Catching self-directed investors to manage investment trust liquidity

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A key industry trend is increased ownership of investment trusts by self-directed investors using direct-to-consumer (D2C) platforms. Marketing, to develop self-directed investor ownership and sustainable demand, is a strategic option for investment trust boards and managers. It can improve the management of liquidity and discount volatility, stabilise share registers and ultimately reduce the need to do share buybacks, or even tenders in extremis.

Investment trust boards and managers must connect with self-directed investors, the most significant, growing group of investment trust owners. Reaching self-directed investors is not straightforward, nor automatic. Establishing a meaningful connection requires visibility and relevance, targeting and bespoke marketing communications, underpinned by ongoing meaningful ownership analysis and measures of success.

Self-directed investors

According to research by insight and strategy consultancy BritainThinks for the Financial Conduct Authority (FCA) in 2021, self-directed or DIY investors are ‘those who are making investment decisions on their own behalf, i.e., selecting investment types and making trades themselves without the help of a financial advisor.’

This research highlighted several key drivers of the growth in self-directed investment. These include the availability of new apps and the move to online sources of information. The online availability of investment-related information and options is crucial. What is now available online is vast in terms of volume and variety and also in terms of velocity, the abundant variations and frequency of updates. Self-directed investors read their own preferred media.

As a result, the veracity, location and relevance of information has become a challenge. The self-directed investor uses a wide range of decision-making frameworks, tools, online accounts, tuned to their individual preferences and needs. Marketing precision is therefore essential to reach self-directed investors.

As also highlighted in the BritainThinks research for the FCA, self-directed investors have become more demographically diverse. However, from an investment trust perspective, older age groups still remain the significant cohort, reflecting national wealth dispersal.

Research by opinion company YouGov in 2021 revealed unsurprisingly that over 60% of investment trust owners are in the 55+ age group. This group has surplus capital to invest and investment trusts are a vehicle of choice to foster and protect retirement assets.

Analysis by market research company Research in Finance in 2021 confirmed a wide selection of starting points for investment research by investors, with significant variation between age groups, how they consume information and their choices. For example, the personal finance sections of newspapers were referred to as significant by only 6% of investors aged under 55, compared to 26% of investors aged 65 or older. Hence, traditional media, as well as online sources of information, are still relevant.

The rise of the self-directed investor

Analysis by RD:IR and Warhorse Partners shows that a structural change in ownership of investment trusts has been in progress for the past decade. This reflects three key ownership trends: (i) the changing types of institutions; (ii) declining participation by wealth managers; and (iii) the increasing share of self-directed investors using D2C platforms as a cohort.

Once traditional cornerstone institutional investors in investment trusts, such as public sector and corporate pensions, are no longer prevalent in the sector. There has also been growth in holdings by index-tracking funds and ETFs which follow markets passively. Institutions also include shorter-term investors, such as activists. These investors are already invested in specific trusts, or are looking for available liquidity. They are often shorter-term, price sensitive investors. Alternatively, they can seek to build a core holding in a trust and exert influence the board and manager.

The decline in wealth managers' ownership has been significant and basically reflects a preference for open ended funds in their model portfolios. This preference reflects issues such as available liquidity for rebalancing portfolios. Also, they access the larger open ended funds universe, especially in lower risk sectors.

However, the decline in wealth managers' ownership has been offset by growth in ownership by self-directed investors using D2C platforms. Wealth managers and D2C platforms now own around 28% and 34% respectively of investment trust shares in aggregate. Institutions are the final third in broad terms.

Six D2C platforms dominate, with combined ownership of around 22% of the investment trust universe. Hargreaves Lansdown and Interactive Investor are by far the largest, with around 16% ownership of the sector. Examining ownership of a specific trust vs. competitors, on the major D2C platforms, provides insight of where self-directed investor penetration may be underweight or overweight to its peers. This can inform and guide marketing initiatives.

Secondary market liquidity from self-directed ownership

Ownership and trends in buying and selling activity matter for investment trusts. Typically, the rolling top-20 buyers and sellers account for around 90% of annual turnover in a trust's shares. The net position of buyers vs. sellers is an important health check. A surplus of buyers can lead to a premium and the need to issue more shares, generally seen as a positive. Alternatively, too large a surplus of sellers can lead to a widening of the discount and the need to buy back shares.

In 2021, according to analysis by brokers Numis Securities, some 120 investment trusts completed share buybacks totalling £1.9 billion. Given an investment trust universe of around 400 companies, some 30% therefore completed share buybacks during the year. It is quite a concentrated group. Excluding Scottish Mortgage Trust, the top-20 trusts in terms of buyback value, accounted for £950 million or 50% of the total buybacks. The average buyback amount for these firms was around £50 million and ranged approximately from £20 million to £150 million. A bespoke marketing program could drive natural buying demand for shares and provides an alternative to buying back shares. Buybacks indicate a lack of natural demand for shares.

Of significance in 2021 was how dominant the older international generalist trusts were as a group in buying back shares. Eight of the top-20 firms were international generalists that bought back shares, totalling £530 million, around a quarter of the total for the year. This indicates somewhat a failure to connect with self-directed investors.

An unequal mix of shareholders can create complications for investment trust boards and managers. For example, a trust's register that is overly concentrated with activist, shorter-term investors, can create discount volatility. Hence, boards and managers may need to focus on using share buybacks in an effort to manage or control the discount. They may also need to focus on less productive or defensive deployment of limited marketing resources and of board and manager time.

Individual investors are typically longer-term holders, a stabilising influence on company structure. A balanced register, with significant individual investor ownership, is therefore critical for sustainable investment trust structures and their boards and managers.

Marketing, focused on developing self-directed investor ownership via D2C platforms, can be a strategic alternative or complement to share buybacks to manage liquidity and discount volatility. Marketing should therefore support investment trust ownership and liquidity management, a different function to asset gathering by open-ended funds. A liquid and a structurally balanced investment trust benefits old and new shareholders alike.

Bespoke marketing and ownership analysis matter

Connecting with self-directed investors, using D2C platforms, is not straightforward. Indirect marketing, such as press relations via "earned" media, is typically not enough in itself to engage self-directed investors fully, nor is it consistent and controllable. Direct, bespoke marketing is required, ideally underpinned by s793 analysis to enhance communication engagement and consistency.

Communication and disclosures to individual investors are a key focus of the FCA, as well as the Association of Investment Companies (AIC). Bespoke marketing to individual investors, that is accurate, informative and tailored, is beneficial.

In summary, it is increasingly a priority for investment trust boards and managers to use marketing budgets to connect with and share in the growing pool of self-directed investors. This is because of the trends in investment trust ownership, the benefits of strategic liquidity management and the advantages of individual investors. Establishing a meaningful connection requires bespoke and persistent marketing, underpinned by ongoing ownership analysis to track progress.

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