THE SCOTTISH
Investment Trust

The CONTRARIAN
SPRING 2020

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

Navigating the Storm

As contrarians, our job is to navigate the many risks that stockmarkets and the wider world throw at us. A key tenet of our philosophy is that protecting capital, as best we can, is an important part of maximising long-term returns. In other words, looking out for excessive complacency (where the odds of a fall look too great). And, conversely, seeking stocks where investors have grown too gloomy (where the odds of a recovery are in our favour).

Throughout the history of stockmarkets, there has always been something for investors to worry about. Recently, investors have had to cope with a number of issues: Brexit, the US-China trade war and even the threat that US-Iranian conflict could escalate into World War III. But at the time of writing, there's no doubt as to the number one risk: Covid-19.

The Covid-19 pandemic is a public health crisis and our thoughts are with those affected. For investors, the virus presents an acute problem in that it arrived during a mature economic cycle and after a long bull market for stocks. On top of that, the outbreak began – and hit hard – in China, which produces a huge amount of the world's manufactured goods. So, it threatened not only to dampen a growing market for Western products but also to drastically disrupt global supply chains.

Complacency

Despite these threats, the stockmarket's initial reaction was indifference. It wasn't until the final week of February that fear really began to infect markets. Until then, most equity indices were close to record highs, with losses chiefly confined to companies directly affected by the virus, such as airlines and cruise lines.

Apple embodied this apathy. Its shares fell by less than 2% after the company warned

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 above average investment returns over the longer term for our investors.

Our contrarian approach is benchmark agnostic and aims to benefit from 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 36 years. Our independently managed, closed-ended fund structure allows us to be patient with our investments.

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that the closing of Chinese factories and housebound Chinese shoppers would mean that it would fall short of its sales forecasts. The shares recovered most of that modest loss the following day. This was curious as Apple has complex supply chains that are deeply entwined with China, which is also one of its biggest end markets. Disruption there was clearly terrible news.

That attitude worried us, and we made some timely changes to our portfolio. The apparent complacency around risks facing the wider economy and stockmarkets also led us to downsize our most economically sensitive investments and increase those with more resilient revenue.

Admittedly, nobody knows how significant the eventual impact of the pandemic will be. The unenviable task facing CEOs and economists is to work out the impact over the next quarter while news of more cases breaks by the hour. The outbreak may, as some suggest, be a terrible but short-lived event. All we can do, as contrarian investors, is be alert to the risks – in particular, the broader threat to investor sentiment.

The problem with popularity

In general, we see the greatest potential for losses in investments near the peak of their popularity and where complacency has set in. For us, this underappreciated danger has loomed large in several areas of the market – most notably in technology and growth stocks.

Many professional investors have monitored the contrasting fortunes of ‘growth’ and ‘value’ investments in recent years. The gap between the two styles recently reached a new peak, surpassing that of the year 2000. The peak of 20 years ago highlights why keeping an eye on risk is so important: it marked the bursting of the 1990s technology bubble which led to precipitous falls in value.

The triggers for such dramatic shifts often turn out to be surprising. Many explanations have been proffered for 1987’s Black Monday crash. Among them is that year’s Great Storm – which took even the weathermen by surprise. When market valuations are stretched, anything unexpected can upend investor sentiment. For popular technology companies, the dampening effect of the pandemic could shine a light on the cyclicality of their earnings.

Opportunities

As contrarian investors, we are always on the lookout for opportunities that accompany such risks. Gold could be a beneficiary of the current threats. At The Scottish, we have championed gold for some time. This has been expressed through our investments in miners such as Barrick Gold and Newmont Mining. Besides offering a haven in turbulent times, gold provides shelter from the devaluing effects of measures used to counter slowing economic growth – quantitative easing (i.e. money printing) and fiscal spending (which tends to cause inflation). With US Treasury yields at record lows, gold looks increasingly appealing.

We also see opportunities in out-of-favour ‘value’ stocks – those that appear undervalued relative to their prospects. Unlike the market’s recent favourites, value stocks tend to be shares in companies exposed to real world industry. Faced with the pandemic, authorities are realising that monetary stimulus is not the only game in town. Many governments around the world are turning to fiscal stimulus instead. This could be a welcome fillip for unloved value shares.

However, the psychology of investing during turbulent times can be very challenging. And the opportunities we see may take time to gain widespread traction. But anticipating change is the core of contrarian investing. That’s why we’re focusing on unloved opportunities while we steer well clear of stocks that look especially vulnerable. While it remains too early, we will be watching for signs that investor sentiment is ready to recover and stand ready to seek out the attractively valued opportunities that will inevitably result.

31 March 2020

A Dividend Hero

The Scottish has 36 consecutive years of increased regular dividend and currently one of the highest dividend yields in its peer group. The Trust has been listed as a ‘Dividend Hero’ by the Association of Investment Companies. It should be remembered, however, that dividends are not guaranteed and income can fall as well as rise.

We’ve increased our regular dividend for 36 consecutive years

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 as a result of market and currency fluctuations. You may not get back the amount you invest.

Investment trusts for generations

When it comes to investing, those with years of experience are often the most knowledgeable. As a reader of ours, it could be that your investment journey began a while ago. If you're in the lucky position to have secured your family's future, why not pass your hard-won investment wisdom down to the next generation? After all, whenever possible, good financial habits are the first steps to a prosperous future.

Starting out

The habits we form in early life tend to stick with us, and investing discipline is no exception. Those finishing school and entering the workplace today could be working for 50 years or more as they live longer, healthier lives. The downside, of course, is that this generation might need more funds to spend these years comfortably. And while young people would probably far rather pay for experiences now, there are certain features of long-term investing worth paying attention to.

The earlier you start, the more time you have to meet longer-term financial goals. It's less stressful to dedicate a smaller proportion of your income to investing early on, than having to play catch-up in later years. For those opening their ISAs or SIPPs, shares are a common choice. Although equities can fluctuate more in the shorter term, younger investors, with the benefit of time, have a better chance to ride out this volatility. And by investing regularly, even in small amounts, fluctuations can be smoothed due to the effect of pound cost averaging.

Planning for the future

As life progresses, new priorities are bound to come to the fore. These could include saving for a new home, bringing children into the world, or increasing pension contributions. Costs associated with raising a family can include school and university expenses and they need to be considered as part of your financial plan.

If you are considering putting any surplus income aside, conventional bank savings accounts look a safe option. But they often offer interest rates below that of inflation, eroding purchasing power over time. Another option could be investing for the long-term, which may help your money work better for you.

At retirement

In the years approaching retirement, the main question is whether you have accumulated a big enough pension pot to fund the standard of living you wish to enjoy. Let's assume you've been prudent, and gathered a substantial fund. This stage of the process also needs to be managed carefully. For the majority of retirees, maintaining a reliable and predictable source of income is the most important objective.

Currently, with interest rates set so low, annuities have become a less attractive way to invest your pension pot. Where appropriate, an alternative is to have an investment portfolio to generate income, which also retains the potential for capital growth. If dividends earned from an investment portfolio are significant, they could form a substantial portion of your overall retirement income.

Finally, it's important to note that everyone's personal circumstances and financial goals differ. If you're unsure about the suitability of any investment option, or are worried about making a decision, you should always speak to a professional financial adviser.

Visit our learning hub for more on investing and investment trusts - whatever your generation...
www.thescottish.co.uk/learning-hub

Investing for the long-term?

Go the whole 'hog

Like our spiny, self-shielding little friend the hedgehog, current events may make us more likely to focus on capital preservation and dividend income. As well as reminding us that, as investors, we can aim to weather volatility in markets by regular drip fed investments over the long-term into tax efficient ISAs and/or SIPPs, or other dealing accounts.

It should be remembered that the value of any tax benefits depends on your individual circumstances and tax rules may change in the future. We are unable to provide individual investment or taxation advice. You should consult a professional adviser should you require such advice.

Staying connected

During this extraordinary time, please rest assured that steps have been taken to ensure business will continue as usual at The Scottish. The safety of our team is paramount, as is our sincere wish that you also remain safe and well.

To keep up to date with our news and views you can visit our website www.thescottish.co.uk, subscribe for our monthly email or follow us on social media.

Should you have any queries – you can contact us by telephone or email on the details below.

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