THE SCOTTISH
Investment Trust

The CONTRARIAN
WINTER 2020

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

What is the cost of free money?

Many of the UK's workers are doubtless relieved that the Chancellor has extended the government's furlough scheme until the end of March. This means that employees who would otherwise be redundant – close to a third of the labour force – can continue to receive at least partial salaries. It also means that the government will have had millions of workers on its payroll for an entire year. In the US, meanwhile, Joe Biden's presidential victory likely heralds a further colossal fiscal stimulus package.

In this era of ultra-low (or even negative) borrowing costs, it is easy to see why governments are so willing to borrow unimaginable quantities of 'free' money to fund their spending ambitions. There is, however, little appreciation of the longer term significance of burgeoning debt piles or, indeed, the potentially profound consequences for investment markets.

Forget debt

With the world in the throes of a global pandemic, concern over the parlous state of government finances has, understandably, been put on the back burner.

Debt burdens were substantial even before the pandemic struck, with government debt already at its highest ever peacetime level in the months before Covid-19 emerged in Wuhan. Since then, budget deficits have expanded to their highest percentage of GDP since World War II. And, despite hopeful signs on the vaccine front, extraordinary support looks set to be required for some time.

Banking on support

Governments would be unable to fund this enormous expenditure without the cooperation of their central banks.

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 37 years. Our independently managed, closed-ended fund structure allows us to be patient with our investments.

What is the cost of free money?

Continued from: Front Page

Colossal issuance of debt requires a colossal buyer, and central banks have assumed that role. This represents a new era of economic policymaking whereby budget deficits no longer matter so long as they can be financed by 'free' money from central banks.

> “extraordinary support looks set to be required for some time”

Central banks responded to the Covid crisis with yet another wave of monetary stimulus – putting interest rates back to record lows and ramping up bond purchases using money that they have effectively newly printed.

These purchases have driven up the price of bonds, such that many have negative yields which guarantees a loss if held to maturity – the stock of such bonds has grown to a staggering $17 trillion. That figure, almost beyond human comprehension, has important implications for all of us. Negative bond yields encourage governments to take on even more debt and, because it's difficult to earn a reasonable return on low risk assets, they also push investors into riskier investments.

'Hot' money

All this 'free' capital generated by central banks' money printing needs to find a home somewhere – and somewhere that offers, at least, the prospect of a positive return. This money has tended to flow into more risky assets such as 'growth' stocks which are perceived to be the biggest beneficiaries. Almost inevitably, some of these investments have been dubious. A recent example of this is Nikola, the zero-emission-truck company that attracted a huge market valuation despite having exaggerated or even faked its technological progress.

Inflating away problems

The combination of fiscal and monetary stimulus has other important consequences too. Government and central bank largesse is inherently inflationary. By increasing the overall quantum of money, you effectively devalue it.

While initially deflationary, Covid itself may also prove to have a longer term inflationary effect. Social distancing is expensive. That's especially true for restaurants, entertainment venues and airlines, which can no longer pack in nearly as many customers. So, as long as the virus poses a threat, these businesses are going to be under significant financial pressure, and they'll have to pass much of that on to the consumer in order to survive.

On top of that, US-China tensions have led to a reassessment of global supply chains, particularly those reliant on Chinese manufacturing. The need to source components closer to home is likely to drive up the prices of many consumer goods.

Already, we've seen signs that central banks are preparing for inflation, with the US Federal Reserve indicating its willingness to tolerate longer periods of higher inflation.

But if inflation does rise sharply, would central banks be willing to raise interest rates to contain it? How would they balance that against a potential wave of insolvencies as repayment costs escalated? And would governments be allowed to become insolvent too? A bout of inflation may be the most desirable outcome.

Although they can't say it out loud, most governments would welcome inflation. It would allow them to diminish their debt burdens without having to raise taxes excessively – a measure that would be extremely unpalatable with taxpayers (who vote).

Gold shines in an era of inflation

Money has no intrinsic value, of course – it is only worth what it can buy. And as inflation erodes money's purchasing power, it diminishes as a store of value. Such conditions are favourable for gold – which has limited supply and has served as a store of value for thousands of years.

In our portfolio, we have exposure to gold miners such as Barrick Gold, Newmont, Newcrest Mining, AngloGold Ashanti and Gold Fields. These investments have been rewarded during the pandemic and, as inflationary pressures build, we're confident that they are well worth their weight.

November 2020

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A New Year's resolution that could prove rewarding

Should auld acquaintance be forgot, and never brought to mind? Well, in the case of 2020, many might be eager to forget their acquaintance with this year, which will long be synonymous with a devastating pandemic and the economic turmoil that ensued. However, the turning of a new year is an opportunity to look forward with optimism, refresh plans and get our habits in order.

Volatile times reinforce both the need for, and benefits of, sound planning. This year, so many people have had their contingency plans tested. So, before we set out our new year's resolutions, we should take a moment to consider the role financial planning will play in supporting our future.

How to keep the golden years, golden

Although the *best-laid schemes of mice and men gang aft agley*, at least if we start early, we have a better chance of our plan being flexible enough to meet our goals. Nowhere is this adage truer, than in retirement planning, where a sensible approach adopted early in one's career can help you get through tough times. As we bed into winter, it's perhaps a good time to reassess your retirement plan and goals. Are you on track to have a big enough pension pot at retirement to supply the income you need to live off in your golden years?

As we get older, our attitude to risk often changes. In our younger years, we are better positioned to take a bit of risk and, with a diversified portfolio of equities, that risk has historically been rewarded with higher returns. That's effectively how a pension pot is built up. As we approach retirement, the rule has usually been to balance your portfolio with a mix of bonds and equities.
The dichotomy that those with pensions face is that government bonds, traditionally seen as a risk-free investment, have such a low return that they may no longer provide a sufficient income.
Many have moved up the risk curve to find the better returns and attractive dividend yields – though returns are not guaranteed, of course.

Investing in your children's future

This year has served as a timely reminder of the importance of education. What steps can parents (or grandparents) take to meet the associated long-term costs?
Many already know that investing money to celebrate a child's birth can mature and be used to generate income to help, even partially, cover educational expenses. As little as £25 per month invested can be enough to provide a useful contribution to school or university costs.

Planning for home ownership

For many, purchasing a property is not only a key milestone on the journey to independence, but has tended to be a good financial move. Getting on the property ladder is increasingly challenging for first time buyers and around half of them are turning to the 'Bank of Mum and Dad' for help. This option might not be available, however, which can mean having to squeeze spending more and more on the way to make housing plans a reality.
Starting to set aside some funds early, which can grow over time, can help overcome this struggle.

New year resolutions: a matter of planning

In an uncertain and volatile world, the seeds you plant could reap literal dividends in the future.
If that fact wasn't clear before 2020, it certainly is now. As we move into the festive period and beyond, adopting some New Year's resolutions around your financial future might just be the best thing to come out of 2020.

November 2020

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.

If you'd like to invest in The Scottish, our shares are available on all the major online share-dealing platforms, via stockbrokers or other financial intermediaries.

For more information, please visit www.thescottish.co.uk/how-to-invest

Opportunities for investors in #Contrarian2021

As contrarian investors, we are always wary of fads and trends. We focus on the stocks that are unloved and underappreciated – but have a catalyst for change that others miss. As we look towards 2021, we have singled out three key areas of the market where we believe the best opportunities may lie.

A REVIVAL OF 'VALUE'

The contrasting fortunes of 'growth' and 'value' investments have reached new extremes lately, but can this endure indefinitely? The video looks at a potential reversal, reflecting on the impact of positive news about prospective vaccines.

HIDDEN GEMS IN THE RECOVERY

We highlight a few interesting additions to our portfolio recently, including Capri Holdings, Ambev and Banco Santander – 'back to work' stocks that are exposed to consumers' return to normality.

A GOLDEN DECADE

Gold has lived up to its safe-haven status this year, offering investors a refuge from the volatility brought by the pandemic. However, the current environment provides all the ingredients to support gold prices longer term.

www.thescottish.co.uk/blog/video

You can find these videos and follow our latest news & views on Twitter, LinkedIn and YouTube using #Contrarian2021.

Increasing our regular dividend for 37 consecutive years

The pandemic's had a vast impact on businesses, with many having to suspend or cut dividend payments to shareholders. The Scottish has built a substantial revenue reserve to support our dividend paying capability for difficult times like this.

We are delighted to add another year to our long track record of regular dividend increases.

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.

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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