City of London

CTY appears well-set to continue to deliver on its objectives...

Update
04 March 2025

Overview

City of London Investment Trust (CTY) aims to deliver income and capital growth through a cautious investment strategy that is typically focussed on larger UK-listed equities. Job Curtis has been the trust's manager over the past 33 years, a tenure that gives him huge experience with which to navigate markets and economic cycles.

It is his success in delivering steady outperformance over the long term, as well as CTY's unrivalled track record of delivering successive dividend increases for 58 years, that has allowed the trust to build a strong following amongst investors, enabling it to grow and benefit from economies of scale. The most recent OCF is 0.37% (see **Charges**), which makes CTY highly competitive.

With a mix of higher yielding stocks as well as lower yielders that have higher growth potential, Job remains convinced of the quality and attractive valuations of the companies in the CTY portfolio. It is this backdrop that has led Job to gently increase **Gearing** to c. 8% currently.

As at 31/01/2025 CTY's NAV had outperformed the benchmark over one, three and five years (see **Performance section**). As we discuss in the **Portfolio section**, the strong track record comes not from any investment heroics, but in our view is more a result of Job's risk-averse approach to stock picking. Job likes to ensure that CTY is always exposed to a broad spread of investments, which is complemented by Job's valuation-based investment framework, focussed on quality companies but sometimes with a contrarian tilt. Generally, capital invested in each company corresponds not only to Job's estimation of the share price relative to fair value, but also his confidence in the quality and future trajectory of the dividend.

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Analyst's View

CTY is the biggest and cheapest trust of its peer group, with the longest track record of dividend increases (of any trust): in every sense the superlative of the UK Equity Income sector. The dividend yield is currently 4.7%, well ahead of the benchmark and peer group average, and the board's clear focus on discount control means that historically the share price has closely reflected the characteristics of the NAV – something that can't be said of some investment trusts. Additionally, low-cost long-term gearing should confer a steady advantage to the trust over many years to come. As such, in our view CTY continues to be advantageously set up to deliver on its income and capital growth objectives for shareholders.

These attractive characteristics have not been missed by investors, and over the past ten years CTY has issued shares at a premium to NAV, boosting returns for existing shareholders and leading to economies of scale and a progressively lower OCF. Indeed, over the decade to 30 June 2024, the share count has increased by a total of c. 76%. However, over much of 2024 and so far in 2025, CTY's shares have traded at a small discount in absolute terms, a symptom of negative market sentiment towards the UK. In our view, for long-term investors wishing to take advantage of the inevitable cyclicality of sentiment, CTY is worthy of consideration. Indeed, as the chairman observes in the recently announced interim report, the dividend yield of 4.7% (see **Dividend section**) means shareholders are "paid to hold on" until the UK sees a change in sentiment, and potentially an improvement in valuations.

BULL
Very low OCF of 0.37%
Consistency and experience of manager who has delivered long-term outperformance of the FTSE All-Share Index in capital and income terms
Track record of 58 years of progressive dividend increases

BEAR
Cautious approach means that NAV can underperform in some market conditions
Income track record highly attractive, so manager might risk long-term capital growth in trying to maintain it
Structural gearing can exacerbate the downside

Portfolio

City of London Investment Trust (CTY) aims to deliver income and capital growth through a cautious investment strategy that is typically focussed on larger UK-listed equities. Job Curtis has been the trust's manager over the past 33 years, and his tenure makes up a large part of CTY's unrivalled 58-year track record of consecutive dividend increases. For the last few years, David Smith (deputy manager for CTY) has been working closely with Job, seeking to continue the impressive progressive track record of the dividend.

Aside from positive stock picking, in our view a key element of CTY's success over the years has been Job's preference to take a cautious and conservative stance, ensuring that CTY is exposed to a broad spread of investments. This has protected CTY against many sector-specific issues that have arisen over the years, but also in our view complements Job's valuation-based investment framework, which favours quality companies, and sometimes has a contrarian tilt towards identifying new ideas. Generally, the amount of the trust's capital invested in each company corresponds to Job's estimation of the share price relative to fair value, and also his confidence in the quality and future trajectory of the dividend.

When selecting investments, the prospective dividend yield and growth of that dividend is a key determinant for Job. Holding a company that doesn't pay a dividend is relatively rare, but Job does hold a number of companies that pay a relatively low dividend yield but which in his view have strong or resilient growth characteristics. Given the overall portfolio yield is in excess of the FTSE All-Share benchmark, Job aims to offset any lower yielders (such as RELX, the trust's third largest holding) by also investing in steady, highly resilient dividend payers with strong balance sheets such as Imperial Brands, which has a dividend yield well in excess of the benchmark and is also buying shares back aggressively. Job notes that it wasn't long ago that market trends, which shied away from the tobacco sector on ESG concerns, left these companies looking very cheap. With long experience on which to draw, Job saw these stocks as highly attractive from an investment and dividend standpoint, and CTY has benefitted from Imperial Brands' strong performance as the pendulum of attitudes towards ESG have swung the other way.

The overall conservatism driving CTY's manager is illustrated by the fact that Job does not invest in turnaround stories, which in his view confer too much risk and do not represent the higher quality companies that have contributed to CTY's long track record of dividend increases (see **Dividend section**). At times, this can cost the trust in terms of relative performance, and one such instance is Rolls-Royce (referenced in the recently announced interims to 31/12/24), which has had well-publicised problems with its business, but has recovered very strongly in share price terms. Given CTY has not owned it, this has been a headwind to relative performance, although as we highlight in the Performance section, Job's strong run of outperformance has continued since our last note published in October 2024.

Top Ten Holdings As At 31/01/2025

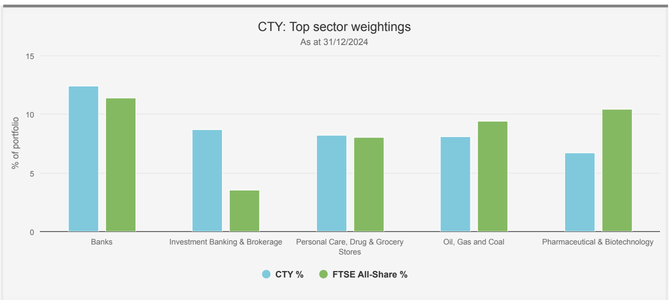
COMPANY	% OF PORTFOLIO
HSBC	4.8
Shell	4.5
RELX	4.3
Unilever	3.7
British American Tobacco	3.6
BAE Systems	3.3
Imperial Brands	3.3
NatWest	3.2
Tesco	3.1
AstraZeneca	2.9
Total	**36.7**

Source: Janus Henderson

CTY's portfolio is a result of Job's stock picking, itself built on his own analysis of company fundamentals. As we discuss in the **Management section**, Job and David sit within Janus Henderson's global equity income team, which, amongst other advantages, helps give them an understanding of relative valuations on an international basis. CTY has the ability to invest up to 20% overseas, exposure which at times Job has fully embraced. Given the relative valuations of the UK market are so depressed, especially when compared to the US, CTY has only c. 9%. That said, CTY's portfolio has plenty of international exposure, with c. 63% of the portfolio's revenues earnt overseas (as estimated by Janus Henderson, as at 31/12/2024).

We show the largest sector exposures in absolute terms, and the equivalent exposure of the benchmark, in the graph below. Banks have been an overweight exposure for Job for over a year, with Job positive on the improved environment for domestic deposit takers such as NatWest, Lloyds and Barclays. This has been a positive contributor to relative performance. Job believes the benefit of the rise in interest rates for these banks will continue, and the downside is limited by their highly regulated balance sheets. As such, Job believes they are relatively well insulated (certainly, in the context of history) in the event of a UK recession. In the same vein, Job is positive on housebuilders, who he thinks are well positioned for supportive changes to planning regulations. As such he is overweight Persimmon and Taylor Wimpey, as well as owning Ibstock and Marshalls which are leading manufacturers of materials used in housebuilding.

Fig.1: Top Sector Exposures



Source: Janus Henderson

As the chart highlights, Investment Banking and Broking is CTY's second largest sector exposure, and its biggest overweight. Job's stock exposures within this sector demonstrate that it is something of a misnomer, with holdings here including IG Group, St. James's Place, Schroders and TP ICAP. Somewhat confusingly, 3i is also represented in this sector, which Job has owned for the main underlying holding, Action Group, a European discount retailer. With the shares trading at a 40% premium to NAV and the shares having performed strongly, Job has been taking profits in his position in 3i.

One area Job has been adding to exposure and is increasingly overweight, is REITs. Job owns Land Securities, British Land and Segro all of which trade at fairly significant discounts to NAV. With employees increasingly returning to the office, rents for high quality office space are moving up, and Job expects a turn in values to reflect this. In the meantime, they offer yields of nearly double the benchmark. In total REITs comprise a total of c. 4% of the portfolio, and so whilst not a significant exposure in absolute terms, Job is optimistic these companies will contribute in both capital and income terms.

Overall, and reflected in CTY's Gearing level, Job remains quietly optimistic on prospects. The number of companies in the portfolio has been coming down (80, compared to 84 six months ago), with quality and resilience remaining the key determinants for investee companies. Job believes that investors are paid to hold on for better valuations, and in the meantime companies are pursuing a record number of share buybacks. Private equity interest in UK companies continues to offer upside, should share prices not recover on their own. With Job's track record of adding alpha, CTY remains a highly liquid and low-cost way to gain exposure to the attractive dividends and capital growth potential of the UK market.

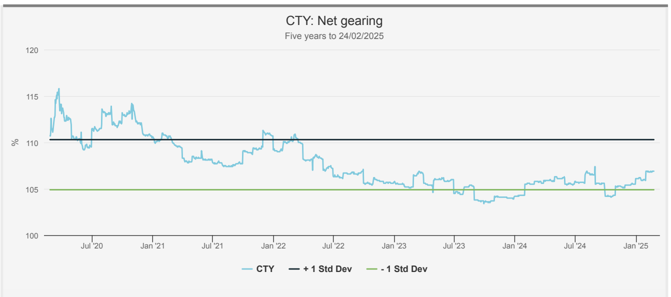
Gearing

CTY has a clear advantage when compared to open-ended funds, in that it has the benefit of £115m of long-term structural gearing, secured at very low cost. Currently, the weighted average cost of structural borrowings is 3.35%. It is not hard to imagine that CTY's long-term returns could be considerably in excess of this, which would mean gearing would be additive to returns over the long term. In addition to the of long-term structural gearing, CTY has a more flexible overdraft facility of up to £120m available to be deployed tactically. Since the rise in interest rates, observable in the graph below, CTY has used significantly less of the overdraft facility, the simple reason being that it now costs more.

Overall, Job believes that CTY's portfolio beta will, typically, be around 0.9 to 0.95, so he reasons that CTY's NAV beta (which reflects the effect of gearing) should not necessarily be significantly higher than the wider market. Gearing decisions are the responsibility of the manager but discussed at board meetings and with the chairman between times. Overall, CTY is currently c. 8% geared (as at 31/01/2025), with c. £ 40m of short-term gearing employed. As we show in the graph below, it has been below the longer-term average level of gearing, but in line with the experience of more recent times. The recent rise in the gearing position reflects Job's cautiously optimistic outlook. If markets take a turn for the worse, then the remaining overdraft facility represents firepower to take advantage of opportunities.

It is worth remembering that gearing adds to volatility, and can exacerbate the downside. However, if long-term returns from CTY's portfolio outpace the costs of borrowing, then returns will have been boosted. An added boost comes from the effect of inflation, which eats away at the real value of the principal of the loan, whilst over the long term equities should deliver positive real returns.

Fig.2: Net Gearing



Source: Morningstar

Performance

As we highlight in the **Portfolio section**, CTY is managed in a relatively cautious manner, with the portfolio not exposed to significant single company or single sector risk. As such, the pattern of returns is unlikely to deviate wildly from the benchmark index. However, as Job's investment process is based on fundamental analysis and stock picking, relative performance tends to be primarily driven by stock selection. Positive attribution from stock selection is the hallmark of a successful active investment strategy, and as we showed in the last note we wrote on CTY, stock selection has been strong over the past decade, making positive contributions in five out of the last ten financial years. We also note that gearing has contributed to relative returns more years than not, and over time CTY's low fees also give it an advantage relative to peers (see **Charges section**).

Over time, Job's focus is to try to deliver meaningful increases in the dividend as well as outperformance of the benchmark. To 31/01/2025, CTY had outperformed the benchmark on a NAV basis over one, three and five years (although slightly behind over ten years), which we show in the table below. Whilst Job cannot deliver outperformance every year, this does show that active management, and investing cautiously for the long term does add value.

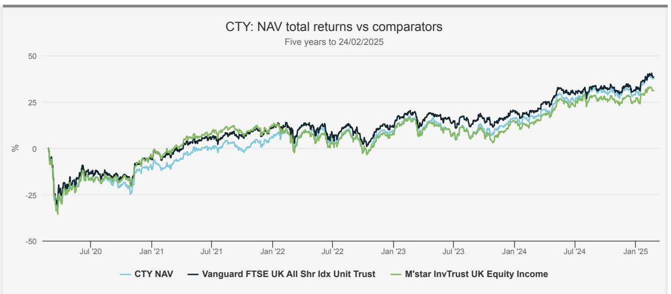
NAV Performance (As At 31/01/2025)

CUMULATIVE PERFORMANCE (%)	1 YEAR	3 YEARS	5 YEARS	10 YEARS
CTY NAV	18.1	30.0	39.8	86.2
FTSE All-Share Index	17.1	25.5	37.9	87.1

Source: Janus Henderson Investors
Past performance is not a reliable indicator of future results

Looking at five-year performance statistics, as with all equity strategies, the 2020 COVID-19 crisis has a big influence on statistics. We discuss the detail and implications in a recent editorial, available **here**. Being upwards of 10%+ geared in early 2020 (see **Gearing section**) meant that the market downdraft was always going to be a tricky time for CTY. As the graph below illustrates, the sell-off was dramatic, but CTY – because of its safety first, income focus and lack of exposure to growth stocks – lagged the rebound. Despite this, subsequent outperformance means that over the five years to 24/02/2025, CTY's total return NAV has performed in line with the FTSE All-Share ETF that we show in the graph below.

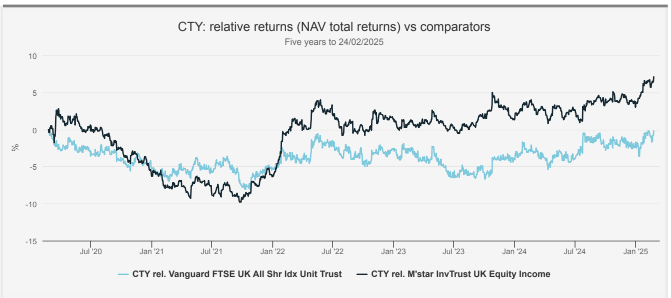
Fig.3: Five-Year Performance



Source: Morningstar
Past performance is not a reliable indicator of future results.

The graph below shows relative returns (with a rising line indicating periods of outperformance, and downwards, underperformance) over the same five-year period. Relative to peers (which includes Nick Train's Finsbury Growth & Income) CTY has performed very well since September 2021. Relative to the benchmark, outperformance has been decent, but marked by a period during 2023 when CTY underperformed as a result of several stock specific headwinds experienced by the portfolio. Since then Job has delivered decent outperformance.

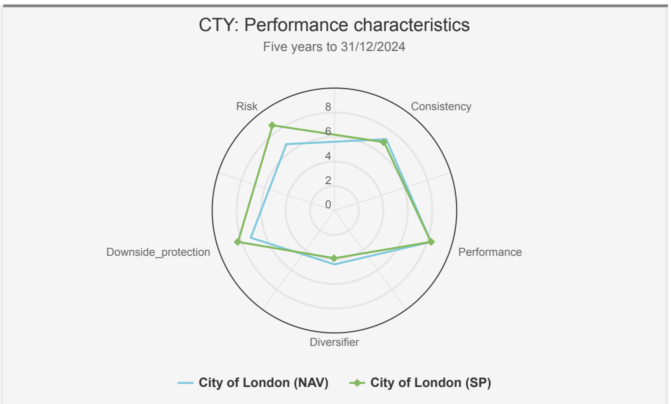
Fig.4: Relative Returns (5Yrs)



Source: Morningstar
Past performance is not a reliable indicator of future results.

Our KTI Spider Chart below shows how CTY's NAV has performed versus the peer group of UK equity income trusts over the past five years, in some key categories. Each category is scored out of ten, based on returns over the last five years, and scores are normalised to the peer group, with a higher score indicating superior characteristics. CTY continues to rank well almost across the board, as one might expect from a trust that is managed in a risk-averse manner. As we have highlighted before, CTY's lowest score is for the diversifier category, which is to be expected given that the managers do not tend to take particularly strong sector views against the benchmark. In the graph below we have also included the share price in our analysis. Because of the relatively tight control exercised by the board on the discount (see **Discount section**) relative to peers, which

Fig.5: KTI Spider Chart



Source: Morningstar, Kepler calculations
Past performance is not a reliable indicator of future results.

tend to have more volatile discounts, CTY can be seen in an even more attractive light. The other consequence of the tight discount control policy is that CTY's share price characteristics are relatively similar to the NAV characteristics – which is not something that investors in investment trusts can always take for granted.

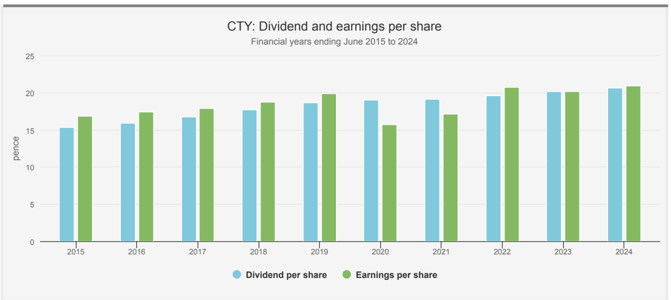
Dividend

CTY's 2024 dividend equates to a dividend yield of 4.7% at the current share price (443p), significantly higher than the AIC UK Equity Income peer group weighted average of 4.1% and the FTSE All-Share yield of 3.5%. In our view, the higher yield that CTY offers is one of the attractions to investors, given that shareholders can also derive an element of reassurance that comes with knowing CTY has a 58-year track record of delivering consecutive annual dividend increases. Job believes that this record has not been surpassed by any UK-listed company, and in our view is a considerable achievement. The board aims to grow the dividend ahead of inflation over longer time frames, and in this they have been successful: over the ten years to 30/06/2024 (the end of the last financial year) CTY's dividend has grown by 39.6% compared with a cumulative increase in UK CPI inflation of 33.8%.

In delivering this enviable track record of dividend increases, CTY has used investment trusts' ability to retain up to 15% of each year's income in a reserve, and to use this in future years to smooth dividends if revenues subsequently fall. The two years following the outbreak of COVID-19 serve as a good example of the benefits of an investment trust such as CTY's ability to do this to the advantage of shareholders. In 2020 and 2021 many companies cut or passed on their dividends, which had a direct impact on income distributions for open-ended equity income funds. In contrast, CTY continued to pay a progressive dividend year-on-year, albeit uncovered. Since then, subsequent years' revenues have improved such that they have exceeded dividend payouts, enabling surplus revenues to be used to top up revenue reserves once again. As at 30/06/2024, revenue reserves equated to 0.44× the annual dividend of 20.6p. In extremis, the board has stated that capital reserves of £346.3m could also be used to support future dividend growth.

Job observes that the UK is a good market in which to invest for an income stream, not least because of the lower valuations that companies currently attract when compared to equivalent companies listed on other stock exchanges, the US in particular. However, a key contributor to delivering such an attractive income stream over such a long period has been Job's relatively conservative approach to investing. As we outline in the **Portfolio section**, Job seeks to spread risks, and he tends to complement high yielders with those companies that may pay a lower dividend yield, yet have strong growth prospects. In such a way, Job aims to deliver on his twin aims of income as well as capital growth.

Fig.6: Financial Year Dividends And Earnings



Source:Janus Henderson Investors

Management

CTY has been managed by Job Curtis since July 1991, meaning he has an impressive tenure approaching 34 years. David Smith, who is also the manager of Henderson High Income, was promoted as CTY's deputy fund manager in September 2021. David and Job work closely together, but we understand that Job still holds the ultimate responsibility for any holding within the portfolio.

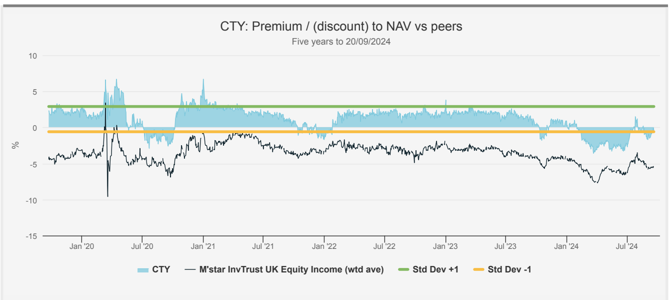
Job and David are part of Janus Henderson's 13-person global equity income team, who generate suggestions and lead company meetings. Overall, the global equity team manage £13.1bn of assets (as at 30/06/2024).

Discount

CTY has been a regular issuer of shares, and the board aims to keep the discount to NAV in a relatively narrow band, illustrated in the graph below. Over time, CTY's advantages, record of dividend increases and its following by both retail and professional investors have allowed it to grow organically. Over the past ten years CTY has issued shares at a premium to NAV such that it has increased the share count by 76% over this time. Over the past year or so, with sentiment towards the UK being a headwind, the board has been buying shares back.

Overall, the board aims for "the company's share price to reflect closely its underlying net asset value" and states that it intends to consider share issuances and buybacks within a relatively narrow band around the net asset value, but highlights that it does not have a specific level at which share issuance and buybacks may occur. Over the past five years, CTY's average premium to NAV has been 0.9%, which compares to the current slight discount to NAV of 2.5%. Through the board's rigorous discount-control activities, discount volatility has been minimised, and as such (as we discuss in the **Performance section**) this means that shareholders can be relatively confident of continued good liquidity, and that the share price characteristics will over time closely resemble the characteristics of the NAV.

Fig.7: Five-Year Discount



Source: Morningstar

Charges

CTY's management fee is charged at 0.3% for up to £3bn of net assets and 0.275% above £3bn. No performance fees are applicable. These highly competitive fees mean that CTY has the lowest OCF in the sector, most recently reported at 0.37% for the financial year ending 30/06/2024. The weighted average for the AIC UK Equity Income sector is significantly higher than this, at 0.57% on a weighted average basis (Source: AIC).

CTY's most recent KID RIY is 0.0% (zero), as of 30/10/2024. We note the regulation around KID RIYs is changing, and a consensus on how they should be calculated has not yet been formed.

ESG

The fund manager and deputy fund manager, supported by specialists at Janus Henderson, give careful consideration to ESG-related risks and opportunities when selecting stocks for the portfolio. The board recognises that these risks are highly relevant to the long-term performance of CTY. An analysis by MSCI, a company widely used in the review of ESG factors, shows that City of London's portfolio as at 30/06/2024 had a lower weighted score for ESG risks than the FTSE All-Share Index.

It is important to highlight that CTY is by no means an ESG fund, and the managers do not specifically exclude any companies based on ESG considerations. However, Job and David look to avoid companies if ESG risks are either not explained in sufficient detail or are managed poorly. They believe that governance is a key part of fundamental analysis and that strong corporate governance is supportive towards long-term decision making and investment returns.

Job and David consider each ESG factor, in addition to qualitative and quantitative assessments, before concluding the suitability of a holding. They are increasingly aware of climate change and other ESG risks that pose threats to the long-term financial returns that companies deliver. However, the team are not afraid to invest in sectors that have a perceived high level of ESG risk but have attractive valuations. Where held, the team need to believe that such companies are demonstrating they are taking positive steps towards improving their products and reducing health-related risks, whilst still offering highly attractive financial returns.

Stewardship and active engagement are areas that Job and David value highly, with the view that strong ownership principles, which can include engagement with management and boards, can assist in improving long-term shareholder value. CTY's managers are assisted with this analysis by Janus Henderson's dedicated governance and responsible investing team, who take stewardship voting at shareholder meetings extremely seriously and consult the fund managers on a case-by-case basis.

In our view, CTY is unlikely to appeal to strict ESG investors, but Job's interpretation of ESG factors, and engagement with investee companies is having an impact. At the time of writing, in comparison to the UK equity large-cap peer group, CTY has been designated an average ESG rating, according to Morningstar (December 2024).

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