Gabelli Value Plus Trust

- **A value-focused US equity trust managed by a highly-experienced team who have a long-term track record of delivering strong relative and absolute returns in a market where active managers have historically struggled**
- **Though a relatively unknown quantity here, GAMCO Investors is a household name across the pond and this recently-launched trust is the group's first real push into the UK market**
- **An investment approach known as 'Private Market Value with a Catalyst' that was developed by co-manager Mario Gabelli in the 1970s, which leads to a portfolio that is highly-differentiated to its peers and a bias to non-mega-caps**
- **Biased more towards smaller companies, the portfolio is likely to benefit if inflation continues to tick up (due to its announced merger allocation and value tilt) and if Trump implements his tax reforms and plans for deregulation**

Summary

The Gabelli Value Plus Trust is a highly-differentiated US equity portfolio that is genuinely all-cap in its nature as it tends to avoid the mega-cap end of the S&P 500 due to its unique investment process.

Though not particularly well-known in the UK, Gabelli is in 'household name' territory across the Atlantic. GAMCO Investors, which is the investment manager for the trust, was launched by veteran value investor Mario Gabelli (who also co-manages the trust itself) in the mid-1970s and has grown to be one of the leading fund management groups in the US with assets of $40bn.

This trust is the group's first major push into the UK market and is run along the exact same lines as its more established counterparts. The managers (Mario Gabelli, his son Marc Gabelli, Caesar Bryan and Robert Leininger) launched Gabelli Value Plus trust in 2015 and follow the 'Private Market Value (PMV) with a Catalyst' investment strategy, which was developed by Mario Gabelli in the 1970s and is now taught as part of the value investing course at Columbia Business School.

It is based on classic Benjamin Graham and David Dodd-style value investing, but with a difference, as while the managers aim to understand all aspects of a business and its intrinsic value, this classic approach is taken one step further by analysing what that business is worth to an informed buyer in a privately negotiated transaction. As such, they seek out companies whose share prices are trading at a discount to what they deem to be the private market value of that given stock (which they describe as a 'margin of safety'). They will, however, only buy companies where they see a catalyst for that value to be realised including the likes of spin-offs, management changes, tax reforms and financial engineering.

Though not an out-and-out M&A process, it is little surprise that over the 40 year life of the Gabelli All Cap Value strategy, around 10% per year of holdings have been subject to some form of M&A activity – usually adding value for investors. This process has ensured that the All Cap Value strategy has delivered significant outperformance relative to the wider US market over the long term with a CAGR since inception in 1977 of 16.7% compared to the S&P 500's CAGR of 11.5%.

Having outperformed the index by a wide margin last year due to its value tilt and small- and mid-cap bias, the trust has handed back some of those returns over the course of 2017 (to the 5th June) with NAV total return losses of 2.1% thanks to its sector positioning, falling bond yields and the outperformance of mega-caps. As such, the trust is narrowly underperforming both the S&P 500 and the AIC North America sector since its IPO in 2015. However, it is worth noting that a hallmark of the Gabelli process is patience as the managers don't benchmark themselves against an index and, instead, aim for absolute returns typically to the tune of inflation plus 10%. As such, this strategy tends to generate its relative outperformance in falling markets (the trust itself has been less volatile, had a smaller maximum drawdown and a lower down market capture than the sector and index since launch) and will typically lag in strongly rising ones despite the fact it is underweight mega-caps relative to the S&P 500.

Despite its relatively muted start, there is little stopping this trust delivering similarly strong long-term, risk-adjusted returns as some of its more established US stablemates, especially as it is run by the same experienced team but has the ability to gear

and offers an uncorrelated source of returns via its 'merger arbitrage' allocation (which is only available outside of this trust to GAMCO's US institutional investors).

There are a number of potential drivers for the portfolio (such as rising inflation which should benefit its announced merger allocation and Trump's planned tax reform and de-regulation which should support the portfolio's numerous domestic stocks), yet recent underperformance has led the discount to widen to 4.2% over recent weeks.

Portfolio

Gabelli Value Plus is a relatively diversified portfolio of 95 holdings, with the top 10 holdings usually accounting for a third of the trust's NAV.

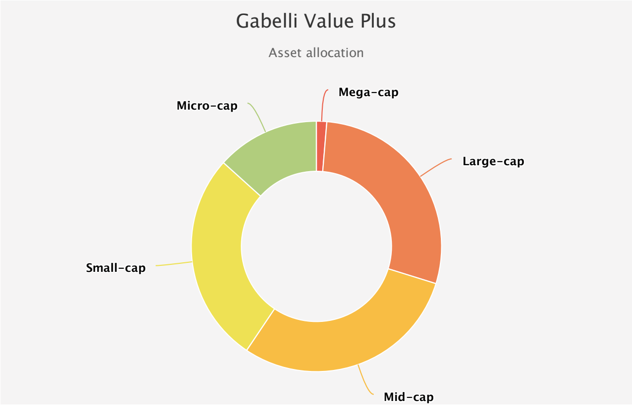
The managers follow an 'old fashioned' stockpicking, value-orientated approach to the market and take little interest in the make-up of a given index. The trust's process – The Gabelli Private Market Value with a Catalyst (PMV) - is similar to classic Benjamin Graham value investing. It boils down to viewing companies from the standpoint of what their intrinsic value is to an informed buyer in a privately negotiated transaction.

Ultimately, there are two parts to this process. There is the Graham and Dodd-style intrinsic value analysis (what is a business' worth; what is its earnings power; what's the cash on the balance sheet; what's the land worth; what's it on the books for etc.) but the managers take it one step further by looking at the private market value – so what is it worth to an informed buyer? Effectively, it is the intrinsic value plus a strategic premium.

However, as the name of the investment process suggests, the managers will not take a position in a company on value alone. Firstly, they only own companies that they deem to be high-quality and they focus on potential catalysts that will cause the discount of current share prices to the PMV to narrow. These catalysts can be both company specific and macro-orientated, with the managers aiming to buy companies that are trading on a 50% discount to their PMV and the objective is to earn that spread over a three-year time frame.

Before investing, the managers aim to understand all elements of a business. For example, when looking at an asset, manufacturing facility or a salesforce, they try to understand the respective replacement values. The initial process starts with balance sheet and cashflow analysis before working their way up to overall share count and what they are paying for the actual representation of a given business.

Given this highly differentiated approach, it is little surprise that Gabelli Value Plus differs significantly compared to most other US equity funds. For example, the trust has very little in mega-caps compared to its peers as the managers prefer investing further down the market-cap spectrum – especially as this is where they believe they can add the most value as many of the companies they research are not covered by Wall Street. According to Morningstar, some 70% of the trust is invested across mid, small and micro-caps while the average market-cap across the portfolio is £21bn, compared to £130bn within the S&P 500.



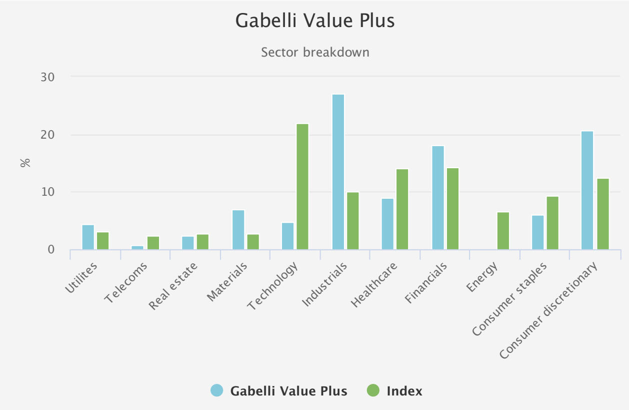
Source: Morningstar

Apart from a lack of analyst coverage further down the market-cap spectrum, another reason for avoiding mega-caps is because they believe that these companies in the mid (small end of large-cap) space offer attractive merger opportunities thanks to what they call the 'fifth wave of global M&A activity' (which we will discuss in the performance section). While this trend has been put on hold somewhat over recent months due to US politics, the managers argue it will undoubtedly continue as cash rich mega-caps will want access to these companies' intellectual property, technology and customers.

The managers' PMV with a Catalyst approach means while not an out and out M&A portfolio, over the life of the strategy, around 10% p.a. of the portfolio has been subject to some form of M&A activity. The managers also work closely with the companies they own to create shareholder value, and will block potential deals if they believe price is well below their valuation.

Outside of this part of the portfolio, however, the trust offers investors access to 'merger arbitrage opportunities' (which is only usually available to institutional investors in the US). Around a third of the portfolio is invested in announced mergers. This part of the portfolio can offer returns that are independent to market movements, as the trust's returns are driven by the spread between a stock's share price at the time a deal is announced and the price of the deal itself. As such, the return is subject to deal risk, not market risk.

In terms of sector exposure, the trust's largest allocations are to financials, consumer discretionary and industrials.

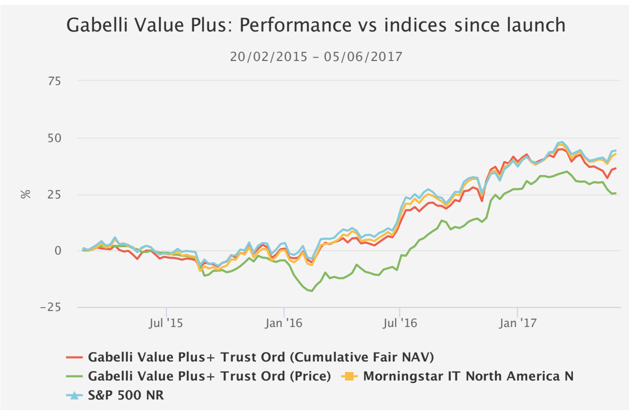


Source: GAMCO

This sector allocation (as well as its bias towards non-mega-caps) has hindered relative performance over the course of 2017, with S&P 500 having outperformed the Russell 1000, 2000, and 3000 indices while technology and healthcare stocks (areas the trust is underweight) have led the US market. Nevertheless, the managers argue their positioning is conducive to the new era of President Trump (especially in the case of its high weightings to industrials and financials), given his plans for future infrastructure investment and the prospects of reduced financial regulation. They also note that both Trump and the Republican Congress favour reducing the corporate tax rate to 20%, eliminating most corporate tax breaks, and the immediate deductibility of capital costs instead of repaying such costs. They add that these business-friendly proposals will benefit the portfolio's holdings, most which are domestically-orientated.

Performance

Gabelli Value Plus was launched in February 2015. It enjoyed a strong 2016, a year when value investing fell back into favour, as the portfolio benefitted from this reversal in trend, rising bond yields and the outperformance of smaller companies relative to large- and mega-caps. It delivered a NAV return of 38.1%, compared to gains of 32.7% from the S&P 500.



Source: Morningstar

However, it has handed back that outperformance over the course of 2017 (to the 5th June), as it has lost 2.1% in NAV returns compared to returns of 5.1% from the index. This underperformance has been driven by the trust's underweight to large-cap technology and healthcare, as well as its significant overweight position in industrials and materials (plus the fact that value stocks have generally underperformed relative to growth stocks). As such, the trust is currently lagging both the index and its peers in the AIC North America sector since its launch with NAV returns of 36.3%.

This is still a very short period of time to judge performance, but the trust's investment strategy has a far longer track record of market-beating returns. This PMV with a Catalyst process has ensured that the All Cap Value strategy has delivered a CAGR since inception in 1977 of 16.7% compared to the S&P 500's CAGR of 11.5%.

It is worth noting, however, that the managers of the trust pay no attention to the make-up of the index and do not aim to beat it in any given year, instead preferring to focus on long-term absolute returns typically to the tune of inflation plus 10% p.a. This approach, along with the margin of safety they look for in each stock they buy, means the strategy has tended to generate relative outperformance in flat or falling markets and has usually lagged in strongly rising ones.

According to research from GAMCO, for example, since the 'Gabelli All Value Cap' strategy was first put into place in 1977, it has (on average) outperformed the S&P 500 over the 44 'down' quarters by 10 percentage points, but only underperformed the index (again, on average) by 0.4 percentage points over the 111 'up' quarters.

RISK METRICS SINCE LAUNCH*

NAME	VOLATILITY	MAX DRAWDOWN	DOWN MARKET CAPTURE**
Gabelli Value Plus Trust (NAV)	10.45%	-6.39%	81.77%
AIC North America (NAV)	11.25%	-9.96%	94.92%
S&P 500	11.02%	-8.34%	100.00%

Source: Morningstar *Date range is from 19/02/2015 to 31/05/2017 **Relative to S&P 500

The trust itself, while having underperformed from a relative total return perspective, has been less volatile, produced a smaller maximum drawdown and delivered a significantly lower down market capture ratio than both the sector and index since launch.

Though volatility is likely to be a feature, there are various reasons why the trust can benefit over the medium to long term. Though the franticness of Donald Trump's first few months as president has dominated newsflow, the team believe that the 'Fifth Wave' of global M&A activity is still very much underway, with cash rich mega-caps preferring to buy growth via takeovers of smaller businesses (and all the intellectual property, technology and customers they can access) rather than building organically.

The managers note that further deal making could come once there is clarity on tax reform in the US, as well as a better sense for regulatory scrutiny by the Trump administration – but it is positive for the strategy that, in the first quarter of 2017, global deal volume totalled $777bn, a 12% increase compared to the first quarter of 2016.

Gradually rising rates in the US should also provide a boost. Not only does value tend to outperform in an environment of rising yields, but also the merger arbitrage allocation is likely to profit from an increase in the risk-free rate which will lead deal spreads to widen – as has been the case over the 30 years' GAMCO has run such a strategy.

Dividend

The trust is run with a total return mindset and so it is unlikely to ever pay a high dividend yield. At the time of writing, the trust's yield is 0.2% with last year's final dividend amounting to 0.3p per share.

The board notes that the trust's dividend yield is a by-product of the investment process and can be expected to vary significantly relative to that of the broader market, adding that investors "should have no expectation that the company will pay dividends as anticipated or at all".

Gearing

The trust has the authority to borrow up to 40% of its shareholder's funds but since launch the trust has not been geared.

Management

The trust is run by four lead portfolio managers – GAMCO Investors' Robert Leininger, Mario Gabelli, Marc Gabelli and Caesar Bryan – and they are supported by four members of the research team. Between the four lead managers, they have 136 years' worth of experience.

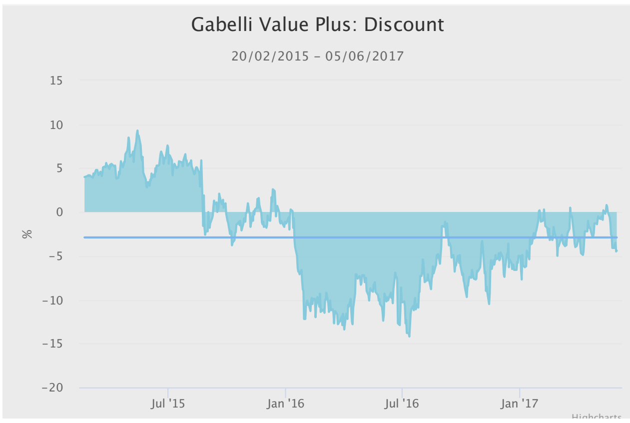
GAMCO was founded by Mario Gabelli, who pioneered the PMV with a Catalyst approach, in 1976 as an institutional research firm. It is now a publically-listed company in the US that employs 200 individuals, overseas c.$40bn and manages around 2,000 separate accounts for institutions and high-net worth individuals. It runs over 30 open-ended funds and 15 closed-ended funds, making it one of the largest closed-ended players in the US, with c.$7.5bn AUM. Outside of the US, it has offices in London, Tokyo and Shanghai.

Andrew Bell, who is also chief executive at the top performing Witan trust, is chairman of the board. Given this is GAMCO's first real venture into the UK market, we believe having such an experienced pair of hands chairing the trust can only be a positive.

Discount

Like the majority of recent IPOs, the trust's shares jumped to an immediate premium after its launch in February 2015. It fell back to parity and traded around NAV for the remaining months of that year, before falling to a wide discount during the global sell-off that occurred in January 2016 on the back of China concerns and another plunge in the oil price.

Following its recent NAV underperformance, its shares currently trade on a 4.2% discount, which is wider than average as the chart below shows.



Source: Morningstar

A positive for potential investors, however, is that the board has been very active in trying to manage the discount. Though no formal level policy is in place, the board has bought back stock when the trust's discount has widened in the past (such as over the summer of 2016 and in January this year).

Following supportive feedback from existing shareholders and potential new investors, the board announced plans for an upcoming C-share issue in March. Little is known about this, however, as the board noted that "further proposed details of the C share including its structure, timing and size, will be subject to prevailing market conditions and will be announced in due course".

Charges

The trust has ongoing charges 1.48% while GAMCO is entitled to a monthly management fee, accrued daily, equal to 1% p.a. of market capitalisation.

Important Information

Kepler