THE SCOTTISH Investment Trust

The CONTRARIAN

SPRING 2018

ANALYSIS AND INSIGHT FROM **THE SCOTTISH INVESTMENT TRUST**

No time for triumphalism

According to the Roman writer Tertullian, victorious generals would employ a servant to stand behind them and whisper "remember you are mortal" lest they get carried away with the pomp of triumphal processions. Investment managers should never be triumphalist, of course, nor should they forget that good times don't last forever.

Tertullian's warning is particularly pertinent after a period in which global stock markets have soared through successive all-time highs. With some valuations at dizzying heights, investors should remember that paper returns can prove all too mortal once sentiment shifts. Everything is cyclical and stock market performance is no exception.
Moreover, there are signs today that some shifts are underway. We've seen sizeable wobbles in many equity indices since the start of the year, with most developed markets down or flat over that period. Most of last year's eye-catching gains are still intact, for now, but many investors must be wondering where they should put their money, if the recent volatility heralds a more sizeable downturn.

Alternatives on offer

Since the long recovery from the global financial crisis began, the stock market mantra has been 'TINA' – 'there is no alternative'. An obvious consequence of a world awash with cheap money has been an indiscriminate appetite for equities. Now, however, alternatives are suggesting themselves.

Rising government bond yields are something to watch here, with short-dated government bonds now offering a reasonable – and 'risk-free' – return. Short-term US Treasury yields, for example, are significantly higher than in the recent past. The current yield on the two-year US Treasury bill is around 2.3%. It was little more than half that a year ago and well below 1% a year before that. In the UK, short-term gilt yields are still less than compelling, but where the US leads, the rest of the world usually follows. For contrarian equity investors like us, undervalued stocks that have been ignored in the recent rally present more compelling opportunities still.

Another sign that a new period of sobriety is setting in is the collapsing value of cryptocurrencies. With more regulatory intervention looming and investors apparently digesting the implications of an asset that has no tangible fundamentals, it looks as if the Bitcoin boom is over – suggesting that the speculative frenzy is abating.

At the same time, investors have to contend with persistent uncertainties in politics and policy. Despite defeats for populist candidates in European elections last year, populist movements continue to pose potential challenges. The surge in populism that led to Brexit and President Trump's election may well continue. Electorates weary of austerity or eager for tax cuts encourage politicians to ignore yawning deficits, and debt crises continue to be kicked further down the road.

Continued: Overleaf

ABOUT

The Scottish Investment Trust

At The Scottish, our experienced team actively manages a high conviction, global investment portfolio with the aim of generating superior investment returns over the long-term for our investors. Our contrarian approach is benchmark agnostic and provides profitable opportunities in any market environment. Founded in 1887, the trust has a long tradition of providing shareholders with an accessible, low cost way to invest in companies from around the world, whilst further boosting returns through the provision of a growing dividend. The Scottish has grown its regular dividend every year for the last 34 years. Our independently managed, closed-end fund structure allows us to be patient with our investments allowing them to mature profitably.

DIVIDEND **REINVESTMENT**

Certificated Shareholders

The default arrangement for shareholders who hold share certificates, is for dividends to be paid out as income, either by cheque or by direct credit to a bank account. However, certificated shareholders who would prefer to have their dividends automatically re-invested into further purchases of Scottish Investment Trust shares, can easily arrange this by joining the **Dividend Reinvestment Plan (DRIP).**

Details of the Dividend Reinvestment Plan, together with an application form, can be found on our website; **www.thescottish.co.uk**

Alternatively, to receive a DRIP application form and booklet by post, please telephone our Registrar, Computershare Investor Services PLC, on 0370 703 0195.

Other Shareholders

If your shares are held elsewhere, you should refer to your broker or platform provider for details of their dividend reinvestment facilities.

Most brokers and platform providers offer a dividend reinvestment service which allows you to have dividend cash automatically reinvested to buy more shares.

Please note that most of these services charge for each dividend reinvested, and you should establish the cost of any such facility with your provider.

We do not offer advice about the suitability of any arrangement for your personal circumstance. Should you require financial advice you should consult a suitably qualified financial adviser.

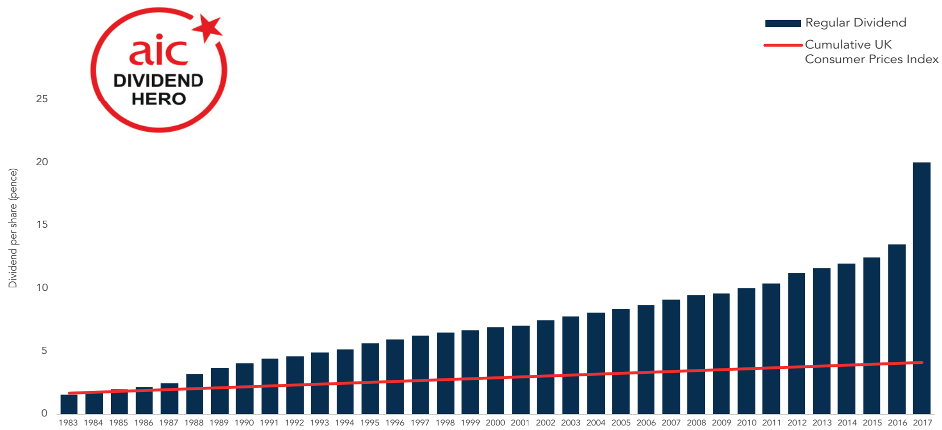
Please note the value of investments, and any income from them, can go down as well as up and you may not get back your original investment.

Past performance is not a guide to future performance and some investments need to be held for the long-term.

QUARTERLY DIVIDEND PAYMENT DATES 2018

FIRST INTERIM	11 May 2018
SECOND INTERIM	3 August 2018
THIRD INTERIM	2 November 2018
FINAL	8 February 2019

Increasing our regular dividend for 34 consecutive years



No time for triumphalism

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A reassessment of risk

None of this means that a full-scale stock market collapse is imminent but it may be a sign that investors are starting to consider risk more seriously. As the market climbed last year, risk appeared to be largely forgotten. The default assumption was that the winners would keep on winning and industry-leading companies would remain at the forefront indefinitely. History tells a different story, today's winners are often tomorrow's losers. Many companies that are now forgotten were the 'must-have' stocks of decades past.

The recent excitement over the technology sector is a case in point here. Although there's been a fair bit of volatility since the end of 2017, the big US technology stocks have continued to rise in 2018. Investors still seem to have considerable faith in these companies' invulnerability to cyclical swings or unforeseen disruptions. But things can change and, given time, they always do. Threats can emerge from new competition or from politics and popular discontent. Managements can be distracted by the allure of non-core businesses and apparently effective business models can conceal fatal flaws. At the same time, companies that have been in the doldrums for long periods can adjust and adapt. In our view, unfavoured companies that are making positive changes offer the best balance of risk and reward.

Ripe for reassessment

We aren't in the business of speculating about the fates of shares that we don't hold nor are we claiming any special insights as to the overall direction of the market this year. But in the uncertainty that follows a period of ebullient stock-market behaviour, we believe that it's better to be invested in companies that have been overlooked in the excitement and are ripe for reassessment as sobriety settles in.

As contrarian investors, we are in the business of seeking out overlooked and undervalued shares in companies that have been out of favour during the market's long bull run. Across the centuries, Tertullian warns us to avoid triumphalism. But, as we look for unheralded turnarounds, slow-burning transformations and long-term opportunities in unfashionable companies, we are equally aware that we should avoid defeatism too.

Investment **INSIGHT**

The importance of income

One advantage of contrarian investing is that the out-of-favour stocks we look for often offer higher-than-usual dividend yields. But we never consider a high yield an attraction in its own right.

All that glitters is not gold – and an enticing dividend is worth little if it can't be sustained.

Instead, what we look for are companies with a yield that is both attractive and sustainable over the long-term. As part of a 'belt and braces' approach we look for a reliable dividend to provide us with a return while we wait for our investment thesis to play out. As we typically invest in companies where major change is planned or already afoot, this is crucial. Executing an effective turnaround can require time and patience, and we want to be sure that the company has the wherewithal to maintain shareholder payouts through potentially turbulent times.

Being paid for our patience

If our research shows that the dividend is sustainable, however, then we can afford to be patient – secure in the knowledge that we are being paid to wait. That's the ideal situation for us: a strong dividend yield that gives us a consistent and attractive level of income while we await the return of health to the business – and hence its share price.

We value dividends not only because they boost portfolio returns, but also because we understand the importance of regular income to our investors.

Making income more predictable

We announced a step-change increase in our dividend in December. This boosted our regular dividend by 48.1%. As our investment style tends to generate an above-average dividend income, we aim to reward our shareholders with a higher and more predictable income stream than previously.

Simultaneously, we have moved from semi-annual to quarterly dividend payments. This provides a more regular income stream to our shareholders.

Thirty-four not out

Another key objective remains to increase dividends ahead of UK inflation. We have increased our net dividend in each of the last 34 years, and the net dividend has been increased or maintained since at least the Second World War.

Just as with our portfolio of investments, the sustainability of our own dividend is important to us. To that end, the company has reserves of more than three times the regular dividend. This provides the dividend with a strong foundation. So were the portfolio to experience a temporary shortfall in income, the company would still be able to maintain the dividend policy.

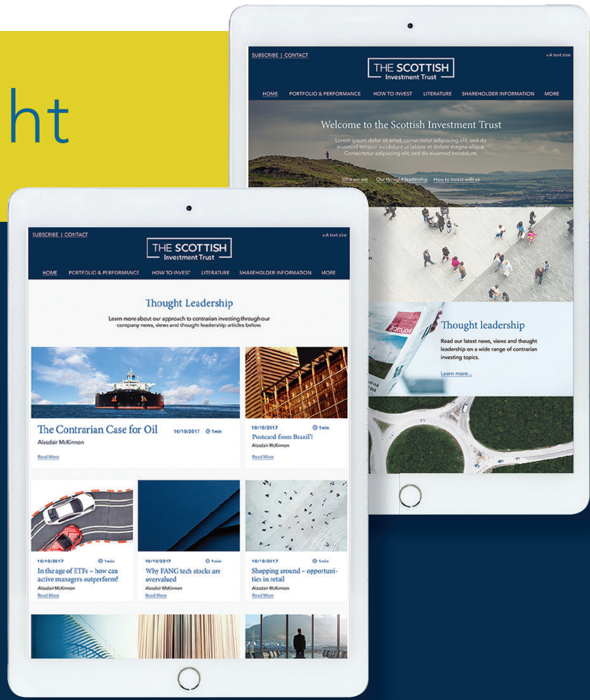
> "We understand the importance of regular income to our investors"

Drip, drip

Finally, it is always worth emphasising the importance of reinvesting dividends. Dividends form a large part of total returns and this is especially true when the income is reinvested. Most of our investors can take advantage of a Dividend Reinvestment Programme (DRIP), allowing them to harness the power of compounding and potentially enhance returns significantly over the long-term. As at the end of January 2018, an investment in The Scottish Investment Trust would have returned 3.2 times its value over the last 20 years. With dividends reinvested, this would have returned 4 times the original investment – a further uplift of 25%. This underscores the importance of income – and shows how a steady drip of dividends can swell to a sizeable flow.

Please remember that past performance may not be repeated and is not a guide for future performance. The value of shares and the income from them can go down as well as up. You may not get back the amount you invest.

REGISTER for more insight



EMBRACING THE DIGITAL AGE

Come and visit us online. We have regular updates, opinions and contrarian thoughts to share with you – and if you'd like these delivered to your inbox we only need your email address – register at

www.thescottish.co.uk/subscribe

You can access much more on our website:- follow press coverage of the Trust and your Manager and find out which events we will be presenting at, keep up to date on performance and portfolio statistics, browse through annual and interim reports and other shareholder and key information. We will continue to develop the site with features and materials that we hope you find interesting and useful and we'll be streamlining navigation to make things even easier.

Register your email address and receive our monthly factsheet with up-to-date commentary on the markets and trends, our newsletter and latest insights on a range of subjects that impact your investment in The Scottish.

TELL US WHAT YOU THINK
We want to make sure we're hitting the mark so do get in touch with any suggestions...

Contact **US**

...to get in touch and find out more

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