HARDMAN&CO.

Investment Companies

Right back where we started from[1] –retail influence and specialist fund managers?

By Hardman & Co in collaboration with Argus Vickers

ARGUS VICKERS®
Intelligent Shareholder Analysis

[1] *Right back where we started from*, originally recorded by Maxine Nightingale, released 1975

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Summary

- We believe this is the first paper to analyse ownership of Investment Company (IC) sectors by type of investor. It has been written in collaboration with Argus Vickers.
- ICs were originally created in the 19th century as a vehicle for wealthy private investors and those who wanted to utilise the skills of a specialist in the asset class.
- They increasingly fell out of favour in the middle of the 20th century as retail investors flocked to mutual funds, institutions took specialisation in-house and ICs came to be viewed as old-fashioned with weak governance.
- ICs are back in fashion, partly following recent difficulties relating to illiquidity and suspension of dealing by some mutual funds.
- All ICs offer investors the benefit of pooling risk and diversification for a small investment, whilst "alternatives" can have additional advantages, such as creating liquidity in illiquid assets and providing exposure to asset classes investors wouldn't otherwise be able to access.
- Strangely, these attributes were precisely why investors clubbed together in the 19th century to form investment trusts, as ICs used to be called. In fact, you could say we are *Right back where we started from*[2].
- At the end of 2019, the combined market capitalisation of all ICs was more than £170bn. If we exclude the "Unknown Unknowns"[3], 52% of the shares were owned by institutions, 44.7% by retail investors, according to our definitions[4]. In "traditional" ICs, which invest in quoted securities, retail accounted for nearly 60%, whilst they owned just under 20% of "alternatives", which focus on unquoted investments; we expect retail to take an increasingly larger share of alternatives as the attractions of the yields and covenants become better known.
- Retail ownership varies dramatically by AIC sector.
- We are likely to see greater interest in ICs from retail in the future, reflecting dramatic growth in SIPPs, declining final salary scheme provision and the availability of better investment tools for retail. At end-2019, platforms had assets of £713bn, with a potential to grow to £5,306bn[5]. ICs are a perfect way for SIPPs to get diversification for a low fee.
- Addressing the new audiences for ICs, such as retail, wealth managers and family offices, requires different channels and approaches than those used for institutional.

[2] Right back where we started from, originally recorded by Maxine Nightingale, released 1975
[3] See Methodology for further detail about "Known Unknowns" and "Unknown Unknowns".
[4] All the tables and charts in this paper calculate percentages of types of investor in respect of the shareholder registers that are known, i.e., excluding "Unknown Unknowns".
[5] *Platform potential: How big is the potential investment platform market in the UK?*, Hardman & Co, May 2020

The purpose of this paper

In the past two years, since Hardman & Co first started to target the IC sector, we have heard many managers of ICs and boards talk of the growth of the retail investor on their registers. Many have approached Hardman & Co for help in addressing this market, since we have a unique strength in this field relative to other providers.

We answer the question of how important retail investors are

There has been much talk of a changing shape to shareholder registers, and individual IC managers can talk about their own share register. However, when questioned about the aggregate impact, nobody seems to know the answers. Indeed, we have found no available analysis of IC registers by sector or type. This paper seeks to fill that gap. We are indebted to Argus Vickers, without whom this *Insight* would not be possible.

This paper looks at the position at the end of 2019. It proves conclusively that retail investors are critical to share registers for ICs. Our work on other parts of the market suggest that retail is even more important to liquidity in shares (institutions tend to buy strategic stakes to hold), than their presence on registers would suggest[6].

[6] *Share ownership: for the many, not the few?*, Hardman & Co, 13 January 2020

Investment Companies – A little history

The beginning

ICs (or trusts, as they used to be called) have been around since the middle of the 19th century. They were the first collective investment vehicles, through which many investors could club together to benefit collectively from pooling investments. It is arguable where they first started; however, in the English-speaking world, the first is generally considered to be the Foreign and Colonial Government Trust, founded in 1868, whose name was subsequently changed to Foreign and Colonial Investment Trust.

Trusts founded so wealthy investors could club together and find new, adventurous investments

Essentially, these trusts were created for two reasons. The first reason was that they enabled groups of wealthy individuals to band together to share the risk of investing their surplus cash. The second was that they could employ experts to look after their money, critical if the money was being used to finance overseas "adventures" or developments. For example, the Scottish Mortgage and Trust Company Limited, today a FTSE 100 constituent, was founded in 1907 as the Straits Mortgage and Trust Company Limited, to lend money to rubber planters in the Far East, secured on their rubber estates. Another example was the Alliance Trust, created in 1888 from the merger of Dundee Investment Company, the Dundee Mortgage and Trust Investment Company and the Oregon and Washington Trust; these three trusts helped recycle the capital being accumulated by successful Dundee businessmen. As an example of its investments, the Oregon and Washington Trust made loans to immigrant farmers on the West Coast of the United States. Much of this money helped build the modern world with railways, ships, farming, etc. being funded[7].

Interesting though all this history is, the point is that it was wealthy individuals who were the shareholders in these early trusts. That all changed after the Second World War as the shareholder registers came to be dominated by institutions – pension funds, life companies, insurance accompanies and their like. Why? Well, because, as money flowed into these institutions, trusts could provide diversification and, in many cases, specialist investment skills. If you were a small, internally managed pension fund that wanted exposure to Japanese equities, and couldn't justify having an in-house Japanese expert, you could "outsource" that allocation by buying a stake in a trust (the old-fashioned term) whose remit was to invest in Japan.

Falling out of favour

Trusts fell out of favour because mutual funds seemed more attractive…

In recent decades, interest in ICs waned for many reasons. Retail investors increasingly turned to mutual funds instead[8]. These were easy to understand (for example, investors did not need to consider discounts or premia to Net Asset Value, which can be key to evaluating trusts), heavily marketed and simple to deal in (you didn't need an account at a stockbroker)[9]. As platforms, such as Hargreaves Lansdown, grew, mutual funds had the advantage of being able to continually issue new units to meet demand. In contrast, platforms wishing to invest in ICs would need to find sellers of the shares in the stock market, or persuade an IC to go through the process of have another issue, a cumbersome and expensive process

[7] For those of you who would like to read more, try one of John Newlands' wonderful publications such as *Murray International Trust PLC - Celebrating more than a hundred years of sound investment*, Second Edition, 2018 or *The History of Dunedin Income Growth Investment Trust PLC*; see www.newlandsfr.com.

[8] M&G launched the first unit trust in the United Kingdom in 1931

[9] For more detail, see Appendix – A brief synopsis of the differences between ICs and mutual funds, p.27.

involving, brokers and lawyers. As a consequence, the open-ended or mutual fund market is several times the size of the IC market in the UK.

...as fund management groups combined, they didn't need to outsource to specialised areas...

ICs fell out of favour with institutions as well. As these institutions merged into ever-bigger entities, they had their own in-house specialists, who could cover every geography in equities and bonds. Why pay someone else to do this and what might it imply about your confidence in your in-house team? Of course, small institutions and pension funds still needed to outsource, but their share of the market shrunk.

...and they seemed to have weak governance

Other than these clear reasons for retail and institutional investors to look elsewhere, investment trusts came to be seen as simply outdated, perhaps representative of an era in financial services whose time had gone. There seemed to be a close-knit clique of directors who sat on each other's boards, perpetually re-electing one another. The fund managers were never sacked, however poor performance might be, and shareholders seemed to be an inconvenient necessity. Shareholders might worry about a gap between the share price and NAV – boards seldom did.

The phoenix from the ashes

Recent years have witnessed a reversal of the post-war trend.

Governance issues have been addressed...

Company directors now come under far more scrutiny. In the past, the asset manager that created the trust would always run it, whatever happened. Now, the asset manager risks losing the contract to manage the fund if it performs poorly. A striking early example of this occurred in 2002 when Edinburgh Fund Managers (later subsumed into Aberdeen Asset Management) suffered the embarrassment of being fired by its board as the manager of their flagship vehicle, The Edinburgh Investment Trust, in favour of Fidelity Investments International. Mandates now regularly change hands. There is also emphasis on managing any discount to NAV, with several techniques developed to address this.

...new asset classes have been created that appeal to institutions...

Institutional investors still have little interest in outsourcing management of "plain vanilla" assets, such as equities in various geographies. However, they have rediscovered ICs as a means to access the expertise needed to invest in the esoteric asset classes offered by ICs. It is unlikely, for example, that they will have a specialist in music royalties. Want to invest in music royalties? – two ICs offer that choice, Hipgnosis and Round Hill. They won't have a team devoted to wind energy (Greencoat Wind), nor battery storage (Gore Street Energy Storage and Gresham House Energy Storage), nor lending to drug companies (BioPharma Credit). Often, these asset classes are ones in which individual assets are illiquid – the closed-end structure of ICs enables investors to take an exposure without being locked in; there is always a price for the shares, albeit a big discount to the apparent NAV might open up. We are likely to see an even greater range of such unique asset opportunities in the future.

...and mutual funds have come under a cloud

Retail has become more interested in ICs as well. Perhaps this has been helped by recent travails in mutual funds. Several times, some of these have had to suspend dealing. For example, the £2.5bn M&G Property Portfolio suspended dealing in December 2019 due to "unusually high and sustained outflows" as investors demanded their money back, amid worries about Brexit and retail property. The difficulties of getting your money back from the Woodford Equity Income Fund will be known to most retail investors from newspaper coverage, even if they aren't investors themselves. Similar investment headwinds might affect an IC, but there will always be a price in it.

Retail investors are going to become even more important to ICs

Retail investors are a growing influence on the market. We have written elsewhere, about how their share of the stock market as a whole fell sharply from 1963 when they owned 54% of the total market, before rebounding in recent years[10]. What has driven this growth in direct retail investment?

- Many retail investors are desperate for income as returns on deposit accounts have collapsed. The capital markets have been able to use the IC structure to list certain types of assets, which are inherently illiquid, but provide high running returns to accommodate this demand.
- As final salary pension schemes have closed, retail investors have taken more control of their own investments through SIPPs. ICs are great for these because they provide a spread of assets for smaller investments with reasonable fees.
- We estimate that, by December 2019, investment platforms held assets of £713bn and their addressable market was £5,306bn[11].
- There are more tools today to help the man in the street invest, ranging from easier access to information on company websites and active Twitter communities to sponsored research, such as that from Hardman & Co.
- There are many simple-to-use providers of execution-only, online share dealing services at remarkably low prices. Gone are the days when you needed to be introduced to a stockbroker by your playing partner at the golf club and needed to visit the broker at his stuffy offices in Austin Friars.

So it is that ICs are again appealing to retail investors seeking diversification and institutions wanting expert management of exposure to new areas. The early decades of the 21st century have seen investors coming back to ICs for the very same reasons they were established in the late 19th century. Hence, we seem to be *Right back where we started from*.

Brief synopsis of the methodology in this paper

Hardman & Co has worked with Argus Vickers the complete intelligent shareholder analysis service, to understand the registers of ICs quoted in London.

There are a number of assumptions that we have used. More detail on these assumptions can be found in the Methodology section of this paper, but below is a brief summary:

- **Date of data:** All the data, unless otherwise specified, is for the end of calendar 2019. For some ICs, Argus Vickers checks the register every month. Thus, the data for December 2019 will be used (it may not have been collected on the last day of the month, however). For other ICs, data is collected quarterly, so the data will be for a date within the fourth quarter of 2019.
- **IC sectors:** Where we refer to a sector, we are using Association of Investment Companies (AIC) definitions. Each IC is allocated to just one sector, even though it could, arguably, qualify for several categories.
- **"Traditional" vs. "alternative":** Professionals in the space use these terms. There is no agreed definition, but, generally, a "traditional IC is one which invests in

[10] *Share ownership: for the many, not the few – The sequel*, Hardman & Co, February 2020
[11] *Platform potential: How big is the potential investment platform market in the UK?*, Hardman & Co, May 2020

traded (or perhaps quoted/listed) securities such as equities and bonds, whilst an "alternative" IC invests in untraded, illiquid assets. We have allocated funds to traditional or alternative at the AIC sector level; i.e., every IC within a sector is in the same basket, traditional or alternative.

- **Investor groups:** Argus Vickers has identified 53 types of investors in ICs. For ease of analysis, we have divided these into five groups: institutions, retail, market, government and other. We carried out a sampling exercise with Argus Vickers looking at individual entries within each category to satisfy ourselves. Given the particular emphasis in this article on retail, readers might wish to review the Argus Vickers investor types that we classify as retail[12]. Inevitably, there will be differing opinions as to which investor group an investor type should be allocated.

- **Percentage of register identified:** Argus Vickers is unable to identify every holder on the register. Unidentified holders fall into two groups. To use Donald Rumsfeld's terminology, the first group is the "Known Unknowns"; the holding is held in a nominee name, but Argus Vickers has been unable to identify the ultimate beneficiary; these holdings are included in the "Others" investor group. The second group is the "Unknown Unknowns"; many ICs are registered overseas, where there is less transparency on the share register, unlike the United Kingdom, meaning Argus Vickers cannot see the holders; the second group also includes holders with holdings below a minimum threshold – Argus Vickers does not collect data for holders of less than 0.01% of the share capital if they are institutions or 0.1% if retail.

- **Errors:** If there are errors in the data or its presentation, they are entirely the responsibility of Hardman & Co.

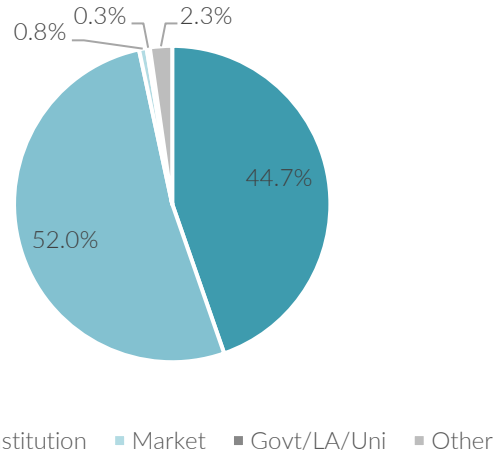
[12] Retail includes "Private Holder", "Director Holdings", "Personal Equity Plan", "ISA", "Employee Share Ownership Plan", "Stockbrokers", "Employee Benefit Trust", "Saving Scheme", "Trust", "Self-Invested Pension Plan" and "Share Incentive Plan". See Methodology for more detail.

The big picture

ICs quoted in London represent a substantial repository of funds. At the end of 2019, the combined market capitalisation of all quoted ICs was more than £170bn[13]. We use this figure because this is the value that shareholders would receive if they sold all their shares at the closing price on that day. Of course, all investors could not sell all their shares on the same day and the market capitalisation of ICs is not the same as the value of their underlying assets – some trade at a discount to assets, others at a premium – that is the nature of closed-ended funds.

Institutions and retail investors dominate IC share registers

Ownership of ICs at end-2019

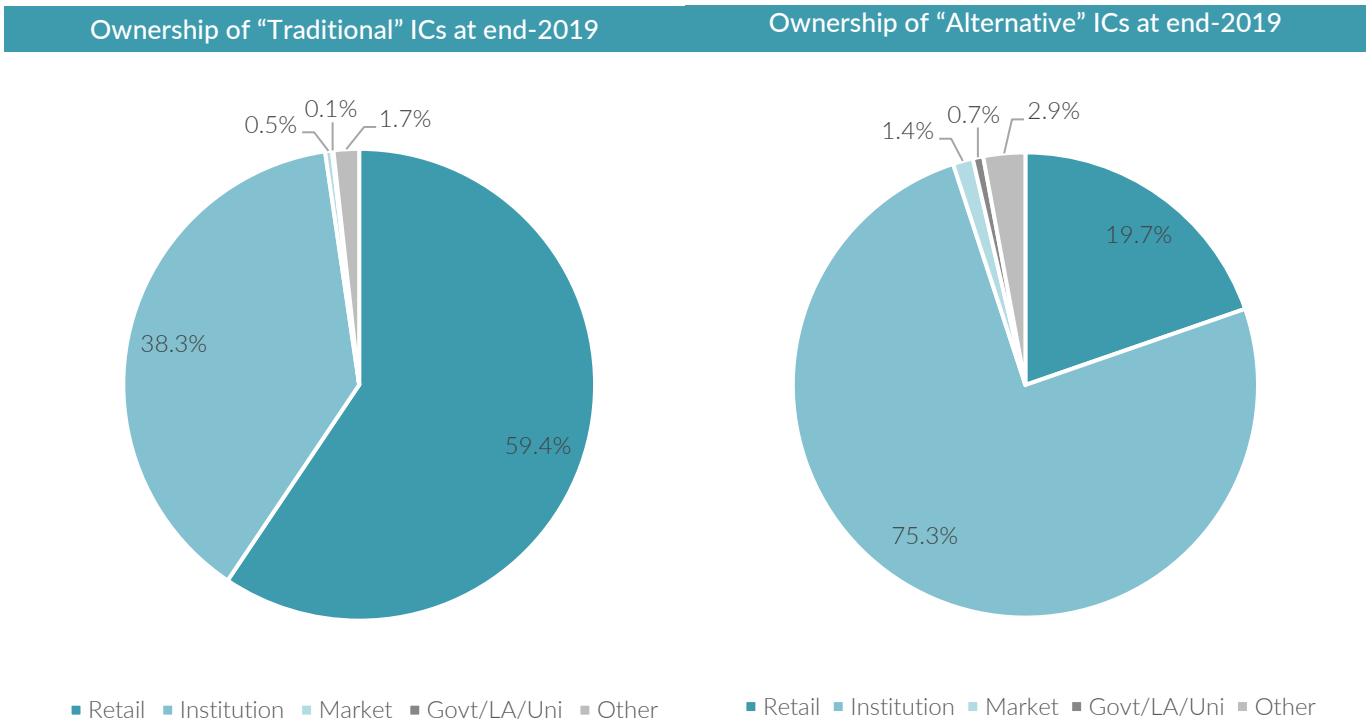


Source: Association of Investment Companies, Argus Vickers, Hardman & Co

Looking at the entire universe of London-quoted ICs, we find that share registers are dominated by two types of investor – institutions and retail. This paper will delve into the detail behind these headlines.

[13] Including approximately £30bn of "Unknown Unknowns", i.e., unaccounted for holdings. See Methodology for detail.

Traditional and alternative ICs



Source: Association of Investment Companies, Argus Vickers, Hardman & Co

The charts above show the dominance of traditional registers by retail. These investors appear less important to alternatives, but are critical to particular alternative sectors.

Larger institutions less interested in outsourcing in traditional equity and bond fields

As institutions have merged in recent decades and small funds have been outsourced to the big boys, they have increasingly built teams to cover quoted markets, whether it be Japanese small caps or North American equities. They have less justification for, or need to gain, that exposure through ICs. The slack has been taken up by the retail investor who now dominates the share registers of traditional ICs.

Alternatives have grown rapidly in recent years, meeting the demand for income and exposure to unusual assets. Retail represents a smaller part of the register for alternatives but, at just under 20%, should not be ignored. Indeed, as we shall demonstrate, for many alternative sectors, retail dominates, and, we suspect, retail will take an increasing share over time.

New issuance predominately in alternatives space

At end-2019, the total market cap of all traditional ICs was £99.7bn[14], whilst alternatives had grown to £67.5bn[15]. The gap between the two is likely to continue to close as alternatives managers continue to meet investor demand.

[14] Including £9.9bn of "Unknown Unknowns"
[15] Including £15.9bn of "Unknown Unknowns"

New IPOs in 2019/20			
Date	Investment Company	New money raised (£m)	Type
10/12/2019	Octopus Renewables Infrastructure Trust Plc	350.00	Alternative
13/11/2020	Round Hill Music Royalty Fund Limited	214.84	Alternative
16/04/2019	US Solar Fund Plc	153.10	Alternative
24/09/2019	JPMorgan Global Core Real Assets Limited	148.97	Traditional
05/06/2019	Aquila European Renewables Income Fund Plc	136.29	Alternative
21/02/2020	Nippon Active Value Fund Plc	103.00	Traditional
28/05/2019	Riverstone Credit Opportunities Income Plc	76.80	Alternative
Total		**1,183.01**	

Source: London Stock Exchange, Hardman & Co

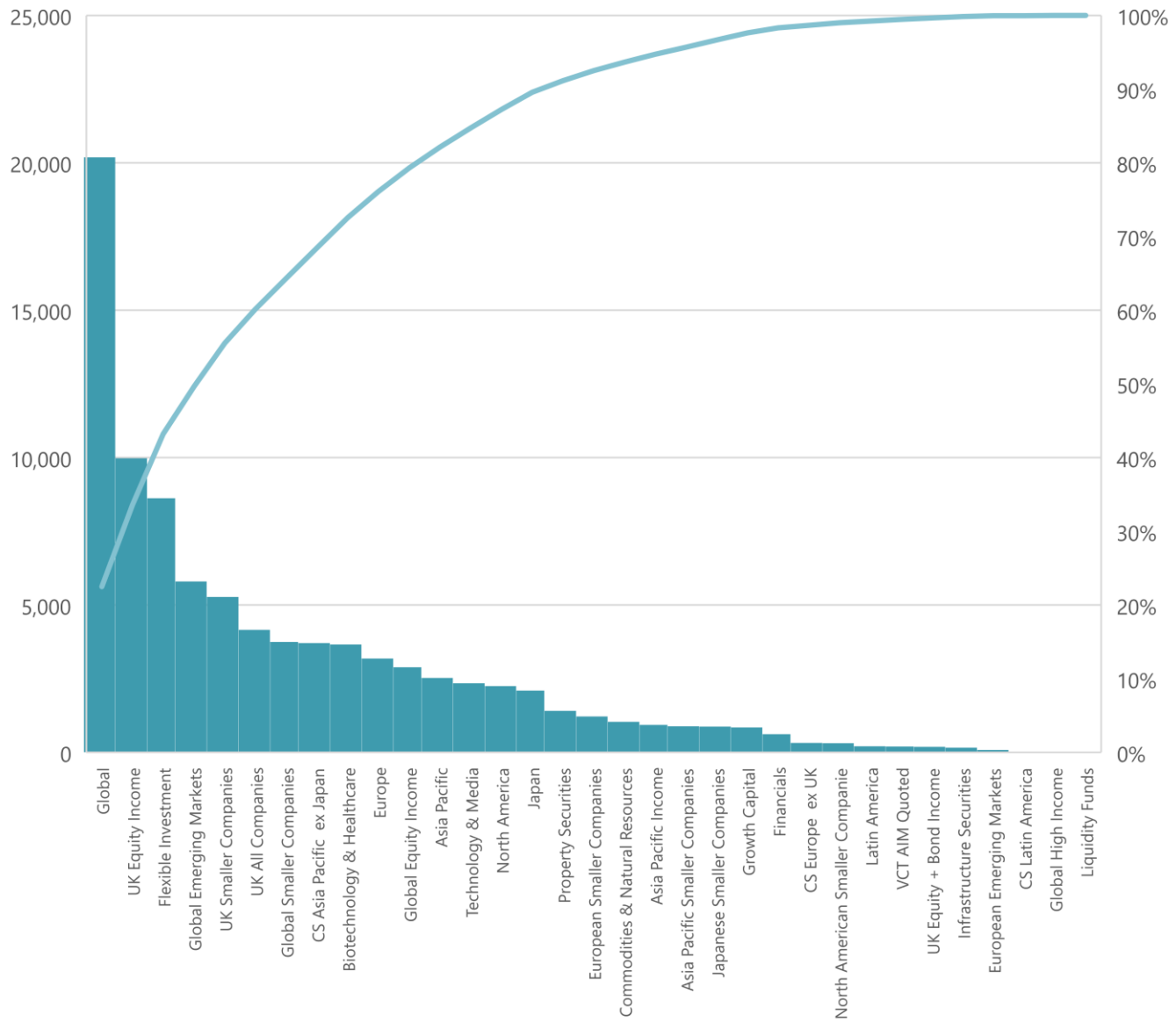
The table above shows that just under £1.2bn was raised by new ICs listing via IPO on the Main Market of the London Stock Exchange in 2019 and 2020. Of all the money raised, only 21.3% was in the traditional sectors; JP Morgan's Global Core Assets is classified as "Flexible Investment", whilst the Nippon Active fund is in the "Japanese Smaller Companies" sector.

Traditional IC ownership by sector

If you have skipped to this section, let us remind you that we define "traditional" ICs as those for whom the bulk of assets are quoted securities.

At the end of 2019, the market capitalisation of all the traditional ICs was £99.7bn[16]. The largest component was the "Global" sector, which accounted for 22.5% of the total, followed by "UK Equity Income" (11.1%), "Flexible Investment" (9.6%) and "Global Emerging Markets" (6.5%). The chart below gives further detail.

Traditional IC sectors by market cap (£m) at end-2019

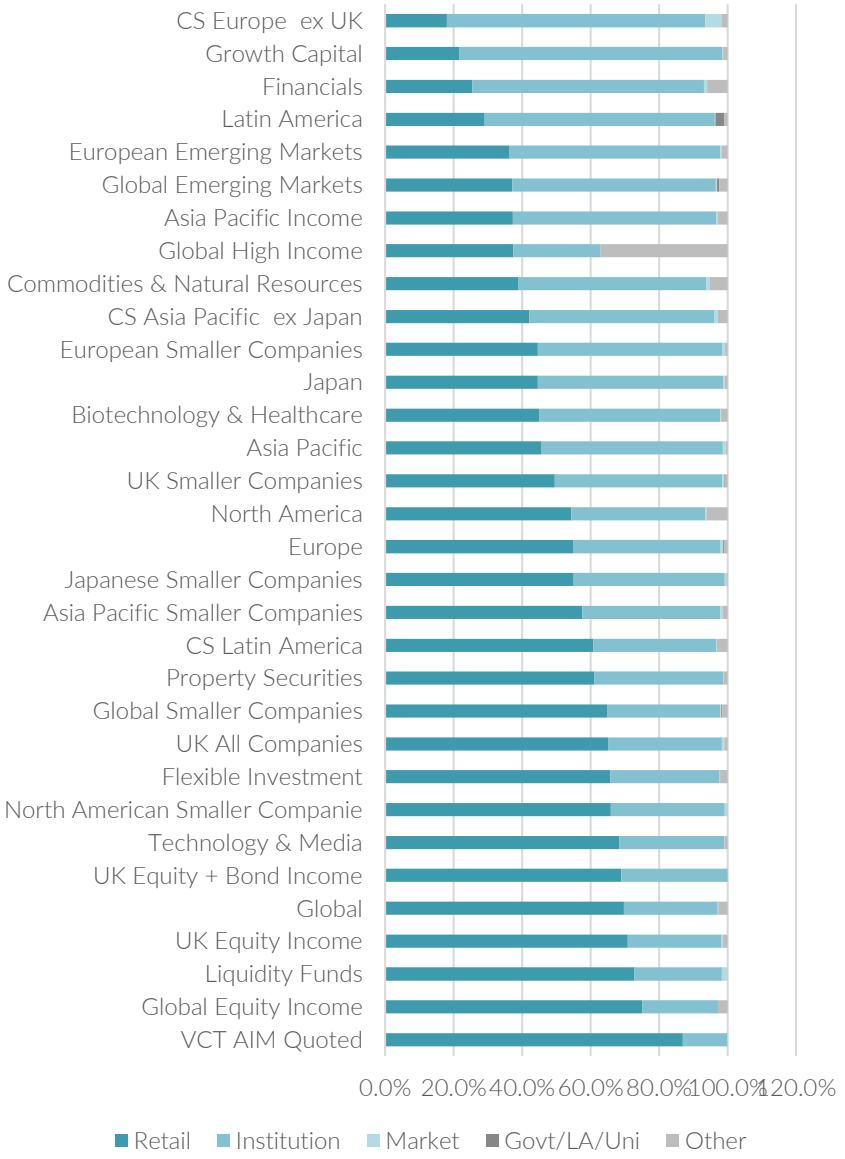


Source: Association of Investment Companies, Argus Vickers, Hardman & Co

[16] Including £9.9bn of "Unknown Unknowns"

wTurning to how ownership varies by sector, the following chart shows that the sector least owned by retail is “Country Specialist, Europe ex UK” (18%). The most owned is “Global Equity Income” at 75%, if we ignore the special case of VCT (venture capital trust) AIM Quoted, which, as we explain later, is targeted at retail.

Traditional IC ownership by sector at end-2019



Source: Association of Investment Companies, Argus Vickers, Hardman & Co

The more general a fund's aims, the bigger the proportion owned by retail

If there is a theme to be extracted, it is that the more general a fund, the larger the retail portion of its register. Or you could say, the more specialist, the more significant is institutional; that should not be a surprise if institutions use funds to gain exposure to assets where they might lack specialist expertise themselves.

Alternative IC ownership by sector

If you have just jumped to this section, let us remind you that we define "alternative" ICs as those for whom the bulk of assets are in unquoted assets.

Alternative ICs can create liquidity for illiquid assets

In recent years, there has been an explosion of issuance in the alternatives space in contrast to "traditionals". Capital markets professionals have found that the closed-ended structure is ideal for making illiquid asset classes liquid! Thus, they have been able to raise money for asset classes such as roads, solar farms, song catalogues and warehouses. We referred earlier to the risks of using mutual fund structures to hold illiquid assets, using the example of the suspension of the £2.5bn M&G Property Portfolio in December 2019 due to *"unusually high and sustained outflows"*. A closed-ended fund would not need to do this – there will always be a price in the market for the shares, albeit maybe not palatable to some investors. The IC structure has created liquidity and given investors access to asset classes they might otherwise have been excluded from.

Alternatives provide what investment trusts did in the early days:

- the chance to combine your investment with others in a collective manner;
- the benefit of diversification with even a small investment;
- access to opportunities that would otherwise be unavailable; and
- the comfort that you have an expert making the decisions and monitoring your investment.

Some alternative ICs are very attractive to income investors…

Therefore, it is not surprising that demand for the asset classes that alternatives offer has boomed, and, principally for two reasons. The first factor is the desperate search for income. Retail investors who focus on income have struggled to find it as the returns on savings accounts at banks have quite simply collapsed; indeed, there is talk of negative interest rates being applied. Living off the income from your bank accounts is no longer possible for most retirees. Also, that is just looking at nominal interest rates – most bank accounts are, in reality, providing negative returns, when inflation is taken into account. There are plenty of professional investors who are also seeking income and for whom alternatives offer a new route.

…and institutions looking for exposure to esoteric assets that comes with specialist expertise

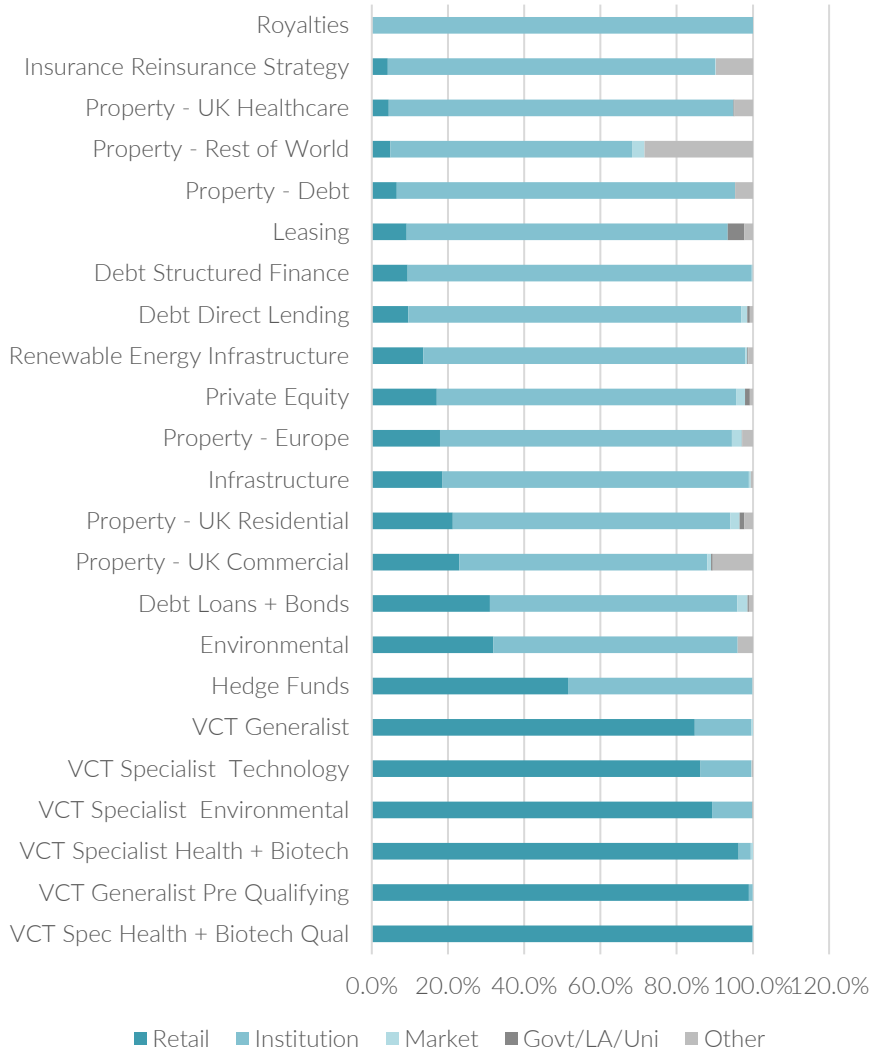
The second factor is that alternatives offer institutional investors access to asset classes which they themselves couldn't find, or lack the expertise to manage. These asset classes may be of interest because they enable wider diversification of risk, faster capital growth or returns that are uncorrelated to the economy, equities or bonds. For example, there has been much debate about the growth of private equity (PE) and its returns. If you run a small institution and cannot invest directly in PE, you have the choice of 14 quoted PE ICs. A small institution can effectively delegate management of their PE exposure to a specialist in the sector, and even buy at a big discount to the value of the underlying assets (unweighted average discount to NAV at end-December 2020 of 16.3%). If that weren't attractive enough, you also get liquidity, unlike direct PE investments – the PE IC sector had a total market cap of £18.3bn[17] at the end of 2019.

The table below shows that the sectors in the alternatives space appeal to different classes of investor. At one extreme, there are virtually no retail investors in "Royalties" ICs and low percentages in the specialist and complex sectors of "Property – Debt" (6.6% of the register), "Leasing" (9.2%) or "Debt Structured Finance" (9.4%). In contrast, retail investors feel more comfortable in the more

[17] Including £1.6bn of "Unknown Unknowns"

generalised sector of "Debt, Loans and Bonds" (31%) and care about "Environmental" (31.9%) and, of course, dominate VCTs.

Alternative ICs ownership by sector at end-2019

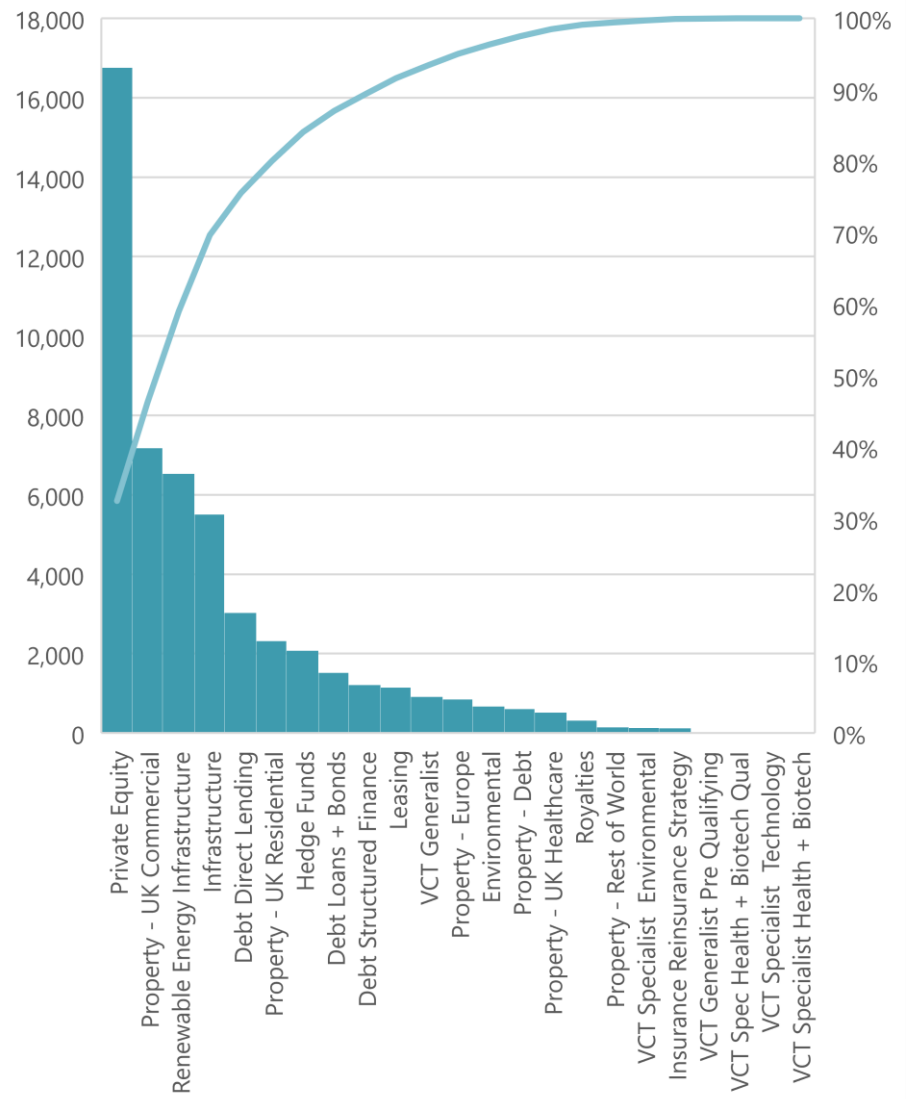


Source: Association of Investment Companies, Argus Vickers, Hardman & Co

At the end of 2019, the market capitalisation of all the alternative ICs was £67.5bn[18]. "Private Equity" was the largest sector, accounting for 32.5% of the total, followed by "Property – UK Commercial" (13.9%), "Renewable Energy Infrastructure" (12.7%) and "Infrastructure" (10.7%). The chart below gives the full picture.

[18] Including £15.9bn of "Unknown Unknowns"

Alternative IC sectors by market cap (£m) at end-2019



Source: Association of Investment Companies, Argus Vickers, Hardman & Co

VCT IC ownership by sector

VCTs aimed at retail, so no surprise they dominate the register

All but one VCT sector is categorised as alternative because they invest in private opportunities. The one exception is the "VCT AIM Qualifying" sector whose constituents invest in shares on the Alternative Investment Market (AIM) of the London Stock Exchange (LSE). These companies have to qualify for tax relief (not all do); this sector is defined by us as "traditional". This section looks at all VCTs as a separate group.

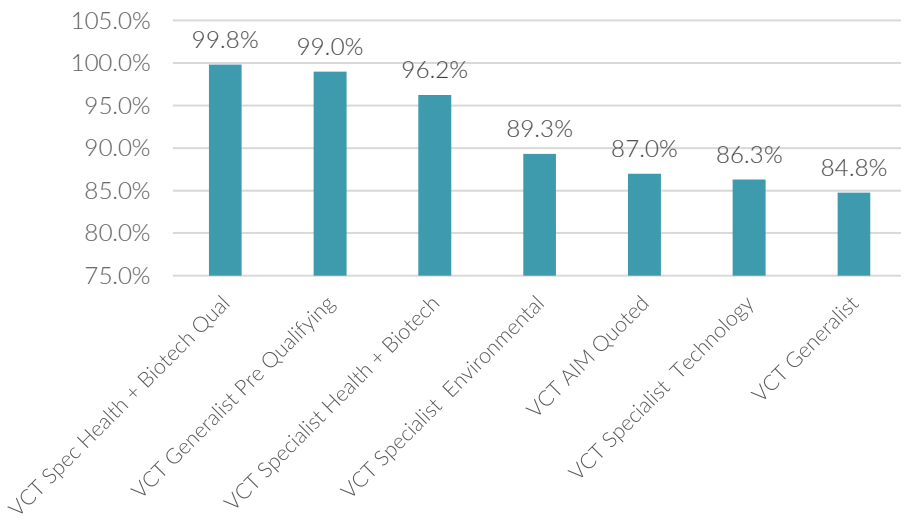
VCTs provide a tax incentive to individuals to invest in early-stage companies, meeting specific qualifying criteria where there is a significant risk of loss of capital. Unlisted companies can qualify if they meet certain conditions[19].

Investors subscribing for new shares in VCTs get relief of 30% of their investment (up to £200,000 p.a.) against income tax, so long as they hold the shares for a minimum of five years. There is also income tax relief for dividends and any gains on disposal are free of Capital Gains Tax (CGT).

Investors who buy existing VCT shares qualify for the income tax relief on dividends and gains are free of CGT, however short their holding period. However, they do not get the initial relief.

It is to be expected, therefore, that the shareholder registers of VCTs are dominated by retail, as indeed they are. The real surprise in the table below is that the shareholders register isn't simply 100% retail – maybe we have been too conservative in our definition of "retail".

Retail ownership % by VCT sector

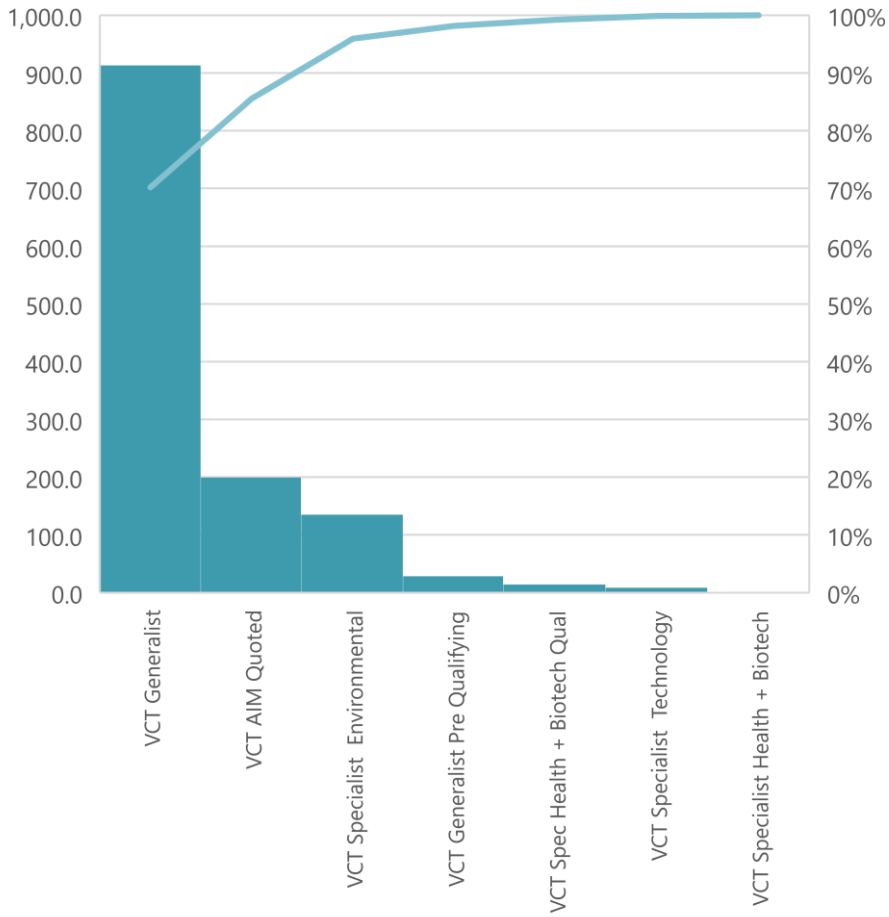


Source: Association of Investment Companies, Argus Vickers, Hardman & Co

[19] HMRC draws a distinction between companies that are listed on the LSE Main Market and do not qualify for tax relief, and those that are traded on AIM, deemed "unlisted", which potentially do qualify.

The chart below shows that this part of the IC market is dominated by "Generalist" funds, which accounted for just over 70% of the combined market capitalisation of VCTs.

VCT sectors by total market cap (£m)



Source: Association of Investment Companies, Argus Vickers, Hardman & Co

Reaching the new IC investor audience

The boards and managers of ICs should be well used to reaching institutional investors with tried and trusted methods. Their challenge is in addressing retail.

Getting through to retail investors requires a different approach

When considering retail, it is easy to make the mistake of thinking that they are all the same. We prefer to think of retail investors on a spectrum. At one end, you have investors who want to take long-term decisions (perhaps for their Self-Invested Pension Plan (SIPP)), might have considerable sums to invest (at the end of 2019, it is estimated that there were 2m SIPPs with £180bn in assets) and think carefully about their decision – they have the added benefit as shareholders in that they are not governed by quarterly performance reviews. At the other end of the scale are "punters", for whom the stock market is an alternative, when dog-racing at Walthamstow is rained off. Thankfully, there is generally insufficient share price volatility in ICs to attract the latter; however, investor targeting should focus on the former and avoid the latter.

Access via platforms

Unless you can get on platforms' preferred list, best to go over their heads and straight to retail

Many of the sophisticated retail investors in ICs do so via a platform (e.g., Hargreaves Lansdown). Platforms jealously guard access to their clients. Platforms often have shortlists of funds they put to their clients. There has been some debate about these lists; some have argued that they constitute a recommendation, which would be subject to greater oversight, others question what the nature of the financial relationship is between the platform and the fund. The platforms refuse to carry independent research by third parties and, in reality, the only way to access their clients via the platform is to get on their shortlist, whatever that might take.

Ways to directly target retail investors

Advertising in the press

In the past, both mutual funds and ICs were heavy users of press advertising. Increasingly, professionals in the industry think this is a blunderbuss and are looking to a more targeted approach.

Investment research available to retail

Sponsored research can prove a valuable tool, but much of what is available is dull, fails to address the key issues and is probably best described as advertorial rather than research

Our earlier comments in this section highlight the sophisticated nature of many investors in this sector. It is disappointing, therefore, to find that most of the research that they can read is best described as "lightweight". Most research in the space is just description rather than analysis. It does not answer the fundamental questions about why an investor should be interested in the space and what the risks are. Instead, it largely consists of a review of past performance, consideration of the current portfolio, or even simply reporting an interview with the manager. Much of this "research" runs to less than 10 pages.

There is also an overemphasis on past net asset value (NAV) performance and the discount or premium to NAV. There is nothing wrong with considering NAVs and discounts and it might be sufficient for traditional ICs. It is, however, wholly inappropriate for alternatives. For example, if the alternative is invested in credits, then the key questions concern the risks in the lending, the stage of the credit cycle and how defaults are dealt with. Worrying about discounts is almost an irrelevance. To cover alternatives, you really need to be a specialist (a credit analyst for credits, a renewables analyst for renewables, etc.). These are areas where an investment trust analyst will be lost.

Hardman & Co's approach has been to use experienced specialist analysts to write authoritative research that answers every question an investor might have, backed up by thought-provoking updates addressing particular topics.

Distribution

Great research without the right distribution is a waste of time

Having great research is of no use if nobody can read it. The reach into retail of many research providers is best described as "challenged". For example, one of Hardman & Co's competitors, which claims to actively address retail, has a Twitter following of 655; Hardman & Co has 19,600 followers[20] – Twitter has generated a powerful community of retail investors. Hardman & Co also has an email campaign system, which is modelled on that of successful online retailers, using multiple targeted campaigns with a system of optimisation; this generates opening rates of, typically, 15%-20%, way above the industry average of 2%-5%; this is not surprising, since other providers often just send out one email per research note.

Feedback

Great research combined with good distribution is equally useless. Finding new investors needs feedback and targeting. Spraying a machine gun of distribution and investor invites wastes management time.

Equally, there is little point having great research, complemented by widespread distribution, if you cannot use that distribution to generate new shareholders. Traditionally, research providers and investor engagement firms have sprayed a machine gun across the usual suspects hoping to hit lucky. Hardman & Co starts by using the data from openings and downloads of its research, about which it prepares a detailed report, to generate warm leads.

Capital Markets Day

CMDs have become popular among quoted company managements, but are rare in the IC space. Normally, the company takes an afternoon out to present its case to invited investors (now, this usually includes retail), with a series of sessions by divisional heads, the finance director, etc. There is no reason why ICs could not follow this example. A specialist fund in a geography (e.g., Asia Pacific) could put up speakers on the economic background for the region, another on the industry strengths and opportunities (e.g., Korean cars and shipbuilding), before finishing with the fund manager telling the audience why, if you agree that the economic and industry prospects are good, his/her fund is the best way to play the opportunity.

Events

There are several retail investor events and conferences for funds to present their case, such as those organised by the *Investors Chronicle*, *Shares Magazine* and *Mello*. There are other events which we would not recommend where the presenting parties are largely early-stage oil and gas or mining companies; we think these attract the wrong audience for funds (more those interested in Walthamstow dog racing!)

Webinars

There has been growing engagement between our investor base and funds through video and audio content. Presenting the case for an IC through a webinar where investors can ask questions is very popular. Hardman & Co has had some very successful examples. Clearly, it helps that we have a very wide distribution for our research, which boosts the audience.

PrimaryBid

We would recommend working with execution-only private client broking platforms and organisations, such as PrimaryBid when raising money, to enable retail investors to participate on the same terms as institutions. A measure of the role that PrimaryBid can play in assisting public companies is the fact that it recently signed

[20] As at end-December 2020

an agreement with the London Stock Exchange[21]. In 2019, Mark Payton, CEO of Mercia Asset Management (an investor in small, growth companies, mainly outside London), was forced to apologise for not including a retail offer in a further fundraising[22].

Accessing other non-institutional investors

Just as the route to retail investors is different to that for institutions, so is the case for wealth managers, family offices and Independent Financial Advisers (IFAs). It takes specialist understanding to be effective with these. For example, Hardman & Co has teamed up with a specialist marketer to IFAs, which gives it access to 14,000 contacts at approximately 7,000 firms.

Peer group analysis

We would also extol the virtues of Argus Vickers to carry out an audit of shareholder registers. Boards and managers should cross-reference the holders on their register with that of similar funds. That will set up a target list.

[21] See interview with Marcus Stuttard, Head of UK Primary Markets and Head of AIM, London Stock Exchange and Anand Sambasivan, CEO and Co-Founder of PrimaryBid here: https://www.lsegissuerservices.com/spark/in-conversation-primarybid

[22] Financial Times, 29 December 2019, *Mercia contrite over small investors left out of £30m fundraising*: https://www.ft.com/content/ee75c2c2-228a-11ea-b8a1-584213ee7b2b

Conclusion

- We believe this is the first paper to analyse ownership of IC sectors by type of investor. It has been written in collaboration with Argus Vickers.
- ICs were originally created in the 19th century as a vehicle for wealthy private investors and those who wanted to utilise the skills of a specialist in the asset class.
- They increasingly fell out of favour in the middle of the 20th century as retail investors flocked to mutual funds, institutions took specialisation in-house and they came to be viewed as old-fashioned with weak governance.
- ICs are back in fashion, partly following recent difficulties of illiquidity and suspension of dealing by some mutual funds.
- All ICs offer investors the benefit of pooling risk and diversification for a small investment, whilst "alternatives" can have additional advantages, such as creating liquidity in illiquid assets and providing exposure to asset classes that investors couldn't otherwise access. Strangely, these attributes were precisely why investors clubbed together in the 19th century to form investment trusts, as ICs used to be called. In fact, you could say we are *Right back where we started from*[23].
- At the end of 2019, the combined market capitalisation of all ICs was more than £170bn. If we exclude the "Unknown Unknowns"[24], 52% of the shares were owned by institutions, 44.7% by retail investors, according to our definitions[25]. In "traditional" ICs, which invest in quoted securities, retail accounted for nearly 60%, whilst they owned just under 20% of "alternatives", which focus on unquoted investments; we expect retail to take an increasingly larger share of alternatives as the attractions of the yields and covenants become better known.
- Retail ownership varies dramatically by AIC sector.
- We are likely to see greater interest in ICs from retail in the future, reflecting dramatic growth in SIPPs, declining final salary scheme provision and the availability of better investment tools for retail. At end-2019, platforms had assets of £713bn, with a potential to grow to £5,306bn[26]. ICs are a perfect way for SIPPs to get diversification for a low fee.
- Addressing the new audiences for ICs, such as retail, wealth managers and family offices, requires different channels and approaches than those used for institutional.

[24] See Methodology for further detail about "Known Unknowns" and "Unknown Unknowns".
[25] All the tables and charts in this paper calculate percentages of types of investor in respect of the shareholder registers which are known, i.e., excluding "Unknown Unknowns"
[26] *Platform potential: How big is the potential investment platform market in the UK?*, Hardman & Co, May 2020

Appendix – Methodology

Collecting the data

Argus Vickers combines detailed share registry work with a sophisticated database of the real beneficial owners behind nominee names

Argus Vickers employs a team of professionals to interrogate share registers. The law requires the share register of UK-domiciled companies to be a public document. Although the collection of all the data from share registers is a mammoth task in itself, it is only part of the work needed to produce the data used in this report. Much of a share register is held in nominee names; Argus Vickers uses its proprietary analytical tools and software to extrapolate the readily available information to understand who is behind these nominee names. For example, Rule 8 of the Takeover Code in the UK requires certain parties to disclose dealing in shares of a company involved in a bid situation and to reveal who is behind a nominee name. Indeed, the form that must be completed says specifically, "*The naming of nominee or vehicle companies is insufficient. For a trust, the trustee(s), settlor and beneficiaries must be named*". This is a key plank of the transparency, which is a hallmark of the British capital markets – parties cannot hide behind nominees, as is common in many other regimes. The detail about the beneficiary behind a nominee name revealed during a takeover bid is cross-referenced to uncover the beneficial owners on other companies' share registers.

Treatment of missing data

Despite this thorough analysis, there are still gaps in the data, primarily for two reasons. The first reason is that there may be a newly registered nominee, or one that has never had to make a regulatory disclosure before – so the beneficiary behind the nominee cannot be discovered – these might be called "Known Unknowns".

Many ICs quoted in the UK are not domiciled here, and so their share registers may not be available to public scrutiny. Therefore, it is not possible to ascertain even the identity of a nominee, let alone the ultimate beneficiary. These could be called "Known Unknowns". This second group includes holders with holdings below a minimum threshold – Argus Vickers does not collect data for holders of less than 0.01% of the share capital if they are institutions or 0.1% if retail.

In this paper, we have calculated ratios, percentages, etc. after excluding both these categories; we do not know how these unknowns split between the types of investor, so excluding unknowns entirely is the most sensible route to take. The significance of these exclusions is set out in the following table:

The impact of "Unknowns"

	% of "Known Unknowns"	% of "Unknown Unknowns"
Entire Universe	0.37%	16.72%
Traditional All	0.33%	10.90%
Alternative All	0.45%	24.30%
Asia Pacific	0.05%	10.10%
Asia Pacific Income	0.10%	49.72%
Asia Pacific Smaller Companies	0.21%	7.55%
Biotechnology & Healthcare	0.12%	18.23%
Commodities & Natural Resources	0.01%	15.33%
CS Asia Pacific ex Japan	0.15%	19.08%
CS Europe ex UK	0.00%	1.41%
CS Latin America	0.00%	3.27%
Debt Direct Lending	1.74%	9.99%
Debt Loans + Bonds	1.67%	31.61%
Debt Structured Finance	0.50%	34.79%
Environmental	0.00%	6.66%
Europe	0.18%	8.29%
European Emerging Markets	0.00%	17.78%
European Smaller Companies	0.02%	21.74%
Financials	0.00%	12.62%
Flexible Investment	1.78%	10.32%
Global	0.05%	9.48%
Global Emerging Markets	0.96%	7.62%
Global Equity Income	0.01%	13.31%
Global High Income	0.00%	24.27%
Global Smaller Companies	0.25%	6.97%
Growth Capital	0.25%	25.72%
Hedge Funds	0.09%	54.76%
Infrastructure	0.03%	39.84%
Infrastructure Securities	0.07%	2.84%
Insurance Reinsurance Strategy	0.28%	1.02%
Japan	0.03%	8.26%
Japanese Smaller Companies	0.58%	6.52%
Latin America	1.96%	9.99%
Leasing	0.00%	33.01%
Liquidity Funds	0.00%	1.75%
North America	0.08%	7.29%
North American Smaller Companies	0.02%	6.76%
Private Equity	0.24%	8.29%
Property - Debt	0.00%	33.62%
Property - Europe	2.40%	28.89%
Property - Rest of World	0.00%	21.36%
Property - UK Commercial	0.25%	14.28%
Property - UK Healthcare	0.08%	38.44%
Property - UK Residential	0.58%	1.24%
Property Securities	0.31%	5.29%
Renewable Energy Infrastructure	0.93%	24.24%
Royalties	0.39%	23.64%
Technology & Media	0.08%	11.77%
UK All Companies	0.20%	5.17%
UK Equity + Bond Income	0.54%	30.73%
UK Equity Income	0.04%	10.70%
UK Smaller Companies	0.18%	5.39%
VCT AIM Quoted	0.57%	69.01%
VCT Generalist Pre Qualifying	0.00%	31.62%
VCT Generalist	0.11%	71.57%
VCT Specialist Environmental	0.40%	18.16%
VCT Specialist Health + Biotech	0.00%	15.49%
VCT Spec Health + Biotech Qual	0.00%	15.08%
VCT Specialist Technology	0.29%	11.73%

Source: Association of Investment Companies, Argus Vickers, Hardman & Co

Timing

The data used in this report comes from the end of 2019. For some companies, the data is collected quarterly, in which case the analysis of the company's register will have taken place sometime within the last quarter of 2019. For companies where the data is collected monthly, the analysis will be based on data from December 2019, although not necessarily the last business day of the month.

Aggregation of data

All the data is aggregated using market capitalisation weightings.

Investor types and groups

Argus Vickers allocates shareholdings to one of 53 investor types. For the purposes of this report, Hardman & Co has aggregated these "investor types" into four broad baskets, called "investor groups" – "Institution", "Retail", "Government/Local Government/University" and "Other". Inevitably, some holders could be categorised in several ways and readers may have their own views on the right allocation. The precise identities of the 53 types is critical to the analyses that Argus Vickers conducts and is commercially sensitive. We are, therefore, not able to reveal these details.

Investment company sectors

In this paper, we use the definitions of sectors published by the AIC. A company cannot be allocated to more than one sector.

"Traditional" vs. "Alternative" sectors

The terms "Traditional" and "Alternative" are widely used to describe ICs by professionals in the sector. There is no "official" definition, but, broadly, "Traditional" is used to describe ICs whose portfolios largely consist of quoted shares, bonds or securities, whereas "Alternatives" specialise in unlisted investments. For ease of analysis, we have assumed that all constituents of an AIC sector are classified as either "Traditional" or "Alternative".

The full mapping of AIC sectors is set out below:

Mapping AIC sectors to "Traditional" or "Alternative"			
AIC sector	Traditional or Alternative?	AIC Sector	Alternative or Traditional?
Asia Pacific	Traditional	Japanese Smaller Companies	Traditional
Asia Pacific Income	Traditional	Latin America	Traditional
Asia Pacific Smaller Companies	Traditional	Leasing	Alternative
Biotechnology & Healthcare	Traditional	Liquidity Funds	Traditional
Commodities & Natural Resources	Traditional	North America	Traditional
CS Asia Pacific ex Japan	Traditional	North American Smaller Companies	Traditional
CS Europe ex UK	Traditional	Private Equity	Alternative
CS Latin America	Traditional	Property - Debt	Alternative
Debt Direct Lending	Alternative	Property - Europe	Alternative
Debt Loans + Bonds	Alternative	Property - Rest of World	Alternative
Debt Structured Finance	Alternative	Property - UK Commercial	Alternative
Environmental	Alternative	Property - UK Healthcare	Alternative
Europe	Traditional	Property - UK Residential	Alternative
European Emerging Markets	Traditional	Property Securities	Traditional
European Smaller Companies	Traditional	Renewable Energy Infrastructure	Alternative
Financials	Traditional	Royalties	Alternative
Flexible Investment	Traditional	Technology & Media	Traditional
Global	Traditional	UK All Companies	Traditional
Global Emerging Markets	Traditional	UK Equity + Bond Income	Traditional
Global Equity Income	Traditional	UK Equity Income	Traditional
Global High Income	Traditional	UK Smaller Companies	Traditional
Global Smaller Companies	Traditional	VCT AIM Quoted	Traditional
Growth Capital	Traditional	VCT Generalist Pre Qualifying	Alternative
Hedge Funds	Alternative	VCT Generalist	Alternative
Infrastructure	Alternative	VCT Specialist Environmental	Alternative
Infrastructure Securities	Traditional	VCT Specialist Health + Biotech	Alternative
Insurance Reinsurance Strategy	Alternative	VCT Spec Health + Biotech Qual	Alternative
Japan	Traditional	VCT Specialist Technology	Alternative

Source: Hardman & Co Research

Appendix – A brief synopsis of the differences between ICs and mutual funds

Names

In short, there are two ways of holding assets in a fund. The fund can be structured as "open ended" or "closed ended".

Open-ended funds have many names. In the US, they are called "'mutual funds", whereas in the UK they used to be described as "unit trusts". More recently, legislation in the UK has entitled them "Open Ended Investment Companies" (OEICs).

Closed-ended funds in the UK used to be called investment trusts, but are now described as ICs.

Buying and selling

In an OEIC, units are issued to investors. Typically, the manager adds up the value of all the holdings in the funds at midday and divides the entire value of the fund by the number of units to give an asset value per unit. The manager then sets a price for buyers and sellers a small percentage either side of this AV. It is easy to generate a value for quoted assets, but more "challenging" for private assets. If there are more buyers than sellers, the manager can create new units, gather more funds and invest those funds; if he holds units in his "warehouse", he can sell them out. If there are

more sellers than buyers, the manager has two choices – he can redeem those assets and shrink the fund by selling assets, or he can buy those units at principal and hold them in a warehouse in the hope that more buyers will come along later.

One of the issues for investors in OEICs was demonstrated by the Woodford Equity Income Fund's tribulations in 2019. As investors became concerned about performance, they sold out in droves. The manager was forced to redeem units and finance those redemptions by selling assets from the fund. The fund had an unusually large proportion of unquoted and illiquid stocks. Initial redemptions were met by selling liquid, quoted shares. But, as the selling of units went on, remaining investors were left with an illiquid portfolio and dealing in the units had to be suspended.

Matters are simpler for closed-ended funds. They have a fixed share capital like any other company. It can be increased (or contracted) like other quoted companies. However, unlike a unit trust, this might require shareholder approval, lengthy legal documents and substantial cost; thus, this happens rarely. Meanwhile, the number of units in an OEIC can change daily.

Whilst investors can deal directly in an OEIC, they need to buy shares in the stock market to invest in closed-ended funds. The manager will regularly publish the NAV of an IC fund (some do so daily), but the price of the shares does not necessarily equate to the NAV – it all depends on the balance between buyers and sellers. Hence, the shares can trade at a discount or premium to the asset value. Some professional investors specialise in "playing the discount", i.e., buying the shares at historically wide discounts and selling at a low discount.

Asset values and gearing

Another fundamental difference between open-ended and closed-ended funds is the ability to gear up. Closed-ended funds, like companies, can borrow money. If the manager thinks his assets will increase in price, it might make sense to borrow money to invest in assets and gear up the return to investors. Open-ended funds cannot borrow.

This explains why we talk about NAV for closed-ended funds. The NAV is the value of all the assets the fund holds, less the borrowings.

Further help

The trade association for the quoted closed-ended market in the UK is the AIC. Its website[27] is a very helpful resource for investors, particularly retail.

[27] https://www.theaic.co.uk

About Argus Vickers

Argus Vickers provides a complete Intelligent Shareholder Analysis service, which enables companies and investors to identify and track the real beneficial owners and fund managers behind a company share register.

The shareholders behind Nominee accounts are identified and their trading behaviour is tracked. This intelligence is key for building strong investor relationships, developing efficient corporate communication and identifying investment trends of fund managers and beneficial owners. The service enables an investment bank equity trader, corporate financier, institutional stockbroker or investor relations consultant to find out who owns 'what' and 'how much' within a public listed company. Argus Vickers' professional analysts and products deliver detailed and accurate fund manager and beneficial owner shareholding information behind all companies listed in the UK and Ireland.

www.argus-vickers.co.uk

About Hardman & Co

Hardman & Co is a rapidly growing, innovative corporate research & consultancy business, based in London, serving the needs of both public and private companies. Its expert team of nearly 35 sector analysts and market professionals collectively has more than 400 years of experience. This depth of knowledge and a reputation for integrity have built trust with investors.

Hardman & Co has developed a very differentiated proposition for the IC space. This combines deep research, written by specialists in their field rather than generalist IC analysts, with comprehensive distribution to every sort of investor. This is complemented by a thorough feedback process, which identifies potential new investors.

www.hardmanandco.com

About the authors

Keith Hiscock is the Chief Executive of Hardman & Co

Keith is personally responsible for the firm's relationships with its corporate clients and also for corporate finance. In addition, he is the author of several articles tackling the issues facing companies in today's climate. Keith has 40 years' stockbroking experience and has developed long-standing relationships with many major institutional investors, including Private Client Brokers and Wealth Managers. He started his career at James Capel, at the time the top-ranked research house in London. He was a founding member of Schroder Securities and of Agency Partners, a leading research boutique house, and was a member of the five-man securities board at Evolution. Keith has also advised companies, large and small, on their relationships with the capital markets.

Yingheng Chen is a senior financial analyst at Hardman & Co

Yingheng has particular experience in the markets for palm oil, cocoa, citrus, coconut, Jatropha and sugar. She worked as a corporate finance analyst at the Agricultural Bank of China, and is fluent in Cantonese and Mandarin. She has a thorough understanding of the Chinese financial and business markets, as well as of those in the UK. Yingheng joined Hardman & Co in 2008. She holds the Chartered Financial Analyst Level 2 qualification, together with a BSc in Economics from the London School of Economics.

Ben Brougham is Head of Sales & Marketing at Argus Vickers

Ben has spent a career in the B2B media sector, as a publisher, and head of events, marketing and business development. His career includes spells at Euromoney Institutional Investor, Caspian Publishing, jointly running Real IR and Vitesse Media (now Bonhill Group Plc), publishers of *Growth Company Investor* and *What Investment*, and manager of the Quoted Company Awards. He started at Argus Vickers in February 2017, and heads up the sales function, with a focus on cultivating the knowledge and understanding on the value of shareholder intelligence.

Telephone +44 (0) 20 4513 4369
Email: *bbrougham@argusvickers.com*

Richard Downard is Head of Business Development at Argus Vickers

Richard started his career as a trader in the London capital markets, working for firms such as BZW, Panmure Gordon and Jeffries. He has more than 25 years' experience covering global equities, specialising in UK/Pan-Euro/Canadian and Small/Mid-Cap and Natural Resources companies. Richard is a proven account relationship manager with extensive Institutional and Broker/Dealer contacts. He joined Argus Vickers in May 2016.

Tel: +44 (0) 20 4513 4370
Email: *rdownard@argusvickers.com*

Antonio (Tony) Martins is an IT Consultant at Argus Vickers

Tony Martins started his career as an Environmental Data Analyst, using Relational Data and Satellite images to analyse environmental impacts in areas of Hydroelectric Power Plants, working for companies such as CESP, CETESB and AXA-IM. With more than 30 years' experience working in Database Technology, he has been creating and implementing processes and data analysis reports. Tony joined Argus Vickers in July 1999.

Email: *amartins@argusvickers.com*

Gianluigi La Salvia is Head of Analytics & General Manager at Argus Vickers

Gianluigi La Salvia started his career as an Analyst, joining London-based Argus Vickers in 2012. He is the Head of Analytics, with 9 years of experience in share register analysis and commands a deep knowledge of the Financial sector. Gianluigi leads the Analysts' team and works closely with the IT department, developing new tools and apps, ensuring the data is of the highest standard. He is also the General Manager of Argus Vickers, overseeing several departments. Gianluigi earned an MSc in Finance and BSc in Financial Markets from Università di Siena Facoltà di Economia R. Goodwin

Email: *glasalvia@argusvickers.com*

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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research@hardmanandco.com

1 Frederick's Place
London
EC2R 8AE

+44 (0) 20 3693 7075

www.hardmanandco.com