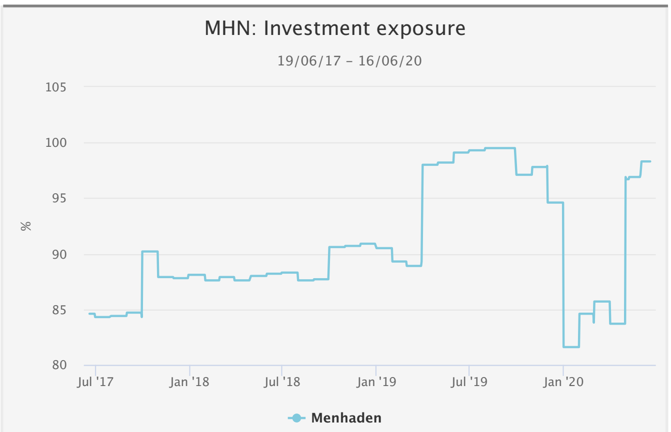
Gearing

Historically Menhaden has typically run with a higher cash level than most equity trusts, given the various private equity commitments that it has. As we discuss in the **Portfolio section**, the last six months has seen a transformation in the overall exposure in the portfolio; with several private investments having been realised and cash redeployed into public market investments.

As a result the trust's cash position has significantly reduced over the year to date, with the managers taking advantage of equity market weakness to put their cash to work. The graph below shows MHN's investment exposure as a percentage of NAV over time. Currently the trust has net cash of around 2%, which – as we demonstrate – is towards the lower end of the historic range.

MHN has shareholder permission to employ gearing, but does not currently have a gearing facility in place. We also note that the trust has outstanding commitments (which may not all be drawn) of around £10m – mainly to the TCI Real Estate Partners Fund. MHN's public equity portfolio remains highly liquid. So if these commitments are called, we do not envisage a problem for the managers in funding them.

Fig.4: Net Gearing



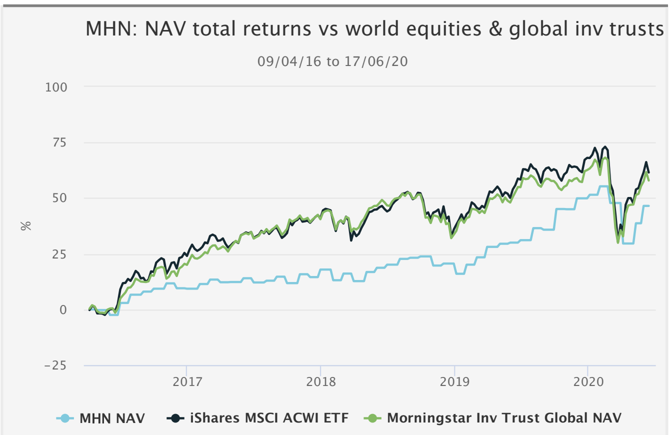
Source: Morningstar

Returns

Originally launched in 2015, Menhaden (MHN) had a difficult start in life. A new management team, led by Luciano Suana, was recruited in March 2016 and the portfolio was repositioned. Subsequently the managers reallocated the trust's overall exposure more evenly between public equities, private equity and yield investments; this process was largely completed by Q1 2017. Below we illustrate the trust's NAV performance since the new team joined. This graph shows that the trust lagged during the period when the portfolio was being repositioned, but since then has been catching up with world equity markets and the average global investment trust.

The past three years have been strong against comparators. According to Morningstar the NAV total return to 30/05/2020 (MHN announces NAVs only monthly) was 28.5%, compared to the MSCI ACWI return of 20.5% and the average global investment trust return of 17.8%. It is worth noting that this performance has been achieved despite much of the trust's overseas currency exposure being hedged back into sterling since 2018. This likely means a higher GBP exposure than most peers, i.e. a headwind as GBP depreciated over this period.

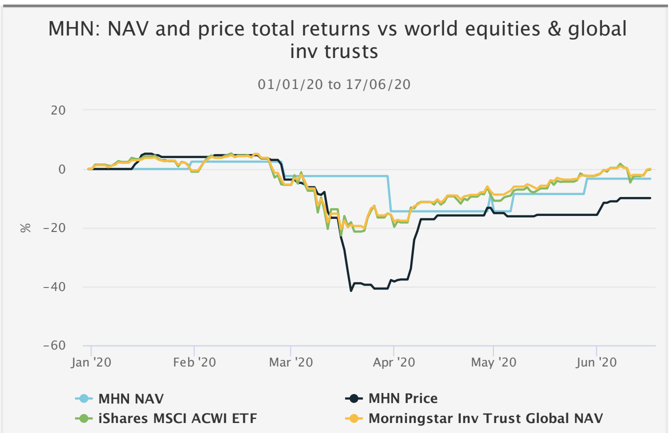
Fig.5: Performance



Source: Morningstar

The graph below shows the experience of 2020 to date. As we note above, MHN announces NAVs only monthly, and the uncertainty caused by this factor may have contributed to the discount widening so dramatically during March. However, as the graph illustrates, the NAV fell by less than the trust's comparators and has also largely recovered. As at the end of May 2020, the NAV was only 3% behind global equity markets.

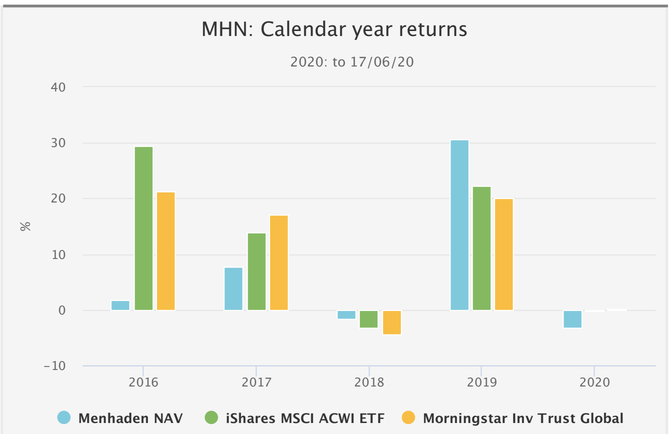
Fig.6: NAV Performance



Source: Morningstar

The graph below shows calendar year performance relative to world equities and global investment trust peers. As we have noted in the **Portfolio section**, MHN is highly concentrated and the managers pay no heed to any benchmarks when assembling the portfolio. As a result performance in any one year is likely to deviate considerably from the benchmark – which has certainly been the case historically. It is also worth bearing in mind that a proportion of the portfolio is invested in private market investments; where valuation changes are reflected only periodically, and sometimes in a lumpy fashion.

Fig.7: Calendar Year NAV Returns



Source: Morningstar

As we highlight above, MHN's performance has been strong on a relative basis over the past three years – including excellent performances during 2018 and 2019. The managers' rigid focus on fundamentals during the market panic in 2020 gives grounds for optimism, and is a further sign that the clearly thought out investment rationale is now bearing fruit.

Dividend

MHN currently has a pure capital growth objective, so the dividend is not an area of focus for the managers or the board. The directors are bound by the investment trust requirement to distribute at least 85% of net income, however. Consequently MHN paid a dividend of 0.4p per share on 12 June 2020. Over the longer term – assuming the managers can achieve their ambition of investing around a third of the portfolio in 'yield' investments – the hope is that the trust will pay a dividend which will yield c. 2%.

Management

Menhaden portfolio is managed by Menhaden Capital Management LLP (MCM). The three partners of MCM – Ben Goldsmith, Luciano Suana and Graham Thomas – form the investment committee, which is responsible for all investment decisions.

Luciano manages the portfolio on a day-to-day basis, with a particular focus on the publicly traded and yield elements of the portfolio. He joined MCM in March 2016, having previously been a director at Barclays Capital where he ran credit operations for Brazil in Sao Paulo. Using this previous credit experience, Luciano helps the team look at the market through a 'value' lens – particularly when it comes to assessing potential downside risk in the portfolio.

The investment committee is chaired by Graham Thomas. Graham previously chaired RIT Capital's executive committee and was a member of its investment committee, with direct responsibility for its private investments. Ben Goldsmith co-founded WHEB group – one of Europe's leading energy and resource-focussed fund investment businesses – prior to setting up Menhaden Capital Management. As well as managing the portfolio alongside Luciano and Graham, Ben focusses on originating new private investment ideas for the trust.

The managers are supported by an analyst, Edward Pybus. Edward previously worked at Exane BNP Paribas in the research division, specialising in oil and gas.

It is worth noting the experience of the trust's independent board. Chairman Sir Ian Cheshire was previously CEO at Kingfisher, during which time he was one of the leading lights in driving attitudes towards energy and resource efficiency at a corporate level. He also chaired the Ecosystem Markets Task Force, an independent business-led initiative aimed at helping UK businesses to find new opportunities to drive green economic growth and to profit from valuing and protecting nature.

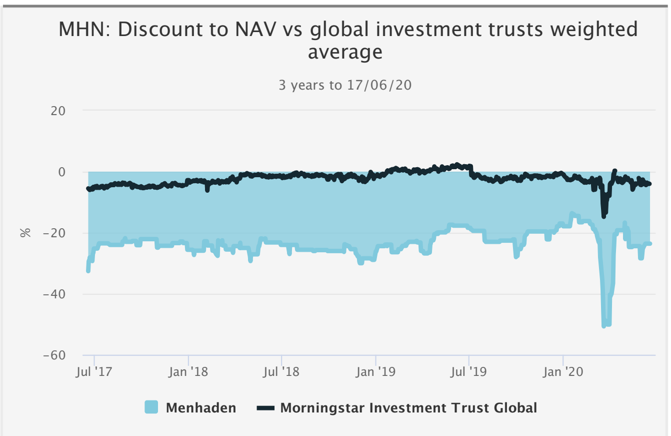
The other board members include: Emma Howard Boyd – who was director of stewardship at Jupiter Asset Management and a major driving force behind the group's environmental markets investment team; Duncan Budge – who was previously a director of J. Rothschild Capital Management and a director and chief operating officer of RIT Capital Partners; and Howard Pearce – founder of HowESG Ltd, which is a specialist environmental, asset stewardship and corporate governance consultancy business.

Discount

MHN trades on one of the widest discounts in the equity investment trust sector. In fact, according to the **AIC website**, it is in the top ten widest discounts for trusts which invest in liquid public equities. We believe that part of the reason for the wide discount can be attributed to the trust's poor start in life, which saw the NAV underperforming markets significantly after launch. Initially, in 2016, the discount widened out to more than 30%, but since then – following the trust's good performance in 2018 and 2019 – it did regain some ground, narrowing from around 34% in October 2016 to trade in the high teens during 2019.

Latterly, however, as the graph below shows, the discount has widened once more following the COVID-19 market sell-off. The current discount of c. 24% is wide in both absolute terms and relative to global investment trusts.

Fig.8: Discount



Source: Morningstar

Another possible reason why the discount has historically remained wide is that private investments – which hitherto have represented a good proportion of the trust's portfolio – are illiquid and often relatively hard to value. Conversely public market investments are priced daily and are usually very liquid. As a result, a trust with a significant proportion of its assets in unlisted investments might justify a wider discount than one with pure exposure to listed investments. As we discuss in the **Portfolio section**, MHN's underlying portfolio has evolved rapidly over the last six months, with only around 20% of the portfolio now unlisted. We believe that a large discount, on this basis, is getting harder and harder to justify.

The recent market sell-off saw MHN's discount widen to an almost incredible 50%. We believe that part of the cause of this extreme move could be the fact that MHN only publishes its NAV on a monthly basis. When markets are moving rapidly – combined with a certain amount of panic and illiquidity in the market – having a 'stale' NAV creates uncertainty. But, at the same time, the portfolio is concentrated and the managers have a low turnover approach. Consequently it should have been possible for market participants to model the likely NAV and take advantage of such a wide discount. After all the discount remained wider than 40% for over two weeks.

We think it likely, in fact, that a large part of the large discount widening was a result of market illiquidity; given the trust is relatively tightly held and has a market capitalisation of £69m. Whatever the cause, the recent experience serves as a warning that the MHN's discount is volatile – which presents both risks and potential opportunities. We continue to believe that Menhaden is an interesting trust, with a discount of c. 24% (to the 31/05/2020 NAV); both for the value opportunity, the differentiated investment portfolio, and the evolving track record of the management team.

Charges

When we last wrote about Menhaden, we understood that the board was undertaking a review of the ongoing costs and fees paid to third parties. In the trust's annual report the board announced that it had appointed a new auditor, presumably at a lower cost, but had also negotiated a revised fee tiering arrangement with the managers.

Consequently the fees remain the same, but the lower fee tier will apply from £100m rather than £150m previously. While the immediate impact of the board's cost review is therefore slight, it does mean that, as the trust grows, shareholders will benefit from lower charges. The revised fee terms are 1.25% on net assets up to £100m, falling to 1% thereafter. An AIFM fee of 0.225% of NAV up to £100m, 0.2% from £100 to £500m, and 0.175% thereafter also applies. A performance fee of 10% of the excess of NAV over a compounding 5% hurdle (since launch) also applies. We calculate that the NAV has to rise by a further 12.3% to reach the current hurdle of c. 127p.

It is worth noting that Menhaden pays no third-party fees on co-investments made in the private equity portfolio (such as X-Elio). The ongoing charges figure in 2019 was 2% (2018: 2.1%). While this may not be cheap, the trust's wide discount – if it moves in the right direction – should more than make up for the higher costs. The KIDRiY cost for the trust is 2.3%. The fact that this measure is only marginally higher than the OCF reflects the portfolio's lack of gearing and relatively low turnover.

ESG

The managers of MHN invest globally, which restricts their focus to companies which deliver – or benefit from – the efficient use of energy and resources. As a result the mandate and the investment philosophy behind the trust might be considered well aligned with many ESG investors. But at the same time the managers embrace engagement with their companies, and do not apply negative selection criteria to investments. An example of two investments that might not fit negatively screened investors' portfolios are Airbus and Safran. The airline maker and engine manufacturer (respectively) might not seem obvious choices for investors aiming to invest in a low-carbon economy. Menhaden, however, takes a pragmatic approach and sees these two companies as industry champions, helping airlines to reduce their carbon emissions.

The managers believe that ESG processes are fully embedded in their investment process; in their view this helps them avoid companies which are badly managed – both from an 'impact' perspective and in a business sense. The managers aim to be invested in their companies for the long term. So they aim to ensure that each company they invest in has a sustainable business, in both senses of the word.

On a macro view, the team believe that all of their investee companies are playing their part in efforts to slow the pace of global warming. In the trust's annual results the Menhaden team say they plan to engage with their portfolio companies more proactively, and to ensure the companies understand the importance of taking action to reduce carbon emissions.

Menhaden review the 'impact' of the portfolio every year: estimating the impact that their stakes in the companies in the portfolio have had in reducing greenhouse gas emissions, renewable electricity generated, etc. **The most recent impact report can be found by following this link**. In summary, Menhaden's holdings helped generate 47,000 MWh of clean energy in 2019, contributed to 32,000 tonnes of avoided greenhouse gases and 61,000 m3 of water saved. We discuss specific holdings, and their contribution to a lower carbon economy (among other things), in the **Portfolio section**.

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