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The low-cost trusts run by top managers

Investors can earn better returns by avoiding funds with higher charges

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BRITAIN's top fund managers have returned up to 60% more in their lesser-known investment trusts than in their more popular funds which levy much higher fees.

Star managers, including Mark Mobius of Templeton and Harry Nimmo at Standard Life, have all achieved better returns on their investment trusts — which are, in effect, companies that invest in assets such as shares — over the past three years than on their better-known open-ended funds, according to analysis for The Sunday Times by Bestinvest, the adviser.

For example, Nimmo's Standard Life UK Smaller Companies fund is up 111% over three years, but his UK Smaller Companies investment trust is up 152%. Mobius's Global Emerging Markets fund is up 57%, compared with a 107% rise for his Emerging Markets investment trust.

Investment trusts, sometimes known as close-ended funds, are effectively companies that make investments. Investors buy shares in the company and these can be traded on the market meaning their value can rise or fall. Investment funds, the common name for open-ended investment companies and unit trusts, pool investors' resources together and grow bigger or smaller as more people buy in or sell out. It means there is no share price to consider as with investment trusts.

Research by Winterflood Securities, an analyst, shows investment trusts outperformed open-ended funds in 13 of 15 investment sectors over the first three months of this year. The FTSE 100 recorded its best first-quarter performance in 12 years, although markets fell sharply last week amid growing concern about a possible eurozone bailout for Spain. The Footsie fell 2.24% on Tuesday and closed the week down at 5,652.

Investment trusts tend to perform better when markets rise, though experts caution that they are more vulnerable in a dip.

Adrian Lowcock at Bestinvest said: "Investment trust managers are able to borrow, known as gearing, in order to invest. It means they are better able to take advantage of rising share prices. However, they can also lose more money in a falling market. That means investment trusts are more volatile than unit trusts."

Analysts have predicted a boom in interest in the trusts ahead of the introduction of the retail distribution review (RDR) at the end of this year. Its aim is to overhaul the way the investment industry operates. Under the RDR, fund providers will be banned from paying commission to advisers. As a result, investment trusts, which have never paid commission, could be recommended by advisers more often.

Analysis for The Sunday Times by Lipper shows the average trust charges 1.14%, against 1.66% for funds.

Growth and income

The growth-and-income investment trust sector has been the best performer relative to the open-ended fund equivalents, adding an average 6.2% more to returns every year for the past decade, according to Winterflood.

Simon White, head of investment trusts at Black Rock, the fund manager, said: “In these turbulent years, trusts have been well positioned to maintain their dividends and in many instances increase payouts. They are allowed to retain up to 15% of income and they use this to build a revenue reserve, creating a buffer against dividend volatility.”

Kieran Drake at Winterflood likes Perpetual Income & Growth. The fund yields 3.8% and is one of the few in this sector to have a dividend that is covered by income — meaning its payouts are more secure. The fund invests mainly in defensive sectors such as pharmaceuticals. It is up 6.3% over a year, but is trading at a small premium of 1.9%.

Discounted trusts

Investors benefit by being able to buy at a discount to the underlying assets held by the trust, known as the net asset value (NAV). Though discounts have fallen since their 2009 high, from -14.8% to -8.5% on average, there are still opportunities. Maltin said: “The difference in the share price and the NAV of the underlying holdings can create excellent investment opportunities, enabling one to purchase 100p of assets at, say, 50p.”

He is looking to buy trusts such as Pantheon International, which is at a 32% discount. It has risen 2.6% over one year, but 189% over three. Another option is British Empire, a global fund of funds trading at a 10% discount. However, it holds investment trusts that are themselves at a discount, so the overall discount is closer to 30%, said Maltin.

Specialist sectors

Simon James at Gore Browne, the adviser, said investment trusts perform well in specialist areas such as technology and smaller companies.

Darius McDermott at Chelsea Financial Services, another adviser, likes Polar Capital Technology trust. It is trading at a 2.7% discount and the fund is up 10.5% over a year, against a 1.4% rise for the technology, media and telecoms sector.

Case study: Diversity is the key

Tony Fox, 52, a garden designer, and his wife Jackie, a nurse, hold 25 different investment trusts.
Using Bestinvest, the adviser, they have recently increased exposure to trusts managed by Franklin Templeton Investments and Invesco Perpetual.

Tony said: “Trusts provide a level of diversity from our other investments, which include unit trusts and open-ended investment companies. We have been drip-feeding into them regularly to pick up more shares when they are at a discount.”

HOW THE STAR MANAGERS' RETURNS COMPARE

		1 year	3 years
	**RICHARD BUXTON**		
	Open-ended fund: Schroder UK Alpha Plus	-0.2%	89%
	Investment trust: Schroder UK Growth Investment Trust (IT)	0.2%	103%
	**NEIL WOODFORD**		
	Open-ended fund: Invesco Perpetual	11%	58%
	Investment trust: High Income Edinburgh IT	18%	100%
	**SEBASTIAN LYON**		
	Open-ended fund: Trojan Fund	10%	13%
	Investment trust: Personal Assets Trusts IT	13%	56%
	**HARRY NIMMO**		
	Open-ended fund: Standard Life UK Smaller	-3%	111%
	Investment trust: Standard Life UK Smaller Cos IT	-0.1%	151%
	**MARK MOBIUS**		
	Open-ended fund: Templeton Global Emerging Markets	-17%	57%
	Investment trust: Templeton Emerging Markets IT	-10%	107%

Source: Bestinvest