EDISON

Pacific Assets Trust

Asian specialist with differentiated approach

Investment trusts

Pacific Assets Trust (PAC) is a specialist Asia ex-Japan investment trust with a differentiated investment process, seeking to invest in companies that contribute to, or benefit from, the sustainable development of the Asian region. It has recently passed its fifth anniversary under its current manager, and has outperformed the MSCI AC Asia ex-Japan index in the past four discrete years in terms of both share price and NAV total return. The trust has low exposure to China, does not use gearing and has a net cash weighting of c 11%, which could mitigate near-term volatility. Moreover, the manager is looking for opportunities to reinvest cash in favoured stocks on any significant market pullback.

12 months ending	Share price (%)	NAV (%)	MSCI AC Asia ex-Japan (%)	MSCI World (%)	FTSE All-Share (%)
30/06/12	0.3	0.0	(11.1)	(2.2)	(3.1)
30/06/13	24.8	21.0	12.9	23.3	17.9
30/06/14	11.8	7.0	3.5	10.6	13.1
30/06/15	20.9	17.0	13.2	10.9	2.6

Source: Thomson Datastream. Note: Total return basis.

Investment strategy: Responsible stewards of capital

PAC is managed by the Sustainability team at Stewart Investors, part of the First State Investments stable. The team focuses on being a responsible steward of investors' capital over the long term, and seeks to invest in companies with a similar aim. The research process looks to identify quality businesses with sound growth prospects, and team members travel frequently to meet companies. Quality is assessed in terms of management, franchise and financials, as well as sustainability positioning. All investments are made with at least a five-year view, focusing on absolute rather than relative return potential.

Outlook: Balance of positive and negative factors

Asian markets have seen a pullback in recent weeks, driven by a sharp correction in domestic Chinese A shares following runaway gains. This may prove a long-term buying opportunity given that at a regional level, Asian P/E valuations are in line with 10-year averages, while most Western markets are trading at significant premiums. However, with uncertainty surrounding the pace and timing of US interest rate increases, and concern over whether the Chinese government can successfully manage the country's transition to a lower growth path, there may be volatility ahead over the near term.

Valuation: At a slight premium after rerating

At 27 July, PAC's shares stood at a 1.5% premium to cum-income net asset value, following a period of steady rerating since earlier in the year. This premium compares with an average discount of 1.7% over one year, 5.3% over three years and 7.0% over five years, and may reflect the trust's differentiated investment process as well as its strong performance history (first in its peer group over one and three years). PAC has recently issued new shares to meet demand, the first time it has done so.

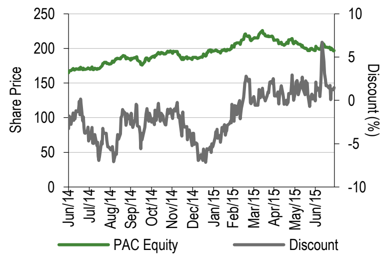
30 July 2015

Price	**198p**
Market cap	**£232m**
AUM	**£226m**
NAV*	192.6p
Premium to NAV*	2.3%
NAV**	194.1p
Premium to NAV**	1.5%
Yield	1.3%

*Excluding income. **Including income. Data at 27 July 2015.

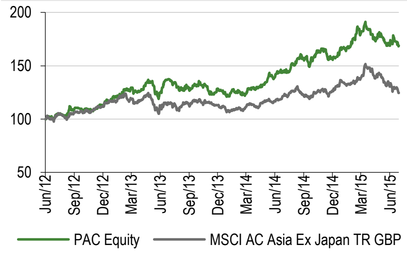
Ordinary shares in issue	117.3m
Code	PAC
Primary exchange	LSE
AIC sector	Asia Pacific – ex-Japan

Share price/discount performance*



*Including income. Positive values indicate a premium; negative values indicate a discount.

Three-year cumulative perf. graph



52-week high/low	226.0p	169.5p
NAV* high/low	222.9p	177.8p

*Excluding income.

Gearing (30 June 2015)

Gross	0%
Net	-10.6%

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Edison profile page

Pacific Assets Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

Pacific Assets Trust (PAC) aims to achieve long-term capital growth through investment in selected companies in the Asia-Pacific region and the Indian sub-continent, but excluding Japan, Australia and New Zealand. Up to 20% of total assets may be invested in companies incorporated and/or listed outside the region if economic activities are predominantly within the region. The limit for a single investment is 7.5% of total assets at the time of investment. The benchmark is the MSCI AC Asia ex-Japan Index (total return, sterling adjusted).

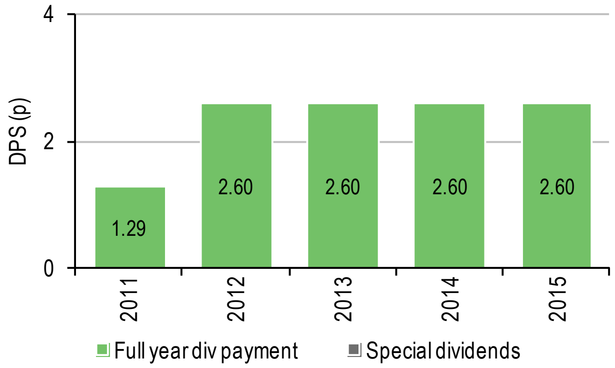
Recent developments

- 24 June 2015: retirement of chairman David Nichol from the board. James Williams takes over as chairman.
- 27 March 2015: annual results for the year-ended 31 January. NAV total return of 32.6% compared with 24.1% for MSCI AC Asia ex Japan index.

Forthcoming		Capital structure and fees		Fund details	
AGM	June 2016	Ongoing charges	1.3%	Group	Frostrow Capital LLP
Half-year results	September 2015	Net gearing	-10.6%	Manager	First State Stewart
Year end	31 January	Annual mgmt fee	0.9% of NAV +0.15% of NAV up to £275m and 0.1% above (page 7).	Address	25 Southampton Buildings, London, WC2A 1AL
Dividends paid	June	Performance fee	No (effective 01/02/15)		
Launch date	January 1985	Trust life	Indefinite	Phone	+44 (0)20 3008 4910
Continuation vote	No	Loan facilities	None currently	Website	www.pacific-assets.co.uk

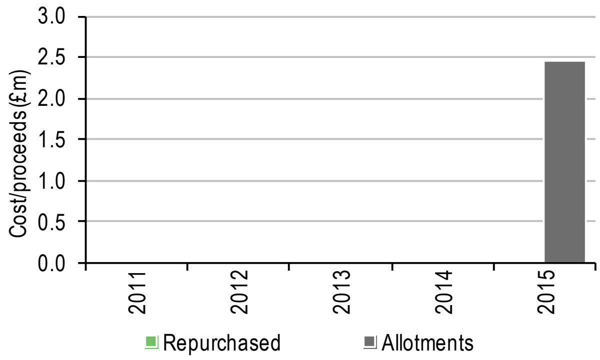
Dividend policy and history

An annual dividend is paid in June. PAC is focused on capital growth. Income generation is secondary and dividends are likely to fluctuate.

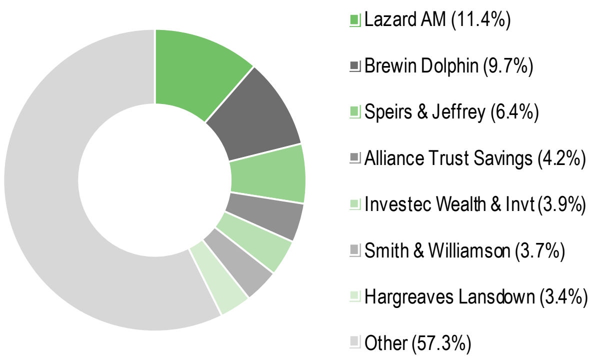


Share buyback policy and history

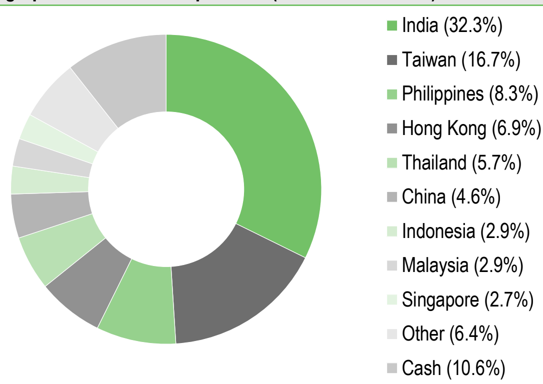
The board has a repurchase authority (14.99%), which it has not used since July 2010. New shares up to 10% of shares in issue may be allotted.



Shareholder base (as at 16 July 2015)



Geographical allocation of portfolio (as at 30 June 2015)



Top 10 holdings (as at 30 June 2015)

			Portfolio weight %	
Company	**Country**	**Sector**	**30 June 2015**	**31 December 2014***
Marico	India	Consumer staples	5.5	4.6
Vitasoy International Holdings	Hong Kong	Consumer staples	5.5	4.0
Tech Mahindra	India	Information technology	4.9	5.9
Delta Electronics (Thailand)	Thailand	Information technology	4.5	3.7
Standard Foods	Taiwan	Consumer staples	4.2	3.2
Idea Cellular	India	Telecom services	3.4	3.1
E Sun Financial Holding	Taiwan	Financials	3.4	3.2
Taiwan Semiconductor Mfrg	Taiwan	Information technology	3.2	4.2
Dr Reddy's Laboratories	India	Health care	3.0	N/A
Kotak Mahindra Bank	India	Financials	2.9	3.1
Top 10 (% of portfolio)			**40.5**	**38.2**

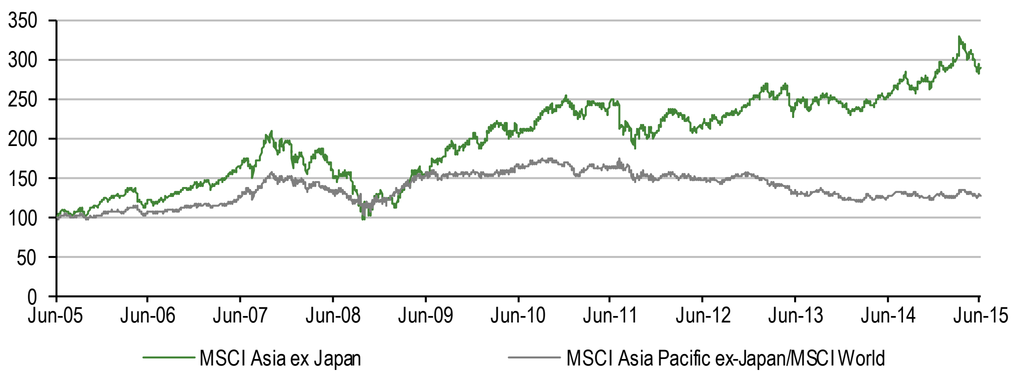
Source: Pacific Assets Trust, Morningstar, Bloomberg, Edison Investment Research. Note: *N/A where not in top 10 at end-December 2014.

Market outlook: Short-term pain, long-term gain?

Equity markets across Asia have seen fallout in recent weeks from a correction in the Chinese A share market, with the MSCI AC Asia Pacific ex-Japan index falling 8.6% in total return terms from its mid-April peak to 20 July. As seen in Exhibit 2, absolute returns from Asia have been strong in the post-2008 period, although relative to the world market they have lacked sparkle. Sources of uncertainty remain, such as the pace and timing of US interest rate rises and how successfully the Chinese government can manage the country onto a lower and more sustainable growth path.

However, despite lower economic growth than previously, Asia is still on track to outperform the rest of the world. The IMF forecasts a compound annual GDP growth rate for Asia ex-Japan of 5.8% for 2015-20, compared with 7.1% for 2005-14. The comparable figures for the developed G7 countries are 1.9% and 1.1% respectively, reflecting the greater economic impact on the West of the global financial crisis. With a large, young population and a steadily, if no longer so rapidly growing regional economy, it should still be possible for long-term investors in Asia to find companies with good growth potential, although valuations in some markets may be less attractive than others.

Exhibit 2: MSCI AC Asia ex-Japan index, and relative to the MSCI World index



Source: Thomson Datastream. Note: MSCI AC Asia ex-Japan Index is trust benchmark. TR in £ terms.

Fund profile: Sustainably positioned Asian specialist

Pacific Assets Trust (PAC), launched in 1985, has been managed since 1 July 2010 by a division of First State Investments, a subsidiary of Commonwealth Bank of Australia. The trust invests principally for long-term capital growth across the Asian region, excluding Japan and Australasia, and is managed on a bottom-up basis with a strong sustainability focus to stock selection. It uses the MSCI AC Asia ex-Japan index as a benchmark for performance comparison, although its focus is on achieving absolute rather than relative returns, so both the portfolio and its performance may deviate substantially from that of the index.

First State Stewart splits into two competing teams

PAC's manager will be known as Stewart Investors following First State Stewart's split into two teams with effect from 1 July. Stewart Investors is based in Edinburgh and manages global emerging markets and sustainability funds and Angus Tulloch's flagship First State Asia Pacific Leaders portfolio, in addition to PAC. FSS Asia is headquartered in Hong Kong and manages regional and single-country Asian funds including the Scottish Oriental Smaller Companies trust. The split is designed to facilitate rather than impede idea generation, as the new, smaller teams will have more time for interaction and sharing research, and a more specialist focus. Both companies are still owned by Commonwealth Bank of Australia, but are separated by Chinese walls.

The fund manager: Stewart Investors

The manager's view: Valuations high, but opportunities remain

Valuations are currently one of the biggest sources of concern for PAC's management. Senior investment manager David Gait says the team has the highest cash level across its portfolios in 25 years, largely as a result of trimming or exiting positions in favoured stocks as they approach or exceed valuation targets. Cash is being kept on the sidelines to be deployed in the event of a correction either at the market or individual stock level. (The recent turmoil in Chinese markets is unlikely to have sparked significant activity, however, as less than 5% of the trust is invested there).

Gait sees some of the more recent froth in the region as symptomatic of market short-termism, with high-frequency trading enriching market intermediaries rather than investors. While a cause of near-term volatility, Gait says such near-sighted practices are beneficial to long-term investors like PAC, as stable, good-quality businesses may be overlooked in favour of the latest hot stock story.

While higher valuations may have led to fewer immediate opportunities, Gait says the investment universe in Asia continues to expand, as stock market culture is entrenched in the region and families see floating the businesses they have built as an important and logical step. "There are lots of new businesses listing all the time, although maybe only one in a hundred would interest us," he adds.

One of the major sustainability trends Gait observes at present is in renewable energy, with the price of solar panels coming down to a level where, in most countries, solar is in a position to compete on cost with fossil fuels, without the need for subsidies. The next piece of this jigsaw is the development of storage batteries for home use, currently at an early stage but with the potential to provide energy self-sufficiency for consumers and further sustainability benefits such as small-scale desalination to reduce water scarcity. While this could negatively affect the oil price and firms that are exposed to fossil fuels (such as traditional power generators), it could benefit businesses like portfolio holding Delta Electronics, which specialises in connecting devices to power points. Gait points out that whichever of the competing battery storage systems becomes the eventual market leader, Delta could work with it to provide connectivity.

Asset allocation

Investment process: Sustainability, quality, valuation

PAC's investment approach is unusual in that it hinges on a focus on sustainability and seeks to invest in companies that contribute to, or benefit from, the sustainable development of Asia and the wider world. The team believes human development is not just a social issue, but the biggest long-term investment issue: China, India and Indonesia can clearly not follow the same resource-hungry development pattern as the West a century ago, and this gives rise to investment opportunities to address the challenges of health and nutrition, land and water scarcity and energy use among others.

Members of the PAC investment team aim to be responsible stewards of investors' capital over the long term, and focus on investing in companies with the same aim. This often leads them to family businesses, where management is experienced in accumulating and preserving inter-generational wealth. For potential investments, good governance is as important as good quality. One area of focus is the 'social licence to operate': that is, companies that act responsibly in terms of paying an appropriate level of tax, looking after their workers and not making products that negatively affect health or the environment and will be less likely to fall foul of government crackdown or consumer backlash.

PAC is managed by Stewart Investors' Sustainability team, based in Edinburgh and Singapore. Team members do not have specific country or sector responsibilities, meaning all ideas can be freely debated across the whole team. The research process seeks to identify quality businesses with sound growth prospects, and team members travel frequently to meet companies. Quality is assessed in terms of management, franchise and financials, as well as sustainability positioning.

All investments are made with at least a five-year view, focusing on absolute rather than relative return potential. Risk is defined as the possibility of capital loss rather than underperformance versus a benchmark. Sustainability is seen as a key measure not just of the company's quality, but of its future growth potential, so the team also focuses on risks to sustainability as potential threats to growth. Managers will engage directly with companies where there are governance concerns.

Turnover is low and remarkably consistent: over the four full financial years under its current management, PAC's average annual turnover is 28.0% and has ranged from 27.0% to 29.1%. Most exits from the portfolio are because holdings have reached their long-term fair value; the team is disciplined about this even where there are limited opportunities for reinvestment.

Current portfolio positioning

At 30 June, PAC had 53 holdings, with 40.5% of the portfolio in the top 10 stocks. This is both a shorter stock list and a greater degree of concentration than the peer group average.

Exhibit 3: Sector analysis as at 30 June 2015

	Trust weight (%)	Benchmark* weight (%)	Trust active weight (percentage points)	Trust weight/ benchmark weight
Consumer staples	20.6	5.3	15.3	3.9
Telecom services	8.5	6.6	1.9	1.3
Utilities	4.9	4.0	0.9	1.2
Healthcare	3.0	2.2	0.8	1.4
Industrials	8.6	8.9	-0.3	1.0
Info technology	19.7	21.0	-1.3	0.9
Consumer disc.	3.0	7.7	-4.7	0.4
Materials	0.0	4.8	-4.8	0.0
Energy	0.0	4.9	-4.9	0.0
Financials	21.2	34.7	-13.5	0.6
Cash	10.6	0.0	10.6	N/A
	100.0	**100.0**	**0.0**	**N/A**

Source: Pacific Assets Trust, Edison Investment Research. Ranked by active weight (excluding cash). Note: *Benchmark = MSCI AC Asia ex-Japan. Columns may not sum due to rounding differences.

Geographically there is a large overweight to India, where the managers find many sustainably positioned family businesses. An example is top holding Marico, which makes naturally-sourced personal care products such as coconut hair oil. The trust has also invested in Marico Bangladesh, which is illiquid but has significant growth potential given the country's large population and scope for GDP per capita to increase from a low base. The India weighting has been driven by stock-specific considerations rather than politics, although the managers say Indian prime minister Narendra Modi is putting in the groundwork for a sustainable improvement over the long term.

Another consumer staple stock at the top of the portfolio (helping drive the large overweight to the sector compared with the MSCI AC Asia ex-Japan index) is Vitasoy, a maker of mainly soya-based drinks. The company was founded by an entrepreneur in Hong Kong during World War II, to provide affordable nutrition to Chinese refugees from the Japanese invasion of the mainland. Sustainability positioning remains strong, with the firm eschewing GM soya, and although the company's valuation looks quite expensive, the managers see it as a stock they can buy and hold for 20 years.

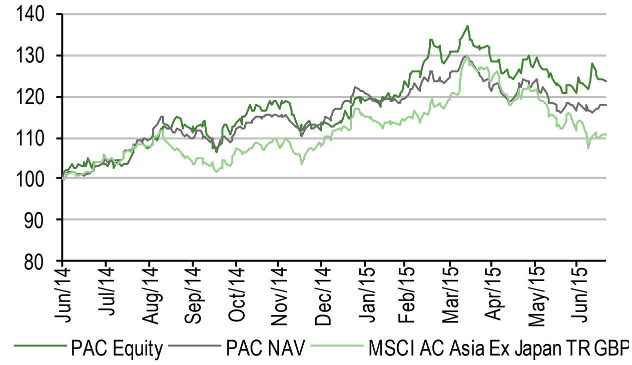
Recent sales have been mainly on valuation grounds. The managers look at a number of metrics, not just P/E ratios, but say that as a crude rule of thumb, a P/E over 30x would be a warning sign even for a company they particularly liked. A Bosch subsidiary in India rose rapidly in value and was sold at a P/E of 60x, while microfinance provider Gruh Finance had reached 12x book value.

The trust may invest up to 20% outside Asia and has recently bought logistics firm Expeditors International of Washington, which has strong links with Asia. In addition, a handful of portfolio companies are Cayman Islands-listed for historical (rather than tax-avoidance) reasons.

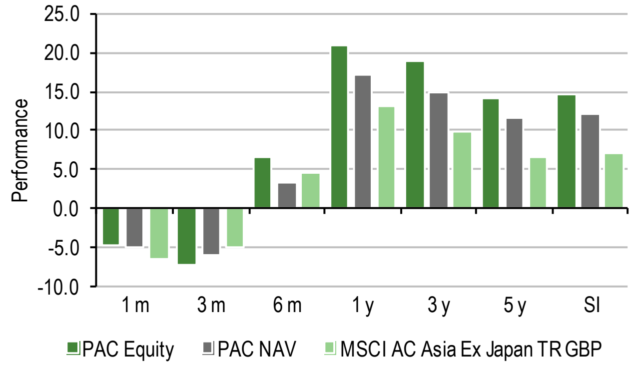
Performance: Five strong years under new management

Exhibit 4: Investment trust performance

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



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: *Managed by First State Stewart from 1 July 2010. Three-year, five-year and since-managed (SI) figures are annualised.

Exhibit 5: Share price and NAV total return performance, relative to benchmarks (%)

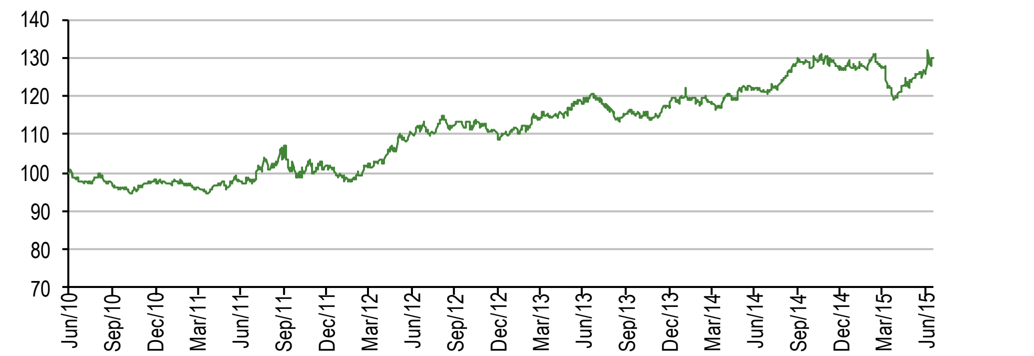
	One month	Three months	Six months	One year	Three year	Five year
Price relative to MSCI AC Asia ex-Japan	1.8	(2.3)	1.8	6.8	27.5	39.5
NAV relative to MSCI AC Asia ex-Japan	1.6	(1.1)	(1.4)	3.4	14.5	26.1
Price relative to MSCI World	0.4	(2.2)	4.4	9.0	11.5	6.5
NAV relative to MSCI World	0.2	(1.0)	1.1	5.6	0.1	(3.8)
Price relative to FTSE All Share	1.0	(5.7)	3.5	17.8	23.2	15.6
NAV relative to FTSE All Share	0.8	(4.6)	0.2	14.1	10.7	4.5

Source: Thomson Datastream, Edison Investment Research. Note: Data to 21 July 2015. Geometric calculation.

PAC now has a five-year track record under its current management, and has outperformed its benchmark, the MSCI AC Asia ex-Japan index, in both NAV and share price terms over almost every period except three months (Exhibit 4). This is significant given the trust's 10.6% cash weighting (which produces very little return) and low exposure to China, which had performed very strongly before the recent sell-off that began in June. Three-month returns were dented by a blip in India, where the headline Sensex index fell by 10% between early March and early May. The trust has also outperformed the global and UK markets over most periods (Exhibit 5) in spite of generally stronger returns from developed than emerging markets over the years since the global financial crisis.

Exhibit 6 shows performance relative to the benchmark over Stewart Investors' (formerly First State Stewart) first five years in charge. Solid relative gains have been punctuated by occasional reverses, often when markets are rising indiscriminately. Underperformance in the early part of 2015 has been made good over the most recent period, probably owing to net cash and the low exposure to China.

Exhibit 6: NAV performance relative to benchmark over five years



Source: Thomson Datastream, Edison Investment Research

Discount: Premium leads to first ever new issuance

PAC's shares have been trading above their cum-income net asset value for most of the period since early March 2015, and at 27 July stood at a premium of 1.5%. This compares with average discounts over one, three and five years of 1.7%, 5.3% and 7.0% respectively. PAC has no formal mechanism to control a discount or premium, but in light of recent strong demand it has issued new shares for the first time in its 30-year history, with 1.2m new shares allotted in June and July, raising £2.5m gross. No shares have been bought back since 2010.

Exhibit 7: Discount over three years (NAV at fair including income)

Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

PAC is a conventional investment trust with one class of share with 117.3m ordinary shares in issue. The trust has a sizeable net cash position and currently has no borrowing facilities in place. Under the Alternative Investment Fund Managers Directive (AIFMD), PAC has registered as a small UK Alternative Investment Fund Manager (AIFM), and as such it is not permitted to gear.

A review of management arrangements during FY15 has seen some changes to fees with effect from 1 February 2015. First State now receives a management fee of 0.9% of net assets (previously 0.75%). Frostrow Capital, which provides administrative and company secretarial services, receives a fee of 0.15% of net assets up to £275m, and 0.1% of net assets above this level. (Previously Frostrow also provided marketing services and was paid 0.2% of market cap.) The previous performance fee arrangement has now been removed, although a performance fee equivalent to 0.7% of net assets was paid in respect of outperformance over the three years to 31 January 2015. Ongoing charges are currently 1.3% (not including the performance fee).

Dividend policy and record

PAC aims to achieve the majority of its returns from capital growth but has also paid a dividend every year since its launch. Dividends are paid annually in June. For the year ended 31 January 2015, a dividend of 2.6p was declared, equal to the dividend in each of the previous three years. However, with a fall in net earnings per share from 2.5p in FY14 to 2.1p in FY15, PAC used £511,000 of its revenue reserve to cover the shortfall. Revenue was lower in FY15 partly because of a relatively high cash position and partly because of the large exposure to India, which is a generally low-yielding market. The board has guided that it may reduce the dividend in future years if there continues to be a revenue shortfall, although the revenue reserve remains large at c 4.3p per share, equivalent to nearly two years' dividends.

Peer group comparison

The AIC Asia Pacific ex-Japan sector has 15 constituents. PAC is mid-table in terms of size, but stands out for its performance: NAV total returns are the highest in the group over one and three years and second over five years, while risk-adjusted performance as measured by the Sharpe ratio is also highest over both one and three years. PAC stands at the highest premium to NAV and is the only non-income specialist to trade at a premium. It also has the highest net cash balance in the group. PAC's yield is below the weighted average for the whole sector, but is exactly in line with the peer group average excluding the three income specialists. PAC has recently removed its performance fee, although ongoing charges are towards the higher end for the group.

Exhibit 8: Asia 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 yr	Sharpe NAV 3 yrs
Pacific Assets Trust	**238.2**	**16.3**	**49.7**	**76.4**	**1.3**	**No**	**2.0**	**89.0**	**1.3**	**1.3**	**1.3**
Aberdeen Asian Income	371.3	-2.4	11.8	57.5	1.3	No	1.0	109.0	4.5	0.1	0.4
Aberdeen Asian Smaller Cos	310.0	-2.7	28.1	75.5	1.5	No	-10.6	110.0	1.6	0.2	0.8
Aberdeen New Dawn	217.4	3.2	16.4	33.7	1.1	No	-11.8	110.0	2.2	0.4	0.5
Asian Total Return Inv Company	145.1	12.0	26.5	24.0	1.1	Yes	-7.1	116.0	1.6	1.0	0.6
Edinburgh Dragon	527.5	6.2	16.6	36.0	1.2	No	-11.1	109.0	0.8	0.6	0.5
Fidelity Asian Values	164.2	10.7	43.0	45.0	1.5	No	-11.0	97.0	0.5	0.8	1.0
Henderson Far East Income	360.1	5.7	24.8	40.0	1.2	No	1.2	98.0	6.0	0.7	0.8
Invesco Asia	166.3	10.6	43.5	56.8	1.1	No	-10.1	99.0	1.9	0.9	1.0
JPMorgan Asian	219.1	12.7	30.6	25.2	0.9	Yes	-11.2	103.0	0.9	1.0	0.8
Martin Currie Pacific	108.4	7.6	15.2	26.0	1.3	No	-13.1	96.0	2.6	0.4	0.4
Pacific Horizon	122.0	9.4	30.2	37.8	1.0	No	-9.6	109.0	0.7	0.7	0.8
Schroder Asia Pacific	478.5	11.0	30.6	57.0	1.1	No	-9.5	102.0	1.0	0.9	0.7
Schroder Oriental Income	451.3	5.9	36.4	75.3	0.9	Yes	1.0	103.0	4.0	0.7	1.0
Scottish Oriental Smaller Cos	256.5	7.6	44.2	85.7	1.0	Yes	-10.2	95.0	1.4	0.7	1.1
Sector weighted average		**6.8**	**28.7**	**53.2**	**1.1**		**-6.5**	**103.4**	**2.3**	**0.7**	**0.8**
PAC rank in sector	**8**	**1**	**1**	**2**	**3**		**1**	**15**	**10**	**1**	**1**

Source: Morningstar 20 July 2015. Notes: TR = total return. TER = total expense ratio or last ongoing charge. 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 (100 = ungeared).

The board

PAC will shortly have five directors. James Williams joined the board in 2013 and became chairman in June 2015 after the retirement of David Nichol. Nigel Rich has been a director since 1997, while Terence Mahony was appointed in 2004. Charlotta Ginman joined the board in October 2014. Sian Hansen is to join the board on 3 August; she is currently executive director of Legatum Institute.

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