The Church of Scotland Investors Trust

Constituted by Act of Parliament 1994

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IMPORTANT INFORMATION FOR INVESTORS
MARKET RESPONSE TO COVID-19

Covid-19 pandemic has been much more severe than originally thought, and governments have acted primarily to reduce the mortality risks despite the steep drop in economic activity this produces. Financial markets could not have anticipated this viral attack on health, so as it developed the shock to economic activity triggered uncertainty and falling stock markets, coupled with concern that some companies would be forced into liquidation.

Governments have generally responded by boosting liquidity in the banking sector and introducing massive compensation schemes for companies and workers. These schemes are ultimately funded by taxpayers, but in the short term government borrowing will expand at a rate which is even greater than during the banking crisis in 2008.

This shock comes at a time when world economies, particularly those in the western world, were slowing anyway. This raises doubts about the speed at which countries will be able to recover even their previous levels of output, let alone to grow at rates which will allow debt levels to be repaid in the coming years.

To date, the response from many companies has been to act cautiously and not to anticipate an early and explosive rebound in activity (which is being referred to as a V-shaped recovery). Many companies have deferred a decision on whether to pay dividends at their previous levels and some have cancelled their dividends without predicting when they may be restored. This will have a very significant impact on the ability of the Growth Fund to make income payments to investors in respect of the current year (payments are made in three instalments, starting with a payment in May, followed by a second payment in October and a final payment in May of the following year).

At present, it is quite possible that the payments for 2020, including the final payment in May 2021, will be at half the rate paid in respect of 2019. Further out it is very difficult to predict what might happen, but at the very least for several years it will be a challenge to return to the historic income levels paid from the Growth Fund, given the difficulty of generating dynamic economic conditions worldwide after this shock. For example, governments have little more that they can do to provoke a rebound when debt levels are already stretched.

The Income Fund has been less affected than the Growth Fund. This is because it relies heavily on bonds issued by companies which will avoid defaulting on these "promises to pay" as such action would push the companies into insolvency and liquidation. Also, the action taken to boost liquidity in the banking sector means that companies can cover cash shortfalls by taking loans from banks and this will not cause long term damage if their trading recovers later in the year.

Nevertheless, the probability of corporate failure has increased generally, even if it varies massively between different industrial sectors, and corporate bond markets have responded by reducing price levels and offering higher yields to investors as a result. At present, we expect this to mean that any reduction in income levels paid from the Income Fund will be small, but if the wider picture deteriorates and the failure of large companies becomes common, a reduction in the income levels from the Income Fund would be unavoidable.

The Deposit Fund provides returns which are largely determined by the Bank of England Base Rate and by rates offered as a result by the main banks for large deposits over terms of up to twelve months. The Bank cut its Base rate to 0.125% to mitigate the impact on the economy of the Covid-19 pandemic, but as the previous rate was 0.75% this will only have limited effect. It is unlikely that an increase in interest rates will take place for a long time, so rates payable to investors in the Deposit Fund are also likely to be low, and indeed are expected to decline from those currently payable as deposits mature and are reinvested at lower levels.

Each year the Trustees agree with the Growth Fund Manager a realistic income target. For 2019, this target was 17.0p but a slightly higher income was received allowing the Trustees to distribute a total of 17.25p per unit. The final instalment of this distribution, 5.25p, will be paid on 15 May 2020. However, the Trustees agreed to reduce the targeted distribution for 2020 to 12.0p per unit. If achieved, this will be distributed as:

	Rate (p per unit)	**Payable**
Q1	4.0p	15th May 2020
Q2	2.0p	15th November 2020
Q3	2.0p	15th November 2020
Q4	4.0p	15th May 2021

This has not been an easy decision for the Trustees who will continue to monitor the situation and communicate any further impacting as soon as possible. Please consult the Investors Trust section of the Church of Scotland website regularly for up-to-date information and if you would like to receive e-mail communications from us, please respond to the e-mail address above, advising the e-mail address you would like us to use.

Brian J Duffin
Chairman