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Business

Two trusts that have sailed through market turmoil and belong in any portfolio

Questor
Trust Bargains

A select group of listed funds aim to conserve your capital no matter what events throw at them. *Danielle Levy* reports

If 2022 has taught us anything, it is to expect the unexpected. At the end of last year few would have predicted a war in Europe, which has stoked existing inflationary pressures, shaken markets and caused geopolitical risk to emerge once again.

This has coincided with interest rate rises here and in America, causing some to conclude that the "Goldilocks" era for the global economy – low inflation and moderate economic growth (not too hot or cold) – is ending.

"The inflation monster is now out of the bag, which is going to have significant ramifications for portfolios," says Alan Brierley, an analyst at Investec, the bank.

"We have had this 'great moderation' since the financial crisis in 2008, when interest rates and market volatility have been low. It has been a Goldilocks scenario that has favoured growth companies. But a sustained rise in inflation really lobs a hand grenade into that thesis.

The question is: how do you defend yourself against inflation?"

Capital Gearing Trust
Hold
Manager has delivered positive returns in 39 out of a possible 40 years

Fortunately, a handful of "multi-asset" investment trusts are designed to do just this. They include Ruffer Investment Company and Capital Gearing Trust, two of our previous tips. These conservative all-weather trusts aim to preserve capital regardless of what markets throw at them and to hold a mix of assets that can cope with inflation.

For years their respective fund managers have warned that debt-saddled nations, particularly in the West, will allow inflation to run ahead of short-term interest rates in order to devalue their debts over time. It is a situation that appears to be materialising. Yet in spite of similarities in the objectives and ethos of the two trusts, there are some important differences. First, Capital Gearing is easier to understand, partly because it does not use derivatives (contracts that allow investors to profit from falling stock markets or rising interest rates, for example). Ruffer does.

Peter Spiller, who is on course to deliver positive returns in 39 out of a possible 40 years at the helm of Capital Gearing, concedes that the portfolio is defensively positioned, even by his standards. He says prospective returns look "lousy" for practically every type of investment.

The portfolio has more than a third of its money in index-linked government bonds; here the fund manager favours US Treasury inflation-protected securities or "Tips" thanks to their inverse correlation with shares.

Around 46pc of the trust is in other investment trusts, exchange-traded funds and listed property companies. These include infrastructure trusts, specific discount opportunities and residential property landlord Grainger. Finally, Capital Gearing has 25pc in "dry powder" (short-dated bonds and cash), which can be put to work quickly in the event of a sell-off.

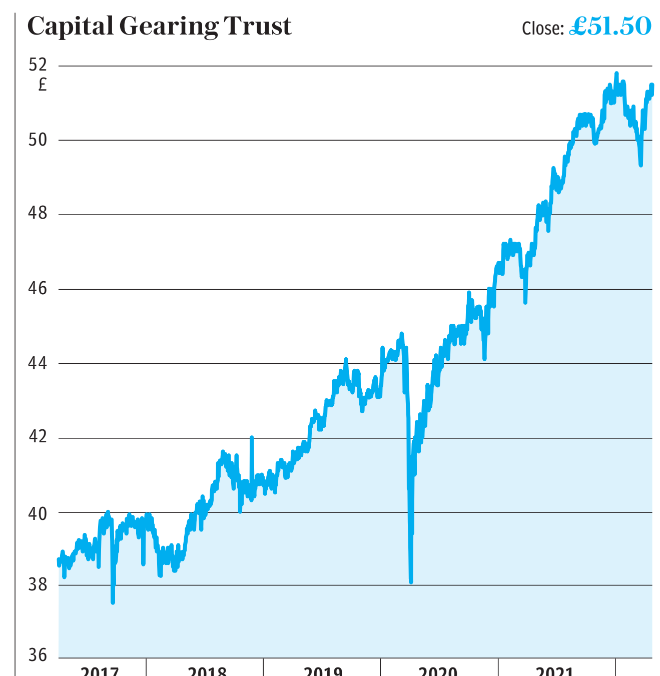
Ruffer has more money in individual shares, which account for 41pc of the portfolio. Its managers, Hamish Baillie and Duncan MacInnes, favour economically sensitive stocks such as BP and NatWest. The fund has meaningful exposure to inflation-linked government bonds, which account for 28pc of the trust. Its managers prefer gilts over Tips. Eight per cent is in gold.

Notably, the fund has almost 14pc in "unconventional protection", comprising derivatives and credit default swaps. The latter is a form of insurance on bonds that offsets the risk that a borrower defaults. As investors start to worry more about the risk of default, Baillie expects these investments to grow in value. They also offer a negative correlation to shares and bonds, which the fund manager expects to start to move in tandem.

When it comes to derivatives, Ruffer uses "equity put options" to profit from falling shares and "interest rate options" to protect the portfolio from the effects of rising bond yields.

Ruffer and Capital Gearing deserve a place in any portfolio because they have shown they can protect shareholders' capital through challenging periods. According to Investec, Ruffer has delivered a cumulative 9.4pc gain in net asset value across six market crashes, which include the financial crisis and the Covid-induced sell-off in 2020, while global shares fell by 152pc. Capital Gearing returned 3.3pc.

Questor hopes this is a sign of things to come for Ruffer and Capital Gearing in light of the challenging conditions that lie ahead. The one sticking point is that they trade on respective premiums of 1.8pc and 2.3pc. Hold.



Key numbers

- **Market value: £1.1bn**
- **Year of listing: 1963**
- **Discount: 2.3pc premium**
- **Ave discount over past year: 2.2pc premium**
- **Yield (April 2021): 0.9pc**
- **Most recent year's dividend: 45p**
- **Gearing (Feb 2022): nil**
- **Annual charge (April 2021): 0.58pc**

Read Questor's rules of investment before you follow our tips: telegraph.co.uk/go/questorrules; telegraph.co.uk/questor