THE SCOTTISH Investment Trust

The CONTRARIAN AUTUMN 2020

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

Will unlimited money printing cause inflation?

The word 'unprecedented' is cropping up everywhere these days. Perhaps at an unprecedented rate. It's not hard to see why, of course – the circumstances we find ourselves in today have provoked change at breakneck speed. Consider, for example, the optimistic outlook late last year. Then, markets took comfort from a UK general election outcome that put to bed the threat of unrestrained government spending. Now, it is a welcome relief to see the government paying a good proportion of the country's wages. But will the unprecedented actions around the world today lead to a potentially insidious threat to wealth: inflation.

The people's QE

Admittedly, the prospect of inflation in the near-term divides opinion. As things stand, the destruction of demand for consumer goods and services – airlines, retailers and hospitality, to name a few – is deeply deflationary. But there's a confluence of factors that could drive up inflation in the not-too-distant future.

The first inflationary factor to consider is the staggering amount of new money which has been created as a result of government interventions worldwide. The US, for example, is spending trillions of dollars to support its economy. But how is this being paid for? Such a burden on the taxpayer would be far too great to bear, of course. In reality, this spending is made possible by 'money printing' (or quantitative easing to give it its technical term). A significant portion of the US government's spending has been facilitated by the Federal Reserve this year. This flood of new money deployed into the economy means more money competing for goods and services, in turn pushing up prices. This creeping diminution of purchasing power is, superficially, more palatable than levying additional taxes.

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.

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. The Scottish Investment Trust PLC has a long-term policy of borrowing money to invest in equities in the expectation that this will improve returns for shareholders. However, should markets fall these borrowings would magnify any losses on these investments. Investment trusts are listed companies and are not authorised or regulated by the Financial Conduct Authority. Please note that SIT Savings Ltd is not authorised to provide advice to individual investors and nothing in this newsletter should be considered to be or relied upon as constituting investment advice. If you are unsure about the suitability of an investment, you should contact your financial advisor. Issued and approved by SIT Savings Limited. Authorised and regulated by the Financial Conduct Authority.

Will unlimited money printing cause inflation?

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Politics is at play here. Politicians, who universally want to be re-elected, are not prepared to make any tough, unpopular decisions – such as turning off the money printer that has facilitated huge government support. In the UK, with a large proportion of the workforce and electorate having been furloughed, money printing fuelled spending has popular backing. It not only provides welcome relief for those that might otherwise have lost their jobs, but preserves economic capacity and spending power, heading off the threat of deflation. However, such policies can become addictive, and some politicians have proposed bolder forms of stimulus that inject money directly into the consumer's pocket – often dubbed 'the people's QE'.

A shift from China

A second inflationary factor exposed by the pandemic is the fragility of corporate supply chains, particularly those that are reliant on China's low waged manufacturing base, which may now need to be re-engineered. Rising tensions between China and the US look set to exacerbate this trend. President Trump has publicly blamed China for the pandemic and has encouraged US businesses to reduce their dependence on Chinese suppliers. A large shift in manufacturing from China would require companies to make significant adjustments, inevitably increasing costs which would push prices up.

The after-effects of Covid-19 are the third factor likely to influence pricing going forward. If airlines, for example, are compelled to fly half-empty, that will lead to more expensive tickets. Can bars, restaurants and cinemas make money at current prices if forced to operate at reduced capacity? In these instances, higher prices will weigh on demand, unless wages keep up, which, in essence, is the definition of inflation.

Old patterns reassert themselves

Governments can never openly own up to the fact that they would like to generate a bit of inflation. But from their perspective, it is the least painful way to dilute the burgeoning debt pile. Instead of openly targeting inflation they implement policies that should, ultimately, generate it.

Despite that, price increases have remained modest, even in the face of massive quantitative easing and low interest rates. What's kept prices in check? One of the principal factors, in the lack of inflation to date, is the availability of cheap goods from China and beyond. Continued loose fiscal and monetary policy, coupled with the manufacturing shift toward higher cost producers, may well tip the balance in favour of the inflation that authorities secretly crave.

Opportunities for investors

The global economy is showing some signs of bottoming and, in the absence of a major flare up, we are probably past the worst of the pandemic. Markets have responded well to this incremental good news – stockmarkets are near all-time highs. However, the recovery in financial markets has been largely confined to a handful of stocks that have been winners from 'stay at home' orders. The real-world recovery is still very much underway, and the shares of many companies exposed to that revival are still some way below their previous levels.

Despite the tough near-term outlook for earnings, these value-type stocks are often best positioned for periods of sustained inflation.

If, and when, inflation does resurface, gold should prove to be an excellent inflation hedge. That's one reason that we have exposure to some of the world's top gold miners in our portfolio.

It may take some time for the effects of the pandemic to fully mend, but we see many underappreciated contrarian investments that can participate in the next leg of the recovery.

August 2020

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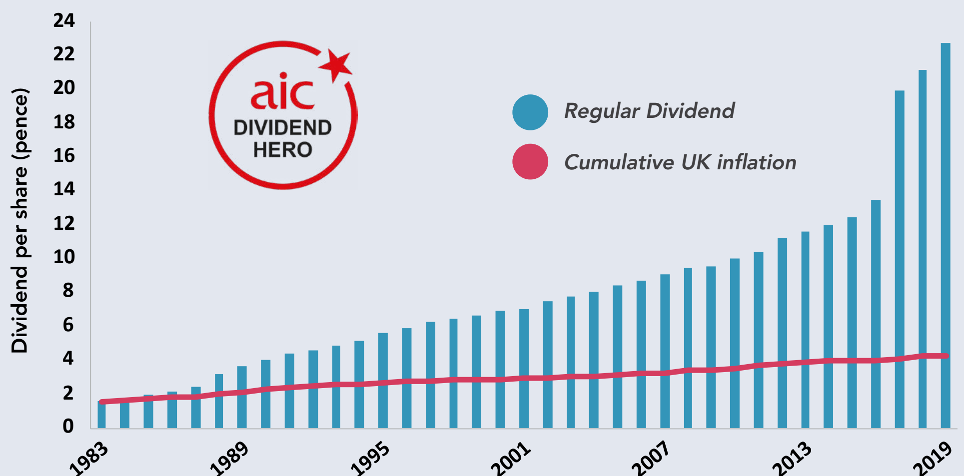
Cementing our Dividend Hero status

It is well known that the pandemic has had a vast impact on businesses' revenues. The Scottish have long prepared for difficult scenarios like this and, over the years, have built a substantial revenue reserve to support our dividend paying capability over the longer term. We've recently re-affirmed our intent to grow our dividend ahead of UK inflation and, at the Interim stage, our revenue reserve amounted to more than 2.5 times last year's regular dividend. Of course, it must be remembered that dividends are never guaranteed and can fall as well as rise.



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Finding income in a dividend drought: A contrarian approach

Whatever your stage of life, Covid-19 has caused huge changes. From unprecedented restrictions on personal movement to an accelerated shift to online working and shopping, no life has been untouched. For those in retirement, concerns about reliable income have been growing as the global economic outlook has worsened and dividend cuts abound.

Why income investors should look globally

The pandemic has had a major impact on corporate revenues, and it will take some time for companies to fully get back on their feet. To secure their long-term survival many businesses have boosted their cash reserves by reducing their dividends, with roughly half of the UK's FTSE 100 companies cancelling, cutting, or suspending payments.

For retirees reliant on equity portfolios for income, the scarcity of dividends is a headache. Historically, a relatively small number of UK stocks have provided the majority of income, but now investors with a UK bias are facing a potential shortage.

The obvious answer to concerns about the concentration of income risk in the UK is to diversify. Investing in a portfolio of global equities provides an income stream from a much broader pool of investments than is available from UK stocks alone.

A contrarian approach can pay dividends

The Scottish's high-conviction, bottom-up investment approach delivers an equity portfolio that is spread across multiple regions and sectors, providing diversification of risk. Although our contrarian investment style doesn't actively target companies that pay high dividends, the out of favour investments that we are attracted to tend to pay higher dividends over the course of an economic cycle. That rewards us, and our shareholders, while we wait for the improving business prospects that we foresee.

The Scottish currently has a dividend yield of around 3.1%, which is one of the highest in our AIC peer group. What's more, the Company recently announced that it will increase its regular dividend for the year, despite the dividend drought.

A dividend reserve – the benefit of long-term thinking

Over the years, The Scottish has prudently built a substantial revenue reserve in preparation for leaner times. As at 30 April 2020, this reserve was greater than 2.5 times last year's regular dividend, giving the Company the ability to keep paying its investors when dividends are temporarily in short supply.

> "The Scottish has prudently built a substantial revenue reserve"

The Scottish's intention to continue to grow the regular dividend over the longer term backs up our status as a 'dividend hero' (as recognised by the Association of Investment Companies). By adding to our unbroken run of 36 consecutive years of regular dividend growth we aim to keep income flowing, when other funds may be turning off the taps.

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PREPARING FOR YOUR OWLET'S JOURNEY AHEAD?

As the world is returning to the 'new normal', you're probably excited to see your little owlets finally back at school. And if you're planning for their future, why not consider storing something away for their journey ahead. Indeed, there is a rationale to starting to invest early – with the benefit of a long time horizon, your young ones have a better chance of riding out the volatility that will occur along the way, having funds in place for going to university, buying a home or some other of life's big expenses.

Among the tax-efficient ways to invest for children are Junior Individual Savings Accounts (JISAs) and even Junior Self-Invested Personal Pensions (Junior SIPPs). This year, the JISA annual allowance is £9,000 and Junior SIPP contributions of up to £2,880 per annum receive government tax relief. Those and a number of other accounts and wrappers are available through many share dealing platforms, stockbrokers and other financial intermediaries.

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 in touch with The Scottish

Please be assured that we are operating as normal during this Covid-19 pandemic.

Our latest company announcements are published on the Regulatory News Service and our website **www.thescottish.co.uk**
If you have any queries you may contact us by telephone, email or post, and if you'd like to hear from us more frequently, please subscribe for our monthly email via **www.thescottish.co.uk/subscribe**

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