We have put together a short guide on the essentials of Investment Trusts and Funds. We hope you find it useful, and we look forward to seeing you at the Trusts & Funds event in May.

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What is a fund?

A fund is a pool of investors' money run by a fund manager who invests on behalf of the customer, invested into different assets and professionally managed by the fund manager and their research team. Each investor receives units, which represent a portion of the holdings of the fund.

What is an Invesment Trust?

Investment Trusts are listed companies that invest in the shares of other companies or fixed income securities, unquoted securities or property.

As a listed company its shares are quoted on the London Stock Exchange and the share price is determined by demand and supply.

What is the difference between a fund and a trust?

Investment Trusts are closed-ended companies which means they have a fixed number of shares in issue. Whereas Funds are open-ended investment companies ('OEICs') or Unit Trusts. Investment Trusts are also listed companies and must have an independent board of directors that are obliged to answer to their shareholders.

Premium and Discount

Investment Trusts have a fixed number of shares (closed-ended companies). This means that rather than growing or shrinking with demand like an open-ended fund, the share price will go up or down according to investor appetite for the shares, and may not exactly match the value of the underlying assets in the fund (‘net asset value’, or NAV). If the share price is higher than the NAV the trust is said to be trading ‘at a premium’, and if the share price is lower, it is trading ‘at a discount’. Generally speaking, more trusts trade at a discount than a premium, meaning that investors can buy exposure to the underlying assets at less than their true worth, although this is only beneficial if the discount to NAV is smaller when they come to sell the shares than when they bought them. We discuss discounts and premiums, and the ways investment trusts manage them, in this article.

Investment Trust

An investment trust is a type of collective investment or fund, where the money of many investors is pooled together. In this way, investors can access a more diversified portfolio of investments than they might otherwise achieve individually. A professional fund manager is responsible for investment decisions in return for a management fee. In addition, the fund charges an annual fee - normally between 0.5% and 1.5% of the value of the holding, although some may charge more or less than this.

The Association of Investment Companies (AIC) classifies Investment Trusts into sectors including:

§ Global equity and bond sectors

§ UK equity & bond sectors

§ Developed market equity sectors

§ Emerging market equity sectors

§ Private equity.

§ Hedge funds.

§ Property sectors

§ Sector specialist (equity or debt) sectors

§ Venture Capital Trust (VCT) sectors

Collective Investment or Fund

A collective fund may seek to reward investors with capital growth, income (through share dividends or interest income) or both. There are funds that seek to match the performance of a market index like the FTSE 100 or S&P 500 (‘index trackers’), those that seek to beat an index through active management, and those that seek to provide positive returns whether markets are going up or down (‘absolute return’ funds).

Open- vs closed-ended funds

The majority of collective fund assets in the UK are invested in open-ended funds – unit trusts or OEICs (open-ended investment companies). These funds are called ‘open ended’ because they can grow and shrink according to investor demand, issuing new shares or units when money comes in from investors, and cancelling them when investors wish to withdraw their money. Figures from the Investment Association’s website state that £1,199,809 m was invested at the end of November 2018 in open-ended funds.

Investment trusts have been around for longer – the first one, Foreign & Colonial Investment Trust, was launched in 1868, whereas the first unit trust, M&G First British Fixed Trust, did not appear until 1931. In spite of its long history, the investment trust sector is comparatively small: £181.6 bn was invested in 401 closed-ended funds at the end of November 2018. The reasons for this size differential are largely historical: until the beginning of 2013, most open-ended funds paid commission to financial advisers, while investment trusts did not. However, there are some specific characteristics of investment trusts that make them more complex than the ‘what you see is what you get’ nature of open-ended funds, which may also account for some of the disparity.

Corporate structure

An investment trust is structured as a company and listed on a stock exchange such as the London Stock Exchange (LSE). Investment trusts (ITs) and investment companies (which are functionally the same as ITs, but are usually incorporated outside the UK in jurisdictions such as the Channel Islands) are called closed-ended funds because they have a fixed number of shares in issue. Because an investment trust is technically a company, it has a board of directors – a feature not shared by open-ended funds. The role of the board is to set the investment policy and ensure it is adhered to. The board appoints the fund manager, and has the power to seek a new manager if results are not as expected. The board will also decide the gearing policy (the extent to which a trust can borrow money to invest), the level of dividend, and may implement a discount management policy to ensure the share price does not deviate too far from the NAV. Board members are usually independent of the fund management company, and may have specific expertise in areas such as accountancy, or experience in the region or asset class in which the trust invests. Open-ended funds do not have an independent board.

As listed companies, investment trusts also have a requirement to publish annual and half-yearly reports and accounts, which can give investors a wealth of information on the portfolio and performance of the trust. Significant events are reported on the LSE's Regulatory News Service (RNS), which can be viewed on the LSE's own website or on third-party sites such as Investegate. Investment trusts also hold annual general meetings for shareholders, where investors can have a say on matters such as investment policy and performance, discount management and directors' remuneration.

Investment trusts are a specific form of company under UK legislation that benefit from certain tax rules. 'Investment company' is a generic term that includes investment trusts and other closed-ended funds that may be domiciled outside the UK