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The Diverse Income Trust plc

Preparing for the UK super-cycle

FOR INVESTMENT PROFESSIONALS ONLY. CAPITAL AT RISK.
MARKETING COMMUNICATION.

Thinking ahead of the curve

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Agenda

1

Asset valuations have been unusually buoyant for decades, so what is the most appropriate metric to assess the degree of valuation overstretch currently?

2

If nationalism and protectionism are now injecting all sort of uncertainties, how might this affect the returns on mainstream indices and the flow of capital allocations in the future?

3

Given these potential changes, what are the characteristics of strategies that might be vulnerable, or those best positioned to deliver strong and resilient returns in the future?

4

Even if all this change does lead to renewed UK outperformance, will its recovery ever really be significant enough in the global context, given that many consider the UK to be only a market of marginal interest?

5

UK-quoted small caps are by their nature fiddly, and illiquid, so is it really credible that mainstream portfolios will ever seriously consider allocating a significant weighting of their asset mix in future?

Equity markets returns come in two flavours – capital appreciation and the compounding of cash dividends…

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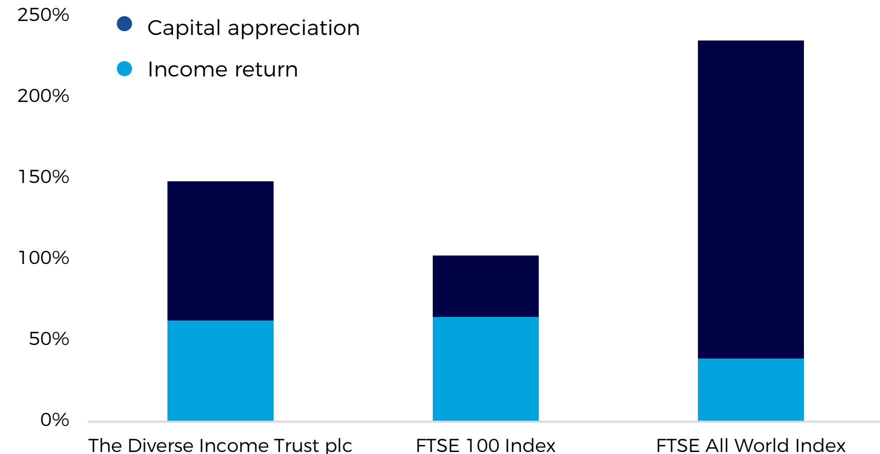
- Quoted companies that succeed, don't just generate return via share price appreciation, but many add resilience to that return by using their substantial cash generation to pay good and growing dividends
- The buoyant equity market conditions during globalisation, however, have made it incredibly easy for immature large caps to access ever larger sums of risk capital, and deliver unusually strong returns via share price appreciation alone. Capital appreciation strategies are popular because they have outperformed for some decades
- In contrast, stocks delivering less buoyant share price appreciation mixed with cash dividends that enhance their return, are now perceived as dull, and lacking ambition as they have been outpaced
- Over the decades, capital appreciation strategies have become so popular, and they have gathered such large capital allocations, in a favourable trend that has persisted for so long, that very few investors recognise the nature of the risk they are now carrying
- The nightmare about an overreliance on capital appreciation strategies is that at a time of high valuations, their returns can be lost near-instantaneously, permanently, and without warning.
- In capital appreciation strategies, investors wholly rely on two well-timed transactions to succeed in securing an attractive return for clients. In the case of dividend compounding strategies, the return is generated gradually over time, without the necessity of getting transaction timings precisely correct

Capital appreciation and cash dividend contribution of the returns of FTSE Global Index, the FTSE 100 Index, and the Trust since issue



…after persistent globalisation tailwinds for so long, few have major weightings in funds that generate a larger proportion of return via dividend compounding

Source: Bloomberg, data from trust inception, 28.04.2011 to 31.07.2024

Past performance is not a reliable indicator of future returns.

Yet our strategy has always focused on stocks well-positioned to pay good and growing cash dividends

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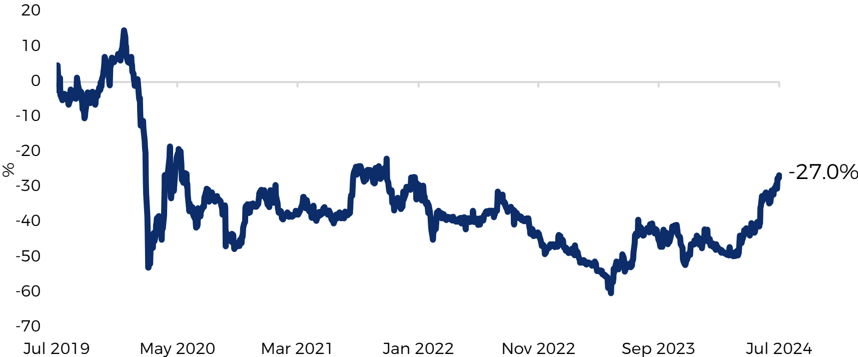
Paypoint Plc

- Prospects for rising turnover?
- Do unexpected cost increases get passed on to the customer?
- Does the management team make decisions that we feel will build value?
- How much financial headroom is there in the balance sheet?
- Are there low expectations in the share price?

Paypoint share price from 31.07.2019 to 31.07.2024



- Paypoint Plc is a national network for collecting payments typically over the counter in newsagents, convenience stores, supermarkets and forecourts
- It's extended its network via Multipay, that is bringing in a wider range of customers such as local authorities, charities and housing associations
- The acquisition of Appreciate plc broadens its offering further to include consumer vouchering, gifting/reward solutions
- Investec forecast that its free-cash-flow will rise from 6.7% in 2022 to 17.9% in 2026
- This is expected to drive the dividend yield up from 7.0% in 2022 to 9,8% in 2026

That generate good long-term returns, along with disproportionate upsides at times, albeit that most haven't done so over recent years

Source: FE Analytics, on a UK Sterling basis, bid to bid, from 31.07.2019 to 31.07.2024. Paypoint Plc was first purchased on 18.03.2020.

Past performance is not a reliable indicator of future returns. Forecasts are not reliable indicators of future returns.

We place a heavy emphasis on portfolio diversification, where a long portfolio doesn't just make the trust near-unique...

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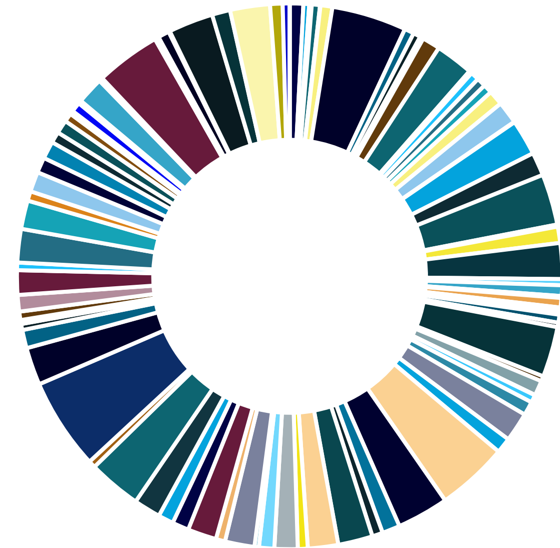
- The Diverse Income Trust specifically has a longer list of portfolio holdings than most other equity income funds
- This means that the trust's stream of dividend income comprises dividends from numerous holdings that in general comprise relatively small proportions of the overall dividend income, which has the advantage that any stock specific disappointments only have a minor impact
- Importantly, in our view, the longer list of portfolio holdings offers the opportunity to invest in the full range of stocks generating good and growing income, including genuine smallcaps that sometimes deliver exceptional dividend growth
- We believe that the Diverse Income Trust even contrasts with most multicap income OEICs in this area
- The bottom line is that stocks that succeed in generating exceptional dividend growth, normally also deliver exceptional share price appreciation, all the more so if they stand at overlooked valuations at the time of investment

Illustrative example of the multiple sources of income within the Diverse Income Trust plc



...in terms of moderating stock specific risk, but opens up access to the exceptional dividend growth of genuine smallcaps, which occurs sometimes

For illustrative purposes only.

Investing across the full multicap universe for example, purposefully includes numerous smallcap income stocks…

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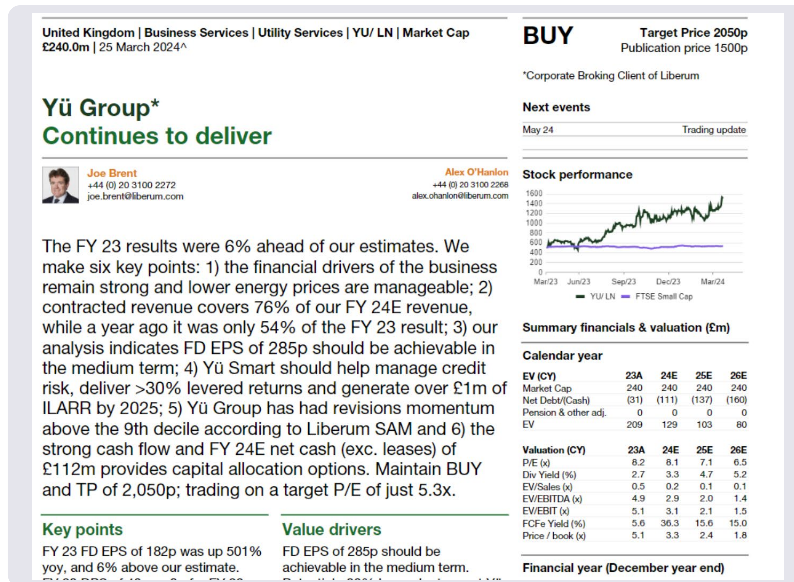
- Few professional investors (including professional smallcap investors), research stocks below an arbitrary market capitalisation such as £150m, and as such they overlook the upside potential of more than half of all the UK quoted companies
- A good example is Yu Group, that during 2020 was standing at a market capitalisation of £16m despite having sales of £101m, net cash balances of £10m, and rapid growth potential[1]
- Subsequently, Yu Group has reported accelerating sales and profit growth, such that it has now started to pay good and growing dividends
- One of the advantages of a multicap strategy is that the trust can invest in companies like Yu Group as they start to generate considerable surplus cash, when they may be set to pay a rapidly growing stream of dividends
- Hence, as soon as Yu Group started to generate abundant surplus cash, and could pay a healthy stream of dividends in future the trust was quick to invest, and participate in its outperformance
- In summary, when maturing quoted smallcaps succeed, sometimes they can deliver quite exceptional returns for years

The Liberium analyst's assessment of Yu[2]



United Kingdom | Business Services | Utility Services | YU/ LN | Market Cap £240.0m | 25 March 2024^

BUY Target Price 2050p
Publication price 1500p

*Corporate Broking Client of Liberum

Yü Group*
Continues to deliver

Joe Brent
+44 (0) 20 3100 2272
joe.brent@liberum.com

Alex O'Hanlon
+44 (0) 20 3100 2268
alex.ohanlon@liberum.com

The FY 23 results were 6% ahead of our estimates. We make six key points: 1) the financial drivers of the business remain strong and lower energy prices are manageable; 2) contracted revenue covers 76% of our FY 24E revenue, while a year ago it was only 54% of the FY 23 result; 3) our analysis indicates FD EPS of 285p should be achievable in the medium term; 4) Yü Smart should help manage credit risk, deliver >30% levered returns and generate over £1m of ILARR by 2025; 5) Yü Group has had revisions momentum above the 9th decile according to Liberum SAM and 6) the strong cash flow and FY 24E net cash (exc. leases) of £112m provides capital allocation options. Maintain BUY and TP of 2,050p; trading on a target P/E of just 5.3x.

Key points

FY 23 FD EPS of 182p was up 501% yoy, and 6% above our estimate.

Value drivers

FD EPS of 285p should be achievable in the medium term.

Next events

May 24	Trading update

Stock performance

Summary financials & valuation (£m)

Calendar year

EV (CY)	23A	24E	25E	26E
Market Cap	240	240	240	240
Net Debt/(Cash)	(31)	(111)	(137)	(160)
Pension & other adj.	0	0	0	0
EV	209	129	103	80

Valuation (CY)	23A	24E	25E	26E
P/E (x)	8.2	8.1	7.1	6.5
Div Yield (%)	2.7	3.3	4.7	5.2
EV/Sales (x)	0.5	0.2	0.1	0.1
EV/EBITDA (x)	4.9	2.9	2.0	1.4
EV/EBIT (x)	5.1	3.1	2.1	1.5
FCFe Yield (%)	5.6	36.3	15.6	15.0
Price / book (x)	5.1	3.3	2.4	1.8

Financial year (December year end)

…that in some cases deliver quite extraordinary dividend growth and as they often start on such overlooked valuations, excellent capital gains as well

Source: [1]Bloomberg as at 31.12.2020. [2]Liberium

Specifically, a trust that succeeds in sustaining ongoing dividend growth over time will have two features...

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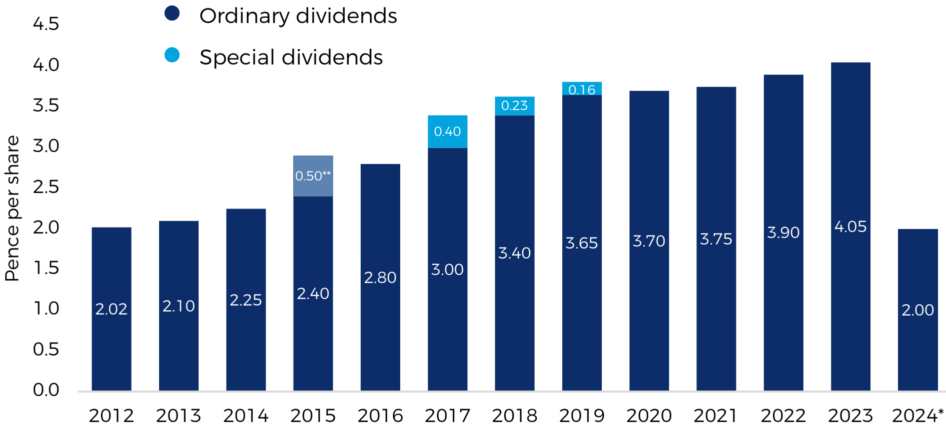
- Although many AIM-listed holdings have continued to progress over recent years and as such they have often continued to grow their dividends, this is at odds with their share price returns
- Generally, the share prices of many smallcap and AIM-listed stocks in the portfolio have typically been weak, even when they have continued to succeed
- Overall, the trust's dividend stream was affected by the dividend cuts during Covid although it has been rebuilt progressively since that time.
- Furthermore, as the share price of the Diverse Income Trust has not kept pace with its income growth over recent years, then the yield on the trust has increased to 4.7% currently[1]



...either its initial yield will steadily grow, or if the trust's yield remains static, then it will deliver both capital appreciation and a consistent yield

Source: Premier Miton. Total distributions paid for each financial year of the Trust, ending 31 May. *The income for the 2023/24 financial year represents 2 out of 4 payments.
**In order to allow shareholders to vote on the dividend, a final dividend was introduced in the year that ended 31 May 2015, resulting in the payment of five dividends for that year. Since then, the Company has paid three interim dividends and a final dividend in respect of each year. [1]Source: Bloomberg, the historic yield reflects distributions declared over the past twelve months as a percentage of the trust price as at 31.07.2024. It does not include any preliminary charge, and investors may be subject to tax on their distributions.

Past performance is not a reliable indicator of future returns. The level of income paid may fluctuate and is not guaranteed.

The trust's capital returns may have been comparatively weak over recent years due to UK OEIC redemptions...

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- The overall returns of the Diverse Income Trust are not closely correlated with that of most other UK equity income funds, and even relatively uncorrelated with most other UK equity multicap income funds
- The outcome is that the trust has a history of sometimes delivering returns when the mainstream equity indices are not

Cumulative performance %	1 year	3 years	5 years	Since launch[1]
Trust NAV	20.8	-4.8	35.4	233.9
Trust share price	19.5	-11.2	30.3	191.8
UK Equity Income sector	16.9	15.2	44.9	180.7
Deutsche Numis Smaller Co + AIM (ex ICs) Index	14.6	-14.1	26.4	174.3
Deutsche Numis All-Share Index	16.7	18.9	34.8	123.7

Discrete annual performance %	2019	2020	2021	2022	2023	2024 ytd[2]
Trust NAV	12.5	7.6	15.8	-13.4	-2.6	16.6
Trust share price	6.9	8.6	19.5	-16.8	-5.7	14.4
UK Equity Income sector	22.5	-7.8	18.7	0.1	3.9	10.7
Deutsche Numis Smaller Co + AIM (ex ICs)	22.2	4.9	20.0	-21.9	3.2	9.0
Deutsche Numis All-Share Index	18.8	-7.9	17.1	-2.5	7.8	10.6

...when compared to the scale of many growth trusts it may be modest, but investors overlook the 'self-liquidating' nature of its stream of dividends

Source: Morningstar™, as at 31.08.2024, net income reinvested, bid to bid basis. ©2024 Morningstar. All Rights Reserved. The information contained herein; is proprietary to Morningstar and/or its content providers; may not be copied or redistributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. [1]Trust launched on 28.04.2011. [2]2024 ytd to 31.08.2024.

Past performance is not a reliable indicator of future returns.

Performance

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Discrete annual return %	31.08.2019 to 31.08.2020	31.08.2020 to 31.08.2021	31.08.2021 to 31.08.2022	31.08.2022 to 31.08.2023	31.08.2023 to 31.08.2024
Trust NAV	6.8%	33.1%	-13.7%	-8.6%	20.8%
Trust share price	3.8%	41.5%	-16.5%	-11.1%	19.5%
UK Equity Income sector	-12.4%	43.6%	-6.9%	5.8%	16.9%
Deutsche Numis Smaller Co + AIM (ex ICs)	-0.3%	47.6%	-22.6%	-3.2%	14.6%
Deutsche Numis All-Share Index	-11.2%	27.6%	-2.5%	4.5%	16.7%

Source: Morningstar™, as at 31.08.2024, net income reinvested, bid to bid basis. ©2024 Morningstar. All Rights Reserved. The information contained herein; is proprietary to Morningstar and/or its content providers; may not be copied or redistributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. **Past performance is not a reliable indicator of future returns.**

Since issue for example, the trust has returned over 100% of initial capital…

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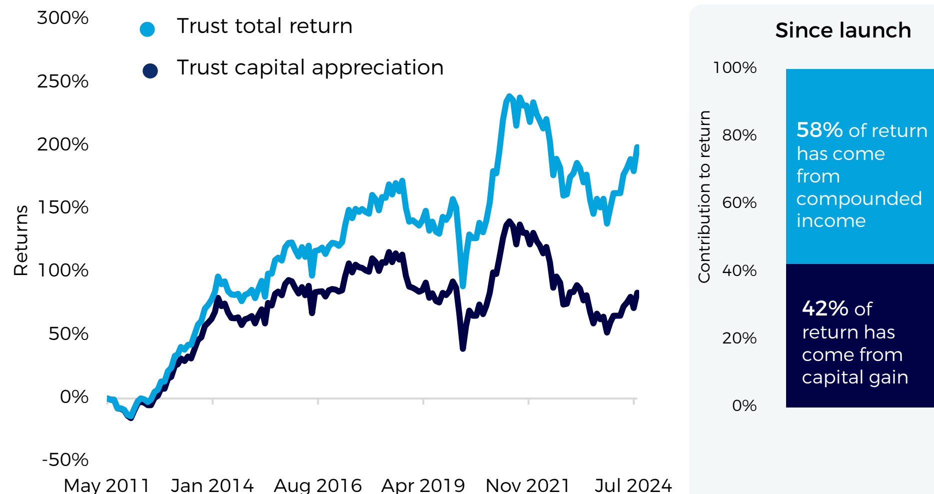
- Capital appreciation strategies need two transactions to take the return, one at the time of investment, and one at its sale, when the cash uplift is crystalised. Between these two points the notional return can be highly volatile
- In contrast, as the cash dividends on cash compounding trusts are booked progressively, so its returns are regularly taken in part
- When market prices decline, investors seeking to take returns on capital appreciation strategies often find they liquidate less than expected because of other sellers, or that the exit price is much worse than expected – both can significantly detract from return
- In contrast, whilst the trust's NAV might be marked down considerably when market prices decline, providing the dividends aren't cut, the investors ongoing cash dividend return continues as before
- Hence, whilst it is disappointing that the market prices of the trust's smallcap holdings have been devalued over recent years, it should be remembered that the Diverse Income Trust's significant dividend payment give it a 'self-liquidating' nature. Hence, whilst the client's weighting in the Diverse Income trust may have suffered a setback, it is naturally a lesser weighting than the equivalent capital appreciation fund, and therefore the impact of the setback isn't as great.
- Providing the dividends aren't cut, we also anticipate that in time the trust's NAV appreciation will subsequently catch up again with the growth of its dividends, and hence it has the capacity to deliver much stronger returns in future

Chart of how much the Trust's income and capital have contributed to return since launch



…we anticipate that equity income funds will now become a much larger portion of investors allocations. So, why do we have such a high conviction?

Source: Bloomberg, data from 28.04.2011 to 31.07.2024. Trust launched on 28.04.2011.

Past performance is not a reliable indicator of future returns.

Nationalistic and protectionist policies are now starting to drive deep-seated generational changes in financial trends…

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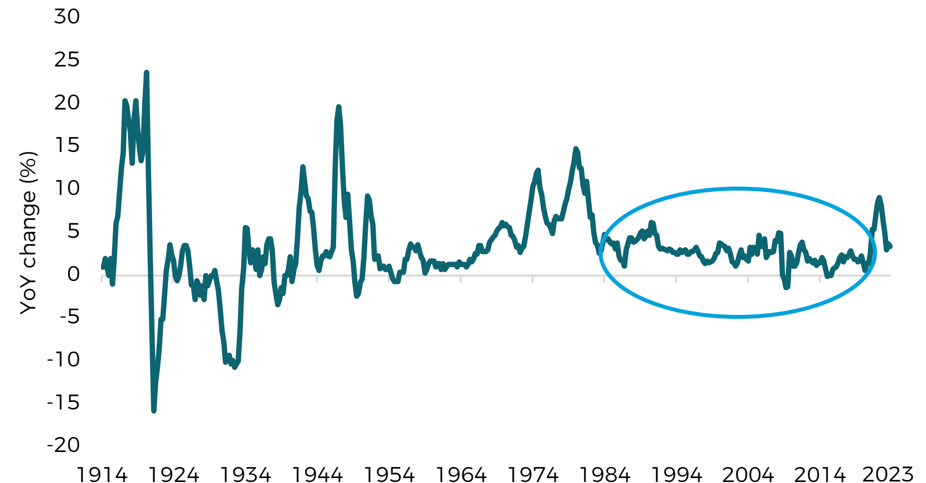
- The period of globalisation contrasted with others, in that the surge of low-cost imports offset ongoing local service sector inflation
- In the absence of the risk of inflation, central banks have injected additional demand at will when growth faltered
- Hence, global growth has been persistent, and as the cost of debt fell, the increased use of debt boosted corporate profit margins - ultimately to supernormal levels
- Since the mid-2010's however, nationalistic and protectionist policies displaced those of the globalisation decades
- Unfortunately, inflationary pressures now sit just below the water line, ready to resurface when additional demand is injected or when currency weakness is persistent
- Over the coming decades, we anticipate these will return to the prior inflationary norms and are matched by equally deep-seated and profound changes in longer term trends in financial markets

US inflation has a history of being spikey
(other than during the period of globalisation)



….from here, inflationary pressures are returning to prior norms – they will be routinely too high, or else sub-zero and deflationary

Source: Bloomberg, US CPI Urban Consumers YoY Index, data from 31.03.1914 to 31.12.2023.

As it is, governments have become so accustomed to operating without any real market constraints on expenditure…

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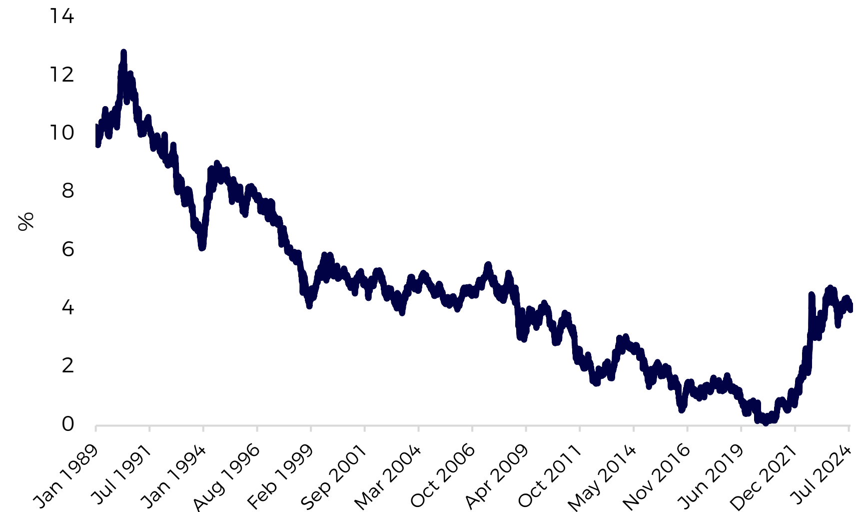
- Prior to globalisation, it was very difficult for governments to balance expenditure with receipts, especially when receipts fell during a recession, or when there was an unplanned rise in expenditure, such as to fund a rise in unemployment pay for example
- With globalisation however, economic growth has been persistently strong, and corporate profit margins have risen, so government receipts have grown dramatically, whilst unplanned costs such as unemployment have tended to fall to generational lows
- Meanwhile as bond yields fell, the cost of government debt has also fallen. During these years, governments have had no real constraint of expenditure and even giant one-off expenditures could be actioned, such as during Covid when QE offset any shortfalls in bond investors
- Now that globalisation is fading, governments have greatly scaled up taxation to balance the books, and got away with unusually large budget deficits for now - that they cite as temporary
- But as the imbalances between government receipts and expenditure become persistent, we anticipate that excess taxes or QE will be immediately be offset by a pullback in demand from bond investors, driving bond yields up and making the imbalances greater

The cost of UK government debt fell dramatically between 1990 & 2020, but with globalisation fading this is changing



…that when market tailwinds die away, we anticipate that politicians (and indeed, central banks) will be caught out as market constraints return

Source: Bloomberg, data from 02.01.1989 to 31.07.2024.

Buoyant markets and passive allocations actively enhanced the returns of growth stocks during globalisation…

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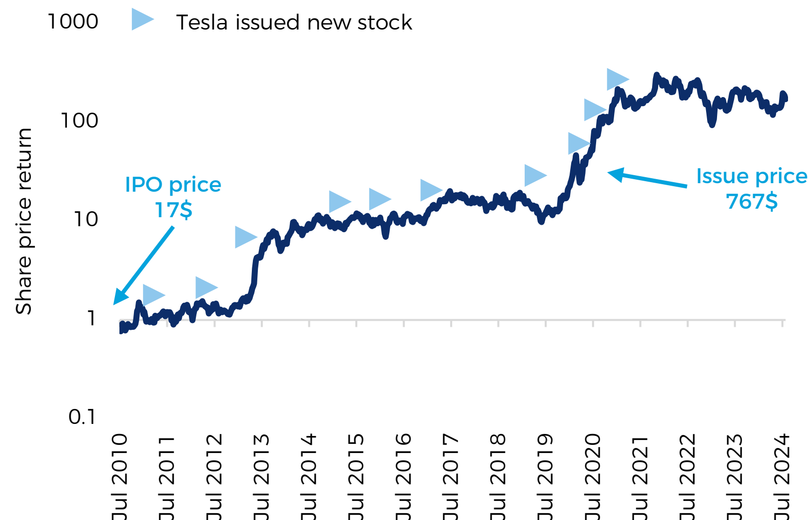
- When asset markets were buoyant, and central banks could reverse recessions at will through injecting additional demand, corporates that needed external capital to survive have not only survived, but they've also thrived
- Specifically, a stock reliant on external capital to fund great growth prospects, was able to raise additional capital at progressively higher share prices whilst it delivered abundant sales growth
- This self-feeding process greatly enhanced the returns of early investors in growth stocks, plus as they scaled up their market capitalisations, their share prices were further enhanced as passive funds allocated ever larger capital sums to keep up with their mega cap index weightings
- Unfortunately, this self-feeding cycle wholly relies on asset market valuations appreciating, and growth stocks continuing to grow well
- Elevated interest rates work by suppressing demand, so growth momentum is currently due to stall – and even if interest rates were cut hard, their impact will only come through after a time lag
- Hence, whilst passive fund flows may increase further, mega caps valuations are now becoming unstable, potentially destabilising the ability for growth stocks to raise additional capital at ever higher share prices, which may mark the start of a reversal of the prior trend

Markets valuations have risen, and this tailwind has enhanced the share price of Tesla's capital raisings



…but, when market tailwinds die away, the same stocks may end up heavily detracting shareholder returns via issues at distressed prices

Source: Bloomberg, data from 02.07.2010 to 26.07.2024.

Past performance is not a reliable indicator of future returns.

Overall, the valuations of growth stocks, most specifically those of US-listed growth stocks, appear wildly out of balance currently…

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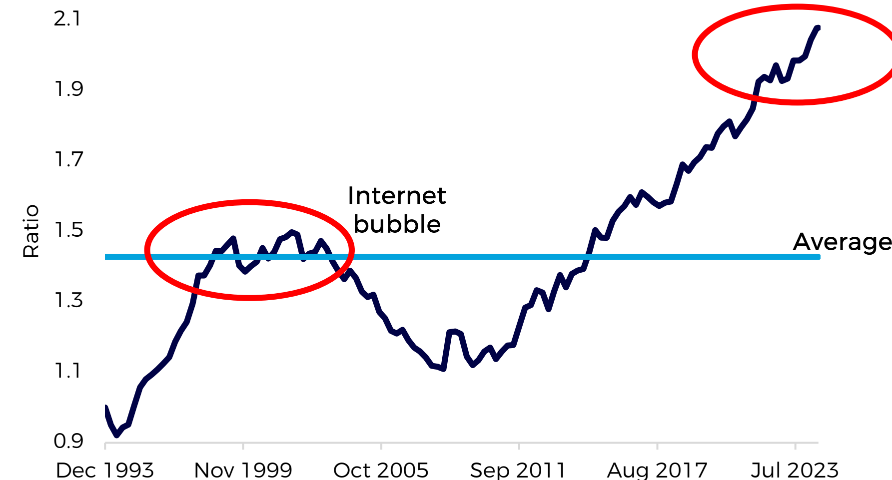
- Market beta has generated such good returns, over such a long period, that low-cost, highly liquid passive funds have gathered considerable assets
- Over recent years, with ever-growing sums being invested in passive strategies, and with large portions being invested in US megacaps, the trend has become a reflexive, self-feeding cycle
- US technology megacaps that have grown well, have also risen in valuation, driving a giant exaggeration in US equity market returns when compared with other global equity markets
- The price to book ratio is often used by academics as a measure of market valuation. As at 30 June, Alphabet and Amazon were on 7x, Microsoft on 12x, Apple on 51x and Nvidia on a P/B ratio of 62x. For reference the FTSE100 P/B ratio is around 1.9x (as at 22.08.2024)
- Overall, this has led to an incredibly crowded position that is super-sized in scale, invested in stocks that appear to be on very elevated valuations, and reliant on capital appreciation to generate return
- The nightmare about an overreliance on capital appreciation strategies is that at a time of high valuations, their returns can be lost near-instantaneously, permanently and without warning
- Overall, investors rely on two well-timed transactions to succeed in generating a good return for clients in capital appreciation strategies. In the case of dividend compounding strategies, the return is generated gradually over time, without the necessity of getting transaction timings precisely correct

The rise in US tech valuations has been amplified by passive investing in megacap index weightings

S&P 500 Index vs FTSE All World Index



…so, when market tailwinds die away, we fear US capital losses might be megacap in scale, along with potentially eye-watering downsides

Source: FTSE International Limited ("FTSE")/S&P Dow Jones Indices LLC/Bloomberg, data from 31.12.1993 to 23.07.2024.

Past performance is not a reliable indicator of future returns.

All this opens giant risks for the financially weak – either they radically retrench, or else risk becoming insolvent…

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- During globalisation, market liquidity was abundant, and when economic setbacks occurred it was enhanced further by financial stimulus, such that even zombie companies survived
- As nationalism and protectionism displaces globalisation, we are fearful that market constraints will bear down on governments and central banks
- In time, it may get harder to roll over existing loans as credit criteria tighten, which will initially lead to numerous zombie companies failing, although unfortunately, their suppliers may fail in time due bad debts
- Whilst bad debts won't be good news for stocks with strong balance sheets and cash-cash-generative businesses, their prospects will improve as they expand into all the markets vacated by insolvency
- In addition, quoted stocks can buy overleveraged, but otherwise viable businesses debt-free from the receiver, often for a nominal sum, greatly enhancing their upside at a time when mainstream stock market indices might be delivering very little return
- Overall, we believe that the forthcoming years will be defined by the strong getting stronger, and those with insufficient safety margins suffering badly, with numerous zombie companies at risk of insolvency

…whilst all the while the financially strong will typically get stronger, with some getting disproportionally stronger

Active fund management isn't just about picking stocks with upside potential, but also about being attentive to downside risk…

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- It is customary for fund managers to assess risk in terms of whether their strategy delivers a good return versus a median, or in comparison to the mainstream equity indices
- We are less concerned about variance versus indices, as long as the strategy is successful longer term, then any underperformance versus an index will be temporary, and followed by extra upside
- The risks we are most worried about, are related to a potential permanent loss of capital, where a major market drawdown is crystalised because there is no prospect of any subsequent recovery
- Furthermore, we are also wary of inherent risks that are difficult to capture within statistics, as sometimes these are disregarded, because measured risks are easier to discuss and monitor
- Overall, as highlighted in the prior slides, we believe that investment risks might be rather more wide-ranging in future years, as asset market trends evolve from globalisation to reflect the policies of nationalism and protectionism
- Given these concerns, the Diverse Income Trust intentionally has much greater diversification than most others, and furthermore it sometimes actively invests in options that appreciate when markets suffer absolute losses

…and actively seeking to minimise portfolio drawdown risks, especially during periods when electorates drive radical change in political policies

Bonds and equities were typically diversifiers for each other in recent decades, but with inflation their returns correlate…

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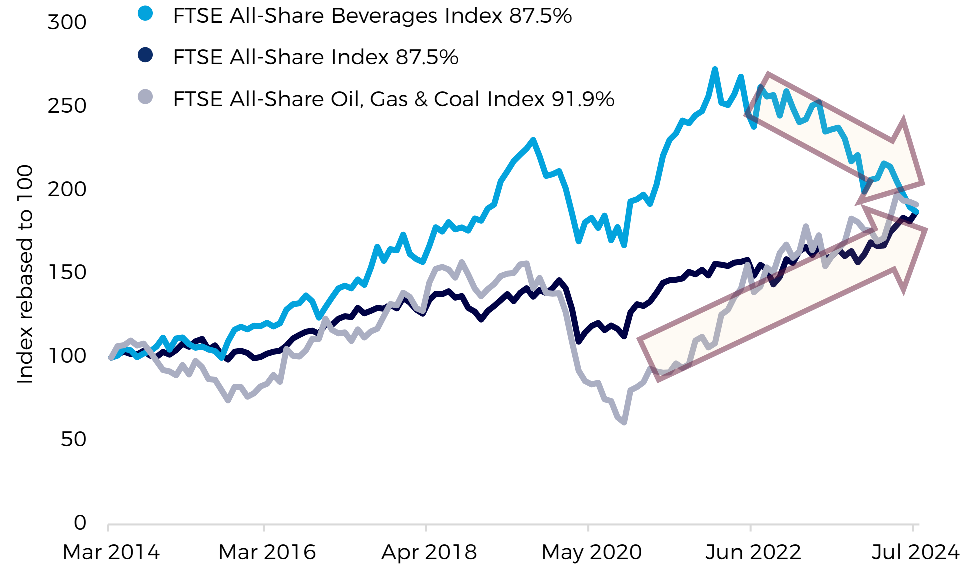
- Those external to the financial services sector often assume that portfolio management is merely about investing in a number of stocks with upward price momentum, and taking profits before their share prices fall back significantly
- But this assumption overlooks event risk, where the prospects for numerous stocks can suddenly change and become quite weak
- When an unexpected event occurs, whilst the prospects for some portfolio holdings might be much weaker, across a portfolio hopefully there may be other relatively uncorrelated holdings where the event leads to their prospects becoming more upbeat
- In the example alongside, the prospects for many stocks in the Beverages sector were somewhat correlated to bond valuations, whereas the prospects for the Oil, Gas and Coal sector were principally correlated with the price of energy
- Following the invasion of Ukraine, and the revival of inflation, bond valuations declined whereas the energy price increased, so a portfolio containing holdings in these two sectors delivered both sustained dividend income growth through the unexpected challenge, and a portfolio return that was less volatile than either of the two industry sectors individually

Chart highlighting how industry sector diversification within a portfolio can sometimes moderate the volatility of overall portfolio return



…so, in future, stocks operating in capital-intensive sectors for example, may provide better portfolio diversification

Source: FE Analytics, from 31.03.2014 to 31.07.2024.

Past performance is not a reliable indicator of future returns.

As capital becomes costlier, some capital-intensive businesses may even offer ‘option-like’ upside potentials…

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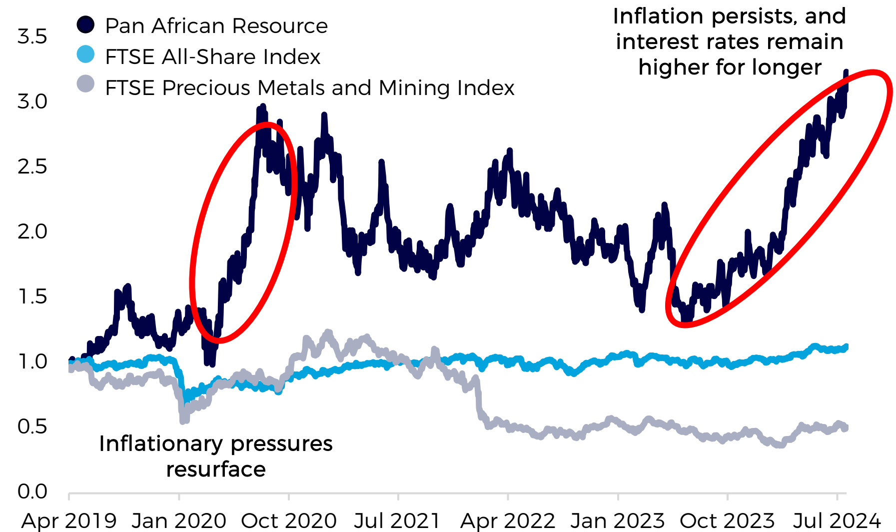
- Many fund managers choose to avoid researching industry sectors such as complex financials or various mining or energy stocks, on the basis that they don’t have conviction as to imminent interest rates or commodity prices
- Including stocks like these that are often more uncorrelated with the fluctuations of most mainstream portfolio holdings actively helps to diversify risk, and hence dilute potential drawdown risks
- Better still, because of the supply/demand characteristics of many of these industries, when they succeed, their profitability and potentially their cash generation can sometimes rise rapidly
- If anything, because smallcap operators are often immature, their scope for profitability increases can sometimes be even greater than those of the mainstream stocks in these sectors
- A good example are gold mining business for example, where the Pan African Resource share price appreciated during the global pandemic because the gold price is not closely correlated with the fluctuations of the global economy



…because if demand is sustained, their ‘corporate moats’ notionally widen, and their profitability will sometimes increase dramatically

Source: FTSE International Limited (“FTSE”)/Bloomberg, from 09.04.2019 to 31.07.2024.

Past performance is not a reliable indicator of future returns.

Overall, a portfolio including a near-comprehensive list of industry sectors will not only have greater diversification…

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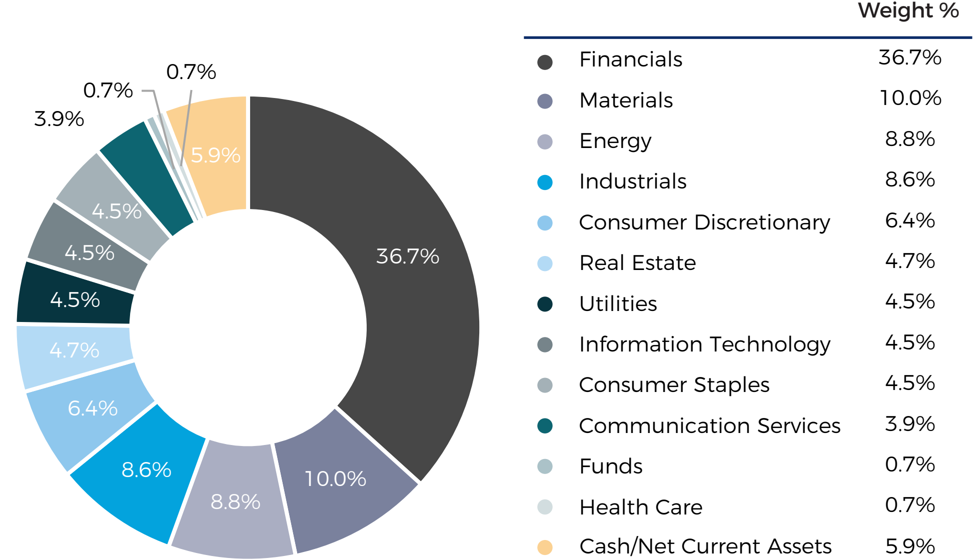
- One of the advantages of portfolio investing, is that the volatility of individual stocks is reduced, due an absolute stock specific losses being offset by others that generate absolute stock specific gains
- The unit price volatility of a portfolio with numerous portfolio holdings with very uncorrelated returns tends to be less than a portfolio where the portfolio holdings are more correlated
- At times when geopolitical and economic risks are elevated, portfolios with better diversification are more likely to deliver a sustained return, than those that have much higher levels of correlation between holdings
- A multicap portfolio includes individual holdings that are largely mature, along with others that are less mature
- In addition, a portfolio with a near-comprehensive list of industry sectors, is also likely to be more diversified than those with a narrower range
- We believe that the long list of diversified holdings generating surplus cash, not only has the potential to better manage downside risks, but also to enhance their upsides as they move into markets where the weak have withdrawn

Trust sector weightings



…but also maximises its chances that event downsides can be offset, at least in part, by the extra upsides of other portfolio holdings

Source: Premier Miton, data as at 31.08.2024.

If corporate insolvencies do become more numerous, generally equity income stocks that can still raise additional capital…

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K3C share price 14 April 2017 to 13 February 2023

- One of the problems of having a large market position during a global recession, is that as demand declines, it is difficult for a largecap business to take enough additional market share from others to offset the setback
- Since less immature stocks normally have lesser market shares, if they are adept, sometimes they can take more than enough market share from others during the downturn, so their overall profitability continues to grow
- Furthermore, those with access to capital (such as plc's) can also acquire over-leveraged but otherwise viable businesses from the receiver often for a nominal price, where the upside can generate very good rates of return on the invested cash
- When a largecap acquires businesses from the receiver however, often the absolute added value only amounts to a relatively small percentage of their market capitalisation
- In contrast, when a smallcap does an identical deal, the absolute added value is a much larger percentage of their market capitalisation, so these deals can greatly enhance their upside potential, sometimes in a transformational way

…can then fund low-cost, debt-free acquisitions, including some potentially large enough to generate transformational returns

Source: Bloomberg, on a UK Sterling basis, from 14.04.2017 to 13.02.2023. K3 Capital were acquired by Sun European Partners LLP in 2023.
Past performance is not a reliable indicator of future returns.

‘Bigness’ may have prospered during globalisation, but in future we believe smallness may be one of the few areas that appreciates well…

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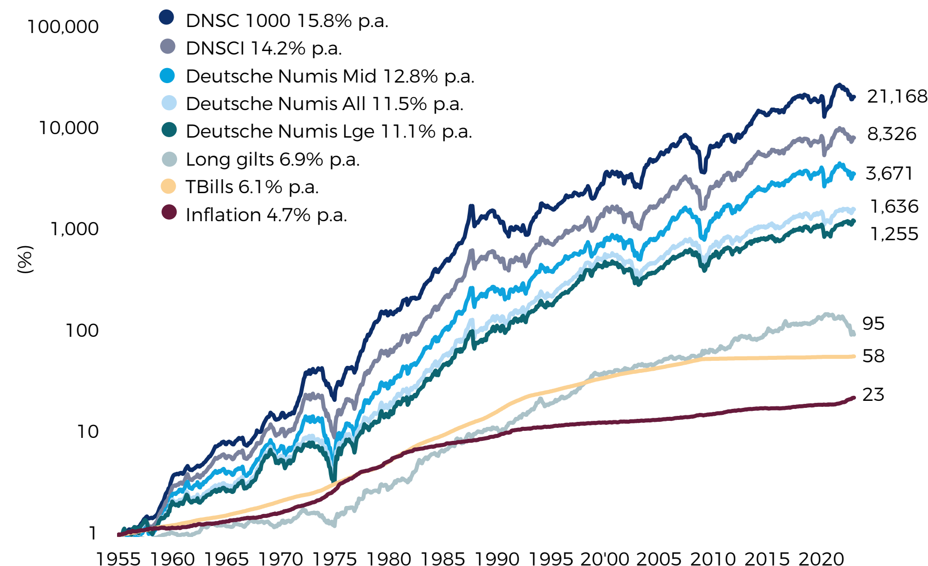
- The largest 80% of UK-quoted companies (known as the Deutsche Numis Largecap Index) underperforms the Deutsche Numis All Share Index on a near-permanent basis
- When the cost of capital rises, or when demand is being actively supressed so it falls below supply, largecaps are vulnerable. Being large they find it harder to dodge the recessionary bullets,
- Hence if economic conditions do become persistently more challenging, we believe that stock market index returns might struggle to keep pace with inflation, especially if asset valuations were to return to past norms
- In addition, most large quoted companies operate in a narrow range of sectors, so their industry sector risk is typically replicated across a wide range of developed market exchanges
- The arguments above imply that as market dynamics change, investors should anticipate that the upside potential for small caps may diverge considerably from those of large caps

Total return of the Deutsche Numis family of UK stock market indices, 1955-2021



…given their low valuations of smallcaps, their lesser reliance on global growth, and ‘option-like’ upside potential at a time of uncertain political risks

Source: Deutsche Numis ; Evans and Marsh, Deutsche Numis Indices 2021. Annual Review; Dimson-Marsh-Staunton DMS Database, 2023.

Past performance is not a reliable indicator of future returns.

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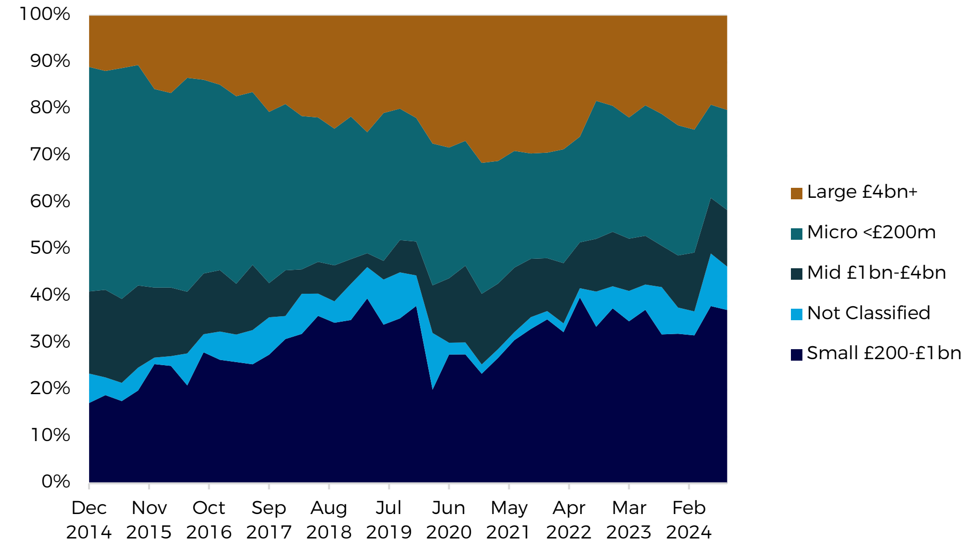
Hence, our multicap strategy intentionally has a portfolio that includes numerous genuine smallcaps…

- During globalisation, nearly all asset valuations increased, and successful strategies have sometimes been able to specialise in an unusually narrow range of high-performance industry sectors
- As globalisation fades, we believe that the cost of downside risks will be much more severe, and hence in our view the value of genuine portfolio diversification will become much more important
- When we set up the trust, we were already anticipating how the characteristics of equity markets might change beyond globalisation, and hence we built in wide-ranging asset diversification from the start
- The trust's longer list of portfolio holdings makes it easier to access the full range of industry sectors, as well as the full range of different market capitalisations, and even a FTSE100 Put option at times
- This breadth of portfolio diversification has been a feature of the trust since issue, and this breadth has somewhat enhanced the trust's return since issue



…given their potential to sometimes generate extraordinary dividend growth, plus quite exceptional capital appreciation as well

Source: Bloomberg, data from 31.12.2014 to 31.07.2024.

Stocks like Cerillion, that built a strong record of good and growing dividend income over several years....

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- Cerillion first listed in March 2016, with a market capitalisation of £23m and we were foundation shareholders
- Whilst the Cerillion share price didn't appreciate significantly for some years after issue, it gradually built an increasingly significant market share in providing billing software for mobile network businesses
- Over time, as the growth of its business accelerated, and as its market capitalisation increased, it rose to be large enough to be researched by a wider range of institutional shareholders
- Given its growth characteristics, and the potential to map out the future profitability and cash generative potential, along with a decline in the discount rate, its valuation rose dramatically
- This appreciation made it easy to take very substantial profits, and reallocate capital in other overlooked small and microcaps standing on very overlooked valuations with what we consider to be disproportionate upside option value
- Some will highlight that in this case, we may have sold too early, but we would argue that stock standing on demanding valuations carry somewhat greater downside risks were their prospects to peak out for some reason

...before benefiting from a dramatic valuation improvement, when it came to the attention of the wider pool of institutional investors

Source: FE Analytics, on a UK Sterling basis, bid to bid, from 18.03.2016 to 31.07.2024. Cerillion first listed in March 2016.
Past performance is not a reliable indicator of future returns.

Helpfully many AIM-listed equity income stocks also operate in relatively specialist industry sectors…

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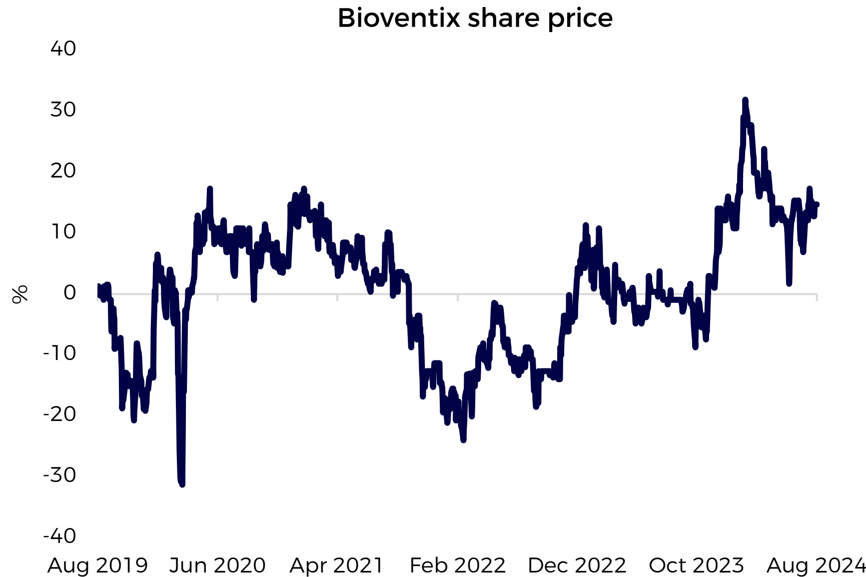
- BioVentix was originally listed on the Offex market, and despite its ongoing profitability and highly cash generative business model, its share valuation was dominated by a venture capital holding that needed to liquidate as the fund matured
- Given these factors, our clients were able to invest in the business at a discount to the then share price
- BioVentix is an example of a microcap business that serves a very narrow market – the supply of hospital test reagents in technically difficult areas
- When they develop a successful test, they progressively displace other suppliers, and thereafter layer on additional profit streams as new tests come to market
- The net effect is that the profitability and cash generation of BioVentix has progressively risen along with its dividend, delivering a quite exceptionally large return



…that their prospects are unaffected by global recessions, and hence their dividends can sometimes grow even through a global downturn

Source: Bloomberg, on a UK Sterling basis, from 21.08.2019 to 21.08.2024.

Past performance is not a reliable indicator of future returns.

In the past when nationalism and protectionism were rife, low-cost acquisitions enhanced the upside of the financially strong...

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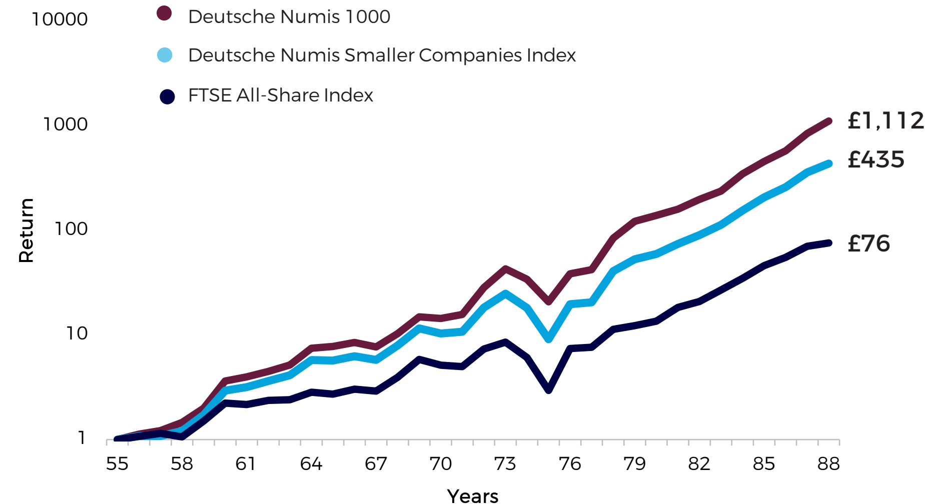
- Economic conditions were very testing in the UK between the 1960's and the late 1980's, yet the period was marked by relatively strong returns from the FTSE All Share Index, as numerous equity income stocks thrived
- Even so, despite the weakness of the Sterling exchange rate which favoured stocks with major international operations such as those in the FTSE100 Index, UK small caps nonetheless outperformed considerably
- Specifically, as many stocks with large debts suffered, those with strong balance sheets had the advantage
- Whilst a low-cost acquisitions from the receiver might have generated a good uplift in value for an individual large cap, the same uplift is so much more lucrative in the case of a quoted small cap, and potentially transformational for some
- The bottom line is that, counterintuitively, the returns on quoted small caps were often much stronger than the global large caps at a time when Sterling was relatively weak



...although note that it was financially-strong, quoted microcaps that typically had the greatest upside potential of all

Source: Deutsche Numis Securities, Elroy Dimson and Paul Marsh of London Business School. [1]Formerly RBS Hoare Govett Smaller Companies Index.

Past performance is not a reliable indicator of future returns.

After decades of UK underperformance, as cash compounding strategies become popular again, the UK is set to outperform…

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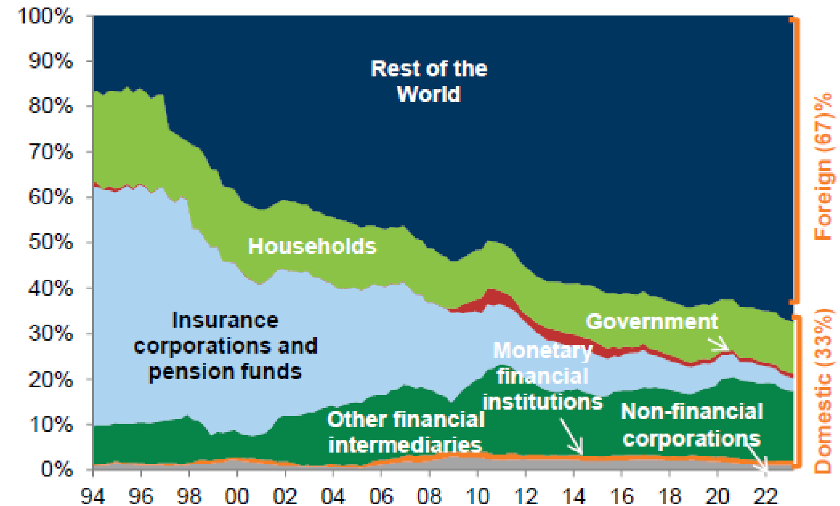
- Prior to the period of globalisation, UK institutions held the vast majority of UK-quoted companies
- With the ongoing underperformance of the UK stock market, progressively over time institutions have reduced their UK equity weightings and reallocated capital into other stock markets overseas
- When a trend like this becomes persistent over decades, then the capital outflows progressively depress the valuation of the less-favoured exchange, depressing its return yet further
- From here, we anticipate that there will be a radical shift in portfolio allocations from growth stocks to equity income stocks, reflecting policy change from globalisation to nationalism
- In our view, this change will greatly favour the returns of the UK exchange, in part because it's dominated by equity income stocks, in part because it is currently standing on what appear to be sub-normal valuations, and in part because most UK institutions will need to scale up their portfolio weightings in UK equities

…67% of UK equity is owned outside the UK – it was 17% in 1994

UK equity market ownership



…and with the renewed capital inflows, we believe that portfolios invested across the full range of market capitalisations will have the greatest upside prospects

Source: Haver Analytics, Goldman Sachs Global Investment Research.

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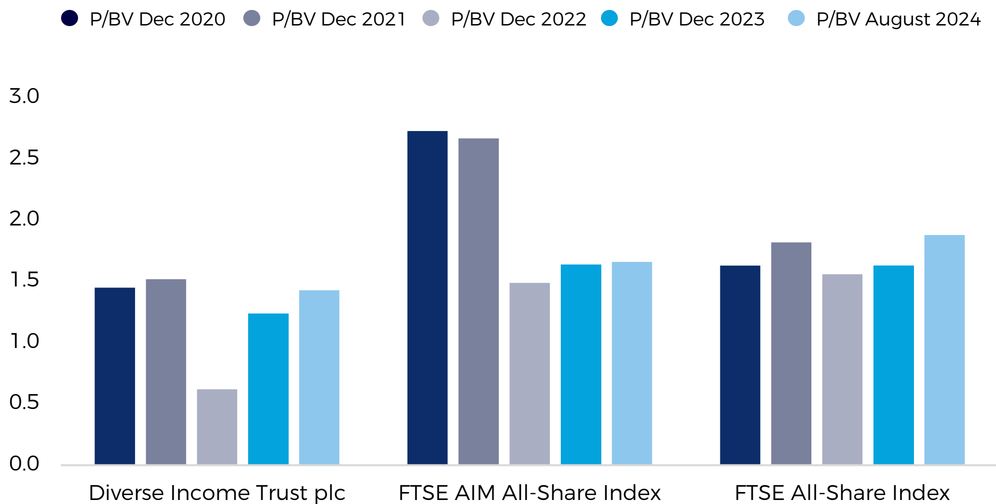
The bottom line is that we believe the Diverse Income Trust strategy is now set for a UK super-cycle tailwind…

- As outlined earlier in this presentation, investors have come to regard the UK exchange as one that is a perennial underperformer
- Even so, since issue in 2011, the Diverse Income Trust has been able to deliver attractive returns that outpaced its peer group, despite its returns having been depressed over recent years with the devaluation of UK smallcaps
- As the UK stock market starts to recover, it will be noted that at present many UK mainstream stocks are still standing on very undemanding valuations
- Alongside, the bar charts highlight how much the valuation of AIM listed stocks have been devalued over recent years, hence their additional recovery potential compared with UK mainstream stocks
- Specifically, the bar charts also highlight the lowly valued nature of the trust, which in some cases may include quoted smallcap equity stocks that have the potential to generate quite exceptional dividend growth in some cases
- Furthermore, we believe the new tailwinds will become persistent for an extended period, maybe lasting for decades

Price to Book of the Diverse Income Trust plc compared with the FTSE All-Share Index & the FTSE AIM All-Share Index



…as equity income trusts gather additional support, and as our near-unique strategy can hopefully generate extra dividend growth

Source: Bloomberg, as at 31.08.2024.

Past performance is not a reliable indicator of future returns.

Note how the near-unique nature of the trust's strategy contrasts with global equity income trusts in particular…

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- The top 20 holdings of the Diverse Income Trust alongside highlight that its portfolio differs considerably from others such as global equity income trusts, and even those of most UK multicap income OEICs
- Whilst the trust does invest in many UK largecaps, the weightings of these holdings are generally modest at the time of purchase, in line with most others in the portfolio
- Since all individual stocks are at risk of disappointment, in general we aim to limit the scale of new holdings to 1.5% of the portfolio at the time of investment. Most are around 1% and many smallcaps lesser still
- The modest percentage weighting in each portfolio holding means that the trust can include some stocks where their market capitalisation or where the availability of stock is limited
- Specifically, a portfolio of numerous holdings actively enhances the potential of the trust to diversify risk, whilst alongside also giving it the potential to invest in some undervalued smallcaps that have the potential to deliver quite exceptional dividend growth and capital appreciation

Top 20 trust holdings	Weight %
CMC Markets	3.3
XPS Pensions Group	3.1
TP ICAP Group	2.8
Pan African Resources	2.6
Galliford Try Holdings	2.6
Paypoint	2.5
Plus500	2.0
Kenmare Resources	1.9
Savannah Energy	1.8
BT Group	1.8
Aviva	1.7
Phoenix Group Holdings	1.7
Sainsbury (J)	1.7
Concurrent Technologies	1.7
Tesco	1.6
Sabre Insurance Group	1.5
Man Group	1.5
Legal & General Group	1.5
Just Group	1.4
Intercede Group	1.4

…at a time when the FTSE100 Index has recently broken out of its 1999 trading range on the upside, and smallcaps are due to follow

Source: Premier Miton, data as at 31.08.2024.

In some ways, our strategy is near-unique which is why the trust has a high alpha along with a well moderated beta...

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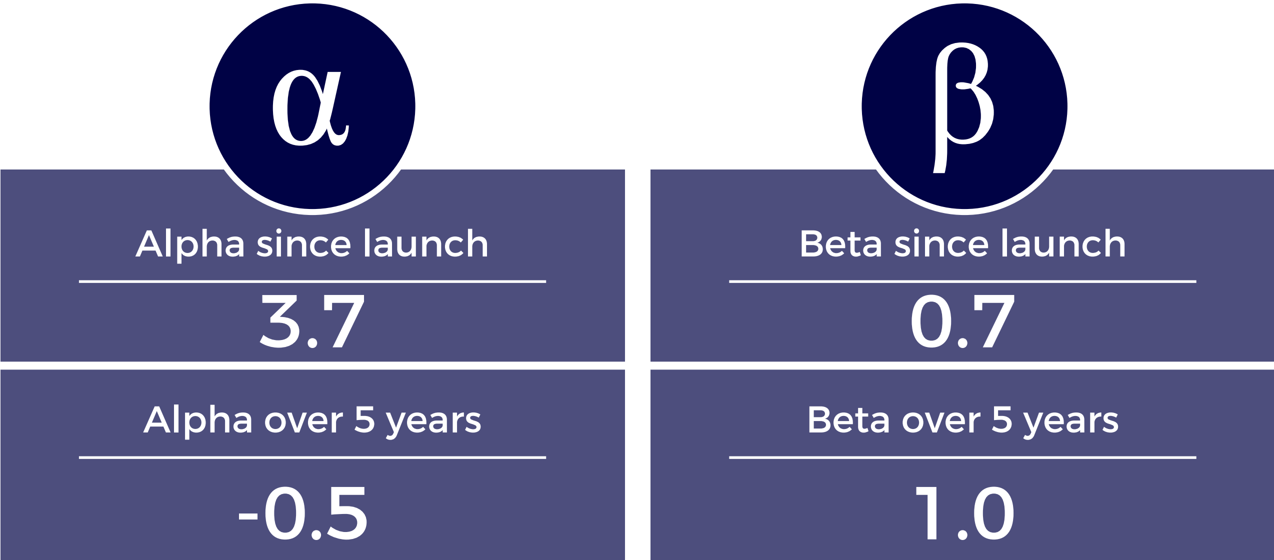

...but if market tailwinds die away, a trust with these characteristics that can also delivers better dividend growth than others will be even more valuable

Source: Morningstar™, as at 31.08.2024, net income reinvested, bid to bid basis. ©2024 Morningstar. All Rights Reserved. The information contained herein; is proprietary to Morningstar and/or its content providers; may not be copied or redistributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

Past performance is not a reliable indicator of future returns.

Specifically, the Diverse Income Trust has a number of features…

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- **Investment trusts have the potential to deliver premium returns**
  When investors board their portfolio allocation to include those that generate return via cash compounding, as well as capital appreciation, then some multicap OEICs may grow beyond their ability to deliver a return. An investment trust doesn't carry this risk, as the board can cease to issue new shares
- **Removing friction from daily stock market trading volumes**
  The trust redemption mechanism regularly clears the register of ongoing institutional sellers, which seeks to reduce the chances of 'Mexican stand-off' where buyers hold back until large sellers have cleared. Removing this friction enhances the daily stock market trading volumes
- **A share price that has traded close to its underlying NAV**
  The trust's share price has stood above and below its NAV at times
- **Competitive costs**
  The trust pays a 0.8% fund management fee on the first £450m of assets, adjusted for its discount. The fees tier lower beyond £450m of assets. The trusts OCF figure is 1.14%

…that we anticipate will help it to fully deliver on the advantages of its strategy

OCF calculated as at 31.05.2024. The ongoing charges figure (OCF) is not the same as the ongoing costs figure set out in the Company's Key Information Document. The key differences are that gearing costs and portfolio transaction costs are not included in the OCF. In addition, costs are calculated on slightly different bases. The OCF figure set out above mirrors that in the Report and Accounts and is based on costs incurred in the year which are likely to recur in the foreseeable future. The ongoing costs figures in the Key Information Document provide investors with the impact costs have had on returns averaged over the five-year recommended holding period. Transaction charges will also apply. These can be found in the total costs and charges document on the website. Fund management fees are tiered and calculated based on the share price, so may vary in each year. With effect from 1 June 2024, the Manager receives a management fee of 0.80% per annum on the average market capitalisation of the trust up to £450m and 0.70% per annum on the average market capitalisation above £450m.

We believe that the new self-feeding virtuous spiral has already started within the UK stock market...

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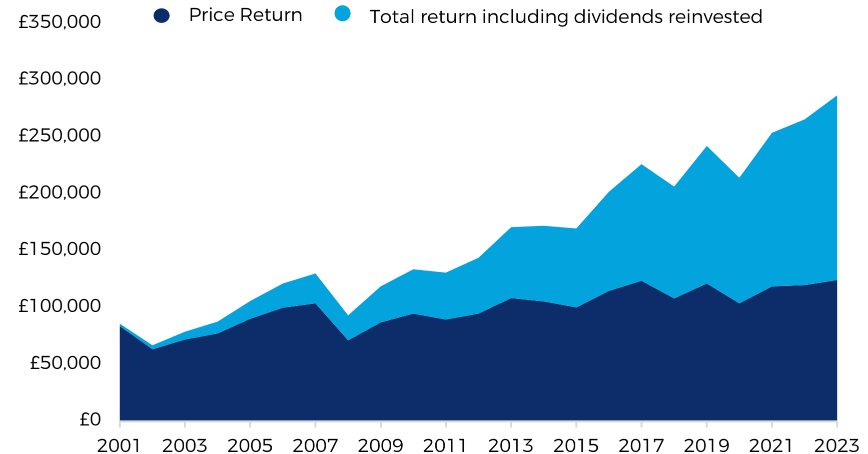
- The UK stock market is dominated by capital intensive stocks, that typically invest substantial sums of capital, and then provide a return via a stream of good and growing dividends
- Interestingly, when economic conditions are testing, equity income stocks not only start with a greater margin of safety, but if conditions get very testing some can use their surplus cashflow to improve their income by expanding into markets vacated by insolvent competitors
- Better still, some can acquire overindebted but overwise viable businesses, debt-free from the receivers often for a nominal sum, and greatly enhance their prospective cashflow and dividends
- Specifically, when economic conditions are unsettled, dividend compounding strategies have a history of generating better returns than those that rely on capital appreciation, because some capital growth stocks run out of capital, or are obliged to raise new capital at very dilutive share prices
- Specifically, when the stock market indices flatline, we believe that even investors seeking total returns will start to buy equity income funds

The UK is near-unique in its large universe of dividend compounding stocks

Value of £100.000 invested in the FTSE 100 Index, (2001 to 2023)



...and now anticipate UK microcap outperformance that will last for decades.

In short, we're getting ready for a UK equities super-cycle.

Source: Bloomberg, data as at 31.12.2023.

Past performance is not a reliable indicator of future returns.

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Conclusions

1. During globalisation, decades of buoyant asset valuations have led to capital appreciation strategies growing to what now appear to be exceptionally overstretched levels

2. Meanwhile global financial trends are now changing, and politicians and central banks appear unprepared for the return of market constraints regarding budget and current account deficits

3. All this implies giant risks for the financially weak, although fortunately the financially strong should get stronger, with some potentially getting disproportionally stronger

4. Given the natural 'self-liquidating' nature of equity income strategies, we believe that it will prove much harder to actively increase client weightings than envisaged from here

5. Overall, we believe the new trends will specifically drive renewed UK exchange outperformance, in a trend lasting decades, with extra upside from its overlooked valuation currently

6. Since genuine small caps can sometimes deliver exceptional dividend growth, The Diverse Income Trust plc appears particularly well-positioned for the future

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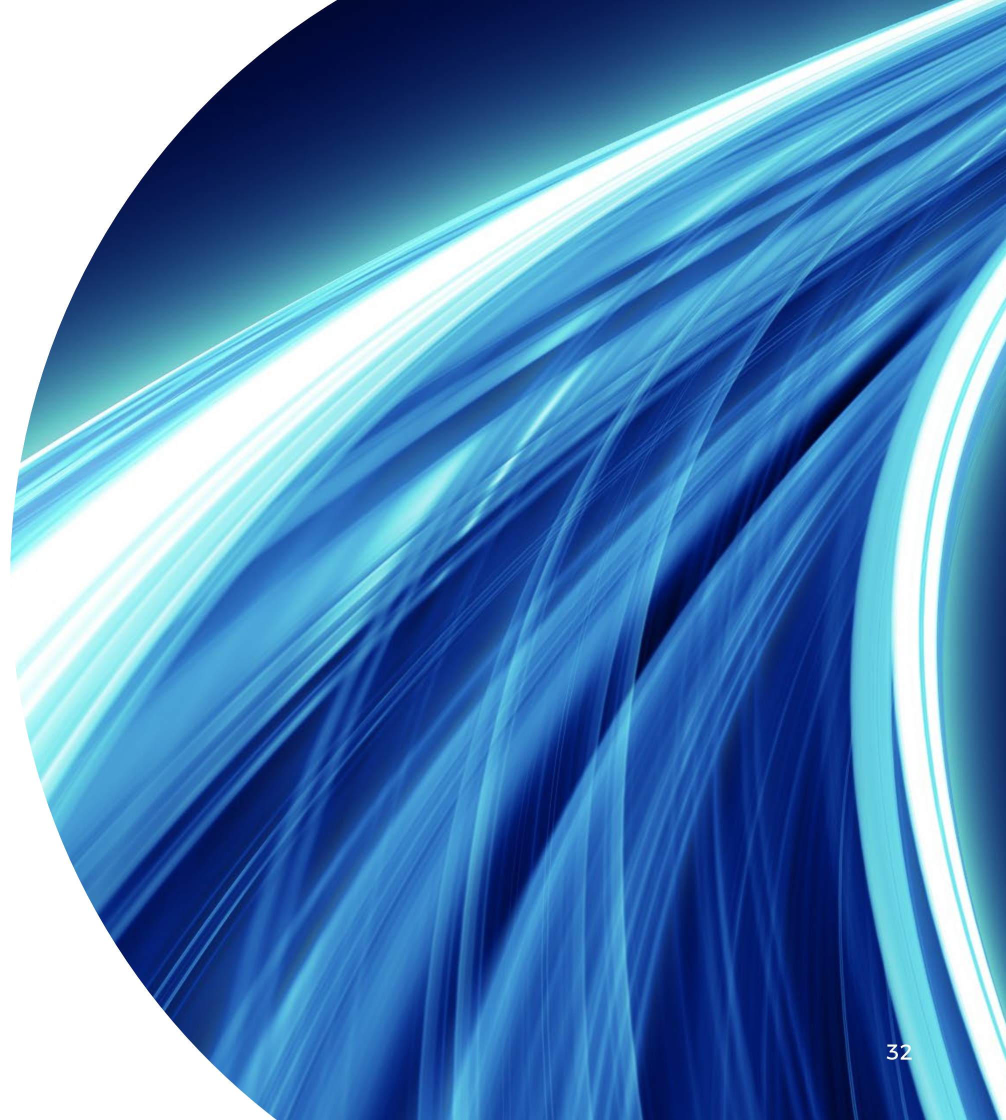
Appendix



As capital markets become more unsettled, we believe the self-liquidating nature of 'natural income'…

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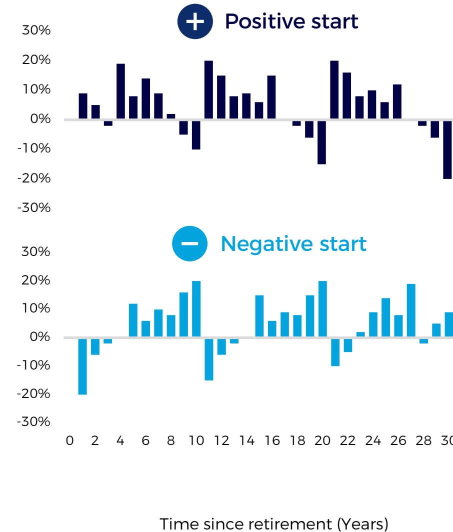
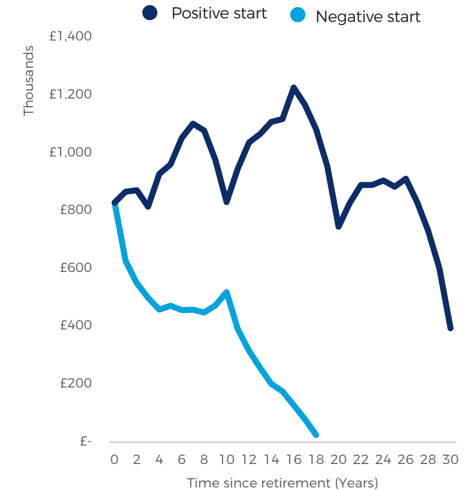
- During globalisation, funds generating regular capital appreciation have outperformed other strategies, and hence it has become customary to use regular unit encashment to provide a retirement income from an initial capital sum
- At times other than globalisation however, market valuations can be a lot more volatile, and sometimes recessions need to be tolerated to bring inflationary pressures back under control
- A capital sum that is subject to unit encashment is incredibly vulnerable to running out early for example, if market returns in the early years are poor, because the impact of the early drawdown is so damaging
- Hence beyond globalisation, we believe that it will become customary to generate retirement income from the dividends of an equity income fund, (known as natural income) where unit encashment can either be avoided entirely, or massively reduced, along with the drawdown risks that go with it

How long does your money last with unit encashment?





…will quickly make it the optimum method of delivering retirement income, because unit encashment will have unacceptably high risks

For illustrative purposes only. Remaining capital after 4.5%/£37,000 p.a withdrawals growing at 3% p.a

At times the mainstream indices deliver a series of years of strong appreciation as valuations and profit margins rise…

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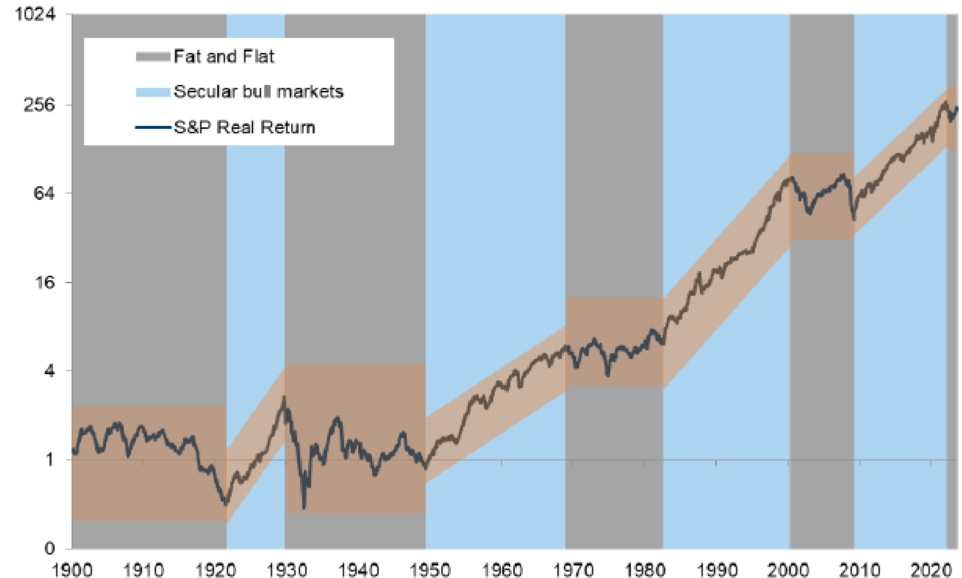
- Long term stock market returns can be sorted into multi-year segments where their returns were well above underlying inflation, and those where returns were not above underlying
- During the buoyant periods, as return is relatively abundant, typically investors narrow their investment universe into the mainstream stocks given they also have the advantage of copious market liquidity
- When market returns are relatively poor however, investors priorities change, given the urgency to generate an absolute return that doesn't rely on general market appreciation
- Specifically, when the returns on the mainstream indices are relatively poor, market correlation becomes a hinderance, as it specifically holds back the potential to deliver attractive absolute returns
- When market returns are relatively poor, investors often tolerate lesser market liquidity because absolute returns and portfolio diversification are so vital to get good client outcomes

Secular & non-trending bull markets - S&P 500 (log scale)



…although markets can flatline in real terms too, when investors need to identify specialist parts of the market that are continuing to perform

Source: Robert Shiller, Goldman Sachs Global Investment Research.

Past performance is not a reliable indicator of future returns.

Reassuringly, when there were inflationary pressures before, the UK stock market outperformed the US for decades…

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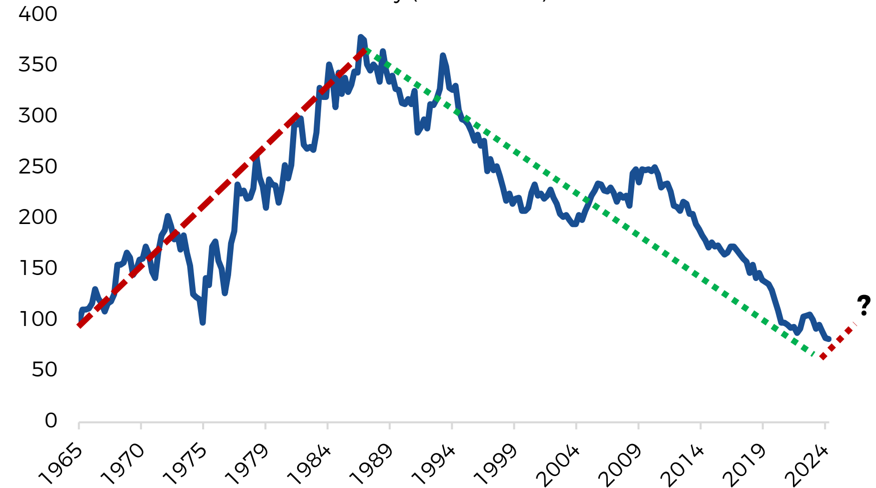
We anticipate the outperformance of the UK stock market will surprise in both scale and duration

- After decades of UK equity market underperformance, most local investors have scar tissue that influences their assessment of the prospects of the market in future
- Interestingly, UK equities look very different from the perspective of international investors
- As many have very modest low-beta weightings, they welcome return generated by income compounding instead of capital gain alone, as this represents genuine portfolio diversification
- The UK market mainly comprises equity income stocks, that have higher margins of safety if economic conditions remain testing
- Its valuations are standing below equivalent stocks quoted on other exchanges, so they may have greater upside potential
- Importantly, as most global investors are so heavily underweight the UK stock market, it is starting from a very undemanding valuation, which gives it even greater scope to surprise on the upside in scale and duration

A chart of the FTSE All-Share Index versus the S&P 500 Index, both in a common currency (1965 – 2024)



…and over time global investors came to hold increasingly large UK stock market weightings

Source: Bloomberg/ S&P Dow Jones Indices LLC., data from 31.03.1965 to 28.06.2024.

Past performance is not a reliable indicator of future returns.

Trust risks

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Some of the main specific risks of investing in this trust are summarised here:

Equities: Equities (company shares) can experience high levels of price fluctuation. Smaller company shares can be riskier than the largest companies, companies in less developed countries (emerging markets) can be risker than those in developed countries and funds focused on a particular country or region can be riskier than trusts that are more geographically diverse. These risks can result in bigger movements in the value of the trust. Equities can be affected by changes in central bank interest rates and by inflation.

Derivatives: Derivatives may be used within trusts for different reasons, usually to reduce risk, which can be called "hedging". This can limit gains in certain circumstances as well. Derivatives can also be used to generate income or to increase the risk being taken, , which can have positive or negative outcomes. The derivatives used can be options or futures which are types of contracts that are dealt on an exchange or negotiated with a third party. More complex derivatives may also be used. Derivatives can also introduce leverage to a trust, which is similar to borrowing money to invest.

Other investment risks: Trusts may have holdings in investments such as commodities (raw materials), infrastructure and property as well as other areas such as specialist lending and renewable energy. These investments will be indirect, which means accessing these assets by investing in companies, other funds or similar investment vehicles. These investments can also increase risk and experience sharp price movements. Funds focused on specific sectors or industries, such as property or infrastructure, may carry a higher level of risk and can experience bigger movements in value. Certain investments can be impacted by decisions made by third parties, such as governments or regulators.

Other risks: There are many other factors that can influence the value of a trust. These include currency movements, changes in the law, regulations or tax, operational systems or third-party failures, or financial market conditions that make it difficult to buy or sell investments for the trust.

Important information

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For Investment Professionals only. No other persons should rely on the information contained within. This is a marketing communication. A free, English language copy of the trust's full Prospectus, the Key Information Document and Pre-investment Disclosure Document are available on the Premier Miton website, or copies can be requested by calling 0333 456 4560 or emailing contactus@premiermiton.com.

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Premier Miton Investors

premiermiton.com

info@premiermiton.com

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