The Daily Telegraph

The Daily Telegraph Thursday 20 March 2025

Stop missing out on the home advantage – this trust is primed for recovery

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TRUST BARGAINS

UK companies have been oversold on depressed sentiment

THE UK market remains firmly out of favour. Open-ended UK equity funds haemorrhaged £22.7bn in net outflows last year as retail investors pulled their cash.

It is not hard to find reasons for this – the FTSE All Share has risen 82pc over the past 10 years, while the MSCI World index has delivered more than double that at 168pc, driven largely by stellar returns in the US. In addition, it is easy to dismiss the UK market for lacking the growth potential found in the US, given just 1.3pc of its value is represented by technology stocks.

Questor recognises that GDP growth in the UK remains anaemic, while business confidence is suffering from rising taxes and the uncertain geopolitical environment. However, UK equity valuations have already priced in a lot of bad news, and it is worth recognising that more than 75pc of revenues of UK-listed companies come from overseas. The key catalysts for a recovery come in the shape of the wave of takeover approaches by overseas corporates and private equity, as well as the ongoing return of capital via share buybacks. These are already having an impact – the FTSE All Share is up 11.1pc over the past 12 months, beating the global market's 8.2pc.

Questor believes a value investment approach is well placed to benefit in the current environment, and Fidelity Special Values investment trust – which recently passed its 30th anniversary – offers precisely that. Over its lifetime the contrarian investment vehicle focused on UK equities has grown assets from under £50m to over £1.1bn. For the first 18 years of the fund's life, the portfolio was run by Anthony Bolton, one of the leading fund managers of his generation.

He was never going to be an easy act to follow, but Alex Wright has continued to deliver strong performance since taking over as lead manager in September 2012, with annualised Nav total returns of 11.4pc versus 7.5pc for the FTSE All Share, outperforming in 8 of 12 financial years.

The manager seeks out unloved companies trading at attractive valuations that are entering a period of positive change, ones the market hasn't cottoned on. The investment universe includes large, mid and small-cap stocks, as well as up to 20pc in companies outside the UK. Risk is managed partly through diversification, typically holding 80-120 investments, with the largest, currently Imperial Brands, at 4.5pc of assets.

In addition, stock selection focuses heavily on the potential downside risk. In part, this is achieved by buying companies that are valued cheaply relative to their history or peers, but also by avoiding businesses that are highly leveraged. Furthermore, a strict sell discipline is imposed once a company's share price has recovered.

Just 39pc of the current portfolio is invested in the UK's largest companies, compared with the benchmark's 86pc FTSE 100 allocation, demonstrating a bias towards the less well-covered mid and small cap stocks. The active management approach is illustrated by having no exposure at all to several of the largest companies in the FTSE All Share, including Shell, BP, HSBC and Unilever. As a result, the fund should not be expected to perform in line with the benchmark, and there will be periods of underperformance, as was the case during the Covid pandemic.

By sector, the portfolio is typically overweight towards financials, and the largest holdings currently include Standard Chartered and NatWest, as well as Direct Line, which recently agreed a takeover bid from Aviva. However, some profits have been taken from banking shares over the past year following strong share price performance. As a result, the largest overweight sector is industrials, with holdings such as Keller, DCC and Coats. By contrast, the fund is underweight towards energy and healthcare.

The £3.3bn open-ended variation – Fidelity Special Situations – has a similar portfolio. However, Questor favours the investment trust as it has a lower management fee and is trading at a discount to Nav of 5.6pc, with a commitment to buy back shares to keep the discount in single figures.

Over the long term the performance has been enhanced by modest gearing, typically 10pc, and the ability to take positions in less liquid companies. Although the emphasis is on capital growth, it yields 2.9pc via semi-annual dividends, and has increased its dividend every year for 15 years.

Questor says: buy
Ticker: FSV
Share price at close: 333p

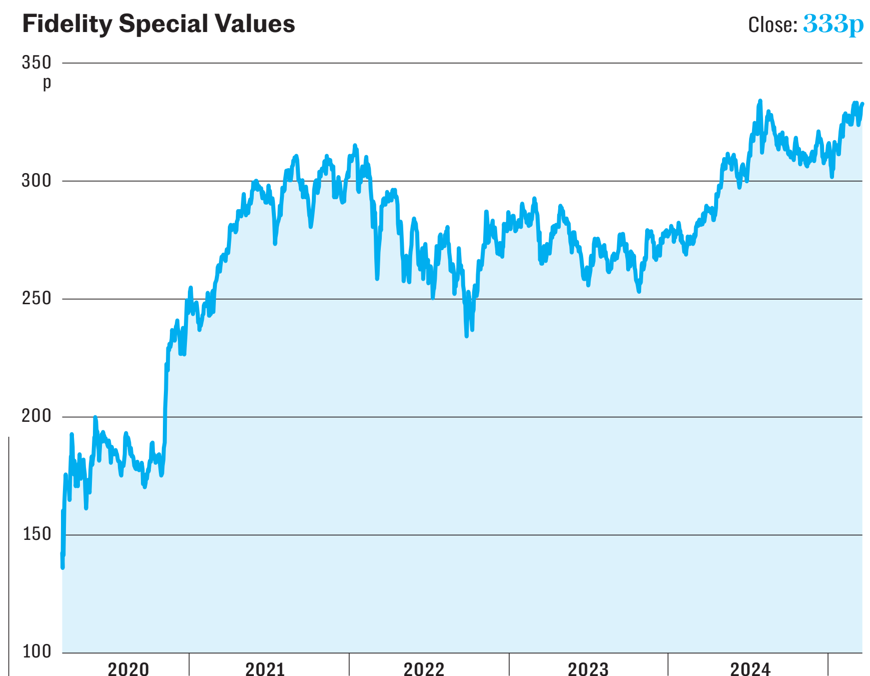
Charles Cade is an investment trust specialist and non-executive director

Fidelity Special Values

BUY

The fund's manager looks for unloved companies that are entering a period of positive change, before the rest of the market cottons on

> 'Anthony Bolton was never going to be an easy act to follow but Alex Wright has continued to deliver'



Key numbers

- **Market value: £1.1bn**
- **Year of listing: 1994**
- **Discount: 5.6pc**
- **Average discount over past year: 8.2pc**
- **Yield: 2.9pc**
- **Most recent year's dividend: 9.54p**
- **Gearing: 8pc**
- **Annual charge: 0.7pc**

Read Questor's rules of investment before you follow our tips: telegraph.co.uk/go/questorrules