EDISON

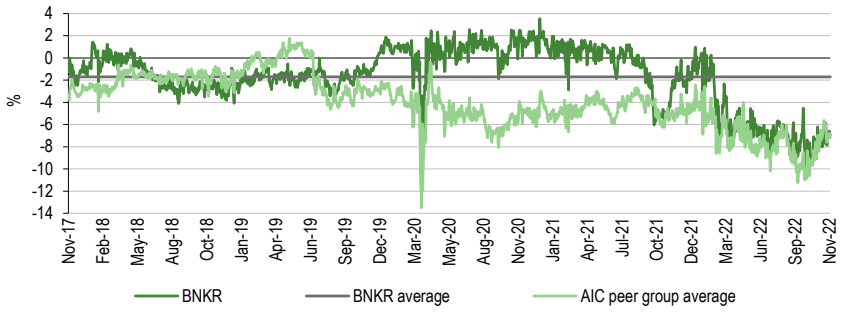
The Bankers Investment Trust

Maintaining a defensive tilt

Investment trusts
Global equities

In our update on The Bankers Investment Trust (BNKR) in August, we updated readers on fund manager Alex Crooke's macroeconomic views and positioning. As one would expect, there have not been wholesale changes since then in his views and the resultant positioning, as invariably BNKR's style is incremental change. There are some developments on the potential direction of travel for geographic weightings, with the manager taking advantage of the recent relative strength in UK large caps to raise levels of liquidity modestly, likely to be deployed in Asia over time. In other news, 2022 has been a decent year for a recovery in dividends. Janus Henderson Investors (JHI) estimates that on a 12-month forward basis, the top 10 positions within the trust (on an unweighted basis) should on average generate dividend increases of 11% and at H122 the board guided for an FY22 dividend increase of at least 5% over the level paid in 2021, which could well be a conservative estimate.

BNKR has seen a modest de-rating over the last 12 months



Source: Morningstar. Note: AIC peer group is unweighted.

Why consider BNKR now?

In our previous updates we have highlighted the merits of BNKR for long-term core global equity growth and income investment. In particular, BNKR has a consistent investment process, making good use of the best investment talent that JHI has to offer, guided by an experienced manager and all at very competitive terms.

BNKR's short- and medium-term NAV performance has been a little underwhelming when compared with the index (although it is more competitive against peers), which may have contributed to the widening discount over the past 12 months. BNKR currently trades on a discount to its NAV (debt at fair value, cum income) of 5.9% versus its five-year average of a 1.7% discount, which we believe offers investors an attractive entry point for a prudent but actively managed portfolio delivering both growth in income and capital.

29 November 2022

Price	**102.2p**
Market cap	**£1,323.3m**
Total assets	**£1,545.9m**
NAV*	108.6p
Discount to NAV	5.9%

*Including income at 28 November 2022.

Yield	2.1%
Shares in issue	1,294.9m
Code Ord/ISIN	BNKR/GB00BN4NDR3
Primary exchange	LSE
AIC sector	Global
Financial year end	31 October

52-week high/low*	125.0p	93.0p
NAV* high/low	125.2p	102.8p

*Including income.

Gearing at 28 November 2022

Gross gearing	10%
Net gearing	6%

Fund objective

Over the long term, The Bankers Investment Trust (BNKR) aims to achieve capital growth in excess of the FTSE World Index and dividend growth greater than inflation, as measured by the UK Consumer Price Index, by investing in companies listed throughout the world.

Bull points

- Experienced management.
- Diversified portfolio.
- Low fees.

Bear points

- Medium-term underperformance.
- Likely to remain structurally underweight the United States.
- Share discount has recently drifted out.

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The Bankers Investment Trust is a research client of Edison Investment Research Limited

Looking through the next 18 months to better times ahead

Crooke explains that the last 10 years have been difficult for a global growth and income mandate due to the narrowness of sector and geographic market leadership, together with the low yields on offer in the United States. He believes that the next 10 years are likely to be a better, more normalised environment with interest rates in the 3–4% range and inflation at similar levels over the long term. Macroeconomic events in 2022 such as the Ukraine war and the 'violence' in the bond markets caused by surging inflation and political events, especially in the UK, have made for increased volatility and created headwinds for investors. This has been a source of some frustration to the manager as the generally good corporate results seen within the portfolio through May to July have largely gone unrewarded.

Soaring inflation has been the largest economic challenge of 2022, with US goods price inflation recently hitting a 50-year high and US services at a 30-year high. Central banks, which had arguably been asleep at the wheel, have reacted aggressively and government bond yields in the developed economies have spiked as investors have questioned the ultimate level and duration of the current interest rate cycle. This has led to volatility in equity markets, especially the significant derating of long-duration growth assets, previously priced off low bond yields. There are some tentative signs that the inflation outlook could be easing, with energy and commodities prices rolling over and supply bottlenecks clearing. However, wage inflation looks to be a more persistent factor and global growth is likely to slow in 2023, with many western countries forecast to tip into recession. In general, the consumer remains under severe pressure with the 'cost of living crisis' an ever-present feature in the media and this is likely only to increase with slowing economic activity and the prospect of unemployment increasing, albeit from low levels.

Maintaining a defensive tilt

With the currently somewhat gloomy economic outlook, the portfolio has been tilted over the last 12–18 months or so in favour of defensives, such as healthcare and non-discretionary consumer stocks, with reduced exposure to bigger ticket (automotive and tourism, etc) consumer discretionary names as inflation has latterly bitten into household budgets. There has been an increase in holdings in financials such as CME Group, basic materials like Sherwin-Williams and healthcare companies such as Zoetis. Other changes include less in technology, with the sale of Amazon and a reduction in Microsoft, and consumer-facing discretionary spend stocks such as Netflix which has been sold. Crooke has been reducing the transaction-based financial stocks, such as Visa, Mastercard and American Express, which were beneficiaries of COVID-19, and instead investing the proceeds into conventional, well-capitalised retail banks Lloyds and Austrian peer Bawag, which should be beneficiaries of rising rates, although Crooke is wary of the credit cycle. With an eye to transitioning over time to a more global portfolio, representative of the opportunity set, Crooke has taken some capital from the allocation to the UK (as it has held up overall a bit better through 2022), and is keeping the proceeds liquid, with a view to deploying, probably to Asia when the timing is right. Reductions in the UK sleeve include Compass Group, James Fisher & Sons, Reckitt Benckiser and RELX. Currently BNKR has 10% gross gearing partially offset by 4% in cash so there is dry powder to take advantage of opportunities. Crooke believes that Asia is further through the economic downturn and will thus recover quicker than Europe or the United States, where recovery looks further off. Investing in China is problematic on a number of levels, however there is scope for Chinese stimulus to boost growth while other central banks are raising interest rates into an economic slowdown.

Within the Pacific ex Japan/China sleeve, Mike Kerley (who is BNKR's deputy fund manager) has been buying CapitaLand Integrated Commercial Trust, which is a Singapore-listed and focused real estate investment trust, with a broadly spread portfolio of retail, office and mixed-use property, including some development. Kerley favours those banks based in south Asia that are seeing credit and stronger economic growth, such as Bank Mandiri in Indonesia, which is another recent addition

Exhibit 1: Portfolio geographic exposure versus benchmark (% unless stated)

	Portfolio end-October 2022	Portfolio end-October 2021	Change (pp)	Index weight	Active weight vs index (pp)
North America	39.1	34.2	4.9	68.4	(29.3)
UK	17.9	18.6	(0.7)	4.2	13.7
Europe ex-UK	17.1	19.9	(2.8)	12.3	4.8
Japan	12.3	11.7	0.6	6.4	5.9
Emerging markets	6.9	9.5	(2.6)	0.0	6.9
Pacific ex-Japan	6.7	5.5	(1.2)	8.7	(2.0)

Source: BNKR. Note: The benchmark is a broad global equity index.

In Europe, which is most exposed to the economic effects of war in Ukraine and which is consequently seeing an especially weak manufacturing purchasing managers index, growth as a style still looks expensive according to portfolio sleeve manager Jamie Ross, who has been adding quality stocks at more depressed prices via French aerospace operator Airbus, German healthcare company Sartorius, German stock market platform Deutsche Börse and Spanish renewable energy company EDP Renováveis. Ross has sold bond proxies in the European sleeve, such as Italian utility Enel, and cyclical industrials, such as Italian CNH Industrial and French auto company Stellantis.

Exhibit 2: Portfolio sector exposure versus benchmark (% unless stated)

	Portfolio end-October 2022	Portfolio end-October 2021	Change (pp)	Index weight	Active weight vs index (pp)
Financials	21.4	19.5	(1.9)	14.1	7.3
Industrials	19.3	18.7	0.6	13.3	6.0
Technology	13.9	15.6	(1.7)	20.6	(6.7)
Consumer discretionary	12.3	16.9	(4.6)	13.6	(1.3)
Health care	10.9	9.4	1.5	13.2	(2.3)
Consumer staples	10.0	8.0	2.0	6.9	3.1
Basic materials	3.6	3.8	(0.2)	3.7	0.1
Energy	2.5	1.0	1.5	5.8	3.3
Real estate	2.4	2.5	(0.1)	2.7	(0.3)
Telecommunications	2.3	3.1	(0.8)	2.9	(0.6)
Utilities	1.5	1.5	0.0	3.2	(1.7)

Source: BNKR. Note: The benchmark is a broad global equity index.

Within the China sleeve, the manager, May Ling Wee, has been adding LONGi Green Energy Technology, which develops solar technology and associated power plants for industrial and retail end use. Midea Group is another addition; it is an electrical appliance manufacturer with a strong brand and a strong balance sheet, and it was trading on an attractive price following a sharp fall. The managers expect the trend for consumers to prefer domestic brands to continue and have used market volatility to build up positions in such opportunities. Chinese food producer ChaCha Food is another recent example.

In the US, sleeve manager Gordon Mackay has added consumer defensive Coca Cola, software giant Oracle and Warren Buffett's multinational conglomerate investment vehicle Berkshire Hathaway. Mackay has sold some of the more expensively rated higher-growth-orientated holdings over the last 12 months, such as Amazon, Adobe and PayPal, which could be vulnerable to further share price derating while inflation remains at elevated levels.

Exhibit 3: Top 10 holdings (as at end October 2022)

Company	Country	Sector	Portfolio weight %		Index weight (%)	Active weight vs index (pp)
			31 October 2022	31 October 2021*		
Automatic Data Processing	US	Industrials	2.8	1.7	0.2	2.6
Berkshire Hathaway	US	Financials	2.3	N/A	1.0	1.3
Oracle	US	Technology	2.1	N/A	0.2	1.9
Roper Technologies	US	Industrials	2.0	N/A	0.1	1.9
American Express	US	Financials	2.0	2.0	0.2	1.8
CME Group	US	Financials	2.0	1.8	0.1	1.9
Microsoft	US	Technology	2.0	2.8	3.4	(1.4)
Coca-Cola	US	Consumer defensive	1.9	N/A	0.5	1.4
Visa	US	Financials	1.8	N/A	0.7	1.1
Otis Worldwide	US	Industrials	1.8	1.5	0.1	1.7
Top 10 (% of holdings)			**20.0**	**9.8**		

Source: BNKR. Note: The benchmark is a broad global equity index. *N/A where not in end-October 2021 top 10.

Performance has lagged over the last 12 months

In the calendar year to the end of September 2022, BNKR's NAV returned (total return, debt at fair value, in pounds sterling) -9.9%, compared with the MSCI ACWI return of -4.2% and the Morningstar Global Blend Equity peer group return of -6.9%. Sleeve performance was positive on a relative basis in Japan and the Pacific, but negative in the UK, Europe, United States and China.

US: Underweight and underperforming

BNKR offers diversified exposure to a range of global markets based upon the attractiveness of those markets and the stocks within them from a capital and income growth perspective. The United States accounts for around 68% of global equity market indices, but only 39% of BNKR's portfolio, while global peers as defined by Morningstar have around 65% invested in the United States. This underweight position reflects the desire for a diversified portfolio, the outlook for capital returns, but crucially also the relative attractiveness for dividends. JHI points out that US earnings per share are at all-time highs and showing signs of rolling over. Increasing the weighting to the United States would reduce diversification, reduce the trust's flexibility to choose attractively valued stocks and also increase the requirement for income from the other regional sleeves.

The US sleeve has historically performed strongly, which we covered in our August update Navigating through choppy waters ahead. However, sleeve manager Gordon Mackay's growth investment style has faced challenges recently. Surging inflation has prompted central banks to raise interest rates with the expectation that this cycle could be higher and longer than expected. This has had the effect of derating long-duration growth assets, which traded on elevated valuations, in favour of those securities where the cash flows are more immediate and the valuations nearer to trend. Stocks within the US sleeve that were weak in share price terms over this period included Intuit and Alphabet, although some healthcare holdings such as The Cooper Companies and Zoetis were also out of favour with investors. These offset the good performances by holdings such as Automated Data Processing, Union Pacific Corporation and Apple. Over the year to the end of September 2022, the US equity market (although volatile) outperformed broad global indices in aggregate by around 6%, thus the underweight relative position within BNKR combined with the underperformance of the sleeve detracted from the fund's relative performance.

China: An off benchmark, underperforming position

Over the year to the end of September 2022, the MSCI China Index returned -22% versus the broad global index return of -4.2% BNKR has a weighting of 6.9% versus 0% in the fund's benchmark. China is important for the region and globally. Mike Kerley, Pacific (ex Japan, China) sleeve manager and deputy fund manager of BNKR, does not expect the zero COVID-19 policy to

be relaxed before March 2023 at the earliest, as by March, winter will have passed, which is the most significant period for the spread of the COVID-19 virus, and there are also a number of mRNA drugs in Phase III trials that could provide a catalyst for targeted reopening. Chinese equities have had a torrid 2022 and for some investors have become almost uninvestable, with the volatility surrounding central policy on certain sectors and the extended periods of draconian lockdowns, which have hampered worker mobility. There is also the possibility of a property slowdown in China, with diminishing asset and credit quality and the delisting of Chinese corporates listed as American depository receipts on the NYSE. These factors have all led to very negative investor sentiment to Chinese equities. Kerley acknowledges these risks and the likely ongoing volatility, but feels that valuations have reached extremely depressed levels reflecting these concerns.

Energy: Not enough exposure, but for good reasons

Over the year to the end of September, the MSCI ACWI Energy Index returned 40.4% versus the broad global index return of -4.2%. Energy in its current state is arguably an industry in structural decline, as the world transitions away from energy derived from carbon to one based on alternative technologies. The war in Ukraine has brought forward the necessity for transition from a geopolitical perspective, as has the ongoing climatic volatility from an environmental viewpoint. In the near term, the reliance on fossil fuels cannot be avoided, but the direction of travel is clear. Energy companies have been positioning themselves as a part of the solution and there is a broad trend of investing in alternative energy sources to futureproof their businesses. However, currently they are reinvesting cash flows from high returning assets (ie conventional oil extraction) into broadly low returning renewables. The portfolio has only 2.5% in energy (October 2022), while the benchmark has 5.8%, and there are only three energy stocks held: Woodside Energy in Australia, Inpex Corporation in Japan and Total in France.

Exposure to the domestic UK economy and Europe has been painful for investors through 2022, with respective underperformance of UK mid caps and European equities of 18.9% and 6.7% versus global equities through the course of the year. Holdings such as Hilton Food in the UK, which had a profit warning in September 2022, and Spanish healthcare company Grifols have been weak through 2022. The weighting to UK and European equities stood at 35% at October 2022 from 38.6% at October 2021. Crooke believes that the UK will settle in the longer term in a 10–15% range, rather than the 15–20% within the portfolio. Crooke and Kerley, who manages the Pacific ex Japan/China sleeve, are looking for opportunities over the coming months to deploy some of the cash retained from the reduction of UK equities into Asia, where they see the potential for a quicker recovery than in other parts of the global economy.

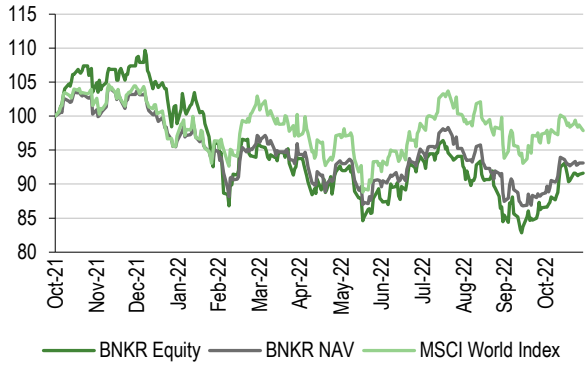
Exhibit 4: Five-year discrete performance data

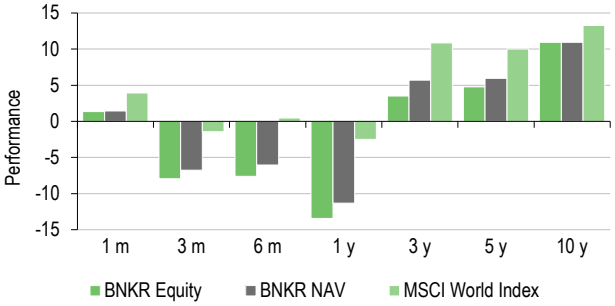
12 months ending	Total share price return (%)	Total NAV return (%)	MSCI World Index (%)	CBOE UK All Companies (%)
31/10/18	0.2	0.8	5.7	(1.6)
31/10/19	13.6	12.1	11.9	6.9
31/10/20	8.0	5.3	5.0	(20.2)
31/10/21	18.6	26.4	33.0	36.0
31/10/22	(13.4)	(11.3)	(2.5)	(1.6)

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

Exhibit 5: Investment company performance to 28 November 2022

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





Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

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