

## Investment Trusts

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### Produced by

Michelle Perkins

Private Wealth Research

### Key Data

Code	SST.LN
Current price	£5.84
Net asset Value	£6.12
Prem/(Disc)	-4.6%
Gross yield	1.46%
Total exp ratio	1.00%
Gearing	100%
Market cap (m)	£175.1
Year End	31-Aug

### Private Wealth Research

Portfolio classification:  
**NICHE**

Portfolio view:  
**OVERWEIGHT**

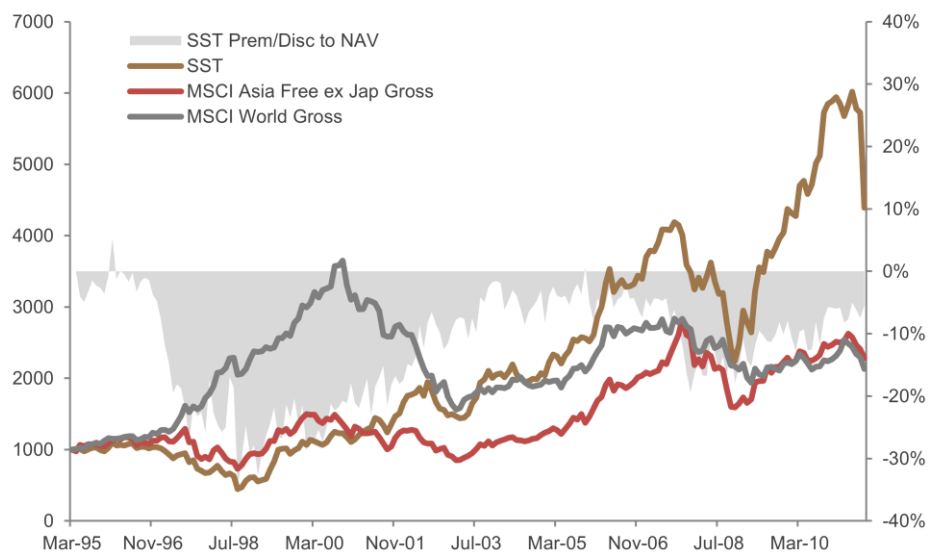
## Scottish Oriental Smaller Companies

This week Susie Rippingall, Fund Manager of Scottish Oriental Smaller Companies (SST), provided advisers and the research team with an update on the fund via a conference call. SST is a UK listed Investment Trust and has generated a strong performance record by investing in Asian companies with a market cap of less than US\$1bn.

### Investment view

SST benefits from a stable, experienced and well resourced management team whose focus on investing in good quality companies with sustainable and predictable EPS growth has resulted in consistent long-term outperformance in Asia Pacific (ex-Japan) markets. Since inception in March 1995, the fund has provided a total return of 339.1% or 9.5%pa compared to a 128.2% or 5.2%pa lift in the MSCI Asia Free excluding Japan Index (Gross).

**Chart 1: SST total return performance: March 1995 – July 2011 (NZD)**



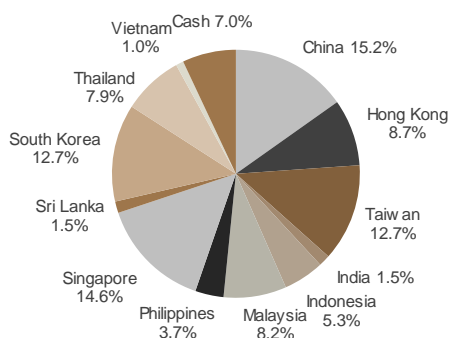
Source: Bloomberg, Craigs Investment Partners

SST's investment style is inherently conservative, focusing on capital preservation as well as capital growth. We like the fact that the fund manager pays particular attention to the potential downside as well as the upside when making any investment decision, which aids in reducing the risk to long-term returns. According to the fund manager, the companies SST invests in are simple companies with easy to understand balance sheets, strong cashflows, and lower levels of gearing and earnings volatility than the peer group.

SST's performance relative to the broader market throughout the recent bout of volatility has remained strong, +8.7% versus the broader market, and in our view this outperformance is reflected in its relatively tight discount to net asset value (NAV), currently -4.6%. While SST's discount is in line with its average discount over the past 12 months of 6.5%, it trades at a significant premium to its long run average discount of c11%. We view this premium rating as a reflection of both the relative strength of the

Asian region and SST's strong performance relative to its peers and view any weakness in SST's share price as a long term buying opportunity.

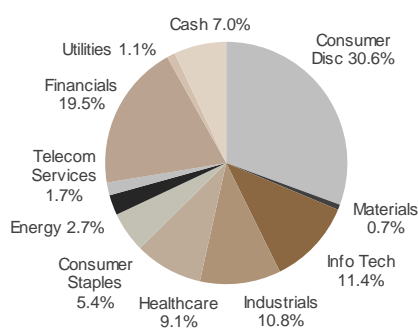
### Geographical Breakdown



SST is one of three investment trusts used to gain an exposure to Asia in our Sample Global Funds Portfolio. In our view, the diversified nature of SST has seen the fund provide much more consistent returns (with a significantly lower level of risk) than single country specific funds and some of the more growth focussed generalists investing in the region. The fund manager's focus on quality companies which tend to have strong balance sheets, generate good cashflows and in many cases, pay dividends has also seen the fund provided strong and consistent growth in dividends to investors. While capital growth not dividends is the primary focus of the fund, we believe that SST's investment philosophy is likely to result in a continued improvement in distributions to shareholders.

Our current allocation to SST in the Sample Global Fund is 2%. Potential funding sources for investors with an existing exposure to Asian equities include:

### Sector Breakdown



**1) Consider reducing weightings to country specialist funds** – Country specific funds including JPM Chinese, JPM Indian, New India Investment Trust, FTSE/Xinhua China 25 Index Fund, and the Vietnam Opportunities Fund, have historically shown much higher levels of volatility than generalist funds such as SST. With the issues that underpinned that latest bout of market volatility (slowing global growth, high sovereign debt levels etc) still needing to be dealt to, investors looking to reduce the overall volatility of their portfolio while remaining exposed to Asia should look to either switch-out of, or re-weight the portfolio away from, country specific funds towards a generalist fund.

**2) Re-weight away from Asia Pacific including Japan funds to Asia Pacific excluding Japan funds** – Aberdeen All Asia, Martin Currie Pacific, and Witan Pacific are the three Investment Trusts that provide exposure to Asia including Japan. c27% of each fund is invested in Japan and this exposure has weighed on the long term performance of the sector. On average, Asia Pacific including Japan funds have underperformed Asia Pacific excluding Japan funds by c4.9%pa over the past 10 years or a total of 179%.

**3) Lighten weighting to Henderson TR Pacific (HPI)** – HPI is significantly overweight China versus its benchmark (c35% vs 23.9%) and has the highest weighting of the Asia Pacific generalist funds to the region. In our view, SST is significantly more diversified on both a geographical and sector basis than HPI, which has helped SST provide superior risk adjust returns versus HPI over the longer term.

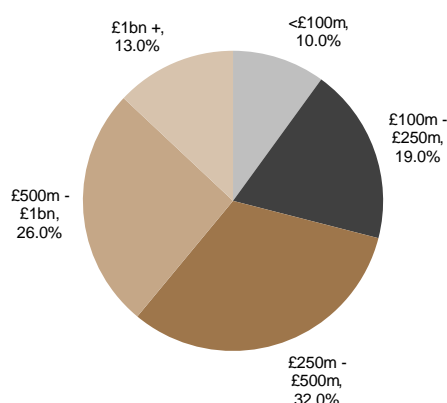
### Top 10 Holdings

JVM Co	2.3%
Media Prima	18%
Texwinca	18%
A morepacific Group	17%
Security Bank	17%
Aeon Company	16%
CSE Global	16%
Ezion Holding	16%
Tisco Financial Group	16%
TK Corp	16%
<b>Total</b>	<b>17.3%</b>

### Key takeaways

- SST was launched in 1995 with the aim to achieve long-term capital growth by investing mainly in smaller Asian quoted companies with market capitalisations under US\$1bn at the time of investment. Asia is deemed to include the Indian subcontinent but excludes Japan and Australasia.
- Fund manager, Susie Rippingall, who has managed the fund since 2000, has been with First State Investments, part of the international investment management division of the Commonwealth Bank of Australia, since 1995. The fund manager is based in Hong Kong.
- The fund manager is using the current volatility in markets to add to positions / buy companies that they have identified as having a quality management teams,

### Breakdown by investment size

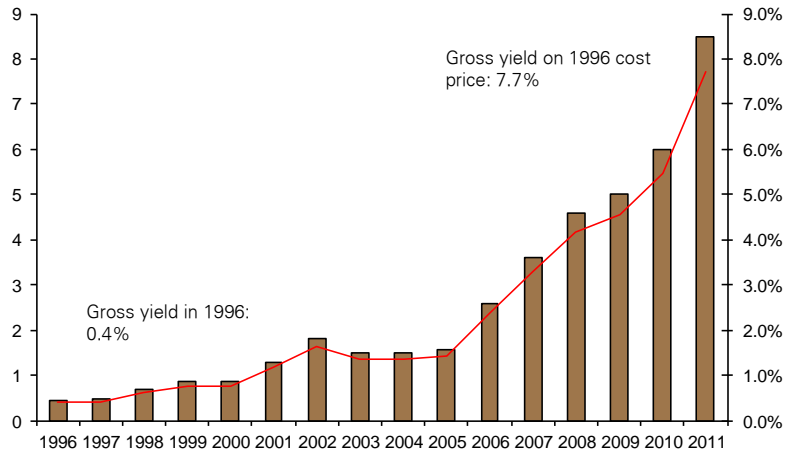


good business models, no balance sheet issues, are well positioned to cope with in a downturn and, while short term earnings may be modestly impacted, on a 3-5 year view the companies are still expected to be able to achieve 15% EPS growth and provided a dividend yield of c5%.

- The fund manager is not tied to the country, sector or company exposures of its benchmark with the makeup of the portfolio clearly driven by stock ideas. In terms of country allocation, the fund is well diversified with 42.2% of the portfolio currently invested in South East Asia (Singapore, Malaysia, Indonesia, Thailand, Philippines, Sri Lanka, Vietnam) , 36.6% in Greater China (China, Hong Kong, Taiwan), 12.7% in Korea, 1.5% India and cash of 7%.
- When it comes to company selection, the manager focuses on good quality companies with sustainable and predictable EPS growth. Given SST invests in the smaller cap space, investee companies must have a strong management team, strong franchise (good brand, pricing power, competitive advantage), and good financials (strong balance sheet, good cashflows).
- On a sector basis, the fund is overweight consumer discretionary stocks (30%) versus its benchmark (9%). This exposure reflects a number of factors including: 1) a greater number of smaller companies operate in this space; 2) growth in consumer spending is a strong theme for Asia; and 3) the manager is seeing a structural change in the way consumer companies operate (ie the development of modern retailing).
- The portfolio is well diversified, typically holding c85 companies, with the largest holding currently representing just 2.3% of the portfolio. The portfolio is ungeared at present and has a 7% weighting to cash.
- Average annual turnover is c25% of the portfolio and reflects ongoing rebalancing in the portfolio (SST trims holdings as they trade up to the identified target price, and adds to holdings that may have underperformed the broader market). In general, there are on average five new holdings added a quarter (20 new holdings a year) and, in order to make room for these, an existing holding must be sold.
- The manager's long term outlook for Asia remains positive relative to developed the world. Key themes underpinning this view include: 1) favourable demographics; 2) low consumer debt; 3) significant gains from globalisation; and 4) the view that above average GDP growth rates can be supported by low corporate debt, better corporate governance and a continued improvement in the dividend culture of Asian/Emerging companies.
- The fund manager noted that the significant inflow of funds into the developing markets over recent years has underpinned the performance of Emerging Markets/Asian equities, and that smaller cap companies have also benefitted from this inflow versus larger cap equities. Should volatility in markets continue, and the risk aversion of investors increase, we may see a reversal in this trend.
- From an income perspective, SST would be classified as low yield, trading on a historic gross yield of 1.5%. However, as is the case with a single company (SST is a portfolio of companies), what is important is that company's, or fund in this case, ability to grow this yield over time. As can be seen from the chart below, SST's portfolio of companies has done just that with shareholders enjoying an average increase in dividends of 22.0% pa since 1996. This means that investors who purchased SST in 1996 on a yield of 0.4% are now enjoying an annual yield of 7.7%. It should be noted however, that SST's main focus is capital growth and that growth in dividends is not a primary object of the fund - it is a result of the

fund's focus on quality companies which tend to have strong balance sheets, generate good cashflows and in many cases, pay dividends. SST's dividends are paid annually in January.

**Chart 2: SST has a solid track record of dividend growth**



Source: Bloomberg, Craigs Investment Partners

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