EDISON

The Brunner Investment Trust

Improving performance under sole manager

Investment trusts

The Brunner Investment Trust (BUT) aims to generate long-term growth in capital and income from a portfolio of high-quality global equities. Over time the exposure to overseas stocks has increased, providing a broader opportunity to generate income and capital growth, and the number of holdings has been reduced. Since June 2016, BUT has had a single manager, Lucy Macdonald, who has refined the UK stock selection process in line with that for overseas companies. Under her sole tenure, the trust has outperformed the composite benchmark by more than 4pp. BUT has a distinguished record of dividend growth; annual dividends have increased for the last 45 consecutive years and the current yield is 2.3%.

12 months ending	Share price (%)	NAV* (%)	Benchmark (%)	FTSE All-Share (%)	FTSE All-World ex-UK (%)
31/08/13	24.6	25.8	19.3	18.9	19.6
31/08/14	11.7	10.9	12.0	10.3	13.6
31/08/15	(0.1)	0.9	0.2	(2.3)	2.4
31/08/16	16.0	17.1	19.9	11.7	27.8
31/08/17	27.1	23.5	17.6	14.3	20.1

Source: Thomson Datastream. Note: All % on a total return basis in sterling. *NAV with debt at market value. Until 21 March 2017, benchmark was 50% FTSE All-Share and 50% FTSE All-World ex-UK index. From 22 March 2017, benchmark is 70% FTSE All-World ex-UK and 30% FTSE All-Share Index.

Investment strategy: Fundamental stock selection

The recent change in BUT's benchmark, shown in the note to the table above, is illustrative of the exposure shifts towards more overseas and fewer UK equities. The manager selects stocks on a bottom-up basis, with an awareness of the macro environment, seeking companies with attractive fundamentals that are trading on reasonable valuations. She is able to draw on the well-resourced Allianz Global Investors (AllianzGI) investment team. Gearing of up to 20% of net assets is permitted; at end-August 2017, net gearing was 6.3%.

Market outlook: Reasons to be selective

Following the global financial crisis, in an environment of ample liquidity and low interest rates, global equities have appreciated significantly. Shares have continued to move higher in 2017 as investors are encouraged by improving corporate earnings. As a result, world equities are trading at a forward P/E multiple that is a c 20% premium to the 10-year average. In such an environment, investors may benefit from an actively managed fund aiming to invest in attractively valued equities to grow both capital and income.

Valuation: Discount in narrowing trend

BUT's discount has been in a narrowing trend since late 2016. Its current 11.9% discount to cum-income NAV with debt at fair value is narrower than the one-, three-, five- and 10-year averages of 14.5%, 13.8%, 13.5% and 12.9%. There is scope for the discount to continue to narrow as the redemption date approaches for BUT's first tranche of high-cost debt in January 2018, or if investment performance continues to improve. BUT has a progressive dividend policy and its annual dividend has increased for the last 45 consecutive years.

27 September 2017

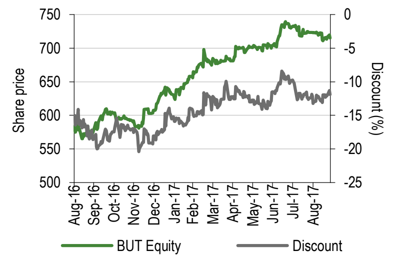
Price	**715.0p**
Market cap	**£305m**
AUM	**£402m**

NAV*	803.1p
Discount to NAV	11.0%
NAV**	811.5p
Discount to NAV	11.9%

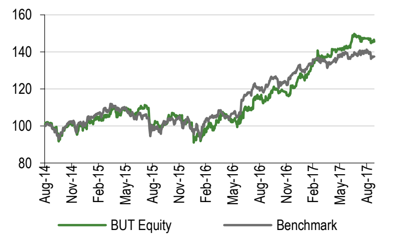
*Excluding income. **Including income. As at 25 September 2017.

Yield	2.3%
Ordinary shares in issue	42.7m
Code	BUT
Primary exchange	LSE
AIC sector	Global
Benchmark	Composite benchmark

Share price/discount performance



Three-year performance vs index



52-week high/low	739.5p	573.0p
NAV** high/low	834.8p	698.5p

**Including income.

Gearing

Gross*	12.8%
Net*	6.3%

*As at 31 August 2017.

Analysts

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Edison profile page

The Brunner Investment Trust is a research client of Edison Investment Research Limited

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Exhibit 1: Trust at a glance

Investment objective and fund background

The Brunner Investment Trust aims to provide growth in capital value and dividends over the long term through investing in a portfolio of UK and international securities. From 25 March 2008, the benchmark was a composite of 50% FTSE All-Share and 50% FTSE All-World ex-UK Index (£). From 22 March 2017 the benchmark is a composite of 70% FTSE All-World ex-UK (£) and 30% FTSE All-Share Index.

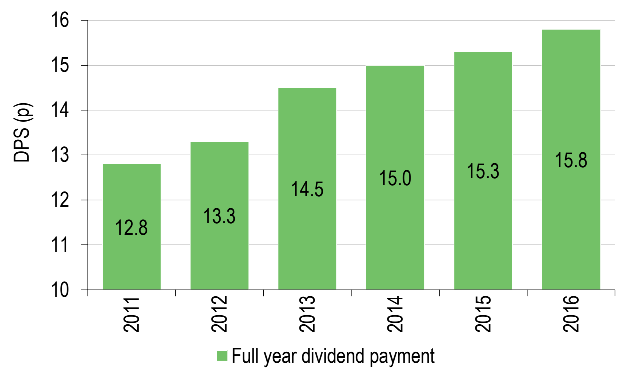
Recent developments

- 18 July 2017: Six-month report ending 31 May 2017. NAV TR +12.6% versus +11.1% for composite benchmark.
- 14 February 2017: 12-month report ending 30 November 2016. NAV TR +20.2% versus +18.0% for composite benchmark.
- 22 July 2016: Six-month report ending 31 May 2016. NAV TR +2.6% versus +2.2% for composite benchmark.

Forthcoming		Capital structure		Fund details	
AGM	March 2018	Ongoing charges	0.78% (at 31 November 2016)	Group	Allianz Global Investors
Final results	February 2018	Net gearing	6.3%	Manager	Lucy Macdonald
Year end	30 November	Annual mgmt fee	0.45%	Address	199 Bishopsgate London, EC2M 3TY
Dividend paid	Jun, Sep, Dec, Mar	Performance fee	None		
Launch date	January 1927	Trust life	Indefinite	Phone	+44 (0)800 389 4696
Continuation vote	None	Loan facilities	See page 7	Website	www.brunner.co.uk

Dividend policy and history (financial years)

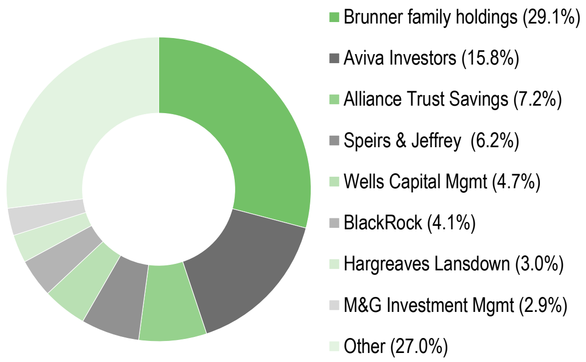
From FY14, dividends have been paid quarterly in June, September, December and March. Dividends are expected to rise over the long term and have increased for 45 consecutive years.



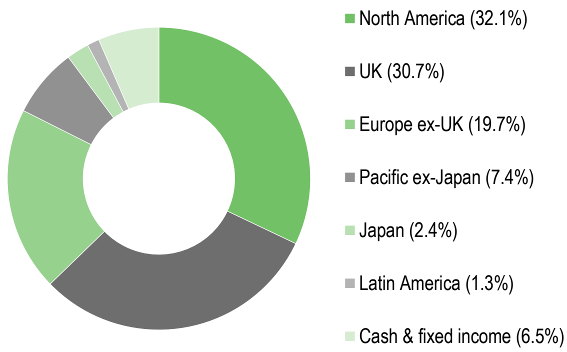
Share buyback policy and history (financial years)

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

Shareholder base (as at 31 August 2017)



Distribution of portfolio (as at 31 August 2017)



Top 10 holdings (as at 31 August 2017)

			Portfolio weight %	
Company	**Country**	**Sector**	**31 August 2017**	**31 August 2016***
UnitedHealth	US	Healthcare services	2.5	2.4
Royal Dutch Shell 'B'	UK	Oil & gas producers	2.5	2.6
Microsoft	US	Software & computer services	2.5	2.9
AbbVie	US	Pharmaceuticals & biotechnology	2.4	2.3
Estée Lauder	US	Personal goods	1.9	N/A
Muenchener Rueckver	Germany	Insurance	1.9	N/A
BP	UK	Oil & gas producers	1.9	2.1
HSBC	UK	Banks	1.8	N/A
Visa	US	Financial services	1.8	N/A
Roche	Switzerland	Pharmaceuticals & biotechnology	1.7	1.9
Top 10			**20.8**	**22.0**

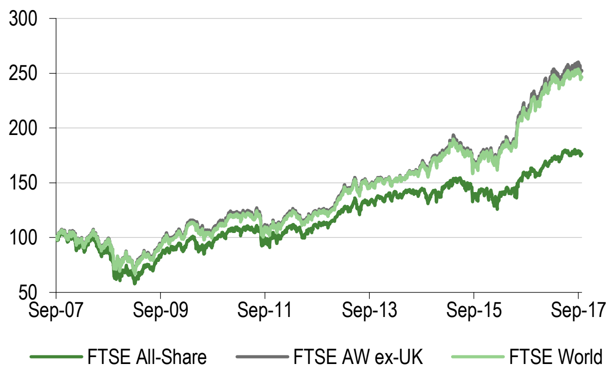
Source: The Brunner Investment Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not August 2016 top 10.

Market outlook: P/E multiples remain above average

Over the last 10 years, overseas equities have meaningfully outperformed UK equities, illustrating the historical benefits of global diversification of investment. Despite a year of above-average returns for equity holders in 2016, share prices have continued to move higher in 2017 to date. Investors have focused on the synchronised improvement in the global economy, which is driving higher corporate earnings. As a result, equity valuations are looking relatively full. World equities are trading at a c 20% premium forward P/E multiple versus the 10-year average, with developed markets such as the US and Europe trading at an even higher premium. Against this backdrop, investors may wish to consider an actively managed fund with a disciplined bottom-up investment process aiming to invest in attractively valued global equities.

Exhibit 2: Market performance and valuation

Performance of indices (last 10 years in £ terms)



Datastream World Index valuation metrics (as at 26 September 2017)

	Last	High	Low	10-year average	Last as % of average
P/E 12 months forward (x)	15.6	16.0	8.8	13.1	119
Price to book (x)	2.1	2.5	1.1	1.8	120
Dividend yield (%)	2.4	4.6	2.0	2.7	90
Return on equity (%)	10.8	16.9	4.7	11.0	98

Source: Thomson Datastream, Edison Investment Research

Fund profile: 45 consecutive years of dividend growth

BUT was launched in 1927 to manage the wealth of the Brunner family following the sale of Brunner Mond & Co, which was the largest of four companies that combined to become Imperial Chemical Industries (ICI). The Brunner family still owns c 30% of BUT. Following the departure of co-manager Jeremy Thomas in June 2016, the trust has been solely managed by Lucy Macdonald, who is AllianzGI's CIO Global Equities; she aims to generate long-term growth in capital and income from a portfolio of global equities. BUT's benchmark has evolved over time to reflect a higher exposure to overseas companies, and the portfolio has become more concentrated. Prior to 26 March 2008, the benchmark was 60% FTSE All-Share and 40% FTSE All-World ex-UK indices, before moving to a 50:50 split. The benchmark was revised again from 22 March 2017 to a 30:70 split between the two indices in favour of the FTSE All-World ex-UK index. BUT has investment limits in place; at the time of investment, the maximum holding in a single asset is 10% of gross assets and the portfolio must hold at least 50 stocks to ensure adequate diversification. Gearing of up to 20% of net assets is permitted; at end-August 2017, net gearing was 6.4%. BUT has a distinguished dividend history; annual dividends have increased for the last 45 consecutive years.

The fund manager: Lucy Macdonald

The manager's view: Remains favourable towards equities

Macdonald continues to have a favourable view on equity markets, believing that the liquidity backdrop will change very slowly. In the US, interest rates rises are happening slowly and the unwinding of the Federal Reserve Bank's balance sheet is measured. As a result, stock market volatility has been low and equity prices have continued to rise. The outlook for corporate earnings remains positive; Q217 results were strong as margins were bolstered by a lack of wage pressure. Earnings reports were particularly robust in Europe ex-UK, which is a region that is also benefiting from a more stable political environment. The manager says that equity valuations in absolute terms are not cheap, but versus other asset classes, equities offer relatively good value. Given the strength in global equities since early 2016, Macdonald believes that future returns will be more moderate and therefore the importance of active management is particularly high; she continues to focus on companies which offer growth and valuation upside.

Within the US, a key question is whether the government will be able to put through tax reforms. President Trump is looking to reduce the corporate tax rate, working on the assumption that lower taxes will lead to higher growth, which together will be revenue-neutral. A tax cut would be positive for domestic companies, such as financials, rather than international companies with large overseas earnings. The president has already shown that he is willing to get bipartisan support if needed to move forward with his proposed reforms. Macdonald notes that mergers and acquisitions could provide further support for equity markets. Although incentives for tax-inversion transactions have been removed, there is potential within a programme of tax reform to make it attractive for US companies to repatriate their overseas assets. This would provide extra firepower to already strong company balance sheets. Corporate confidence remains quite high, which is another potential catalyst to more merger and acquisition activity.

Asset allocation

Investment process: Bottom-up stock selection

Lucy Macdonald has been BUT's sole manager since June 2016; she was previously co-manager, responsible for overseas stock selection, while co-manager Jeremy Thomas was responsible for UK stock selection. Macdonald selects stocks on a bottom-up basis, taking account of the macroeconomic background. She is able to draw on the extensive resources of the AllianzGI investment team to construct a portfolio of global equities with a style balance between growth and value, aiming to generate long-term growth in capital and income. The manager seeks companies with favourable fundamentals that are trading on reasonable valuations. In recent years the number of holdings has reduced from c 100 to c 75 and there is a higher overseas equity weighting, which provides more diversified potential capital and income growth and access to companies with higher levels of dividend growth.

Current portfolio positioning

At end-August 2017, BUT's top 10 holdings comprised 20.8% of the portfolio, which was a modest reduction in concentration versus 22.0% at end-August 2016.

Exhibit 3: Portfolio geographic exposure vs benchmark (% unless stated)

	Portfolio end-August 2017	Portfolio end-August 2016	Change (pp)	Benchmark weight	Active weight vs index (pp)	Trust weight/ index weight (x)
North America	32.1	30.4	1.7	40.5	(8.4)	0.8
UK	30.7	33.5	(2.9)	30.0	0.7	1.0
Europe ex-UK	19.7	17.3	2.4	12.2	7.5	1.6
Pacific ex-Japan	7.4	6.4	1.0	9.2	(1.9)	0.8
Japan	2.4	3.3	(0.9)	6.2	(3.9)	0.4
Latin America	1.3	1.6	(0.3)	1.1	0.3	1.3
Middle East & Africa	0.0	0.0	0.0	0.9	(0.9)	0.0
Cash & fixed income	6.5	7.5	(1.0)	0.0	6.5	N/A
	100.0	**100.0**		**100.0**		

Source: The Brunner Investment Trust, Edison Investment Research, FTSE Russell. Note: Benchmark is 70% FTSE All-World ex-UK Index and 30% FTSE All-Share Index.

On a geographic basis, over the last 12 months the largest changes in exposure are Europe ex-UK (+2.4pp) and UK (-2.9pp). BUT's sector exposure is shown in Exhibit 4; over the last 12 months the largest increases in exposure are technology (+2.3pp) and industrials (+1.9pp), while the largest decreases are oil & gas (-2.4pp) and financials (-1.6pp). The trust remains underweight the consumer sectors as the manager believes there are some industries where business conditions are disrupted, such as retail, where traditional business models are being negatively affected by the growth in online purchasing, or stocks are generally too expensive. It is important to note that all geographic and sector changes over the last 12 months are a result of bottom-up investment decisions.

Exhibit 4: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-August 2017	Portfolio end-August 2016	Change (pp)	Benchmark weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Financials	21.0	22.6	(1.6)	24.0	(3.0)	0.9
Industrials	20.1	18.2	1.9	12.5	7.6	1.6
Healthcare	11.2	10.8	0.4	10.0	1.2	1.1
Technology	10.3	8.0	2.3	10.0	0.3	1.0
Consumer services	8.7	9.8	(1.1)	10.4	(1.7)	0.8
Consumer goods	7.1	6.8	0.3	13.8	(6.7)	0.5
Basic materials	5.5	3.8	1.7	5.6	(0.1)	1.0
Oil & gas	5.3	7.7	(2.4)	7.2	(1.9)	0.7
Utilities	2.4	1.4	1.0	3.3	(0.9)	0.7
Telecommunications	1.9	3.4	(1.5)	3.3	(1.4)	0.6
Cash	6.5	7.5	(1.0)	N/A	N/A	N/A
	100.0	**100.0**		**100.0**		

Source: The Brunner Investment Trust, Edison Investment Research, FTSE Russell. Note: Benchmark is 70% FTSE All-World ex-UK Index and 30% FTSE All-Share Index.

A key theme within BUT's portfolio is digital transformation, which is widespread and not just confined to the technology sector. Some companies are thriving from the latest technological innovations, making them more innovative and productive, while others are experiencing negative structural change. A key beneficiary of the digital transformation is Accenture, which is being engaged to undertake huge enterprise transformation projects. The company installed a lot of its clients' original systems, so is also in a position to implement hybrid projects with legacy systems.

Ecolab is an example of a recent new holding. It has a relatively low dividend yield of c 1%, so until BUT's portfolio was reorganised to include more overseas exposure and a more diverse income stream, it was ineligible for inclusion. The company is a provider of water, hygiene and energy technologies and services. While the acquisitions of Nalco (water treatment) and Champion (consumable chemicals for the oil & gas industry) have altered Ecolab's business mix somewhat, the overall company is able to generate attractive returns and free cash flow across the economic cycle. Ecolab's products and services are a relatively small part of a client's total cost, but essential to their operations and reputations. It operates a 'razor and blade' business model, such as loaning its customers cleaning equipment, which can only use Ecolab's proprietary consumables, and operates a high level of customer service, which encourages brand loyalty.

Another new position in BUT's portfolio is US financial company Charles Schwab. The company is consolidating its already strong position in wealth management and is aggressively growing its relatively small broking business. Schwab's clients hold a lot of cash on its balance sheet, so as interest rates continue to rise, this will be beneficial to Schwab's earnings. Similar to Ecolab, there is a strong focus on customer service, which leads to high referrals and low client attrition rates.

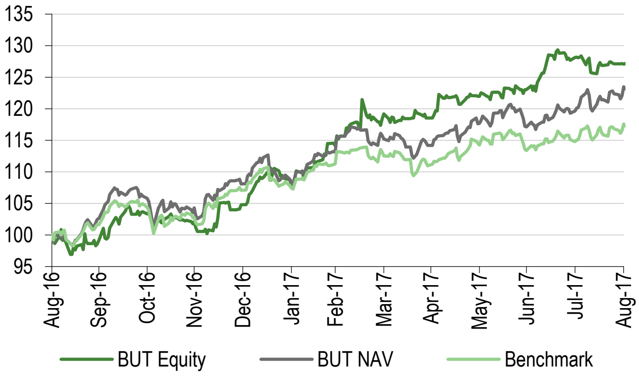
There is a style balance in the BUT portfolio between cyclical and growth companies. Macdonald notes that in recent months, growth stocks have done relatively well, so she is likely to take further profits in these positions. Microsoft was formerly the largest holding in the portfolio and has been trimmed following a period of outperformance. Relatively recent complete disposals within the fund include US agricultural products company Monsanto, whose share price has risen after a takeover bid from German life science company, Bayer, the timing of which remains unclear.

Performance: Improving under sole manager

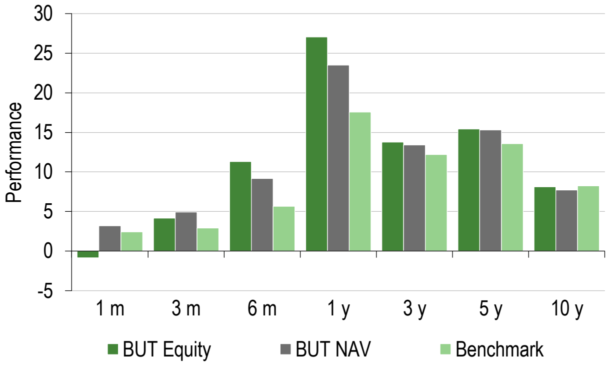
Exhibit 5 shows BUT's absolute returns. Over the last 12 months the value of overseas assets for a UK investor has been boosted by the weakness of sterling. During this period, BUT has performed well and its NAV and share price total returns of 23.5% and 27.1% respectively are meaningfully ahead of the 17.6% composite benchmark total return.

Exhibit 5: Investment trust performance to 31 August 2017

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. Composite benchmark prior to 26 March 2008 was 60% All-Share/40% All-World ex-UK, from 26 March 2008 to 21 March 2017 was 50% All-Share/50% All-World ex-UK, and 30% All-Share/70% All-World ex-UK from 22 March 2017.

The near-term improvement in investment performance means that the trust is now ahead of its composite blended benchmark over one, three and five years, while trailing over 10 years (Exhibit 6). The benefits of investing in international equities are illustrated by BUT's significant outperformance versus the FTSE All-Share index over one, three, five and 10 years.

Exhibit 6: 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 benchmark	(3.2)	1.2	5.3	8.1	4.3	8.5	(1.4)
NAV relative to benchmark	0.8	2.0	3.3	5.0	3.3	7.9	(5.0)
Price relative to FTSE All-Share	(2.2)	4.1	5.7	11.1	18.0	25.2	21.6
NAV relative to FTSE All-Share	1.8	4.9	3.7	8.0	16.9	24.4	17.2
Price relative to FTSE AW ex-UK	(3.6)	0.0	5.6	5.8	(6.3)	(4.1)	(16.3)
NAV relative to FTSE AW ex-UK	0.3	0.8	3.5	2.8	(7.2)	(4.6)	(19.4)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-August 2017. Geometric calculation.

BUT's relative performance over the last three years is shown in Exhibit 7. Since the move to a sole manager in June 2016 to end-August 2017, the trust has outperformed its composite benchmark by more than 4pp.

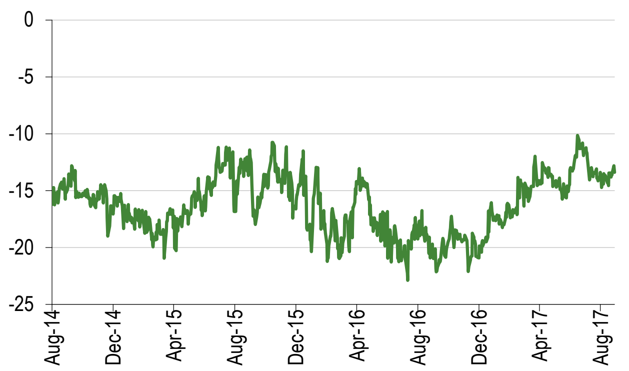
Exhibit 7: NAV total return performance relative to benchmark over three years

Source: Thomson Datastream, Edison Investment Research

Discount: In a narrowing trend

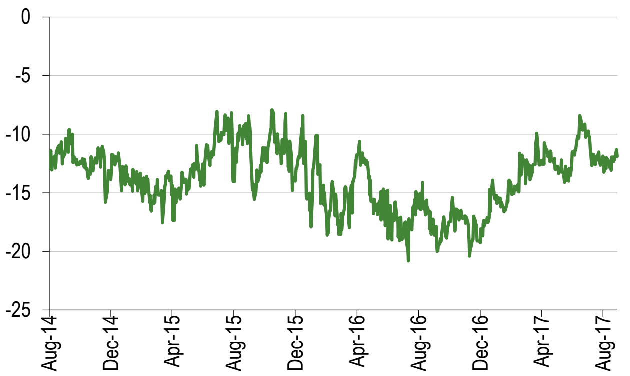
BUT's current 11.9% discount to cum-income NAV with debt at fair value is narrower than the 14.5% average discount of the last 12 months (range of 8.4% to 20.4%). It is also narrower than the averages of the last three, five and 10 years of 13.8%, 13.5% and 12.9% respectively. The discount has been in a narrowing trend since late 2016 and there is scope for it to contract further as the January 2018 redemption of BUT's first tranche of high-cost debt approaches, or if the manager is able to build on the improving investment performance.

Exhibit 8: Three-year discount to NAV (debt at par or book value)



Source: Thomson Datastream, Edison Investment Research

Exhibit 9: Three-year cum-income discount (debt at fair or market value)



Source: Thomson Datastream, Edison Investment Research

Given BUT's structural gearing, it is sensible to also consider the discount with debt at par value (currently 13.6%, Exhibit 8). The trust's discount with debt at par value tends to be wider than with debt at fair value, as the market value of the debt is higher than the par value, reducing the NAV.

Capital structure and fees

BUT is a conventional investment trust with 42.7m ordinary shares outstanding. The trust has structural gearing of c £50m, the bulk of which was taken on when interest rates were considerably higher than they are today. BUT's debt profile is as follows: an £18.2m stepped interest rate loan (effective rate of 11.27%, due on 2 January 2018), a £28.0m fixed-rate loan (9.25%, due on 20 May 2023) and £0.5m of 5% cumulative preference stock. The trust has cash available to repay the loan due in January 2018 and, as this date approaches, there is scope for BUT's discount to narrow further. The manager is genuinely excited by the increased financial flexibility that the debt repayment will afford, and the board routinely discusses the available options for the remaining high-cost debt. BUT pays AllianzGI an annual management fee of 0.45% of net assets less short-term liabilities, excluding any funds managed by AllianzGI. In FY16, ongoing charges were 0.78%; this was a modest 3bp increase versus the previous financial year.

Dividend policy and record

BUT has a distinguished dividend history, with annual dividends having increased for the last 45 consecutive years. Over the last five years the dividend has grown at a compound annual rate of 4.3%. In FY16, the annual dividend of 15.8p was 3.3% higher than in FY15 and was 1.04x covered by earnings. Since FY14, dividends have been paid quarterly in June, September, December and March. Following the payment of all four FY16 quarterly dividends, the revenue reserve was 23.3p, which is equivalent to c 1.5x the annual dividend. BUT's current dividend yield is 2.3%, which compares favourably to the peer group average shown below.

Peer group comparison

In Exhibit 10, we have listed the 10 trusts in the AIC Global sector that have exposure to the UK between 15% and 45%. BUT's NAV total returns are behind the peer group averages over the periods shown, but its better performance over the past year is illustrated by its improving ranking of seven out of 10 funds. It has the widest discount in the group, but there is scope for the discount to narrow as the repayment date for the first debenture approaches in January 2018, or if investment performance continues to improve. BUT's ongoing charge is broadly in line and its gearing is modestly higher than the peer group average. The trust has a competitive dividend yield, ranking second within the peer group and 0.8pp higher than average.

Exhibit 10: Selected global peer group (as at 26 September 2017)

% 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 (%)
Brunner	305.3	15.0	41.5	78.0	88.3	(13.4)	0.8	No	106	2.3
Bankers	993.1	17.1	54.3	99.1	128.8	(2.4)	0.5	No	102	2.3
Edinburgh Worldwide	315.1	20.0	67.2	115.6	146.5	(5.8)	0.9	No	108	0.0
F&C Global Smaller Companies	763.0	14.9	56.6	120.8	206.4	1.2	0.6	No	103	0.9
F&C Managed Portfolio Growth	66.4	16.7	37.3	81.4		1.7	1.0	Yes	100	0.0
JPMorgan Elect Managed Growth	249.5	15.2	41.7	96.4	117.1	(2.2)	0.6	No	100	1.5
Law Debenture Corporation	693.6	15.0	34.6	82.2	135.4	(10.7)	0.4	No	115	2.9
Lindsell Train	164.0	30.1	115.2	200.1	399.9	23.5	1.0	Yes	100	1.9
Scottish Investment Trust	669.8	14.6	48.8	83.4	100.3	(10.7)	0.6	No	104	1.7
Witan	1,813.2	15.6	51.6	105.1	142.2	(1.9)	0.8	Yes	108	1.9
Simple average	**603.3**	**17.4**	**54.9**	**106.2**	**162.7**	**(2.1)**	**0.7**		**105**	**1.5**
BUT rank in sector (10 funds)	**7**	**7**	**8**	**10**	**9**	**10**	**4**		**4**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 25 September 2017. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

BUT's board comprises five non-executive independent directors. Since March 2016, the chairman is Carolan Dobson, who was appointed as a director in December 2013. The senior independent director is Vivian Bazalgette; he joined the board in January 2004. The other three directors are Ian Barlow (appointed in November 2009), Peter Maynard (appointed in October 2010) and Jim Sharp (appointed in January 2014; he is a member of the Brunner family by marriage).

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