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"I'm from the government and I'm here to help"

Richard Parfect
Portfolio Manager

24 July 2023

President Reagan referred to those words as being the "nine most terrifying words in the English Language". August 1986 feels like a distant era and in many ways it is, however the debate over what any government's role should be in a capitalist free market system is as relevant today as it was back then. The primary and most important function of an elected government is the defence of the realm; I doubt President Zelenskyy is spending much time thinking about reform of Ukraine's education system or how to pay for public health programs. Therefore, how and to what extent government should reach into these other areas is something of a philosophical political debate.

Central governments, not least that of the UK, do not have a fantastic record when it comes to efficiently allocating taxpayer capital into physical projects. However, perhaps that is a little harsh as it depends upon what the objective is. Is it simply to make a profit, or alternatively is to try and influence the course of events in altruistic ways; with the expectation that money is likely to be lost in the process? The problem is that the objectives of such spending are rarely communicated.

Climate change is an increasingly hot topic (pun intended). One of the problems in addressing that is how to help developing nations adopt clean energy, when dirty energy may be more accessible or cheaper. It is therefore in addressing this conundrum that the Foreign, Commonwealth and Development Office (FCDO) decided to support the Initial Public Offering (IPO) of a new investment trust in 2021 with $32 million of taxpayer capital.

Thomas Lloyd Energy Impact Trust (TLEI) had the laudable ambition of investing in various construction ready infrastructure and renewable energy assets in Asia, India, Philippines, Vietnam, Bangladesh, and Indonesia (countries that are on the front line of climate change impacts). Targeted returns to investors were for 10-12% per annum.[1] At the time of the IPO, a key hook offered to investors was that they would be investing alongside the UK Government, the implication being (deliberate or otherwise) that could provide a degree of comfort on the due diligence already carried out and execution risks had been appraised by them.

We decided not to invest at the time, as despite the laudable aims, the targeted returns (given the risks) did not compare favourably against proven operating assets of a similar nature closer to home. Furthermore, the "attraction" of the UK Government having done rigorous due diligence felt far from compelling. Unfortunately, things have not gone well for TLEI. The shares were suspended in April 2023 due to "material uncertainty regarding the fair value of certain of its assets and liabilities", the issue surrounded problems over the proposed construction of a 200MW solar plant in India that could cause a $8.2 million impact.[2] An update on 12 July 2023 brought to light a number of non-completion liabilities facing the investment that could amount to $33.5 million; quite significant for a trust that last reported Net Assets of $142 milion.[3] The shares remain suspended and are yet to publish their report and accounts for December 2022.[4]

Investing in investment trusts is not risk free (we previously wrote about the collapse of Home REIT). Due diligence needs to be conducted at every level and an assessment made of whether the valuation and returns on offer are sufficient compensation for those risks. However, when good quality management teams are found, they can deliver compelling value; there have been various success stories raising primary capital for renewable energy (and other assets) in the UK over the last decade, for example the £3.9 billion Greencoat UK Wind.

It therefore remains a significant frustration for us that the Financial Conduct Authority (FCA) (the regulator, and by extension, an arms' length branch of government) has in place retail cost reporting guidelines that results in mis-leading over reporting of costs to investors of investment trusts (see link here to our previous comment on this). The result has been a loss to "UK plc" and increased risks for retail investors. Those guidelines are resulting in multi-asset investors, such as ourselves at MGIM, having to reduce the allocation given to investment trusts in portfolios in order to reduce our optical "look through" costs. Consequently, retail investors who wish to gain access to specialist investment trusts are being forced to conduct their own due diligence. Given recent examples of some trusts permanently losing shareholder capital, it is indeed terrifying that the government (via the FCA) has provided "help" to retail investors resulting in cost (mis)disclosure.

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Sources: [1]Thomas Lloyd Energy Impact Trust PLC 2022 Interim Report [2]24 April 2023 Thomas Lloyd Energy Impact Trust RNS, [3]Net Asset Value, Dividend, and Operational Update 3 November 2023, [4]12 July 2023 Thomas Lloyd Energy Impact Trust RNS. Unless stated all other sources are Bloomberg Finance L.P.

For more information, please contact:

Distribution Services

E: distributionservices@momentum.co.uk

T: T: +44 (0)207 618 1803