The Church of Scotland Investors Trust
Constituted by Act of Parliament 1994

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Church of Scotland Investors Trust
Bulletin for Investors – February 2021

This Bulletin is published for investors in the Church of Scotland Investors Trust. It provides an update to the Bulletin published in November 2020, which was intended to help investors understand the likely impact of the COVID-19 pandemic on their holdings in the Growth, Income and Deposit Funds.

In this Bulletin we describe a change in strategy for the Growth Fund which will be implemented this month and what this may mean for investors. We also comment on the Income and Deposit Funds.

Growth Fund

The Growth Fund sets a strategy for our managers, Newton, by allocating percentages of the fund to different asset types (UK Equities, Bonds, Property, etc) and asking the managers to select the investment securities within these sectors. We also give the managers freedom to change the proportions invested in each sector within agreed ranges. In this way we are giving the managers freedom to exercise their judgement on both the best securities to select in each sector but also the most attractive sectors at any time – they are encouraged to make tactical decisions within the overall strategy which is set for them. We can assess the performance of the managers by comparing the actual returns achieved over each period (say, each year) against the returns which would have been enjoyed if we had simply invested each sector in the strategy in the most appropriate investment index (such as published stock-market indices). These are known as the benchmark returns. In this respect, “returns” means the combination of both capital and income. Although there have been some adjustments in the strategy from time to time, the strategy in 2020 has been held for many years, and was as follows:

Asset Class	Benchmark %
UK Equities	37.5
Overseas Equities	37.5
UK Fixed Interest - Gilts	6
UK Fixed Interest - Other Bonds	6
Property Funds	10
Cash	3
Total	**100**

It is entirely consistent for a Growth Fund to be heavily invested in Equities, as this class of security is expected to deliver superior returns as companies develop and trade profitably. However, the proportion currently devoted to UK companies is disproportionate for a few reasons. Companies listed in the UK market represent a shrinking proportion of the companies available for investment in the global markets – less than 6% according to some indices. Secondly, the UK market is heavily concentrated in some commercial sectors and lightly represented in others – a high proportion of the UK comes from financial companies such as Banks and Insurance and from Oil and Gas and Mining, for example. On the other hand, the listed Technology sector is small in comparison to overseas markets. Consequently, the trustees believe that selecting investments from a global perspective offers greater potential as well as better diversification of risks. It is also relevant that many overseas economies are expected to grow more quickly than the UK's domestic economy, and more exposure to these faster-growing economies should be beneficial.

A proportion of the Growth Fund is allocated to Bonds, although this is a much smaller allocation than for Equities. This category provides some diversification as well as a small boost to the income component of total returns. However, secure bond yields in the UK (such as gilts) are currently very low, and even corporate bonds also produce much lower income levels than previously seen. This has prompted consideration of investing in bonds on a global basis, taking measures to remove the currency risks involved. A much wider choice of bonds gives access to higher yields, while acknowledging the need for consistent analysis and scrutiny to be applied as is done for UK bonds.

Property also offers good returns, and the sector often operates on a different cycle to the Equity markets. In 2020 the Property sector suffered from the pandemic, particularly the retail category although office valuations also weakened as a change in working practices came into being and may not be fully reversed. However, it should continue to provide a growth component over long periods.

With these considerations in mind for existing asset types, we considered new options. These may include Infrastructure (providing facilities for transport, public services, and energy production in return for a reliable and growing income) and Sustainable Energy. But there are other opportunities as well including Peer-to Peer Lending, Music Streaming and Social Housing, although these are unlikely to be large investments and will be carefully scrutinised for security and liquidity. To capture these opportunities rather than to exclude them, a new category of Alternatives was proposed.

The outcome of these discussions is a new Strategy for the Growth Fund which has been implemented on 24th February, although the full implementation of the Alternatives category will take longer.

New Growth Fund Strategy	
Asset Class	**Benchmark %**
Global Equities	75
Global Bonds	10
Alternatives	8
Property Funds	5
Cash	2
Total	**100**

The new Strategy is expected to produce a higher total return, largely due to the greater use of Global Equities, exposure to Global Bonds and to the impact of Alternative investments. However, there may also be more volatility of prices as the converse of these changes. Income levels are expected to reduce very slightly in the immediate future but to grow more strongly over the longer term than would have been the case with the old Strategy. Newton is targeted to outperform the aggregate benchmark returns by 1.0% or more over five year rolling periods, which is the same target as previously in force. Income is targeted to grow as well, but without setting a specific rate of growth as the main focus is on total returns. Nevertheless, we expect to advise investors of income forecasts on a regular basis.

Investors will be interested to know that our managers have sold the remaining holdings in Oil and Gas companies as part of the transition to the new Strategy. This reflects their view that these companies will find the transformation of their businesses to be more costly and less profitable than the market expects. The recent surge in oil prices and the resulting increase in oil company share prices made a switch into other sectors more attractive.

It will be appreciated that assigning precise numbers to the difference in future capital and income returns under the two strategies is impossible. However, aware that church treasurers and others will be keen to know the prospects for immediate income payments a few comments are offered.

As was stated in November, the biggest current impact on income has come from UK Equities, particularly due to reductions or cancellations of dividends in Q2 2020 and subsequently. Although there have been some dividend recoveries since then, the biggest dividend payers (such as the Banks and Oil companies) have not restored their dividends or indicated how they will pay them in 2021. The main reporting season in February and March will be critical, but it seems likely that companies will be slow to increase dividends significantly having survived the pain of cutting them. While overseas companies have also been cutting dividends to some extent, the impact has not been as severe due to a different mix of commercial sectors and smaller declines in economic activity.

In the November Bulletin we suggested that investors should prepare to receive 10.0p in the calendar year 2021, compared with the amount of 13.25p received in 2020 (please note that these figures are based on payment dates rather than the financial years to which the Growth Fund operates). More recent figures suggest that total income payments in 2021 could be a little higher at 11.0p.

The Growth Fund price at end 2020 was £5.37. If the total paid in 2021 is 11.0p, this represents an income yield of 2.05%. Looking beyond 2021, the old Strategy might be expected to produce a bounce in income in 2022 if the pandemic impact has disappeared by this time, but growth in income under the new Strategy would also be expected. As far as we can judge from published index levels and associated income yields, the new Strategy has a slightly lower current yield (0.2% lower) than the old Strategy, but this comparison is not wholly reliable as these income figures are backward looking rather than forecasts. We suggest that the fairest conclusion is that any reduction in income will be slight and should be seen against the likelihood of greater increases in both capital and income growth in future years.

Income Fund

In the November Bulletin we suggested that income receipts in 2020 (paid in September and March 2021) may be 42.5p per unit. Further, as the level of long-term yields continued to decline in 2021, the payments in 2022 may reduce further to 40.0p per unit. There has been no significant difference in bond yields since this Bulletin was issued, so these figures remain our best estimates. During the current quarter of 2021, the trustees will review the Strategy for the Income Fund and will report if this is to change with a description of any impact on investors.

Deposit Fund

The Base Rate remains at a nominal figure of 0.1% and even deposits for longer terms offer very low rates of interest as a result. During 2020 higher rates of interest than the Base Rate were declared in the Deposit Fund as the deposits made previously at higher rates provided support. However, this process has almost finished and unless there is a change in the Base Rate or demand from banks for longer term funds, the rate payable on deposits in this Fund will be close to nil after deducting the expenses of running it.

Brian Duffin
Chairman
February 2021

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Scottish Charity No. SC022884