



13 March 2025

Thematic review

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Myth from manufacturers

Costs are reflected in the share price;
therefore, we don't have to show
them.



- Efficient market hypothesis
 - All information is reflected in the share price
 - Pricing of options in “risk neutral” terms
 - Argument to invest in index tracking funds

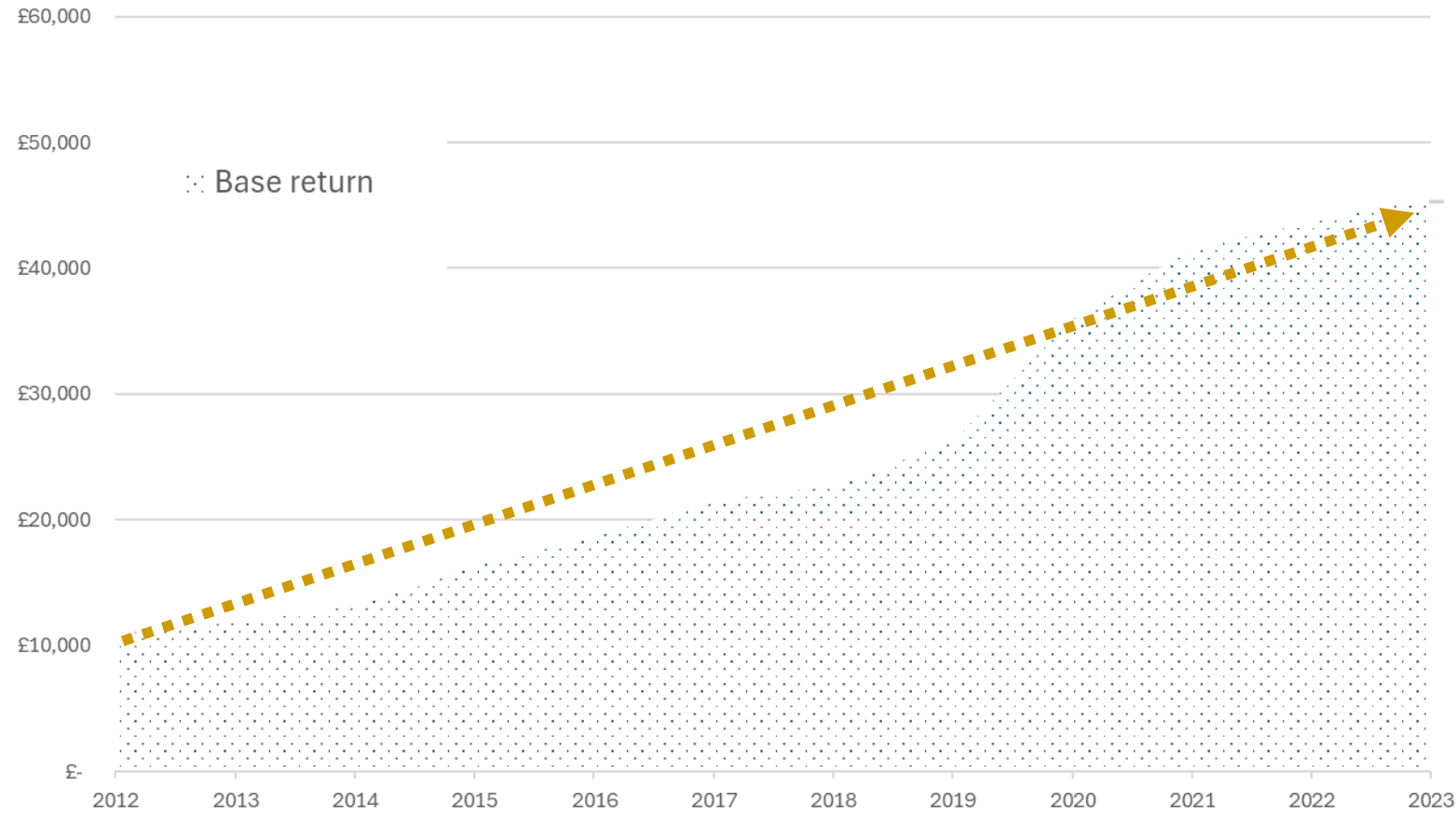


NAV is a key element for pricing
an investment trust



Real life example PE fund with NAV > £1 billion

Impact on NAV



£46k Net return



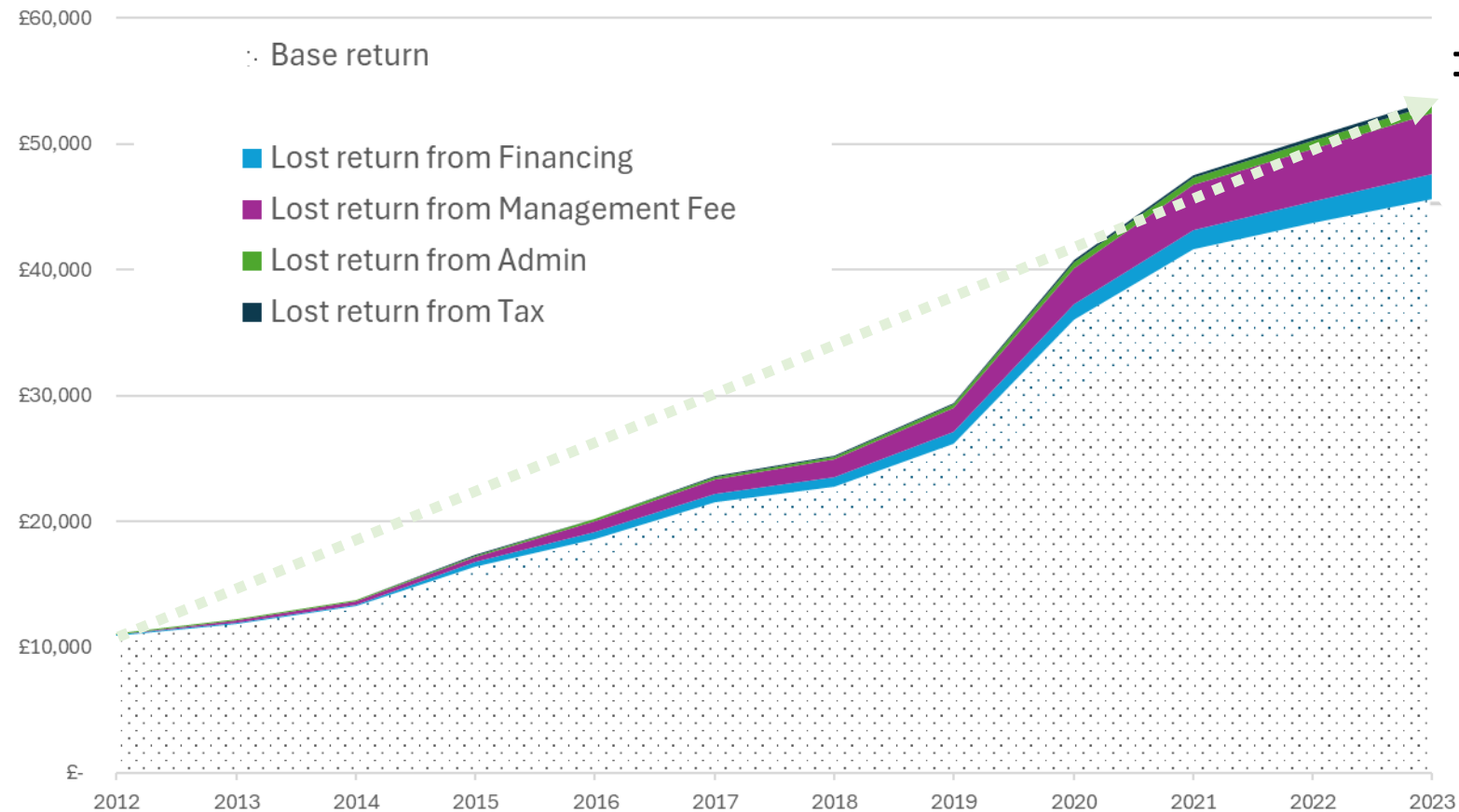
What if there were no costs?



Fund A: If no costs were borne by the trust

NAV would grow to £54k with no costs

Impact on NAV



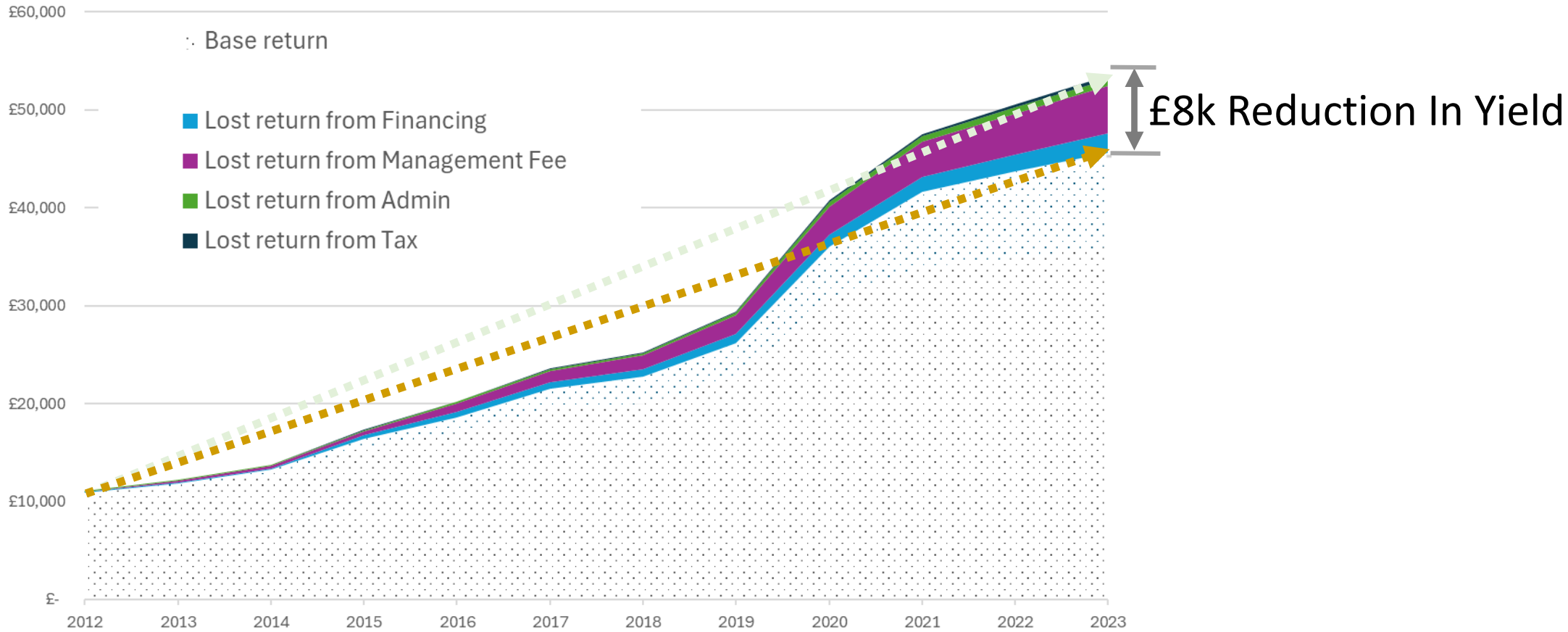
£54k Gross return



Fund A: What is the reduction in yield

The reduction in yield

Impact on NAV

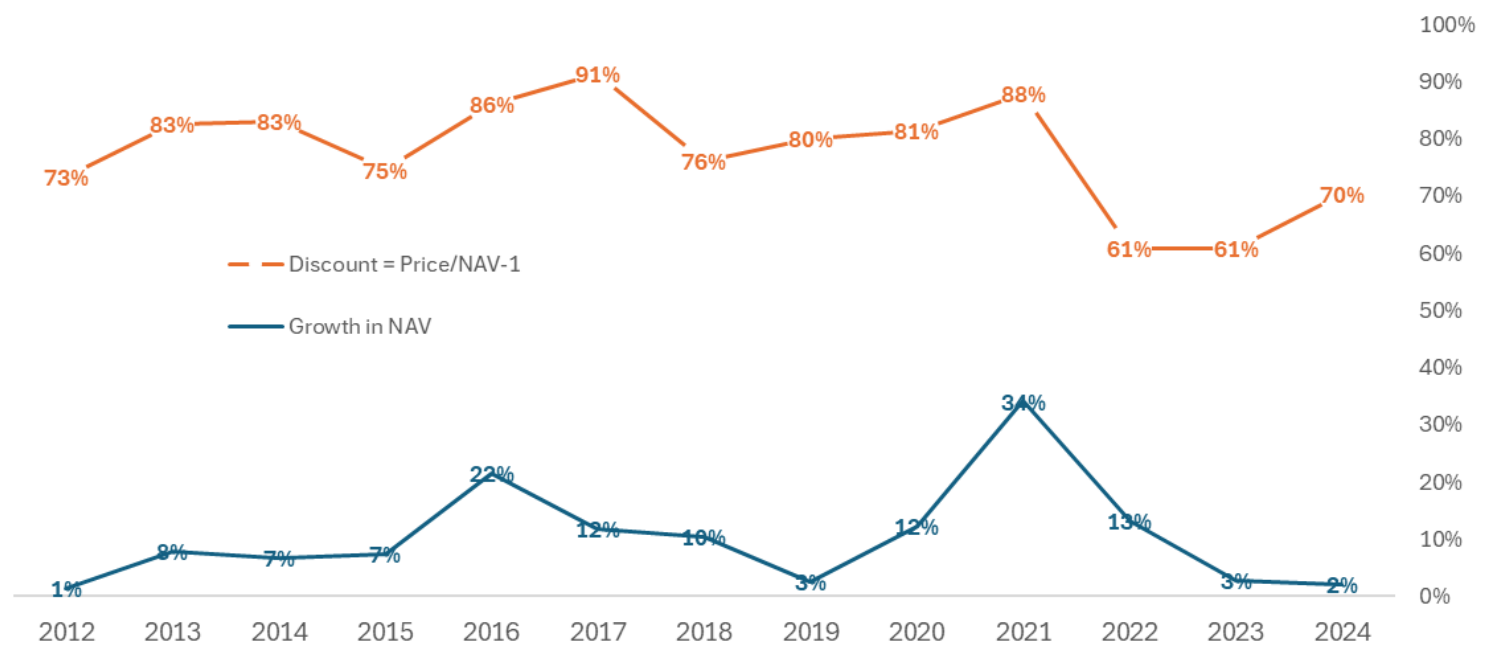




Discount rates vary but in very long-term “stationary”

Many factors impact discount rates

DISCOUNT RATES FOR FUND A



<i>Correlation</i>	<i>NAV growth per share</i>	<i>Price growth per share</i>	<i>Discount rate</i>
NAV growth per share	0.8%		
Price growth per share	0.7%	3.3%	
Discount rate	0.4%	1.0%	0.8%



Mathematically impossible for “costs” not to impact on NAV



Mathematically impossible for “costs” not to impact on NAV

NAV is a fundamental part of pricing



Mathematically impossible for “costs” not to impact on NAV

NAV is a fundamental part of pricing

∴ costs impact pricing



Mathematically impossible for “costs” not to impact on NAV

NAV is a fundamental part of pricing

∴ costs impact pricing

A zero cost in RIY is misleading

Not a myth

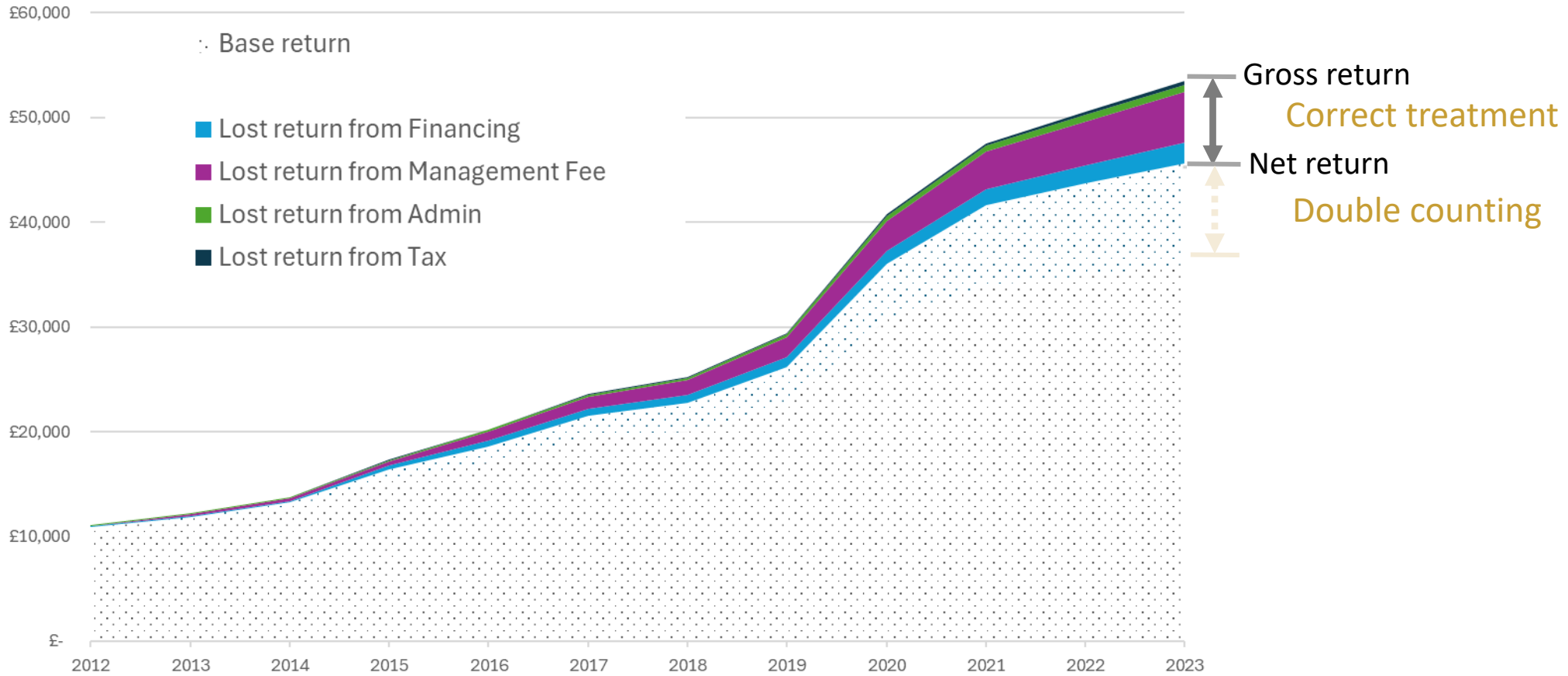
Platforms are double counting costs.



Fund A: Confusion in the market about where to apply fees

Important note

Impact on NAV



Myth

Investment Trusts should be treated like ordinary listed companies (with no onerous disclosures).

Motivation is to avoid burden
of cost disclosures.

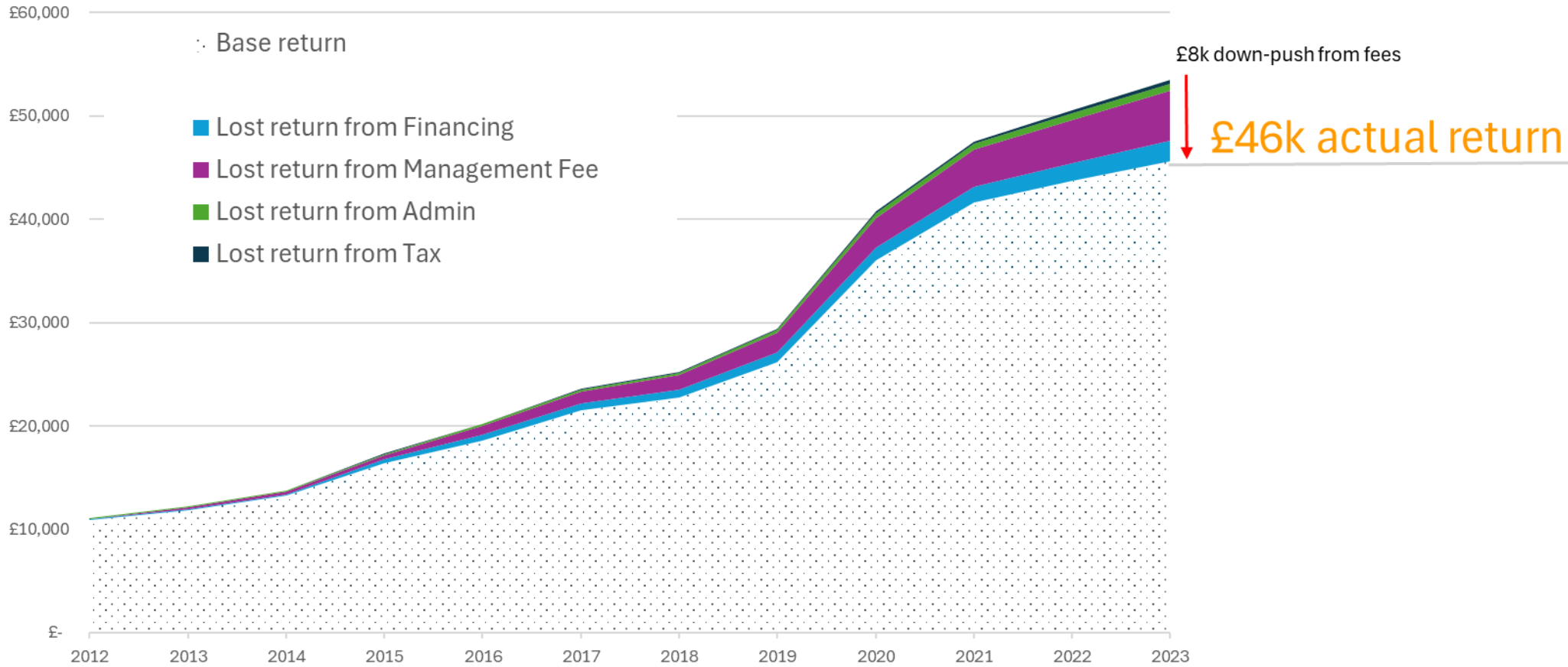
But this is only half the story.



Fund A: Private equity fund with NAV >£1bln

NAV would grow to £54k with no costs

Impact on NAV

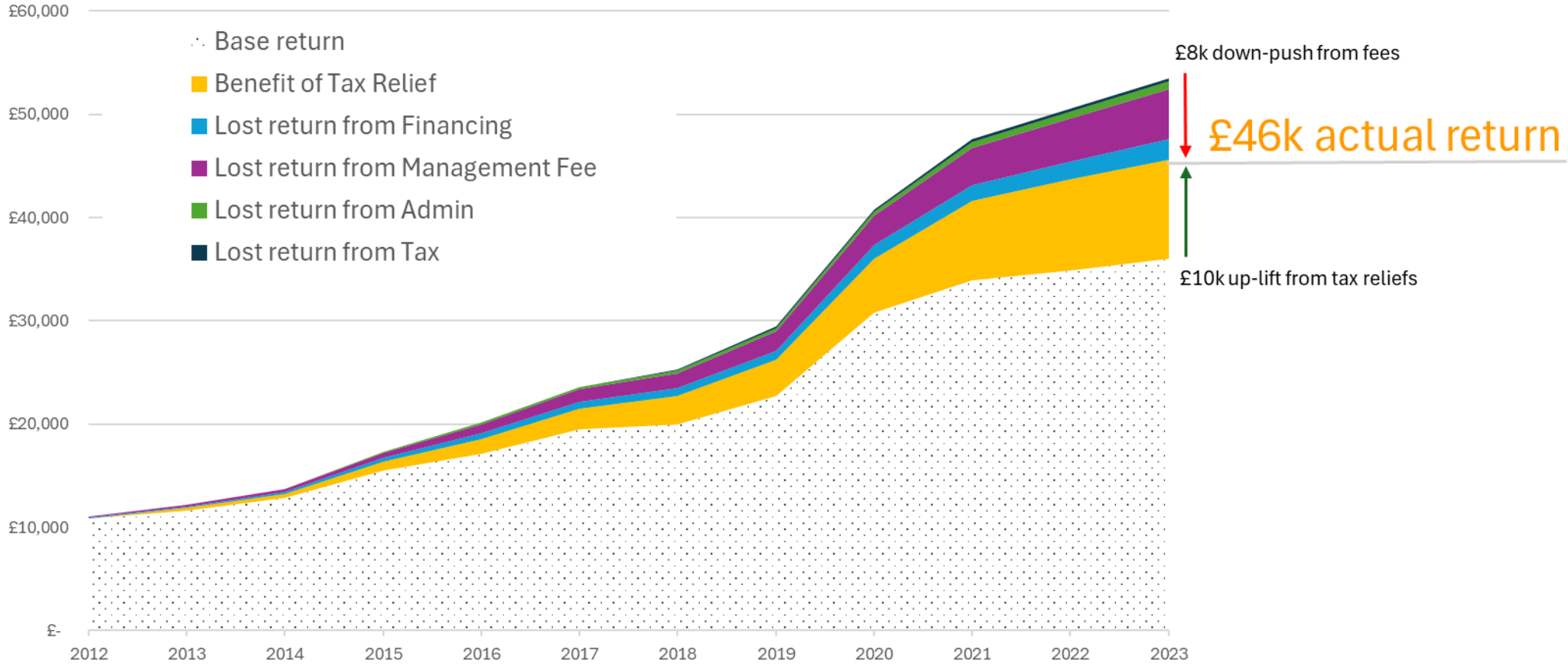




Fund A: A private equity fund

Tax reliefs a significant source of value

Impact on NAV from fees and tax relief on returns

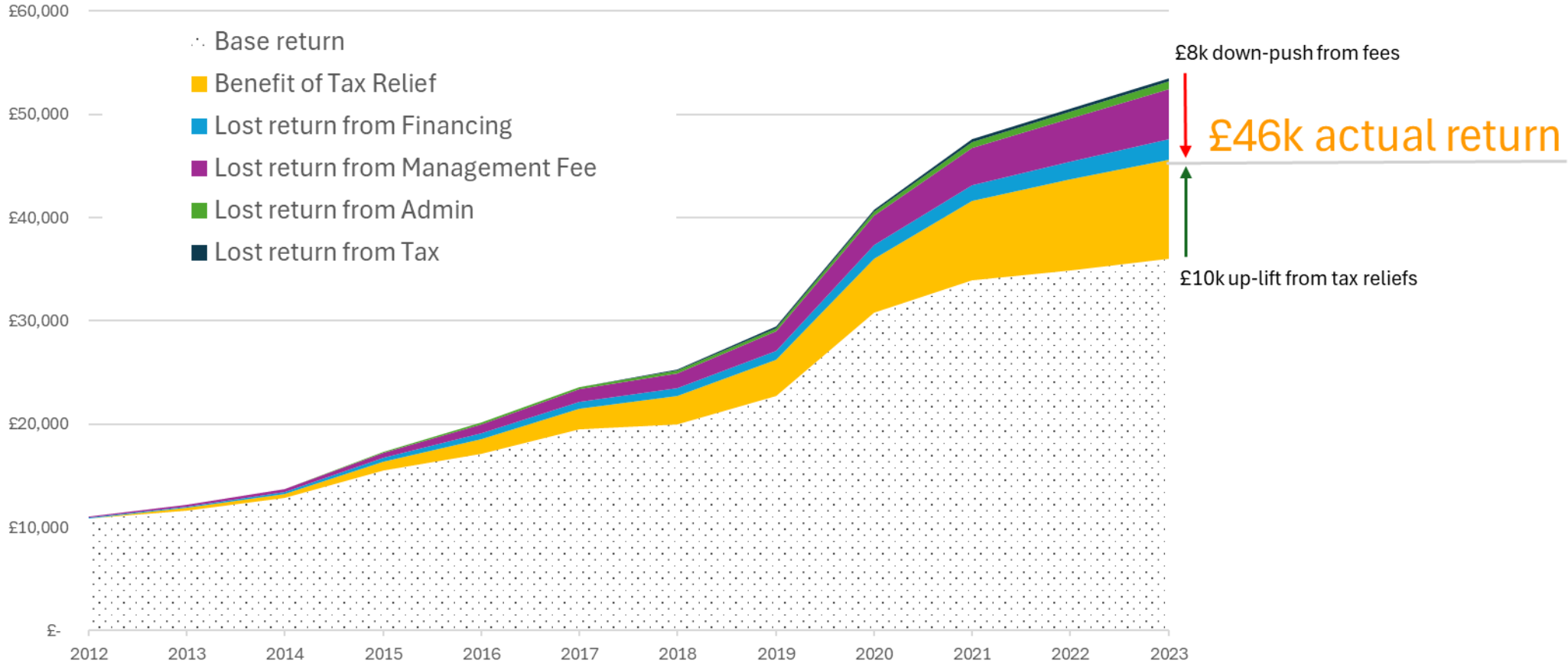




Fund A: A private equity fund

Without trust status investment would be worth £36k

Impact on NAV from fees and tax relief on returns



Disclosures should not just be about costs.

Tax benefits from Trust status need to be better communicated by the market.

Myth

No one reads KIDS so we
shouldn't bother with them.



■ Information for investors

Quantitative

Risks

Returns

Costs

Term

Qualitative

Objectives

What is the
product

Characteristics

Important
warnings



Small proportion of investors refer to KIDs



Small proportion of investors refer to KIDs

Set expectations fairly and manage complaints



Small proportion of investors refer to KIDs

Set expectations fairly and manage complaints

Pricing



Myth

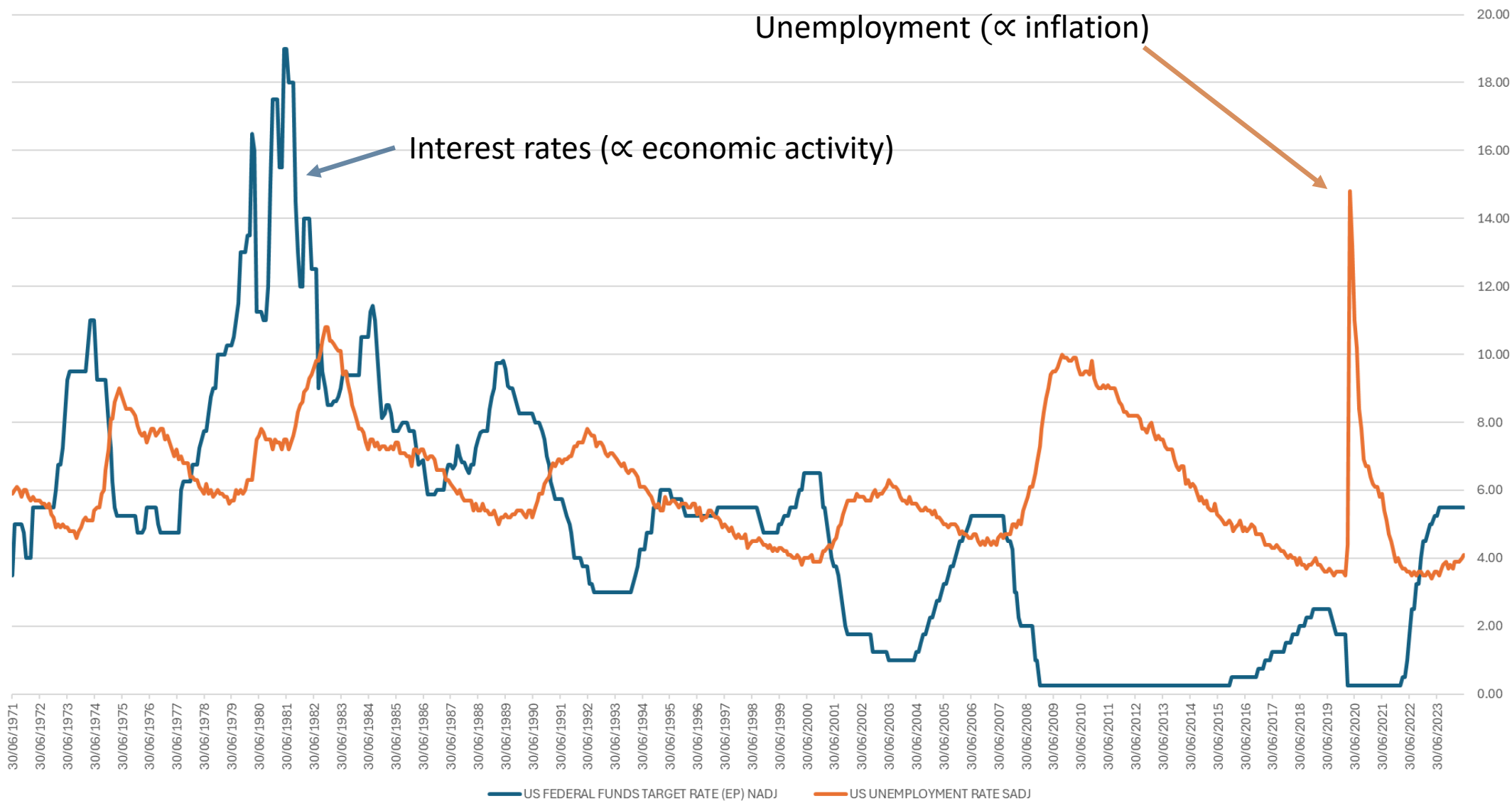
Disclosure hurts discount rates.

Discount rates are only down to economic conditions.



The economic cycle

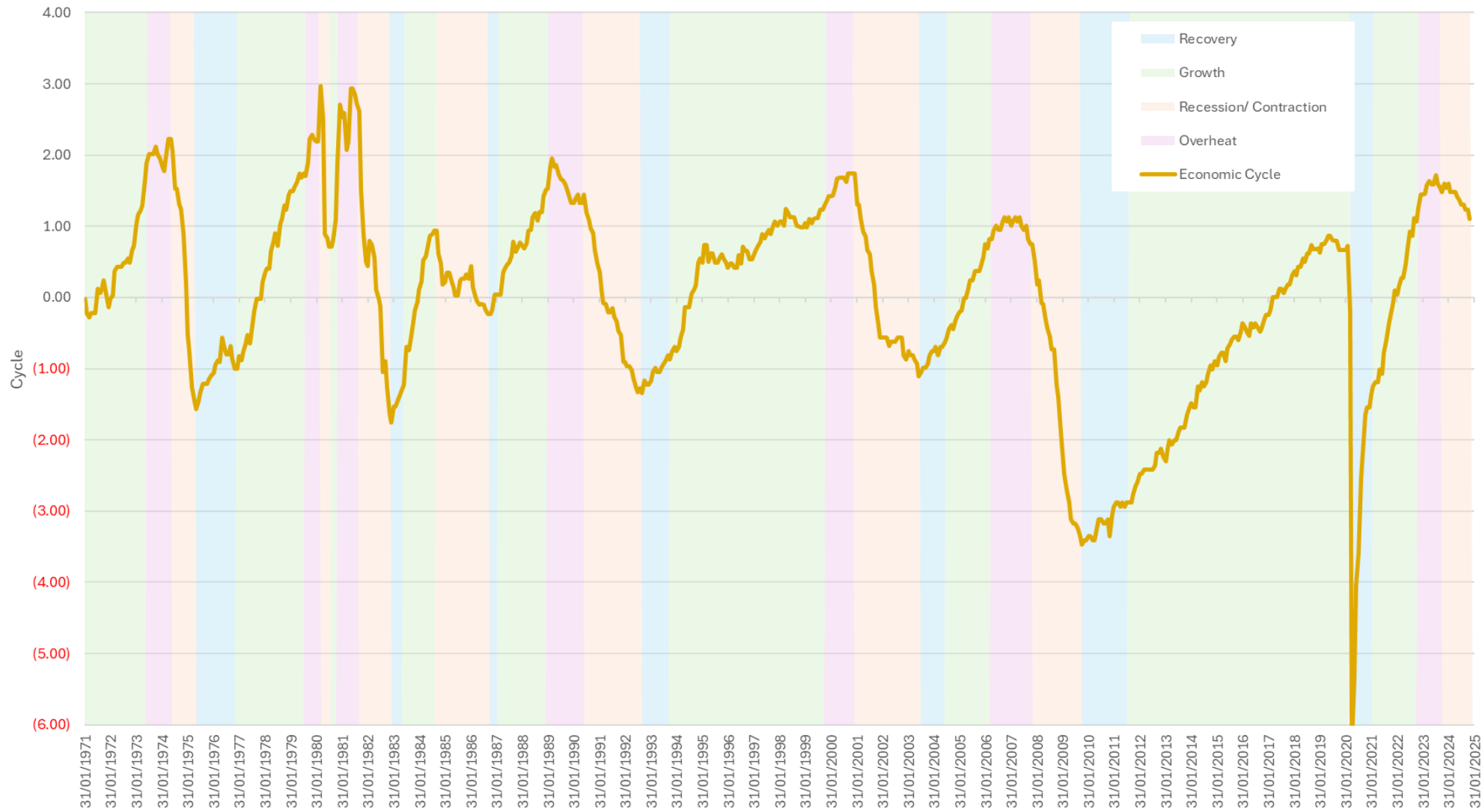
Monetarist Policy





Economic cycle

Economic Cycle



A basic market model for the average discount rate

Objective is to build a simple to communicate model based on long term data – 20 years.
The underlying sample size of funds increased from 98 to 168 funds, and the average discount rate was taken.

Linear regression model:

Explains 62% of discount price movements from December 2005 - December 2025

IndustryWideDiscountToNAV = 1 + VIX + GiltPrices5_7Years + PERatio + Contraction + Recovery + Overheat

Estimated Coefficients:	Estimate	SE	tStat	Pvalue*
Constant	-8.36%	1.51%	5.52	0.00%
VIX	-0.08%	0.01%	10.30	0.00%
GiltPrices5_7Years	0.05%	0.01%	3.82	0.01%
PE Ratio	-0.11%	0.01%	10.02	0.00%
Contraction	-5.19%	0.24%	21.37	0.00%
Recovery	-2.56%	0.19%	13.27	0.00%
Overheat	-0.60%	0.25%	2.42	1.58%

 Good economic fundamentals = narrow discounts

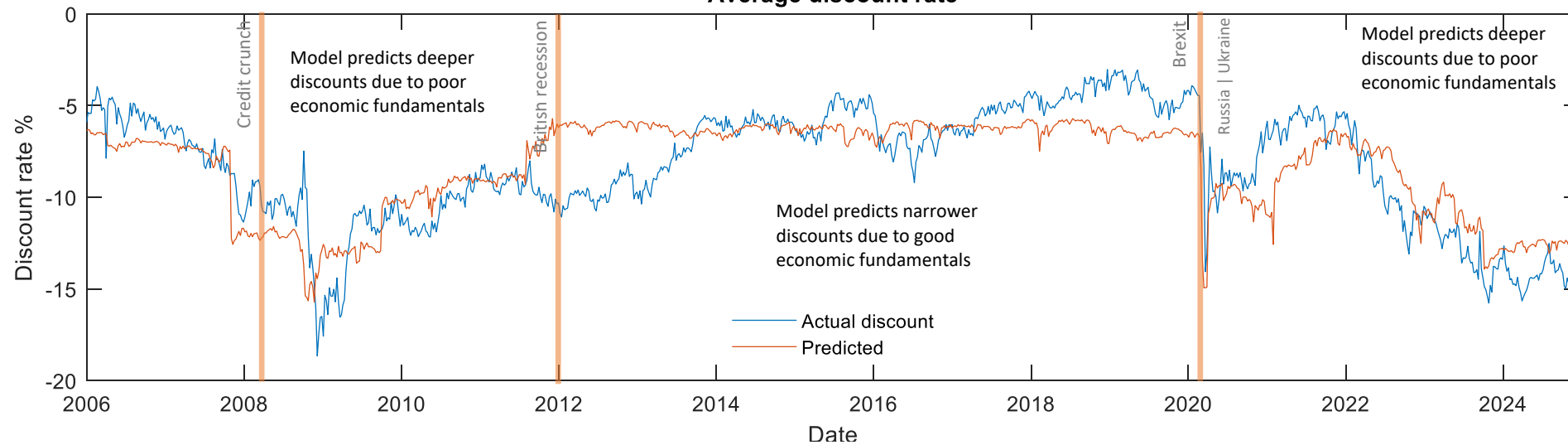
Number of observations: 991, Error degrees of freedom: 984

Root Mean Squared Error: 0.0196

R-squared: 0.622

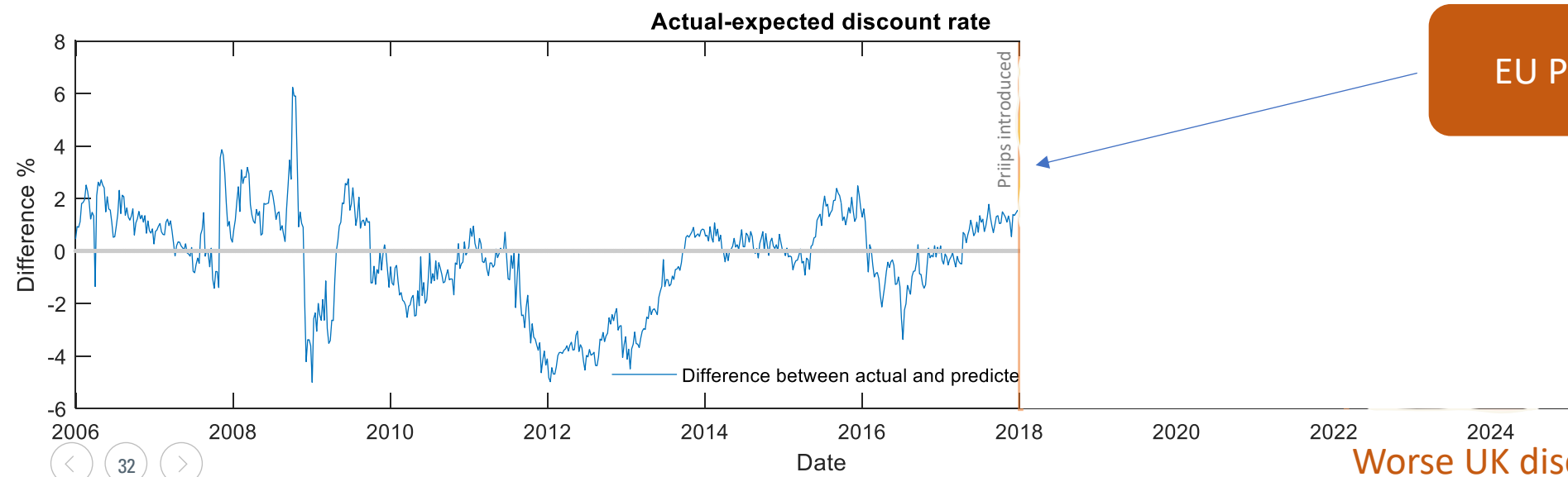
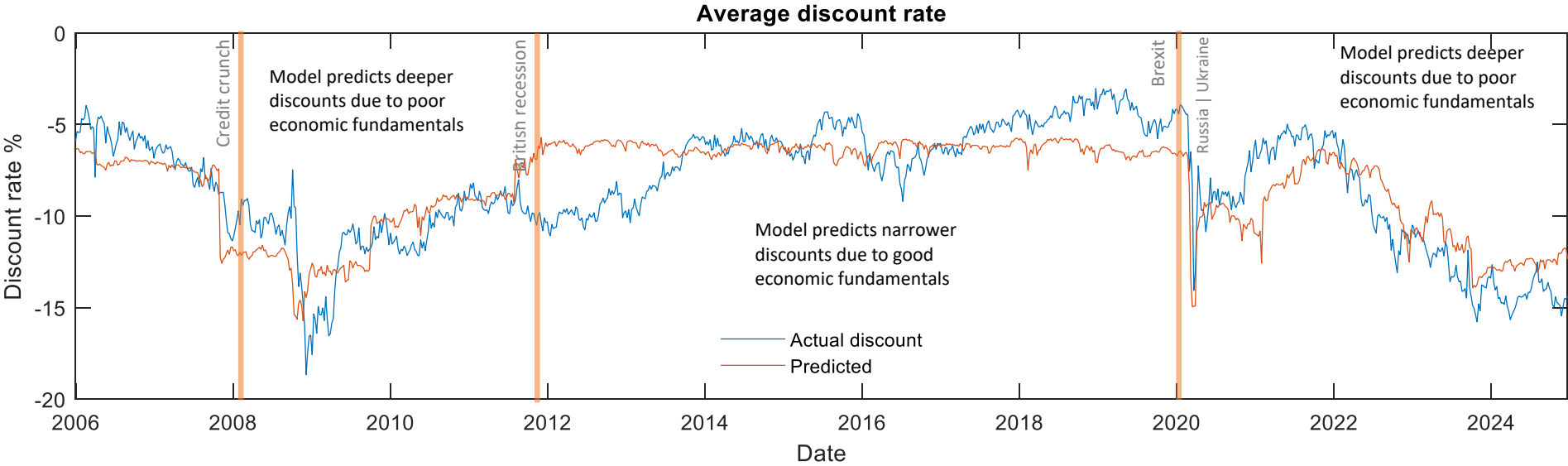


Average discount rate





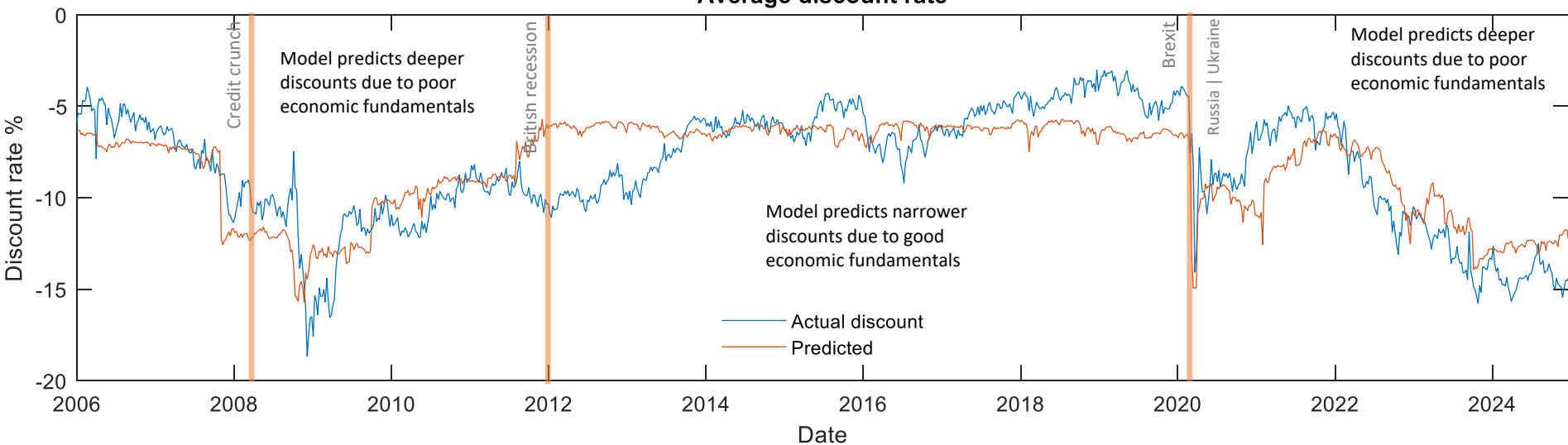
Reduced disclosures has not led to narrower discounts





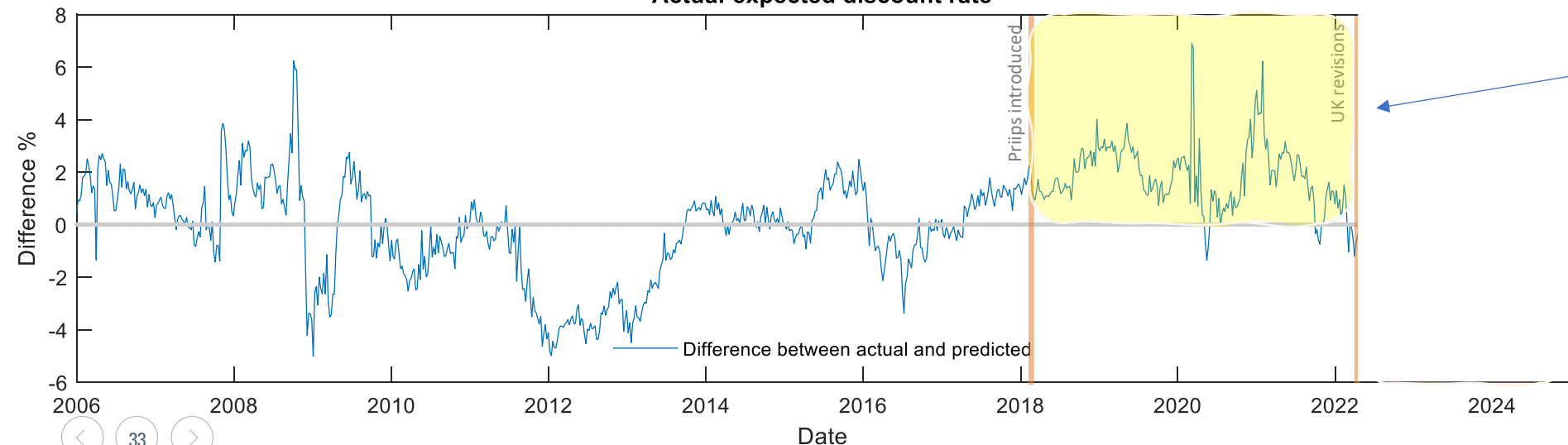
Reduced disclosures has not led to narrower discounts

Average discount rate



Actual-expected discount rate

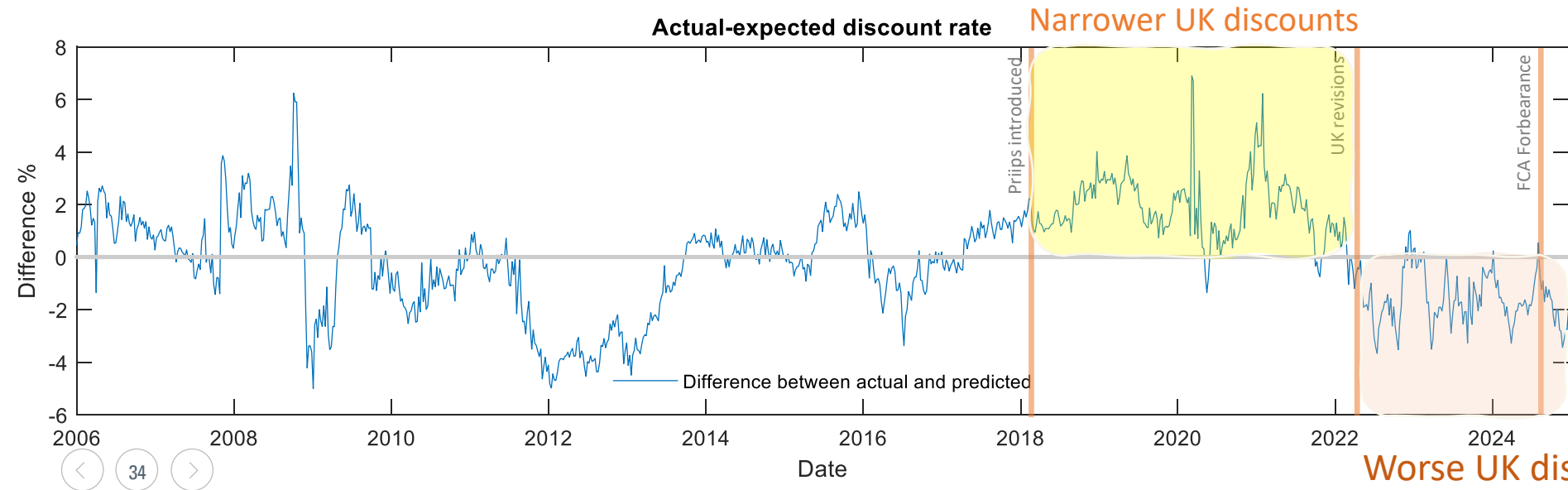
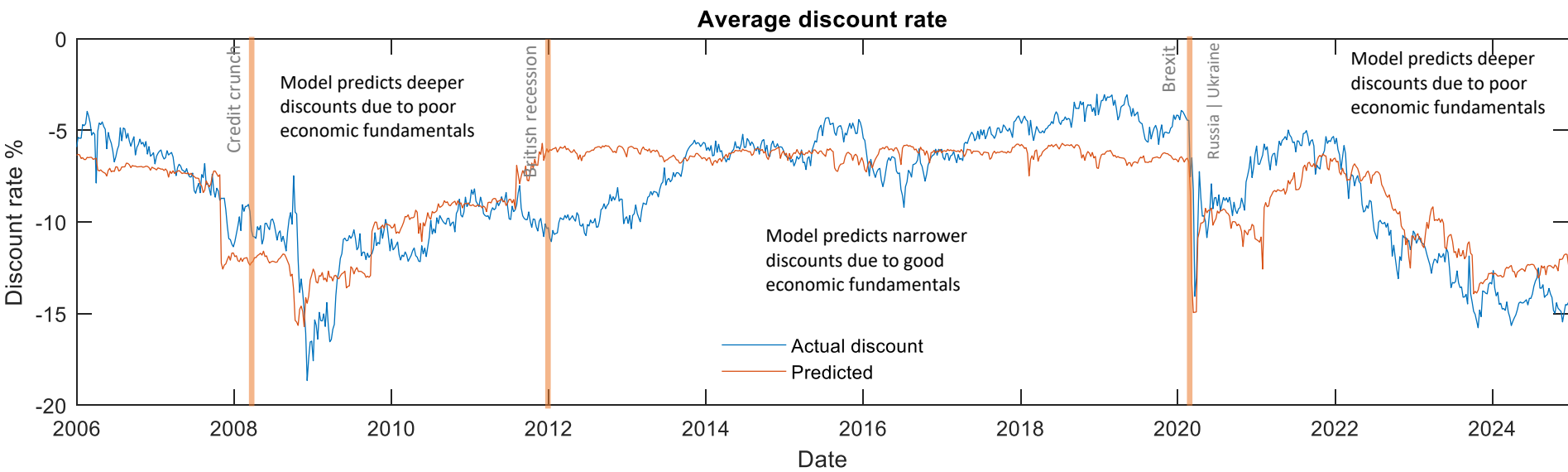
Narrower UK discounts



Call for less rigid disclosures



Reduced disclosures has not led to narrower discounts



Hasn't narrowed discount rates



The analysis puts a value on disclosure across industry

PRIIPS regime effect coincides with a narrowing of discount rates by 1.8%

Estimated Coefficients:	Estimate	SE	tStat	Pvalue*	Impact on a 250m fund
PRIIPS	1.77%	0.12%	14.67	0.00%	4.4M Better off
FCA Amendments	-5.65%	0.26%	-22.11	0.00%	-14.1M Worse off

Reduced disclosures effect coincides with a widening of discount rates by 5.7%

Significance: R^2 Improves from 62% -> 82%

Going from the PRIIPS regime to today is:
1.8% + 5.7% = 7.5% widening of discounts

Myth

Removing costs gives
me a competitive
advantage.



Nobel prize winner George
Akerlof

The “Market for lemons 1971”





Is your car a lemon or a peach?

Have you got a lemon or a peach?





Is your car a lemon or a peach?

What would you pay if you don't know what you are getting



£10,000 $\frac{1}{2}$ a chance



£5,000 $\frac{1}{2}$ a chance



Is your car a lemon or a peach?

What would you pay if you don't know what you are getting



Expectations theory

$$£10,000 \times \frac{1}{2} + £5,000 \times \frac{1}{2} = £7,500$$

Behavioural finance

Avoid regret

£5,000





Is your car a lemon or a peach?

Share prices across the market are impacted by reduced trust

Wide discounts mean new funds don't get put on the market



A lemon market for investment trusts will occur when:

- Asymmetry of information
 - buyers have difficulty assessing a product's characteristics
- Sales hazards
 - pass off a high-cost product as a low cost one
 - pass off a high-risk product as a low risk one
- Sellers with a great product have no way to disclose this credibly to buyers
- Deficiency of public quality assurances (by reputation or lack of regulation)

- We rated the quality of 270 UK KIDs as at Jan 2025
 - A number of factors considered (document stale)
 - Clarity of written information
 - Credible information was in the KID
 - Cost, risk and performance information



Quality of cost disclosure has a measurable effect on discount rates over 2024

Just TER				
Coefficient	Estimate	Average input	ImpactOn250mTrust	
Return1Year	0.18	6.6%	£2.9m	
TER	-3.33	1.6%	-£13.5m	
KIDRating	0.23	59.4%	£34.2m	
NumberOfFunds	223			
Discount impact			£23.6m	

- Good past returns narrows discounts
- Costs widen discounts
- Disclosure narrows discounts

Fitted to daily data from Jan 2024 to Jan 2025 on 223 funds



Quality of KIDs has a measurable effect on discount rates over 2024

Full KID Costs & RIY			
Coefficient	Estimate	Average input	ImpactOn250mTrust
Return1Year	0.18	4.8%	£2.2m
CostsAndRIY	-3.15	2.5%	-£20.1m
KIDRating	0.34	66.9%	£57.4m
NumberOfFunds	112		
Discount impact			£39.5m

More disclosure leads to stronger pricing effects

Fitted to daily data from Jan 2024 to Jan 2025 on 223 funds



Quality of KIDs has a measurable effect on discount rates over 2024

KID Rating above 70% with Full KID Costs			
Coefficient	Estimate	Average input	ImpactOn250mTrust
Return1Year	0.64	-0.6%	-£0.9m
CostsAndRIY	-0.94	2.7%	-£6.4m
KIDRating	0.49	86.4%	£105.0m
NumberOfFunds	38		
Discount impact			£84.1m

Excellent disclosure leads to trust pricing effects



No costs in the KID associated with odd pricing effects

No costs in the KID			
Coefficient	Estimate	Average input	ImpactOn250mTrust
Return1Year	0.29	10.2%	£7.3m
TER	8.11	1.3%	£25.5m
KIDRating	-0.21	52.3%	-£26.9m
NumberOfFunds	69		
Discount impact			£7.3m

More emphasis on past performance, TER & KID ratings all go the wrong way.



True, fair, not misleading

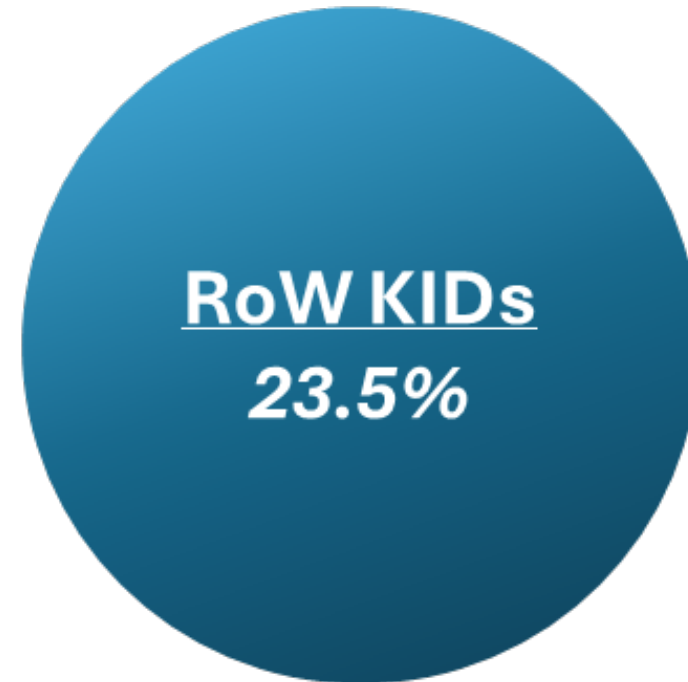
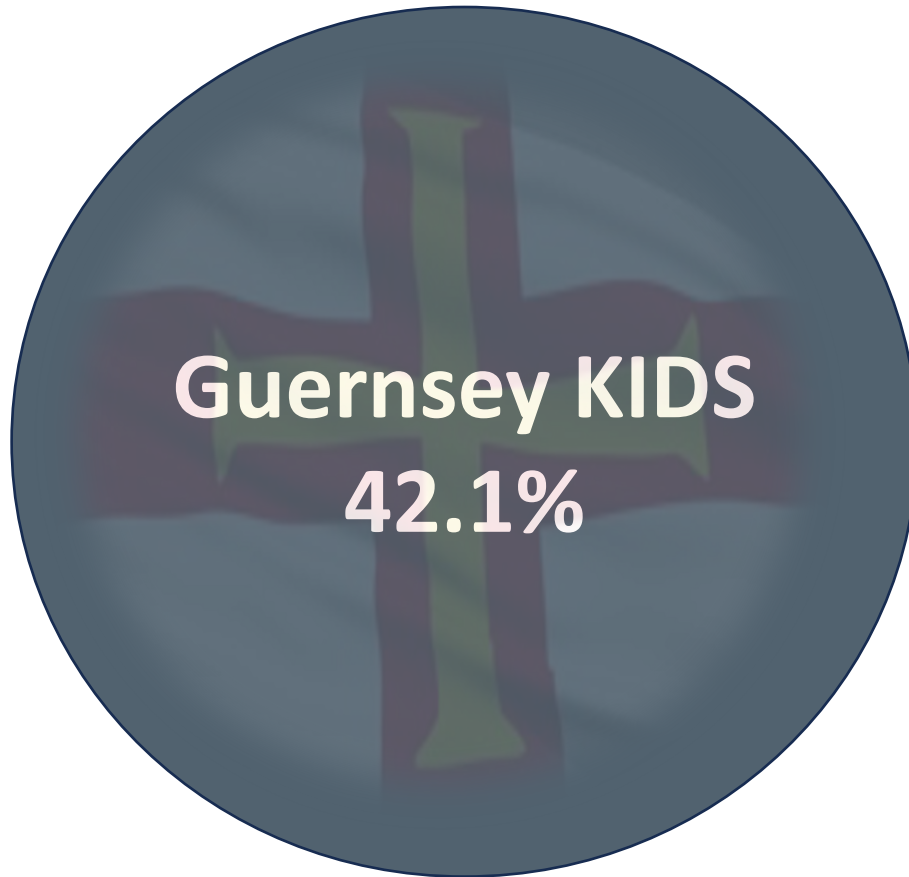
Evidence that disclosure correlated to pricing

Lack of cost can be reflected in price



- Correlation between poor quality KIDs/ modified KIDs and widening discount rates.
- Investment companies with better disclosures typically, but not definitely, have narrower discount rates.
- Findings support a widely accepted economic theory called “The Market for Lemons”
- If disclosures are poor, investors assume they are buying a lemon.

Proportion of KIDS with a quality rating over 65%



Possibly due to a focus on individual director liabilities in Guernsey, rather than firm risk exposures in the UK.



- There is a public interest to producing KIDS
- You can replace Vev with σ little overall impact
- However “vev” is a filter for technical competency
 - Public interest in a KID more likely to be met with Vev

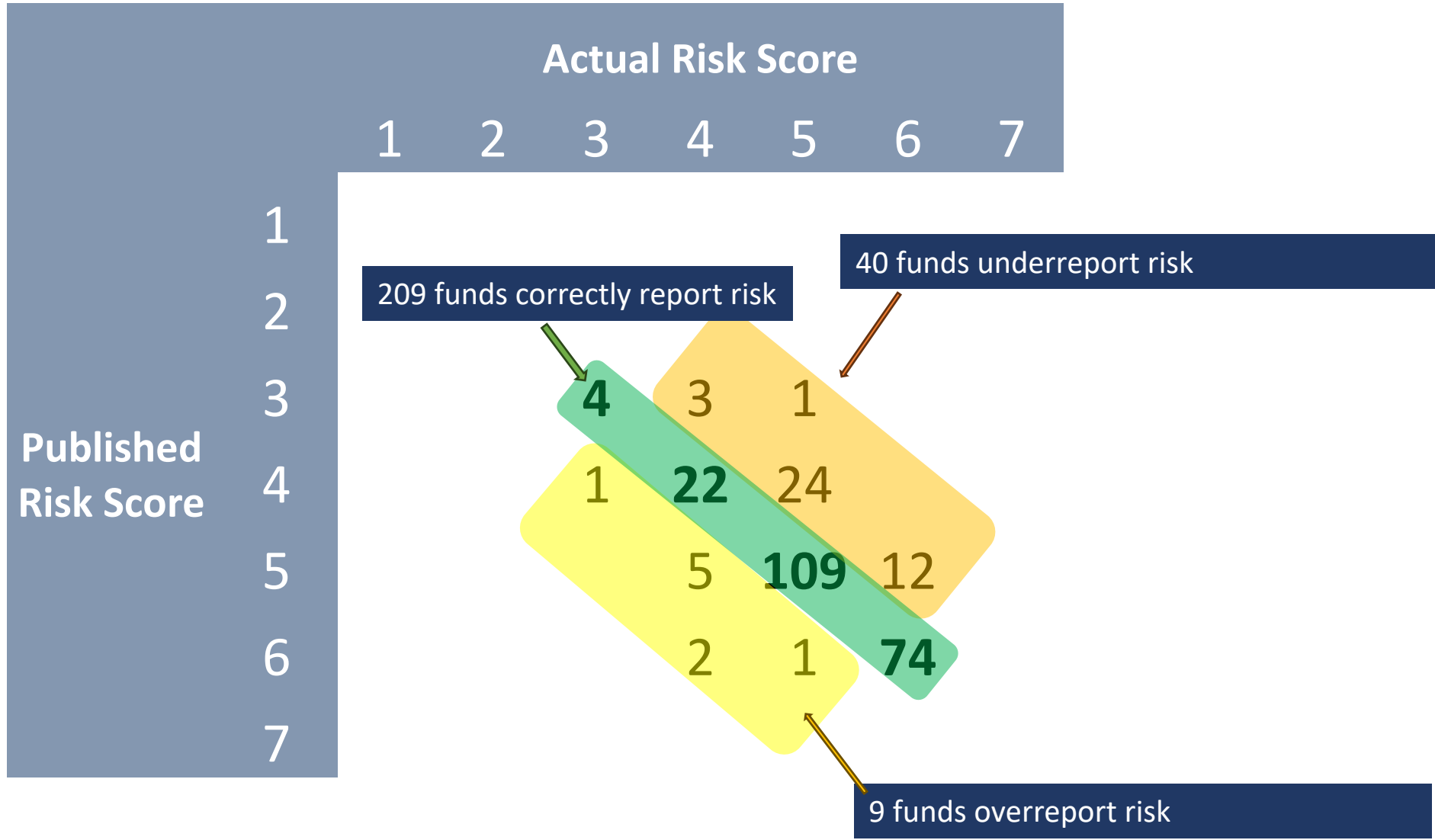
Myth

New CCI regime will
improve the risk rating of
funds.



20% of universe not reporting risk correctly

258 funds

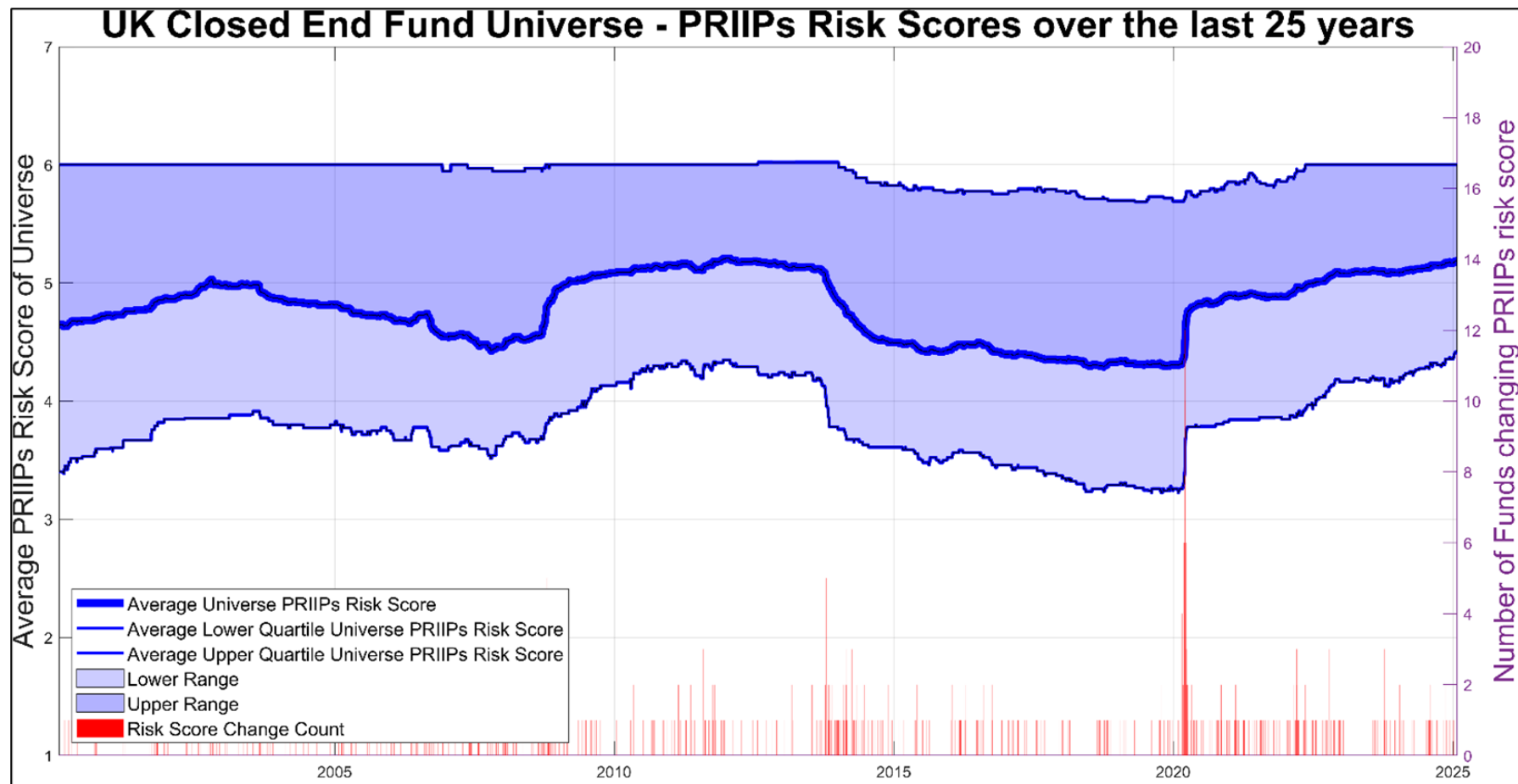




- Investment trusts are “equities”
- A correct risk or return benchmark would have equity-like properties
- Equity risk has long tail properties

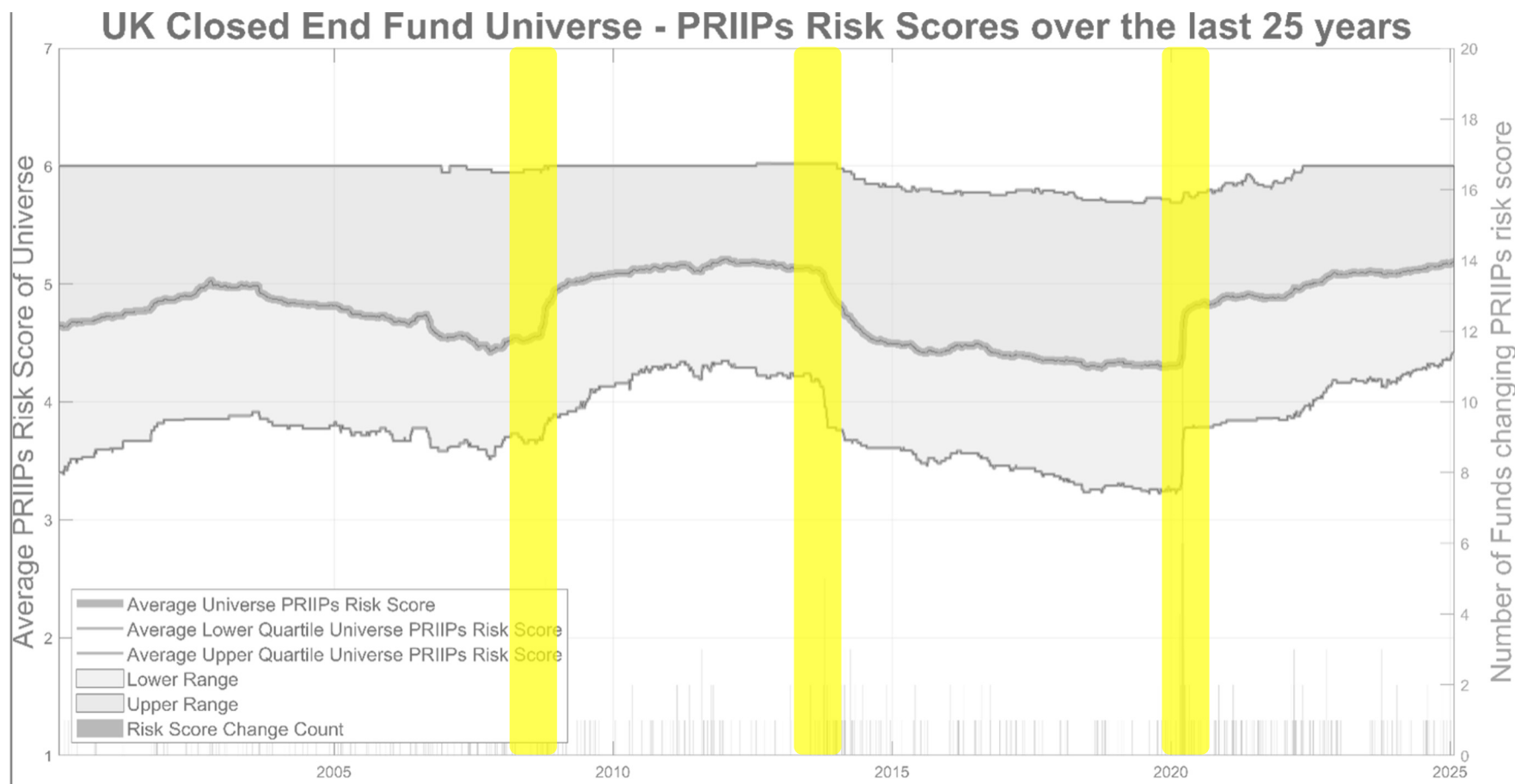


Back test of PRIIPS Risk Scores: 270 funds



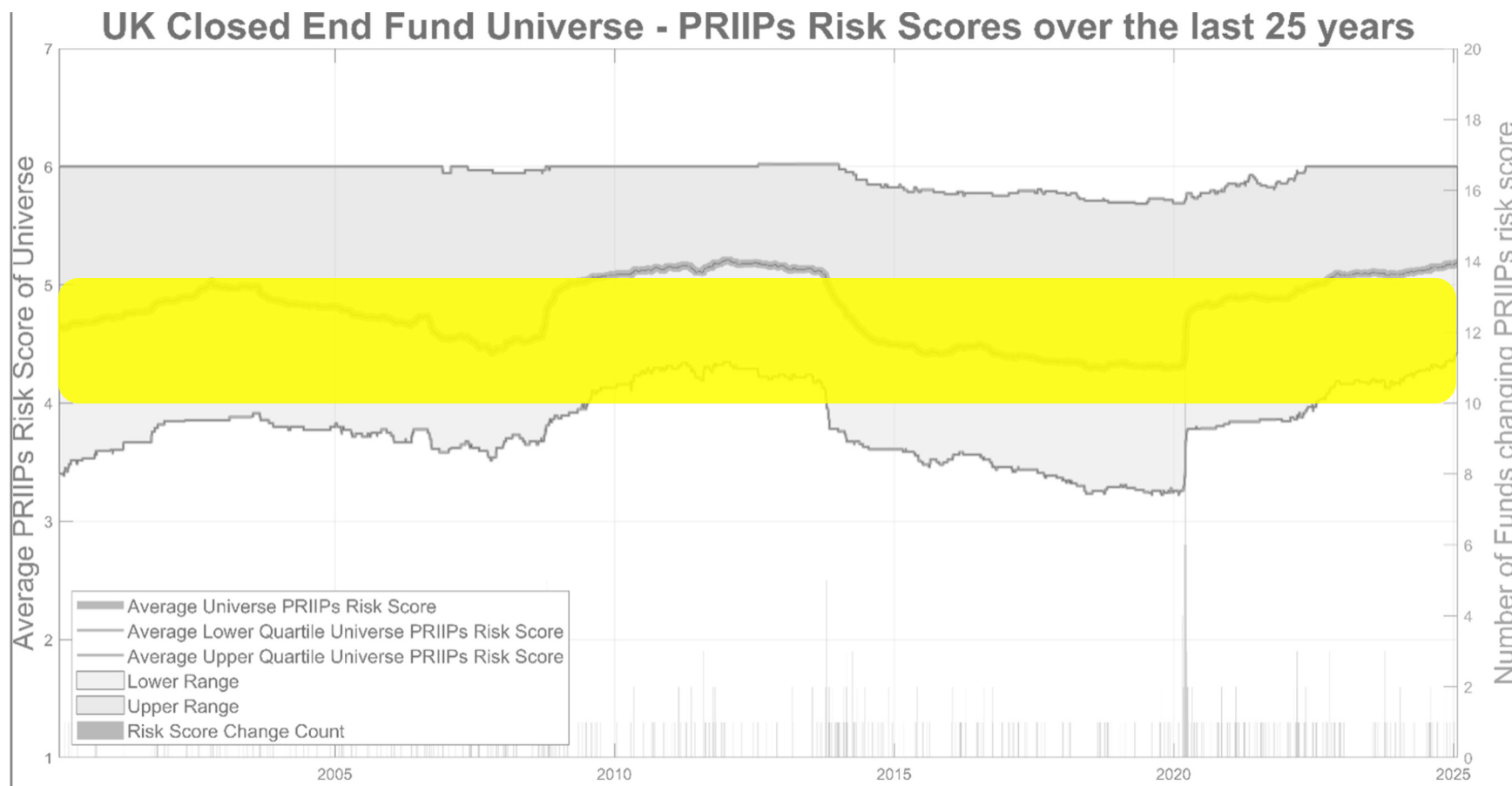


Sudden changes in risk ratings





Most trusts are around a “4” – so limited value

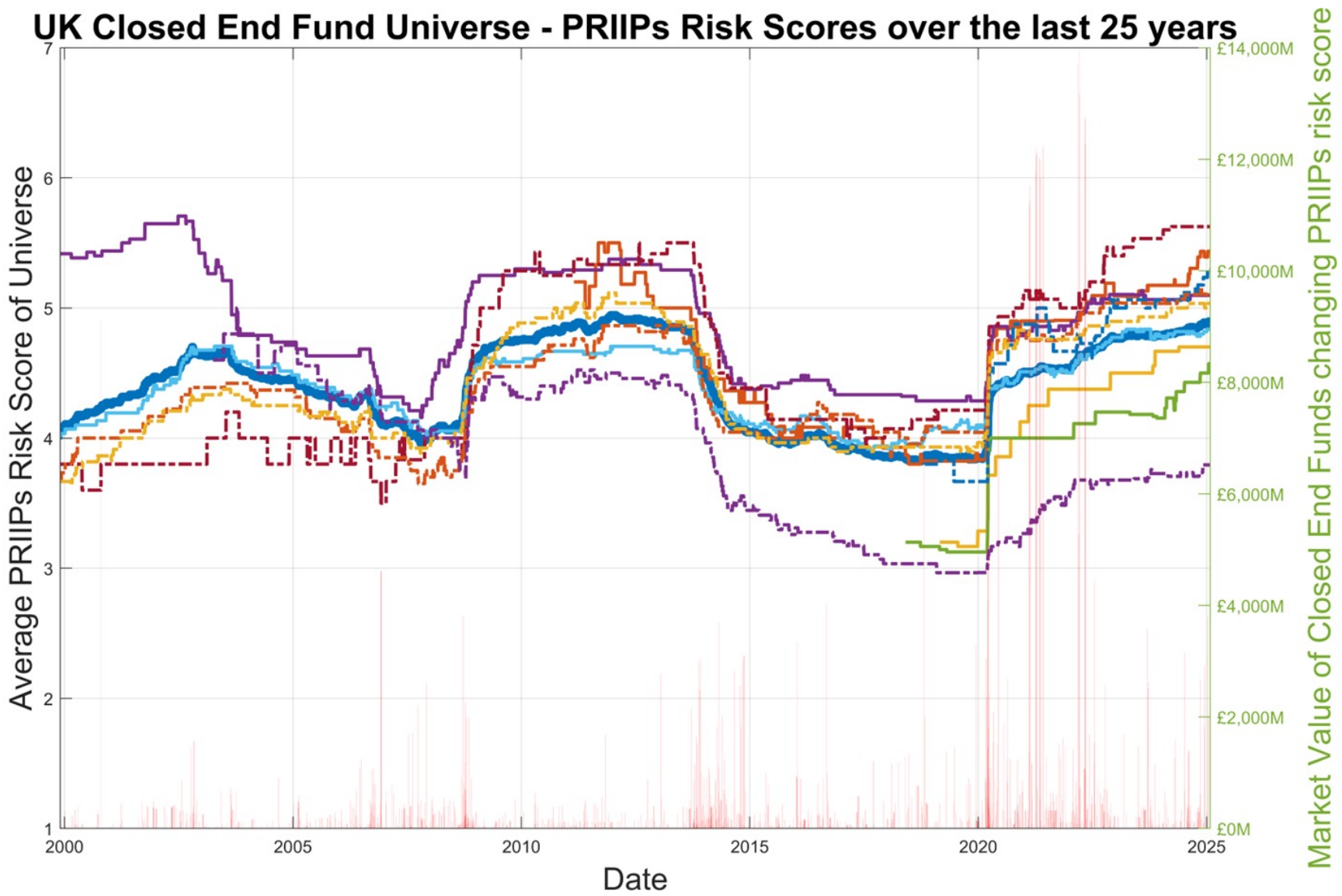




Back Test in PRIIPS Risk Scores

UK Closed End Fund Universe - PRIIPs Risk Scores over the last 25 years

- Average Universe Risk Score
- Alternative Assets
- Debt
- Emerging Markets
- Energy Transition
- Global Equity
- Private Equity
- REIT & Property
- Small Cap
- UK Equity
- VCT
- Risk Score Change Count

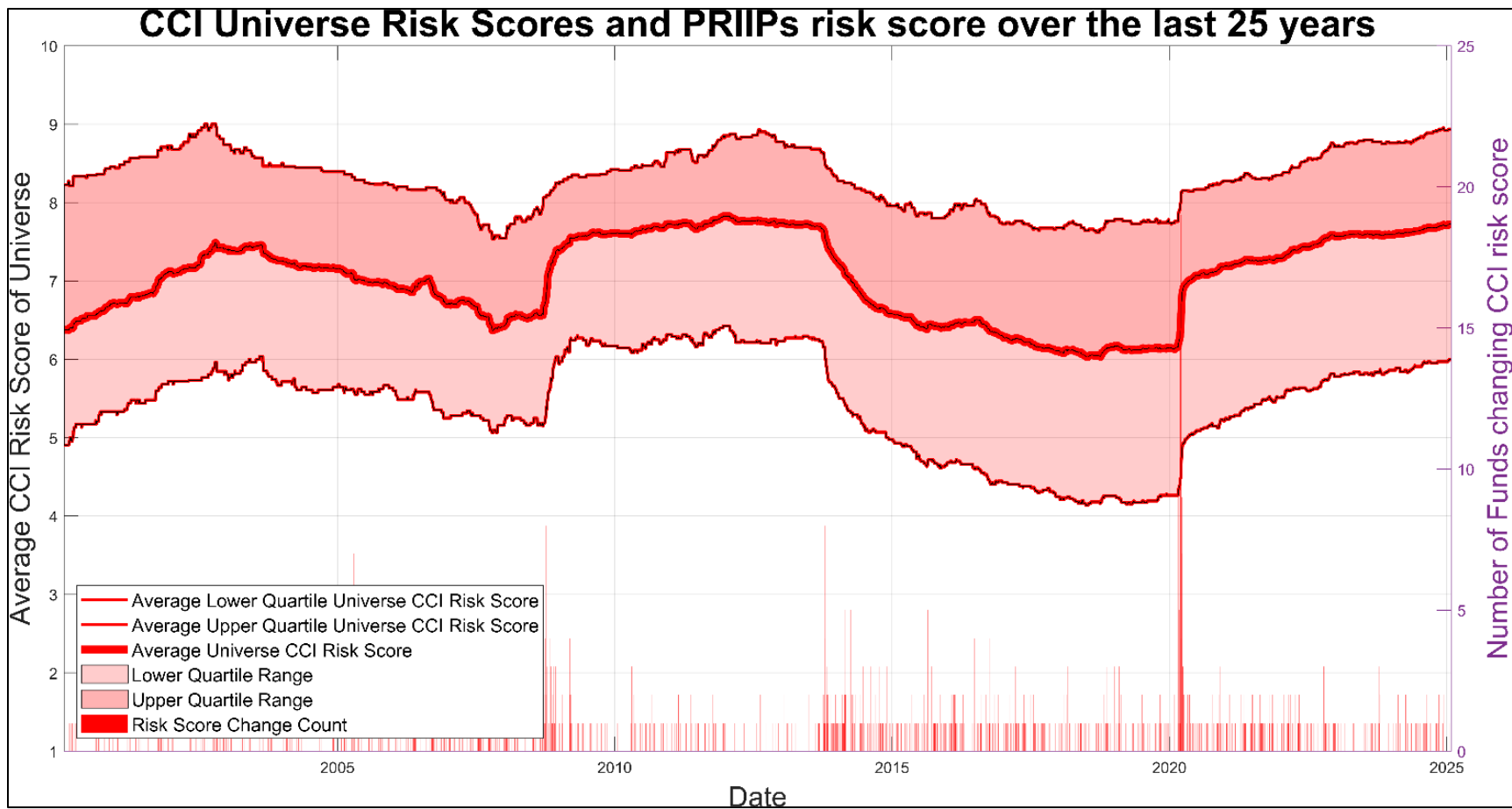


Some sectors jump a lot

Will CCI market risk be better?



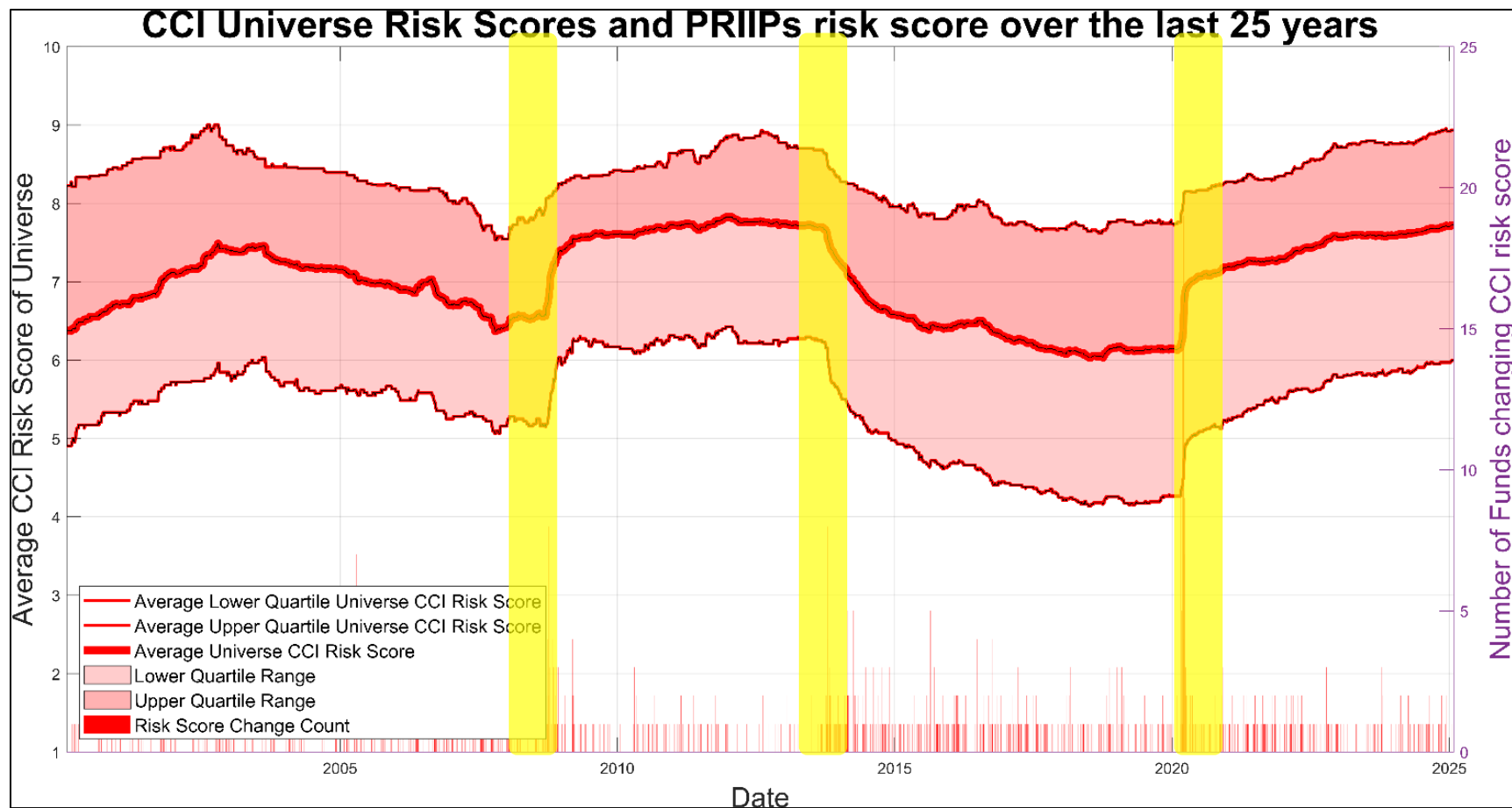
New CCI risk scores – a back test





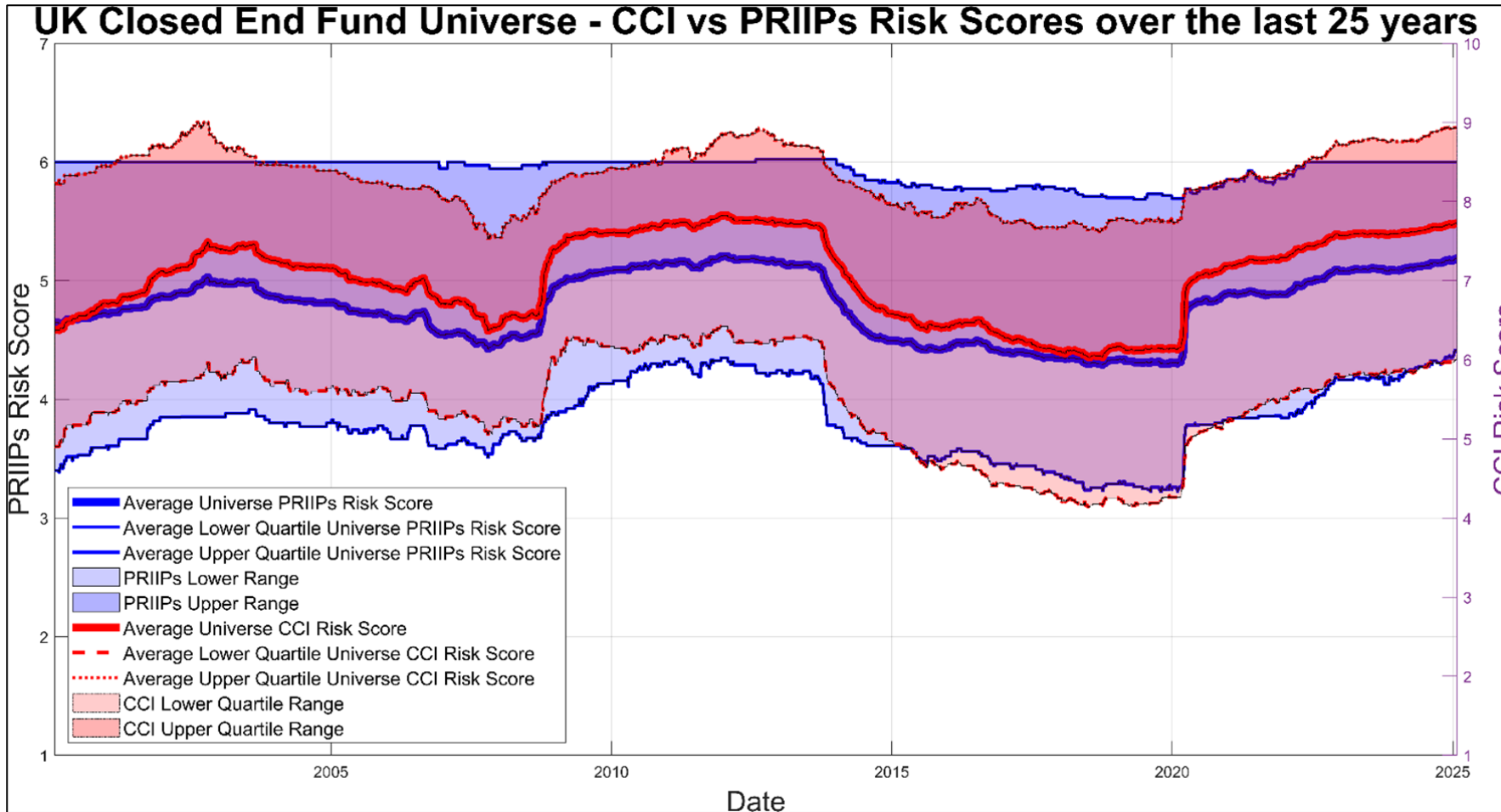
New CCI risk scores – a back test

Still jumping



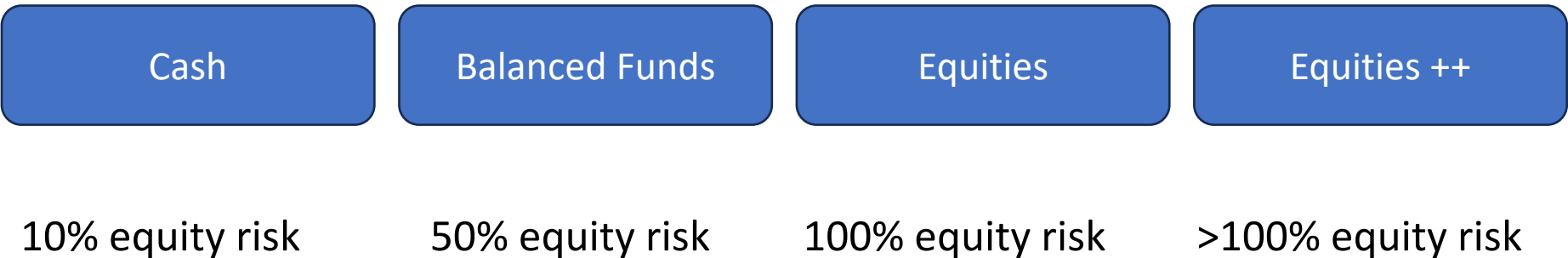


Not really an improvement just an adjustment





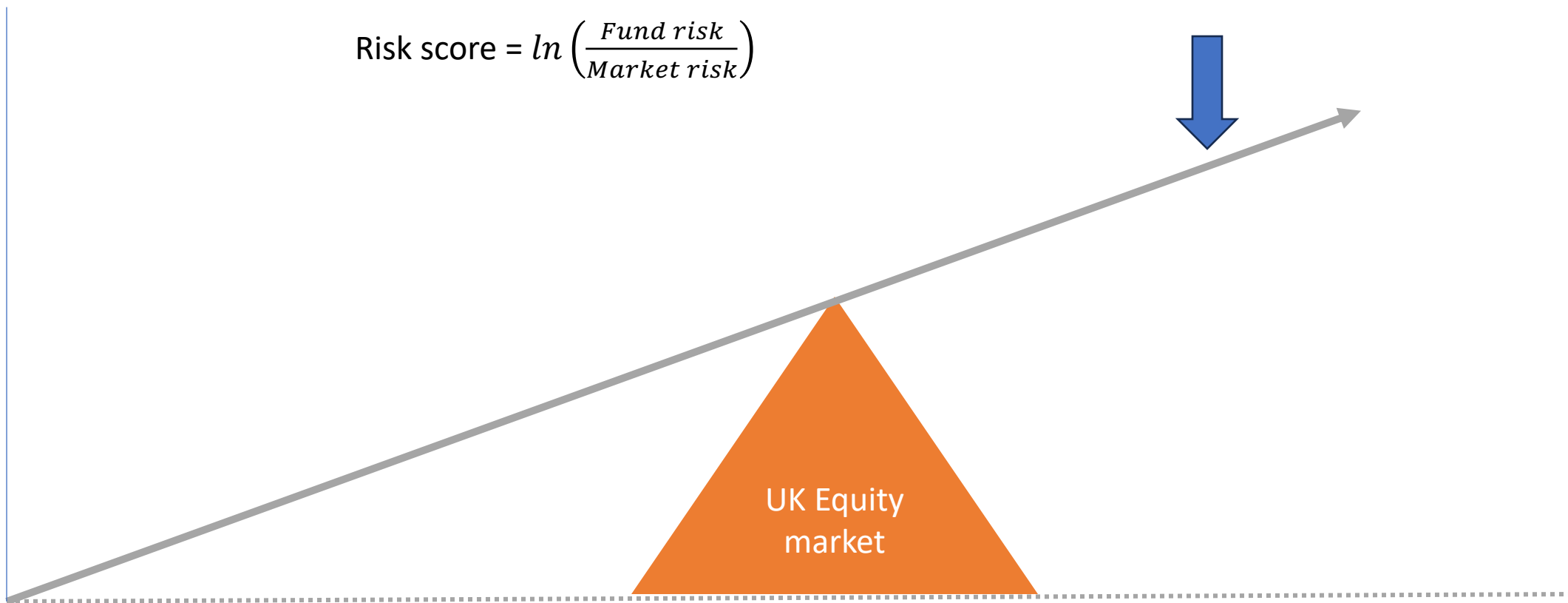
How retail investors think about risk





Where does fund fit on a risk line from cash to the UK Equity market

$$\text{Risk score} = \ln \left(\frac{\text{Fund risk}}{\text{Market risk}} \right)$$





Proportionate Risk Metric (PRM)

$$PRM = \ln\left(\frac{x}{m}\right)$$

Where x is calculated as the five-year annualised standard deviation of the fund's total return index using latest available data, and m is calculated as the five-year annualised standard deviation of the FTSE All-Share total return index over the same period.

The fund will then be allocated a Proportionate Risk Score, PRS, according to the intervals in the following table:

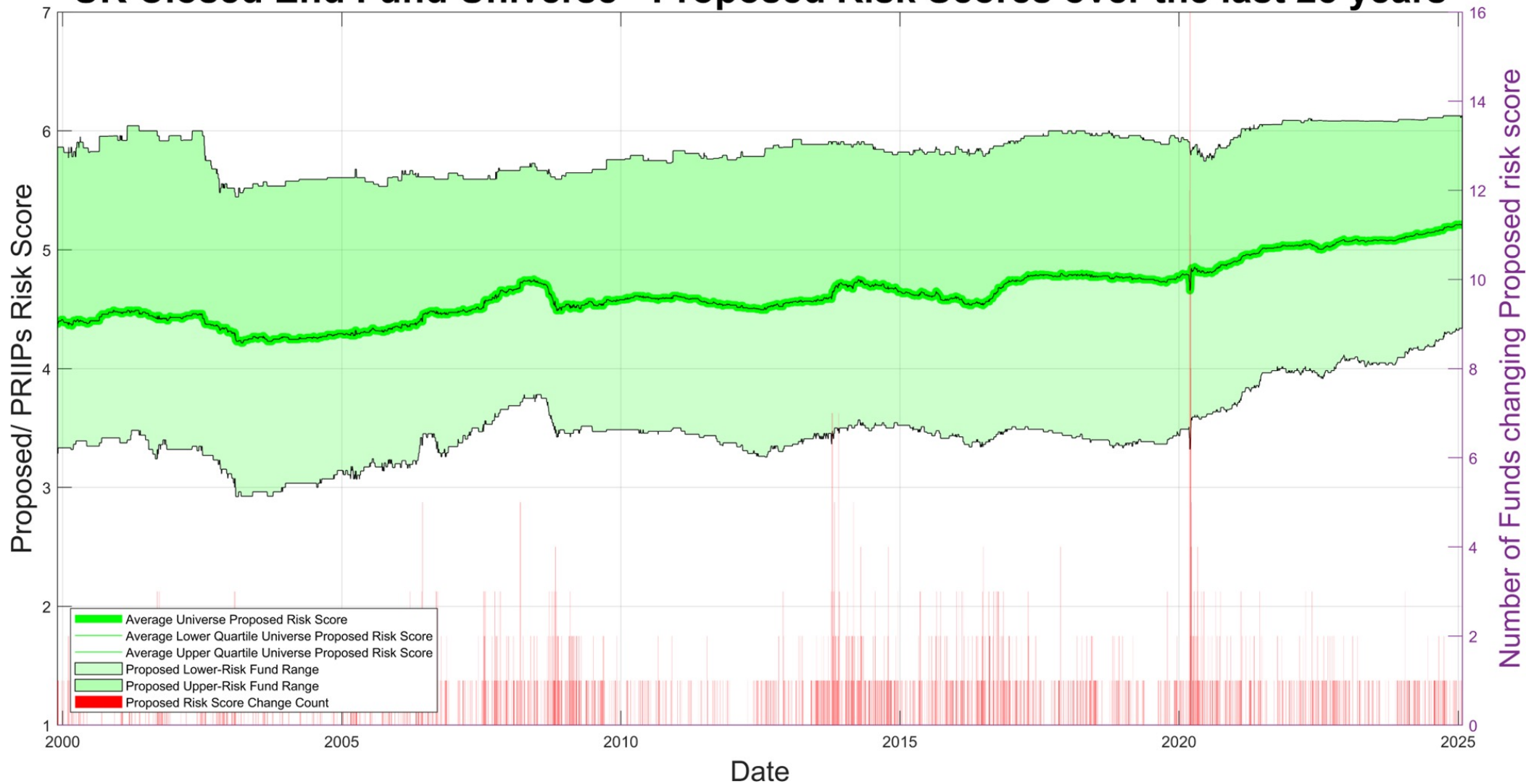
<i>PRS</i>	<i>PRM</i>	Corresponding Standard Deviation as at 28/01/2025 with FTSE All-Share volatility at 17.0% pa
1	$(-\infty, -1.50)$	$< 3.79\%$
2	$[-1.50, -0.75)$	$3.79\% - 8.03\%$
3	$[-0.75, -0.20)$	$8.03\% - 13.92\%$
4	$[-0.20, 0.15)$	$13.92\% - 19.76\%$
5	$[0.15, 0.55)$	$19.76\% - 29.47\%$
6	$[0.55, 1.05)$	$29.47\% - 48.59\%$
7	$[1.05, \infty)$	$> 48.59\%$

Odd numbers used because you move out from 4 in the middle



No discontinuities in the PRM

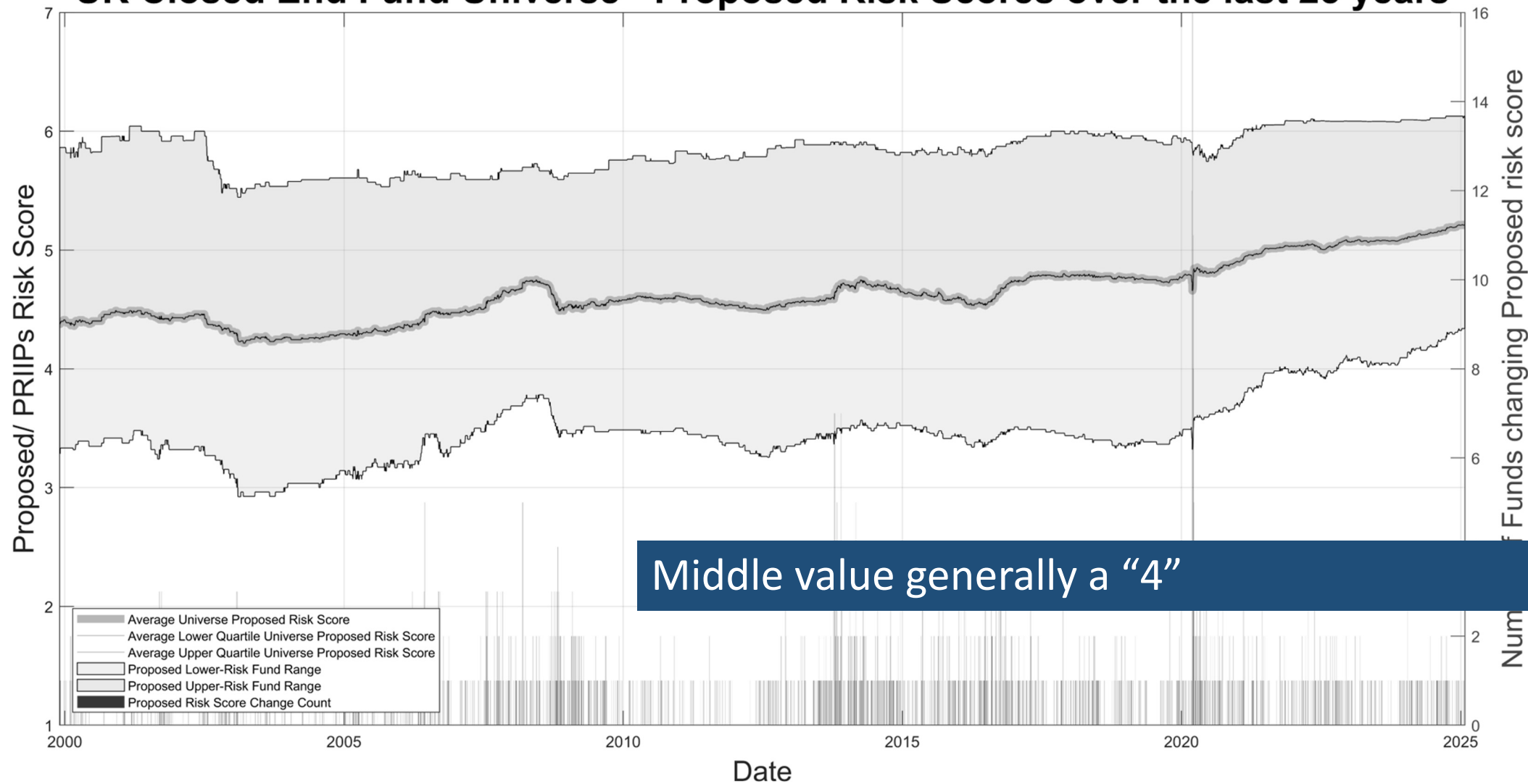
UK Closed End Fund Universe - Proposed Risk Scores over the last 25 years





Communication with current regime is important

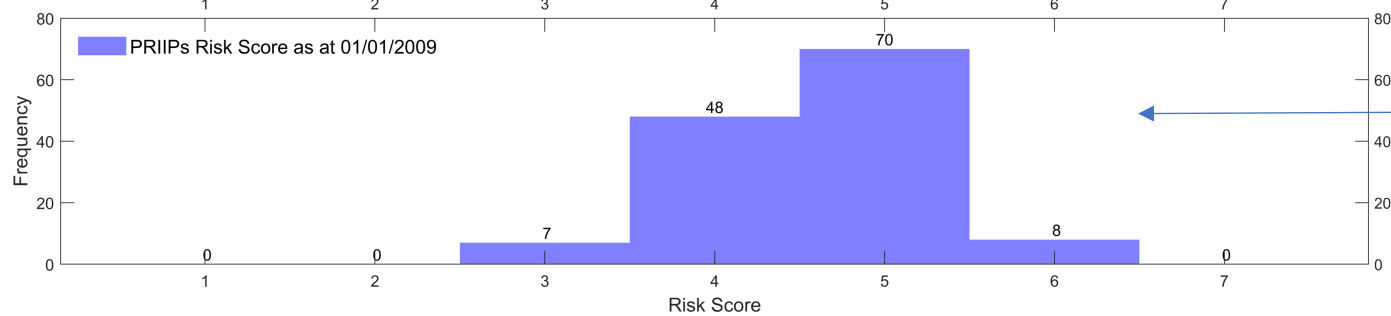
UK Closed End Fund Universe - Proposed Risk Scores over the last 25 years



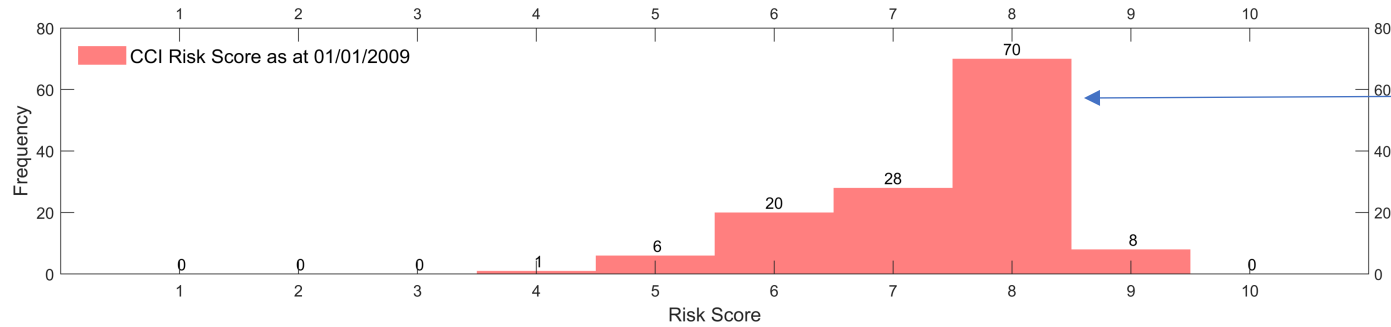
Middle value generally a "4"

Bear markets

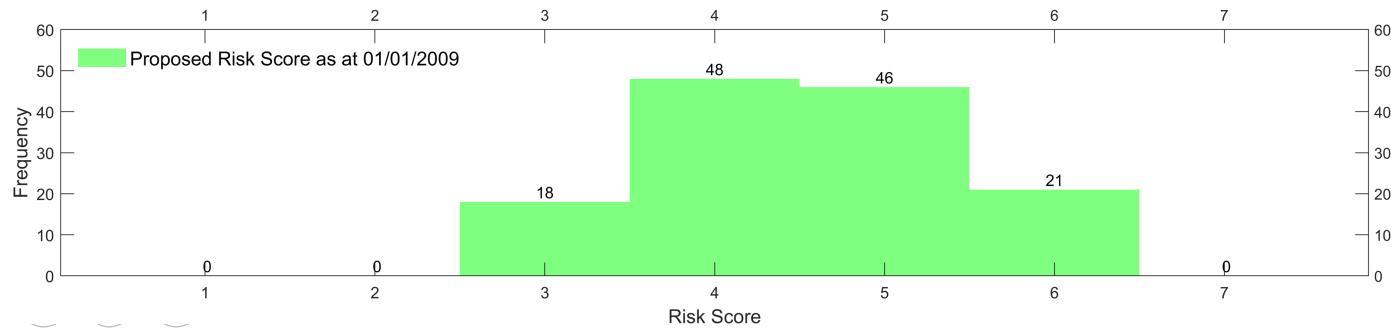
Adverse Market Conditions Risk Scores - Universe Comparison



PRIIPS cluster at "5"



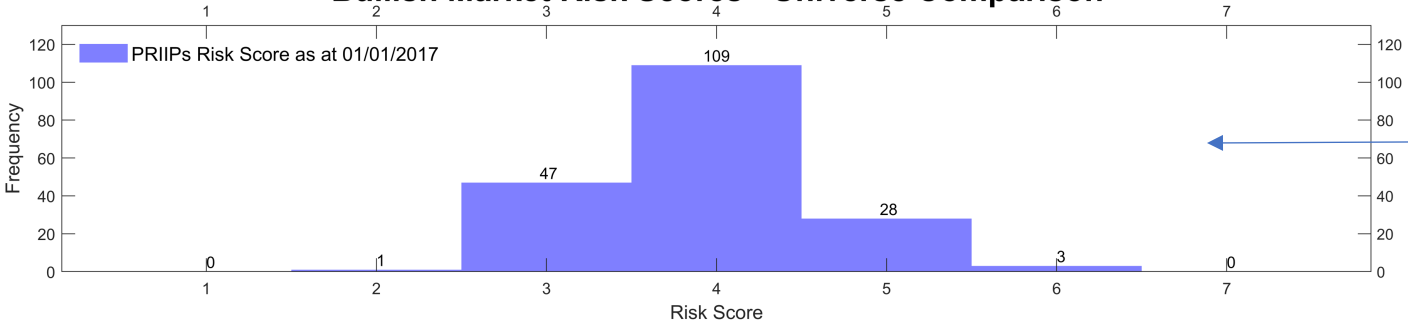
CCI gives a cluster at "8"



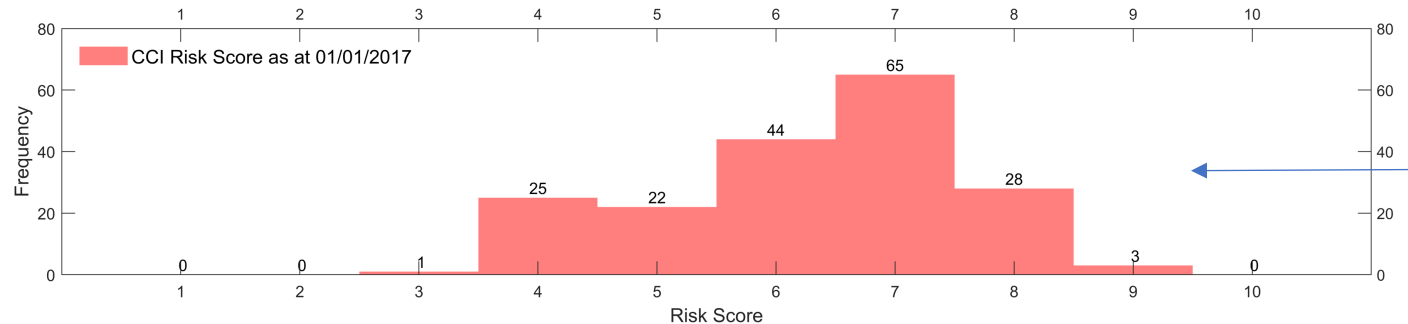


Bull markets

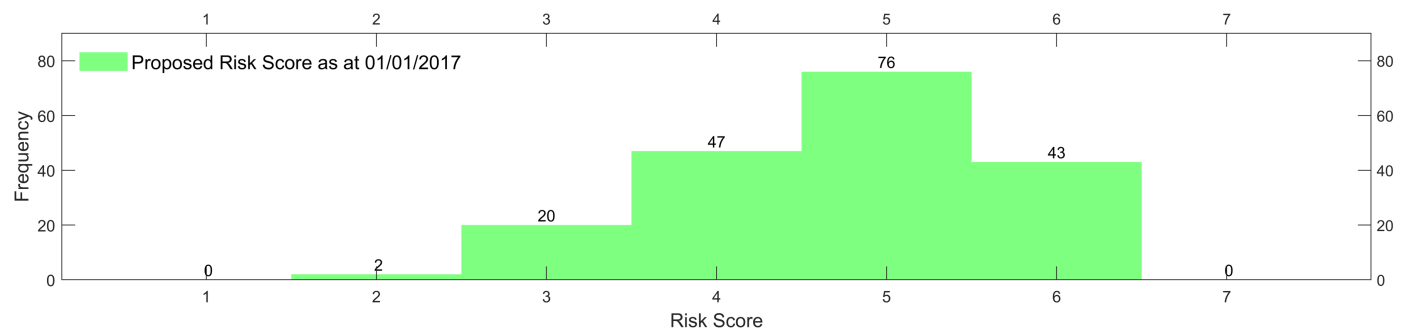
Bullish Market Risk Scores - Universe Comparison



PRIIPS gives a cluster at "4"



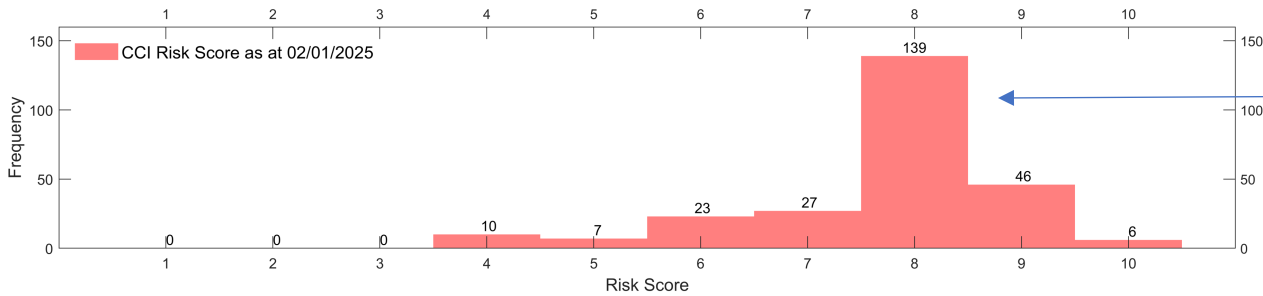
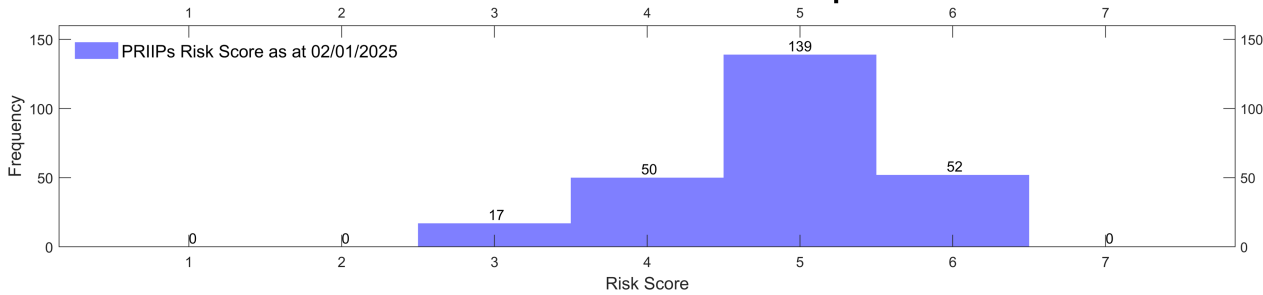
Shift away from "8"



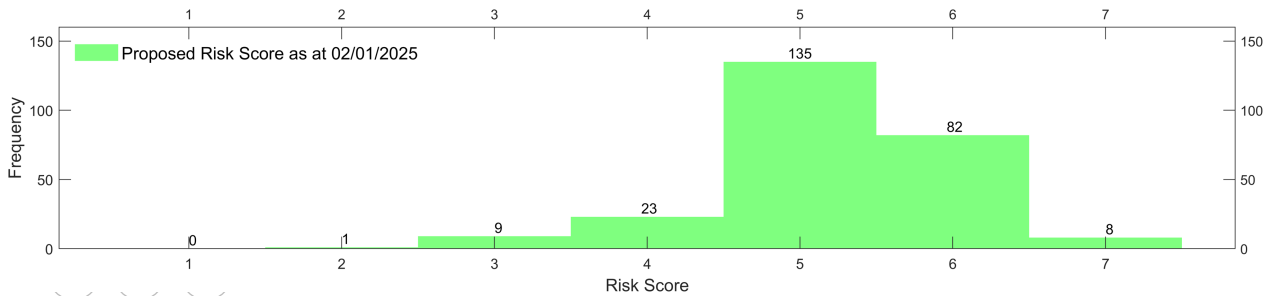


January 2025

Latest Risk Scores - Universe Comparison



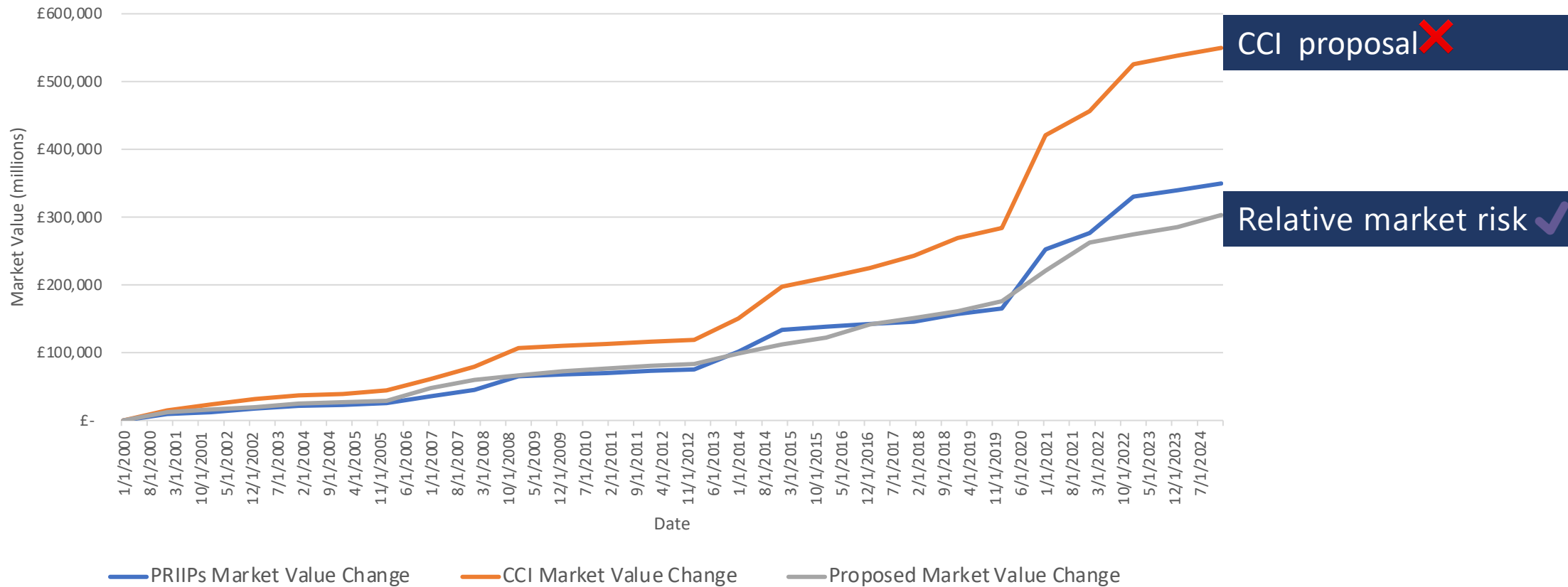
CCI gives a cluster at "8"





Stability in risk rating

Cumulative Market Value of Funds when Changing Risk Score





CCI does not really improve on PRIIPS market risk measure



CCI does not really improve on PRIIPS market risk measure

Proportionate Risk Measure looks better for public trust

Myth

Not saying anything will
make a good KID.



- Long term upside against inflation
- Short term downside
- Regret on missing out on market movements
- Performance during period of market stress
- Investment recovery times

These are numerical items



- Investors need

- Description of product and characteristics

These are language items

- Range of returns

- Impact of costs

These are numerical items



Consumers need to understand the document

Flesch reading ease [\[edit\]](#)

In the Flesch reading-ease test, higher scores indicate material that is easier to read, while lower numbers mark passages that are more difficult to read. The formula for the Flesch reading-ease score (FRES) test is:^[7]

$$206.835 - 1.015 \left(\frac{\text{total words}}{\text{total sentences}} \right) - 84.6 \left(\frac{\text{total syllables}}{\text{total words}} \right)$$

Scores can be interpreted as shown in the table below.^[7]

Score	School level (US)	Notes
100.00–90.00	5th grade	Very easy to read. Easily understood by an average 11-year-old student.
90.0–80.0	6th grade	Easy to read. Conversational English for consumers.
80.0–70.0	7th grade	Fairly easy to read.
70.0–60.0	8th & 9th grade	Plain English. Easily understood by 13- to 15-year-old students.
60.0–50.0	10th to 12th grade	Fairly difficult to read.
50.0–30.0	College	Difficult to read.
30.0–10.0	College graduate	Very difficult to read. Best understood by university graduates.
10.0–0.0	Professional	Extremely difficult to read. Best understood by university graduates.

US Army measures accessibility of manuals

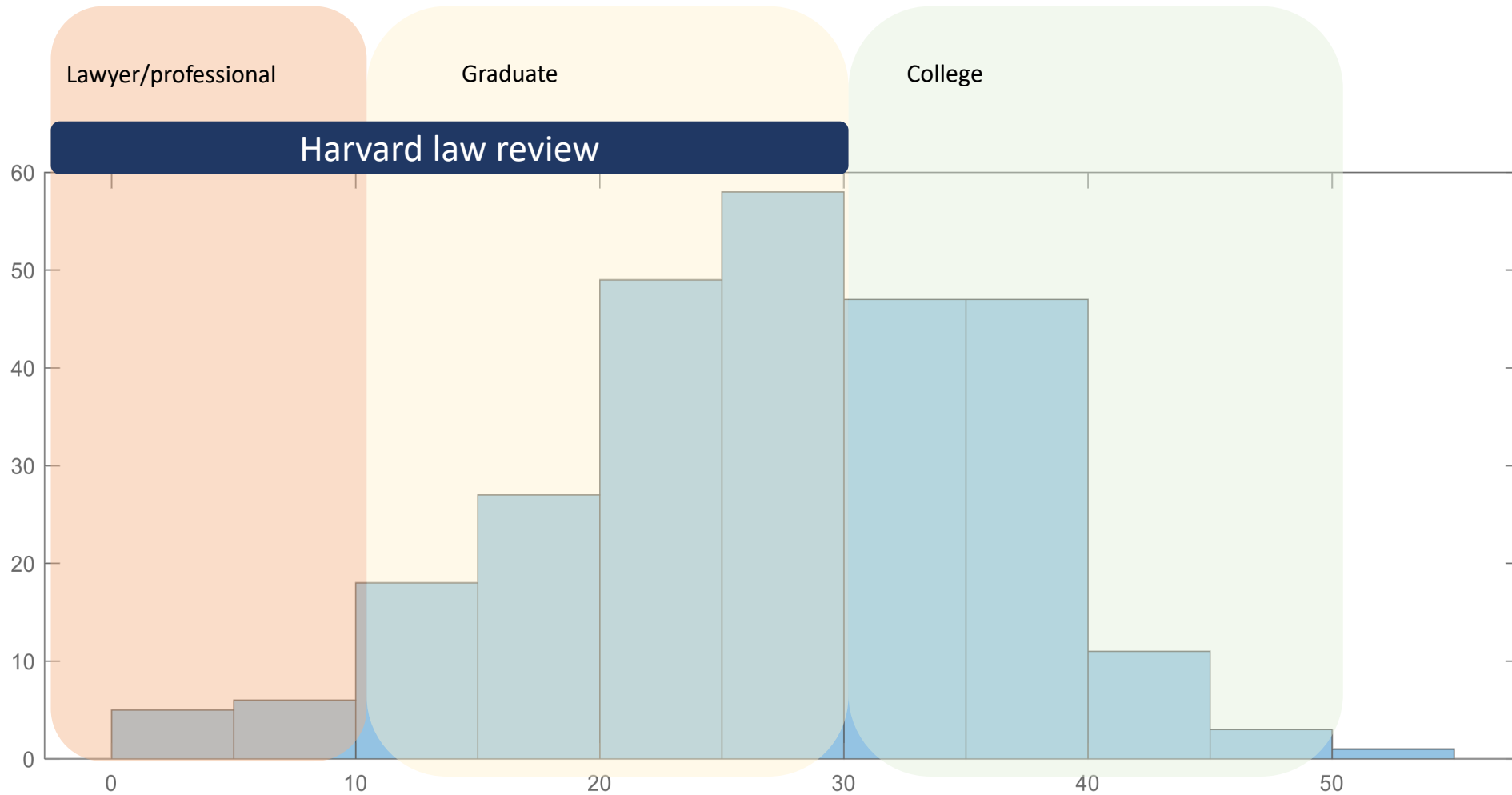
Statute in states like Pennsylvania for car insurance



Can consumers understand the type of product?

Readability metrics: Flesch–Kincaid

Over 50% copy and pasting from the prospectus





- Disclaimer rather than disclosure?



What could impact my return positively?

Factors that are likely to have a positive impact on returns include market increases in sectors and regions invested in, and the narrowing discount or higher premium attached to the Company’s share price relative to its Net Asset Value.

Statement applies to any fund in the market

This is a disclaimer



What could happen under severely adverse market conditions?

If a shareholder decides to sell their shares under severely adverse market conditions, they may get back less than the amount initially invested.

Statement applies to any fund in the market

This is a disclaimer



What could impact my return positively?

Specific factors that could affect returns positively would be an increase in the market valuations of **properties** within the Company's portfolio and **the scope for rental increases, which is driven by increasing demand for affordable home ownership and an increasingly older population**; the ability of the Board to effectively manage the property portfolio and make promising acquisitions; and the ability of the Company to pay a dividend. General factors that affect positive returns for the Product would be an extended period of UK economic growth and fiscal stability. An increase in **demand for real estate** is likely to benefit the returns of the Company.

Quantitatively, the most favourable **one-year** shareholder total **return** possible was **39.3%**. Over the longer period available from the proxy's history, the proxy experienced a favourable **five-year** rolling shareholder total **return of 25.1% per annum**.

Specific
Measurable
Achieved objectively
Realistic for future expectations
Time periods addressed



What could happen under severely adverse market conditions?

Between **September 2022 and February 2024**, the market capitalization of the company **reduced by 53.3%**. In addition, **during the financial crisis from February 2007 to March 2009 the proxy experienced a loss of 79.6%**. Under severely adverse market conditions, the value of the Product may fall by similar amounts relative to the scale of a market crash.

During such periods of stress, there is a risk that the capital value of an investment in the Company's shares could reduce significantly, potentially down to zero.

Specific
Measurable
Achieved objectively
Realistic for future expectations
Time periods addressed

Suggestion:

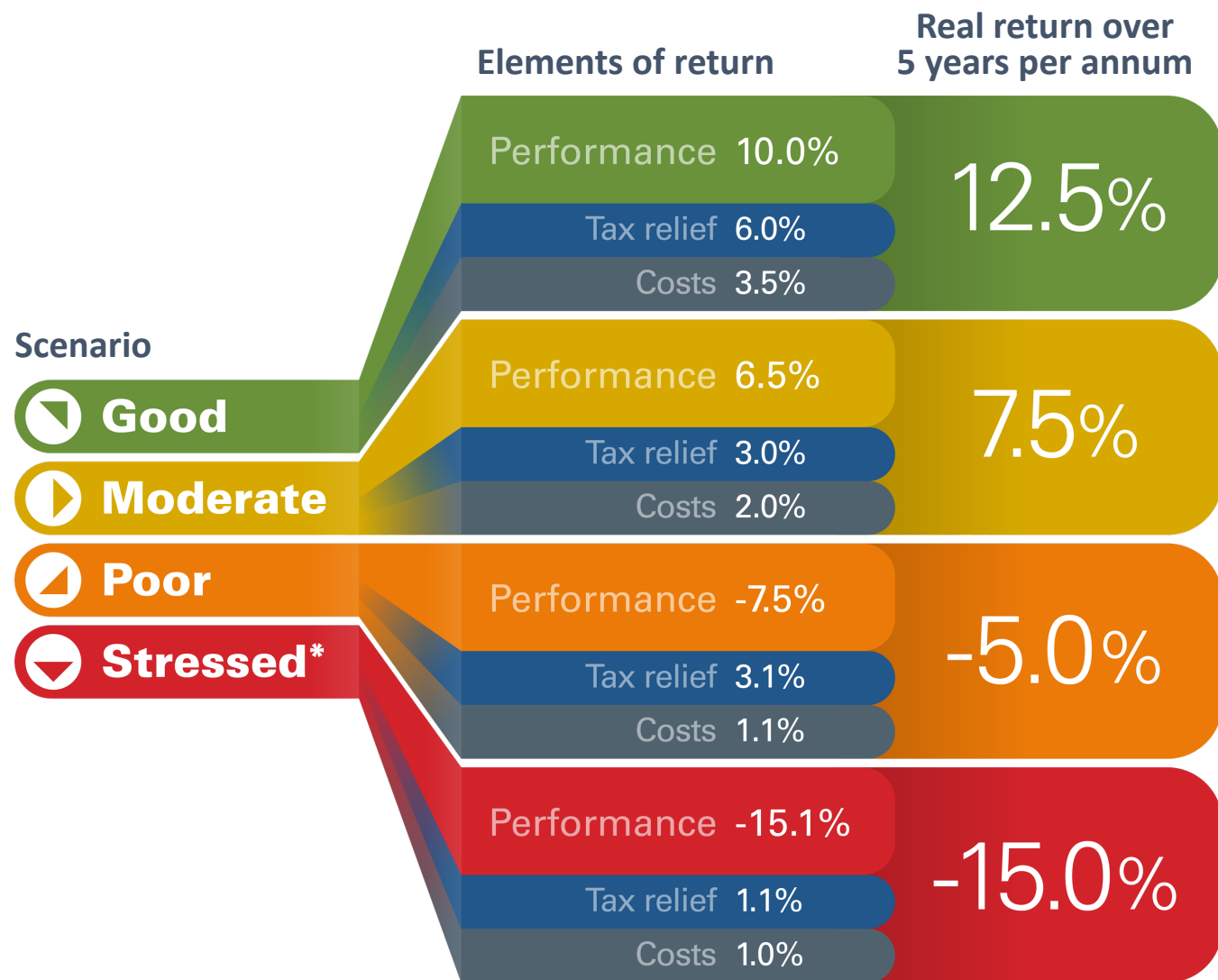
Consistent performance and costs



- Range of returns is critical
 - Good, moderate, poor, stressed conditions
- Tax relief
- Role of inflation
 - Show real returns
- Consistency between fees and performance



Sample approach



- Communicate net **real** returns and costs using scenarios. The scenarios are produced by the manufacturer.
- These returns and costs should come from manufacturers.
- The platform can add platform costs to the net real returns for each scenario.
- The platform has sufficient summary information to show gross returns if they choose.
- The platform has sufficient information to interpolate between scenarios.
- The platform should aggregate underlying products' net returns in the same scenario.

*A stressed performance occurred between Oct 2007 to December 2012, during which the share price fell 47% before recovering.