.0	15.7	16.0
30/09/13	16.4	9.1	13.1	5.3	15.5
30/09/14	1.5	0.9	5.5	8.4	11.4

Source: Thomson Datastream, Martin Currie Pacific Trust, IMF, Edison Investment Research. Note: Total return basis. *Blended benchmark is MSCI AC Asia Pacific Index (Japan fixed at 40%) until 30 June 2008, then MSCI AC Asia Pacific Index from 1 July 2008 to 30 June 2011, then MSCI AC Asia Pacific Index (Japan fixed at 25%) from 1 July 2011 to 10 July 2014, then three-year rolling nominal Asian GDP growth from 11 July 2014.

Investment strategy: Discipline and focus

The Asia Long-Term Unconstrained strategy adopted by MCP seeks to find 20-30 Asian companies across all sectors, markets and capitalisation sizes that can produce long-term returns commensurate with regional nominal GDP growth. The team uses screens to filter the universe, before undertaking rigorous valuation work to identify companies with good capital discipline and returns on equity. Likely candidates for inclusion go forward to a forensic accounting and corporate governance assessment programme. Changes to the portfolio are rare; a significant percentage of the strategy's 26 stocks have been held for the whole six years since ALTU's launch.

Market outlook: Scope for recovery to continue

With Asian GDP forecast to continue to outstrip other regions over the next five years, albeit by a narrower margin than hitherto, the outlook seems favourable for investors with a focus on companies likely to benefit from economic growth. While valuations have expanded recently, the Asia ex-Japan region still trades at a c 10-20% discount to the world and US markets, although investors should be mindful of risks associated with the end of QE and ongoing geopolitical tensions.

Valuation: Potential for discount to reverse

MCP's 11.8% discount to cum-income NAV at 8 October is narrower than the average over one, three and five years. The discount has not been below 10% since before the Lehman Brothers collapse in September 2008, and is significantly wider than the peer group average of 5.8%. However, as MCP now offers the only retail investor access to Martin Currie's ALTU strategy with daily liquidity, there is scope for the discount to narrow significantly if demand for the process is strong.

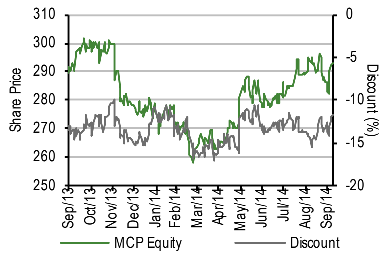
14 October 2014

Price	**293p**
Market cap	**£111m**
AUM	**£127m**
NAV*	322.4p
Discount to NAV	9.2%
NAV**	331.7p
Discount to NAV	11.8%

*Excluding income. **Including income. Data at 8 October 2014.

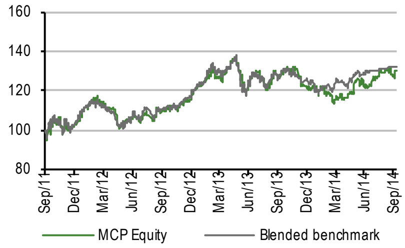
Yield	2.6%
Ordinary shares in issue	38.0m
Code	MCP
Primary exchange	LSE
AIC sector	Asia Pacific ex-Japan

Share price/discount performance*



*Including income. Negative values indicate a discount; positive values indicate a premium.

Three-year cumulative perf. graph



52-week high/low	302p	258p
NAV* high/low	342.3p	299.0p

*Excluding income.

Gearing

Gross	0.0%
Net	-5.0%

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Edison profile page

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

Exhibit 1: Martin Currie Pacific Trust at a glance

Investment objective and fund background

Martin Currie Pacific 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. Prior to 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%).

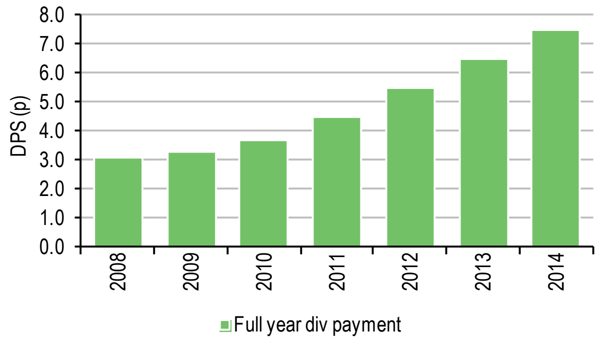
Recent developments

- 15 August 2014: IMS for three months to 30 June. NAV TR +1.8% versus 3.6% for benchmark. Price TR +5.8%.
- 10 July 2014: Patrick Gifford retires from board; Harry Wells appointed chairman.
- 10 July 2014: Investors vote in favour of change of investment policy to unconstrained Asia ex-Japan.

Forthcoming		Capital structure		Fund details	
AGM	July 2015	Ongoing charges	1.3%	Group	Martin Currie Investment Management
Half-year results	November 2014	Net cash	5.0%	Manager	Andrew Graham
Year end	31 March (was 28 February)	Annual mgmt fee	Tiered, 0.6-0.75% (see page 10)	Address	Saltire Court, 20 Castle Terrace, Edinburgh EH1 2ES
Dividend paid	November/December, August	Performance fee	No		
Launch date	1985	Trust life	Indefinite	Phone	0131 229 5252
Continuation vote	Five-yearly, next in 2015	Loan facilities	£20m revolving	Website	www.martincurriepacific.com

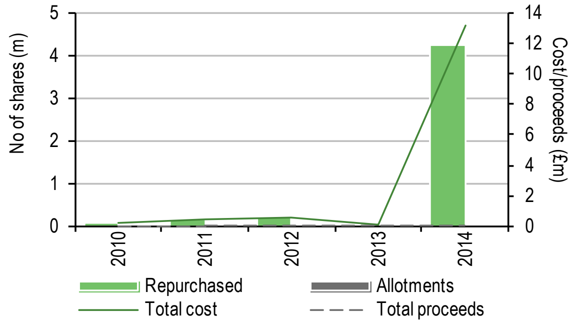
Dividend payments

Dividends paid twice yearly (since FY14) in November (moving to December following change of year-end) and August. There is a progressive dividend policy.

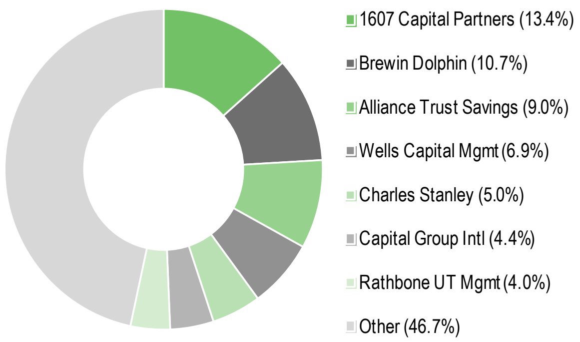


Share buyback policy and history

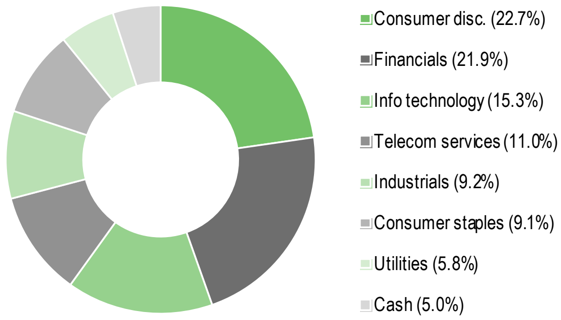
MCP may buy back up to 14.99% of its issued share capital and allot up to 5%. Shares bought back may be held in treasury. In July 2014 a tender offer saw 10% of shares bought back for cancellation.



Shareholder base (as at 9 September 2014)



Sector allocation of portfolio (GICS sectors) (as at 30 September 2014)



Top 10 holdings as at end September

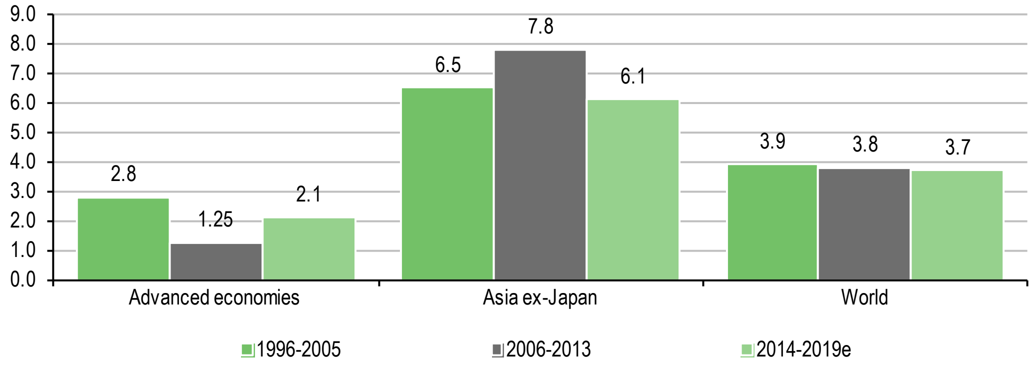
			Portfolio weight %	
Company	**Country**	**Sector**	**30 Sept 2014**	**31 March 2014***
AIA	Hong Kong	Insurance	6.0	3.1
China Mobile	China	Telecom services	4.9	N/A
HSBC	Hong Kong	Banks	4.8	N/A
Infosys	India	Software & services	4.5	N/A
Genting Berhad	Malaysia	Hotels, restaurants & leisure	4.2	N/A
Taiwan Semiconductor Mfrg	Taiwan	Semiconductors & equipment	4.1	3.9
Johnson Electric	Hong Kong	Industrials	4.1	N/A
United Overseas Bank	Singapore	Banks	4.0	N/A
Samsung Electronics	South Korea	Tech hardware & equipment	3.9	4.5
Jardine Matheson	Singapore	Industrials	3.9	N/A
Top 10 (% of portfolio)			**44.4**	**32.2**

Source: Martin Currie Pacific Trust, Edison Investment Research, Morningstar, Bloomberg. Note: *Top 10 – N/A where not in top 10 at end March 2014.

Asian market outlook: Still scope to perform

With a rapidly growing middle class, significant infrastructure investment and an expanding export base, Asian economic growth has outstripped every other geographic region over the past two decades. And while questions remain as to whether Asia, and particularly China, can continue the trajectory seen in recent years, the region is still set to lead the world in GDP growth. Latest IMF predictions (Exhibit 2) forecast average Asia ex-Japan GDP growth from 2014-19 to be 1.7 percentage points lower than the growth seen from 2006-13, but this is still well ahead of the forecast for developed economies and the world as a whole, suggesting ongoing opportunities in areas such as consumer stocks as Asian nations develop and their people continue to become more prosperous.

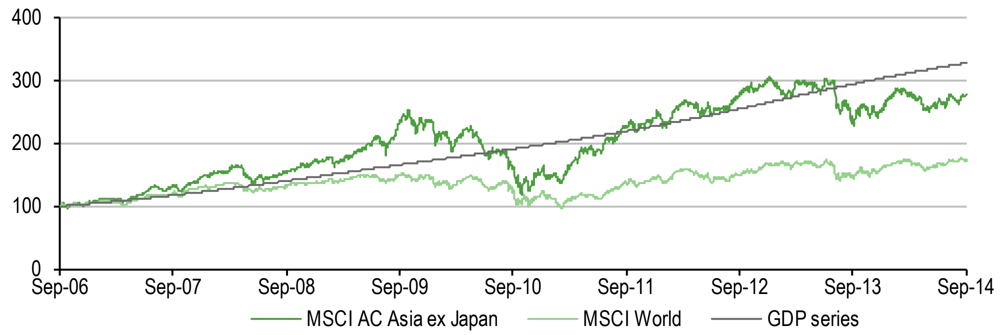
Exhibit 2: Average % real GDP growth – Asia versus advanced economies and world



Source: IMF October 2014 World Economic Forecast. Note: Asia ex-Japan group made up of MSCI Index constituents.

However, Asian economies, and Asian stock markets, are not immune to external shocks. This is evident in Exhibit 3: the MSCI Asia ex-Japan Index fell by more than the MSCI World Index during the 2008/09 financial crisis in spite of the crisis itself being largely a Western phenomenon (Asian GDP growth, measured on a three-year rolling basis, continued to rise). Growth in Asian economies is significantly associated with growth in their trading partners, while volatility in Asian stock markets is often a direct result of foreign capital flows and currency movements, particularly in the US dollar, where strength has tended to have a negative impact. Therefore, the region will not be unharmed by recession and risk-aversion in the West. Similarly, however, the pattern of economic recovery in developed markets, coupled with buoyant investor sentiment driving Western markets close to all-time highs, could point to a continued spell of positive performance in Asia.

Exhibit 3: MSCI AC Asia ex-Japan, MSCI World and Asia ex-Japan GDP over 10 years



Source: Thomson Datastream, IMF, Edison Investment Research. Note: Sterling-adjusted, total return indices.

The major risk to this scenario is the potential fallout from an end to US quantitative easing. At the current pace of tapering, the Federal Reserve is due to make its last bond purchases in October, and the expectation of monetary tightening may see capital flow back to the relative safety of US treasuries as yields begin to normalise. Risks also remain in the shape of continued geopolitical tensions in the Middle East and Eastern Europe.

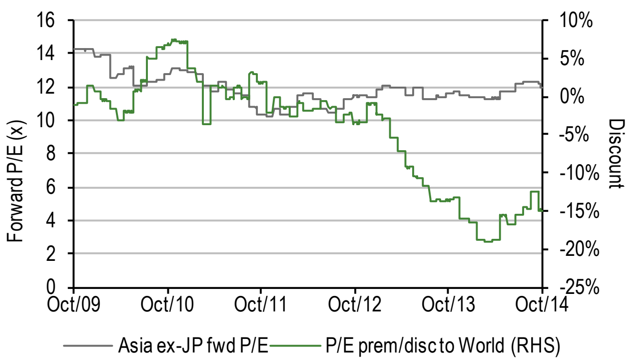
Exhibit 4: Asia ex-Japan – prospective country P/Es

Price to earnings (forward)	Last	High	Low	10-year average	Last % of average
China	8.8	36.7	8.0	14.6	61%
Hong Kong	12.5	19.6	9.2	13.5	93%
India	15.2	20.0	8.6	13.6	112%
Indonesia	15.0	15.9	7.6	13.0	115%
Korea	10.1	12.4	6.9	9.5	107%
Malaysia	16.1	16.3	10.9	14.3	112%
Pakistan	8.4	11.8	5.4	8.4	101%
Philippines	17.5	19.1	8.6	13.2	132%
Singapore	14.0	17.1	8.4	13.5	104%
Taiwan	13.3	18.0	10.4	13.2	101%
Thailand	14.3	14.3	6.7	11.1	130%
US	16.0	16.3	11.2	13.7	117%
World	14.1	14.5	10.1	12.5	113%

Source: Thomson Datastream. Note: Data at 1 October 2014. Uses Datastream indices.

Valuations in many Asian equity markets do not look stretched in relation to world averages (Exhibit 4) or relative to history (Exhibit 5); while the forward P/E ratio for Asia ex-Japan has risen in 2014, it remains at a significant discount to the forward P/E ratio for the world. Price/book, dividend yield and return on equity remain at or below 10-year averages (Exhibit 6), suggesting some value still remains for investors, particularly in light of the more favourable economic prospects for the region.

Exhibit 5: Asia ex-Japan Index prospective P/E



Source: Thomson Datastream. Note: Datastream indices.

Exhibit 6: Datastream Asia ex-Japan Index metrics

	Last	High	Low	10-year average	Last % of average
P/E(fwd) (x)	12.0	16.9	8.7	12.2	98.4%
Price to book (x)	1.7	2.8	1.1	1.7	94.3%
Dividend yield (%)	2.6	5.1	1.7	2.6	100.7%
Return on equity (%)	13.0	17.0	9.9	14.5	89.4%

Source: Thomson Datastream. Note: Data to 1 October 2014.

Fund profile: New strategy for Asian specialist

Martin Currie Pacific Trust was launched in 1985 as a pan-Asian investment trust including Japan and Australasia. After several changes in benchmark in recent years (see table on page 1), on 30 May 2014 the trust's board proposed a change in investment policy to a focused, unconstrained Asian fund excluding Japan and Australasia, aiming to achieve total returns commensurate with nominal GDP growth in the region (on a rolling three-year basis). The proposal was accepted by investors at the AGM in July and the process of rebalancing the portfolio is now largely complete.

MCP continues to be managed by Martin Currie's Asia investment team, led by Andrew Graham in Edinburgh. The team designed the Asia Long-Term Unconstrained (ALTU) investment strategy the trust has adopted, but also runs relative-return portfolios. ALTU has returned 16.1% a year net of fees (annualised) since launch in 2008, compared with 16.3% for the MSCI AC Asia ex-Japan Index. Martin Currie Investment Management specialises in overseas equities, with 30% of its assets in Asian portfolios and a further 10% each in Japan and China. The company has agreed to become a wholly owned affiliate of US-based Legg Mason in a deal expected to complete this year.

Under the terms of the agreement, Martin Currie will retain operational and investment autonomy, so there should be no client impact as a result of the change of ownership.

The fund managers: Andrew Graham and team

Background to the change in strategy

Investor appetite for Asia including Japan strategies has been limited, and following MCP's adoption of an ex-Japan approach, there is only one pan-Asian investment trust remaining in the market. The managers note that investors tend to prefer to allocate to Japan and the rest of Asia separately, as the two areas have very different macroeconomic fundamentals and are suited to different investment styles. Index-relative strategies have also been less in demand, as investors have moved to a more absolute return mindset. The MCP board's decision to move to an Asia ex-Japan approach gave Martin Currie the opportunity to offer its ALTU strategy in a retail fund with daily dealing. Previously the approach was only available in offshore or SICAV funds and segregated mandates with weekly, fortnightly or monthly liquidity, but the closed-ended structure of MCP favours the long-term buy-and-hold strategy, as the managers do not have to manage inflows and outflows as would be the case in an open-ended fund such as an OEIC. It is anticipated that the new strategy will lead to both an improvement in MCP's performance, which has been lacklustre, and a narrowing in its discount, which has been persistently wide.

The manager's view: Looking for good stewards of capital

Lead manager Andrew Graham has more than 20 years' experience in Asian equities. He joined Martin Currie in 2010 and became head of the Asian team in March 2013 following the departure of Jason McCay. Graham says the ALTU strategy was born out of the observation that returns for Asian equity investors had been disappointing compared with the region's impressive GDP growth since the 1990s. The primary reason for this is that GDP growth in Asia has tended to be very capital-intensive, but with so many investors keen to be part of the Asian growth story, capital has been cheap, and so use of capital has not been disciplined. As a result, sustainable, industry-standard returns on capital have not been achieved, leading to disappointing performance for many.

In an environment where it is easy to raise money from investors, companies can begin to see the stock market as a 'piggy bank', issuing new shares to raise money for sometimes ill-judged expansion, which in turn dilutes returns for existing shareholders. Graham says the idea of ALTU was to find companies that were exposed to the growing economy, but would act as responsible stewards of investors' capital, avoiding dilution and allowing the benefits of growth to compound over time. This also has the benefit of lowering volatility compared with the market, as self-funding businesses with strong balance sheets are likely to weather storms better than those in a weaker financial position. "We can't forecast economic cycles so we want companies that can navigate whatever the global economy throws at them," says Graham.

While not 'deep value' investors, the team are not prepared to overpay for growth. "We look at intrinsic value over long periods, which allows us to look through shorter periods of earnings volatility," Graham explains.

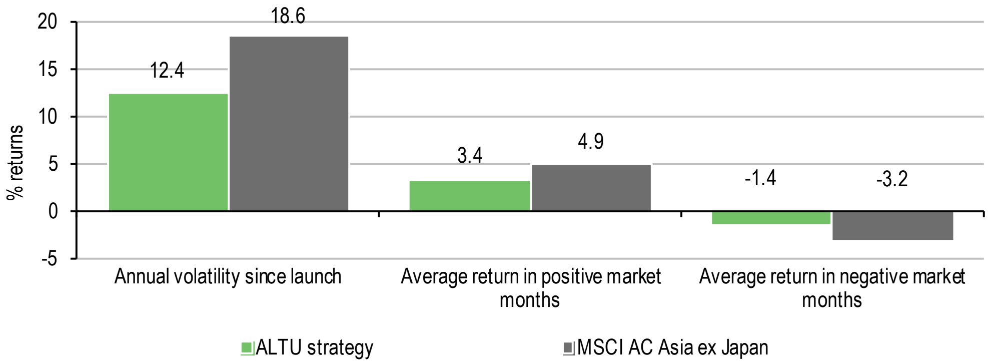
The unconstrained style leads the team to look at all shapes and sizes of company, from large global players to smaller, family-owned businesses. Graham says the quality of engagement from management is an important factor in investment decisions, but it is not necessarily the small firms that are more responsive: "Sometimes companies don't want to talk to us, or they don't understand why we are asking these questions. With family owned businesses, some are focused on achieving long-term returns both for their own interests and those of minority shareholders, while some seem less bothered. With a large company like HSBC, we have a very good relationship even though we will only ever be a small shareholder."

Asset allocation

Investment process: Asia Long-Term Unconstrained (ALTU)

Martin Currie's Asia Long-Term Unconstrained investment strategy was set up in October 2008 and now accounts for roughly half the firm's Asian assets under management ($1.7bn of c $3.2bn). Its aim is to capture Asian GDP growth over the long term, at lower volatility than the market (although there is no specific volatility target). The strategy is long-only, with an absolute return mindset, and does not hedge currency exposure. As shown in Exhibit 7, it has tended to capture the majority of market upside since launch, while outperforming in falling markets. Turnover is low – generally less than 30% a year, implying at least a three-year holding period – in line with the long-term buy-and-hold philosophy. Only 12 stocks have been fully exited in the six-year life of the ALTU strategy.

Exhibit 7: Volatility and upside/downside participation of ALTU strategy since inception



Source: Martin Currie Pacific Trust. Note: Inception date is 31 October 2008. Data to 31 July 2014.

While the strategy is not constrained by any index and can invest across the Asia ex-Japan universe in stocks of any size, there are some broad risk controls, limiting position sizes to a maximum of 10% of the portfolio at purchase, and a maximum of 10% of a company's shares. The ALTU portfolio is concentrated, with 20-30 stocks chosen for their ability to grow with the region, and to translate that growth into good returns for shareholders. Risk is also managed through diversification by country, sector and business maturity, and at the stock level by undertaking thorough due diligence to identify sound businesses.

The seven-strong Asian equities team at Martin Currie are mostly based in Edinburgh (investment director Paul Danes is based in Singapore), but regularly travel to Asia, meeting around 500 companies a year for both ALTU and relative return strategies. Initial screening of the Asian market filters out illiquid stocks, bringing the universe down to c 1,200-1,300 companies. Analysis using Holt and a tool designed by Graham called AsiaVal evaluates stocks for return on capital, cash flow and earnings metrics, and valuation, and provides a ranking for all stocks, with those in the top three deciles (c 360-390 companies) considered as candidates for inclusion in portfolios. Within this group, the Martin Currie team looks for companies with stable and responsive management teams with a good track record of capital allocation.

For the couple of hundred potential investments that reach this stage of the process, team members work up a brief investment case for why or why not, and Graham and Danes then decide which companies progress to financial modelling and meeting with management. This stage of the process focuses on identifying sustainable growth, assessing competitive positioning and evaluating strategic direction, modelling for long-term cash returns and growth and estimating intrinsic value versus current market value. Long-term cash flows are discounted at 10%, which is the minimum required rate of return for a company to be included in the ALTU strategy. The models are used as a framework for discussion with companies and a way of ongoing monitoring, and to help the team understand the sensitivity of valuations to changes in key metrics and think more rationally about the valuation. Graham says the whole screening process allows the team to filter out "the weak and the lucky" and find good companies at good prices. After the modelling stage, team members will meet with company management, before Graham and Danes decide whether to proceed to the forensic accounting stage of the process (described below). Companies that get through this stage will only be added to the portfolio if they can be bought at a meaningful discount to long-term value. Graham says: "The best company in the world can be a lousy investment at the wrong price."

As ALTU is long-term buy-and-hold strategy, companies do not move in and out of the ALTU portfolio very often. A stock may be sold if there is a structural change in the business that has a negative impact on the long-term investment case; if there is a breach of good corporate governance; if the market value of the company is significantly above Martin Currie's valuation; or if other investments offer significantly superior potential. The team runs stock screens every five to six weeks and there is a constant process of re-evaluation of holdings.

Forensic accounting and corporate governance analysis

Martin Currie uses forensic accounting to gain a competitive advantage over time-poor investors who may read company information electronically but lack the capacity to go back over several years' accounts before making an investment. The function is outsourced to a qualified team in the Indian subcontinent, who undertake careful analysis of five years of company reports to assess whether there have been any breaches, changes in accounting policy or corporate governance that diverge from best practice or are contrary to investors' interests, and the significance of any such developments. The output of this process is a 40-60 page Accounting Diagnostic Report, which the ALTU team uses as the basis for a traffic light analysis of potential investments for accounting and corporate governance issues. Around 20 companies each year go forward to the forensic accountancy stage; last year the system produced three candidate investments, of which only one was bought as the price on the other two was deemed to be too high.

Current portfolio positioning

At 30 September Martin Currie Pacific had 28 holdings across eight countries; the ALTU strategy has 26 holdings so the number of stocks in MCP should fall a little in the short term as the final stocks from the old strategy are sold (disposal of some has been delayed so as not to miss out on dividends).

The ALTU process focuses on quality, cash-generative companies with low levels of debt. As shown in Exhibit 8 this leads to a higher average price/earnings and price/book value than the broad MSCI Asia ex-Japan Index, but also higher returns on equity and a focus on companies that have enough cash to be self-funding and are therefore less likely to dilute equity investors' holdings by further share issuance to fund growth.

Exhibit 8: Portfolio characteristics

End-August 2014	MCP portfolio	MSCI AC Asia ex-Japan
Price/earnings*	15.2	11.6
Price/book	2.3	1.6
Yield (%)	2.7	2.7
EV/EBIT	12.4	11.9
EV/EBITDA	8.8	7.2
Net debt to equity (%)	-10.2	31.0
Return on equity* (%)	15.0	13.5

Source: Martin Currie Pacific Trust. Note: *Indicates consensus forecasts.

The rebalancing of the portfolio to the new strategy has led to significant changes in country exposure (see Exhibit 9), not just as a result of exiting from Japan and Australia (previously the two largest country weightings) but also as a result of stock-specific factors. Graham explains that although almost half the portfolio is now in Hong Kong and Singapore, these markets contain a geographically diverse range of companies: insurer AIA operates in 17 Asian countries; HSBC is global but generates around 70% of its profits in Asia; and United Overseas Bank in Singapore has significant business elsewhere in Asia. The average market capitalisation of holdings is just over $50bn, although this is dragged upwards by the presence of HSBC (4.8% of the portfolio); the smallest stock held is just over $2.0bn.

Exhibit 9: Exposure by country (% unless stated)

	Portfolio end September 2014	MSCI Asia ex JP weight	Active weight vs index (% pts)	Trust weight/ index weight (x)	Portfolio end March 2014	Change from March (% pts)
Hong Kong	31.0	12.4	18.7	2.5	12.5	18.5
Singapore	17.2	6.3	10.9	2.7	N/A	N/A
India	17.0	9.0	8.0	1.9	3.9	13.1
China	10.7	24.6	-13.9	0.4	12.7	-2.0
Malaysia	7.2	5.0	2.2	1.4	2.7	4.5
Taiwan	4.1	15.2	-11.1	0.3	7.6	-3.5
South Korea	4.0	19.2	-15.3	0.2	10.0	-6.0
Thailand	3.8	3.1	0.7	1.2	5.6	-1.8
Indonesia	0.0	3.4	-3.4	0.0	N/A	N/A
Australia	0.0	0.0	0.0	N/A	14.8	-14.8
Japan	0.0	0.0	0.0	N/A	24.3	-24.3
Other	0.0	1.8	0.0	0.0	5.9	-5.9
Cash	5.0	0.0	5.0	N/A	0.0	5.0
	100.0	**100.0**			**100.0**	

Source: Martin Currie Pacific Trust, Edison Investment Research. Note: Rounding errors mean some figures may not sum. MSCI 'other' includes the Philippines. MCP Singapore and Indonesia weightings were not individually stated at 31 March.

At a sector level (Exhibit 10) there is large weighting to consumer stocks, which are more directly exposed to the wealth effects of GDP growth in the region. There is no exposure to materials and energy on the basis that it is hard for companies in these areas to sustain returns on capital. Barriers to entry are lower when commodity prices are high, as a higher cost of production can be borne, but higher-cost producers inevitably tend to produce worse outcomes for investors. In addition, most resources and materials companies have little control over either input costs or the selling price of their goods. Of the sectors where the trust does have exposure, financials and information technology are the biggest underweights compared with the index, although they are the second and third largest weightings on an absolute basis. The cash position of 5% is expected to fall into line with the ALTU strategy, which has a long-term average cash level of c 2%.

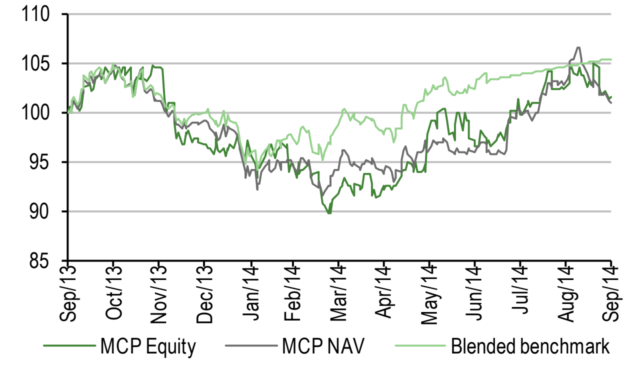
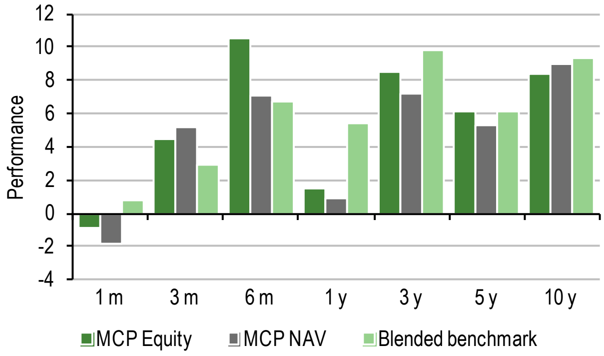
Exhibit 10: Sector allocations (% unless stated)

	Portfolio end September 2014	MSCI Asia ex JP index weight	Active weight vs index (% points)	Trust weight/index weight (x)
Consumer disc.	22.7	9.3	13.4	2.4
Telecom services	11.0	6.7	4.2	1.6
Consumer staples	9.1	5.4	3.7	1.7
Utilities	5.8	4.1	1.7	1.4
Industrials	9.2	8.6	0.6	1.1
Healthcare	0.0	1.8	-1.8	0.0
Other	0.0	2.5	-2.5	0.0
Info technology	15.3	18.6	-3.3	0.8
Materials	0.0	5.2	-5.2	0.0
Energy	0.0	5.9	-5.9	0.0
Financials	21.9	31.8	-9.9	0.7
Cash	5.0	0.0	5.0	N/A
	100.0	**100.0**	**0.0**	

Source: Martin Currie Pacific Trust, Edison Investment Research, MSCI. Note: Ranked by active weight (excluding cash). Sector classifications in line with MSCI index methodology using GICS sectors.

Performance: Early days, but change seems positive

Exhibit 11: Investment trust performance

Price, NAV and benchmark one-year total return performance	Price, NAV and benchmark total returns (%)*
	

Source: Thomson Datastream, Edison Investment Research. Note: *Three-, five- and 10-year figures annualised. Data to 30 September.

Exhibit 12: Share price and NAV total return performance, relative to indices

	One month	Three months	Six months	One year	Three years	Five years
Price relative to blended benchmark	(1.7)	1.5	3.6	(3.7)	(3.4)	(0.0)
NAV relative to blended benchmark	(2.6)	2.2	0.4	(4.3)	(6.9)	(3.9)
Price relative to MSCI AC Asia ex Japan	2.8	0.6	1.7	(6.3)	(3.1)	(3.5)
NAV relative to MSCI AC Asia ex Japan	1.8	1.3	(1.5)	(6.9)	(6.7)	(7.2)
Price relative to MSCI World	(0.6)	1.1	4.4	(9.9)	(20.2)	(20.9)
NAV relative to MSCI World	(1.6)	1.8	1.2	(10.4)	(23.1)	(24.0)
Price relative to GDP series	(1.7)	2.0	5.2	(8.8)	(14.3)	(32.0)
NAV relative to GDP series	(2.6)	2.7	1.9	(9.4)	(17.4)	(34.6)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end September 2014. Geometric calculation.

MCP's past performance is of limited relevance to new investors given the recent change in strategy. However, the blended benchmark used here for comparison purposes does include three-year rolling nominal GDP growth for the countries that make up the MSCI Asia ex-Japan Index (with effect from 11 July 2014). As can be seen in Exhibit 11 (left-hand chart), MCP's share price and NAV total returns recovered significantly following the end of May, when the new strategy was first proposed, before drifting off a little during September. NAV and share price total returns have generally been more positive versus regional and global indices over three and six months, but the tendency to underperform over longer periods (Exhibit 11 right-hand chart and Exhibit 12) was a factor in the adoption of the new strategy. An uptick in relative performance when the trust took on the ALTU approach (relative performance based on three-year rolling GDP growth) is evident in Exhibit 13, although some of this relative gain was given back in September.

Exhibit 13: NAV performance relative to blended benchmark over 10 years

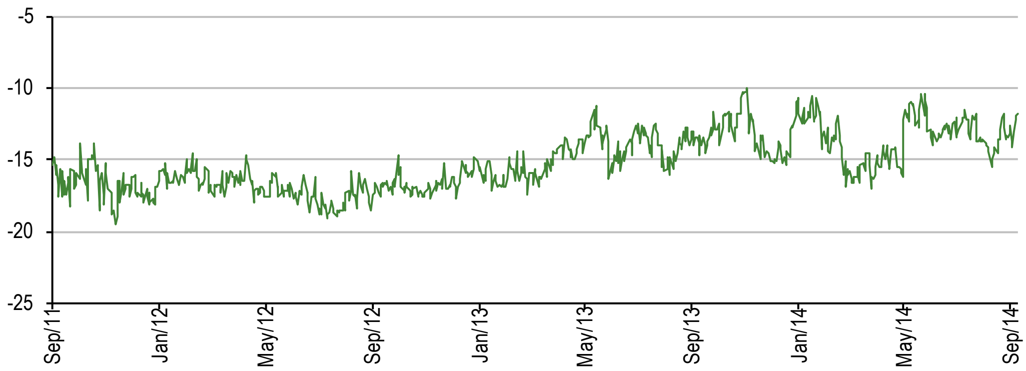
Source: Thomson Datastream, Edison Investment Research

Discount: Scope to narrow under new strategy

At 8 October MCP shares traded at an 11.8% discount to cum-income net asset value. This is narrower than the averages over one, three and five years (13.4%, 15.2% and 15.6% respectively) and only a little wider than the five-year low of 10% reached in December 2013.

MCP's board may allot up to 5% and buy back up to 14.99% of shares. Buybacks may be undertaken to manage the discount, provide liquidity or enhance NAV for remaining shareholders. There is no formal target level of discount that will trigger a buyback, and buybacks have been relatively small and infrequent: in FY14 37,591 shares were bought back into treasury at a cost of £113,000. The tender offer undertaken in July (see Capital structure section) has had little discernible effect on the discount, which averaged 13.2% (cum-income) over the three months to 8 October. However, if the ALTU process proves a success in the closed-ended structure, the fact that MCP represents the only way for UK retail investors to access the strategy in a vehicle with daily liquidity could see the discount narrow as a result of increased demand, perhaps to a level closer to the 5-6% average for the Asia ex-Japan sector.

Exhibit 14: Discount over three years (to cum-income NAV with debt at fair value)



Source: Thomson Datastream, Edison Investment Research.

Capital structure and fees

Martin Currie Pacific is a conventional investment trust with one class of share. There are 38.0m ordinary shares in issue plus a further 1.5m held in treasury. A 10% tender offer in July 2014 (timed to coincide with the new investment mandate) was oversubscribed, with 52.7% of shares being validly tendered. Under the tender offer, 4.23m shares were bought back for cancellation at 312.18p per share, a 3% discount to cum-income NAV minus costs.

The trust is permitted to gear up to 20% of net assets and to hold up to 15% net cash. It has a £20m revolving bank loan, of which £4.1m (in yen ¥688m) was drawn at the 31 March year-end. Under the ALTU strategy the managers do not expect to use gearing to finance investments, although subject to board approval they may consider using a small amount of leverage to offset the payment of dividends, as long as the incremental volatility this implies can be kept within acceptable bounds. (The other vehicles using the ALTU strategy do not pay dividends, instead reinvesting all income to compound as future growth.) At 31 August MCP had net cash of 7.1%, partly as a result of the process of rebalancing the portfolio.

Martin Currie Investment Management receives a management fee of 0.75% of net assets up to £150m and 0.6% of net assets thereafter. This fee arrangement was renegotiated in FY14 and has been in place since 1 January 2014. Prior to this the fee was 1% of net assets up to £150m, 0.85% between £150m and £225m, and 0.75% thereafter. As a result ongoing charges fell from 1.4% in FY13 to 1.3% in FY14. As noted in the Peer group section below, ongoing charges are above average for the sector, partly as a result of the greater impact of other fixed costs (which were higher in FY14 than in FY13 even adjusting for the 13-month financial year) on a relatively small fund, and partly because the 31 March year-end means only three months under the new fee structure were captured in the ongoing charge for FY14. There is scope for the ongoing charges figure to fall should the trust grow its net assets, either as a result of portfolio performance or expansion in the number of shares in response to higher demand.

The trust is subject to a five-yearly continuation vote, with the next vote due to take place at the AGM in July 2015.

Dividend policy and record

MCP has a progressive dividend policy that is unlikely to change under the new investment mandate. The board recognises the importance of income in a low-yield environment and therefore sees raising the portfolio yield and increasing the dividend as an important part of its overall strategy. Looking at the record since 2008, dividends have been raised every year, with only one year (FY09) seeing an increase of less than 10% on the year before. Dividends have been partly uncovered in four of the seven years. However, MCP has a sizeable revenue reserve (£3.63m at 31 March 2014, equivalent to more than one full year's dividend payment based on the FY14 dividend of 7.5p per share) that the board has stated it intends to distribute over time.

In recognition of the increased level of dividend (up from 3.1p in 2008 to 7.5p in 2014), in its last financial year MCP moved from a single dividend payment in July to two payments: an interim, paid in November 2013 but moving to December following the change in year-end from 28 February to 31 March, and a final dividend in August. The 7.5p dividend for FY14 represents a yield of 2.6% based on the 8 October share price of 293p.

Peer group comparison

Exhibit 15 shows a comparison of the 15 investment trusts in the Association of Investment Companies' Asia Pacific ex-Japan sector that have a track record of three years or more. Given MCP's recent change in strategy its past performance is of limited relevance to future investors. It is currently the smallest trust in the sector. In terms of NAV total return performance it ranks 15th over one and three years and 13th over five years. Risk-adjusted performance as measured by the Sharpe ratio is well below average over both one and three years. MCP has the third highest ongoing charge in the sector at 1.3%; this is largely a function of the impact of fixed costs on a relatively small portfolio, as its management fee is a competitive 0.75%. The net cash position (one of the highest in the sector) is partly a result of the process of rebalancing. MCP's yield is the fourth highest in the sector.

Looking at other funds in the sector, those with a differentiated approach have in many cases performed better than average. There are three income specialists whose high yields have helped boost total returns over the longer periods, though they all lag the average over one year. The two smaller companies trusts in the sector are significantly ahead over five years. Pacific Assets Trust, which also focuses on finding companies that are good stewards of investors' capital, without reference to benchmark weightings, provides an interesting comparator (although not a guide to the potential performance of MCP's new strategy); its NAV total return places it near the top of the sector over one, three and five years, showing the value of a differentiated approach in more muted market conditions.

Exhibit 15: Asia Pacific ex-Japan investment trusts

% unless stated	Market cap £m	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	Discount (-) /premium	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
Martin Currie Pacific	**115.7**	**0.3**	**23.6**	**28.8**	**1.3**	**No**	**-12.2**	**93.0**	**2.2**	**0.4**	**0.5**
Aberdeen Asian Income	392.3	2.0	44.5	84.8	1.2	No	0.0	105.0	3.9	0.6	0.9
Aberdeen Asian Smaller	368.4	7.8	74.1	161.0	1.2	No	-3.9	110.0	1.0	0.8	1.1
Aberdeen New Dawn	224.2	4.7	31.0	56.5	1.1	No	-9.6	108.0	2.0	0.8	0.5
Asian Total Return Inv Company	136.4	7.2	29.0	24.3	0.8	Yes	-6.7	99.0	1.8	1.0	0.2
Edinburgh Dragon	539.3	4.3	32.2	57.0	1.2	No	-9.5	108.0	0.8	0.8	0.5
Fidelity Asian Values	158.3	11.1	42.0	55.5	1.6	No	-10.3	112.0	0.5	1.6	0.7
Henderson Far East Income	345.5	3.0	44.9	41.9	1.3	No	0.0	102.0	5.7	1.0	0.7
Invesco Asia	162.4	15.6	43.2	60.6	1.1	No	-11.0	102.0	1.9	1.7	0.7
JPMorgan Asian	200.1	4.5	28.0	24.2	0.8	Yes	-12.6	107.0	1.2	1.0	0.3
Pacific Assets	219.4	17.2	65.5	77.3	1.2	Yes	-1.3	90.0	1.4	1.9	1.3
Pacific Horizon	125.5	10.7	35.9	40.7	1.2	No	-8.5	102.0	0.8	1.7	0.7
Schroder Asia Pacific	441.7	8.2	44.1	69.4	1.1	No	-10.7	99.0	1.3	1.3	0.7
Schroder Oriental Income	417.5	5.3	50.6	90.9	1.0	Yes	1.1	105.0	4.0	1.1	1.0
Scottish Oriental Smaller Cos	276.9	13.8	74.1	134.4	1.0	Yes	-4.6	93.0	1.3	1.5	1.1
Sector weighted average		**7.0**	**46.2**	**74.8**	**1.1**		**-5.8**	**103.1**	**2.2**	**1.1**	**0.8**
MCP rank in sector	**9**	**15**	**15**	**13**	**3**		**14**	**13**	**4**	**15**	**13**

Source: Morningstar, 9 October 2014, Edison Investment Research. Notes: TR = NAV total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show 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 shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds.

The board

Martin Currie Pacific has five directors. Harry Wells joined the board in 2003 and became chairman in July 2014 following the retirement of Patrick Gifford. John Scott (chairman of the audit committee) has been a director since 2002. Gregory Shenkman (senior independent director) and Peter Edwards were appointed in 2007, while Anja Balfour joined the board in 2012. All the directors have significant Asian experience and four of the five have investment backgrounds; Edwards' career was as a lawyer.

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