THE SCOTTISH Investment Trust

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# THE CONTRARIAN

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

SUMMER 2021

## 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.

# Why we value valuations

**At The Scottish, we're rarely accused of being fashionable. We seek opportunity in the unloved and underappreciated. But stockmarkets are fickle in their affections: 'ugly ducklings' can go on to become beautiful swans, while the market's passionate affair with the most exciting investments often unwinds. Something of the sort appears to be underway at present – which could make our portfolio look uncharacteristically chic.**

Markets are driven by sentiment and emotion, and they frequently lurch too far in one direction or the other. That's why we pay attention to valuations – quantitative assessments of a company's fundamental current and projected worth.

Of course, valuation metrics are imperfect tools. Any projection of a company's future value rests on assumptions, estimates and best guesses. What valuations do provide are anchor points that give a credible approximation as to the real worth of a company. That discipline can help investors avoid being swept along by the tides of market sentiment.

We put valuation at the heart of our investment process. For contrarians like us, the key is judging whether the valuation implied by current share price is realistic before judging how we view the potential for change. This approach requires patience, but we believe that it provides a favourable long-term balance of risk and reward.

**Continued: Overleaf**

## REVIEW OF INVESTMENT MANAGEMENT ARRANGEMENTS

On June 2, the Board of The Scottish Investment Trust PLC (the "Company") announced that it will undertake a review of the future investment management arrangements of the Company. In 2015 the Company adopted a high-conviction, global contrarian investment approach. The Board's view was that a period of at least 5 years would be required to evaluate the Company's returns under this mandate. The Company does not have a formal benchmark but, by way of comparison, the Company's NAV total return has underperformed the sterling total return of the MSCI All Country World Index over the 5 years ended 30 April 2021. The Board has therefore appointed Stanhope Consulting to assist it in the review of the Company's investment management arrangements. The Board invites proposals from established fund management groups, with the experience of managing listed closed-ended funds, designed to deliver, over the longer term, above index returns through a diversified global portfolio of attractively valued companies with good earnings prospects and sustainable dividend growth. Any such proposals will be considered alongside the current management arrangements, which the Board notes have delivered strong recent short-term performance.

**Continued: From front page**

# Why we value valuations

While valuations are an important part of our approach, we never buy a stock just because it appeared 'cheap'.

The quantitative appeal of the valuation must be mirrored by qualitative attractions such as strong leadership or enduring competitive advantage. Crucially, there must be clear catalysts for improvement; we want the company to positively surprise.

## FUNDAMENTALS OUT OF FAVOUR

For a prolonged period many investors have been apparently indifferent to valuations, and this has shaped the market's direction. The main effect has been a strong emphasis on momentum. In other words, previous 'winners' have kept winning, regardless of how stretched valuations have become.

There are several reasons for the perceived lack of interest in fundamental valuations.

One is the rise of passive investing, which drives momentum by automatically buying more of the stocks that have already performed well, further driving up valuations.

Another is the growing proportion of inexperienced retail investors. Many people bought shares for the first time during the pandemic. These investors often have little understanding of fundamental valuations and are sometimes motivated by short-term gains ahead of long-term returns. A classic example was GameStop's incredible performance earlier this year, when huge numbers of retail investors bought the company's shares in complete disregard of its fundamental value, or lack of it.

A third factor is the extraordinary monetary policy that has persisted since the 2008 financial crisis. With interest rates and bond yields held so low, investors have required ever more speculative investments to earn a return. This has driven the market valuations of certain sectors to dizzying heights; some technology companies are obvious examples here. As central banks have maintained interest rates at historically low levels to combat the economic effects of Covid, they have inadvertently sustained momentum investments. The corollary is that any normalisation of monetary policy could reverse this momentum.

Together, these factors have led to an extreme divergence in market valuations between the most and least expensive stocks. Historically this has proved unsustainable.

## THE OPPORTUNITY AHEAD

As the recovery from the pandemic shifts us from a period of low economic growth and inflation to one of higher growth and rising prices, the tide seems to be turning. For the year to date, many lowly valued investments have outperformed the stockmarket's previous winners.

For those like us who keep a sharp eye on fundamental valuations, this is not a surprise. We have positioned our portfolio to capitalise on such a shift. Should current trends persist, our attractively valued holdings will be back in vogue.

June 2021



# Investment team

**ALASDAIR MCKINNON**
Manager

**MARTIN ROBERTSON**
Deputy Manager

**MARK DOBBIE**
Investment Manager

**JAMES WEBB**
Investment Manager

**IGOR MALEWICZ**
Investment Analyst

# The rise of Pop Investing culture

There's no ignoring the rise of influencer culture – even for those people who have no desire to keep up with the Kardashians, or watch K-pop on TikTok. What's interesting, however, is that influencers are branching out from the realms of entertainment and fashion into the world of personal finance and investing. Put simply, a new generation of self-appointed pundits is giving financial advice on social media to attract followers and income.

While the democratisation of investing is a positive, the way in which investment ideas are conveyed through online social channels is not always comprehensive. Social platforms' algorithms favour short and sharp messages from charismatic presenters highlighting all that's appealing or trending. So the words 'safe', 'guaranteed returns' and 'instantly' have entered the jargon commonly used among millennial and Z-er investors.

According to the recent survey by Charles Schwab, 15% of participants in US markets have invested for the first time during the last year. Government-fuelled stimulus allowed stockmarkets to stage a strong recovery from the lows of early 2020, presenting new investors with the false impression that making gains is always this 'quick' and 'easy'.

## THE DRAW OF THE CROWD

Of course, even professional investors aren't immune to herd behaviour, but they are at least educated on the risks. Having seen the side-effects of crowd mentality, asset booms and busts, they also know how human emotions can influence investing and more than try to stay dispassionate. Experienced investors are also more likely to have a defined 'sell' discipline, often outlining in advance the circumstances that would trigger a sale.

These are important considerations that may not always be given thought by day traders using platforms such as Robinhood. The very name is predicated on taking money from the rich to give to the poor: a clear play on investors' emotions. It taps into the human psyche - they too can access a service that's usually seen as reserved for the well off. Such platforms are adept at selling themselves to new audiences that are more at home with YouTube and TikTok than the FT, with users sometimes investing student loans rather than pension pots.

## INVESTING TIME BEHIND THE SCENES

Analysing prospective investments is not glamorous work. It involves scouring the company's financials – looking at cashflows, profits and the ability to pay dividends among others. Then there's qualitative research – investigating or meeting management and examining how stakeholders such as employees or the supply chain are treated. It's essential background data, but probably wouldn't make a riveting TikTok video.

*“ there's no better way to start investing than learning about the essentials first ”*

When an investment is chosen by word-of-mouth on social media, relying purely on an exciting story, it's equivalent to gambling on a horse that has an 'interesting name'. It might be a winner, but without looking into the fundamentals or its long-term prospects, it is effectively a punt.

Instead, there's no better way to start investing than learning about the essentials first. And there's nothing wrong with using the innovative apps and tools available – far from it. However, it's vital that choices are researched thoroughly, weighing up the pros and cons of a potential investment before it is made. So it's not just a punt, but a decision that can prove financially rewarding into the future.

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# Getting off to a good start

# Your learning hub

If you're thinking of investing for your future, it makes sense to gain a more in-depth understanding of the investment concepts before you set off. Our learning hub offers a host of educational materials to help you make informed choices as your first steps in building long-term wealth.

### NEW TO INVESTING

Investing can be so much more than making a 'quick buck' overnight. Check out our collection of balanced videos from the Association of Investment Companies (AIC) – these can help inspire your choice of long-term financial goals.

### ABOUT INVESTMENT TRUSTS

Since 1868, investment trusts have been through a number of bull and bear markets in the most volatile conditions. Learn about their unique features, operation and how they can serve you today – and for decades to come.

### CONTRARIAN INVESTING

Every investor is somewhat contrarian at heart in their quest to spot an opportunity that others miss. No matter the style you end up adopting, you'll find our contrarian views worthwhile reading that can contribute to your investment thought process.

**www.thescottish.co.uk/learning-hub**

## UPCOMING DATES

Quarterly dividend payment

| | | |
|---|---|---|
| FIRST INTERIM | → | MAY |
| SECOND INTERIM | → | AUGUST |
| THIRD INTERIM | → | NOVEMBER |
| FINAL | → | FEBRUARY |

## More ways to connect 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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