

Foreign & Colonial Investment Trust

Still going strong after 150 years

Foreign & Colonial Investment Trust (FRCL) is the world's oldest investment trust and has a distinguished dividend history. The fund is on course for its 48th consecutive year of dividend increases and an annual distribution has been paid in each of the 150 years since FRCL was launched in 1868. Paul Niven has managed the trust since 2014 and has continued to build on FRCL's long-term record of outperformance versus its benchmark. Helped by another period of good relative performance in H118, the trust's share price total return has now outperformed the FTSE All-World index total return over the last one, three, five and 10 years. Although equities have performed well in recent years, the manager believes there is potential for further upside, supported by corporate earnings growth.

12 months ending	Share price (%)	NAV (%)	FTSE All-World (%)	FTSE All-Share (%)	FTSE World-ex-UK (%)
31/08/14	11.3	10.9	13.3	10.3	13.6
31/08/15	12.4	7.2	1.9	(2.3)	2.9
31/08/16	18.7	22.4	26.7	11.7	27.6
31/08/17	26.2	21.1	19.7	14.3	19.9
31/08/18	20.0	12.6	10.9	4.7	12.1

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling.

Investment strategy: Diversified global equities

FRCL's manager aims to generate long-term growth in capital and income from a widely diversified portfolio of global securities (both listed and unlisted). He believes this strategy reduces risk and can limit the volatility of investment returns. FRCL's portfolio contains a broad range of strategies from both Bank of Montreal's (BMO's) specialist teams and third-party managers and includes an allocation to private equity. Compared to the benchmark, the trust's largest deviations are a c 6pp underweight exposure in North America and a c 4% overweight in Europe ex-UK.

Market outlook: Broad exposure may be warranted

Since early 2016, equity investors have enjoyed annual total returns above the long-term average. As a result of a revaluation of global equities, alongside corporate earnings growth there are regions where valuations now look less attractive, such as the US, which on a forward P/E multiple basis is trading at a c 15% premium to its 10-year average. In such an environment, investors may benefit from broad exposure to global stock markets, including regions that look more attractively valued, such as Japan.

Valuation: Discount has narrowed meaningfully

FRCL's discount has narrowed meaningfully since mid-2016 and as a result the board no longer employs a hard discount control mechanism, which previously aimed to keep the discount below 7.5%. The trust's current 1.4% share price premium to cum-income NAV compares with the average discounts of the last one, three, five and 10 years of 3.0%, 6.7%, 7.7% and 8.8% respectively. FRCL has a progressive dividend policy, having increased the annual distribution in each of the last 47 consecutive years. Its current dividend yield is 1.4%.

Investment trusts

4 September 2018

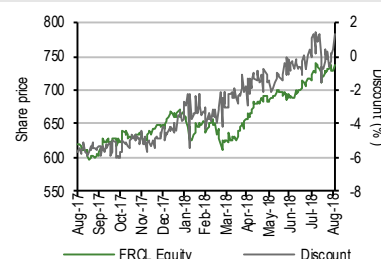
Price 737.0p
Market cap £3,996m
AUM £4,195m

NAV* 721.1p
 Premium to NAV 2.2%
 NAV** 727.0p
 Premium to NAV 1.4%

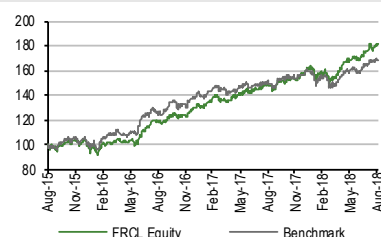
*Excluding income. **Including income. As at 31 August 2018.

Yield 1.4%
 Ordinary shares in issue 542.2m
 Code FRCL
 Primary exchange LSE
 AIC sector Global
 Benchmark FTSE All-World

Share price/discount performance



Three-year performance vs index



52-week high/low 741.0p 595.0p
 NAV** high/low 737.9p 630.7p

**Including income.

Gearing

Gross* 9%
 Net* 8%

*As at 31 July 2018.

Analysts

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Exhibit 1: Trust at a glance
Investment objective and fund background

FRCL's investment objective is to secure long-term growth in capital and income through investing primarily in an internationally diversified portfolio of listed equities, as well as unlisted securities and private equity, with the use of gearing. FRCL's benchmark is the FTSE All-World Index.

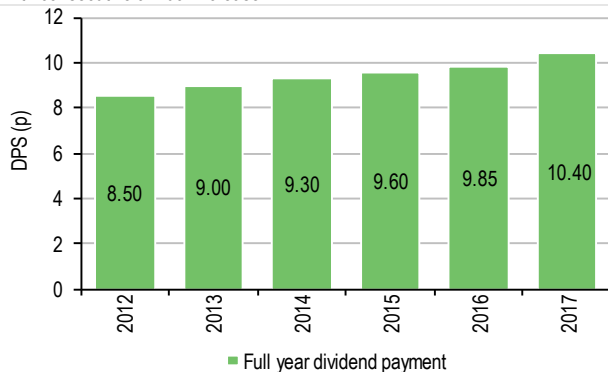
Recent developments

- 30 July 2018: Six-month results ending 30 June 2018. NAV TR +3.7% versus benchmark TR +2.1%. Share price TR +8.0%.
- 13 June 2018: Announcement of first interim dividend of 2.7p (+8.0% year-on-year).
- 14 March 2018: Announcement of issuance of £75m of 2.92% 30-year, fixed-rate senior unsecured private placement notes (funding date in May 2018).
- 7 March 2018: 12-month results ending 31 December 2017. NAV TR +16.9% versus benchmark TR +13.8%. Share price TR +21.0%. Announcement of fourth interim dividend of 2.7p (in line with prior year).

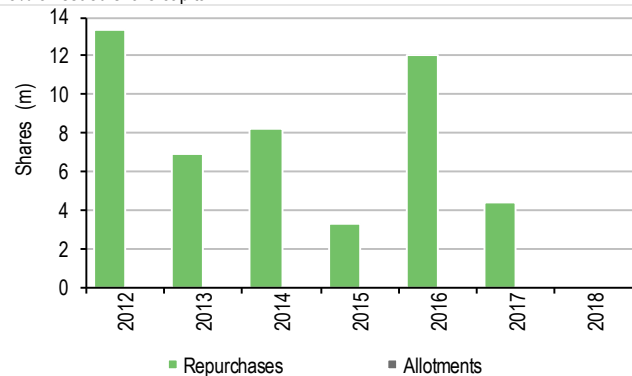
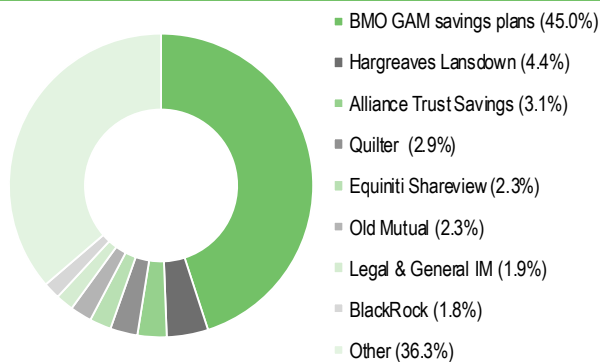
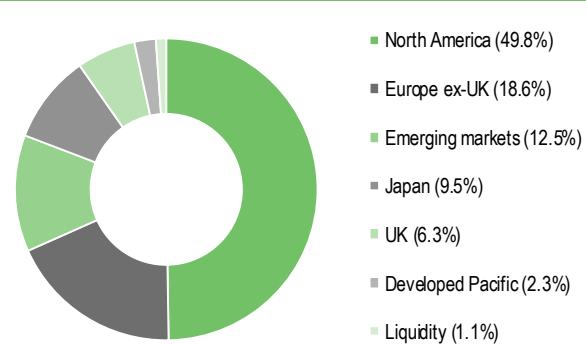
Forthcoming		Capital structure		Fund details	
AGM	April 2019	Ongoing charges	0.79%	Group	BMO Global Asset Mgmt (BMO)
Final results	March 2019	Net gearing	8%	Manager	Paul Niven
Year end	31 December	Annual mgmt fee	0.365%	Address	Exchange House, Primrose Street London EC2A 2NY
Dividend paid	Aug, Nov, Feb, May	Performance fee	None	Phone	+44 (0)800 136 420
Launch date	March 1868	Trust life	Indefinite	Website	www.foreignandcolonial.com
Continuation vote	None	Loan facilities	See page 7		

Dividend policy and history (financial years)

FRCL pays dividends quarterly. The 2017 total dividend of 10.4p represented the 47th consecutive annual increase.


Share buyback policy and history (financial years)

Renewed annually, FRCL has authority to purchase up to 14.99% and allot up to 5% of issued share capital.


Shareholder base (as at 31 August 2018)

Strategy allocation (including private equity, as at 31 July 2018)

Top 10 holdings (as at 31 July 2018)

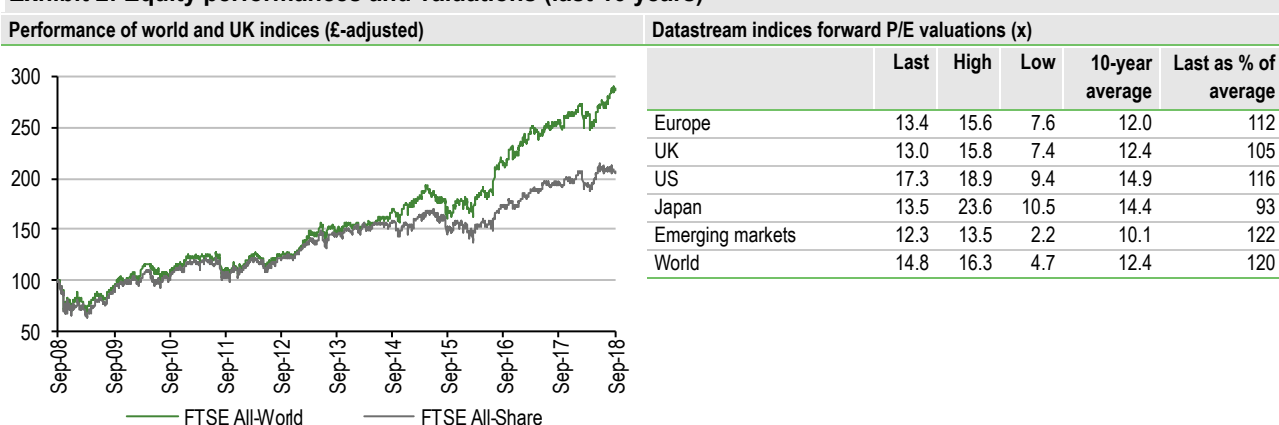
Company	Country	Sector	Portfolio weight %	
			31 July 2018	31 July 2017*
Amazon	US	Consumer services	2.1	1.4
Microsoft	US	Technology	1.4	1.1
Alphabet**	US	Technology	1.2	1.1
UnitedHealth	US	Healthcare	1.1	1.1
Anthem	US	Healthcare	1.0	N/A
Facebook	US	Technology	0.8	1.0
Booking Holdings***	US	Consumer services	0.7	0.8
JPMorgan Chase	US	Financials	0.7	N/A
Novo Nordisk	Denmark	Healthcare	0.7	N/A
Utilico Emerging Markets	UK	Financials	0.7	0.9
Top 10			10.4	9.8

Source: Foreign & Colonial Investment Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in July 2017 top 10. **Formerly known as Google. ***Formerly known as Priceline.

Market outlook: Potential benefits of a global approach

Exhibit 2 (left-hand side) shows the potential benefits of global investing as over the last 10 years, global equities (in sterling terms) have considerably outperformed the returns of the UK stock market. In 2018, global equity markets have returned to more normal levels of volatility following a particularly benign period in 2017, with investor concerns centring on macroeconomic issues such as the implications of disruptions to global trade, and the UK's ongoing negotiations to exit the EU. However, against this backdrop, corporate earnings growth remains supportive for further global equity gains, albeit with more modest upside than in recent years. Although equity valuations in general have expanded, there are still pockets of value, such as in Japan, which on a forward P/E basis is trading at a discount to its 10-year average (Exhibit 2, right-hand side). In such an environment, investors may be attracted to a global fund with a wide remit that includes exposure to regions where valuations are relatively more attractive.

Exhibit 2: Equity performances and valuations (last 10 years)



Source: Thomson Datastream, Edison Investment Research. Note: Performance data as at 3 September 2018.

Fund profile: Providing broad global equity exposure

Launched in 1868, FRCL is the oldest investment trust. It initially invested in bonds, but made its first equity investment in 1925 (by 1965, equities made up 95% of the portfolio). The trust has also invested in private equity since 1942. FRCL has had 11 managers in the last 150 years; current manager Paul Niven is only the third since 1969. He aims to generate long-term growth in capital and income, and attractive risk-adjusted returns from a diversified global portfolio of listed equities and unlisted securities (including private equity).

FRCL is benchmarked against the FTSE All-World index. Risk is managed via diversified investment across geographies and sectors (there are no specific geographic or industry sector exposure limits for the publicly listed equities). A maximum 5% of the portfolio at the time of investment may be invested in unlisted securities (excluding private equity) and requires prior approval by the board. Shareholder approval would be required to increase FRCL's private equity exposure above 20%. At the time of investment, a maximum 10% of the portfolio is permitted in a single investment and up to 5% may be in funds managed by BMO Global Asset Management (subject to board approval). Gearing in either sterling or foreign currencies is permitted up to a maximum 20% of NAV (net gearing was 8% at the end of July 2018).

FRCL has over 100,000 investors, 90% of whom are retail rather than institutional holders, and the manager notes that the average age of new investors is coming down, suggesting the trust's appeal is broadening. Data from Newlands Fund Research suggests a £100 investment in FRCL at the time of the fund's launch in 1868 would now be worth c £13m. The board intends to increase the

annual dividend once more in 2018, which would represent the 48th annual increase (the trust has paid a distribution every year since launch).

The fund manager: Paul Niven

The manager's view: Room for further share price appreciation

At the beginning of 2018, Niven believed the bull market was not over and there was potential for further share price appreciation on the back of global economic growth. He expected increased equity market volatility, compared to the very benign levels in 2017, higher dispersion of equity returns and wider credit spreads. He also believed stocks that had been leading the global stock markets would continue to do so. So far this year, all of these expectations have come to fruition. One prediction that was less successful was the expected outperformance of financial stocks due to higher interest rates and credit growth in Europe. So far in 2018, financials have lagged; however, the manager suggests these stocks will perform better in the second half of this year as a result of a continued improvement in their fundamentals. Although Niven remains optimistic on the outlook for global equities, supported by corporate earnings growth, he notes there are macroeconomic issues to consider, such as trade conflicts as a result of the US's protectionist policies. Further out, he says there could be monetary policy missteps as a result of an underestimation of inflationary pressures, although he suggests this is not a near-term issue to concern investors.

Asset allocation

Investment process: Diversified global equity exposure

Niven aims to generate long-term growth in capital and income from a portfolio of global securities that is widely diversified by geography and sector. He is benchmark aware but does not follow the FTSE All-World allocations. FRCL's portfolio is constructed with inputs from both BMO's specialist teams and third-party managers (see Exhibit 3) and includes a c 7% allocation to private equity. Individual strategy allocations are regularly reviewed and altered when deemed appropriate by the manager. He believes a key feature of the trust is its broad diversification in both listed and unlisted securities, which helps both to reduce risk and to limit the volatility of investment returns.

Current portfolio positioning

Exhibit 3: FRCL strategy allocations (as at 30 June 2018)

Strategy	Primary manager	Approach	% allocated	Holdings	Active share (%)**
Regional					
US growth	T. Rowe Price	Growth	19.0	116	78
US value	Barrow Hanley	Value	15.7	48	80
Europe	BMO Global Asset Management	Fundamental quality value	12.2	34	84
UK	BMO Global Asset Management	Quality growth	3.8	28	62
Japan	BMO Global Asset Management	Quality GARP*	8.1	48	75
Emerging markets	LGM	Long-term quality	9.8	37	96
Global					
Income	BMO Global Asset Management	Systematic income GARP*	10.5	61	90
Smaller companies	BMO Global Asset Management	Core quality growth	4.4	81	99
Multi-manager	BMO Global Asset Management	Fund of funds	7.8	23	68
Private equity					
Funds	HarbourVest/Pantheon	Fund of funds	4.2	16	N/A
Direct	BMO Global Asset Management	Direct	2.5	26	N/A

Source: Foreign & Colonial Investment Trust, Edison Investment Research. Note: *GARP is growth at a reasonable price. **Active share is a measure of how a portfolio differs from an index (0% is full index replication and 100% is no overlap with the benchmark).

FRCL aims to generate an attractive, good long-term total return while reducing risk. Its diversified range of strategies is highlighted in Exhibit 3; Niven believes this approach will allow the trust to continue to deliver good risk-adjusted outcomes. The manager is continuing to adjust FRCL's private equity strategy. In H118, there were 10 early-stage investments, five of which were primary and five were co-investments, and there were £65m in new direct commitments during the period. There will continue to be significant cost savings as the trust's historic private equity fund-of-fund investments in HarbourVest and Pantheon are run off.

Exhibit 4: Geographic weightings (including private equity, % unless stated)

	Portfolio end- July 2018	Portfolio end- July 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
North America	49.8	45.7	4.1	55.7	(5.9)	0.9
Europe ex-UK	18.6	20.1	(1.5)	14.5	4.1	1.3
Emerging markets	12.5	12.8	(0.3)	9.9	2.6	1.3
Japan	9.5	10.1	(0.6)	8.2	1.3	1.2
UK	6.3	7.7	(1.4)	5.9	0.4	1.1
Developed Pacific	2.3	3.2	(0.9)	5.6	(3.3)	0.4
Liquidity	1.1	0.4	0.7	0.0	1.1	N/A
	100.0	100.0		100.0		

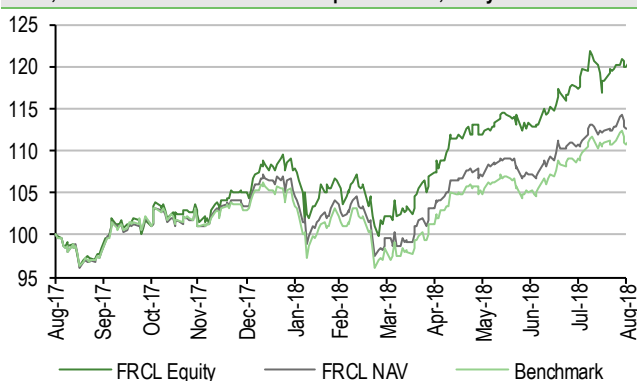
Source: Foreign & Colonial Investment Trust, Edison Investment Research

FRCL's geographic exposure is shown in Exhibit 4. Over the 12 months to end-July 2018, the largest changes in the trust's exposure are to North America (+4.1pp), although the trust remains underweight versus the benchmark, and to Europe ex-UK (-1.5pp) and the UK (-1.4pp). Niven explains that UK exposure has become a much smaller part of FRCL's portfolio, which is unlikely to change. Since the end of H118, there is no longer a direct allocation to UK equities and starting with the 2018 annual report, the UK will be included with Europe, classified as pan-European exposure.

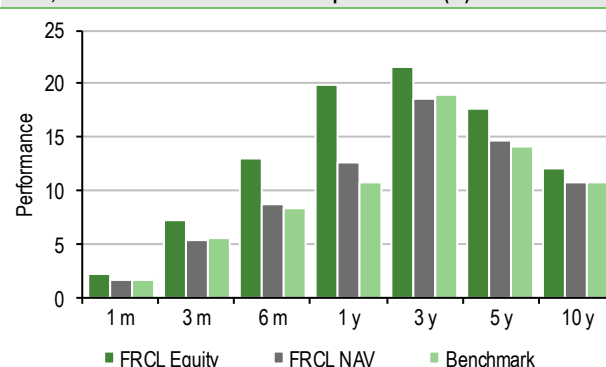
Performance: Further outperformance in H118

Exhibit 5: Investment trust performance to 31 August 2018

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)

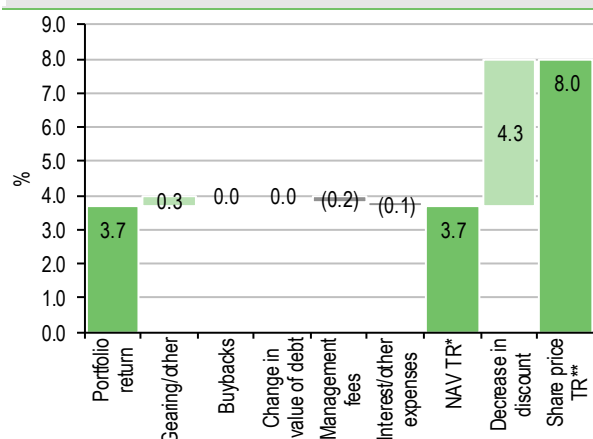


Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

FRCL has recently released its H118 report (to 30 June). Its NAV and share price total returns of 3.7% and 8.0% respectively were ahead of the benchmark's 2.1% total return. The breakdown of the trust's H118 returns is highlighted in the waterfall chart below (Exhibit 6); the higher share price total return compared to the NAV total return accompanied a reduction in the trust's discount.

There was good performance from FRCL's underlying strategies, with most outperforming their respective benchmarks. During the period, an underweight exposure to North America detracted from returns, but was more than offset by positive stock selection and the trust's private equity exposure. Within the key US equity strategies, both the growth and value managers outperformed their respective benchmarks. T Rowe Price generated a 14.9% total return, outperforming its

growth benchmark by 5.0pp, while Barrow Hanley generated a 2.9% total return, outperforming its value benchmark by 2.1pp. Despite the much higher returns from growth rather than value shares in the US, the manager explains that he is happy with the two managers' allocations, and US equity exposures will not be rebalanced. FRCL's private equity strategy generated a 9.6% total return during H118, which compares favourably with the 2.1% total return from global listed equities.

Exhibit 6: Performance attribution in H118


Source: Foreign & Colonial Investment Trust, Edison Investment Research. Note: *Debt at market value, **dividends reinvested.

Exhibit 7: NAV total return performance relative to benchmark over three years


Source: Thomson Datastream, Edison Investment Research.

FRCL's relative returns are shown in Exhibit 8. Its share price has outperformed the FTSE All-World index over one, three, five and 10 years, whereas its NAV has outperformed over one and five years and is broadly in line over three and 10 years. The potential benefits of investing in overseas rather than domestic equities are illustrated by FRCL's outperformance versus the FTSE All-Share index over all periods shown.

Exhibit 8: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to blended benchmark*	0.6	1.5	4.3	8.2	6.9	15.8	11.9
NAV relative to blended benchmark*	0.0	(0.3)	0.3	1.6	(0.6)	2.2	(0.2)
Price relative to FTSE All-World	0.6	1.5	4.3	8.2	6.9	15.8	10.2
NAV relative to FTSE All-World	0.0	(0.3)	0.3	1.6	(0.6)	2.2	(1.8)
Price relative to FTSE All-Share	5.1	9.1	7.1	14.6	34.4	56.0	53.1
NAV relative to FTSE All-Share	4.6	7.2	3.0	7.6	24.9	37.8	36.5
Price relative to FTSE World ex-UK	0.0	0.4	3.4	7.1	4.9	12.2	5.5
NAV relative to FTSE World ex-UK	(0.5)	(1.4)	(0.6)	0.5	(2.5)	(0.9)	(5.9)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-August 2018. Geometric calculation. *Benchmark prior to 1 January 2013 was a composite of 40% FTSE All-Share and 60% FTSE World ex-UK indices (now FTSE All-World index).

Discount: Narrowing trend since mid-2016

Since mid-2016, FRCL has enjoyed a meaningful narrowing in its discount. H118 ended with the lowest discount since 1996, which the board said it found very satisfying as it has been focused on narrowing the discount for a long time. Historically, the board targeted a maximum discount of 10%, but this was reduced to 7.5%, and this target has now been removed altogether; however, the board will repurchase shares if the discount widens meaningfully in normal market conditions (no share repurchases were made during H118). It will consider issuing shares if FRCL consistently trades at a premium.

FRCL's current 1.4% share price premium to cum-income NAV compares to the range over the last 12 months of a 1.4% premium to a 6.1% discount. It is narrower than the average discounts of the last one, three, five and 10 years (a range of 3.0% to 8.8%).

Exhibit 9: Share price premium/discount to NAV (including income) over three years (%)


Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

FRCL is a conventional investment trust with one class of share in issue. There are currently 542.2m ordinary shares in issue, with a further 19.6m held in treasury. The trust is permitted to gear up to 20% of NAV; at the end of July 2018 net gearing was 8%, which compares with a range of 7% to 14% since 2012. As a result of a series of debt refinancings at attractive interest rates, FRCL's weighted average cost of debt has declined to 2.8% at the end of H118, which is meaningfully lower than 7.1% at the end of 2013, prior to the maturity of a longstanding 11.25% debenture. The £345m gross debt at end H118 was split as follows: a £20m 1.12% revolving credit facility (expiring in 2018); ¥6.6bn at 2.50% and \$80m at 4.00% (maturing in 2019); €72m at 1.69% (2022); £25m at 2.80% (2028); £50m at 3.16% (2031); £75m at 2.92% (2048); and a £0.6m 4.25% perpetual debenture.

BMO Global Asset Management is paid an annual management fee of 0.365% of FRCL's market cap and the trust also pays direct fees to its external managers. The board believes FRCL's ongoing charges of 0.79% (in line with FY16) are competitive with its peers given that part of the asset management function is outsourced.

Dividend policy and record

FRCL has a very distinguished dividend history. An annual distribution has been paid in every year since the trust was launched in 1868. In addition, the board intends to pay a higher dividend in FY18 than in FY17 (at a growth rate in excess of UK inflation), which would represent the 48th year of consecutive dividend increases.

The 10.40p per share total dividend paid in FY17 was 5.6% higher than 9.85p paid in FY16 and was more than 1.1x covered. In H118, net revenue was 7.78p per share, which was 7.5% higher year-on-year (+5.0% excluding special dividends). Based on its current share price, FRCL's dividend yield is 1.4%.

Peer group comparison

FRCL is a member of the AIC Global sector. In Exhibit 10, we highlight the 14 trusts in that sector with less than a 25% exposure to the UK. FRCL is the second-largest fund in the selected peer group, with a market cap approaching £4bn. Its NAV total returns are broadly in line with the

averages over the periods shown. Since mid-2016, FRCL's discount has been in a narrowing trend and its shares now regularly trade close to NAV. The trust's ongoing charge is in line with the selected peer group average (despite paying fees to external managers) and, in common with most of its peers, no performance fee is payable. FRCL's net gearing is above average, while its dividend yield is modestly lower than average; although investors should remember the trust's distinguished track record of dividend growth.

Exhibit 10: Selected peer group as at 3 September 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Foreign & Colonial Investment Trust	3,995.9	12.6	67.3	98.1	176.1	1.5	0.8	No	108	1.4
Alliance Trust	2,642.6	9.1	64.5	86.8	163.2	(6.4)	0.6	No	105	1.8
Bankers	1,105.9	9.1	60.7	86.6	171.6	(1.6)	0.4	No	102	2.2
British Empire	854.9	6.8	68.0	69.1	124.0	(8.5)	0.9	No	110	1.7
Caledonia Investments	1,551.5	6.0	37.9	75.6	104.7	(18.2)	1.2	No	100	2.2
Edinburgh Worldwide	563.4	42.2	110.8	150.3	279.2	1.6	0.9	No	109	0.5
EP Global Opportunities	141.8	5.6	52.1	70.0	142.1	(2.3)	0.9	No	100	1.7
F&C Global Smaller Companies	889.9	13.9	62.0	99.5	279.7	(0.8)	0.6	No	105	1.0
Lazard World Trust Fund	121.6	1.7	56.8	76.4	104.2	(2.8)	1.3	Yes	100	2.8
Majedie Investments	153.9	2.2	34.7	64.4	34.9	(12.6)	1.1	No	110	3.5
Martin Currie Global Portfolio	231.6	10.6	64.6	84.2	152.8	0.2	0.7	Yes	100	1.7
Mid Wynd International	203.2	13.5	71.8	112.7	206.7	2.2	0.7	No	100	0.9
Monks	1,847.1	16.2	92.2	102.4	147.2	(0.2)	0.5	No	105	0.2
Scottish Mortgage	8,209.1	27.2	128.2	207.7	376.5	4.0	0.4	No	108	0.7
Average	1,608.0	12.6	69.4	98.9	175.9	(3.1)	0.8		104	1.6
FRCL rank in sector (14 trusts)	2	6	6	6	5	4	7		4	9

Source: Morningstar, Edison Investment Research. Note: *Performance as at 31 August 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are eight directors on FRCL's board, all of whom are non-executive and independent of the manager. The chairman is Simon Fraser, who was elected to the board in September 2009 and assumed his role in May 2010. Sir Roger Bone has been the senior independent director since November 2011 and joined the board in March 2008. The other six directors are: Jeffrey Hewitt, appointed in September 2010; Sarah Arkle and Nicholas Moakes, both in March 2011; Francesca Ecsery in August 2013; Edward Knapp in July 2016; and Beatrice Hollond in September 2017.

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