The Scottish Investment Trust

Growth and income from a contrarian portfolio

Investment trusts

The Scottish Investment Trust (SCIN) seeks to provide investors with capital growth and a growing income, by investing in companies around the globe that are unloved by the majority of investors. The core of its portfolio (74% at 31 October 2018) is in 'ugly ducklings' – stocks that are both out of favour and operationally challenged – as lead manager Alasdair McKinnon says these can generate higher than average returns over the longer term. Because of its contrarian style, SCIN has no benchmark, and generally is not exposed to 'hot money' investments like US and Chinese internet stocks, instead focusing on areas such as bricks-and-mortar retail (where the manager sees the perceived threat from online competition as overdone), European and Japanese banks, 'big pharma' (which McKinnon sees as having stronger long-term prospects than they are currently being given credit for) and gold miners. SCIN recently announced its 35th consecutive annual dividend rise and offers one of the highest yields in its peer group, at 3.2% (2.7% excluding special dividends).

12 months ending	Total share price return (%)	Total NAV return (%)	MSCI AC World (%)	MSCI UK All-Cap (%)	FTSE All-World (%)
30/11/14	6.0	5.1	13.6	4.1	13.6
30/11/15	(0.2)	0.9	2.0	(0.1)	2.1
30/11/16	26.9	26.9	25.6	10.1	25.8
30/11/17	14.8	12.5	15.7	13.2	15.7
30/11/18	1.4	0.7	5.6	(1.6)	5.5

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling.

Investment strategy: Investing away from the herd

Since October 2015, SCIN has followed a high-conviction, contrarian investment process, aiming to exploit opportunities in unloved companies that are overlooked as investors crowd into 'hot' stocks and sectors. The team invests globally, first assessing a company's position in various cycles and then analysing business drivers, valuations, cash flows and dividends, with the aim of identifying businesses whose capacity for improvement is underappreciated. Holdings are classified under one of three headings: 'ugly ducklings', 'change is afoot' and 'more to come'.

Market outlook: Higher volatility, lower valuations

After a year of particularly low volatility in 2017, global equity markets have been far less settled in 2018 and many look set to close out the year in negative territory, acting as a timely reminder that the value of investments can go down as well as up. However, the fall in prices means many markets now look much more attractively valued, which could translate into positive returns if earnings growth is maintained.

Valuation: Discount and yield both above peer average

At 19 December 2018, SCIN's shares traded at an 8.0% discount to cum-income NAV (with debt at fair value). This was close to both the short- and longer-term averages, which range from 8.6% to 9.9% over one, three, five and 10 years. The trust has an active discount management policy, using share buybacks when the discount to cum-income NAV exceeds 9.0% in normal market conditions. SCIN's discount is above the average of its peers in the AIC Global sector, even though it has one of the highest dividend yields at 3.2% (2.7% excluding the special dividend).

20 December 2018

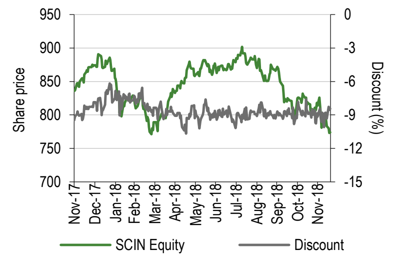
Price	**774.0p**
Market cap	**£595.4m**
AUM	**£751.0m**

NAV*	826.7p
Discount to NAV	6.4%
NAV**	841.4p
Discount to NAV	8.0%

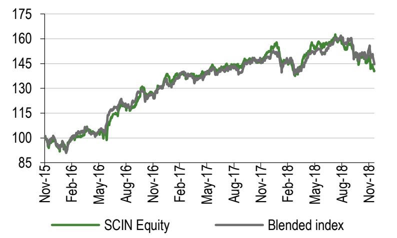
*Excluding income. **Including income. As at 19 December 2018.

Yield (incl. special dividend)	3.2%
Ordinary shares in issue	76.9m
Code	SCIN
Primary exchange	LSE
AIC sector	Global

Share price/discount performance



Three-year performance vs index



52-week high/low	902.0p	771.0p
NAV** high/low	991.8p	844.9p

**Including income.

Gearing

Gross*	12%
Net*	0%

*As at 31 October 2018.

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Edison profile page

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Exhibit 1: Trust at a glance

Investment objective and fund background

The Scottish Investment Trust's objective is to provide investors, over the longer term, with above-average returns through a diversified portfolio of international equities, and to achieve dividend growth ahead of UK inflation. The manager takes a patient approach and seeks to invest in undervalued, unfashionable companies that are ripe for improvement.

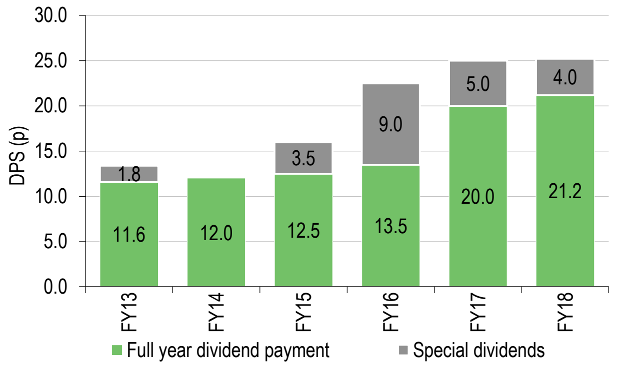
Recent developments

- 10 December 2018: annual results for the year ended 31 October. NAV TR +1.1% and share price TR +1.9%, compared with +3.4% for the MSCI AC World index and -1.3% for the MSCI UK All-Cap index. Total dividends of 25.2p (regular dividends of 21.2p plus a 4p special dividend), a 35th consecutive year of annual growth in the regular dividend.
- 13 September 2018: announcement of third interim dividend of 5.0p, to be paid on 2 November.

Forthcoming		Capital structure		Fund details	
AGM	February 2019	Ongoing charges	0.52%	Group	SIT Savings Ltd (AIFM)
Interim results	June 2019	Net gearing	0%	Manager	Alasdair McKinnon and team
Year end	31 October	Annual mgmt fee	N/A (self-managed)	Address	6 Albyn Place, Edinburgh,
Dividend paid	Quarterly	Performance fee	N/A (self-managed)		EH2 4NL
Launch date	July 1887	Trust life	Indefinite	Phone	+44 (0) 131 225 7781
Continuation vote	No	Loan facilities	£83.8m long-term debt	Website	www.thescottish.co.uk

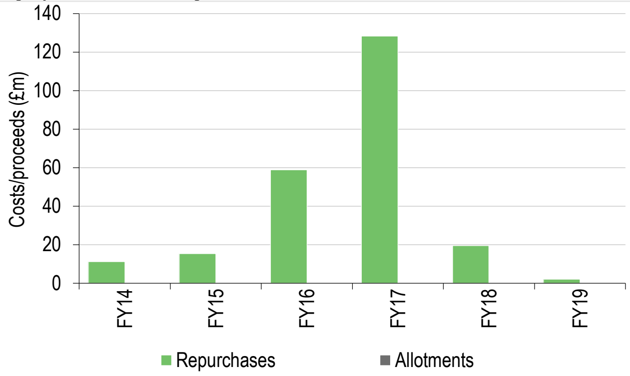
Dividend policy and history (financial years)

Dividends historically paid twice a year in July and February, with special dividends (where applicable) paid alongside the final dividend. From FY18 dividends have been paid quarterly. SCIN has grown its regular dividend every year since 1983.

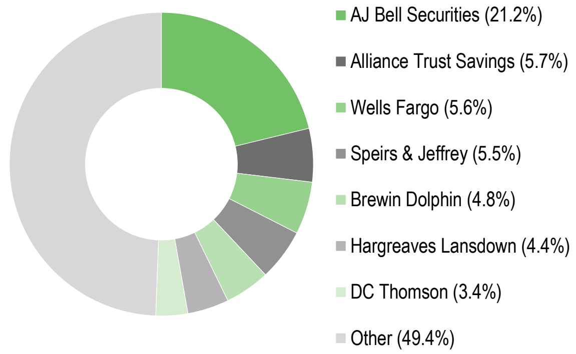


Share buyback policy and history (financial years)

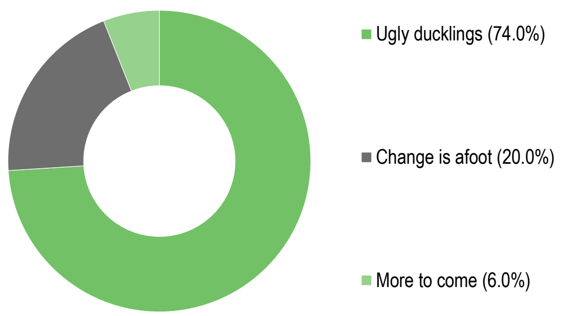
SCIN has the authority to buy back up to 14.99% of shares annually, and targets a maximum discount (based on cum-income NAV with borrowings at market value) of 9%. Buyback figures for FY17 below include the repurchase of the legacy Aviva shareholding.



Shareholder base (as at 17 October 2018)



Portfolio exposure by category (as at 31 October 2018)



Top 10 holdings (as at 30 November 2018)

			Portfolio weight %	
Company	**Country**	**Sector**	**30 November 2018**	**30 November 2017***
GlaxoSmithKline	UK	Healthcare	3.9	N/A
Tesco	UK	Consumer staples	3.8	3.0
Pfizer	US	Healthcare	3.7	N/A
Sumitomo Mitsui Financial	Japan	Financials	3.5	N/A
Newcrest Mining	Australia	Materials	3.3	3.1
Macy's	US	Consumer discretionary	3.2	N/A
Gap	US	Consumer discretionary	3.2	3.0
Royal Dutch Shell	UK	Energy	3.0	2.9
Suncor Energy	Canada	Energy	2.9	2.8
Target	US	Consumer discretionary	2.9	N/A
Top 10 (% of holdings)			**33.4**	**34.9**

Source: The Scottish Investment Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-November 2017 top 10.

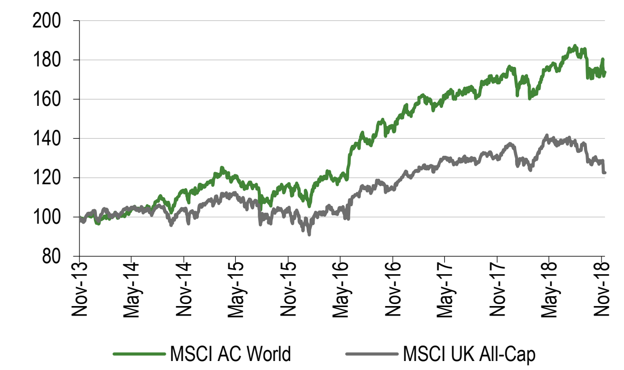
Market outlook: Time for a value resurgence?

Global stock markets have produced solid absolute returns for sterling-based investors over the past five years, albeit not without volatility, particularly in the past 12 months. As shown in Exhibit 2 (left-hand chart), November saw something of a recovery in the MSCI AC World index from sharp falls in October, although investors in the UK market have had a less positive experience owing to the protracted and increasingly ill-natured Brexit discussions.

What has changed significantly in recent months is average equity valuations. Only a few months ago, all major markets (measured using Datastream indices) with the exception of Japan were trading at average forward P/E multiples well in excess of medium-term averages. Today, even the US trades well below its five-year average valuation, with the UK close to a five-year low. While the outlook remains far from certain in terms of global politics and macroeconomics, a greater pool of stocks that look attractively valued could support long-term stock market returns, particularly if companies can continue to grow their earnings.

Exhibit 2: Market performance and valuation

Performance of UK and global indices in sterling terms



Valuation metrics

	Last	High	Low	5-year average	Last as % of average
World	13.5	16.3	13.3	14.8	91
UK	11.4	16.1	11.3	14.3	79
US	15.6	19.0	14.9	17.0	92
Europe	11.8	15.5	11.7	13.6	87
Japan	12.5	15.9	12.5	14.3	88
Asia	12.0	14.2	11.3	12.7	95

Source: Thomson Datastream, Edison Investment Research. Data at 12 December 2018.

Fund profile: Winning plaudits for contrarian approach

The Scottish Investment Trust (SCIN) has been based in Edinburgh since its launch in 1887. It is self-managed and follows a high-conviction, global contrarian investment process, aiming to provide capital appreciation and above-inflation annual dividend growth over the long term (it recently announced its 35th consecutive annual dividend increase). In recent years, it has streamlined its portfolio management team (headed by Alasdair McKinnon), outsourced its administrative functions and closed its in-house savings schemes, and now offers one of the lowest ongoing charges ratios in its peer group (the Association of Investment Companies' Global sector). While SCIN's portfolio is constructed without reference to any benchmark, it uses the MSCI AC World and MSCI UK All-Cap indices to provide context to its performance.

McKinnon and his four colleagues on SCIN's investment team seek to build a portfolio of c 50–100 stocks from around the world, which are out of favour with the majority of investors and have the potential to rerate as a result of operational improvements. The managers take a patient approach to investment and portfolio turnover is relatively low (18% in FY18, implying an average holding period of more than five years). Gearing is permitted up to 20% of net assets and is used flexibly according to the team's assessment of the likely balance of risk and reward. SCIN's board actively manages the discount to NAV and, in addition to regular share buybacks if the discount exceeds 9%, has taken a much more active approach to marketing the trust, the majority of whose investors are private individuals. SCIN has redesigned all its public documents and its website, which now features a regular blog with insights from the management team. In 2018 the trust won several awards, including best investment trust at the Shares Magazine awards, best investment trust for income at the Online Personal Wealth awards, and best PR campaign at the Association of Investment Companies' Shareholder communication awards.

The fund manager: Alasdair McKinnon and team

The manager's view: Will fear supplant 'fear of missing out'?

McKinnon comments that, after a decade of cheap money as a result of quantitative easing and ultra-low interest rates, the global stock market environment has begun to have echoes of the late-1990s 'dotcom' boom. On a recent trip to the US, he noted a number of unprofitable niche businesses, such as fresh dog food companies, whose strategy seemed simply to be to build enough presence in stores to bring them to the attention of growth-starved consumer goods companies on the lookout for acquisitions. Such companies are highly vulnerable to a reversal in investor sentiment, he says. "If you have a company you can't value, because it has never made any money, it can easily fall by 50% or 75% when people get scared, as they inevitably do," he explains. "With a company that has positive cash flows and pays dividends, things can fall a long way too, but you know you have something underpinning it all, and at some point people will think it is too cheap."

While recent stock market falls may point to a shift in the balance of investor sentiment from greed towards fear, McKinnon says markets have arguably been more driven by 'fear of missing out'. This is illustrated by phenomena such as 2017's cryptocurrency boom and the recent mania for cannabis producers in the US and Canada. "People are getting high on the legalisation of cannabis, and they want everything related to marijuana, however tangentially," he says. As a contrarian investor, however, SCIN does not get involved in 'hot money' stocks, but instead seeks a sensible risk/reward balance to navigate periods when confidence is low.

McKinnon says gold is one asset class that has historically offered a safe haven when equity markets are turbulent. As a genuinely scarce commodity, gold has tended to keep pace with rising prices, while also acting as a store of value in deflationary conditions. However, in spite of growing fears of inflation as a result of the ballooning US deficit, and heightened political risk from many quarters, the price of gold is still well below the high levels seen in 2011. In line with SCIN's contrarian principles, McKinnon has chosen to invest in gold miners as a way of gaining exposure to the yellow metal. Miners have suffered as a result of falling gold prices, as well as from the advent of exchange-traded funds backed by physical gold, which have provided investors with a less operationally exposed route into the asset. In addition to a position in Newcrest Mining, an Australian gold producer that has recently resumed dividend payments as the benefits of cost-cutting and efficiency improvements feed through, McKinnon has recently bought shares in US-headquartered Newmont Mining. Holding two gold mining stocks allows the manager to increase exposure to the commodity while diversifying stock-specific risk.

It is easy to be positively surprised when expectations are low, says McKinnon. However, one area of low expectations where he is not yet increasing exposure is emerging markets. The manager has recently cut SCIN's Latin American weighting to zero following the sale (on stock-specific grounds) of Ambev and Cemex. McKinnon will visit China in the New Year to gain further insight into whether 'gloomy' sentiment towards the market reflects a potential trough.

Asset allocation

Investment process: Targeting cyclically out-of-favour stocks

SCIN has followed its high-conviction, global contrarian investment approach since October 2015. The process is based on principles of behavioural finance and is put into practice by lead manager Alasdair McKinnon, with support from deputy manager Martin Robertson, investment managers Sarah Monaco and Mark Dobbie, and investment analyst Igor Malewicz. The process aims to exploit the natural tendency of investors to imitate the successful actions of others, which leads to large volumes of money chasing a relatively small number of popular stocks, while less favoured companies are largely ignored. McKinnon argues that the 'momentum' mentality – whereby investors tend to believe that past performance is the only guide to the future – is what causes bubbles in asset prices and the inevitable downturns that follow the bursting of such bubbles. In contrast, the SCIN team actively seeks unpopular areas, looking among the ranks of unloved stocks to find those that have potential long-term upside, as a result of self-help actions (new management teams, new business strategies, cost reductions and so on) and/or because they are cyclically out of favour. While momentum investors may make the classic mistake of buying high and selling low, McKinnon's strategy is to make the most of business and market cycles by buying at times of extreme pessimism and selling when the consensus view is once more in favour of a particular stock.

Assessing a company's position in a cycle (whether business, market or economic) is the starting point of SCIN's stock selection process. If the team believes the entry point is favourable, the stock is analysed using metrics such as earnings growth, P/E valuations, dividend sustainability and yield, and an assessment of its business drivers. Companies are assigned to one of three categories, depending on the team's view of how out of favour they are.

- **Ugly ducklings** (74% of the portfolio at 31 October 2018). These are companies where poor investor perception is compounded by operational challenges. They often trade on low valuation multiples and may not enjoy a rerating even when results exceed expectations. However, once investors begin to believe in the evidence of operational recovery, share price gains can be significant. Two contrasting ugly duckling examples are US department store Macy's and UK high street stalwart Marks & Spencer (M&S). Having been all but written off as an irrelevance in the age of internet shopping, Macy's share price doubled during SCIN's FY18 on the back of better-than-expected results arising from operational improvements and a buoyant consumer environment. By contrast, M&S, while profitable, is still very out of favour with investors, who have yet to show faith in the ability of its new chairman, turnaround specialist Archie Norman, to reinvigorate the brand.
- **Change is afoot** (20% of the portfolio at 31 October 2018). These are stocks that remain out of favour with most investors in spite of evidence of operational improvement. Pharmaceutical holding Pfizer and Japanese electronics company Sony fall into this category. Investors are now beginning to appreciate both Pfizer's promising pipeline of new products, and that Sony may deliver growing profits after years of losses, in part due to an extensive restructuring.
- **More to come** (6% of the portfolio at 31 October 2018). These are companies where market sentiment is generally favourable, although they are still a far cry from hot-money momentum stocks. 'More to come' stocks may have moved up through the other categories during their holding period and are usually situations where the team believes future operating prospects are still underappreciated, even though the shares are no longer out of favour. This category currently makes up a very small proportion of SCIN's portfolio (compared with 20% a year earlier), after several exits during FY18. Examples of stocks sold during the year include Treasury Wine Estates and Rentokil Initial.

The sell discipline is the opposite of the path to buying a stock: if the earnings cycle, management and investors are all optimistic, there is little margin for error and there are likely to be better opportunities elsewhere. Holdings may also be sold on the basis of fundamental issues, such as in the case of Ambev, where domestic economic woes, and the entry of a large multinational competitor into its home market, meant it no longer offered SCIN the expected combination of relatively safe exposure to Brazil along with some recovery potential.

Current portfolio positioning

At 30 November 2018, SCIN's portfolio was made up of 50 listed holdings (it also owns its Edinburgh headquarters), compared with 54 a year earlier. The top 10 holdings accounted for 33.4% of the portfolio, a slight decrease in concentration from 34.9% at 30 November 2017. At end-FY18 (31 October), nearly three-quarters of the portfolio (74%) was in stocks classified as 'ugly ducklings' (see Exhibit 1), compared with 57% a year earlier. There was a slight fall in those classified as 'change is afoot', from 23% to 20%, and a bigger decline in the 'more to come' category, which stood at 6% compared with 20% at end-FY17. This suggests the manager is finding more opportunities in out-of-favour companies, but equally that it may take some time for these 'ugly ducklings' to develop into swans.

During FY18, five new holdings were purchased and there were nine complete exits. Activity was fairly evenly spread between the first and second half of the financial year, although global equity market conditions were arguably much more buoyant in the first six months. Treasury Wine Estates (an Australian wine producer), previously the largest holding, was sold in February having moved from an 'ugly duckling' to a highly regarded company. Johnson & Johnson, a long-standing holding, was also sold given high investor expectations left little margin for error. Brazilian drinks company Ambev and Mexican cement producer Cemex were also sold in H118, with Ambev facing headwinds from a weaker economy and competition in its home market from Heineken, and Cemex at risk from the cancellation of big infrastructure projects following the election of Andres Manuel Lopez Obrador as president of Mexico. Purchases in H118 were Royal Bank of Scotland (where McKinnon sees good dividend prospects), US mass-market retailer Target and gold miner Newmont Mining. The manager favours gold for its potential as a safe haven asset in an economic downturn, but wanted to diversify SCIN's exposure by holding another name in addition to the top 10 stock Newcrest Mining.

Exhibit 3: Portfolio breakdown by geography

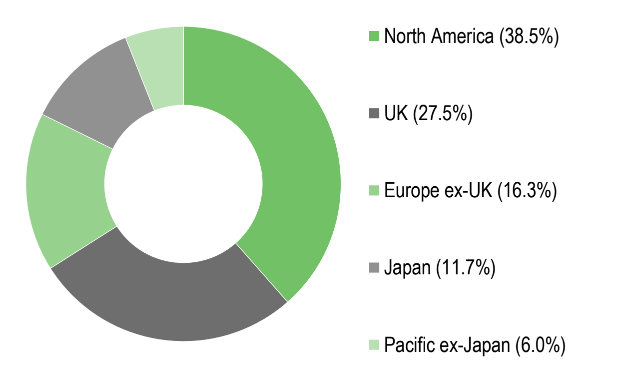
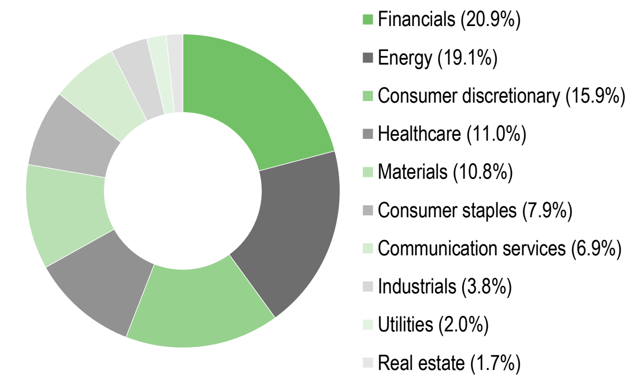


Exhibit 4: Portfolio breakdown by sector



Source: The Scottish Investment Trust, Edison Investment Research. Note: Represents total equities. Data at 30 November 2018.

Sales in H218 included Rentokil Initial, another previous 'ugly duckling' that is now favoured by investors following an operational turnaround, IT stocks SAP (software) and IBM (hardware), and RSA Insurance. General Electric was sold after successive management changes failed to produce any appreciable improvement. Stocks purchased in the period were Japanese bank Mitsubishi UFJ, which has an attractive yield and may benefit from any normalisation in Japanese interest rates, and French supermarket chain Carrefour, which had de-rated substantially since its days as a 'market darling', but now has a new management team with a credible turnaround plan.

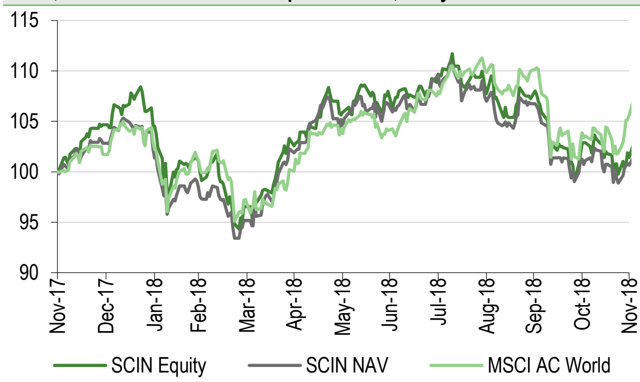
The geographical exposure (Exhibit 3) has seen some notable changes over the past 12 months (to 30 November), partly as a result of portfolio activity. North American exposure rose by 9.7pp through a combination of new purchases and performance (as noted in the Performance section, the share price of Macy's almost doubled in FY18, while new purchase Target is now a top 10 holding). UK and European exposure declined by 2.1pp and 2.4pp respectively, largely as a result of falls in the value of holdings, while Asia Pacific exposure fell by 5.0pp (almost all of which could be attributed to the sale of Treasury Wine Estates), Latin American exposure fell to zero after the exits from Ambev and Cemex, and the Japanese weighting rose by 2.8pp, reflecting McKinnon's positive outlook on Japanese banks (as well as the purchase of Mitsubishi UFJ, Sumitomo Mitsui Finance is now a top 10 stock).

Like geographical weightings, sector exposures (Exhibit 4) are an output of stock selection. Notable changes over the year to 30 November include a fall from 4.7pp to zero in information technology (as well as the sales of SAP and IBM, some IT stocks have been reclassified by MSCI as 'communication services'); decreases in industrials (-6.3pp following the sales of Cemex, General Electric and Rentokil) and consumer staples (-4.6pp); and increases in consumer discretionary (+5.9pp), energy (+3.3pp), basic materials (+2.1pp) and healthcare (+2.0pp).

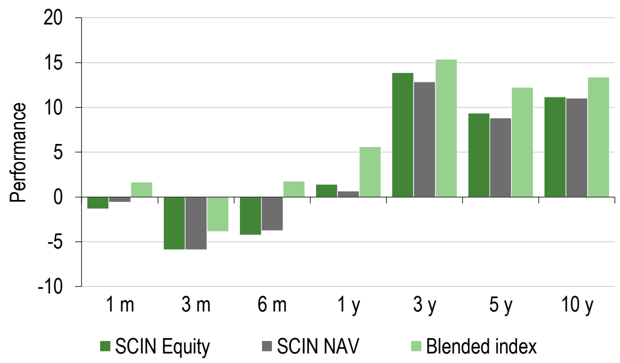
Performance: Creditable record of absolute returns

Exhibit 5: Investment trust performance to 30 November 2018

Price, NAV and index total return performance, one-year rebased



Price, NAV and index total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised. Blended index is FTSE All-World index until 31 October 2016 and MSCI AC World index thereafter.

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-World	(2.9)	(2.2)	(5.8)	(3.9)	(3.7)	(12.2)	(17.8)
NAV relative to FTSE All-World	(2.2)	(2.2)	(5.3)	(4.6)	(6.3)	(14.3)	(19.0)
Price relative to MSCI AC World	(2.9)	(2.1)	(5.9)	(4.0)	(3.8)	(12.1)	(17.3)
NAV relative to MSCI AC World	(2.2)	(2.1)	(5.4)	(4.7)	(6.3)	(14.2)	(18.5)
Price relative to MSCI UK All-Cap	0.5	0.4	4.0	3.1	20.4	22.6	14.1
NAV relative to MSCI UK All-Cap	1.3	0.4	4.5	2.3	17.2	19.6	12.5

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-November 2018. Geometric calculation.

SCIN's performance was modest over FY18, with a cum-fair NAV total return of 1.1% and a share price total return of 1.9%. The top contributor to performance was US retailer Macy's (now a top 10 holding), which produced a total return of 99%. Fellow retailers Tesco and Target also performed well, as did healthcare stocks Pfizer and GlaxoSmithKline. Together, these five stocks produced gains for the portfolio of £32.6m. Detractors from performance included three banks – the European stocks ING and BNP Paribas, and emerging markets-exposed Standard Chartered – as well as General Electric and Mexican materials stock Cemex, both of which were sold during the year. Together, these five stocks produced losses of £28.4m for the portfolio.

Over the year to 30 November 2018 (Exhibit 5), SCIN again produced small positive total returns (NAV TR +0.7% and share price TR +1.4%), somewhat behind the MSCI AC World index total return of 5.6%. US and Asian markets performed most strongly in November following the October sell-off, and SCIN is less exposed to both these areas than the global index. Meanwhile, the UK (where SCIN holds several times the index weighting) and Europe performed poorly. SCIN's approach is benchmark-agnostic; historically, it had a benchmark made up of 50% FTSE All-World and 50% FTSE All-Share, but this was removed to allow it greater flexibility. However, its high UK weighting versus global indices underpins its dividend income, supporting the 35-year record of annual dividend growth.

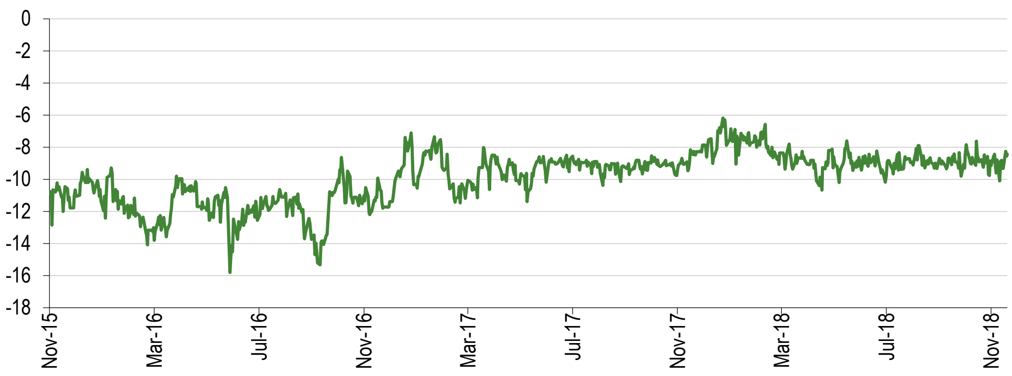
SCIN's contrarian focus means its performance should not be judged over the short term, as it will inevitably take time for the market to reappraise stocks that are very out of favour. In absolute terms, SCIN's annualised share price and NAV total returns of c 9–14% over three, five and 10 years are creditable.

The trust does not expect its portfolio performance to be similar to that of any index in any given year. As shown in Exhibit 6, it has lagged the returns of the two global indices (the FTSE All-World index was used as a performance comparator until the beginning of FY17, changing to the MSCI AC World index thereafter) over all periods shown. This reflects the high weighting of the US and, in particular, highly favoured US technology/internet stocks, in these indices. However, the trust has comfortably outperformed the MSCI UK All-Cap index, illustrating the benefits seen by UK investors in recent years from allocating assets outside the domestic market.

Discount: Close to long-term average levels

At 19 December 2018, SCIN's shares traded at an 8.0% discount to cum-income NAV (with debt at fair value). This was in the middle of the 12-month range of a 6.2% to a 10.7% discount. Over one, three, five and 10 years the average discounts range from 8.6% to 9.9%. This suggests the board's policy of limiting the discount to c 9.0% in normal market conditions has been broadly successful. There is scope for the discount to narrow should investors begin to focus more on attractively valued investments, rather than seeking 'growth at any price'.

Exhibit 7: Share price discount to NAV (cum-fair) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

Structured as a conventional investment trust with one class of share, SCIN had 76.9m shares in issue at 19 December 2018. Its discount management policy aims to keep the discount to cum-income NAV below 9.0% in normal market conditions, and in the past 12 months, 1.7m shares

(2.1% of the total) have been bought back for cancellation, at a cost of £14.4m. SCIN has structural gearing via a 30-year secured bond issue with a fixed coupon of 5.75%, maturing in 2030. The book value of the debt at end-FY18 was £83.8m, representing gross gearing of c 12% at 31 October 2018. However, net gearing is currently zero, reduced from a long-term average of c 5% earlier in 2018, in light of the strong recent performance of global stock markets and the greater number of potentially destabilising events on the horizon.

SCIN is self-managed and as such does not pay a management fee. Total expenses for FY18 were £3.25m (including staff and directors' costs, legal, professional and administration fees, and a refund of previously paid expenses), compared with £3.51m in FY17. Ongoing charges were 0.52% of net assets (FY17: 0.49%). With effect from the start of FY18, expenses have been allocated 65%/35% between the capital and revenue accounts (previously 50%/50%), in line with the expected split of returns.

Dividend policy and record

SCIN aims to provide its investors with dividend growth in excess of the rate of UK inflation, and FY18 represented its 35th consecutive year of growth in the regular dividend. With effect from FY18, dividends are paid quarterly, in May, August, November and February. Previously, they were paid twice a year, with the final dividend frequently augmented by a special dividend, depending on the level of portfolio income received during the year. FY17 marked a step-change in the dividend policy, with a 48% increase in the regular dividend (to 20.0p from 13.5p), alongside a smaller special dividend and guidance that there would be less likelihood of special dividends in future. However, owing to the high level of portfolio income (26.0p per share), a special dividend of 4.0p was declared for FY18 alongside the final dividend of 6.2p, bringing the total dividends for the year to 25.2p (total regular dividends of 21.2p), an increase of 0.8% in the total dividend and 6.0% in the regular dividend compared with FY17.

While income is not SCIN's primary consideration when making investments, its contrarian approach means its holdings have tended to be higher-yielding for two reasons: first, the most favoured stocks in recent years have been low-yielding technology names, and second, out-of-favour stocks may have experienced a falling share price, which has the effect of increasing the percentage dividend yield. Based on the current share price and the total FY18 dividends, SCIN currently has a yield of 3.2% (2.7% excluding the special dividend). The board has guided that for FY19, it is targeting three interim payments of 5.3p per share (compared with 5.0p for the interim dividends in FY18), with a final dividend of at least 5.3p per share. This would mean a total regular dividend for FY19 at least the same as in FY18. SCIN had revenue reserves equivalent to 63.8p per share at end-FY18 (31 October), more than three times the FY18 regular dividend, and could use these reserves to continue to meet its objective of above-inflation annual increases in the regular dividend, should portfolio income in the current financial year be lower than in FY18.

Peer group comparison

SCIN is a member of the Association of Investment Companies' Global sector, which contains some of the largest and longest-established investment trusts. However, many of the funds in this group follow a much more growth or momentum-focused investment strategy than SCIN, meaning it is hard to make 'like with like' comparisons. Below, in Exhibit 8, we instead show a group of funds broadly following a 'value' investment style (with value currently being out of favour as a style, this is a reasonable proxy for SCIN's contrarian approach). These are drawn from a number of AIC sectors, including Global, UK Equity Income, UK All Companies, UK Smaller Companies and Europe (ex UK). In size terms, SCIN's market capitalisation is slightly above the average for the group. Its NAV total return performance is above average over one, three and five years, and below average over 10 years, ranking seventh, fifth, tenth and ninth respectively out of 14 funds. With the exception of the past 12 months, SCIN's absolute returns have also been creditable, at c 10% a year or more over all periods shown. It has below-average ongoing charges, and there is no performance fee. SCIN's discount is wider than the average for the group, and its dividend yield is broadly in line with the average (it is, however, one of the highest in the AIC Global sector). It is one of six funds in the peer group that currently have no net gearing.

Exhibit 8: Selected 'value' style investment companies as at 18 December 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
Scottish Investment Trust	**594.9**	**(6.0)**	**40.6**	**48.2**	**163.4**	**0.5**	**No**	**(8.4)**	**100**	**3.2**
Aberforth Smaller Companies	1,027.2	(13.7)	9.2	21.7	297.3	0.8	No	(10.8)	100	2.5
Bankers	977.2	(4.5)	41.9	62.0	211.7	0.4	No	(2.4)	104	2.5
British Empire	757.7	(1.4)	55.2	54.0	162.9	0.9	No	(9.3)	107	1.9
EP Global Opportunities	129.9	(3.0)	42.2	48.6	162.9	0.9	No	(4.1)	100	1.7
European Investment Trust	326.0	(10.9)	28.9	25.8	114.6	0.6	No	(9.5)	100	3.4
Fidelity Special Values	615.7	(12.1)	18.8	33.9	229.3	1.0	No	1.9	121	2.2
Law Debenture Corporation	645.4	(4.5)	29.6	41.6	208.1	0.4	No	(10.6)	102	3.2
Lazard World Trust Fund	105.6	(8.6)	35.9	55.8	226.7	1.7	Yes	(4.2)	100	7.1
Lowland	352.6	(12.9)	13.8	17.8	291.8	0.6	Yes	(4.4)	113	4.1
Majedie Investments	137.9	(3.5)	20.2	48.0	115.9	1.0	No	(15.1)	111	3.1
Miton Global Opportunities	74.5	(4.5)	50.3	57.2	217.2	1.5	No	1.8	100	0.0
Temple Bar	758.3	(9.9)	19.4	17.1	201.3	0.5	No	(4.0)	107	3.9
Value And Income	118.9	(8.0)	8.8	15.6	127.3	1.5	Yes	(10.8)	130	4.5
Peer group average (14 funds)	**473.0**	**(7.4)**	**29.6**	**39.1**	**195.0**	**0.9**		**(6.4)**	**107**	**3.3**
SCIN rank in peer group	**7**	**7**	**5**	**6**	**9**	**11**		**8**	**9**	**6**

Source: Morningstar, Edison Investment Research. Note: *Performance to 17 December 2018. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

The board

There are five directors on SCIN's board, all non-executive and independent of the manager. The chairman, James Will, took up his current role in January 2016, having joined the board in 2013. Russell Napier is the longest-serving director, having been appointed in 2009. Jane Lewis (chair of the remuneration committee) and Mick Brewis both joined the board in December 2015. Karyn Lamont (chair of the audit committee), the newest director, was appointed in October 2017. The directors all have professional backgrounds related to financial services.

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