88% of Investment Trusts Trading Below Asset Value Amid Market Challenges

City AM has disclosed that a significant 88% of all investment trusts are currently trading at a discount to their underlying assets. Dragon Capital's analysis reveals that the disparity between the share price of investment trusts and the value of their underlying assets is so severe that 30% of all trusts now trade at a discount exceeding 20%.

Approximately 6% of investment trusts have a discount ranging between 15 and 20%, 13% have a discount between 10 and 15%, and 25% have a discount between 5 and 10%, as reported by City AM.

Concurrently, less than one in ten (9%) investment trusts are presently trading at a premium. The last time discounts were this wide was 16 years ago, at the end of 2008.

The sector has been troubled by wide discounts for some time, but upon consideration, it doesn't quite add up. Why would the market price the trust as less than the value of the assets inside it?

Annabel Brodie-Smith, communications director of the Association of Investment Companies, commented: "It's been a challenging couple of years for investment trusts with rising interest rates, misleading cost disclosures and recent market volatility leading to wide discounts," She added, "The average investment trust discount excluding 3i is currently 14.8 per cent, much wider than at the end of 2021 when the average discount was two per cent."

The industry has consistently highlighted, over recent months, the significant impact of cost disclosure on investment trust discounts. It was disclosed this week that Baroness Sharon Bowles is poised to introduce a private members bill aiming to amend regulations around investment trusts; the proposed change would alter the rule that compels trusts to reveal costs and charges just like publicly traded companies.

Unlike equities such as Tesco or Shell, which are not mandated to disclose their costs and charges, trusts have been treated akin to investment funds in terms of disclosure a point of persistent contention for the sector, spawned by European legislation.

Aside from this regulatory issue, high interest rates have adversely affected trusts, although there’s now potential relief with the Bank of England starting to trim the base rate.

“Wide discounts can be a buying opportunity for investors. Our research demonstrated that when discounts were over 10 per cent, the average investment trust returned 89.3 per cent over the next five years,” Brodie-Smith mentioned.

“But when the average discount was less than 5 per cent, the average return was 56.1 per cent over the next five years.”

To conclude, Brodie-Smith stated: “It makes sense that buying at a discount gives you better returns because you are buying assets on the cheap, and periods of wider discounts often coincide with lower underlying valuations, giving the potential for a strong market recovery when market conditions improve.”