Aberforth Unit Trust Managers Limited

Assessment of Value delivered to Unitholders of the Aberforth UK Small Companies Fund for the period ended 31 December 2019

In accordance with the requirements of COLL 6.6.20 R of the Collective Investment Schemes Sourcebook as issued by the Financial Conduct Authority, the Board has undertaken an exercise to assess whether the payments out of scheme property set out in the Prospectus are justified in the context of the overall value delivered to Unitholders.

Conclusion

The Board concluded that, in its opinion:

- the Manager is delivering value to Unitholders; and
- charges borne by the Fund are justified in the context of the value delivered to Unitholders.

In reaching this conclusion, the Board took into account information furnished to them throughout the year and otherwise provided to them, as well as information prepared specifically in connection with their formal annual review. They considered the following factors, among others, but did not identify any single issue or particular piece of information that, in isolation, was the conclusive factor, and each Board member did not necessarily attribute the same weight to each factor.

1. Quality of service

Unitholders benefit from a variety of services, which are provided by several suppliers. The Board reviewed the range and quality of these services, conducting its assessment in three parts.

Investment management services

The Manager outsources the provision of investment management services to the Investment Adviser. The Board's review of investment management services included an assessment of the Investment Adviser's financial strength and stability; the depth, quality, and consistency of its investment management process; the experience, capability, and integrity of personnel managing the Fund's assets; and the ongoing evolution of the investment management team designed to maintain and strengthen these qualities. The Board satisfied itself that the Investment Adviser's policies and processes continue to deliver best execution for the Fund and that transaction costs remain appropriate in this context. The Board took comfort from the collegiate approach to portfolio management and the strong alignment of interests between investment personnel and Unitholders, strengthened by the fact that the investment personnel involved in managing the Fund's assets are themselves investors in the core strategy underpinning the Fund's investment objective, policy and strategy. The Board also noted the significant resources devoted to servicing existing and prospective Unitholders by means of written communications and face-to-face meetings. The Board was also mindful of the Investment Adviser's business philosophy under which its principals endeavour to profit with their clients rather than from them. The Board acknowledged that several regulatory changes introduced in recent years have been consistent with the Investment Adviser's existing policies. Finally, the Board took into account the prompt and in-depth reporting provided by the Investment Adviser on matters relating to investment performance and portfolio management.

Administrative services provided by the Manager

Within this category, notable services include daily fund accounting/ valuation and unit pricing, Unitholder reporting, and client money oversight: all of which the Manager outsources to the Investment Adviser. Unit dealing (including anti money laundering checks) and registration is outsourced to the Third Party Administrator and Registrar.

In assessing the quality of these services, the Board considered the design and effectiveness of the Investment Adviser's internal controls and the level of satisfaction of the Fund's Unitholders. The Board's conclusion on this matter also reflected the regular and comprehensive updates and summaries of the compliance monitoring programme run by the Investment Adviser's Risk & Compliance team, as well as reports from the Trustee and the Auditors. This monitoring programme covers the activities undertaken by third party service providers as well as the services provided by the Investment Adviser, and evidenced a well-managed operation delivering good outcomes on behalf of the Fund and its Unitholders.

Administrative services provided by third parties

These comprise services provided by the Trustee & Depositary, the Custodian, the Registrar and the Auditors. Again, the Board's judgement on the quality of these services reflected the regular and comprehensive updates and summaries of the compliance monitoring programme run by the Investment Adviser's Risk & Compliance team. This monitoring programme evidenced that the third parties' operations were well-managed and delivered good outcomes on behalf of the Fund and its unitholders.

Based on its review, the Board concluded that the quality of service provided to the Fund by the Manager and others is satisfactory.

2. Performance

The Board reviewed the performance of the Fund, after deducting payments out of the property of the Fund, in relation to the investment objective, policy and strategy.

Consistent with the investment objective and with the recommended holding period, the Fund's performance was compared with that of the NSCI (XIC), the Fund's relevant benchmark index, over periods more than 5 years. An important element of the Board's assessment was the investment strategy: since inception, the Fund's portfolio has been managed in accordance with the Investment Adviser's value investment philosophy. The Board noted that, while there is persuasive evidence that a value approach within small UK quoted companies results in superior returns over the long term, there can be extended periods when the value style is out of favour. In this context and taking into account discussions on performance with the Investment Adviser throughout the year, the Board concluded that the Fund's performance has been satisfactory given the style specific headwinds it has faced.

In reaching that conclusion and as part of its assessment of performance, the Board reviewed evidence to satisfy itself that the Fund's assets continued to be managed in accordance with the value investment style. This element of the assessment acknowledged that Unitholders have a broad range of investment choices available and have chosen to invest (and remain invested) in the Fund, which differentiates itself from most other funds in the small UK quoted companies sector by its adherence to the value investment style. The influence of investment style is regularly highlighted in the Manager's Report to Unitholders. The Board noted that the Unitholder register is dominated by institutional investors and that the Investment Adviser regularly offers face-to-face meetings with a high percentage of these firms. Feedback from these meetings with the professionals responsible for investing their clients' capital in the Fund is shared with the Board and acts as an important barometer of investor sentiment.

Performance data for the Fund are shown on page 2 of the Fund's annual report and accounts. Whilst acknowledging the challenge to performance that currently accompanies the Fund's investment strategy, the Board is also conscious that some of the most attractive opportunities in equity markets require a contrarian approach synonymous with the value style and so looks to the future with optimism.

3. AFM costs - general

The Board reviewed the costs of providing the services in relation to the charges incurred by the Fund.

The most material expense borne by the Fund is the Manager's periodic fee, representing 94% of total expenses in the year ended 31 December 2019.

As noted above, the Manager outsources most of its activities to the Investment Adviser and operates on a relatively low margin. The Investment Adviser is an associate of the Manager and is constituted as a limited liability partnership. Each of its full time working partners is remunerated through a share in the business profits, charged as a business expense, such that its profit after partners' remuneration is nil. The level of subjectivity and assumptions required to conduct a cost-based analysis of the Manager's fee arguably generates such a range of possible outcomes as would significantly negate its usefulness in informing a view on value delivered. Nevertheless, the Board is satisfied that, adjusted as appropriate, pro forma profitability at the Investment Adviser is not excessive.

This view takes account of the need to attract and retain high quality personnel as well as the challenges faced by the Investment Adviser in pursuing its chosen business strategy.

The Investment Adviser believes that its clients are best served if it remains a narrowly focused boutique, investing in a single asset class, and wholly devoted to a small number of institutional clients. The chosen asset class – small UK quoted companies – experiences periods in which it is in and out of favour, and the effect of this can be exacerbated by the value investment style described above. In addition, the Investment Adviser has adopted a focused business strategy that it determines to be in the best interests of its clients but that limits the scope for business growth and diversification (this capacity constraint is discussed further below under “Economies of scale”). These factors increase the volatility of, and place limits on, the Investment Adviser’s income stream, which is wholly variable and largely correlated to funds under management. When this is combined with a relatively fixed cost base, business viability is dependent on margins being sufficient “through the cycle”.

In this context, the Board is satisfied that the Manager’s periodic fee is reasonable.

4. Economies of scale

The Board assessed the extent to which savings and benefits from economies of scale could be achieved, relating to the costs of managing the Fund’s property.

The Board noted that the Investment Adviser’s business strategy is to focus on a single asset class – small UK quoted companies – that can be characterised by periods of relative illiquidity. The Investment Adviser is not an asset gatherer and seeks to limit its capacity, in terms of funds under management, as it believes this to be in the best interests of its clients. New product development has been driven solely by investment opportunity and demand, subject always to consideration of remaining capacity. Further, the Board noted that the Investment Adviser does not seek to expand its investable universe beyond that described in the Fund’s investment policy. Accordingly, the Board acknowledged that there is a limit to the level of cost economies available from such a capacity constrained business beyond those already achieved by it having operated for some time at or close to its self-imposed capacity.

All the Investment Adviser’s clients benefit from its current scale but for the reasons noted above there is a limit on the scope to generate further scale efficiencies. The economies of scale shared to date have influenced a decrease over time in the ad valorem rate of management fees incurred by the Fund and by other clients managed by the Investment Adviser. The Board noted that this favourable outcome for the Fund was despite increasing costs being borne by the Investment Adviser.

The Board concluded that the Investment Adviser's disciplined adherence to a ceiling on funds under management, whilst limiting the scope for further cost efficiencies, is in the best interests of Unitholders.

5. Comparable market Rates

The Board reviewed market rates for comparable services, in the context of services provided to the Fund.

The Board compared fees incurred for similar services by other small UK quoted companies funds and satisfied itself that the Manager's periodic fee remains fair and reasonable on that basis.

Whilst significantly less material, the Board also considered other expenses incurred by the Fund and concluded that Ongoing Charges incurred by the Fund compare favourably with market rates.

6. Comparable Services

The Board also compared the Manager's periodic fee charged to the Fund with the level of fees charged to other clients of the Investment Adviser and satisfied itself that the Manager's periodic fee remains fair and reasonable given the level of service delivered.

7. Classes of units

The Board reviewed the charging structure applied to the Fund's classes of units.

The Board noted that the Fund has income units and accumulation units. An income unit entitles the holder to a cash distribution representing the net income attributable to that unit at each income allocation date. An accumulation unit does not entitle the holder to payment of the net income attributable to that unit, but that income is reinvested within the Fund and reflected in the accumulation unit price. The different classes were created to cater for the income preferences of Unitholders, who are free to move between the classes.

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The Board noted that there is no difference in charging structure applied between the two classes of units and accordingly the conclusions reached on value delivered would apply to both classes equally.

K F Muir, *Director*
P R Shaw, *Director*
Aberforth Unit Trust Managers Limited

30 January 2020