



Market Commentary

Recommended Investment:

Mercantile Investment Trust - 8% discount to NAV, 2.4% yield, 0.45% TER

Mercantile Investment Trust (“Mercantile”) is a well-established trust, having been founded in 1884, with over £2bn under management. It aims to achieve capital growth by investing in a diversified portfolio of predominantly UK mid-cap companies. The trust is managed by an experienced team at JP Morgan, backed up by analysts devoted exclusively to this under-researched area of the UK stock market. Stocks are selected on the basis of attractive valuations, good fundamentals and a positive outlook.

The trust has a solid long-term performance record, perhaps reflecting the fact that mid caps have a record of beating both large and small caps over the long term (whilst also incurring less volatility than the SmallCap index). It’s not entirely clear why this has been the case, but there is some evidence that mid cap stocks are less covered by analysts and are generally under-owned by investors. Over the five years to March 2018, the net asset value (NAV) has increased by 73.1%, against a rise in the benchmark of 61.3%. The trust has historically traded at a discount to NAV, though we believe that downside discount volatility is relatively limited from here given the trust’s active share buyback policy.

The portfolio is highly diversified with over 100 holdings and the top ten holdings representing less than 20% of assets. A simple question investors should ask themselves before buying an actively-managed fund is “How many of its top 10 holdings look familiar?” If the fund contains the same old names (BP, GlaxoSmithKline, Vodafone etc), it is questionable how much value is being added versus a low-cost index tracker. The top 10 holdings are Bellway, Spirax Sarco, Intermediate Capital, Beazley, Hiscox, B&M, Hays, GVC, Melrose & Inchcape - hardly household names. The investment management fee has just been reduced, resulting in a highly competitive TER of 0.45%.

We believe the trust is an ideal way to play the second tier of the UK stock market. The FTSE 250 offers investors opportunities to benefit from a skilful investment manager’s potential to outperform the index over time. As one of the largest and most liquid UK-focussed investment trusts, it provides an opportunity to outsource a Mid Cap allocation without liquidity constraints whilst reducing ‘company specific’ risk.

The trust pays a quarterly dividend and the historical yield currently stands at 2.2%. The trust also a progressive dividend policy, which has seen dividend growth of more than 6% over the last ten years. Its ability to grow its dividend is supported by significant revenue reserves.

In summary, we recommend Mercantile for investors looking for capital growth in an under-researched area of the UK stock market. Trading at a 8% discount to NAV, we rate the trust a **strong buy**.