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[INTRODUCTION]

Staci West (SW): Welcome back to the 'Investing on the go' podcast brought to you by FundCalibre. This week we're taking an optimistic view of the UK economy. We highlight the potential benefits of investing in UK equities, including the growth potential and attractive dividend yields.

Chris Salih (CS): I'm Chris Salih, and today we're joined by Job Curtis, manager of the Elite Rated City of London Investment Trust. Thank for joining us again, Job.

Job Curtis (JC): It's a pleasure.

[INTERVIEW]

CS: Let's start with all things UK. I believe you've been speaking recently where you said that the pessimism surrounding UK and the UK economy has perhaps been overdone? I'm a pessimist, so I could do with as much optimism as possible when it comes to the UK.

JC: Yes, well I think it's really pessimism about growth. I think if you go back a few months, both the Bank of England and the IMF and various forecasts were predicting a recession in the UK and that hasn't transposed. In fact, growth has sort of held up - not particularly high growth, but it has been positive - and I think that's got to do with the employment market. I mean, unemployment stayed very low, and we've got fairly full employment still. So, I think that's really been the positive on the economy. I mean, certainly the negative side's been inflation, which hasn't fallen as fast as people have expected. I mean, it's partly the flip side of fairly full employment and the wage increases we've been seeing. So, I think inflation … I mean, I certainly also have been in the camp thinking it would fall but be quite sticky because of the second order effects of wages. I mean, certainly you've initially had the kind of oil price / energy price effect with the Ukraine war, and that's going to come out of the 12-month calculations. So, I think the worry more is on inflation proving sticky. I mean, I think it will decline from where it is above 8% but, you know, [it's] just going to take a long time to get back to the sort of levels we've been used to in recent years. So, I think that's the kind of more worrying side, but certainly in terms of employment and growth, I think the economy has done better than a lot of people are expecting.

CS: Is the dynamic on inflation changing because it's hit wage prices, obviously that's going to slow everything down? Is that the main sort of change in the dial or … ?

JC: Yes, yes, I think it is, I mean, certainly the energy price increases are falling out and producer prices generally have fallen out. Food inflation, of course, as we all know, food price inflation has been high. But I think those sort of effects begin to come out at 12-month figures. But I think it's more … I think the key factor is wages now and which have, we've been looking at kind of wage growth of slightly over 7% and

that's the key influence on inflation at the moment. And you know, it makes the Bank of England's job quite tough at the moment.

CS: I mean, just more broadly, what should people sort of consider when investing in UK equities, I mean, specifically dividend-paying companies in your case? I mean, you mentioned, we talked about inflation there, cash is paying 5% and there's talk of more rate rises coming. I mean, why take the extra risk? What does UK equities offer that perhaps just having a risk-free bond perhaps [doesn't]?

JC: Well, UK equities doesn't equal the UK economy, as you know. UK equities you know, some two thirds of the underlying sales of companies, UK stock market come from overseas [and] only a third come from from the UK, so it gives you a kind of global exposure for a start.

Secondly, I mean, I'd think you'd be very unlikely to get 5% cash in any kind of, it would be a fairly risky bank offering you that! I mean, you can find that in the bond market, but that would be very difficult to find. In fact, you wouldn't be able to find it from a safe bank at the moment. But I think, you know, even if you just compare the 5% figure, what UK equities offer you is the potential of growth and growth in both profits and dividends.

So, you know, whilst your starting dividend yield would be below 5% at the moment, you would have the prospect of a growing dividend and capital appreciation as companies grow their profits and dividends. And, you know, even 5% which you might get in a bond, if inflation is running as it is at the moment above 8%, you're actually losing money in real terms. So, I think in an inflationary era, you want to be in real assets, in companies, you know, companies that have got the ability to grow their profits despite inflation are kind of even more attractive than in ... it's different when you've got kind of you know, if inflation was down at 2%, then 5% would be an attractive return for fixed interest. But unfortunately, inflation is above 8% as we're talking, and so 5%, it's not much compensation - if it's a fixed 5% - whilst equities are offering you a combination of dividend yield and growth, which means you'll probably get … you could hope you have the prospect of a total return that could beat inflation.

CS: Okay. I'm going to continue with the sort of pessimistic thing, so, I'm trying to get UK PLC sold a bit better here. You know, you could argue that perhaps the UK's not as sort of prominent on the global stage today on the company side. I mean obviously, given where you invest, a lot of the companies do have an international footprint, but maybe why should an investor consider the UK? What sort of elements of the market perhaps does it have that other parts of the world don't have? You know, obviously the income is a standout factor, it's the most mature market for that. Maybe just give us a bit more of a selling sort of point on the UK for us?

JC: Well, the UK market is very cheap relative to our equity markets. And, I mean, there's one major reason for this, in that the World Index is dominated by the American market and the American market is homed the big technology companies, the big global technology companies, like Microsoft [Corporation], Apple [Inc.], Amazon [.com, Inc.], and you know, these companies have been extraordinarily successful and some of them are very highly rated and probably with justice. And we certainly can't … [the] UK doesn't have that, you know, and certainly, you know, I would always suggest to people to hold world equities as well as UK equities. I mean, any investor should have a portfolio and he's going to want some global exposure for sure. And you'll get that technology company exposure through the global.

But then if you strip out those technology companies and look at the UK companies we've got and compare them with companies in America and the other major markets in Europe, our companies are still cheap. I

mean, it's been calculated [that] the UK's on a discount of some 20%. I mean, I could look at specific companies: if you look at, say Shell [plc], which is the big oil company in the UK and compare it with Exxon [Mobil Corporation], which is the big American oil company, you know, the discount of Shell is more than 20%. It's the same with, say, British American Tobacco [plc] and Philip Morris [International Inc.] as well. So, and why is this the case? I think it has to be said, the UK's … the kind of global … whatever we feel in the UK about Brexit, the global view hasn't been particularly positive. And I think that's affected people's attitudes.

I think, but probably a more important factor has been that, you know, when I first started working in the stock market in the early 1980s, I mean, pension funds dominated the UK stock market. I mean, pension funds would've had about, you know, over 50% of their assets in UK equities. And that's fallen dramatically over the years, partly because they've de-risked and they've gone more into bonds as their funds have matured, and they've also become a lot more global. And I think there's been a lack of domestic support for UK equities. And, as a result, the actual number of companies on the stock market has been shrinking and companies [have been] getting taken over both by private equity companies and foreign firms. And you know, we in The City of London, you know, have got three examples the last couple years. We had Morrisons supermarket that got taken over by a US Private Equity group. We had Daily Mail, which got taken private by Lord Rothermere. And then we had Brewin Dolphin, the wealth manager, which got taken over by Royal Bank of Canada.

So, but there've been many, many other examples and I think, you know, whilst this discount for the UK persists, whereby we're so cheap on a global stage, and with the amount of private equity money out there, and the fact that we've also got a very open system of corporate control, I can see that this trend of, you know, takeovers continuing. So, at some point, and I'm not sort of arguing it's going to come short-term necessarily, but at some point I think the valuation gap will, on a comparable basis, will begin to close between UK equities and global equities. But in the meantime, you get a very good dividend yield from the UK market. And so, you could argue, you're being paid while you wait.

CS: I was just going to say, I mean the overbearing sort of message often is patience, isn't it? But you are being paid to be patient, I guess, which is something that perhaps is overlooked [JC: Absolutely.] in the market.

Let's turn to the income. Obviously, the Trust is known for having that reliable income. You know, I'd almost see it as like you kind of survived the acid test, which was Covid. I assume that that was a pretty tough time, but you know, you guys managed to navigate that well, in terms of the income and the revenue reserves. Maybe talk to us: why should an investor look at this Trust, should it just be someone who's perhaps at or approaching retirement or would you say it's suitable for younger investors too, in terms of compounding income?

JC: Yes. Well, I think sort of two parts to your question.

I mean, obviously we have a core of consistent companies in our portfolio but as an investment trust, we have a structure whereby we can use revenue reserves. So, in the good years for dividends, we put money … we can save up to 15% and put it into a revenue reserve. And in a difficult year, such as during the early stage of the pandemic when FTSE 100 dividends went down by about 36%, we carried on growing our dividend because we were able to dip into our reserves and we couldn't have done it without those revenue reserves. So, that is why we can look forward with a lot of confidence to continue with our dividend growth track record.

But I think the other point is, you know, should we appeal to younger investors? Well, funnily enough, the dividend is a very important part of the total return from the stock market in the long run. It's often not something that people are, you know, commonly aware of, you know, but actually, if you … very longer term studies, and this is going back – I'm not talking about kind of any single year - but if you go back like 30, 40 years and look at the kind of where the real returns have come from the stock market, it's a combination of income and capital returns, and it's actually a surprisingly high amount of income. So, I think it's the kind of hidden secret of stock markets and it's not just true of the UK, it's also true of overseas stock markets. So, I think younger investors should take heed of the importance of income as part of their total return. And, you know, certainly if you can reinvest that in the fund as you can do, that's a very powerful way of compounding your total return over a long period.

So, obviously, [to] someone kind of close to retirement or in retirement, you know, income is obviously critical. You need a bit of income to pay your bills. But even for those, you know, kind of people in their thirties or whatever, you know, I think that it still is worth thinking about as it is a key part of the longer-term return from equities, both in the UK and overseas.

CS: Okay. I want to finish by talking a bit more about the companies, but obviously you can't really talk about the companies without talking about inflation. Again, I mean, you sort of overlaid us with your view and how you perceived inflation to impact the markets. I mean, how have the companies in your portfolio managed rising inflation and interest rates are the earnings holding up?

JC: It's a very good question. I mean, certainly you know, some companies are very used to inflation. I mean, if you take Unilever [plc], which is one of our biggest holdings, I mean some 60% of their revenue comes from emerging markets. They've got a big business in countries like India, [and] all over the world. And in some of these countries, you know, inflation is very common, similarly with BA [British American] Tobacco. So, a lot of companies, you know, these multinational companies are quite experienced in dealing with inflation. And, if you're selling an everyday product like Unilever, you have got a fair amount of pricing power, particularly if it's a brand that people respect, it's not a kind of big purchase as part of their total budget. So, you know, certainly a good chunk of our portfolio is both used to these conditions. Maybe it's been a long time since we had them in the UK, but you know, on a global basis, they're used to handling inflation and, well, they've got quality products, so they have a degree of pricing power.

So, you know, I mean certainly it is a threat to consumer discretionary companies, particularly high-end discretionary items. I mean, the housing market, you know, faces a challenge as well from higher interest rates, though ultimately, you know, [in] the UK we need a lot more homes, that is absolutely clear with the kind of population growth we've had. So, whilst I think house builders, short-term, are under pressure, I think medium-term, you know, there's a good opportunity there.

So, I think, obviously it comes down to stock selection and being in the companies that have got pricing power and … who can cope with inflation.

In terms of interest rates themselves, obviously, you know, I take a fairly cautious approach and, you know, I think the kind of area to be wary of are companies which are heavily indebted. I mean, they're going to obviously suffer most and, particularly if they're in a cyclical industry, and it's that combination of their profits are declining and their interest payments are going up, that's a kind of toxic combination. And certainly, companies in that sort of predicament are bound to be looking at their dividends and probably cutting them, you know, in that situation.

So, on the other hand, you know, rising interest rates do benefit parts of the market, I mean, for banks, and in some respects, I mean, it's a balancing act, to the extent that it doesn't tip the economy actually into recession, banks should benefit from the fact that, in recent years with virtually zero interest rates, it's been very difficult for them to price their deposits, but actually they can now give people an interest rate on deposits and it makes it easier to earn their margin, or between what they're paying on deposits and what they're charging borrowers. And certainly, in parts of the insurance sector as well, life assurance will benefit from better interest rates on their bond yields.

So, I think it's a complex subject; there are certainly losers, but there are also winners in the stock market in this situation of much higher inflation [than] we've experienced in recent years and higher interest rates.

CS: I just want to finish really by talking about the sort of construction of the portfolio. I mean, you mentioned banks and insurers there. Maybe just talk us through the diversity of the portfolio from a sector perspective and, you know, are there certain sectors - you mentioned banks there - that you find particularly attractive at the moment?

JC: Yes. Well, the biggest part of the portfolio, around 25%, it's in financials;, it’s a mixture of banks, insurers - which is life insurers and non-life insurers - and financial services. I mean, although we have exposure to banks, we're actually slightly underweight relative to the average in the FTSE index – All-Share index. But we're quite heavily overweight in financial services and insurance, [which is] an area I think the UK does well and with some very good quality companies and [which] are attractive in yields. So, that's one very important building block.

The second biggest building block, over 20% of the portfolio, is those consumer staples companies I've referred to just now, like Unilever, British American Tobacco, Diageo [plc]. These are very consistent companies, global, you know, they [have] a very good delivery on dividends over a long period and [are] fairly defensive as well. So, they are the kind of two biggest blocks within the portfolio.

Industrials is around 11%; our biggest holding here is BA Systems, which is the big UK defence contractor, but actually their biggest business is in the US where they’re the sixth biggest contractor - defence contractor to the US government. And obviously [defence spending is a] big change with the Ukraine war, sadly, but I think [it’s] the end of the post-Cold War / Peace dividend and, you know, governments all over are looking to increase defence spending now.

Then I've got, the next two biggest areas are energy; we've got Shell and BP [p.l.c.] there. And then the fifth biggest sector is healthcare, where we have AstraZeneca [plc] and GlaxoSmithKline [GSK plc] and Merck [Merck & Co., Inc.] of the US. So, I think the important thing to emphasise, it's a fairly diverse you know, it's got a defensive stance, but it's a fairly diverse spread of the portfolio. We don't have all our eggs in one basket, so we're not kind of going to suffer if any one particular area does badly. But overall, it's a defensive portfolio and hopefully structured well, it's planned, structured to continue our record of dividend growth and also producing competitive returns.

CS: No problem, Job, once again, thank you for joining us today, talking about all things UK.

JC: Pleasure.

SW: Launched in 1891, the City of London Investment Trust is one of the longest-running investment trusts in the UK and has increased its dividend payment every year for the past 56 years. For more information on

the City of London investment trust visit fundcalibre.com – and don’t forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.