

Henderson Opportunities Trust

A time to act

With a focus on long-term growth, Henderson Opportunities Trust's (HOT's) all-market investment strategy includes a strong bias towards smaller and earlier-stage companies. The relative weakness of smaller companies in the past three years, particularly AIM stocks, has weighed heavily on HOT's performance, obscuring its previous exceptional returns. It is in this context that HOT is one of the trusts targeted by the activist US hedge fund Saba Capital, which is proposing to oust the independent board and replace the trust's investment managers. HOT's board strongly urges shareholders to reject Saba's proposals on their own merits. Only if this occurs will shareholders be able to consider the board's own proposals for HOT, which, in our view, are significantly more attractive. These include a full cash exit at NAV and/or the option to roll over into an alternative, open-ended vehicle.

When investor confidence is low, the share prices of smaller and mid-sized companies, as well as growth stocks, are often weaker compared with large global stocks. Over the past three years, this trend has been particularly pronounced, especially for domestically focused businesses, and is reflected in HOT's performance, even over 10 years. This is despite HOT generating a c 100% NAV total return to the first seven years, double that of its broad market benchmark, and ahead of the Numis Smaller Companies Index including AIM and excluding investment trusts (NSCIAEX), which is more representative of HOT's investment strategy. This strategy has been clearly articulated and consistently applied over many years by two experienced fund managers, James Henderson and Laura Foll of Janus Henderson. Frustratingly for investors, when the asset class is out of favour, the discount to NAV remains stubbornly wide. Historical performance shows that when sentiment turns, discount narrowing significantly enhances shareholder returns. The fund managers are positive about the prospects for the UK equity market and highlight that valuations remain highly attractive on both an absolute and relative basis, particularly for smaller companies.

Saba has beneficial interest in HOT of c 28%. It is proposing to remove the independent board of HOT (and those of six other trusts) and replace it, at least initially, with just two individuals nominated by Saba, one of whom is a Saba partner. We believe this raises important governance issues, particularly as Saba intends the existing management contracts to be terminated and has ambitions to be appointed as investment manager. While the details remain unclear, it appears that, across the seven trusts targeted by Saba, it will, in many cases, seek a significant change in investment mandates, merging the trusts into a new sector consolidations fund. Saba says that it will offer a 'substantial' liquidity event to shareholders wanting to exit HOT, but this appears to be on a partial basis, in contrast to the full cash alternative proposed by the HOT board.

The Saba proposals will be voted on by shareholders in a general meeting requisitioned for 4 February 2025, although the deadline for casting proxy votes through investor platforms will be earlier. The circular can be found [here](#), as well as information on [how to vote](#). HOT's board strongly recommends that shareholders vote against the Saba proposals, and we agree. The proposals put forward by the HOT board are contingent on this being the case. In addition to the full cash exit option, the alternative investment roll-over option into the Janus Henderson UK Equity & Income Growth Fund provides an opportunity for investors to maintain their UK equity exposure and may benefit some in managing capital gains tax liabilities.

Investment companies
UK all-cap equities

17 January 2025

Price	223.00p
Market cap	£87m
Total assets	£99m
NAV	234.2
Discount to NAV	0.5%
Current yield	3.3%
Shares in issue	39.5m
Code/ISIN	HOT/GB00BSHRGN41
Primary exchange	LSE
AIC sector	UK All Companies
52-week high/low	239.0p 182.2p

Fund objective

Henderson Opportunities Trust aims to achieve capital growth in excess of the broad UK stock market from a portfolio of UK investments. Stock selection is not constrained by the benchmark and there are no limits by sector or market capitalisation. Therefore, the portfolio will differ materially from the index.

Bull points

- Opportunities across all market segments and market capitalisation.
- Disciplined approach to stock selection, valuation and portfolio diversification.
- Experienced and stable management team with consistent long-term strategy

Bear points

- High portfolio weighting in smaller and earlier-stage companies, where liquidity can be thin and returns can be volatile.
- Investor appetite for UK smaller companies remains subdued.
- Relatively small size means HOT could be overlooked by some investors.

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True to its strategy and HOT's board has acted decisively

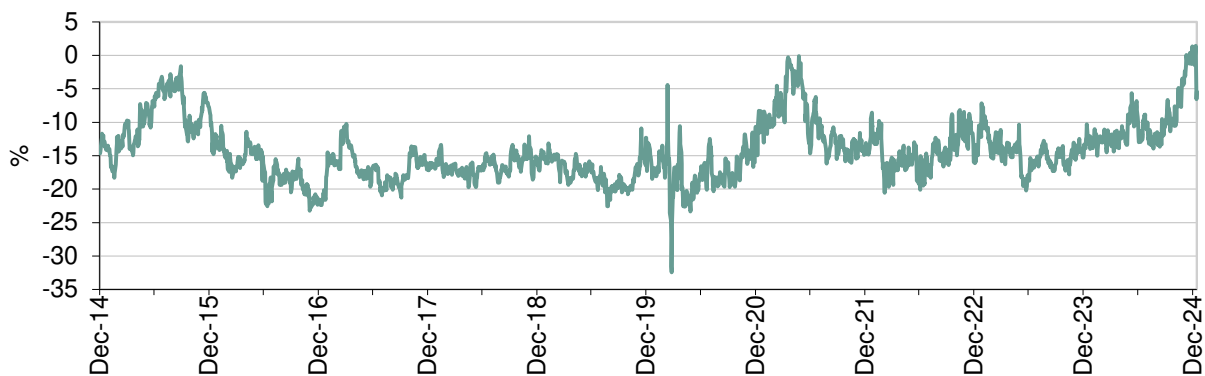
Our previous research covering HOT's strategy, performance, investment process and portfolio positioning can be found [here](#). We have also published in detail and from a sector context on the Saba campaign [here](#). Investor activism may be beneficial for the shareholders of investment trusts as it encourages the trusts' boards to intensify their efforts to maximise shareholder total returns and shareholder dialogue. However, we believe that Saba's intention to use the targeted trusts as a platform to build a UK discount arbitrage franchise goes beyond pure investor activism. Saba presents a biased narrative to achieve its objectives and its recent proposals lack the necessary details to make an informed decision to vote in favour of them. This includes details related to:

1. The significant, immediate liquidity events (eg tender offers and/or buybacks) at NAV to be offered to shareholders, including Saba's approach to the less liquid public small-cap and private holdings of these trusts;
2. The new investment mandate of buying/merging with discounted trusts and the plan for transitioning the trusts' portfolio; and
3. Measures to protect the rights of other shareholders, most notably the process for appointing new independent board members beyond the directors proposed in Saba's open letter.

HOT has consistently provided an investment strategy that is complementary to a wider range of more mainstream offerings, seeking to provide long-term growth, mainly from smaller companies, while balancing the risks through a high level of stock diversification (c 90 holdings) and meaningful exposure to larger, more established businesses. For many investors, this would be difficult to replicate and HOT's permanent capital base is ideally suited to the long-term, patient approach required. The challenging market conditions for smaller companies since late 2021 have been notable for both their duration and extent. While past recoveries have shown that this can quickly change, the timing of a significant turning point remains elusive.

Having traded at close to NAV, as smaller stocks rose strongly in absolute and relative terms coming out of the COVID-19 pandemic lockdowns, the shares have, until recently, traded at a 15–20% discount as investor enthusiasm for smaller stocks waned. It is the steady acquisition of shares by Saba that has closed the discount in recent months. In this context of weak performance and the persistent discount, and pre-dating the Saba proposals, the board had already instructed advisers to commence work on putting forward a scheme of reconstruction, giving all shareholders the choice between ongoing investment in an open-ended investment company managed by Janus Henderson Investors and an unlimited cash exit at NAV. If the Saba proposals are rejected, shareholders will be able to vote on whether the company reconstruction should proceed and, assuming it is approved, they will have the choice between cash or roll-over or some mix of both.

Exhibit 1: 10 year discount to NAV

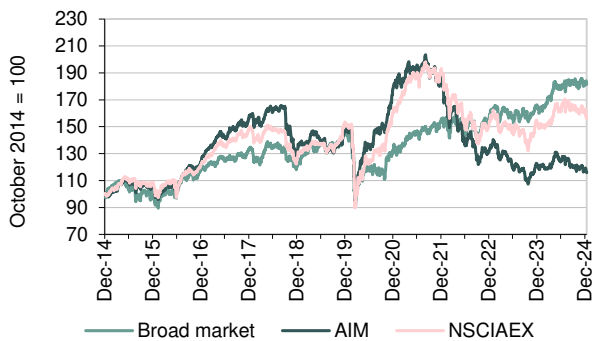


Source: LSEG Data & Analytics, Edison Investment Research

Recent underperformance masks a longer period of success

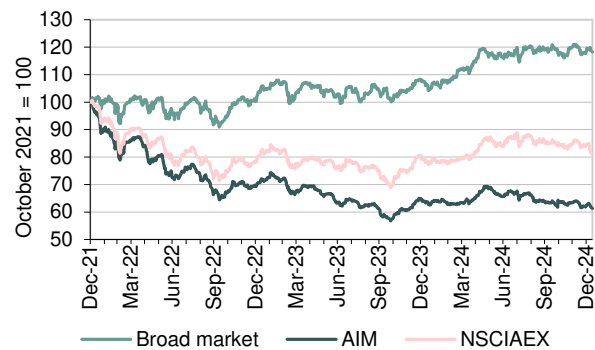
Given its strategic focus on smaller companies, HOT's performance has always showed significant divergence from that of its benchmark over shorter periods. In our view, we believe the NSCIAEX to be more reflective of the trust's clearly expressed and consistently applied strategy. A comparison of performance versus the broad market benchmark is a measure of the long-term success of the strategy. Smaller companies performed strongly coming out of the COVID-19 pandemic lockdowns but this has been followed by three years of underperformance, notable for both its duration and extent, especially for those listed on AIM.

Exhibit 2: 10-year index performance



Source: LSEG Data & Analytics, Edison Investment Research

Exhibit 3: Three-year index performance



Source: LSEG Data & Analytics, Edison Investment Research

In 2021, HOT's investment managers took advantage of rising smaller company share prices to shift the balance of the portfolio towards larger, more-established companies. With the benefit of hindsight, they could have done more but argue against materially doing so now. Smaller company underperformance over the past three years has had a significantly negative impact on HOT's performance track record, obscuring the exceptionally strong performance in the previous period. Over the three years to 31 October 2024 (FY24), HOT's NAV total return of -21.8% compares very poorly with the 19.7% benchmark return and this feeds through to all other periods up to 10 years.

Exhibit 4: Performance data to 31 October 2024 (end-FY24)

Cumulative returns to 30 June 2023	6m	1y	3y	5y	10y
Share price total return	1.1%	26.9%	-16.1%	31.5%	56.1%
NAV total return	-1.2%	17.1%	-21.8%	14.7%	60.9%
Benchmark total return	1.8%	16.3%	19.7%	31.9%	81.9%
Numis + AIM	3.3%	20.0%	-15.2%	18.5%	61.6%
AIM	-2.1%	10.5%	-36.6%	-11.2%	20.3%

Source: Henderson Opportunities Trust Factsheet for October 2024

Looking at the HOT performance data on a discrete calendar year basis highlights that HOT's underperformance stems from the period since FY22 and particularly that year. Somewhat distorted by market volatility during the COVID-19 pandemic, HOT has tended to outperform the index when the market is rising. In FY22, although the broad market fell only modestly, positive performance by the largest 20 companies (almost 60% of total market cap) was offset by strong declines across the wider market and especially AIM.

Exhibit 5: HOT's performance on a company financial year basis

Total return in the period	FY14	FY23	FY22	FY21	FY20	FY19	FY18	FY17	FY16	FY15	FY14
HOT NAV	17.1%	-9.3%	-26.4%	58.5%	-7.5%	0.4%	-5.5%	29.4%	0.6%	13.5%	3.4%
Benchmark	16.3%	5.9%	-2.8%	35.3%	-18.7%	6.7%	-1.5%	13.3%	12.2%	3.0%	1.0%
NSCIAEX	20.0%	-5.9%	-24.9%	43.5%	-2.6%	1.7%	-8.2%	26.1%	7.2%	9.1%	-2.0%
AIM	10.5%	-14.1%	-33.2%	30.1%	7.6%	-7.5%	-4.9%	28.1%	13.1%	3.9%	-10.0%
HOT NAV relative to											
Benchmark	-115.1%	-15.1%	-23.6%	23.2%	11.2%	-6.3%	-4.0%	16.1%	-11.6%	10.5%	2.4%
NSCIAEX	-2.9%	-3.4%	-1.5%	15.0%	-4.9%	-1.3%	2.7%	3.3%	-6.6%	4.4%	5.4%
AIM	6.6%	4.8%	6.8%	28.5%	-15.1%	7.9%	-0.6%	1.3%	-12.5%	9.7%	13.4%

Source: LSEG Data & Analytics, Henderson Opportunities Trust, Edison Investment Research. Note: 12 months to 31 October.

Looking more closely at the past 10 years of annual data, during the first seven years, HOT's NAV total return of 100% was more than twice the 50% delivered by its benchmark. Smaller companies outperformed during the period but HOT's

performance still exceeded the NSCIAEX return of 91%.

Over the more recent three-year period, HOT's NAV total return has materially underperformed its broad market benchmark, driven primarily by small-cap weakness, particularly among AIM-listed companies.

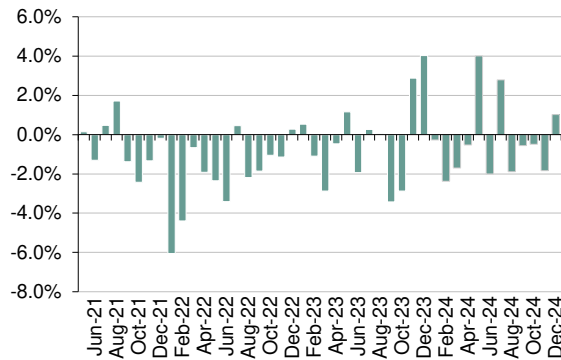
Exhibit 6: Relative performance changed in FY22

Cumulative total returns	Three years to FY24	Seven years to FY21
HOT share price	-14%	102%
HOT NAV	-20%	100%
Benchmark	20%	50%
NSCIAEX	-15%	91%
AIM	-37%	85%

Source: LSEG data, Edison Investment Research

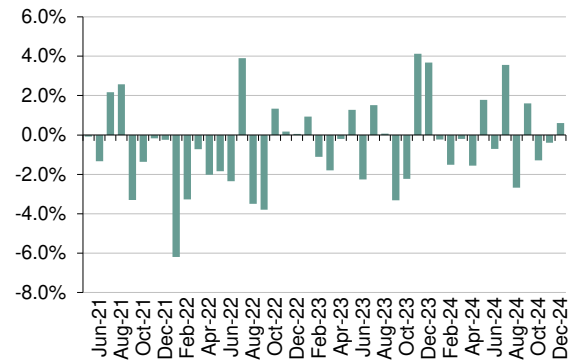
Over the past year, the NSCIAEX has slightly outperformed the broad UK market and so too as HOT, even though AIM has continued to lag significantly, but it is too early to call a turning point. The month-on-month pattern is volatile and smaller companies are typically more sensitive to the UK economy, where growth forecasts have begun to moderate.

Exhibit 7: Smaller stocks (NSCIAEX) versus the broad market, monthly



Source: LSEG Data & Analytics, Edison Investment Research

Exhibit 8: Mid-cap stocks versus the broad market, monthly



Source: LSEG Data & Analytics, Edison Investment Research

The roll-over proposal

The roll-over fund proposed by the board, the Janus Henderson UK Equity & Income Growth Fund, is an open-ended investment company rather than an investment trust like HOT, but it nonetheless provides a significant degree of continuity for HOT investors. Like HOT, it is managed by Foll and Henderson and invests primarily in UK companies selected from across the market, ranging from small-cap and AIM-listed stocks to the very largest companies. It follows a similar bottom-up investment process, with a strong valuation discipline and an often contrarian stance. However, its primary objective is income, which results in a larger weighting to large-cap stocks than HOT (c 70% in the top 100 companies, compared with c 35% for HOT) and a higher portfolio yield. The Janus Henderson UK Equity & Income Growth Fund focuses on companies trading at a valuation discount to peers and/or their historical averages, which the managers believe is unjustified and where there is a clear path to a re-rating. For this reason, its portfolio trades at a valuation discount to the broader UK market. At the end of December, the portfolio was trading at c 9.5x forward earnings. The [31 December factsheet](#) shows a trailing yield for the fund of 4.0%, compared with HOT's yield of 3.3%.

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