The Church of Scotland Investors Trust

Constituted by Act of Parliament 1994

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Bulletin for Investors – November 2021

This Bulletin is published for investors in the Church of Scotland Investors Trust, in which we update the forecast of the income payments which may be made by the Growth and Income Funds. We also comment on the changes in strategy implemented in the Growth and Income Funds this year, and as COP26 has finished we comment on how account is taken of Climate Change concerns in the management of the funds. We hope this information is of particular help to those responsible for investment matters - such as treasurers of parish church finance committees who are monitoring their budgets – but we also would be pleased for this Bulletin to be circulated more widely.

Growth Fund

As previously reported, a new asset strategy was agreed by the trustees and implemented on 25 February by our managers, Newton. The transition was achieved at very little cost despite the large sums involved. The main change was to approach equity investment from a global perspective rather than to hold a disproportionately high percentage of UK shares, so significant sales of UK equities were used to fund acquisitions of overseas equities, of which the largest proportion are in the US. Other changes were to alter the previous focus on UK bonds (including gilts) to global bonds (assessed on the sterling values and returns) and to introduce a new Alternatives category. In this segment of the portfolio, infrastructure and sustainable energy may be held as diversification from listed equities, noting that these holdings may be in the form of externally managed funds as these investments are often not themselves listed.

While it is a short period of time since the new strategy was introduced, our managers reported to us that the Growth Fund has performed well against its new benchmark in the period to end September.

In the June Bulletin we suggested that total income payments for the Financial Year 2021 may be 11.0 p in total. We still expect this to be the case. As a reminder, in May of this year we made a payment of 7.0 ppu which comprised 4.0 ppu as a final payment from the Growth Fund's Financial Year 2020 and a first payment of 3.0 ppu in respect of the Financial Year 2021. We made a payment of 4.0 ppu in November, which was the second payment for our Financial Year 2021, and we expect to make a final payment of 4.0 ppu in May 2022. In line with our normal practice, we also expect to make a first payment in May 2022 for our Financial Year 2022 but it is too early to estimate what amount might be payable. It is worth repeating that the intention of the Trustees is that the Growth Fund should produce a good and growing total return (combining the capital return from rising unit prices with the income distributions paid) rather than setting an income target. Investors should consider carefully whether it is appropriate to rely only on income payments when funding

expenditure, as was often the case in the past, or whether some capital profits should also be realised to meet expenditure from time to time. The Trustees are not able to provide advice on this matter, but would draw attention of investors, as relevant factors, to the terms on which funds are held and the need to protect the real value of funds in view of the purposes for which they are held.

Income Fund

Distributions from the Income Fund are made in March and September, but they are effectively three months in arrear from the periods in which they have been accrued. Consequently, the income accrued in the Fund in the first half of a calendar year determines the distribution made in September and the income received in the second half of a year determines the payment made in the following March. The payment made in September of this year was 20.0 ppu and we expect the same payment to be made in March 2022. These forecasts are unchanged from the amounts published in the June Bulletin.

Previous Bulletins explained that the decline in amounts distributed from the Income Fund is driven by the steady decline in long term bond yields experienced for many years, and which in turn is the result of very low short term deposit rates. As existing bonds mature and are reinvested, the lower levels of yield available have progressively reduced the income received by the Income Fund.

During the current year we have discussed with the managers, Royal London, whether a change in strategy was appropriate as financial conditions have been changing. After considering several possibilities a new strategy was agreed and implemented in September. The main change is to introduce a new holding in Global Bonds, but this holding is managed to optimise the Sterling returns rather than being subject to foreign exchange risks. The new holding was mainly funded by eliminating the previous UK Government holdings (gilts) but also by some rearrangement of the existing funds. The largest holding, in UK Ethical Bonds, is unchanged. This inevitably means a small reduction in the average credit rating of the fund, but it is expected to lead to a noticeable increase in the total yield and the diversification of individual bond holdings within the new Global Bond fund provides a level of protection against the risk of default from individual bonds.

In the period to end October bond yields have risen as economic recovery has been experienced and because of fears of higher inflation. The CPI inflation increase announced for the year to October confirms these fears – the latest rate is now 4.2%. The future prospect for bond yields depends on the same factors – to what extent economic recovery is sustainable and whether central banks will be obliged to raise short term interest rates to control inflation. The new strategy gives the prospect of some recovery in distributions to investors if current conditions continue, but it is too early to give any new forecasts. We hope this will be possible in the next Bulletin.

Deposit Fund

The Base Rate remains at a nominal figure of 0.1% and even deposits for longer terms offer very low rates of interest as a result. Until this changes it is unlikely that we will be able to pay meaningful rates of interest to investors. At the time of writing, the Bank of England continues to offer no definite predictions, but at least the prospect of negative interest rates has receded.

General Assembly and ESG Matters.

In May the General Assembly established a Special Committee to consider the most appropriate way of including the consideration of ethical matters in the investment activities of the Church – which was an initiative backed by Investors Trust. The Committee has two years to report, so there has been no change to our responsibilities or procedures in the meantime.

As a reminder, ESG stands for Environmental, Social and Governance, which are considerations which have become increasingly important in managing investments in recent years – alongside the financial basis for selecting investments.

As Trustees, we review ESG aspects for both the Growth Fund and the Income Fund. We discuss with our managers the principles they apply – rather than checking every decision they make which would be totally impractical – and we receive reports which are growing in depth and scope.

Under the heading of "Governance", the prominent issues are such things as executive remuneration, fairness of corporate structures, quality of reporting and responses to public interest groups. These questions arise mainly in respect of shareholdings rather than bonds, so the Growth Fund is our principal focus and we receive summaries and details of the votes made on our behalf and of the controversial issues lying behind them. Newton assesses the appropriate votes to lodge based on its own analysis rather than relying on an external proxy voting organisation.

The heading of "Social" covers a wide range but the largest issues are in respect of suppliers and employment practices. For example, Modern Slavery is an aspect on which UK companies are obliged by statute to report, but the standards of reporting vary. Similarly, the basis on which suppliers are selected and supervised is increasingly seen as important and in key sectors companies are expected to state their policies and how they are enforced. Extractive industries and fashion retailers are closely scrutinised.

Under the topic of "Environmental", Climate Change dominates, but it is worth noting that Bio-diversity and Water Stewardship also attract a lot of attention.

Newton supplies us with their current thinking and with comparative data, such as the carbon footprint of our portfolio and how this compares with other portfolios or with the financial indices as a whole. However, although these sets of data are published, we know they are based on poor base information, even if this is the only data available. As such, we are reluctant to publicise these analyses, and suggest that investors should not expect Investors Trust or other investment bodies to publish precise calibrations of their Climate Change positioning. Instead, the strategies being followed by companies need to be examined and assessed, looking for transformational short-term and long-term plans and for good quality of reporting against them.

A particular problem is the lack of commonly accepted techniques for calculating greenhouse gas emissions across a company and its customers, which is compounded by the absence of independent verification of the claims made by each company. Just as financial reporting is only trusted if it has been independently audited, the same should apply to ESG claims.

And a further complication is the need to set broad principles for what is good practice and what is unacceptable – for which there is no consensus. For example, is it good practice for Oil and Gas

companies to continue to produce fossil fuels and even to prospect for more – on the basis that a managed transition is needed rather than a complete and immediate cessation? Depending on the view taken, a portfolio which contains no Oil and Gas companies might be seen as conforming with best practice by having a low carbon footprint in comparison with another portfolio in which "good" Oil and Gas companies are held – but the distinction depends entirely on whether or not holding any Oil and Gas companies is justified.

The implementation of Climate Change considerations in investment management is of vital importance and the Trustees are completely in agreement with this. But the way in which this can be done is more difficult to establish. The financial impact of Climate Change is already being included in financial assessments of companies and industries – like other financial considerations – but there remain too many unknowns for responsible investors. As the recent COP26 meeting demonstrated, most of the important levers lie in the hands of governments and for many of these, such as carbon pricing and stopping the burning of coal, widespread international agreements are needed for these measures to be effective. COP in Glasgow made some progress on these issues, but not with sufficient urgency to generate confidence that the Paris targets can be achieved.

Investors Trust and our managers continue to navigate through these complex issues as best we can. In the next few years better techniques for assessing the performance of companies on ESG issues will become available, but applying the funds entrusted to us to promote good practice and avoid damaging outcomes will remain a matter of balanced judgement. In turn, we will continue to report to our investors and to the wider church on these matters, as well as acting with church investor groups from other denominations. Together, we achieve more than by acting in isolation.

Brian Duffin

Chairman

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