COLUMBIA THREADNEEDLE INVESTMENTS

Digging deeper: Investment Trusts

1. Discounts and premiums

Key takeaways:

- Understand what's included in the net asset value (NAV) of an investment trust
- Learn how an investment trust is priced, and what it means for a trust to be trading at par, at a discount, or at a premium
- Understand the pricing differences between investment trusts and open-end investment companies (OEICs)

Category:
Investment insights

A refresher – what is an investment trust?

An investment trust trades as a share. The money an investor pays for shares is pooled with other investors' money and used by the fund manager to purchase company shares and other assets. An investment trust is a **closed-ended investment**, which means there are a limited number of shares available to buy.

For an investor, the value of their investment in a trust depends on two things: the value of the underlying assets that they own and the influence of supply and demand on their shares. As they are public limited companies (PLCs), investment trust shares are bought and sold at the market price.

As a PLC, they publish financial reports and have an independent board of directors overseeing the activities of the trust and the appointed investment manager.

What is the net asset value?

An investment trust's net asset value is the total value of all the fund's assets, minus the value of the fund's liabilities – its shares and debt. An important feature of investment trust shares is that they can be bought at premium and discount to their NAV.

A higher share price than NAV means the trust is trading at a 'premium'. If shares are cheaper than the NAV, then it is trading at a 'discount'. And often trust shares are traded at a discount because of worries that the shares can be tricky to buy or sell. This perception that they are less liquid is due to the closed-ended nature of an investment trust.

Useful terms

Par value: The current share price is equivalent to the value of the trust's underlying assets minus any debt

Trading at a discount: Where the share price is less than the value of the underlying trust asset

Trading at a premium: Where the share price is more than the value of the underlying trust assets

NAV = 100p

95p
Share price = 95p
5% discount

100p
Share price = 100p
PAR

105p
Share price = 105p
5% premium

What are the differences between an investment trust and an open-ended investment company (OEIC)?

Unlike an investment trust, an OEIC is 'open-ended', which means it has an unlimited number of shares that can be bought. For the OEIC fund manager, the fund must remain partly liquid and retain cash reserves so that investors who want to redeem their shares can do so. This can reduce returns as the fund cannot be fully invested at any one time. In contrast, the investment trust manager has greater control of the assets within the portfolio, without concern that there will be spontaneous redemption orders.

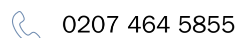
Other differences:

- OEIC share prices always reflect the value of the underlying assets – as there is no market as such for the shares
- OEIC units are bought from and sold back to the fund manager, rather than being bought and sold in the open market

Buying back shares

With the aim to close the discount of an investment trust, the board of directors may decide to buy back shares of the trust through the trust's discount control policy. Please refer to our factsheet number 6 "share buybacks" for more information on this.

Contact us



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