The Daily Telegraph

This trust is too appealing to leave out of our portfolio and will benefit from a domestic revival

ROBERT STEPHENS
QUESTOR
WEALTH PRESERVER

UK-focused fund's solid record and deep discount make it a logical and sensible addition

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When it comes to beating inflation, few assets can compete with shares over the long run. Certainly, stocks have struggled to post gains in recent times as restrictive monetary policy has weighed on economic growth and investor sentiment. In tandem, rampant inflation that remains above the Bank of England's 2pc target has meant that the stock market's returns have generally lagged the rate of price rises over the past few years.

Over a longer period, however, shares have produced an exceptional return on an after-inflation basis. The FTSE 250 index has posted an annualised capital gain of about 6pc over the past 20 years. Inflation, meanwhile, has averaged just under 3pc a year over the same period. This means Britain's medium-sized stocks have delivered a real return of roughly 3pc a year, even before we include the impact of reinvested dividends.

In Questor's view, the stock market's recent downbeat performance is almost certain to be a temporary phenomenon. Normal service will ultimately resume, since inflation is widely expected to decline further and prompt looser monetary policy. This is likely to boost the economy, strengthen operating conditions for domestically focused companies and, perhaps most importantly, boost investor sentiment towards Britain's stock market. Now is therefore the right time for this column to increase the stock market exposure of its Wealth Preserver portfolio.

Schroder UK Mid Cap

BUY

With a gearing ratio of about 7pc, it is well placed to generate index-beating returns as the stock market recovers

Although company shares, excluding commodity stocks, accounted for 20pc of our initial investment, the portfolio does not hold any stock market-focused investment trusts or funds other than the Worldwide Healthcare Trust.

As shares outside the FTSE 100 are particularly cheap at present as a result of their relatively high exposure to the distinctly unpopular British economy, the Schroder UK Mid Cap trust is a sensible addition to our portfolio. It has previously been recommended by Questor and has posted a capital gain of 24pc since our initial tip in April 2020. Over the past five years its shares have risen at an annualised rate of 8.5pc against an annual return of 4.9pc for its benchmark, the FTSE 250 excluding investment trusts.

The fund offers excellent value for money as it trades at a 10pc discount to net asset value. This is largely because of the unpopularity of UK-focused trusts, which this column fully expects to dissipate as the economy's performance improves. And with a gearing ratio of about 7pc, the trust is well placed to generate index-beating returns as the stock market recovers.

Several of its major holdings, such as Spectris, Cranswick and Inchcape, are stocks previously tipped by this column. It currently has "overweight" positions relative to its benchmark among industrials and consumer discretionary stocks, which are the two largest sectors in the index and together account for about 57pc of its portfolio. This compares with 44pc for the FTSE 250 index and shows that the trust has a bias towards cyclical companies, which are likely to benefit the most from an upturn in the economy's growth rate.

While this growth potential may appear to overshadow the trust's income prospects, it still yields a very respectable 3.8pc. More importantly, dividends have risen at an annualised rate of more than 10pc over the past decade. Investors in the trust are therefore likely to enjoy not only a capital gain that is ahead of inflation but also an income return that grows at a positive real rate.

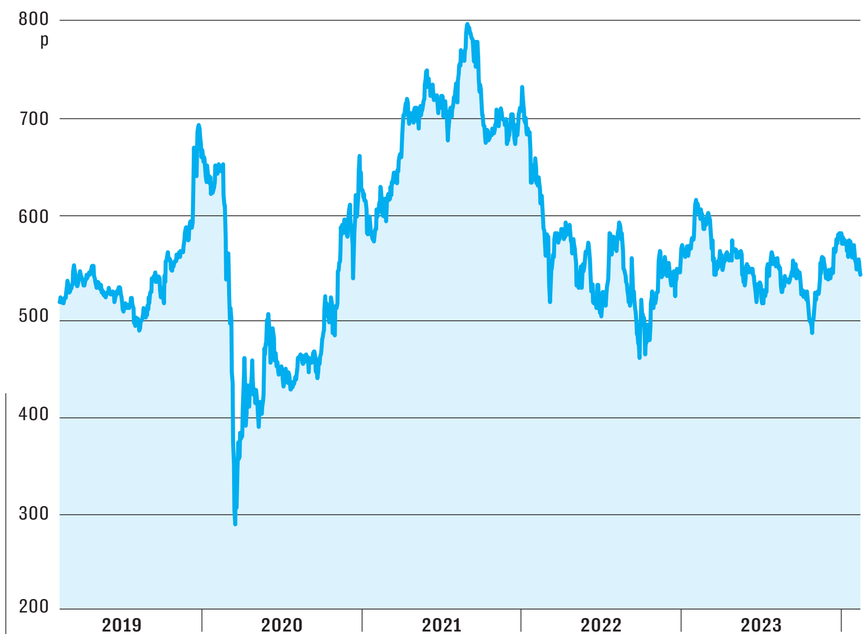
To make way for Schroder UK Mid Cap in our Wealth Preserver portfolio, the holding in BioPharma Credit will be sold. This trust, a lender to companies in the life sciences industry, has produced a 1pc capital loss since its addition to the portfolio in August 2021. Dividends amount to about 26pc of our notional purchase price, though, so our total return is 25pc. This is significantly greater than inflation over the same period, which has amounted to roughly 17pc in total. So it has fulfilled our aim of beating the pace of price rises. However, with the economic landscape likely to change materially over the coming years as interest rates fall, shares are likely to produce a greater total return than other mainstream asset categories.

Given that British shares, and the investment trusts that hold them, currently offer deep discounts, the Schroder UK Mid Cap Fund is a logical addition to our portfolio.

Questor says: buy
Ticker: SCP
Share price at close: 542p

'The trust has a bias towards cyclical companies likely to benefit the most from an upturn in economic growth'

Schroder UK Mid Cap Fund



Key numbers

- **Market value: £187m**
- **Year of listing: 2003**
- **Discount: 10pc**
- **Avg discount over past year: 10pc**
- **Yield (Sept 2023): 3.8pc**
- **Most recent year's dividend: 20.5p**
- **Gearing: 7pc**
- **Annual charge (Sept 2023): 0.97pc**

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