

BlackRock Throgmorton Trust

Throg's shorts shine

With a decision on Brexit looming and US rates climbing, many investors appear to have adopted a more defensive stance. Dan Whitestone, manager of BlackRock Throgmorton Trust (THRG), has reduced the portfolio's net exposure to markets to well below 100%, taking profits on some positions. Otherwise, Dan's focus remains on the long-term drivers of growth. His ability to short (taking a negative exposure to) companies with unsound business models gives him another way of making money even when markets are falling. Over the year to 30 November 2018, short positions added 1.4% to returns.

Both long and short positions in UK small-and-mid-cap companies

THRG aims to provide shareholders with capital growth and an attractive total return by investing primarily in UK smaller companies and mid-capitalisation companies listed on the main market of the London Stock Exchange. It uses the Numis Smaller Companies Index (plus AIM stocks but excluding investment companies) as a benchmark for performance purposes, but the index does not influence portfolio construction. Uniquely among listed UK smaller companies trusts, THRG's portfolio may include a meaningful allocation to short as well as long positions in stocks.

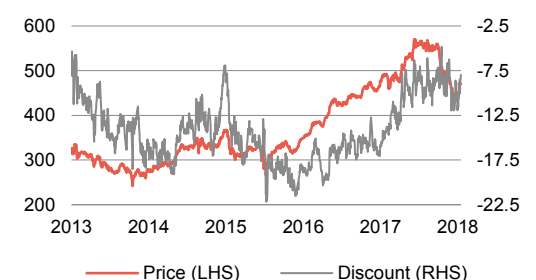
Year ended	Share price total return (%)	NAV total return (%)	Peer group average NAV TR ¹ (%)	Numis Smaller Co.s plus AIM, ex IC ² (%)	MSCI UK total return (%)
31/12/14	(10.9)	(2.3)	(0.6)	(1.9)	0.5
31/12/15	34.7	22.0	17.9	10.6	(2.2)
31/12/16	(2.7)	10.0	9.2	11.1	19.2
31/12/17	39.4	34.0	27.1	19.5	11.7
31/12/18	(6.6)	(11.5)	(12.6)	(16.7)	(8.8)

Source: Morningstar, Marten & Co. Notes: 1) the peer group is defined on page 6. 2) Between 1 December 2013 and 22 March 2018 the benchmark was Numis Smaller Companies excluding both AIM and investment companies.

Sector	UK smaller companies
Ticker	THRG LN
Base currency	GBP
Price	471.0
NAV	511.8
Premium/(discount)	(8.0%)
Yield	2.2%

Share price and discount

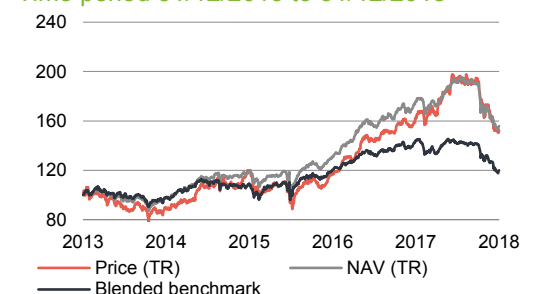
Time period 31/12/2018 to 14/01/2019



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/12/2013 to 31/12/2018



Source: Morningstar, Marten & Co

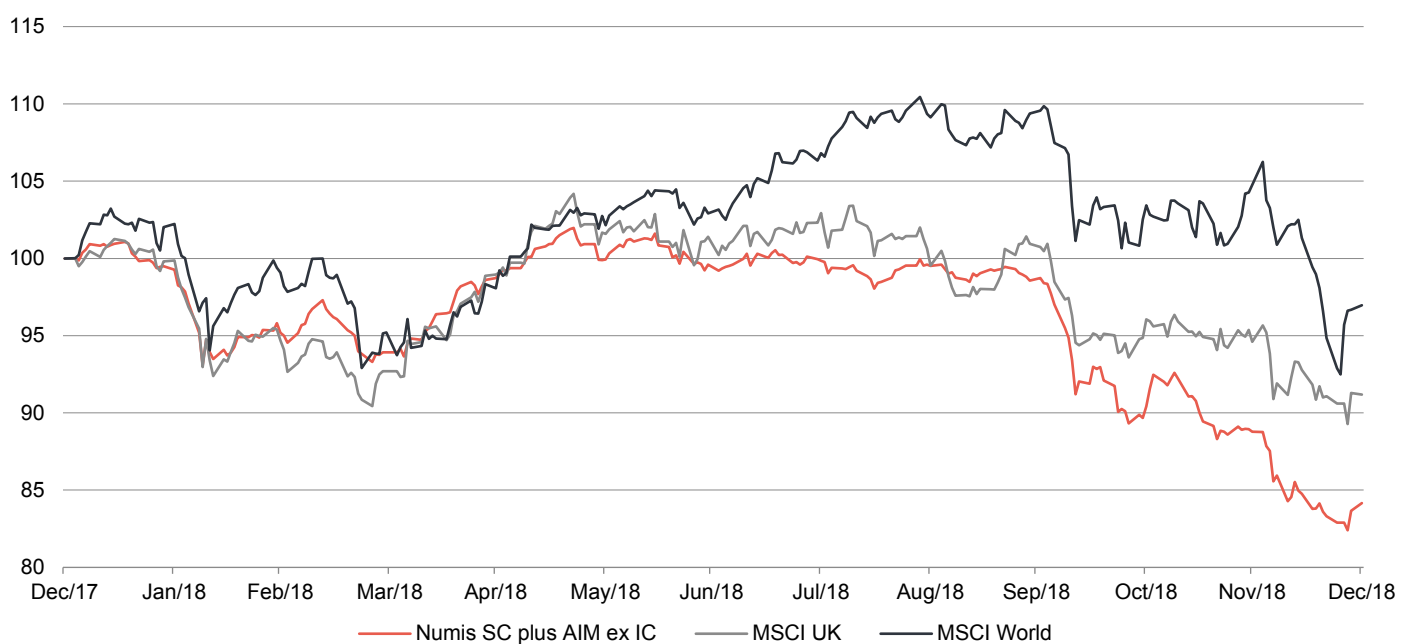
Domicile	England & Wales
Inception date	1 December 1962
Manager	Dan Whitestone
Market cap	344.4m
Shares outstanding	73.13m
Daily vol. (1-yr. avg.)	132,646 shares
Net cash	6.8%

[Click here for QuotedData's initiation note](#)

A correction, not a bear market

As markets retreated in October and assets perceived as risky fell in value, BlackRock Throgmorton Trust (THRG) gave up a little of its outperformance of its benchmark index. However, it remains well-ahead of both the benchmark and competing funds since Dan Whitestone (Dan or the manager) assumed responsibility for the fund in February 2018. THRG’s recent performance and the underlying drivers of it are explored on page 6.

Figure 1: Numis Smaller Companies plus AIM ex Investment Companies, MSCI UK and MSCI World over the year to 31 December 2018



Source: Morningstar, Marten & Co

Investors have been selling risk assets, including ‘growth’ stocks, small and medium sized companies, and technology stocks

A combination of increasing tension between the US and China leading to the imposition of tariffs on imports, rising US rates, Brexit, falling indicators of business confidence and the dramatic collapse of the oil price has helped trigger falls in markets over the last couple of months. Figure 1 shows that the UK market (as represented by MSCI UK) has underperformed world markets (as represented by the MSCI World Index). In addition, smaller companies (as presented by the Numis index) have underperformed larger ones. Investors have been selling assets that they think are riskier than average, including ‘growth’ stocks, small and medium-sized companies, and technology stocks. Dan has taken profits on a number of successful investments and, as discussed on page 3, has also reduced THRG’s net exposure to markets.

Dan’s investments are driven by stock-specific and industry-specific factors. Therefore, macroeconomic considerations are secondary. Dan believes that further interest rate rises are unlikely in the UK and inflation is not a serious problem (as technology and other disruptive influences act to undermine pricing power in many industries). Wages have been rising, but wage inflation is unlikely to become entrenched as technology offers a way of cutting the workforce in many industries.

Market volatility is increasing but THRG's manager believes we are not entering a prolonged bear market

Bias to companies with differentiated and defensive business models as well as international earnings

Dan acknowledges that market volatility is increasing but sees this as a market correction rather than the start of a bear market (even though some stock market indices are in bear market territory). He notes that there do appear to be some pockets of weakness in the global economy, but he points out that there are also many companies with strong order books. Investors are selling companies that they perceive to be expensive; unwilling, for the moment, to believe that earnings growth will be maintained and that these companies' ratings will be justified. We may see an increase in merger and acquisition (M&A) activity as international buyers take advantage of the weak pound and companies look to consolidate as a way of driving earnings forward in a lacklustre business environment (Dan does not believe that this strategy works in the long-term).

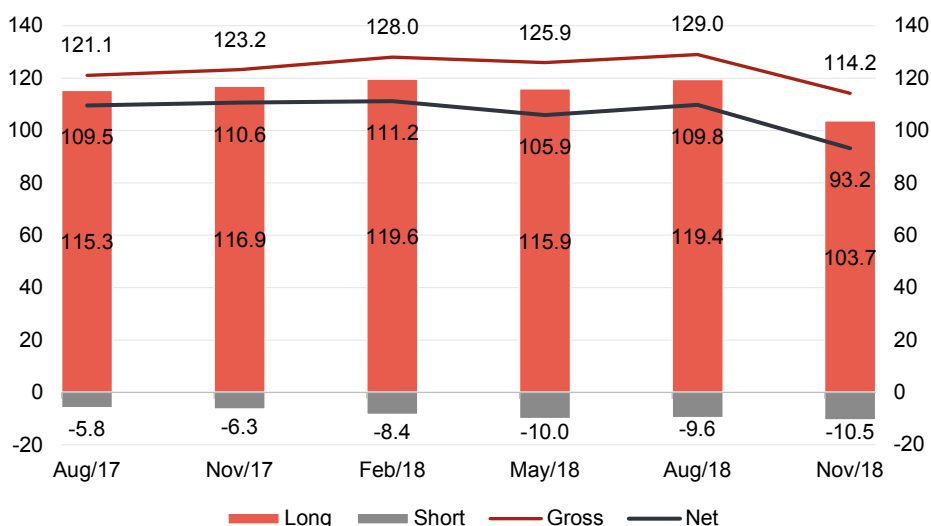
Dan's focus is on companies with differentiated and defensive business models. He expects that this approach should be beneficial in a downturn. While there are some exceptions (such as holdings in Workspace, Derwent London and Howden Joinery), the portfolio is biased naturally towards companies with overseas earnings. Therefore, while THRG has benefited from sterling weakness, it might not keep up with UK market in the short-term on any rally in the currency.

Dan believes that many companies trading on attractive yields are effectively paying dividends from debt. Such practices may be unsustainable, especially if interest rates rise and/or debt finance becomes harder to obtain. Dan suggests that his emphasis on cash generation and avoidance of companies with stretched balance sheets (except for the short portfolio) will also stand THRG in good stead.

Asset allocation

The biggest shift of the past few months has been a reduction in the portfolio's net exposure to equities. This is evident in Figure 2.

Figure 2: THRG quarterly market exposure



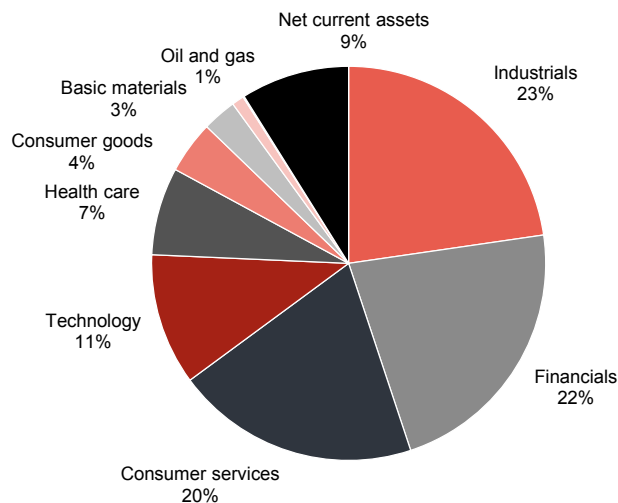
Source: BlackRock Throgmorton Trust

Significant cut in gross exposure

The gross and net exposure have been cut significantly, from around 130 to 114, and 110 to 93 respectively. This is as defensive a stance as Dan has taken since 2009.

At the end of November, relative to the benchmark, THRG had a modestly overweight exposure to FTSE AIM stocks and an underweight exposure to FTSE 250 and FTSE Small Cap stocks.

Figure 3: THRG portfolio by industrial sector as at 30 November 2018



Source: BlackRock Throgmorton Trust

Despite the market setback, Dan’s focus remains firmly on growth companies. He has moderated the portfolio’s exposure to growth cyclicals (companies whose earnings are growing faster than the economy but nevertheless are exposed to economic cycles) and industrials, since the initiation note was published (this used data as at end July 2018). THRG’s exposure to industrials has fallen from 32% to 23% over this period.

Top 10 holdings

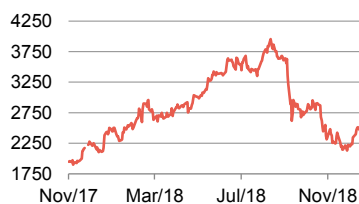
Figure 4 shows the top 10 holdings in the portfolio as at the end of November 2018.

Figure 4: 10 largest holdings as at 30 November 2018

Stock	% of gross assets 30/11/18	% of gross assets 31/07/18	% change	Sector	Business focus
Hiscox	3.0	2.6	1.0	Financials	Insurance
Ascential	2.9	3.2	0.9	Consumer services	Business-to-business media company
SSP	2.8	2.4	0.8	Consumer services	Transport-related food and beverage outlets
Craneware	2.8	0.0	2.8	Technology	Healthcare-related technology
Aveva	2.8	1.0	1.8	Technology	Software for industrial customers
Dechra Pharmaceuticals	2.7	2.8	(0.5)	Health care	Veterinary pharmaceuticals
4imprint	2.5	2.2	(0.4)	Consumer services	Supply of promotional merchandise in the US
YouGov	2.4	2.1	0.3	Consumer services	Polling and market research
IntegraFin	2.2	2.1	0.1	Financials	Owner of the Transact platform
Bodycote	2.2	2.3	0.6	Industrials	Heat treatment and thermal processing

Source: BlackRock Throgmorton Trust, Marten & Co

Figure 5: Fever Tree Drinks

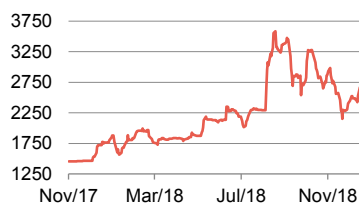


Source: Bloomberg, Marten & Co

Fever Tree Drinks

Fever Tree Drinks (fever-tree.com) did not feature in THRG's top 10 holdings at the end of November 2018, despite having been its third-largest holding at the end of July 2018. Dan has reduced the position significantly, booking considerable profits, ahead of the worst of the share price correction. There has been no news of any significance on the company since QuotedData's last note was published and so the dramatic share price move seems to have been driven by a change in sentiment rather than a shift in fundamentals.

Figure 6: Craneware



Source: Bloomberg, Marten & Co

Craneware

Craneware (craneware.com) is a recent entrant to the list of THRG's top 10 holdings. It provides technology to US hospital groups, aimed at optimising their profitability. It has a good track record of improving its revenue and profits and, for a UK-based investor, its dollar earnings have been flattered by sterling weakness. The company claims to have around a quarter of US hospitals as customers and is broadening the range of services it provides to them.

Figure 7: Aveva Group

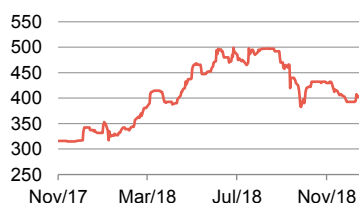


Source: Bloomberg, Marten & Co

Aveva Group

Aveva Group (www.aveva.com) is a global provider of engineering and industrial software focused on digital transformation. It provides a comprehensive range of services that are aimed at improving efficiency and maximising profitability for its customers and it provides these to a wide range of sectors (for example, food and beverages, infrastructure, life sciences, resources, chemicals, water and waste water). Aveva's recent interim results showed 10.9% growth in revenue but a much greater uplift in margins and profits, which delivered a 41% increase in earnings per share. The percentage of its revenues that are recurring is rising too, improving the quality of its earnings.

Figure 8: YouGov

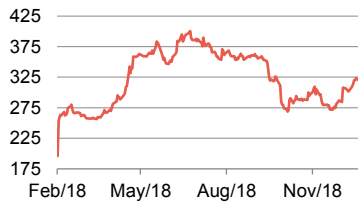


Source: Bloomberg, Marten & Co

YouGov

YouGov (yougov.co.uk) delivered a 9% uplift in revenue and a 52% uplift in its adjusted earnings per share over the year to the end of July 2018. While there is no end of polling opportunities in relation to politics, the real growth of the company is in the services it is providing to companies, not only in relation to their brand presence but also in relation to their online advertising. It is growing internationally and seeing good growth from its data analytics tools as well as from its custom research business.

Figure 9: IntegraFin



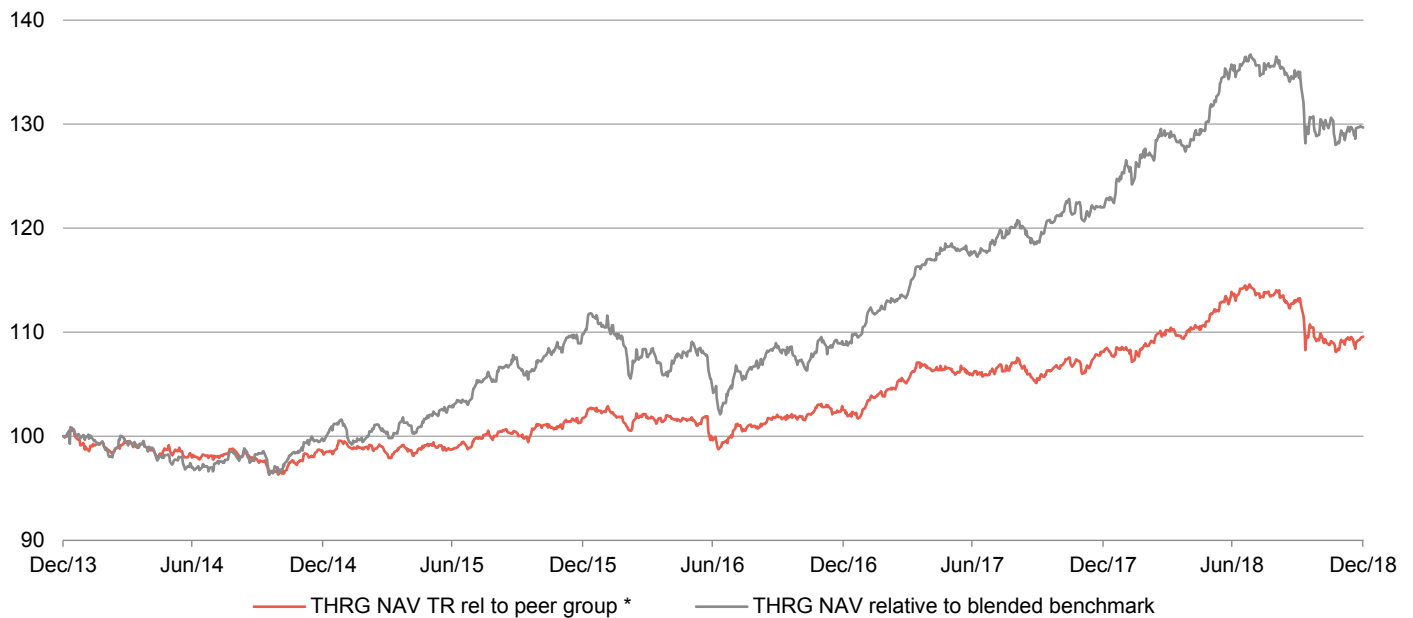
Source: Bloomberg, Marten & Co

IntegraFin

IntegraFin (integrafin.co.uk) is the parent company of the Transact UK investment platform. It had £33.1 billion of funds under direction at the end of September 2018 (up 18.6% year-on-year). Its IPO (initial public offering) in March 2018 was well received and in December 2018 it reported decent revenue and profit growth for the year ended 30 September 2018. However, its share price weakened following an FCA report suggesting that measures needed to be introduced to make it easier to switch investment platforms.

Performance

Figure 10: THRG NAV total return performance relative to benchmark¹ and peer group² to 31 December 2018



Source: Morningstar, Marten & Co. Note 1) Note: THRG has a blended benchmark that is the Numis Smaller Companies Index (plus AIM stocks but excluding investment companies) since 22 March 2018 and prior to 1 December 2013. Between 1 December 2013 and 22 March 2018 the benchmark was Numis Smaller Companies excluding both AIM and investment companies. 2) The peer group is defined below.

Up-to-date information on THRG and its peer group is available on the [QuotedData website](#)

For comparison purposes, this note uses a subset of funds in the AIC’s UK smaller companies sector. Split-capital companies, trusts with a market capitalisation of less than £50m, those that focus exclusively on micro-cap companies and Odyssean Investment Trust (which is a relatively recent new issue) have all been excluded.

THRG’s returns have been affected by recent market weakness and it has given up some of the outperformance of its benchmark and peer group. Nevertheless, as illustrated in Figure 10 and overleaf in Figure 11, over longer time periods THRG has demonstrated strong relative performance when compared to both its benchmark and competing funds, particularly over the last couple of years.

Figure 11: THRG performance over periods ending 31 December 2018

	1 month	3 months	6 months	1 year	3 years	5 years
THRG share price TR	(4.4)	(20.3)	(21.6)	(6.6)	26.7	52.1
THRG NAV TR	(5.0)	(17.8)	(19.3)	(11.5)	30.6	55.7
Blended benchmark ¹	(5.3)	(15.2)	(16.1)	(12.6)	21.2	42.1
Peer group ² avg. NAV TR	(5.2)	(14.6)	(15.5)	(16.7)	10.6	20.1
MSCI UK TR	(3.6)	(9.7)	(10.1)	(8.8)	21.4	19.3

Source: Morningstar, Marten & Co. Note: 1) THRG has a blended benchmark that is the Numis Smaller Companies Index (plus AIM stocks but excluding investment companies) since 22 March 2018 and prior to 1 December 2013. Between 1 December 2013 and 22 March 2018 the benchmark was Numis Smaller Companies excluding both AIM and investment companies. Note 2) The peer group is defined above.

The short book added 1.4% to THRG's NAV over the year ended 30 November 2018

BlackRock has provided some performance attribution analysis, covering the 12 months to the end of November 2018 (its financial year end), a period over which THRG outperformed its benchmark by 6.3%. It is important to highlight that the short book made a net positive contribution to returns over this period of 1.4%.

Figure 12: Positive contributors to relative performance over year to 30 November 2018

	Average weight in THRG portfolio (%)	Average weight in benchmark (%)	Estimated performance impact (%)
Hiscox	1.9	0.0	0.7
IntegraFin	1.4	0.0	0.6
YouGov	1.7	0.1	0.6
4imprint	2.2	0.3	0.5
Fever Tree Drinks	1.8	0.0	0.5
Sumo Group	1.2	0.1	0.5
Lonza Group	0.7	0.0	0.5
Zotefoams	1.0	0.1	0.5
Short position	(0.1)	0.0	0.4
Dechra Pharmaceuticals	2.5	0.1	0.4

Source: BlackRock

Hiscox's share price has had a great run and the company was promoted to the FTSE100 Index recently.

Figure 13: Negative contributors to relative performance over year to 30 November 2018

Heading	Average weight in THRG portfolio (%)	Average weight in benchmark (%)	Estimated performance impact (%)
Boku	0.2	0.1	(0.4)
Restore	1.8	0.2	(0.3)
Fidessa Group	0.0	0.5	(0.3)
Drax Group	0.0	0.6	(0.3)
Hill & Smith Holdings	1.5	0.5	(0.3)
Plus500	0.0	0.5	(0.3)
Superdry	0.3	0.0	(0.3)
Short position	(0.3)	0.6	(0.3)
CVS Group	1.8	0.2	(0.2)
Luceco	0.1	0.1	(0.2)

Source: BlackRock

Boku is a company that helps support mobile commerce, including customer acquisition and billing. The shares did well until a number of early investors sought to sell their

stakes in the company. The share price fell further after Boku used stock to acquire Danal, a provider of mobile identity and authentication solutions.

Short successes

Two examples of short positions that proved profitable in 2018 rewarded the manager's aversion to heavily indebted companies and those with questionable accounting practices

As explained in the initiation note, BlackRock has a strict policy of not naming companies that it has shorted. Successes in THRG's short CFD (contract for difference) portfolio over its financial year included a position in a wholesale drinks company, which went into administration following accounting irregularities, and a construction company that was forced to shore up its balance sheet with a rights issue. THRG had a short position in the construction company for some time. Dan notes that banks are reportedly less keen than they have been to lend to the sector. This may be to the benefit of other short positions that THRG has in this sector.

The unnamed short that lost money during the period is still a position in the portfolio, as Dan remains convinced that it will pay off in time.

In addition to Dan's emphasis on industries facing structural challenges (such as pubs, restaurants and builder's merchants), good indicators of stocks that might be suitable for the short portfolio include those with questionable accounting, overstretched balance sheets and a mismatch between declared profits and cash flow generation.

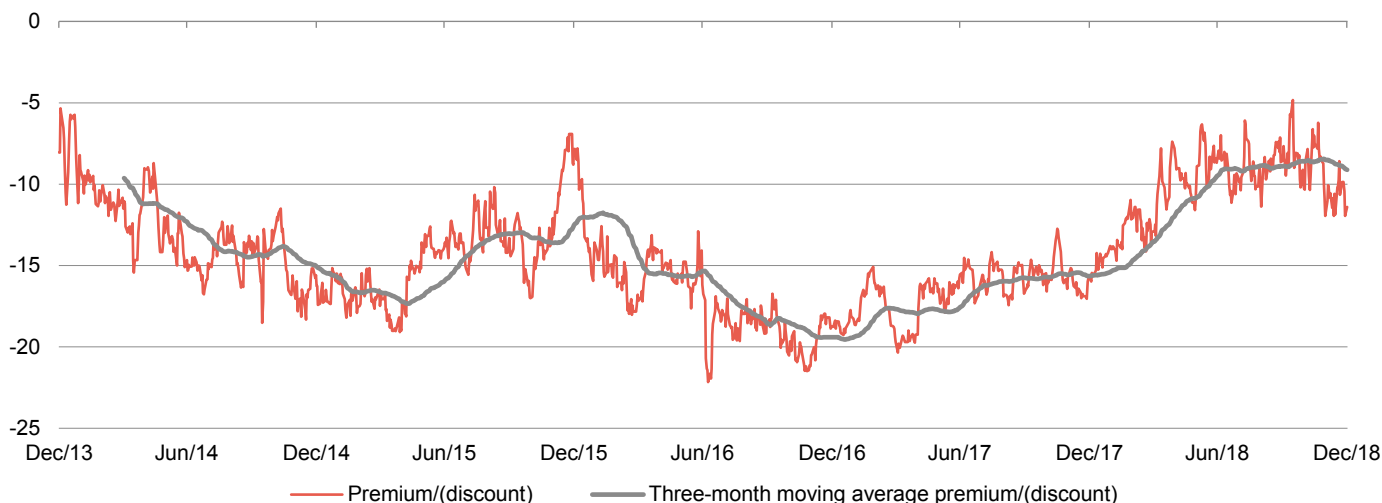
Discount

Discount appears to be on a narrowing trend despite recent setback

Over the past couple of years, THRG's discount has been on a narrowing trend. Over the five-year period to the end of November 2018, THRG's discount has averaged 14.2%. Over the year to the end of November 2018, the discount moved within a range of 4.8% to 16.0% and, as at 14 January 2019, the discount was 8.0%.

The board is keen that the discount should narrow. It believes the best way of achieving this on a long-term basis is for the fund to deliver benchmark and peer group beating returns and to increase the awareness of the fund.

Figure 14: THRG discount over five years to 31 December 2018



Source: Morningstar, Marten & Co

Fund profile

Further information about THRG is available at the investment manager's website. [Please click here](#)

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For the period between 1 December 2013 and 22 March 2018, the benchmark was Numis Smaller Companies Index excluding both AIM stocks and investment companies. There used to be a restriction on the trust's exposure to AIM companies, but this was removed in March 2018 and, at the same time, the manager was given permission to invest up to 15% of the portfolio in stocks listed on exchanges outside the UK.

Both long and short positions

THRG's unique approach includes taking both long and short positions within the portfolio

Uniquely among listed UK smaller companies trusts, THRG's portfolio may include a meaningful allocation to short as well as long positions in stocks. Up to 30% of the portfolio may be invested in CFDs, both long and short. Under normal market conditions, the net exposure will account for 100-110% of net assets.

The manager

Dan Whitestone has been sole manager of the trust since 12 February 2018

BlackRock Investment Management (UK) Limited was appointed manager of the trust in July 2008. Dan Whitestone, head of the smaller companies team at BlackRock, has been sole manager of the trust since 12 February 2018 (he had been co-manager, alongside Mike Prentis, since March 2015). Dan heads a team of four. All members of the team manage portfolios, and between them manage or advise on about £3bn across a variety of different funds. This includes the £140m UK emerging companies fund that Dan manages with an all-cap mandate and permission to hold up to 20% of the fund in international stocks (closely resembling the THRG mandate). The team shares research responsibilities between them.

Previous publications

We published an initiation note on THRG on 11 September 2018 entitled '**Vision, execution and adaptability**'. This is available to read on our website or by clicking the link.

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