EDISON

Henderson Opportunities Trust

Buckets of opportunity drive an impressive year

Investment trusts
UK all-cap equities

Henderson Opportunities Trust (HOT) has posted a very strong performance for FY21 (ended 31 October), with its NAV and share price both up almost 60% on the prior year, albeit with the bulk of the returns coming in H121. Co-managers James Henderson and Laura Foll construct a deliberately diverse all-cap portfolio of between 70 and 100 UK equities, with a bias towards smaller and particularly AIM-listed stocks. While the emphasis is on capital growth, the trust also seeks to reward investors with a growing annual dividend. In the past year, positive performance has been spread across the portfolio's seven 'buckets' (see page 4), with drivers as diverse as UK high street banks, a regional corporate broker, a Scottish housebuilder and smaller North Sea oil & gas names. Looking ahead, the managers are confident that the 'excellent companies with excellent products' in their portfolio can overcome inflationary headwinds.

Opportunities all around: Fund manager video with Laura Foll

Source: Janus Henderson Investors. Note: Information correct at time of filming.

Why invest in UK equities now?

While investors in many areas of the UK stock market have been rewarded with good returns over the past 12 months, the domestic market remains under-owned by international investors and the valuation discount, particularly versus the US, continues to widen. Commentators point to buoyant merger and acquisition (M&A) activity this year, particularly from foreign and/or private equity buyers, as evidence of the continued value on offer from UK companies with good growth prospects.

The analyst's view

HOT offers something different from the majority of UK equity investment trusts, which tend to be focused on income or a particular market segment (such as small- or mid-caps). With a stock list of 70 to 100 companies, HOT is a more focused portfolio than Henderson and Foll's other trusts (Lowland and Law Debenture), but with a broader remit. The resulting selection may seem esoteric, but the 'bucket' system enables investors to understand holdings in terms of a company lifecycle (early stage, fast growth, steady growth, mature but stable), with additional recovery/special situations and natural resources exposure. The persistent discount to NAV looks at odds with the strong long-term performance record, particularly when viewed through the prism of the portfolio construction parameters.

NOT INTENDED FOR PERSONS IN THE EEA

30 November 2021

Price	**1,345.0p**
Market cap	**£106.6m**
AUM	**£136.2m**

NAV*		1,553.3p
Discount to NAV		13.4%

*Including income. As at 29 November 2021. NAV is xd.

Yield		2.0%
Ordinary shares in issue		7.9m
Code/ISIN		HOT/GB0008536574
Primary exchange		LSE
AIC sector		UK All Companies
52-week high/low	1,602.5p	1,040.0p
NAV* high/low	1,676.3p	1,203.0p

*Including income

Gross gearing*	14.0%
Net gearing*	14.0%

*As at 31 October 2021

Fund objective

Henderson Opportunities Trust aims to achieve capital growth in excess of the broad UK stock market from a portfolio of UK investments. Stock selection is not constrained by the benchmark and there are no limits by sector or market capitalisation; therefore, the portfolio will differ materially from the index.

Bull points

- 'Bucket' system of portfolio construction ensures diversity of return drivers.
- Value discipline could prove fruitful in a higher inflation/interest rate environment.
- Considerable potential for discount to narrow if the strong performance record leads investors to take the time to understand the fund.

Bear points

- Relatively small size means HOT could be overlooked by some investors.
- High portfolio weighting in smaller and earlier-stage companies, where returns can be volatile.
- Discount currently narrower than long-term averages and could drift wider if market conditions become more difficult.

Analysts

Sarah Godfrey	+44 (0)20 3077 5700
Mel Jenner	+44 (0)20 3077 5700

investmenttrusts@edisongroup.com

Edison profile page

Henderson Opportunities Trust is a research client of Edison Investment Research Limited

The fund managers: James Henderson & Laura Foll

The managers' view: Seeking excellent firms on good valuations

Considering HOT's portfolio against the current economic backdrop, Henderson argues that rising inflation and interest rates are good for banks and insurance companies (the trust's financials weighting is currently c 20%), unless they reach a point where over-tightening tips the economy into recession. 'A high wage, high productivity economy is a nice idea, but getting there is an inflationary push,' he explains. 'In an inflationary environment, cash is the worst thing you can have, and fixed income is the second worst. Owning companies with pricing power is the best inflation hedge, and we think excellent companies providing excellent products will continue to have pricing power.'

However, excellence can come at a price, and Henderson says that some sections of the market, such as mid-caps, currently look quite expensive; for example, at end-October 2021, the MSCI UK Mid Cap Index was at a forward P/E valuation of 17.7x compared with 12.2x for the broad MSCI UK Index. 'Any correction in this area could have the knock-on effect of a sell-off in small-caps, presenting a buying opportunity for HOT,' he adds.

HOT's enthusiastically esoteric stockpicking approach often means its managers are drawn to interesting small-cap situations with long-term potential. Foll highlights two examples: rail management software firm Tracsis (currently the eighth-largest position), and Bolton-based corporate broker K3 Capital.

'We bought Tracsis in about 2011 when it was very early stage – c £30–40m market cap – and it is now an established software business in the rail and transport sector, used for things like scheduling and maintenance,' she explains of the holding, which sits in the growth small-cap bucket. 'They are replacing pen-and-paper systems, which means their client base is relatively secure: once an operator has switched to a software-based system, they aren't going to switch back.' Tracsis is now over c £300m market cap after a year-to-date share price rise of more than 70%. 'With c £50m of sales, it still quite early in its lifecycle, but I can see us holding it for another 10 years until it is a much bigger company,' adds Foll.

K3 Capital is in the small/mid-cap compounders bucket, and has been in the HOT portfolio since its initial public offering (IPO) in 2017. 'It is still run by its founder, and has gone from c £50m to c £250m market cap,' the manager explains. 'With a focus on areas such as restructuring and R&D, it is a real disruptor in the sector. It gets out there and proactively tries to win business, unlike the big brokers who wait for business to come to them. Like Tracsis, I can see us owning it for a very long time,' she says. K3 Capital's share price is up c 30% year-to-date.

Asset allocation

Current portfolio positioning

At 31 October 2021, there were 94 holdings in HOT's portfolio, towards the top of the 70–100 stock range and a little higher than the 92 positions a year earlier. As shown in Exhibit 1, eight of the top 10 names were AIM stocks, with two high-street banks (Barclays and NatWest) making up the balance. Together, the top 10 holdings accounted for a little over a quarter of the total portfolio.

Foll says that purchases over the past year have spanned a broad mix of companies with their own stories, such as management change coming through. 'This time last year, we were adding banks and taking profits in stronger growth companies – Barclays is now our largest holding,' she adds, explaining that although there has been something of a rotation towards more cyclical areas, 'you need to keep with the growth companies as they add performance over time'. The new or increased bank holdings have a mixture of cyclical and structural drivers, says the manager: 'They were bought on the basis of a good possibility of interest rates going up, as well as the fact they were getting out of business areas that were not adding value, and being modest in their ambitions. The overweight in banks has been helping performance in these more choppy markets.'

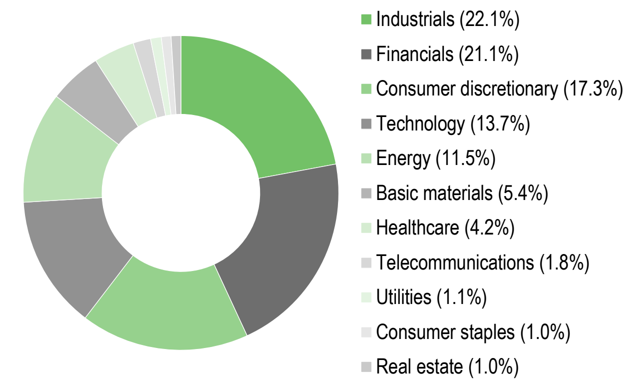
Exhibit 1: Top 10 holdings (as at 31 October 2021)

Company	Index	Industry	Portfolio weight % 31 October 2021	Portfolio weight % 31 October 2020*
Barclays	Large-cap	Banks	3.4	N/A
Serica Energy	AIM	Oil & gas producers	3.2	2.6
Springfield Properties	AIM	Household goods & home construction	2.9	2.6
Next Fifteen Communications	AIM	Media	2.7	2.1
Vertu Motors	AIM	Automotive retail	2.7	1.9
NatWest Group	Large-cap	Banks	2.4	0.7
Boku	AIM	Software & computer services	2.4	3.3
Tracsis	AIM	Software & computer services	2.3	2.3
SigmaRoc	AIM	Construction & materials	2.1	2.8
Blue Prism Group	AIM	Software & computer services	2.0	4.3
Top 10 (% of holdings)			**26.4**	**27.9**

Source: Henderson Opportunities Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-October 2020 portfolio.

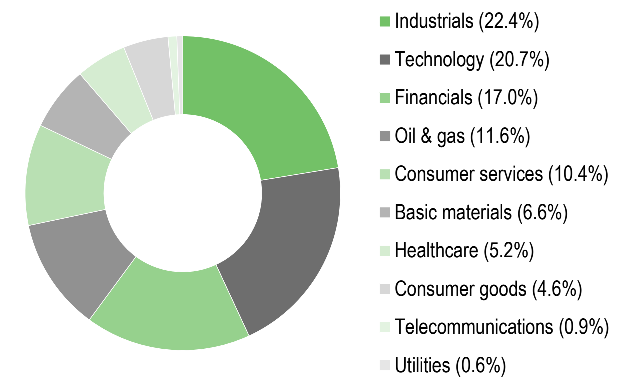
In spite of the increased weighting in banks, industrials – where there is a rich vein of smaller UK quoted companies – remain the largest sector allocation (Exhibit 2). Because of a change in the Industry Classification Benchmark (ICB) sector definitions during the year, a direct comparison of changes over the past 12 months is not possible (see Exhibit 3), although there has been a notable increase in consumer discretionary (broadly analogous with the old consumer services sector) and a decrease in technology over the year as the managers have taken profits in some successful positions. The change to an 'energy' sector from the old 'oil & gas' grouping has removed the anomaly of energy transition plays such as green hydrogen fuel cell specialist Ceres Power (a holding the managers have trimmed after a stellar run of performance in late 2020) being classified as the fossil fuels they are seeking to replace.

Exhibit 2: Sector exposure at 31 Oct 2021 (new ICB)



Source: Henderson Opportunities Trust, Edison Investment Research

Exhibit 3: Sector exposure at 31 Oct 2020 (old ICB)



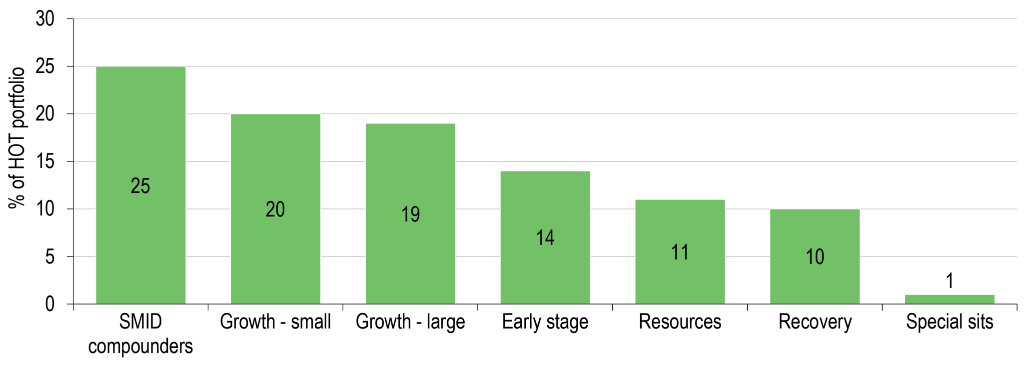
Source: Henderson Opportunities Trust, Edison Investment Research

Purchases and additions over the past year have spanned most of the portfolio 'buckets' (see below) and include early-stage medical device company Creo Medical, growth small-cap stock Dianomi (digital advertising technology), industrial company Morgan Advanced Materials in the small/mid-cap compounders segment, insurer Direct Line and supermarket Tesco in large-caps, and retailer Marks & Spencer and Revolution Bars, bought for their recovery potential. Foll says that while Morgan Advanced Materials is a relatively new position for HOT, it is an established holding in the other funds she manages with Henderson. 'It has a very good management team – conservative, margins-focused; they have reduced the pension deficit and on-balance sheet debt. It is a better business than it was five years ago and post-pandemic it has the potential to achieve higher margins than people expect,' she explains. Direct Line, meanwhile, features a chunky c 8% dividend yield, but has not been bought simply as an income generator. 'The high yield would suggest the market is questioning whether Direct Line can grow, but we think it can, says Foll. 'Its new IT systems mean it can take on a lot more policies at scale.' At the other end of the spectrum, the managers also bought into biotechnology stock Oxford Nanopore Technologies at its IPO on 30 September 2021. Its shares are currently trading at c 60% above the 425p issue price.

HOT's seven portfolio 'buckets'

The managers divide HOT's portfolio holdings into seven classifications, or 'buckets'. Each bucket contains stocks that are likely to perform better or worse at different points in the market cycle and, while the list may look esoteric, Henderson says the seven classifications (each with an indicative exposure range) are based on different ways of looking at valuation, and the diversification should reduce the overall volatility of net asset value (NAV) performance over time. The buckets are as follows:

Exhibit 4: HOT's seven portfolio 'buckets' at 31 August 2021



Source: Henderson Opportunities Trust, Edison Investment Research

- **Small- and mid-cap compounders (20–40% of the portfolio):** quality, usually well-established companies with strong management, offering long-term compounding of returns as they grow. At 31 August 2021, this was the largest element of the portfolio, at 25%.
- **Growth small cap (20–40%):** these earlier-stage quality companies with correspondingly higher growth rates were the second largest exposure (20%) at 31 August, albeit at the lower end of the indicative range.
- **Growth large cap (10–30%):** familiar names that nevertheless offer operational quality and long-term growth potential. These can increase the liquidity of the overall portfolio and may also be an important source of yield. Exposure to this area has risen during FY21, from 15% at end-October 2020 to 19% at end-August 2021.
- **Early stage/university spinouts (0–20%):** although these may be unproven and can be risky, their prospects are largely uncorrelated to market moves and they may offer significant profit potential as assets are commercialised. These made up 14% of the portfolio at 31 August 2021, down c 3pp on end-FY20 after taking some profits in highly successful positions, but still c 7pp higher than at the previous year-end.
- **Natural resources (5–15%):** positioning will depend on the commodity, but these cyclical stocks can add portfolio diversification. Foll notes the importance of the lower end of the range being 5% rather than zero, meaning some resources exposure (11% at end-August 2021) will always be present, which gives the managers scope to benefit from unexpected developments in commodity markets.

- **Recovery (0–20%):** these contrarian value opportunities made up 10% of the portfolio at 31 August 2021, a big rise from 4% at end-FY20 as the managers see attractions in more established businesses that are having to reinvent themselves due to the trends exacerbated by COVID-19.
- **Special situations (0–10%):** distinct from recovery stocks in that they offer a specific catalyst for change, such as a restructuring, rather than simply being out of favour. These accounted for just 1% of the portfolio at end-August 2021.

Foll explains that the first four buckets effectively represent a company lifecycle: beginning at early-stage, then growth small-cap, maturing to small/mid-cap compounders and finally large-cap. She also notes the different growth and valuation characteristics inherent in each bucket: 'Growth small-caps are not going to be cheap because they are fast-growth companies. A lot of our tech holdings are in this bucket. Growth small-cap and compounders are the core of the portfolio, and compounders may also be trading on quite high multiples that they need to grow into.' Large-caps in the portfolio are more than 'ballast': 'they do need a route to sales and earnings growth, as well as being a source of dividends'. Recovery and special situation stocks are likely to be more at the 'value' end of the spectrum, while valuations for both early-stage and resources companies may be more dependent on company- or commodity-specific dynamics.

Performance: Strong returns in FY21 of two halves

Exhibit 5: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	CBOE UK All Cos (%)	Numis Smlr Cos + AIM ex-ICs (%)	CBOE UK 250 (%)
31/10/17	32.2	29.4	13.6	26.1	19.3
31/10/18	(5.3)	(5.5)	(1.6)	(8.2)	(4.8)
31/10/19	(3.7)	0.4	6.9	1.7	8.7
31/10/20	(1.7)	(7.5)	(20.2)	(2.6)	(17.8)
31/10/21	59.5	58.6	36.0	43.5	45.7

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

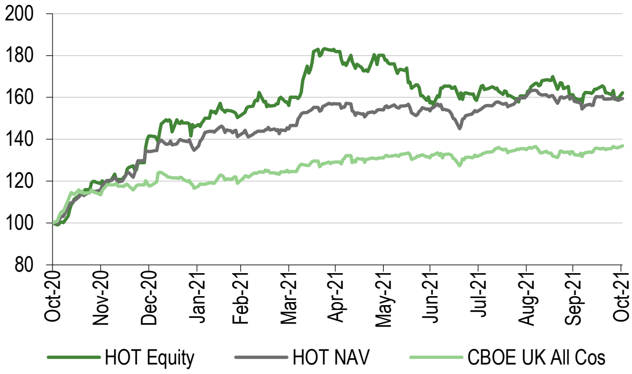
HOT has had a strong year of performance in FY21 (ended 31 October), a period almost exactly analogous with the 12 months since Pfizer first published the results of its successful COVID-19 vaccine trial. Over the year, its share price and NAV total returns of 59.5% and 58.6% respectively (Exhibit 5) have beaten the returns from the broad UK market (excluding AIM), the mid-cap segment and the small-cap universe including AIM stocks, helped by the judicious use of gearing. However, it was largely a 'year of two halves', with the bulk of the NAV gain coming in the first half of the period and the share price declining somewhat in the second half.

While the strong returns from the past year have boosted the longer-term numbers (Exhibit 6), with annualised NAV and share price total returns of c 13–16% over three, five and 10 years to 31 October 2021, we note that in the pre-COVID-19 period, HOT had also outperformed its broad UK index benchmark over all these periods (see our February 2020 initiation note), with annualised returns of c 8–12% over five and 10 years to end-January 2020. We would argue that although there has certainly been some volatility of returns, it would be unfair to characterise HOT's long-term performance record as 'inconsistent', an argument that has sometimes been put forward to explain a discount to NAV that has remained far wider than the majority of its peers.

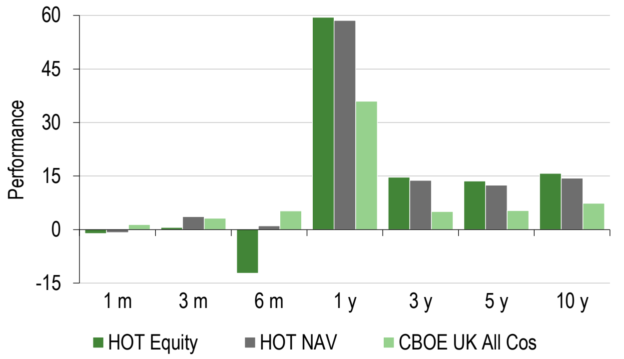
Strong returns in FY21 came from across the portfolio buckets, including growth small-cap (Tracsis, Boku), small and mid-cap compounders (K3 Capital, Springfield Properties), large-cap (NatWest), natural resources (Serica Energy) and recovery (Vertu Motors, International Personal Finance). Foll says that in the longer term, there has also been no particular theme or bucket driving returns, with a mix of natural resources, small-cap growth and small and mid-cap compounders among the strongest performers, which included North Sea gas operator Serica Energy, patent and commercial translations specialist RWS and robotic process automation software firm Blue Prism. However, while these may be an eclectic bunch, Foll says the common thread between many of HOT's biggest winners is that they were bought when they were very small, sometimes below £50m market cap, and held over the long term. 'We are investing at a very early stage and then sitting tight, being very patient', she explains, using the example of Serica Energy, which is currently HOT's second largest holding, having come in as a 50bps position in 2013. 'It did almost nothing for four years – but then it did a deal with BP at the end of 2017 to become one of the largest North Sea gas producers, and now it is a £500m-plus company,' says Foll. She adds that the ability to be this patient with small, illiquid holdings is greatly assisted by the permanent capital nature of an investment trust, as well as by HOT's unconstrained investment approach.

Exhibit 6: Investment trust performance to 31 October 2021

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



Price, NAV and benchmark total return performance (%)



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

More recently (as seen in Exhibits 7 and 8), HOT's relative returns have lagged the various comparator indices, reflecting a dip in performance during the summer months following an exceptionally strong H121 (to 30 April), which saw share price and NAV total returns of 81.8% and 56.9%, respectively.

Exhibit 7: 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 CBOE UK All Cos	(2.5)	(2.5)	(16.6)	17.3	30.2	45.7	111.4
NAV relative to CBOE UK All Cos	(2.2)	0.4	(3.9)	16.7	27.1	38.9	88.6
Price rel to Numis Smlr Cos + AIM ex-ICs	(0.5)	(0.7)	(14.3)	11.2	6.2	14.9	54.4
NAV rel to Numis Smlr Cos + AIM ex-ICs	(0.2)	2.3	(1.3)	10.5	3.7	9.5	37.7
Price relative to CBOE UK 250	(0.5)	0.0	(15.7)	9.5	16.0	28.0	44.1
NAV relative to CBOE UK 250	(0.2)	3.0	(2.9)	8.9	13.3	22.0	28.5

Source: Refinitiv, Edison Investment Research. Note: Data to end-October 2021. Geometric calculation.

Exhibit 8: NAV performance versus CBOE UK All Companies index over three years

Source: Refinitiv, Edison Investment Research

EDISON

Peer group comparison

HOT is a member of the AIC's UK All Companies sector, which is perhaps less than aptly named given several of its constituents specifically exclude investment in large caps (which account for c 80% of the total UK market capitalisation). Effectively, the sector provides a home for UK equity funds that are neither specifically income orientated nor focused only on smaller companies (as opposed to mid caps). HOT is the smallest of the nine members of the peer group.

The trust's all-cap focus and large weighting in smaller stocks have helped propel it to the top of the performance table over one year, ahead of Fidelity Special Values (FSV), which, as the name suggests, shares HOT's valuation-aware tilt. Over three, five and 10 years it ranks third, second (by a whisker) and second, respectively. Despite this strong performance record, HOT stands on the widest discount to NAV, 14.5pp wider than FSV's 1.3% premium. In general, the peers with a more mid- and small-cap focus are on wider-than-average discounts, although the sector average is comparable with that of the UK Smaller Companies sector. Gearing at 14% is the highest in the sector, although only marginally above FSV's 13%. Ongoing charges are a little higher than average, and HOT is one of two funds that may be liable for a performance fee. All of the peers pay some level of dividend, with HOT's current 2.0% yield somewhat above the 1.7% sector average.

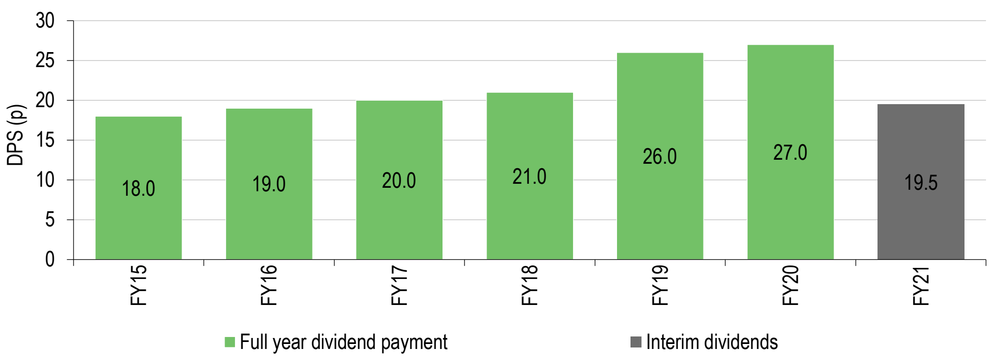
Exhibit 9: Selected peer group as at 26 November 2021*

% 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
Henderson Opportunities Trust	**106.0**	**36.7**	**48.2**	**81.3**	**308.6**	**0.9**	**Yes**	**(13.2)**	**114**	**2.0**
Artemis Alpha Trust	145.3	4.0	33.2	50.6	85.3	0.9	No	(3.1)	100	1.3
Aurora	173.7	17.7	31.6	59.9	62.8	0.5	Yes	(4.1)	100	0.2
Baillie Gifford UK Growth Trust	356.1	19.2	39.7	46.3	161.1	0.6	No	(2.2)	100	1.0
Fidelity Special Values	919.8	33.7	32.8	49.1	259.8	0.8	No	1.3	114	2.3
Independent Investment Trust	293.4	16.6	22.4	73.2	257.0	0.3	No	(10.1)	100	1.4
JPMorgan Mid Cap	298.0	30.6	48.4	65.6	339.5	0.8	No	(11.1)	111	2.3
Mercantile	2,054.0	29.0	53.0	81.5	297.9	0.5	No	(8.7)	110	2.6
Schroder UK Mid Cap	236.3	29.1	45.9	69.6	269.0	0.9	No	(12.1)	107	2.0
Simple average	**509.2**	**24.1**	**39.5**	**64.1**	**226.8**	**0.7**		**(7.0)**	**106**	**1.7**
HOT rank in peer group	**9**	**1**	**3**	**2**	**2**	**2**		**9**	**1**	**4**

Source: Morningstar, Edison Investment Research. Note: *Performance as at 25 November 2021 based on cum-fair NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100=ungeared).

Dividends: Strong evidence of UK income recovery

Exhibit 10: Dividend history since FY15



Source: Bloomberg, Henderson Opportunities Trust, Edison Investment Research

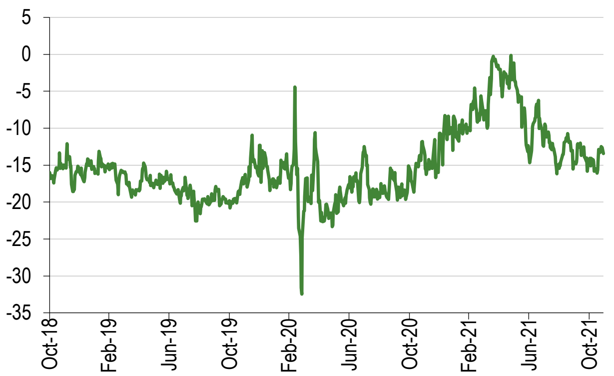
While HOT's investment objective is to achieve capital growth, its portfolio contains many income-generating companies, enabling the trust to pay a growing dividend to its investors over time, with quarterly payments since the beginning of FY20. Having historically covered the dividend from portfolio income (with the exception of a very small contribution from reserves in FY18), the step-change in the payout from 21.0p in FY18 to 26.0p in FY19 made the aim of providing a rising income more difficult in FY20, which saw a 46% decline in aggregate UK dividends as a result of COVID-19. HOT's own dividend income fell by c 57%, but thanks to its large revenue reserve (which stood at 24.4p per share at end-FY19 after deducting all dividends paid in that year) it was able to increase the FY20 payout by 3.8% (well above the rate of inflation at the time) to 27.0p, with a 14.2p per share contribution from reserves. So far in FY21, three dividends of 6.5p per share have been paid (the same as in the first three quarters of FY20), suggesting the fourth payout is likely to be higher than FY20's final dividend of 7.5p per share. Portfolio income has recovered well as many UK companies have resumed paying dividends, with a revenue return of £915,000 (11.6p per share) in H121, a 45.7% increase on H120. After deducting the Q221 dividend payment, HOT's revenue reserve stood at a still healthy 15.3p per share at end-H121. While it is too early to say whether HOT's FY21 income could match the 29.9p per share seen in FY19, the H121 revenue return per share of 11.6p is already above that seen in either the first or the second half of FY18, underscoring the post-lockdown recovery in UK dividends. Based on the last four dividends, HOT currently has a dividend yield of 2.0%.

Discount: Scope for a performance-driven re-rating

The board has an annually renewed authority to buy back up to 14.99% of shares, or allot shares up to 10% of the issued share capital. However, these powers are used infrequently and the 102,483 shares bought back during 2019 were the first repurchases in eight years. The primary reason for undertaking share buybacks is to enhance the trust's NAV when the discount is wide and the underlying holdings look particularly undervalued, rather than as a means of managing the discount. Although the discount has widened in recent months (Exhibit 11), Henderson says that given the number of attractive investment opportunities, the board is happy for the managers to put the trust's money to work in new holdings rather than spending it on share buybacks.

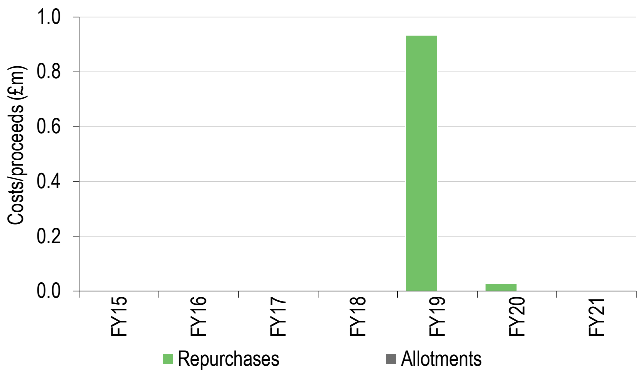
At 29 November 2021, HOT's shares traded at a 13.4% discount to cum-income NAV. Although wider than the 12-month average of 10.5%, this was narrower than the respective three-, five- and 10-year average discounts of 15.1%, 15.9% and 15.0%. The shares reached a five-year narrowest discount of 0.1% in May 2021 on the back of a very strong period of NAV performance and even stronger share price performance (+81.8% in H121), suggesting a degree of profit-taking may have driven the widening in H221. On this basis, we would argue that there is scope for a re-rating of the share price if consistency of NAV performance can be maintained.

Exhibit 11: Discount over three years



Source: Refinitiv, Edison Investment Research

Exhibit 12: Buybacks and issuance



Source: Morningstar, Edison Investment Research

Fund profile: Opportunities across the size spectrum

HOT has existed in its current form since 2007, but dates back to 1988 when it was launched as Henderson Strata, focusing first on global smaller companies and later on UK micro-caps. HOT has an all-cap UK equity mandate, although it retains a distinct bias towards smaller companies and a value-tilted investment style. The trust has been managed since 2007 by James Henderson, first alongside Henderson Strata's manager Colin Hughes and latterly (since Hughes's retirement in 2018) with Laura Foll, who co-manages other mandates with Henderson including Lowland Investment Company (LWI) and The Law Debenture Corporation (LWDB).

HOT's all-cap focus gives it the flexibility to seek out fast-growing smaller companies (including those listed on the junior index AIM, which make up more than 50% of the portfolio) while potentially limiting volatility through holding larger companies (currently c 23%). Although its benchmark is an all-cap UK index, the trust's portfolio differs significantly from the index, which is c 80% large cap, thus performance is also expected to diverge from the benchmark. HOT is a member of the Association of Investment Companies' UK All Companies sector.

Gearing – which the managers believe is accretive to long-term investment returns – is permitted up to 25% of net assets at the time of drawdown (15% without prior board approval), and stood at 14% at 31 October 2021. Portfolio construction is largely unconstrained, although the trust must hold between 70 and 100 stocks (currently 94). Unlisted securities are limited to 10% of gross assets at the time of investment and up to 15% may be held in investment companies (including investment trusts). Up to 30% may be held in cash and bonds, but in practice HOT tends to be fully invested in shares.

Investment process: 'Buying good companies cheaply'

Henderson and Foll describe HOT as 'a good mixer' for a portfolio, bringing diversification as well as the possibility of significant capital appreciation from its smaller company and early-stage holdings. The managers run the trust with a similar philosophy to their other funds, based on valuation awareness, diversification and in-depth research. As HOT has no specific income requirement (although it does seek to grow its distributions over time), the managers are less concerned about the need to mitigate the impact of any dividend cuts and are therefore able to hold a slightly more concentrated portfolio of c 70–100 stocks, compared with c 80–120 for LWI and up to 150 for LWDB. The trust has a higher active share (variance from the benchmark) than the managers' other portfolios and a higher level of risk, owing to its tendency to hold bigger individual positions, and the larger proportion of smaller company holdings – in particular those listed on AIM – whose share prices may be more volatile.

HOT's investment universe is effectively made up of all the companies listed in the UK. Interactions with companies are a key part of the stock selection process, with the managers undertaking several hundred meetings and site visits each year. Henderson and Foll see company management as one of the most important factors in identifying possible investments, noting that a good management team can navigate a difficult economic backdrop, while poor management can get it wrong even in the good times. Although the managers do not use specific quantitative screens to whittle down the large number of stocks in their investment universe, their focus on buying good companies cheaply means they employ a range of valuation criteria, such as P/E ratios, price/book value and enterprise value to sales. They note that the small-cap end of the spectrum often offers superior earnings growth and a P/E discount to the wider market, albeit with the risk of lower liquidity and greater volatility of returns.

Henderson and Foll's long-term approach to investing tends to result in a relatively low level of portfolio turnover, although they point out this will naturally vary across the different buckets (see page 4). While compounders (usually the core of the portfolio) are designed to be held indefinitely, growth large-cap and recovery stocks may be traded more frequently, either as a source of liquidity or because the expected recovery has occurred. Turnover on an annualised basis in H121 was 33.2% (implying an average holding period of three years), which was significantly higher than 14.6% in FY20 (a year affected by limited trading activity during the coronavirus-driven equity market dislocation) but more comparable with 25.1% in FY19. The managers take an active but measured approach to topping up and reducing holdings, to lock in gains and mitigate the possibility of future losses.

HOT's approach to ESG

Janus Henderson Investors' fund managers follow a responsible investing framework that does not rigidly exclude either sectors or companies that score poorly on sustainability metrics, but instead tries to understand why some companies score poorly, whether it is material to the investment case and whether the company is improving.

That said, Henderson and Foll see a role in the HOT portfolio for stocks that contribute positively to environmental, social and corporate governance (ESG), not simply those where there is the absence of a negative. This would include businesses that are involved in the transition to a lower carbon economy, such as clean hydrogen specialist Ceres Power and battery technology company Ilika, as well as those whose activities contribute positively to society, such as Creo Medical, which makes advanced surgical and endoscopy equipment enabling early diagnosis and minimally invasive treatment.

For HOT's full ESG statement please see its entry on the AIC website.

Gearing: Low teens level is still broadly neutral

HOT uses gearing supplied by its £20m unsecured loan facility, which currently represents c 15% of net assets. At 31 October 2021, net gearing was 14%, which is slightly above the 'neutral' level of 13% seen at the start and the mid-point of FY21 and at the end of September. However, this may be a function of the slight fall in NAV during October, rather than a policy decision by the managers, who used the borrowing to invest a net £5m in H121.

Fees & charges: Cap keeps lid on performance bonus

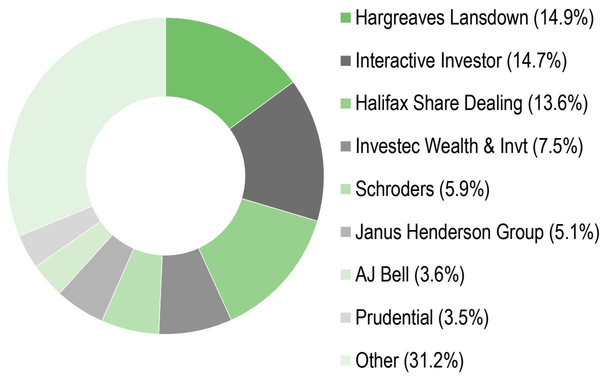
Henderson Investment Funds, a subsidiary of Janus Henderson Investors and HOT's alternative investment fund manager (AIFM) under the AIFM Directive, is paid an annual management fee of 0.55% of net assets. A performance fee (15% of any outperformance of the benchmark) may also be paid, subject to the NAV having increased in absolute terms, with a cap on total management and performance fees of 1.5% of average net assets. Any underperformance versus the index (or any unrewarded outperformance over the fee cap) is carried forward and set against outperformance or underperformance in subsequent years. A performance fee was last paid for FY17, and ongoing charges for FY20 (when HOT outperformed its benchmark but total returns were negative) were 0.88%. At end-H121, a performance fee of £1.18m (c 1.1% of average net assets for the half year) had been accrued. Given a slight underperformance of the official benchmark in Q321 and returns broadly in line in Q421, this sum may be scaled back slightly for the full year, although we would expect total fees for FY21 to be close to the 1.5% fee cap, which may result in some of the performance fee being carried forward.

Capital structure

HOT has one class of share, with 7.9m ordinary shares in issue (unchanged over the past 12 months) at 29 November 2021. As shown in Exhibit 13, the trust is widely held by retail investors, with holdings via the platforms Hargreaves Lansdown, Interactive Investor, Halifax Share Dealing and AJ Bell accounting for c 47% of shares outstanding. The volume of shares traded daily (Exhibit 14) has averaged 18,000 (c 0.2% of the share base) over the past 12 months, with c 58% of HOT's shares changing hands during the year.

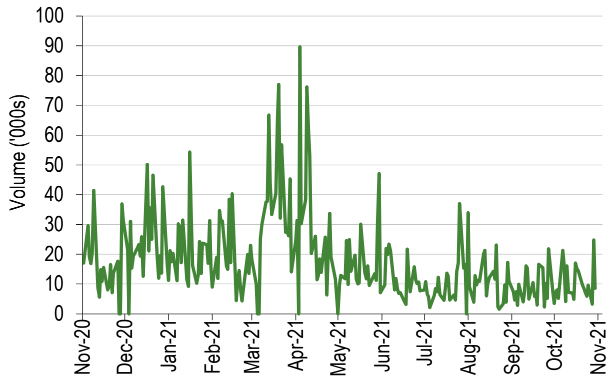
There is a continuation vote every three years, with the next due at the March 2023 AGM. At the last vote in 2020 (as well as at the previous one in 2017), more than 99% of votes cast were in favour of continuation.

Exhibit 13: Major shareholders



Source: Bloomberg, as at 6 October 2021.

Exhibit 14: Average daily volume



Source: Refinitiv. Note 12 months to 29 November 2021.

The board

Exhibit 15: Henderson Opportunities Trust's board of directors

Board member	Date of appointment	Remuneration in FY20	Shareholdings at end-FY20
Wendy Colquhoun (chairman)	2018 (2021)	£20,000	1,000
Frances Daley (audit committee chair)	2015 (2018)	£24,600	2,000
Chris Hills*	2010	£20,000	4,000
Davina Curling	2019	£20,000	0**
Harry Morgan	2021	N/A	N/A

Source: Henderson Opportunities Trust. Note: *Standing down at March 2022 AGM. **Curling purchased 800 shares in December 2020.

Former chairman (since 2016) Peter Jones stood down from HOT's board at the March 2021 AGM after 10 years' service as a director and was replaced as chairman by Wendy Colquhoun. Chris Hills has indicated he intends to retire from the board at the March 2022 AGM. In July 2021, Harry Morgan was named as a new director. He has a professional background in investment management, with more than 30 years' experience, and is also a former director of the Association of Investment Companies.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia