Alliance Trust
INVESTING FOR GENERATIONS

CONNECTION

LOOKING FURTHER AFIELD IN THE HUNT FOR INCOME

Geographic diversity and a mix of investment styles are key in generating income and capital growth.

In a world with interest rates and bond yields near record lows, UK equities remain popular among UK investors in the hunt for income. Investors now hold £63.1bn in open-ended UK equity income funds – nearly four times the amount they hold in open-ended global equity income funds.[2] This is mirrored in the popularity of closed ended funds; UK investors currently hold £11.4bn[3] in UK equity income investment companies – many of which are trading at a premium – compared with £3.4bn[4] in global equity investment companies.

However, yields on UK equities have fallen, dividend cover has reduced, and pay-outs remain dependent on the fortunes of a narrow concentration of companies. Is it time for investors to look further afield for equity income?

CONCENTRATING ON THE INCOME CHALLENGES

The UK equity income market is highly concentrated. Income investors are disproportionately dependent on the UK's largest multinational companies. In 2016, five companies accounted for 38% of all dividends paid out; Royal Dutch Shell alone accounted for £1 in every £8 paid out.[5] Globally, there is less concentration; the top ten global dividend payers, for instance, only accounted for 9.5% of global dividends in 2016.[6]

INVESTMENT STRATEGY

The equity portfolio brings together an alliance of best-in-class[1] equity managers and their best ideas – all at a competitive cost.

It provides access to eight managers from around the world each investing only in their top stock selections. Most of these managers are only available to individuals in the UK through Alliance Trust.

The equity portfolio target is to outperform the MSCI All Country World Index by 2% per year after costs over rolling three-year periods. Alliance Trust has a progressive dividend policy and has increased its dividend every year for over 50 years.

Sign up here to receive future editions of our newsletter →

This dependence on a small group of large companies for dividends is reflected among UK equity income funds. According to data from Morningstar, one in five UK equity income funds analysed relied on their top ten holdings for more than 50% of their yield.[7] This concentration poses a risk for investors, should one or several of these dividend stalwarts run into difficulty.

Use of multiple UK-focused funds can exaggerate the risk. Investors often hold several funds to protect against the impact of a single fund manager's performance, meaning stock-picks and investment strategies are frequently duplicated.

Capital erosion also poses a problem for investors drawing an income rather than reinvesting it. Equity income funds are not always designed for growth, prioritising high yields. Given inflation, portfolios need to grow even more rapidly lest holdings fall in real-terms value. For retirees, for instance, who are likely to be drawing down a certain amount from their pot each year, the issue of capital erosion is even more acute.

BRINGING DIVERSITY: AN ALLIANCE OF BEST IDEAS

For investors looking for global diversification, access to capital growth as well as a respectable dividend, Alliance Trust's alliance of best ideas can form a core part of a long-term income solution.

The alliance of best ideas provides investors with exposure to eight complementary best-in-class[8], high conviction global equity managers. With around 200 stocks in the Trust's portfolio, investors have exposure to true global diversity, and a broad mix of investment styles, at a competitive cost.

Unlike with many equity income funds, investors in the Trust should be well placed to benefit from capital growth. This may present an opportunity for income investors in drawdown to ensure their invested funds do not diminish too quickly. However, as the equity portfolio is designed to outperform the MSCI All Country World Index by 2% per year after costs

> "According to data from Morningstar, one in five UK equity income funds analysed relied on their top ten holdings for more than 50% of their yield."

over rolling three year periods, its return could also be used to generate income through selling down shares.

The Trust's approach is designed to produce income as well as capital growth. The Trust currently delivers a net yield of 1.8%[9], and has increased its dividend every year for over 50 years, supported by the dividends of the underlying companies. Like all investment trusts, Alliance Trust also has the capability to pay dividends out of revenue reserves, which could enable it to maintain dividends even in times of lower income generation. This is a key benefit of investing in an investment trust, rather than an open ended fund. The frequency of the dividend, every quarter, provides a regular income for investors, whether supporting spending in retirement, or funding regular financial commitments such as school fees.

Diversification is one of the most pivotal risk management exercises an investor can take, whether they are looking for growth or income. Given the concentration risk involved in the UK equity income market, it's important investors take a global perspective, and consider a broader range of strategies to secure the diversity they need.

Explore a world of investment expertise here →

Expected performance is not a reliable indicator of future returns

1. As rated by Willis Towers Watson. **2.** Investment Association: Figures correct as of September 2017: https://www.theinvestmentassociation.org/fund-statistics/statistics-by-sectorhtml?what=table&show=21 **3.** AIC UK equity income sector data sourced by Morningstar, correct as at 20 November 2017. **4.** AIC Global equity income sector data sourced by Morningstar, correct as at 20 November 2017. **5.** Capita Asset Services Dividend Monitor, January 2017. **6.** Janus Henderson Global Dividend Index, January 2017. **7.** https://www.investmentweek.co.uk/investment-week/analysis/3007907/how-concerned-should-investors-be-about-dividend-concentration-risk. **8.** As rated by Willis Towers Watson **9.** As of 31 December 2017: https://www.alliancetrust.co.uk/globalassets/documents/factsheets-2017/at-plc-factsheet-december-2017.pdf

EQUITY MANAGER SPOTLIGHT

RIVER AND MERCANTILE ASSET MANAGEMENT

RIVER AND MERCANTILE
ASSET MANAGEMENT

AN INTRODUCTION FROM OUR INVESTMENT MANAGER, WILLIS TOWERS WATSON

River & Mercantile's portfolio with Alliance Trust is managed by the CIO of Equities, Hugh Sergeant. A 30 year industry veteran, Hugh has previously held similar roles at Société Générale Asset Management, UBS Phillips & Drew and Gartmore.

Hugh could be described as a long-term value investor – however, having known him for a long time, what stands out to us is the way he has evolved his approach over his long career. He has developed a framework that is more than simply about buying companies that look cheap on traditional 'value' metrics. The process incorporates aspects of potential, value and timing. He wants to understand where a company is in its life-cycle and has a clear idea of the business characteristics he is looking for in different types of situations, be those high-growth companies, slow-growth but predictable businesses or recovery businesses.

For Alliance Trust, Hugh focuses on recovery situations where his unconstrained approach and contrarian style lead him to find lots of interesting companies that are typically very different from those found in mainstream equity portfolios. By the nature of the way Hugh invests, his portfolios can be more volatile. Historically, this has been rewarded with strong returns. The differentiated nature of his approach makes Hugh an ideal member of Alliance Trust's 'alliance of best ideas'. In this edition, he shares his view on the markets and why a new stock, Tingyi Holding, presents a promising opportunity.

HUGH'S MARKET VIEW

Ten years on from the Global Financial Crisis and we are seeing the first period of synchronised global economic growth. The global financial system and economy have almost fully healed and the resumption of a 'normal' cycle, where economic growth drives robust profit growth and thus equity prices, is well underway.

So far, so very good, and I am happy that this phase will continue for quite a few more quarters. However, this normalisation signifies we are now approaching the top of this particular cycle. But let's not get bearish yet! Valuations of equities around the world (ex the US) remain supportive, profits and cash flows are growing robustly and policy remains accommodative. The Eurozone continued to surprise with economic growth and emerging markets showed clear evidence of a new positive cycle.

> "It's been proven over the years that more concentrated mandates can generate superior absolute and relative returns. We're passionate believers in that."

We remain committed to the Eurozone, emerging markets and Asia Pacific. We like the longer term growth characteristics of Asia which currently combine with depressed but improving returns, attractive valuations and more supportive cyclical stimuli. The portfolio remains better value than the market (<60% on average) and will, we believe, grow profits and shareholder value faster over the medium term because our companies are earlier in their life cycles.

Watch Hugh explain his unique investment style and meet our other managers here →

STOCK SPOTLIGHT: TINGYI HOLDING

In October we purchased shares in Tingyi Holding, China's number one instant noodle brand and number one to three across a range of beverage categories, for example it is Pepsi's exclusive bottling partner in China. The stock has an attractive recovery thesis with the potential to grow operating profit by 50% over the next three years as it continues to focus on increasing average selling prices and rationalisation of the fixed cost base.

Bears confuse some cyclicality with structural decline and miss the critical component of 'premiumisation' as a value driver in noodles (i.e. more profit from the same volumes). Looking at more mature countries suggests there is still scope for many years of value enhancement in its two key end markets, while new management (since 2015) has shown better capital allocation discipline. Investor scepticism still lingers after two years of downgrades (2015-17), which have only just stabilised; cash flow forecasts provide a lead indicator that these will continue to move higher.

The shares are currently priced at 12x 2018 estimated / 11x 2019 estimated free cash flow versus the peer group on 20-23x. Timing looks particularly attractive given supportive peer commentary and a rolling over of the raw material headwind.

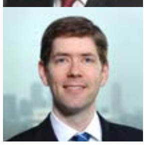
EQUITY MANAGER SPOTLIGHT

FIRST PACIFIC ADVISORS (FPA)

AN INTRODUCTION FROM OUR INVESTMENT MANAGER, WILLIS TOWERS WATSON

First Pacific Advisors (FPA) is a well-established business located in Los Angeles, with a strong reputation as long-term value investors. The team that manages the Alliance Trust portfolio is led by Pierre Py and Greg Herr, Co-Portfolio Managers with an average of 20 years' investing experience. Pierre and Greg invest in high-quality companies that have some form of competitive advantage which gives them long-term staying power. In other words, companies that have the financial and competitive strength to weather short-term disruptions and be long-term winners. Whilst many investors say they look for these characteristics, we believe Pierre and Greg stand out due to their intensive and detailed focus on the operations of the companies. The team conducts extensive site visits with the company, its suppliers, competitors, clients and other industry participants to understand the competitive dynamics in which each company operates and why it has a distinct advantage. They also apply a disciplined valuation framework and only look to buy such high quality businesses when they trade at a material discount to their intrinsic value. We are pleased to have brought this talented team to investors in Alliance Trust.

PIERRE AND GREG'S MARKET VIEW



After recently marking the 30th anniversary of the October 1987 crash, we are reminded of the brutal reality of market cycles, however improbable they seem (beforehand). We also can't help but notice similarities between then and now, including relentless markets, and the potential impact of systematic investment strategies in a downturn. For reference, we have seen estimates that systematic strategies based solely on some form of volatility control currently represent close to $1 trillion in assets (although interestingly, no public statistics on these are readily available).

> "We travel the world looking for opportunities. Our view of businesses is always long term and often contrarian. Strong fundamentals are essential, but we want managers who think and act as owners, and robust balance sheets. A disciplined valuation approach drives our holdings selection."

Today, down cycles may be a distant memory for many, but they do happen over prolonged periods of time. Stretched valuations; over-eagerness to put large amounts of capital to work (leaving cash allocations at record lows); and excessive use of leverage, fuelled by deceptively low volatility, are all clear indicators of market excesses to us. We do not claim to know what will trigger the next correction, and we don't know when it will happen, but we think caution remains warranted. Our focus on business quality combined with discounted valuations might help us weather the storm better than others, but it's unlikely we'll come out unscathed. For that reason, we reiterate our recommendation that from today's starting (vantage) point, equity investors maintain a multi-year investment horizon, preferably over a full market cycle.

Watch Greg's interview on his investment style and meet our other managers here →

STOCK SPOTLIGHT: RYANAIR

One of our portfolio companies dealing with cycles in its business is Ryanair. Based in Ireland, the company is Europe's largest passenger airline. A temporary shortage of pilots for its autumn schedule led the company to cancel an unprecedented number of flights and pledge to boost pilots' compensation.

As the dust settles on these well-publicized announcements, we believe Ryanair continues to possess a massive structural cost advantage against all its competitors, not only the bloated legacy airlines, but also the other low-cost providers. This contributes to making the company's core business model very powerful and extremely difficult for anyone to either replicate or fend off. We believe it also means Ryanair has the opportunity to extend its current lead in the European market. Furthermore, the group can leverage its direct proprietary relationship with customers to grow ancillary revenues and roll-out new digital services. In our view, despite recent execution challenges, management has firmly established itself over time as a best-in-class team. This is underscored by the company's very attractive profitability, returns on capital employed, high cash conversion and net cash balance sheet. Ryanair isn't your typical airline.

PORTFOLIO UPDATE

Willis Towers Watson

A look at what has occurred in the Trust's portfolio over the last quarter.

Over the final quarter of 2017, higher inflation figures in the UK led the Bank of England to implement its first interest rate rise in over a decade and, as was widely expected, rising growth and falling unemployment figures in the US led the Federal Reserve to raise interest rates for the third time in 2017 whilst simultaneously upgrading growth and inflation outlooks for the year ahead. Global equity markets continued to perform strongly, as the MSCI All Country World Index (ACWI) returned 5.0% in Pounds Sterling terms.

The Trust's total shareholder return, Net Asset Value (NAV) total return and equity portfolio return over the quarter were 4.7%, 4.3% and 3.8% respectively, underperforming the MSCI ACWI over the same period. The portfolio has slight overweight exposure to the Eurozone and UK which has detracted from performance as other economies, in particular Asia-Pacific and the US, outperformed when measured in Pounds Sterling. From a sector perspective, managers' stock selection decisions in Utilities, Industrials and Consumer Discretionary also detracted. Since 1 April 2017[1], the Trust's equity portfolio has returned 9.8% and outperformed the MSCI ACWI by approximately 2.2%, with stock selection remaining the main driver of performance.

Learn more about the latest portfolio price and performance here →

BIGGEST POSITIONS SOLD AND ACQUIRED OVER THE QUARTER

10 largest purchases	As at end of quarter (£m)	
	% of Equity Portfolio	Value position
salesforce.com	0.8%	21.8
Fleetcor Technology	0.8%	21.7
HCA Healthcare	0.8%	21.2
Edenred	0.7%	20.3
Barclays	0.6%	15.2
Hain Celestial	0.6%	15.1
Anima Holding	0.5%	14.9
Tingyi Holding	0.5%	14.4
Luxottica Group	0.5%	13.7
Omnicom Cap Inc	0.5%	13.5

10 largest sales	As at start of quarter (£m)	
	% of Equity Portfolio	Value of position
Eaton	0.7%	19.7
Royal Bank Of Scotland	0.6%	15.9
Sodexo	0.6%	15.4
Eni	0.6%	15.2
Cme Group	0.4%	11.3
Capgemini	0.4%	10.8
Maersk	0.4%	10.3
FTI Consulting	0.4%	9.6
Anta Sports Product	0.4%	9.6
Celgene	0.3%	8.9

UPDATE ON BUYBACKS

Last year saw a more active approach to share buybacks, supporting the Board's aim of significantly narrowing the Trust's discount to Net Asset Value which averaged 5.4% in 2017. However, as supply and demand moved towards a state of equilibrium, share buybacks continued to reduce in number and scale during the third and fourth quarters of 2017.

Please remember, past performance is not a guide to future performance, and the value of shares and the income from them can rise and fall, so investors may not get back the amount originally invested. Net Asset Value ("NAV") performance is not the same as share price performance and investors may not realise returns the same as NAV performance.

1. Date Willis Towers Watson assumed responsibility for management of the portfolio

Notes: All data is provided as at 31st December 2017 unless otherwise stated. All figures may be subject to rounding errors. Sources: Investment performance data is provided by BNY Mellon Performance & Risk Analytics Europe Limited, Morningstar and MSCI Inc; key trades data is provided by BNYM Fund Services (Ireland) Limited. Equity portfolio return is the return achieved by the eight equity managers and so includes the effect of any of their cash holdings (gross of their fees). Returns are quoted net of withholding taxes (some of which are potentially recovered at a later date) and therefore potentially underestimate the managers' relative performance.

USEFUL INFORMATION

SHARE INVESTMENT

Alliance Trust PLC invests primarily in equities and aims to generate capital growth and a progressively rising dividend from its portfolio of investments.

Alliance Trust currently conducts its affairs so that its shares can be recommended by Independent Financial Advisers (IFAs) to ordinary retail investors in accordance with the Financial Conduct Authority's rules in relation to non-mainstream investment products, and intends to continue to do so for the foreseeable future. The shares are excluded from the FCA's restrictions which apply to non-mainstream investment products, because they are shares in an investment trust.

The shares in Alliance Trust may also be suitable for institutional investors who seek a combination of capital and income return. Private investors should consider consulting an IFA who specialises in advising on the acquisition of shares and other securities before acquiring shares.

Potential investors are reminded that the value of investments and the income from them may go down as well as up and you may not receive back the full amount originally invested.

Investors should be capable of evaluating the risks and merits of such an investment and should have sufficient resources to bear any loss that may result.

SHAREHOLDER FORUMS

We plan to hold more shareholder forums in the future, providing our shareholders with the opportunity to meet Alliance Trust's equity managers. You can hear from them directly about their investment approach and how they create their portfolios of best ideas. We will publish details of future forums on our website as soon as dates are confirmed. Previous investor presentations can also be found on our website alliancetrust.co.uk/events →

REGISTRARS

Our registrars are:
Computershare Investor Services PLC, PO Box 82,
The Pavilions, Bridgwater Road, Bristol BS99 7NH.

Telephone: 0370 889 3187

Change of address notifications and registration enquiries for shareholdings registered in your own name should be sent to the Company's registrars at the above address. You should also contact the registrars if you would like the dividends on shares registered in your own name to be sent to your bank or building society account. You may check your holdings and view other information about Alliance Trust shares registered in your own name at computershare.com →

HOW TO INVEST

One of the most convenient ways to invest in Alliance Trust is through one of the savings plans run by Alliance Trust Savings Limited who can be contacted online at: alliancetrustsavings.co.uk/apply → or by calling Alliance Trust Savings on 01382 573737. Annual account charges and certain transaction costs will apply according to the type of plan.

Our shares can also be purchased through most online share dealing platforms that offer investment trusts, or through your bank or stockbroker.

Start your investment journey here →

CONTACT

Alliance Trust PLC, 8 West Marketgait, Dundee DD1 1QN
Tel +44 (0)1382 321010
investor@alliancetrust.co.uk
alliancetrust.co.uk →

Alliance Trust
INVESTING FOR GENERATIONS

Sign up here to receive future editions of our newsletter →