Personal Assets

PNL's multi-asset portfolio may provide a safe haven in a volatile market...

Update
22 August 2023

Overview

Personal Assets Trust (PNL) offers investors an unconstrained, multi-asset investment solution focussed on the preservation of its shareholders' capital whilst aiming to increase its value over the long term – in that order. As we discuss in **Portfolio**, PNL's longstanding manager Sebastian Lyon, who is also the CIO and founder of Troy Asset Management, takes an absolute return mindset that is free from the constraints of any benchmark. Although unconstrained, the strategy typically uses a relatively narrow and uncomplicated range of assets including listed equities, bonds, gold, and currency, unlike some other strategies found within the flexible investment trust sector. However, the allocation to each asset class can vary considerably, particularly with respect to equities which at its current level is 24% of the portfolio. This reflects Sebastian's cautious attitudes to risk and the limited availability of high-quality, attractively-valued, and fundamentally sustainable investment opportunities currently in the market.

As we discuss in **Performance**, Sebastian's focus on capital preservation leads to a cautious approach to asset allocation. Combined with the flexibility of the strategy, this has resulted in one of the most consistently strong long-term risk-adjusted performance characteristics in the AIC investment trust universe. The trust has shown a valuable protective capacity during the periods of market turbulence we have seen over the past five years, with the significant allocation to defensive assets such as inflation-linked bonds, US and UK short-dated government bonds, gold, and cash.

PNL's discount control mechanism is designed to minimise discount volatility to maintain shareholder value and liquidity by keeping shares trading close to NAV over the long term. At the time of writing, PNL is trading at a discount of 1% (see **Discount**).

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Analyst's View

We believe PNL has been able to demonstrate its credentials as an all-weather, capital-preservation strategy, particularly effective at shielding investors from extreme financial market turbulence through Sebastian's cautious, yet diversified and flexible approach using a range of asset classes. Although this strategy can sometimes lag stylistically-driven equity markets, the risk-adjusted returns profile of the trust is very attractive. In our view, the strategy may appear even more valuable given the stickiness of inflation, tight monetary policy, and the relatively narrow cohort of performing equities this year to date. In our view, Sebastian's current defensive positioning and high allocation to liquid assets leave him potentially able to invest in equities at lower prices in the future, if his negative outlook for the near future is correct.

The trust has an active discount control mechanism (DCM) in place and its long-term average premium sits around 1%. %. The DCM adds another layer of security for investors wary of discount and the small discount it currently trades on (1.1%) may add a little extra appeal for investors at this point. In turn, the very low charges and strict DCM should mean that shareholders can redeem at a value very close to par, despite volatility in the financial markets and wide discounts across alternative strategies.

BULL
Capital preservation and downside protection strategy proves useful during uncertain market environments
Strict discount control mechanism ensures shareholder value, provides greater liquidity and reduced discount volatility
Multi-asset approach offers a more diversified exposure compared to conventional equity or fixed-income exposures

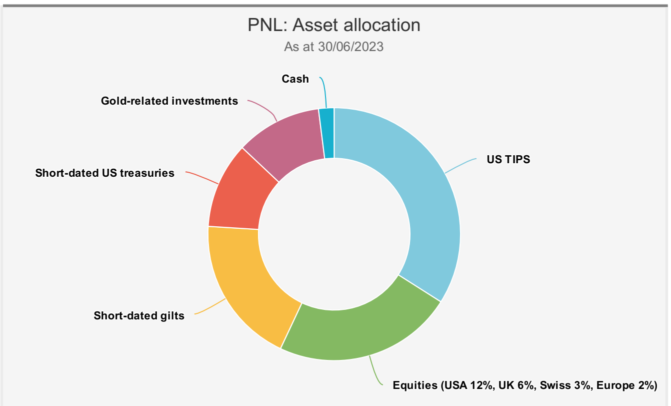
BEAR
May underperform during narrow stylistic-driven equity market rallies
Shareholders are often required to pay a premium for shares
Low current yield in absolute terms

Portfolio

Personal Asset Trust (PNL) has been managed by Troy Asset Management (Troy) since March 2009. Since taking over, Sebastian Lyon has sought to instil Troy's underlying investment philosophy which focusses on protecting investors' capital and increasing its value over the long term (in that order). This philosophy forms the foundation for investment decisions across all Troy's investment offerings since Sebastian founded the company in 2000.

Sebastian works alongside PNL's assistant manager, Charlotte Yonge. To achieve PNL's objective, the pair take a cautious approach but remain dynamic and flexible in asset allocation decisions with this multi-asset approach being the most diversified strategy within the range of Troy's suite of investment products. The absolute return-focussed approach gives Sebastian the freedom to make significant allocations to the asset classes he believes best suit the prevailing economic environment. As shown in the chart below, Sebastian tends to invest in more traditional asset classes, rather than those that are more esoteric in nature such as derivatives. We believe this makes it easier to understand for a wider range of investors and has been a contributing factor to the trust's popularity.

Fig.1: Asset Allocation



Source: Troy Asset Management

The portfolio is currently very defensively positioned. The table below highlights the 15-year range of allocations to the portfolio's core assets, including the 2008 financial crisis. Risk assets, namely equities, are close to their lowest level whilst more defensive, highly liquid assets such as short-dated UK and US government bonds, are close to their 15-year highs. This reflects the dramatic changes to the economic environment that have occurred since Q4 2021. Before this, a prolonged period of low inflation, historically low interest rates and quantitative easing followed the financial crisis of 2008. This period saw yields on cash and bonds fall very low, making equities the only alternative for investors and indeed more risk-averse savers. This was enhanced by the accommodative monetary and fiscal measures made during the coronavirus pandemic. However, over the last 12 to 18 months, inflationary pressures have been followed by sharp rises in interest rates and quantitative tightening, leading to the deflation of risk assets. Sebastian believes this may signal the end of 'The Everything Bubble.'

15-Year Asset Allocation Ranges

	EQUITY (%)	INDEX-LINKED BONDS (%)	GOLD-RELATED INVESTMENTS (%)	LIQUIDITY - INCL. CASH (%)
As of 30/06/2022	24	32	11	32
Maximum	72	44	13	33
Minimum	22	16	5	1
15-Year average	39	31	11	20

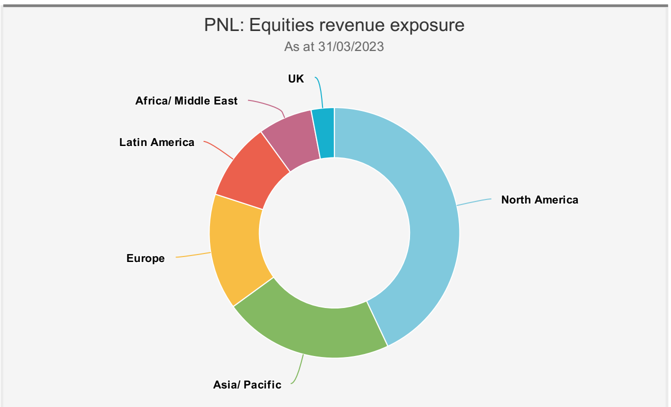
*Liquidity includes cash, short-dated UK and US government bonds, and UK T-Bills

Source: Troy Asset Management, as of 30/06/2023

Troy's equity research is centred around a common and clear philosophy that focusses on high-quality businesses that will grow and not diminish investors' capital over the long term. Although Sebastian and Charlotte are supported by a dedicated multi-asset investment analyst, Marc de Vos, and investment specialist Michael Kinsella, all members of the 14-strong investment team at Troy make contributions to their internally approved buy list of c. 170 stocks, which can be included within the portfolio at the fund managers discretion and depending on the fund's specific mandate. The focus is on identifying sustainable businesses with competitive advantages which can enhance pricing power and the sustainability of cash flows. This includes more defensive companies which typically have more predictable cash flows. These typically operate in sectors such as business software, healthcare, and medical devices, as well as consumer staples such as Microsoft, Nestle, and Unilever. They hope to avoid capital-intensive businesses and those that are exposed to market cyclicality, such as retailers, banks, and oil majors and minors. This is particularly attractive given the tougher environment for borrowing.

PNL is benchmarked against the UK's RPI and the FTSE All-Share Index for comparison purposes and has a predominately UK retail investor base. However, the focus on quality naturally draws the team at Troy to markets such as the US and Europe where they believe there are greater opportunities for genuine long-term growth. The UK market performed very well in 2022, although this was restricted to stocks benefitting from rising interest rates and Russia's invasion of Ukraine. This included those in the oil, gas, and banking sectors which impacted PNL's relative performance. However, Sebastian is focussed on consistency over the long term, and the global focus on decarbonisation and the capital intensity of exploration and mining activities present significant headwinds for the sectors that he hopes to avoid. This also limits the trust's exposure to companies listed in emerging markets due to the volatility associated with political instability, corporate governance, and currencies. However, as shown in the charts below, there is an underlying exposure to the revenue these markets generate due to the global nature of the businesses Sebastian invests in. For example, the purchase of Heineken in June 2023 was initiated due to its competitive valuation. However, a meeting with the company's CEO and CFO confirmed the team's enthusiasm for the family-owned business, operating in the growing premium segment of the beer market with a diversified portfolio of brands and a range of geographical exposures, with around 70% of profits coming from emerging markets.

Fig.2: Revenue Exposure



Source: Troy Asset Management

Sebastian's capital preservation and valuation-sensitive approach also screens out companies that have excessive debt on their balance sheets and those that tend to be reliant on forward-looking cash flow projections. Over the past couple of years, there have been periods where valuations have looked frothy even in higher-quality areas of the market, such as at the start of 2021 and more recently since the start of 2023. Sebastian believes that consensus earnings expectations are not factoring in a downturn, leading him to take profits and reduce the equity exposure of larger holdings such as Microsoft, Alphabet, American Express, and Visa. The more recent pick up in valuations has been from mega-cap technology stocks, which have driven much of the indexes' returns this year to date. This has largely been driven by the perceived peak in inflation and the associated peak in interest rates on the horizon. However, Sebastian has noted that a recession remains a threat, whilst inflation is likely to remain a key feature for longer given the tightness of the labour market, the impacts of deglobalisation, and the lagging transmission of monetary policy caused by the excessive savings created by the COVID-19 rescue packages.

With PNL's objective of 'protect and grow' it is essential that the managers focus on the protection component during moments of market euphoria. PNL's multi-asset portfolio is more flexible, providing investors with alternative sources of returns to equities. The rapid rise in inflation and interest rates seen since the end of Q4 2021 has prompted Sebastian to increase the allocation to index-linked bonds, through the 32% in US treasury inflation-protected securities (TIPS) and UK index-linked gilts. This provides a level of inflation protection to an investor's capital through the capital value and a coupon which is tied to inflation. In addition, there is a significant allocation to liquidity within the portfolio. With a cash allocation of 2%, this is predominantly achieved through the 32% allocation to short-dated US treasuries and UK government bonds. Overall duration risk in the bond portfolio stood at c. 6.4 years as of 30/06/2023. These are highly liquid but also provide a relatively attractive nominal yield with the two-year bonds generating 4.8% and 4.9% respectively and having historically displayed a strong negative correlation to equities. They are also backed by secure governments rather than corporates meaning default risk is far lower.

In addition, PNL includes a significant long-term allocation to gold. Sebastian likes gold's permanent value characteristics which means it tends to do well in an inflationary environment when negative real rates are expanding, or as a 'safe haven' asset during turbulent market environments. This proved particularly valuable during the global financial crisis and more recently during the height of the COVID-19 pandemic in March 2020. Sebastian prefers to hold physical bullion to cut out the middleman and reduce costs that are typically associated with holding exchange-traded contracts (ETCs) – reducing costs to around 10% of what they were.

Finally, Sebastian's management of PNL's currency exposure is also an important consideration particularly between the GBP and the US Dollar with a hedged exposure of 59.8% and 24.4% respectively, as of 30/06/2023. Over 2022, the trust's dollar exposure produced the highest contribution to returns of any asset class at 4% over the year, highlighting sterling's weakness and the dollar's defensive properties during a period where asset price returns were weak. The impact of inflation and interest rates have a material impact on equity valuations and having 'dry powder' through holding highly liquid assets is where its real value comes from. This is not permanent but a tactical short-term position whilst the market adjusts. For now, Sebastian remains cautious, and the equity allocation will depend on valuations. However, as macro factors such as real wage growth start to fall and inflation begins to tail off, he will look to lean into assets as he did in 2008 and 2020, taking on more risk and increasing PNL's exposure to equities.

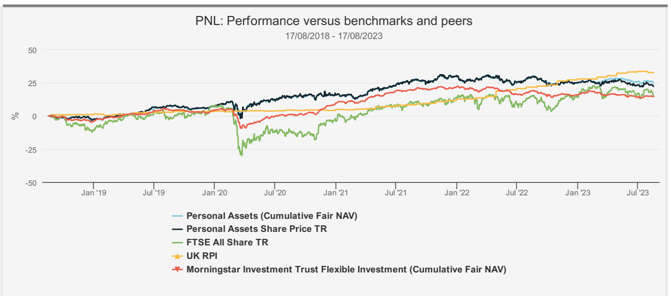
Gearing

PNL's investment policy permits gearing, using short-term borrowed funds and/or the use of derivatives such as FTSE 100 futures equating up to 50% of shareholder funds. We also note that in exceptional circumstances the trust's liquidity could be as high as 100% of shareholders' funds. However, we understand that the board and the investment managers have no intention to employ gearing as they believe it may prove detrimental to their core mandate of protecting the value of shareholders' capital. As of 30/06/2023, PNL has net cash of 1.5%, although, including cash-like assets such as short-dated US treasuries and short-dated gilts, this increases to 32% of the portfolio's allocation (see **Portfolio**).

Performance

Troy Asset Management was appointed investment advisor to PNL on 03/03/2009. Since handling the investment advisory duties of the trust, we believe Sebastian has demonstrated an expert understanding of its purpose – to provide an investment vehicle for investors focussed on protecting and increasing (in that order) the value of their funds over the long term. This has been particularly evident over the past five years where Sebastian has demonstrated how the trust's flexible, multi-asset approach to portfolio construction can benefit performance during fundamentally different economic conditions. Over this time PNL has generated a NAV total return of 25% and a share price total return of 22.3%, demonstrating the function of the discount control mechanism (see Discount). Furthermore, this represents an outperformance of the 14.9% generated by the FTSE All-Share Index (benchmark). PNL has also outperformed the flexible investment trust sector (peer group) which generated an average total return of 14.5% over the same period. However, due to the wide variety of strategies in the sector, a better comparison may be against two similarly defensive multi-asset strategies - Ruffer Investment Company (RICA) and Capital Gearing (CGT), which generated returns of 21.6% and 14.1% respectively.

Fig.3: Five-Year Performance



Source: Morningstar

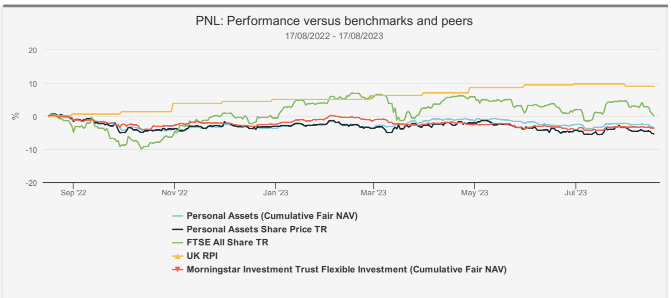
Past performance is not a reliable indicator of future results.

The stark shift in the macroeconomic environment has made it more difficult for global equity markets and risk assets more generally. In addition, rapidly rising inflation levels have made PNL's other benchmark, the UK RPI, a highly relevant comparator. The RPI has risen by 32.8% over the same time period.

More recently, the stickiness of inflation, particularly in the UK, has made delivering a real return more challenging. However, Sebastian's flexibility has proven to minimise volatility to maintain shareholder value, through rotations away from riskier assets (equities) into more protective alternative asset classes such as inflation-linked bonds, gold, and cash (see Portfolio). The trust has also seen positive contributions from holdings in Microsoft and Alphabet, which have generated share price returns of 36% and 44% respectively this year to the end of July. Despite this, the ten-year low allocation to equities of 24% has contributed to the lag in performance in both the equity markets and inflation. Over the 12-month period to 31/07/2023, PNL generated a NAV total return of -3.4% versus the FTSE All-Share Index and UK RPI which have risen by 0.1% and 9% respectively. We note that PNL has outperformed both RICA and CGT which have generated a NAV total return of -8.3% and -11.2% respectively.

However, we believe it may be harsh to criticise PNL's underperformance of the UK equity market over this period since the FTSE All-Share was naturally positioned to benefit from the swift stylistic shift from growth to value at the start of 2022 due to its significant inclusion of cyclically driven 'value' biased companies such as those found in the oil, gas, mining, and banking sectors.

Fig.4: 12-Month Performance



Source: Morningstar

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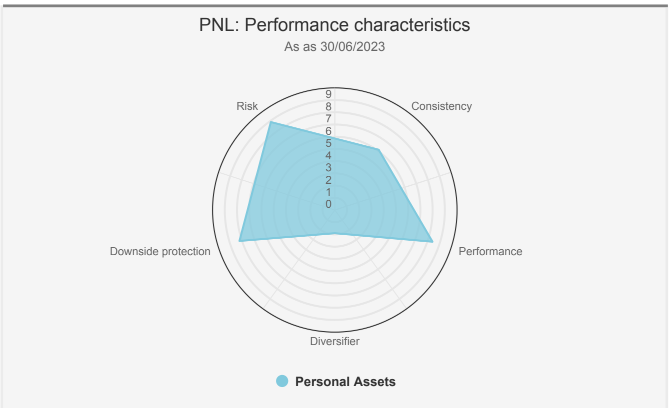
Below is our proprietary KTI spider chart. This shows how PNL has performed versus the other 15 trusts within the AIC flexible investment trust sector over the past five years in a selection of key categories. Each category is scored out of ten and is based on the NAV returns over the period, with the scores normalised to the peer group with higher scores indicating superior performance. The chart illustrates a clear outperformance in terms of downside protection coupled with relatively low levels of risk. These are common characteristics across many of Troy's investment products and a particular reflection of Sebastian's long-term investment objective for PNL. Performance and consistency are also above the sector averages and are a positive reflection of Sebastian's ability to consistently generate alpha. Despite the multi-asset approach, PNL scores poorly in terms of diversification. We think this is likely due to the higher duration in the portfolio, mainly thanks to the allocation to bonds.

Fig.5: KTI Spider Chart



Source: Morningstar, Kepler calculations

Past performance is not a reliable indicator of future results.

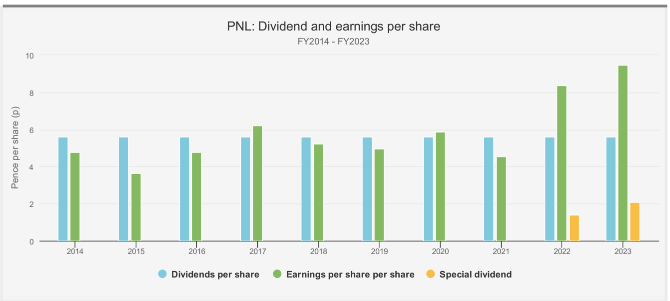
Dividend

PNL aims to pay as consistent and sustainable a dividend as is compatible with protecting and increasing the value of its shareholders' funds whilst being able to maintain its investment flexibility. Since 2013, the board has been committed to paying an annual dividend of 5.60p per share in line with this policy which is typically split across four equal quarterly payments.

However, heightened levels of inflation over the course of the 2022 and 2023 financial years resulted in a significant increase in income from PNL's significant holdings of US TIPS compared to previous years. Therefore, to meet the investment trust distribution requirements, the board paid an additional special dividend of 1.40p per share and 2.10p per share for the 2022 and 2023 financial years ending 30 April 2022 and 30 April 2023 respectively. These were paid to shareholders in July of 2022 and 2023 alongside the respective first interim dividend payments of £1.40 for the years ending April 2023 and 2024.

PNL's current historic yield is 1.2%. This is a low yield in absolute terms. However, it is in line with similarly defensive multi-asset strategies such as RICA and CGT that have a historic yield of 1.0% and 1.3% respectively according to JPMorgan Cazenove, as of 17/08/2023.

Fig.6: Earnings And Dividend Per Share



Source: Troy Asset Management

Past performance is not a reliable indicator of future results.

It is worth noting that PNL offers a Dividend Re-Investment Plan ("DRIP") facility to shareholders who hold their shares in the main register, which allows an investor's cash dividend to be used to purchase shares at current market prices on their behalf instead of receiving any cash dividends. This facility is subject to additional associated dealing charges.

Management

PNL is managed by Sebastian Lyon, who is also Troy's chief investment officer and responsible for Troy's multi-asset strategy. Sebastian is also the senior fund manager for Troy's flagship open-ended fund, the Trojan Fund. Sebastian has so far had a long and well-respected career within the investment management industry, starting at Singer & Friedlander Investment Management in 1989. In 1995, he joined Stanhope Investment Management, which was the management company for the GEC Pension Fund, where he jointly managed the £2bn equity portfolio and the fund's asset allocation. Following his success in the role he was appointed as a director in 1999 but left shortly after to establish Troy Asset Management in 2000.

Sebastian is supported by Charlotte Yonge who is assistant manager of both PNL and the Trojan Fund. Charlotte is also the fund manager of the Trojan Ethical Fund. Before joining Troy, Charlotte worked as an investment associate at Ruffer Investment Management. In our view, the investment backgrounds of both managers are suited to the patient and cautious approach that Sebastian has instilled throughout Troy Asset Management, but more specifically through the Trojan Fund and PNL.

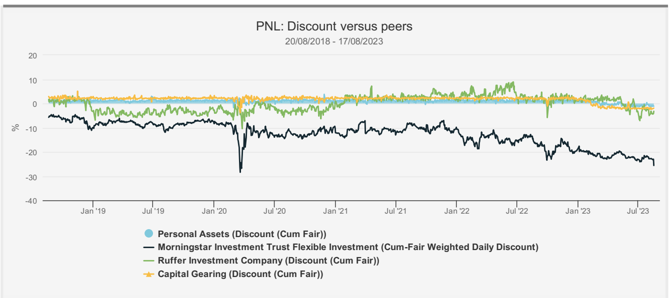
Sebastian and Charlotte are supported by Marc de Vos who is a dedicated multi-asset investment analyst, and investment specialist, Michael Kinsella. The PNL team has joint responsibility, alongside the rest of the 14-strong investment team at Troy, who contribute to the analysis of global companies and their selection across Troy's portfolios.

Discount

PNL is currently trading at a narrow discount of 1.1%. This compares to the AIC Flexible sector's simple average discount of -20.1% according to JPMorgan Cazenove, as of 17/08/2023. We note that the trust's style is more in line with defensive multi-asset strategies such as RICA and CGT, which currently trade on discounts of 3.2% and 1.9% respectively.

However, as the graph below illustrates, PNL's shares have tended to trade on a small premium which has averaged 1% over the past five years. This is similar to the average for CGT and RICA, although PNL has maintained a narrower range with lower discount volatility. We believe this can, in part, be attributed to the high demand for the trust thanks to its consistent long-term success in protecting and increasing the value of shareholders' wealth. However, this is also a function of the trust's discount control mechanism (DCM) which has been in place since 2009. The DCM is designed to minimise discount volatility and maintain shareholder value by ensuring that shares always trade at close to the net asset value. This is achieved through a combination of share buybacks at a small discount to NAV and the issue of new or treasury shares at a small premium to NAV where demand exceeds supply.

Fig.7: Five-Year Discount



Source: Morningstar

The board believes that no investor should be forced to buy or sell a material premium or discount to NAV. We note the DCM has also proven to be accretive to NAV over the long term through premium issuance and discounted buybacks. At the AGM in July 2022, shareholders of PNL approved the resolution to subdivide each ordinary share on a 100 for 1 basis (the "Share Split"). Taking the Share Split into account, over the 2023 financial year (ending 30 April 2023), PNL's board issued a net total of 22,763,300 shares, representing 6.1% of the total shares in issue at the start of this period for a net inflow of £111.2 million.

Charges

PNL's latest ongoing charges figure (OCF) is 0.65%, according to the latest annual report, as of 30/04/2023. This is the third lowest OCF in the AIC flexible investment sector which has a simple average OCF of 1.3%, according to JPMorgan Cazenove, as of 17/08/2023. The board considers the cost competitiveness of the trust as a key performance indicator which has seen the OCF decrease by 31.7% over the last five years from 0.79% in 2018.

The OCF includes a tiered annual management fee linked to the trust's total shareholder assets under management which is charged at a rate of 0.65% for net assets up to £750m, 0.5% for net assets between £750m and £1.5bn and 0.45% of net assets thereafter. Performance and share issuance have seen PNL's net assets grow to £1,798m, as of 02/08/2023. This has contributed to the reduction in the OCF as fixed costs are spread across a larger asset base with a greater percentage of assets moving onto the lower management fee. Based on the current NAV we estimate the management fee to be c. 0.56% on an ongoing basis. There is no performance fee.

The latest Key Information Document Reduction in Yield (KID RIY) figure of 0.71% is the second lowest in the sector and compares to a simple peer-group average of 2.50%, according to JPMorgan Cazenove. However, we would caution that calculation methodologies may vary between trusts.

ESG

Troy's buy-and-hold approach and inherent focus on the quality of the companies they invest in, provide a natural alignment with ESG considerations. Sebastian has ensured that Troy's investment team fully integrates ESG into stock selection. There is a focus on factors such as a company's governance culture and the quality of management which have been formalised as part of the fundamental research process. However, as with all of Troy's associated investment funds, Sebastian does not exclude companies purely on the grounds of ESG. Instead, in-house analysis is supported by external research and data sourced from MSCI, ISS, and Bloomberg.

Troy's investment team make positive engagement with portfolio companies a priority. The aim is to help improve the relevant policies and management systems, whilst enabling the team to gain a better understanding of the ESG factors which could affect long-term investment returns.

We note that the companies in PNL's portfolio tend to be asset-light businesses, reliant on their brand putting a greater importance on their social awareness. PNL's focus on the overall quality and successful integration of ESG means the portfolio has been awarded an 'above average' sustainability rating from Morningstar. However, it is important to note this score may reflect the low allocation to equities currently in the portfolio.

Disclaimer

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