aic The Association of Investment Companies

INVESTMENT COMPANIES

Democratising capital, funding growth and meeting investors' needs

November 2022

www.theaic.co.uk

Investment companies have been serving investors for over 150 years. Their fixed capital structure enables active managers to deliver growth and income across a wide range of geographies and asset classes – from listed shares to property and infrastructure, from green energy to biotech – while their stock market listing makes them accessible to everyone.

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Introduction

Investment companies have been serving investors' needs for over 150 years. They democratise capital and enable investors to access a wide range of assets. They have inherent structural advantages which give them the potential to deliver superior long-term performance, improving consumer outcomes. They can diversify a portfolio, provide a stable income and help to protect portfolios from inflation.

The current economic backdrop means that the advantages which investment companies can bring to bear for investors are as important as ever. There has been a sea change in inflation expectations, growth has stalled, markets have been volatile and there has been a retreat into cash and lower risk assets. This is all in the context of the need to save and invest more, to improve productivity through directing capital to new technologies and infrastructure, and the requirement to move the economy towards net zero. The long term benefits of exposing savings to risk through investment are well documented. Investment companies, with their lengthy track record of delivery, can support investors through the short term volatility and help to meet those longer term needs.

"to provide the investor of moderate means the same advantage as the large capitalist in diminishing risk by spreading the investment over a number of stocks"

F&C Investment Trust's
original prospectus, 1868

Democratising access to a wide range of asset classes that would otherwise be inaccessible has seen the sector expand to record levels in recent years. This has provided a source of capital and secondary market liquidity to support economic growth, and is helping underpin significant investment in assets driving the transition to net zero. Investment companies have enabled individual private investors to be part of this process drawing in additional capital to these asset classes.

The UK listed investment company sector is now bigger than its equivalent in the United States and is substantially larger than similar sectors in the EU or Australasia. This form of pooled investment, whilst not unique to the UK, is a domestic success story looked at enviously by other markets.

Investors in UK listed investment companies have benefited from the unique features of their corporate structure. In recent years, the number of listed companies has declined, fast-growing companies have stayed private for longer and returns have been concentrated in private capital. The investment company structure has proven invaluable in enabling investors, including individual private investors, to gain access to unique and innovative assets that would otherwise not be available to them. All the while, benefiting from **expert active asset management** and the stewardship provided by an **independent board**.

Investment companies which invest in listed equities deliver benefits for investors too – underpinned by the same structural advantages. The ability to take a **long-term view** and **smooth income** can give reassurance to investors. In addition, the ability to invest in a manager's thematic approach to a specific sector or geography, enables investors to benefit from that expertise and navigate those markets when they would not otherwise be able to undertake all the necessary research, or even access those markets directly.

The benefits investment companies deliver for investors, underpinned by their structural advantages, mean that every investor should consider them a potentially vital part of their portfolio. Similarly, policymakers, regulators and others should consider them a critical part of the investment landscape.

Against the current global economic backdrop, with a need to save and invest more, and an ambition to drive growth and support the transition to net zero, never has the case for investment companies been more compelling than it is today.

What is an investment company?

For over 150 years investment companies have opened up a wealth of opportunity to a wide range of investors – allowing anyone from large institutions to private individuals to harness the return potential of many different markets, sectors and industries. Investment companies have always enabled investors to access the frontier markets of the day. Today, in addition to investing in listed equities, they also help provide liquidity for investors in a range of specialist asset classes that those investors would otherwise struggle to access.

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An investment company is a type of collective investment fund. It invests its assets for the benefit of its shareholders. It does this across a portfolio of investments enabling investors, through a single investment in the investment company, to gain a share of that broader portfolio.

By pooling their capital with others, investment company investors can access a broader range of assets and spread their risk. Investment companies are sometimes described as 'closed-ended' because they have a fixed amount of share capital – unlike 'open-ended' funds which create and redeem units as investors put in or withdraw money.

An investment company has two key defining attributes:

– It invests in a portfolio of assets

An investment company does not have any operations or executive management in the way that a trading business might. It has an independent board which appoints an investment manager to invest the company's assets. That asset manager actively selects the investments and does so across a range of assets creating a portfolio. Investment companies do not passively follow an index.

The portfolio spreads the risk for the investor in the investment company. This diversification may be across multiple different asset types, or in the case of some investment companies with very specific investment themes may be diversification within a specific asset type.

– Its shares are traded on a stock market

The shares of investment companies are traded on a stock market. The growth of online investment platforms means that investors can buy and sell the shares with relative ease whenever the market is open.

Investors trade the shares of the investment company with other investors. This trading has no impact on the assets of the investment company itself and, as such, the pool of capital available to the fund manager is fixed – in other words, it is not subject to money inflows or outflows in the same way as other forms of collective investment.

There are three main types of investment company: investment trusts or companies, real estate investment trusts (REITs) and venture capital trusts (VCTs). Investors in VCTs benefit from a tax break at the point funds are first invested into the VCT. VCTs have to invest in more nascent early-stage businesses and are part of the growth capital ecosystem.

Table comparing open-ended funds and closed-ended investment companies

	Open-ended	Closed-ended	Consequence
Income	All income must be distributed in each accounting period.	Up to 15% of the fund's income can be retained in a revenue reserve.	Allows closed-ended funds to smooth income distributions through good and bad periods giving investors greater certainty.
Capital	Capital will vary according to unit creations and redemptions as investors enter/leave the fund.	Capital is fixed, except where the company decides to issue/buy back shares.	Fixed pool of capital enables closed-ended managers to be more fully invested and to take a longer-term view. Also enables investment in less liquid assets.
Borrowing	Cannot use gearing.	Can use gearing.	Enables closed-ended funds to increase exposure to target assets. Can amplify gains/losses. Adds to risk.
Pricing	Price set at net asset value at each trading point.	Price set by the market based on supply and demand for the shares.	Closed-ended funds may trade at a premium or discount to the net asset value.
Trading	Directly with the fund manager.	Via a stock market through a broker or investment platform.	Open-ended funds typically trade at a price fixed once a day, closed-ended vehicles trade continuously through the day and often trades settle in a shorter timeframe.
Governance	No independent board. Limited unitholder participation.	Independent board. Active shareholder role in governance.	The independent board protects shareholder interests, e.g. negotiating management fees. Shareholders of listed closed-ended funds can participate by attending AGMs and voting on company matters.

The investment company sector: an overview

Number of companies

382

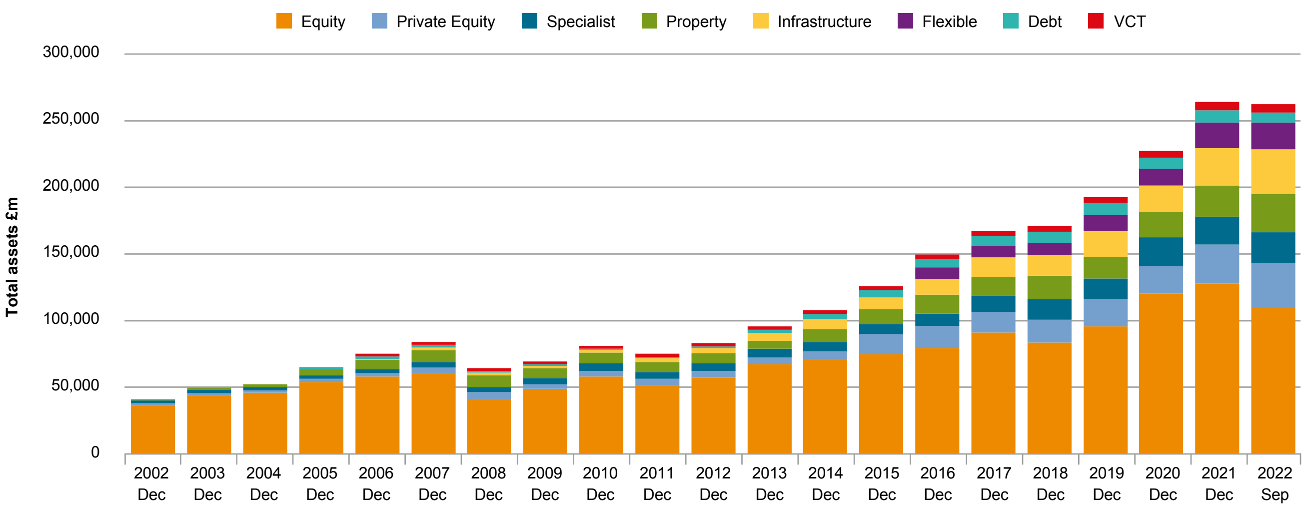
(of which 354 are AIC members)

Assets under management

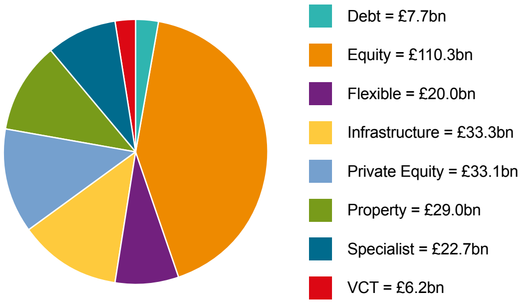
£262bn

(of which AIC members manage £243bn)

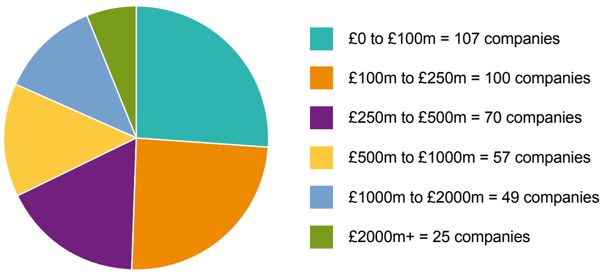
Total assets – sector type breakdown over time



Total asset breakdown by sector type



Investment company breakdown by size



Dividends

£25bn

(the total dividends distributed in the last 5 years 2017-2021)

Fundraising

£46.5bn

(raised in the last 5 years)

There are…

4

FTSE 100

investment companies

and…

87

FTSE 250

investment companies

Gender diversity

43%

of FTSE 350 investment company directors are women

Data as at September 2022

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A UK success story

Since their earliest days, investment companies have provided industries with long-term capital and have facilitated investment into the frontier markets of the time – enabling investors to meet their needs for growth, income and risk diversification. By opening up opportunities in more sectors and asset classes, and by appealing to a growing range of investors, the sector continues to go from strength to strength.

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Investment companies in the UK can trace their history back over 150 years. They were a British invention and, whilst other markets now also have listed closed-ended funds, the UK market is the world's largest. In recent years, it has overtaken its US equivalent, is larger than the listed investment company market in Australia and there is no comparable sector within the EU.

Most investment companies are listed on the London Stock Exchange (LSE). Investment companies listed on the LSE now include four members of the FTSE 100 and 87 members of the FTSE 250. Whilst choosing to list in London, the companies themselves are domiciled in various countries around the world. The majority are domiciled in the UK, but many are based in the Channel Islands with others located in the EU, Canada, the US and beyond. Guernsey and Jersey-based funds make the Channel Islands the most popular domicile for London-listed companies after the UK.

These companies have given investors, and individual investors in particular, access to active investment management across a wide range of asset classes. Thanks to the ready availability of online trading and investment accounts, private investors account for a significant and increasing proportion of the share registers of investment companies and have benefitted from strong long-term returns. In January 2022, interactive investor stated that their younger customers (18-24) had outperformed their overall customer base due to a "higher than average allocation to investment trusts" [(1)].

Investment companies are also providing a way of diversifying portfolios and accessing different asset classes. For example, a significant proportion, estimated to be 30% [(2)], of the £17.3bn of share capital of companies within the AIC's renewable energy infrastructure sector is held by individual investors. This represents capital that would not otherwise have been invested in that sector.

The success of the UK investment company sector has led to interest from overseas markets and it continues to innovate in some vital areas. For example, the recent launch of a sustainable forestry investment company shows the potential for investment companies to contribute to the LSE's Voluntary Carbon Market initiative. The closed-ended structure is ideal for holding carbon credit producing assets such as forests, enabling investors to access and support the creation of those carbon credits either for offset or investment purposes.

The investment company sector is a UK success story and should be celebrated as such. Heralding the sector in this country and overseas, fostering more companies to be created and listed here, encouraging more innovation, building on the heritage and experience of the last 150 years for the benefit of investors and the wider economy, should be the ambition of all policymakers and regulators.

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TERM

The broader economic backdrop

As a country and as individuals, the UK needs to save and invest more to safeguard future economic wellbeing. Investment companies provide an ideal structure to support patient long-term investment. By providing a fixed pool of capital, they enable fund managers and investors to look beyond short-term volatility and focus on the bigger investment picture instead.

It is difficult to overstate how much the global economic situation has changed. The table below sets out some of the key economic data and how in the space of 12 months that has dramatically altered.

Indicator	A year ago	Today
GDP growth	1.3% (Q4 21)	0.2% (Q2 22)
Base rate	0.1% (Nov 21)	3.0% (Nov 22)
Inflation rate (CPI)	3.1% (Sept 21)	10.1% (Sept 22)

Such economic turbulence impacts investor appetite. The Investment Association reported that net retail fund sales were £19.3bn in the second half of 2021 but the first half of 2022 saw net outflows of £11.9bn (3). These outflows from open-ended retail funds in the first half of 2022, which accelerated further in Q3 2022, will have resulted in the asset managers of those funds selling investments, potentially into markets with falling prices and at times when they would not willingly choose to sell.

Investing is a long-term activity, particularly for individual private investors looking to build a portfolio, manage that portfolio and ultimately derive an income in retirement from those assets. During times of economic turbulence it is important to take a long-term view, look beyond the short-term volatility, and be invested in a vehicle which enables that. **Investment companies, including those investing in other listed equities, provide a fixed pool of capital, enabling managers to take a long-term view and have demonstrated their resilience through multiple economic cycles.**

The UK household savings ratio currently stands at a little over 7% [4] and has been declining following a sharp spike during the Covid pandemic. It has been in decline for many years – between 1970 and 1999 it averaged 9.5% while from 2000 up to the pandemic it averaged 7%. With an aging population and increasingly stretched public finances supporting the most vulnerable, it is widely recognised that as a country we individually and collectively need to save and invest more.

The Financial Conduct Authority has recognised the need for increased savings and investment, not least through its Consumer Investment Strategy. This sets specific targets for reducing the number of consumers (currently estimated at 8.6 million) holding more than £10,000 of investible assets in cash [5].

However, since the global financial crisis the number of publicly traded companies has fallen substantially. For example, between January 2015 and September 2022 the number of companies with shares traded on the London Stock Exchange fell from 2,429 to 1,970 [6] – a decline of 19%.

This means fewer choices for investors and a smaller investible universe for funds which invest in listed equities. This decline is not unique to the UK with other markets such as the US seeing a similar decline in the number of publicly listed companies. This has been driven partly by over a decade of low interest rates and quantitative easing. These monetary policy responses to the global financial crisis inflated asset prices and made borrowing cheap which helped fuel the resources available to private capital. This has resulted in more merger and acquisition activity, more companies being taken private and fewer coming to the public market in the first place. In short, it has led to a greater concentration of returns in private capital. **Investment companies can enable investors to access a wider range of assets including unlisted and real assets which have typically been the preserve of private capital.**

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The case for investment companies

Since their beginnings, investment companies have helped to open up investment to a much broader range of people. Perhaps most important of all, the sector has enabled more modest investors to access some of the world's most dynamic and cutting-edge markets – democratising capital and enabling everyone to harness the best opportunities to meet their investment goals.

Delivering results – focusing on consumer outcomes

Investors' primary concern is, of course, the performance of their investments. Investment companies, as a consequence of many of their structural advantages, have the potential to deliver superior long-term performance.

This is backed up by the data which shows that over ten years to the end of September 2022, investment companies outperformed their open-ended fund equivalents in 11 out of 16 sectors.

Investment companies versus OEICs/Unit trusts: total return on £100 over ten years

Sectors	Investment companies	OEIC/ Unit trusts
Global	283.03	270.82
Global Equity Income	248.25	250.90
Flexible	180.90	193.77
UK Equity Income	187.72	177.59
UK All Companies	207.55	182.27
North America	295.25	355.78
Europe vs. Europe ex UK	249.89	229.21
Global Emerging	187.58	158.23
Asia Pacific vs. Asia Pacific ex Japan	266.99	203.51
Japan	296.33	243.13
Property – UK Commercial vs. UK Direct	172.19	160.00
UK SmallCap	234.28	236.54
Japanese SmallCap	309.45	302.48
TMT	594.24	448.83
European SmallCap	306.68	249.41
North American Smallers	308.20	312.72

Indicates investment company outperformance vs. OEIC/unit trust performance over ten years.

Indicates OEIC/unit trust outperformance vs. investment company performance over ten years.

Shareholder total returns to 30 September 2022 (unweighted, £ adjusted, base = 100)

Source: AIC/Morningstar. The investment company data is unweighted share price total return. OEIC/unit trust data is unweighted total return. The AIC accepts no responsibility for any errors or omissions in this table or for any loss occasioned to any person or organisation acting or refraining from action as a result of any material contained or any omissions.

Whilst past performance may not be a sure indicator of future performance, this long-term outperformance, which is after taking into account management fees, should in and of itself, cause investors to consider investment companies within their portfolio.

The London stock market experienced a long period of growth – a bull run – from the financial crisis to 2019. In the ten years from January 2009 to January 2019 the FTSE All Share rose from 2079 to 3852 – a rise of 85%. This was part of the increase in asset prices fuelled by low interest rates and quantitative easing. Today it stands a little below the level it was at in January 2019.

During a sustained period of increasing asset values on the stock market passive investment management – in other words, just following an index – can perform strongly. It can be harder to find outperformance sufficient to offset the additional costs of active asset management in strongly rising markets. Even so, between January 2009 and January 2019 investment companies collectively delivered a total share price return of 275% as compared to the global equity market's return of 237%, and the UK market's 164% (7).

In more challenging market conditions, active asset management means managers can differentiate between companies in the search for better performance. Investment companies are all actively managed and have the ability to invest in a wide range of companies, helping managers deliver.

Active management is not unique to investment companies but combining with the structural advantages that investment companies possess, creates an investment which has the potential to deliver superior performance. Investment companies' track record of delivering results for investors is a key reason all investors should consider including investment companies in their portfolios.

Case study: investment companies holding listed equities

In terms of those investment companies that invest in other listed equities, three particular benefits are of note in helping managers deliver performance for investors.

– Ability to take **a long-term view** and not having to sell assets into a falling market. The fixed pool of capital means investment managers can be fully invested and hold on to investments over the long term and not to be forced to sell, often some of their most valuable or most liquid assets, just to meet unit redemptions. This reduces churn in the portfolio.

– Ability to invest in **smaller cap companies**. As a result of the fixed pool of capital, and therefore the absence of a need to always have immediate liquidity in the underlying investment portfolio, investment managers can invest in smaller cap, less liquid quoted companies. The investment company structure enables them to invest more freely across a broader range of listed companies in terms of size and it is often in the smaller cap elements of the market and portfolio that the greatest opportunities for capital growth exist. Mixing some smaller cap exposure within a principally large cap portfolio can help increase the potential returns.

– Ability to **smooth income**. During times of economic turbulence company dividends often come under pressure. This may reduce the income being generated from a portfolio of listed equities. The fact that investment companies can hold back some of their income and therefore smooth their dividend payments to shareholders over time means that, through the economic cycle, investment companies have the potential to deliver more consistent income for investors.

Democratising capital

One of the difficulties faced by individual private investors is how to access a wide range of different assets when many of those have only been widely available to institutional or large sources of private capital. These investments may involve higher risks but often have the potential for higher returns and have typically been inaccessible to individuals wishing to invest. Private equity, real assets, nascent technologies, infrastructure and property are all examples of such asset classes.

The oldest investment company – now called F&C Investment Trust and in the FTSE 100 – said in its original prospectus that its objective was to "provide the investor of moderate means the same advantage as the large capitalist". It provided a pioneering opportunity for ordinary people to invest in the bonds of foreign governments. Investment companies have been following this mantra for over 150 years since F&C Investment Trust was launched, opening up opportunities for investors that would not otherwise exist.

Investment companies pool the risk of many investors across multiple assets. They provide a structure which is suitable for holding less liquid or indeed illiquid assets. Their shares are traded on a stock market. At a prevailing market price that a willing buyer is prepared to pay, they offer liquidity whenever the market is open regardless of the liquidity in the underlying asset class.

When F&C Investment Trust was launched in 1868 it gave investors access to foreign markets. Since then investment companies have been launched which invest in equities around the globe, and more recently in new technologies such as renewable energy, in infrastructure, in space technology and in music rights – something which investors in 1868 could not have even conceived of as ever being an asset class.

The sector has proven itself to be innovative and adaptable ever seeking new ways to provide investors with access to the frontier markets of the day.

Never has this been more important than today when there is both increasing demand from private investors, an ever pressing need to save and invest more, and over recent years a shrinking listed equity universe. Without investment companies, investors, specifically non-institutional and individual private investors, would not be able to access these asset classes, benefit from the returns on offer, contribute their capital to these important sectors of the economy, or diversify their portfolios as effectively.

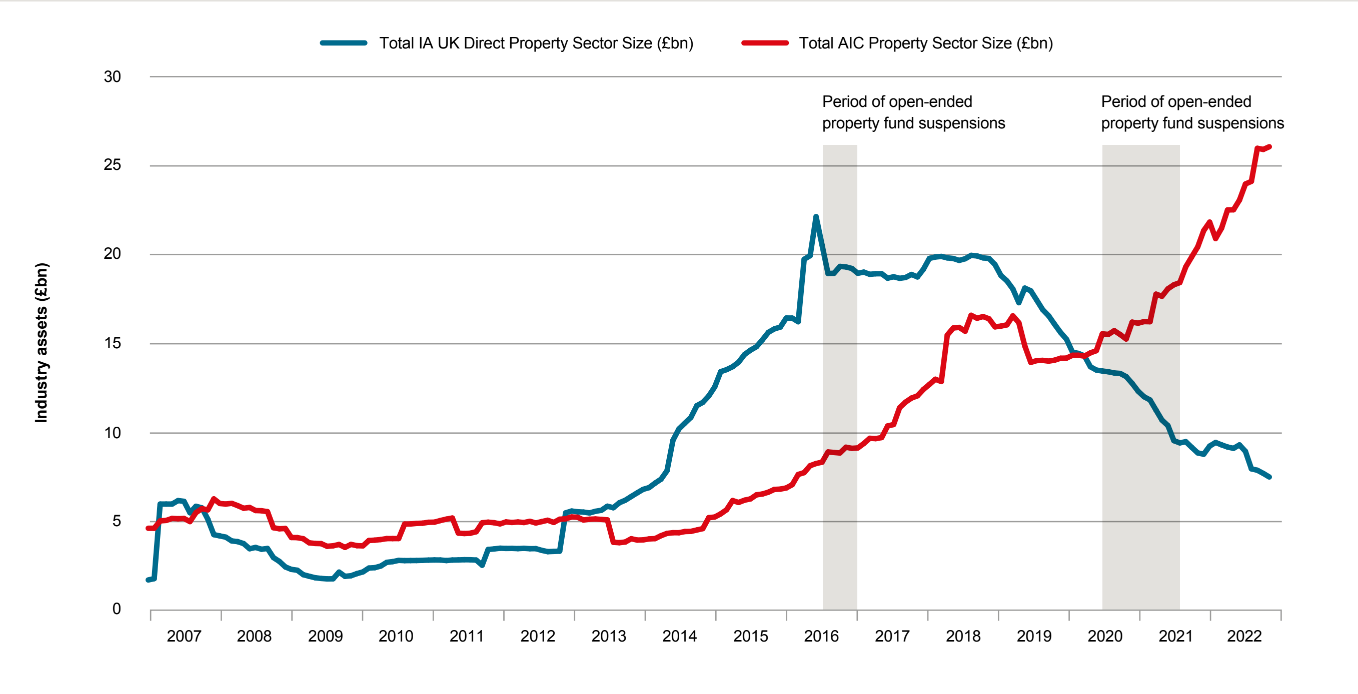
Attempts have been made to provide access to many of these asset classes through other investment vehicles, notably open-ended collective funds. However, the liquidity mismatch between an open-ended vehicle with unit redemptions and the underlying illiquid investments which may need to be sold to meet those redemptions has repeatedly ended in difficulty for the investor. Only investment companies and their unique structure can, as they have proven, really offer investors a reliable means of accessing frontier markets and illiquid asset classes, democratising capital to the benefit of all.

Case study: property

The property sector offers a direct comparison between closed-ended investment companies and open-ended property funds.

The advantages of the closed-ended sector have enabled it to continue to invest, provide investors liquidity and deliver returns throughout various economic cycles and crises which have seen open-ended funds go through repeated bouts of suspensions. The data since 2016 shows a complete reversal in the amount of assets held in open-ended as compared to closed-ended property funds.

Property sectors compared – industry asset size



IA September 2022 figures are based on a number of carried over figures from August due to reporting lag.

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Structural advantages

Investment companies benefit from a number of important structural advantages which underpin their potential to deliver superior performance. It is these advantages which are fundamental to investment companies' unique ability to democratise capital, fund growth and meet investors' needs.

Five specific structural advantages are highlighted here. Collectively they enable investment companies to deliver for investors and to make their broader economic contribution as a critical part of the investment landscape.

Fully invested for the long-term

Investment companies can be fully invested without needing to maintain a pool of liquidity to meet unit redemptions and creations.

The nature of investment companies' fixed pool of capital means that, unlike open-ended funds, the asset manager does not have to be concerned with funding unit redemptions or managing inflows for unit creations. There is no need to maintain an element of cash within the portfolio to meet the demands from investors wishing to redeem their units. Similarly, there is no performance drag from cash held as a result of unit creations waiting to be invested.

Investment companies can instead be fully invested. This ensures that investors are getting the full benefit of having the pool of capital working on their behalf. There is no drag on performance from cash. The drag which uninvested cash can have on portfolios is greater when interest rates are low and cash is therefore delivering a very limited return or when real interest rates are negative and inflation is in effect destroying value.

The difference in the amounts of cash held within comparable investment strategies has been greatest where the asset classes invested in are most illiquid. The property sector is the most obvious example and is used as a case study earlier in this report showing how closed-ended fund structures are best for illiquid assets. Open-ended fund managers, rather than holding cash, can be required to sell their most liquid assets to meet redemption requirements potentially into falling markets or at times when they would not choose to do so. Investment companies can instead remain fully invested for the long-term.

Asset classes and diversification

Investment companies have always provided access to a diverse range of asset classes, including frontier markets to which investors cannot otherwise gain exposure.

From the very origins of investment companies, as set out earlier, they have offered investors access to a range of asset classes. This has become more and more diverse over time and from the origins of investing in multiple global equities markets and sectors, now covers a wide range of private capital and unquoted assets often in emerging technologies or asset classes.

The fixed pool of capital, which is a key feature of investment companies, makes them ideally suited to holding less liquid assets. This may be through investing exclusively in a sector where the assets are real physical assets or unquoted equities, for example, infrastructure or private equity. It may though also be through holding some unquoted investments alongside listed ones. This mixed approach has been used by asset managers in listed equities to seek to boost returns through accessing the growth potential inherent in smaller or more nascent unquoted companies.

Open-ended fund structures have, on occasion, sought to gain exposure to these unquoted investments and typically, other than property funds, have a limit of 10% as the maximum they can invest in such assets. However, this has been shown to be a high risk strategy as redemptions can lead to a fall in the fund's value, an increase in the percentage exposed to those higher risk unquoted investments and ultimately the potential fire sale of such assets in an attempt to maintain liquidity to meet redemptions and stay within their investment limits. Investment companies suffer no such pressures and can therefore offer investors access to these asset classes, either as a whole mandate or as a part of a broader mandate.

A key aspect of any quality investment portfolio, particularly for a private investor, is to ensure a degree of diversification across a range of assets. Investment companies can provide the vehicle through which investors can gain access to a wider range of asset classes and therefore better diversify their portfolios. With a shrinking listed market and low interest rates focusing returns within private capital, this has become all the more important.

Income smoothing

Investment companies do not have to pay all their income out each year and can therefore hold some income back and smooth dividend payments between times of bounty and challenge.

Investment companies generate income through dividends from their investments and from the periodic realisation of capital gains. They can distribute this income as dividends to their shareholders. However, they do not have to distribute all of the income they receive and have the ability to retain **up to 15%** of their income each year. They can also choose to pay dividends **out of capital** should their shareholders wish.

This feature of the investment company structure means that boards can smooth dividend payments to shareholders, holding some income back in good times to enable dividends to continue to be paid during more straitened periods. For shareholders, this has a significant benefit of providing greater confidence in the income streams their investments will likely generate.

The most recent demonstration of the benefit of this aspect of the structure came in the wake of the Covid pandemic. In 2020 64% of investment companies yielding more than 1% increased their dividends, a further 22% held them flat. In the open-ended sector, of the funds yielding more than 1% just 23% increased or maintained them [8].

Some investment companies have made a virtue of this particular feature of the structure and have been able to progressively increase their dividend payments to shareholders year on year for an impressive period of time. Seven have managed to do so for over 50 years – a period stretching back through a number of economic booms and busts. A significant number more, as shown in the table opposite, have increased dividends year on year for over 20 years.

Dividend heroes

Company	AIC sector	Number of consecutive years dividend increased	Yield %
City of London Investment Trust	UK Equity Income	56	5.10
Bankers Investment Trust	Global	55	2.22
Alliance Trust	Global	55	2.50
Caledonia Investments	Flexible Investment	55	1.90
Global Smaller Companies Trust	Global Smaller Companies	52	1.33
F&C Investment Trust	Global	51	1.50
Brunner Investment Trust	Global	50	2.25
JPMorgan Claverhouse Investment Trust	UK Equity Income	49	4.83
Murray Income	UK Equity Income	49	4.72
Scottish American	Global Equity Income	48	2.81
Witan Investment Trust	Global	47	2.55
Merchants Trust	UK Equity Income	40	5.21
Scottish Mortgage Investment Trust	Global	40	0.47
Value and Indexed Property Income	Property – UK Commercial	35	5.96
CT UK Capital & Income	UK Equity Income	28	4.27
Schroder Income Growth	UK Equity Income	27	4.95
abrdn Equity Income	UK Equity Income	21	7.01

Source: AIC/Morningstar

Governance and engagement

Investment companies have independent boards of directors to protect shareholder interests, and through their shareholding investors can actively engage with oversight and governance.

Just like any other corporate entity, investment companies have a board of directors. As with any other company this board will have a chair and various board committees covering topics such as audit and risk and remuneration. This offers a higher quality of governance and independent oversight than is available in the open-ended fund sector.

The investment company board differs from other companies as there is typically no executive management. The board generally comprises just non-executive directors with responsibility for the oversight of the company and protecting shareholders' interests. The company and board have to comply with all the requirements which exist for other companies and specifically other listed companies. This includes requirements around reporting, diversity and shareholder engagement.

Directors have certain legal obligations as directors of the company, and the company secretary similarly has certain legal obligations. This creates a layer of supervision and oversight specifically to protect the interests of the shareholders. For example, typically investment company boards outsource all their activities, the main function being that of asset management. The board has to affirm on an annual basis that the reappointment of the asset manager is on terms which are in shareholders' best interests. As with other corporate entities the auditors also have to report annually to the shareholders.

Investment companies hold an annual general meeting each year. Shareholders can vote on all aspects of governance from the appointment of the board to the annual report and the appointment of auditors. The board has to produce an annual report which is available to all shareholders and there is a requirement to maintain a website for the company on which all information which may be of relevance to investors can be found. This all enables the company's shareholders to engage with the company in broader and deeper ways than are possible with other collective investments.

Borrowing to invest (or gearing)

Investment companies have the ability to borrow money to invest. This 'gearing' can amplify returns if used carefully and successfully. It can also increase risk, including exposure to interest rate risk.

The board of an investment company can decide to borrow money in order to fund further investments. If the investment strategy is successful the investment performance more than covers the cost of the gearing and this can amplify the returns for shareholders. This can though increase risk and, if the investments do not perform, then the borrowing can equally amplify any losses.

Not all investment companies use gearing and those that do tend to use it at modest levels.

The impact of gearing

	Initial position	Total assets grow by 10%	Total assets fall by 10%
Total assets	100	110	90
Borrowing	20	20	20
Net assets	80	90	70
Change in net assets	-	+12.5%	-12.5%
Gearing	25%	22.2%	28.6%

Funding growth, new technologies and the transition to net zero

Investment companies provide a vital conduit for investor capital into new technologies and asset classes. In doing so they help fuel growth and are helping fund the transition to net zero.

WTH

Investment companies have always provided access to the frontier markets of the day. The fixed pool of capital and other structural advantages enable them to offer access to, and invest in, a wide range of assets including companies whose equity is not listed and in real assets.

Venture Capital Trusts (VCTs) are a vital element of the investment company sector and focus on investing in fast-growing businesses and new technologies. VCTs, helped by the provision of a tax break for investors, draw in and pool capital from individual investors which would not otherwise be available to these younger companies. They play a vital role in the chain of growth capital helping companies fund their growth from their early stages into more mature larger scale enterprises. The AIC explored this sector in more detail in its report, 'Funding Opportunity' (9).

The UK economy needs significant investment in infrastructure, technology and in the transition to net zero. Productivity in the UK has been a particular problem, falling in the aftermath of the 2008 global financial crisis and not recovering. This is demonstrated in ONS data from January 2022 which shows that the rate of growth in output per hour in the UK was one of the lowest in the G7 (10). The UK has lower productivity than the US, France and Germany. The solution to this productivity challenge lies in investment in infrastructure and technology. **Investment companies can help direct capital to these sectors.**

In recent times, with increased focus on global climate change targets, interest in Environmental, Social and Governance (ESG) investing has increased. Looking specifically at the environmental aspects, the UK has ambitious targets for reaching net zero which can only be delivered through significant investment in renewable energy and related technologies. These are relatively nascent and exist within businesses which are not typically yet floated on a stock market. In some cases, the investments may also take the form of actual physical assets, for example, wind or solar farms.

Investment companies have provided a conduit for significant capital to be invested in this area to contribute to economic growth and the transition to net zero. They have done so drawing in both institutional and private individual investor capital, not just to invest directly into assets but also through the provision of liquidity and replacement capital for existing businesses and assets allowing initial development capital to be recycled.

There are 22 companies in the AIC's renewable energy infrastructure sector. Collectively they manage over £17.3bn of assets. None of the companies existed ten years ago. This is all new capital which the investment company structure has enabled to be directed into this vital area of the economy, and whilst not all of the assets invested in are necessarily UK-based, a great many are. The capital has been drawn from many sources but these include individual private investors who would not otherwise have had access to these asset classes – this is therefore additive to institutional and other capital which would have come from sources that the original F&C Investment Trust prospectus may have classified as the 'large capitalists'. In other words, the investment company structure has channelled capital and democratised access to those assets.

Renewable energy infrastructure: facts and figures

Funds raised since 2017
£11bn

Number of companies
22

Total assets
£17.3bn

Average yield
5%

Total assets managed in 2022
66% UK 34% non-UK

C M

The competitive struggle

Despite their many valuable features, investment companies are still not as widely understood or used by investors, whether individuals, wealth managers or institutions, as they could be. There is an historic general market preference for open-ended funds – despite the structural advantages that closed-ended investment companies clearly offer.

PETE

Commercial drivers can create a bias towards open-ended funds

It may seem logical to ask that if the case for investment companies is so compelling, why are there not more of them? Why are they not the predominant investment vehicle for investors?

Historically open-ended funds could pay trail commission to distributors – advisors and investment platforms – for the sale of units in their funds. This incentivised distribution of these products to the detriment of others, and had the potential to distort the distribution of products to investors. This was brought to an end following the Retail Distribution Review in 2012. However, much of the structural bias towards open-ended funds still persists within the financial system, especially in the advice market.

In addition to this, there are a number of aspects of investment companies and open-ended funds which encourage investment managers towards a preference for open-ended vehicles, despite the structural advantages of closed-ended investment companies. In particular, open-ended funds can be grown more easily through marketing efforts thus increasing management fees, there is no independent company board which may decide to change asset manager, open-ended funds can be launched more cheaply and their expansion does not require shares to be issued with a prospectus and the associated costs.

For these reasons, there is a bias towards open-ended structures even in the face of the strong evidence which underpins the case for investment companies. The property sector highlights this as a case in point. Many more open-ended funds were launched and they dominated the market for a period. Eventually, through various economic cycles and repeated issues, the continued growth of the investment company property sector as compared to the decline of its open-ended peer, suggests the markets have determined that these assets are best held in closed-ended structures. This did not stop the bias towards launching open-ended structures in the first instance.

It is also only reasonable to recognise that there are some factors of investment companies which should be taken into account when deciding to invest. The trading of shares at the market price, driven by supply and demand, creates premiums and discounts which have to be understood by investors. The regularity with which net asset values are produced can be less frequent for investment companies that invest in illiquid assets, as compared to open-ended funds investing in listed securities which typically produce a daily valuation. Investment companies' shares are traded on the stock market but for investors wishing to trade large quantities or values of shares, for example pension funds, the volume of shares traded daily (i.e. the liquidity) of the investment company may not be sufficient to dispose of a holding in one day.

Despite these challenges, investment companies continue to perform a vital role in democratising capital and delivering results for investors. Policymakers, regulators and others should do all they can to ensure a level playing field on which investment companies can compete allowing their structural advantages to come to the fore for the benefit of investors.

VISI

The AIC

The Association of Investment Companies (AIC) has a bold vision, to ensure that closed-ended investment companies are considered by every investor. To that end, we represent and promote the interests of more than 350 companies managing over £240 billion of assets on behalf of their shareholders.

The Association of Investment Companies (AIC) is the trade association that represents the interests of the investment company sector. For more information and to access the wealth of information on the sector and tools to help decide which investment companies might be right for you, please visit our website: **www.theaic.co.uk**

Our membership covers 93% of the UK and Channel Islands domiciled investment companies that are traded on UK stock markets. Collectively our 354 members manage £243bn of assets on behalf of their shareholders.

Our vision is:
For closed-ended investment companies to be considered by every investor.

Our mission is:
To support and promote the long-term benefits of investment companies by engaging with members, investors, and the wider financial community.

The activity of the AIC falls broadly into three main areas:

Support:

- We support members through our regulatory and lobbying work. We provide substantial information and resources particularly for member company directors. We also seek to provide guidance and examples of best practice on key topics.
- We support investors whether self-directed or advisers/wealth managers, helping them make informed decisions when using closed-ended investment companies as part of an actively managed diversified portfolio of assets through the provision of information, research and ‘best-in-class’ tools.
- We support the wider financial community, fostering their interest in investment companies through our lobbying work, working groups, information sharing and website resources. We work with policymakers, regulators, other industry participants and trade bodies to help their understanding of our members and the benefits they deliver for the economy and investors.

Promote:

– We promote members to investors through our communications work, our website, our training activities, and any other appropriate means.

– We promote the broader virtues of closed-ended investment companies to investors, actual and potential, and the benefits of including them in a diversified portfolio. Regardless of the level of prior knowledge, the tools and information on our website enable investors of all levels of experience to learn more about our sector, our members and ultimately to undertake extensive research.

– In all our support work and engagement activity we proactively seek opportunities to promote to the wider financial community the benefits of the closed-ended investment company structure, its access to a wide range of asset classes and its potential for superior returns.

Engage:

– We engage with members through events, both physical and virtual. We produce regular newsletters and other communications, provide training alongside a wide range of material designed to assist member directors, and we maintain a wealth of information on our member website. Our activity is also designed to enable members to engage with each other, benefiting from others' experiences.

– We engage with investors both potential and actual through our website, newsletters and communications work. We hold events for investors designed to enable members to connect directly with those investors. We engage with the platforms and advisers through which many investors manage their activity, including providing information and training to financial advisers.

– We engage with the wider financial community through active participation in industry groups, through our working groups particularly for key market participants such as management groups and brokers, and through broader communication and lobbying work.

Our members

The AIC represents 354 member companies. The table below lists these companies grouped by their AIC sector, and shows their total assets under management as at 30 September 2022.

Company	Total assets (£m)*
Asia Pacific	
abrdn New Dawn	355
Asia Dragon	616
Pacific Assets	467
Pacific Horizon	593
Schroder Asian Total Return	496
Schroder AsiaPacific	891
Asia Pacific Equity Income	
abrdn Asian Income	442
Henderson Far East Income	410
Invesco Asia	249
JPMorgan Asia Growth & Income	367
Schroder Oriental Income	715
Asia Pacific Smaller Companies	
abrdn Asia Focus	527
Fidelity Asian Values	412
Scottish Oriental Smaller Companies	361
Biotechnology & Healthcare	
Bellevue Healthcare	1,112
Biotech Growth	450
International Biotechnology	311
Polar Capital Global Healthcare	442
RTW Venture	278
Worldwide Healthcare	2,386

Company	Total assets (£m)*
China / Greater China	
abrdn China	284
Baillie Gifford China Growth	184
Fidelity China Special Situations	1,564
JPMorgan China Growth & Income	348
Commodities & Natural Resources	
Baker Steel Resources	86
BlackRock Energy and Resources Income	170
BlackRock World Mining	1,330
CQS Natural Resources Growth & Income	162
Geiger Counter	76
Riverstone Energy	586
Country Specialist	
JPMorgan Russian Securities	19
Vietnam Enterprise Investments	1,627
VietNam Holding	99
VinaCapital Vietnam Opportunity	974
Weiss Korea Opportunity	118
Debt – Direct Lending	
BioPharma Credit	1,243
GCP Asset Backed Income	433
Honeycomb	921
Riverstone Credit Opportunities Income	83
RM Infrastructure Income	123

Company	Total assets (£m)*
SME Credit Realisation	30
VPC Specialty Lending Investments	293
Debt – Loans & Bonds	
Axiom European Financial Debt	85
CQS New City High Yield	269
CVC Income & Growth	216
Henderson Diversified Income	140
Invesco Bond Income Plus	323
M&G Credit Income	137
NB Distressed Debt	104
NB Global Monthly Income	179
TwentyFour Select Monthly Income	151
Debt – Structured Finance	
Blackstone Loan Financing	370
Chenavari Toro Income	183
EJF Investments	142
Fair Oaks Income	220
Marble Point Loan Financing	135
TwentyFour Income	611
Volta Finance	203
Environmental	
Impax Environmental Markets	1,304
Jupiter Green	53
Menhaden Resource Efficiency	103

Company	Total assets (£m)*
Europe	
Baillie Gifford European Growth	365
BlackRock Greater Europe	451
European Opportunities	846
Fidelity European	1,415
Henderson European Focus	345
Henderson EuroTrust	286
JPMorgan European Growth & Income	429
European Smaller Companies	
European Assets	334
European Smaller Companies	660
JPMorgan European Discovery	716
Montanaro European Smaller Companies	248
Farmland & Forestry	
Foresight Sustainable Forestry	179
Financials	
Polar Capital Global Financials	555
Flexible Investment	
Aberdeen Diversified Income & Growth	375
Bailiwick Investments	91
Caledonia	2,781
Capital Gearing	1,232
Castelnau Group	144
CT Global Managed Portfolio	150

Company	Total assets (£m)*
Global Opportunities	103
Hansa Investment Company	355
Invesco Select Trust	206
Investment Company	16
JPMorgan Global Core Real Assets	242
JPMorgan Multi-Asset Growth & Income	73
MIGO Opportunities	82
Momentum Multi-Asset Value	52
Personal Assets	1,811
RIT Capital Partners	4,364
Ruffer Investment Company	1,053
Schroder BSC Social Impact	90
Tetragon Financial Group	2,303
UIL	410
Global	
Alliance Trust	3,078
AVI Global	1,092
Bankers	1,485
Blue Planet Investment Trust	9
Brunner	476
F&C Investment Trust	5,165
Keystone Positive Change	153
Lindsell Train	206
Martin Currie Global Portfolio	265

Company	Total assets (£m)*
Mid Wynd International	446
Monks	2,488
Scottish Mortgage	14,202
Witan	1,777
Global Emerging Markets	
Barings Emerging EMEA Opportunities	75
BlackRock Frontiers	370
Fidelity Emerging Markets	626
Fundsmith Emerging Equities	365
Gulf Investment	85
JPMorgan Emerging Markets	1,358
JPMorgan Global Emerging Markets Income	441
Mobius Investment	136
Templeton Emerging Markets	2,022
Utilico Emerging Markets	522
Global Equity Income	
British & American	8
Henderson International Income	360
JPMorgan Global Growth & Income	1,378
Majedie	138
Murray International	1,754
Scottish American	935
Securities Trust of Scotland	240

Company	Total assets (£m)*
Global Smaller Companies	
Edinburgh Worldwide	896
Global Smaller Companies Trust	876
Herald	1,274
Smithson	2,312
Growth Capital	
Chrysalis Investments	936
Petershill Partners	3,976
Schiehallion	1,115
Schroder British Opportunities	74
Schroder UK Public Private Trust	287
Seraphim Space	249
Hedge Funds	
Alternative Liquidity Fund	18
BH Macro	1,354
Boussard & Gavaudan Holding	309
Gabelli Merger Plus+	87
Third Point Investors	603
India	
Aberdeen New India	453
Ashoka India Equity	230
India Capital Growth	138
JPMorgan Indian	795

Company	Total assets (£m)*
Infrastructure	
3i Infrastructure	2,888
BBGI Global Infrastructure S.A.	1,056
Cordiant Digital Infrastructure	823
Digital 9 Infrastructure	910
GCP Infrastructure Investments	1,167
HICL Infrastructure	3,315
International Public Partnerships	2,971
Pantheon Infrastructure	472
Sequoia Economic Infrastructure Income	1,789
Infrastructure Securities	
Ecofin Global Utilities and Infrastructure	259
Premier Miton Global Renewables	49
Japan	
abrdn Japan	92
Baillie Gifford Japan	879
CC Japan Income & Growth	245
Fidelity Japan	284
JPMorgan Japanese	851
Schroder Japan Growth	311
Japanese Smaller Companies	
Atlantis Japan Growth	85
AVI Japan Opportunity	165
Baillie Gifford Shin Nippon	609

Company	Total assets (£m)*
JPMorgan Japan Small Cap Growth & Income	214
Nippon Active Value	148
Latin America	
abrdn Latin American Income	43
BlackRock Latin American	137
Leasing	
Amedeo Air Four Plus	1,309
Doric Nimrod Air Three	144
DP Aircraft I	221
Taylor Maritime Investments	505
Tufton Oceanic Assets	401
Liquidity Funds	
JPMorgan Elect	333
North America	
Baillie Gifford US Growth	659
BlackRock Sustainable American Income	166
Canadian General Investments	766
JPMorgan American	1,473
Middlefield Canadian Income Trusts	175
North American Income	478
Pershing Square Holdings	10,058
North American Smaller Companies	
Brown Advisory US Smaller Companies	168
JPMorgan US Smaller Companies	290

Company	Total assets (£m)*
Private Equity	
abrdn Private Equity Opportunities	1,125
Apax Global Alpha	1,185
CT Private Equity	523
Dunedin Enterprise	76
HarbourVest Global Private Equity	3,253
HgCapital	2,027
ICG Enterprise	1,208
JPEL Private Equity	48
Literacy Capital	207
LMS Capital	47
NB Private Equity Partners	1,253
Oakley Capital Investments	1,109
Pantheon International	2,548
Princess Private Equity Holding	854
Property – Debt	
Develop North	23
ICG-Longbow Senior Secured UK Property Debt Investments	82
Real Estate Credit Investments	440
Starwood European Real Estate Finance	408
Property – Europe	
abrdn European Logistics Income	569
Phoenix Spree Deutschland	705
Schroder European Real Estate	220

Company	Total assets (£m)*
Tritax Eurobox	1,491
Property – Rest of World	
Ceiba Investments	127
Macau Property Opportunities	181
Property – UK Commercial	
abrdn Property Income	533
AEW UK REIT	251
Balanced Commercial Property	1,352
Channel Islands Property	282
CT Property	412
Custodian REIT	677
Ediston Property	318
Life Science REIT	357
LXI REIT	2,652
Regional REIT	909
Schroder Real Estate	552
Supermarket Income REIT	1,852
UK Commercial Property REIT	1,716
Value and Indexed Property Income Trust	174
Property – UK Healthcare	
Impact Healthcare REIT	530
Target Healthcare REIT	916
Property – UK Logistics	
Tritax Big Box REIT	5,853

Company	Total assets (£m)*
Urban Logistics REIT	1,089
Warehouse REIT	957
Property – UK Residential	
Civitas Social Housing	1,030
Home REIT	1,165
PRS REIT	993
Residential Secure Income REIT	392
Triple Point Social Housing REIT	643
Property Securities	
TR Property	1,252
Renewable Energy Infrastructure	
Aquila Energy Efficiency	98
Aquila European Renewables Income	377
Atrato Onsite Energy	145
Bluefield Solar Income Fund	859
Downing Renewables & Infrastructure	214
Ecofin US Renewables Infrastructure	120
Foresight Solar Fund	756
Gore Street Energy Storage	519
Greencoat Renewables	1,314
Greencoat UK Wind	4,502
Gresham House Energy Storage	795
Harmony Energy Income	245
HydrogenOne Capital Growth	126

Company	Total assets (£m)*
JLEN Environmental Assets Group	814
NextEnergy Solar	916
Octopus Renewables Infrastructure	628
Renewables Infrastructure Group	3,334
SDCL Energy Efficiency Income	1,201
ThomasLloyd Energy Impact	130
Triple Point Energy Transition	96
US Solar Fund	288
VH Global Sustainable Energy Opportunities	478
Royalties	
Hipgnosis Songs	2,272
Round Hill Music Royalty	431
Technology & Media	
Allianz Technology	1,045
Augmentum Fintech	277
Polar Capital Technology	2,821
SuperSeed Capital	2
Sure Ventures	8
UK All Companies	
Artemis Alpha Trust	98
Aurora	145
Baillie Gifford UK Growth	270
Fidelity Special Values	1,047
Henderson Opportunities	109

Company	Total assets (£m)*
Independent Investment Trust	234
JPMorgan MidCap	222
Mercantile	1,848
Schroder UK Mid Cap	212
UK Equity & Bond Income	
Henderson High Income	242
UK Equity Income	
abrdn Equity Income	183
BlackRock Income & Growth	43
Chelverton UK Dividend	48
City of London	1,828
CT UK Capital & Income	320
CT UK High Income	103
Diverse Income Trust	326
Dunedin Income Growth	441
Edinburgh Investment	1,123
Finsbury Growth & Income	1,846
JPMorgan Claverhouse	441
Law Debenture Corporation	1,021
Lowland	357
Merchants	766
Murray Income	1,064
Schroder Income Growth	220
Shires Income	93

Company	Total assets (£m)*
Temple Bar	734
Troy Income & Growth	198
UK Smaller Companies	
Aberforth Smaller Companies	1,201
Aberforth Split Level Income	180
abrdn Smaller Companies Income	65
abrdn UK Smaller Companies Growth	476
Athelney	4
BlackRock Smaller Companies	738
BlackRock Throgmorton Trust	661
Crystal Amber	114
Downing Strategic Micro-Cap	35
Henderson Smaller Companies	695
Invesco Perpetual UK Smaller Companies	157
JPMorgan UK Smaller Companies	255
Marwyn Value Investors	94
Miton UK Microcap	62
Montanaro UK Smaller Companies	195
Odyssean Investment Trust	156
Rights & Issues	153
River & Mercantile UK Micro Cap	58
Rockwood Strategic	37
Strategic Equity Capital	154
SVM UK Emerging Fund	5

Company	Total assets (£m)*
Worsley Investors	14
VCT AIM Quoted	
Amati AIM VCT	212
Hargreave Hale AIM VCT	175
Octopus AIM VCT	131
Octopus AIM VCT 2	93
Unicorn AIM VCT	225
VCT AIM Quoted Pre Qualifying	
Thames Ventures VCT 2	58
VCT Generalist	
Albion Development VCT	114
Albion Enterprise VCT	114
Albion Technology & General VCT	127
Albion VCT	64
Baronsmead Second Venture Trust	224
Baronsmead Venture Trust	203
British Smaller Companies VCT	158
British Smaller Companies VCT 2	110
Calculus VCT	33
Crown Place VCT	87
Foresight Enterprise VCT	135
Foresight VCT	196
Kings Arms Yard VCT	112
Maven Income and Growth VCT	60

Company	Total assets (£m)*
Maven Income and Growth VCT 3	59
Maven Income and Growth VCT 4	87
Maven Income and Growth VCT 5	62
Mobeus Income & Growth 2 VCT	72
Mobeus Income & Growth 4 VCT	78
Mobeus Income & Growth VCT	98
Molten Ventures VCT	114
Northern 2 VCT	115
Northern 3 VCT	117
Northern Venture Trust	108
Octopus Apollo VCT	303
Octopus Titan VCT	1,196
ProVen Growth and Income VCT	178
ProVen VCT	173
Puma VCT 13	75
Thames Ventures VCT 1	108
The Income & Growth VCT	110
Triple Point Income VCT	25
Triple Point VCT 2011	48
VCT Generalist Pre Qualifying	
Octopus Future Generations VCT	36
Puma Alpha VCT	24
VCT Specialist: Healthcare & Biotechnology	
Seneca Growth Capital VCT	18

Company	Total assets (£m)*
VCT Specialist: Technology	
Oxford Technology 2 VCT	9

*As at 30 September 2022

Important notes

– Investment companies offer you access to a much wider range of investments than other funds

– Though these have the potential to outperform in the long term, they can be more risky, particularly in the short term

– Investment companies have some unique advantages when it comes to delivering a regular income, but should not be seen as a substitute for deposit type investments

– Investment companies are primarily intended as long-term investments. You should be prepared to hold them for at least five years, and preferably ten or more

– With investment companies, your income and capital is at risk and may fall as well as rise. You may not get back the full amount invested and, for higher risk investment companies, you may get back nothing at all

– If you are uncertain about whether, or which, investment companies might be suitable for you, you should take financial advice

The AIC website **www.theaic.co.uk** contains a wealth of information and data on investment companies. There are also tools to help you navigate the sector and information on how and where to trade investment company shares and where to get advice.

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(7) AIC/Morningstar. The Global and UK data are based respectively on the Morningstar Developed Markets index, which tracks the performance of developed equity markets targeting the top 97% of stocks by market capitalisation, and the Morningstar UK index, which tracks the performance of the UK equity market targeting the top 97% of stocks by market capitalisation.

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