Update | Investment companies

13 September 2017

Seneca Global Income & Growth

Steady reduction in equity exposure

Over the past year, Seneca Global Income & Growth (SIGT) has delivered returns well in excess of its new benchmark (see page 2), further enhancing its strong track record. SIGT's manager believes we may be due to enter a bear market in 2019, ahead of a slowing global economy in 2020. Given this, it has been steadily reducing SIGT's exposure to equity markets, notably in the US where the fund is now zero weighted. The manager says that it will continue to sell equities over the rest of this year and the next, locking in profits.

Having no exposure to the world's largest equity market is a bold move for the fund and, arguably, reflects the manager's high conviction approach.

Multi-asset, low volatility, with yield focus

Over a typical investment cycle, SIGT seeks to achieve a total return (the capital return plus dividends and other income reinvested) of at least the consumer price index (CPI) plus six per cent per annum, after costs, with low volatility, and with the aim of growing aggregate annual dividends at least in line with inflation. To achieve this, SIGT invests in a multi-asset portfolio that includes both direct investments (mainly UK equities) and commitments to open-and-closed-end funds (overseas equities, fixed income and specialist assets). SIGT's manager uses yield as the principal determinant of value when deciding on its tactical asset allocation and holding selection.

Year ended	Share price total return (%)	NAV total return (%)	Bench-mark* (%)	MSCI World total return (%)	MSCI UK total return (%)
31/08/13	28.7	19.9	3.6	21.5	16.6
31/08/14	13.8	8.5	3.5	13.4	10.1
31/08/15	6.0	3.0	3.6	4.1	(5.8)
31/08/16	14.0	12.5	3.6	26.0	12.8
31/08/17	19.2	17.8	4.2	18.8	14.0

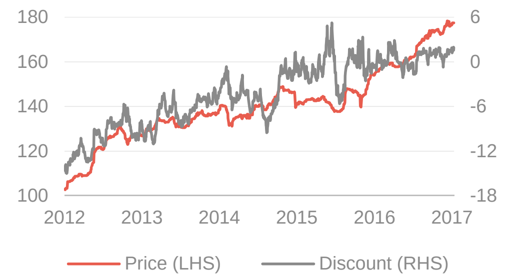
Source: Morningstar, Marten & Co. *Note: SIGT's benchmark is Libor + 3% from 18 January 2012 changing to CPI + 6% with effect from 7 July 2017.

Sector	Flexible investment
Ticker	SIGT LN
Base currency	GBP
Price	177.50p
NAV	173.71p
Premium/(discount)	2.2%
Yield (prospective)*	3.6%

*Note: yield assumes dividend is paid at SIGT's minimum rate of 1.58p per quarter for the remainder of the year ending 30 April 2018.

Share price and premium/(disc)

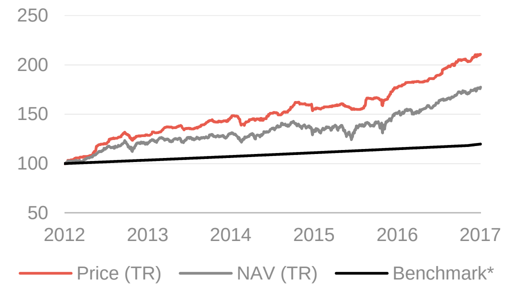
Time period 31/08/2012 to 08/09/2017



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/08/2012 to 31/08/2017



Source: Morningstar, Marten & Co

Domicile	United Kingdom
Inception date	19 August 2005
Manager	Team managed
Market cap (GBP)	74.5m
Shares outstanding	41.9m
Daily vol. (1-yr. avg.)	98.3k shares
Net gearing	5.6%

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Shareholders approve changes to investment objective, investment policy and benchmark

Changes do not require any shift in the way SIGT is managed.

At SIGT's Annual General Meeting (AGM), held on 6 July 2017, shareholders approved changes to the company's investment objective, investment policy and benchmark. These changes do not require any shift in the way SIGT is managed (the amendments effectively formalise more recent developments), but the manager now has a more challenging benchmark (see below). Crucially, the trust still aims to provide low-volatility returns, but it now has a formal objective to grow its total annual dividends at least in line with inflation.

New benchmark (CPI + 6% per annum) is more relevant than Libor + 3% and reflects the importance of achieving real returns

The new benchmark is considerably more relevant to the scale of returns that it has been achieving in recent years.

From 7 July 2017, a new benchmark of CPI (the consumer price index, a measure of inflation in the UK) + 6% per annum came into effect, replacing SIGT's previous Libor + 3% benchmark, which had been in place since the strategy change in January 2012. In the manager's view, the new benchmark is considerably more relevant to SIGT's investment strategy and the scale of returns that it has been achieving in recent years. Some investors may also welcome the emphasis it places on providing returns above inflation.

SIGT's manager says that, as an active manager, CPI + 6% is the sort of return it should be providing.

The manager says that, while it aims to beat CPI + 6% per annum over a typical investment cycle, there may be some cycles in which this is very difficult to achieve (SIGT define a typical investment cycle as one in which various asset classes produce total real returns over the entire cycle that are broadly in line with their long-term average real returns). This would typically be the case during cycles in which inflation rises sharply. Its analysis suggests that it can derive an average of 4.8% per annum from strategic asset allocation and an average of 2.3% from tactical asset allocation and stock selection. Gearing (borrowing) will, it believes, add another 0.5% to returns, whilst costs will detract by around 1.5%, giving a real return of 6.0%. The manager says that, while some commentators would consider this ambitious, as an active manager these are the sort of returns it should be providing. These changes also bring SIGT into line with Seneca Investment Managers' (Seneca IM's) other funds, all of which it says are managed against a 'CPI +' benchmark, formally or otherwise.

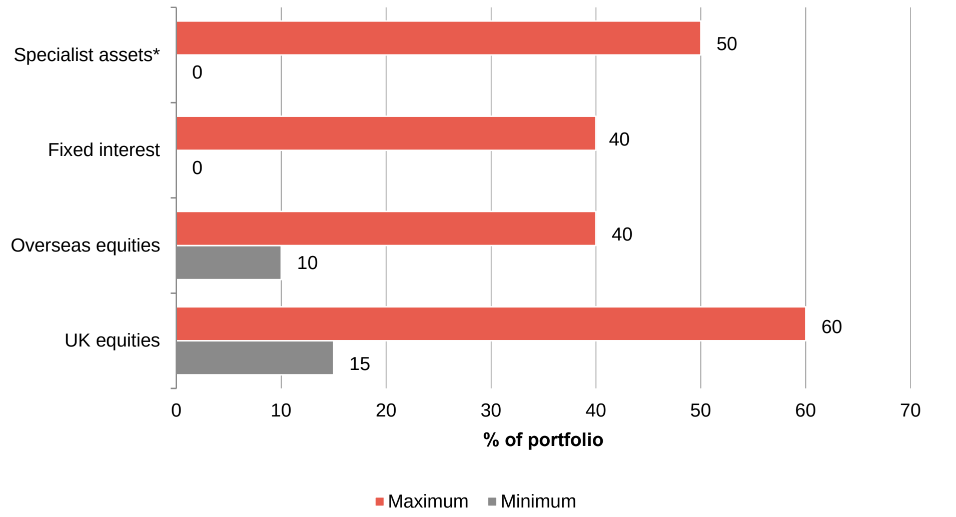
Investment policy changes remove the strategic asset allocation targets, but retain their ranges

As part of the strategy change in 2012, the board set parameters for the individual asset classes in which SIGT invests (see page 7 of QuotedData's annual overview note of 10 March 2017 for more information). These parameters included a strategic asset allocation for each asset class (35% in UK equities, 25% in overseas equities, 15% in fixed interest, 15% in alternative assets and 10% in property) as well as permissible ranges for each asset class. Peter Elston (research specialist for asset allocation) then recommends a tactical asset allocation based on his assessment of the relative value attractions of different asset classes.

> The changes have also seen the combination of the asset classes previously referred to as specialist assets and property.

The investment policy changes have removed the strategic asset allocations for each asset class but have retained the ranges – see Figure 1 below for an illustration (strategic asset allocation remains part of the manager's process but is no longer part of the formal investment policy). The changes have also seen the combination of the asset classes previously referred to as specialist assets and property. Both classes' allocations ranges were 0 to 25% and these have been combined so that the single asset class has a range of 0-50%. SIGT's manager says that this change reflects the fact that it has, for some time, been managing SIGT's property assets as a sub-asset class of specialist assets. Its rationale is that these investments have a number of characteristics in common (a combination of asset backing, inflation-linked income and decisions driven largely by bottom-up considerations. Note: bottom-up considerations relate to individual investments as opposed to top-down, which relate more to macroeconomic considerations.)

Figure 1: Asset allocation ranges



Source: Seneca IM *Note: specialist assets includes property assets.

Aiming to provide real dividend growth

> SIGT has grown its dividends ahead of inflation since the strategy change in 2012

SIGT's new investment objective states explicitly that it aims to grow aggregate annual dividends at least in line with inflation (previously there was no such explicit commitment, although SIGT has grown its dividends ahead of inflation since the strategy change in 2012).

The board has reiterated that it is its intention, barring unforeseen circumstances, to at least maintain the quarterly dividend amount of 1.58p per share for the year to 30 April 2018. This is a total of 6.32p per share, or a yield of 3.6% on the share price of 177.50p as at 9 September 2017.

SIGT's board says that, as the trust aims to grow its dividend at least in line with inflation, the portfolio will also have to achieve real capital growth if it is to meet its proposed investment objective over a typical investment cycle.

Asset growth continues under DCM

SIGT's discount control mechanism has kept the trust trading close to asset value.

SIGT's **discount control mechanism** went live on 1 August 2016 and has been in place for just over a year. During this time, it has kept the trust trading close to **asset value**. The discount control mechanism was designed to give investors confidence that they can enter and exit SIGT at close to NAV. QuotedData has previously said that if SIGT's low volatility returns continue to prove attractive to investors, this, coupled with the confidence offered by the discount control mechanism, could help SIGT to attract new shareholders and grow its asset base over time. This appears to have been the case.

The discount control mechanism has now been tested in both directions.

The trust repurchased one million shares into **treasury** in May 2017, in a single transaction, which the board says it committed to without hesitation. This has been the only repurchase since the introduction of the policy but, with a steady flow of share issuance since, the trust no longer has any shares in treasury and the discount control mechanism has now been tested in both directions. The manager thinks that, with the board ready to stand behind its commitment to repurchase, the absence of any further repurchases since the repurchase in May suggests that the seller has finished exiting. Overall the trust has issued a net 1.635m shares since the policy was introduced, raising net proceeds of £2.85m. The manager says that it continues to see buying from private client brokers and private individuals, the latter predominantly through execution-only platforms.

Manager's view – reducing equity exposure in anticipation of a global recession in 2020

A global equity bear market is expected to commence during 2019, in advance of the global recession.

In June 2017 (see page 3 of that note), QuotedData discussed how the manager has been reducing SIGT's exposure to equities. This reflects both the progression of equity markets as well as a broader view that the global business cycle is making progress and we are moving closer to a point where we experience another global recession. Specifically, Peter Elston (the research specialist for asset allocation) expects to see a global recession in 2020 with a global equity bear market (a period of falling share prices) commencing in advance of this, starting at some point in 2019.

Equities is the worst asset class to hold during the peak phase for the economy.

SIGT's manager says that, while equities are the best overall asset to hold during a recession, it is the worst asset class to hold during the peak phase for the economy. This is why the manager has been reducing incrementally the overall equity exposure over the last 15 months and why it intends to continue to trim the equity allocation roughly by one percentage point every couple of months for the next two years. The combined allocation to equities (UK and overseas) was 60.2% as at 30 June. This suggests an allocation to equities of circa 48% in two years' time, making the fund markedly more defensive than it is today, by the time that the manager expects the global bear market to commence. The manager expects this strategy will soften the impact of the bear market.

Since QuotedData last wrote, equity markets have continued to rise and have become more expensive, supporting the case for reducing exposure. Over the next couple of years, the manager has indicated that it will use periods where equity markets run up to continue to trim the equity exposure, while conversely it will likely hold off where equity markets are experiencing lulls or short-term corrections.

SIGT has a zero allocation to the US.

Recently the manager has been reducing exposure to both the US and Japan. Reflecting what the manager describes as the more advanced nature of the business cycle in the US, SIGT's target allocation for the US is zero and the actual US allocation is at this level.

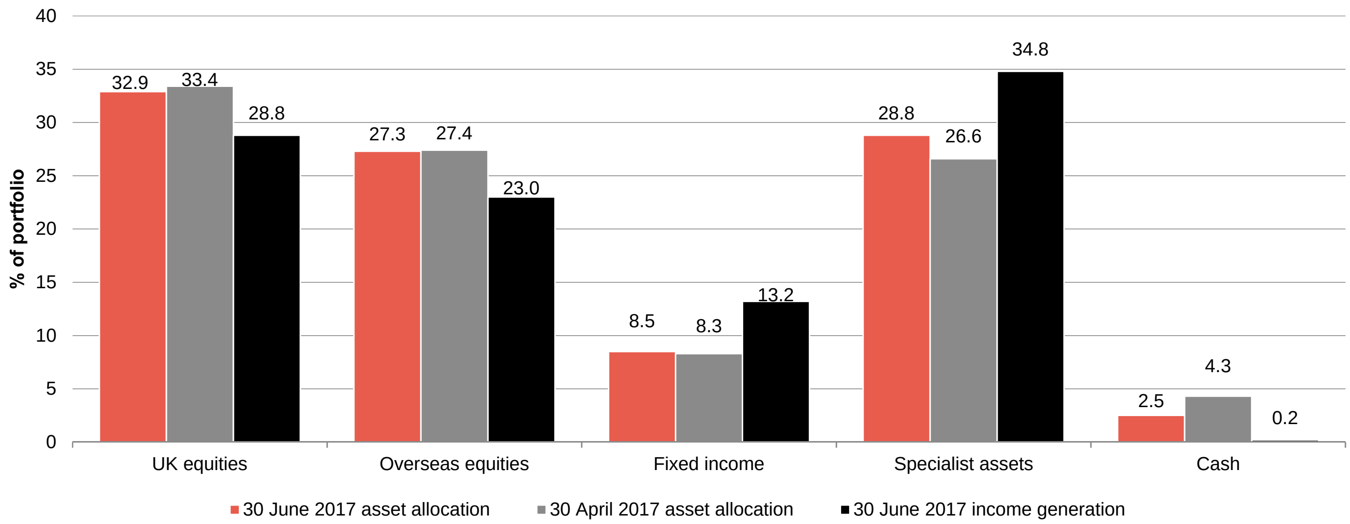
Asset allocation

The trend of reducing equity exposure has continued since QuotedData last wrote on SIGT.

Figure 2 compares SIGT's asset allocations as at the end of April 2017 (the most recently available data when QuotedData last wrote on SIGT) and at the end of June 2017. The proportion of income generation for each asset class is also included. It can be seen that the trend of reducing equities (both UK and overseas) has continued. This, and a reduction in the level of cash, has funded an increase in the allocation to specialist assets.

When QuotedData last published on SIGT in June 2017, it was noted that the research analyst for specialist assets, Richard Parfect, had exited SIGT's residual position in Ranger Direct Lending in April and this funded a small increase in the allocations to Fair Oaks Income and International Public Partnerships. Since this time, changes to the portfolio have been minor with the exception of the initiation of a position in PRS REIT (see below). Amongst the smaller changes, the manager has reduced the exposure to Blue Capital Alternative Income (formerly Blue Capital Global Reinsurance), but has been adding to Aberdeen Private Equity, UK Mortgages and Greencoat UK Wind. The target weight for AJ Bell has also been increased. The manager says that this reflects 'an upward revaluation of the carried value following excellent operating performance in the first half of the company's financial year'.

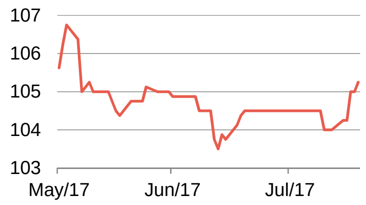
Figure 2: Comparison of end June 2017 asset allocation, end April 2017 asset allocation and end June 2017 income generation



Source: Seneca IM, Marten & Co

Portfolio activity – participated in PRS REIT IPO

Figure 3: PRS REIT share price since IPO

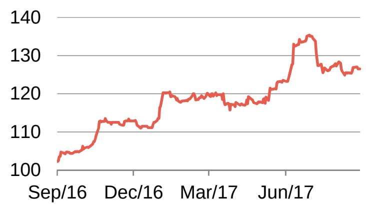


Source: Bloomberg

PRS REIT (PRSR - **www.theprsreit.com**) was admitted to trading on the specialist fund segment of the London Stock Exchange on 31 May 2017. SIGT invested during the IPO, which raised £250m, alongside investors such as Aviva, BMO, Janus Henderson, AXA and the UK government's Homes and Communities Agency. PRS REIT is investing in a portfolio of newly constructed private rental properties (mainly family homes) to be let on assured shorthold tenancies. Its manager, PRS Sigma Management, has two construction partners, Countryside Properties and Keepmoat Regeneration, as well as a longstanding relationship with the Homes and Communities Agency, which it says provides it with a strong source of greenfield and brownfield development opportunities.

PRS REIT invests early in the development process. This releases capital for the developer to allow it to progress the project; improves the developer's working capital ratios; improves the developer's economies of scale; and, because take-up of private rented properties is quicker than buy-to-own, the private rental segment provides the developer with a segment of the development that is established and can be used to market the 'buy-to-own' properties. In return, PRS REIT gets a discount on the cost of the properties it purchases. Richard Parfect, of Seneca IM says that, through economies of scale, PRS REIT is able to purchase its properties at around 88p per £1 of market value and so, on completion of the projects, PRS REIT can usually expect an uplift in its NAV.

Figure 4: Aberdeen Private Equity share price

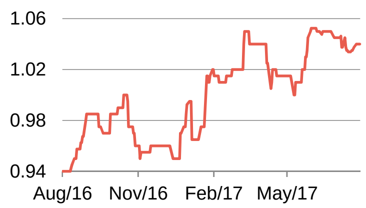


Source: Bloomberg

Aberdeen Private Equity Fund (APEF- **www.aberdeenprivateequity.co.uk**) is a fund that Seneca IM has held in its growth oriented portfolios for some time. Aberdeen Private Equity Fund's September 2016 AGM saw an announcement that the fund would be implementing a new dividend policy whereby it would pay a minimum of 4.0p per annum (two dividends of 2.0p per share). This significantly increases the yield on Aberdeen Private Equity Fund's shares (3.2% as at 9 September 2017) over the previous dividend of 2.2p per annum and this increase made it suitable for inclusion in SIGT's portfolio, given the trust's income and growth focus. The manager says that, at the time of purchase, the sector was on a relatively wide discount of around 30%, with Aberdeen Private Equity Fund at the wider end, arguably reflecting its smaller size.

SIGT's manager says that Aberdeen Private Equity Fund's manager, Alex Barr, is well respected and, in their view, has done an excellent job in turning the fund's performance around. It acknowledges that Aberdeen Private Equity Fund's size (a total NAV of £163.9m and market capitalisation of £145.7m as at 30 June 2017) is an issue and that the fund would benefit from being bigger. However, SIGT's manager believes that Aberdeen Private Equity Fund's board is well aware of this and is motivated to increase the fund's size, having already worked to narrow its discount (Aberdeen Private Equity Fund is trading at a discount of 15.8% to its 30 June NAV of 150.20p as at 9 September 2017).

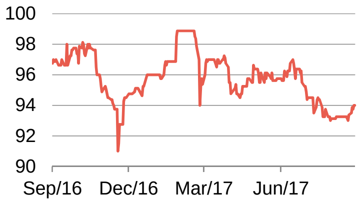
Figure 5: UK Blue Capital Alternative Income share price



Source: Bloomberg

Within specialist assets, the manager has reduced Blue Capital Alternative Income (BCAI – **www.bluecapital.bm**). This reinsurance fund has traded at varying discounts. SIGT's manager considers that Blue Capital Alternative Income's manager has done a good job of managing the fund, providing capital growth, but says that Blue Capital Alternative Income has faced a headwind from low reinsurance rates due to an absence of 'catastrophe events', while considerable capacity has entered the space. SIGT's manager considers that, when investing in reinsurance, it is important to 'follow your money' when rates harden post a significant loss event. He thinks that the fund's change of name is potentially confusing to investors and undermines its appeal. These various issues and changes convinced him to reduce SIGT's holding.

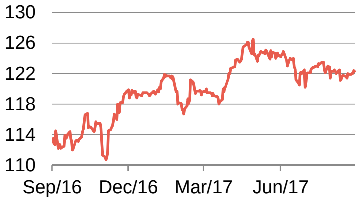
Figure 6: UK Mortgages share price



Source: Bloomberg

In SIGT's manager's view, UK Mortgages (UKML - twentyfouram.com/funds/uk-mortgages-fund) is a fund that has faced a difficult environment since its launch but the worst is now behind it. While it took some time to deploy its IPO proceeds, it is now fully invested and SIGT's manager considers that it has an innovative product that offers a good degree of value protection. The manager acknowledges that growth in the buy-to-let segment could be difficult, but expects to see growth in its other segments. It expects any further equity raises to be done in a controlled fashion and believes risk is skewed towards the upside.

Figure 7: Greencoat UK Wind share price



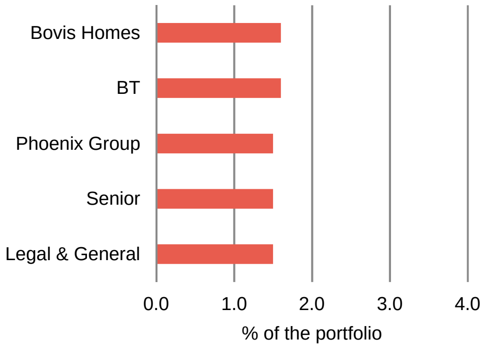
Source: Bloomberg

Greencoat UK Wind (UKW - www.greencoat-ukwind.com) is a fund which SIGT's manager says it likes and knows well. Greencoat UK Wind has been very active in acquiring new assets, thereby increasing its scale. SIGT's manager expects it will seek to raise capital to repay its revolving credit facility, in the not-too-distant-future, allowing it to continue its expansion. SIGT's manager is comfortable with this strategy and believes the increased size allows for greater efficiencies in managing the company and its portfolio of assets.

Largest investments

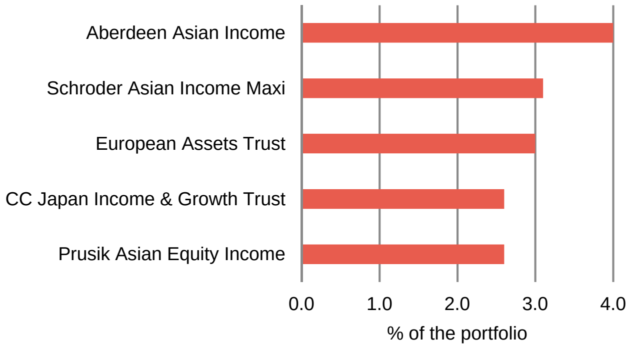
Figures 8, 9, 10 and 11 show the largest positions in each part of the portfolio as at 31 July 2017. Details of the rationale underlying some of these and other positions can be found in QuotedData's previous research notes. Some of the more recent changes are also discussed in detail above.

Figure 8: Top UK equity positions as at 31 July 2017



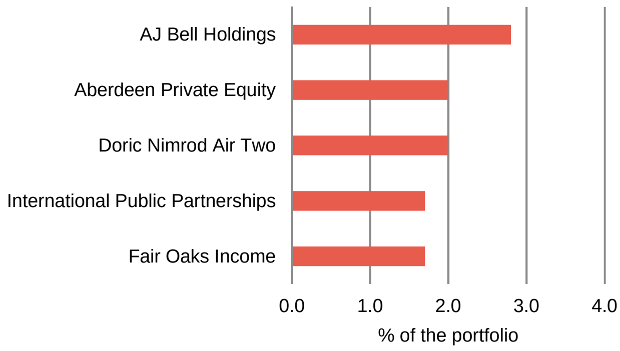
Source: Seneca IM

Figure 9: Top five overseas equity positions as at 31 July 2017



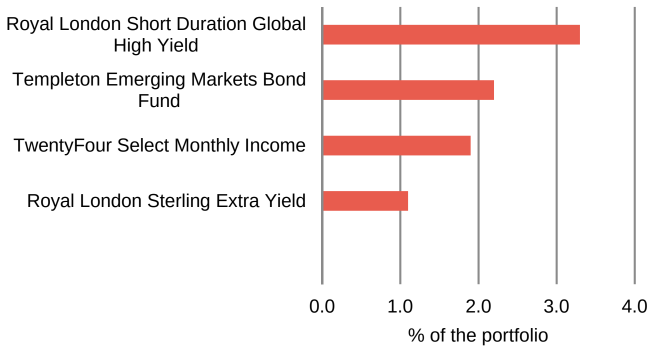
Source: Seneca IM

Figure 10: Top five specialist asset positions as at 31 July 2017



Source: Seneca IM

Figure 11: All fixed income positions as at 31 July 2017



Source: Seneca IM

Performance

Peer group and benchmark-beating returns with lower volatility – click here to see the QuotedData website for up-to-date figures.

Figure 12 illustrates SIGT's benchmark and peer group beating returns over all time periods, a record that SIGT is justifiably proud of. Returns over the past 12 months have been particularly strong, reflecting, in part, strong stock selection as well as asset allocation. Looking at Figure 13, it can be seen that SIGT has achieved these returns with lower volatility than the average of its peer group over all of the time periods provided.

Figure 12: Cumulative total return performance to 31 August 2017

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	Strategy change*
SIGT NAV	1.9	3.0	9.7	17.8	36.5	77.5	87.0
SIGT share price	1.5	2.8	11.2	19.2	44.0	110.8	118.0
Flexible Investment NAV	1.6	1.9	4.8	11.7	30.6	51.5	N/A
Flexible Investment share price	0.5	2.4	6.8	17.0	36.1	59.3	N/A
Blended benchmark**	0.7	1.6	2.4	4.2	11.7	19.8	20.3
MSCI UK	1.5	0.0	4.7	14.0	21.2	55.5	60.8
MSCI World	2.5	3.2	4.5	18.8	55.8	114.6	122.4

Source: Morningstar, Marten & Co. *Note: strategy change was approved by shareholders on 18 January 2012. Please see QuotedData's November 2015 initiation note for more details. **Note: SIGT's benchmark is Libor + 3% from 18 January 2012 changing to CPI + 6% with effect from 7 July 2017.

Figure 13: Annualised standard deviation of NAV returns to 31 August 2017

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
SIGT NAV	6.37	6.48	6.28	7.38	11.08	9.85
SIGT share price	5.84	4.52	4.94	3.91	6.47	6.08
Flexible Investment NAV	6.62	7.32	7.66	8.71	11.15	10.97
Flexible Investment share price	10.94	12.22	11.89	12.31	13.93	13.98
MSCI UK	11.74	10.78	11.04	11.91	18.46	16.53
MSCI World	11.00	10.59	11.33	12.63	15.73	14.38

Source: Morningstar, Marten & Co

Fund profile

Multi-asset portfolio with low volatility returns and an income focus

Further information regarding SIGT can be found at Seneca IM's website: www.senecaim.com

SIGT's aim is to grow both income and capital through investment in a multi-asset portfolio and to have low volatility of returns. Its portfolio includes allocations to UK equities, overseas equities, fixed income and specialist assets.

SIGT is designed for investors who are looking for income, want that income to grow, want the capital of the investment to grow and are seeking consistency, or lower volatility, in total returns. A pure bond fund could meet the first of those needs, a pure equity fund could meet the first three. SIGT invests across a number of different asset classes with the aim of achieving all four objectives.

Seneca Investment Managers – a multi-asset value investor

Seneca IM is a multi-asset value investor. It takes a team approach

SIGT's portfolio has been managed by Seneca Investment Managers (Seneca IM), and its forerunners, since 2005. Seneca IM describes itself as a multi-asset value investor. Its combination of multi-asset investing with an explicit value-oriented approach may be unique. The idea is that Seneca IM can allocate between different asset classes and investments, emphasising those that offer the most attractive opportunities and yields, making asset allocation, direct UK equity and fund selection (for access to other overseas equities and other asset classes) following a value-based approach.

Seneca IM takes a team approach to managing its portfolios: Peter Elston is the research specialist for asset allocation, Alan Borrows for fixed income, Mark Wright for UK equities, Richard Parfect for specialist assets and Tom Delic for overseas equities.

As discussed in QuotedData's note of 13 June 2017 (see page 8 of that note), Alan Borrows intends to retire at the end of this calendar year.

Previous research publications

Readers interested in further information about SIGT, such as investment process, fees, capital structure, trust life and the board, may wish to read QuotedData's annual overview note *Celebrating five years since strategy change*, published on 10 March 2017, as well as QuotedData's previous update notes and QuotedData's initiation note (details are provided in Figure 14 below). You can read the notes by clicking on them in Figure 14 or by visiting QuotedData's website.

Figure 14: Marten & Co. previously published research on SIGT

Title	Note type	Date
Low volatility and growing income	Initiation	2 November 2015
On track for zero discount policy	Update	11 May 2016
In demand and no discount	Update	16 September 2016
Celebrating five years since strategy change	Annual overview	10 March 2017
Changing tack	Changing tack	13 June 2017

Source: Marten & Co.

QuotedData

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IMPORTANT INFORMATION