Professional Asset Management after WWI: UK Investment Trusts' Portfolios Strategies in the 1920s

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The establishment and the evolution of financial markets have been a core topic in the department of economic history. Inside financial markets, crucial is the role of the institutional investors. In this paper I will examine the institutional investors' asset management policies in the interwar UK, focusing on the Investment Trust Companies' (ITC) investment strategies. Very little research has been conducted in the ITCs; additionally, the existed one mainly focuses on the Victorian period. This vacuum I will try to investigate; in particular, a) the ITCs' asset allocation, b) their geographical and sectoral portfolios' compositions in the decade of 1920s.

I

ITCs were an outcome of the British economic euphoria of the nineteenth century which has led to an augmentation of the disposable incomes of extensive middle strata (Floud and Johnson, 2004); thus, extra money appeared which had to be managed, while the offered yields from the traditional investments were insufficient. An answer to these savings' underperformance was the emergence of institutional schemas implementing more appropriate management; *the investment trusts*[1].

The gradual establishment of the ITCs was based on both legal and economic pillars of the British society. The first Investment Trust, the *Foreign and Colonial Investment Trust* was a reality in 1879 (Chambers and Esteves, 2014).

To my knowledge, little research has been done about this form of assets management well known to the Anglo-Saxon world. I have classified the already existing literature about the ITCs into the following: First, the general presentations of the ITCs' industry;[2] namely, a general view of their scope, structure, evolution in time and the differences between them and the corresponding US Trusts. The next category is case study focused, describing the historic evolution of a specific ITC[3]. A third, contemporary approach examines their portfolio strategies, using original sources, and the innovations they introduced in the field of asset management[4]; this path will be followed in this paper.

ITCs are defined as financial institutions specialized in investing the savings of their clients into marketable securities. Since the Victorian period, when they were established, the ITCs are described as institutions: a) implementing high-quality managerial techniques; and b) inaugurating an extremely wise diversification process, expanding their investments all over the world, following the tendency of the export of British capital.

The contribution of this study is the asset allocation of the ITCs using data from the extremely turbulent interwar period, focusing on the 1920s.

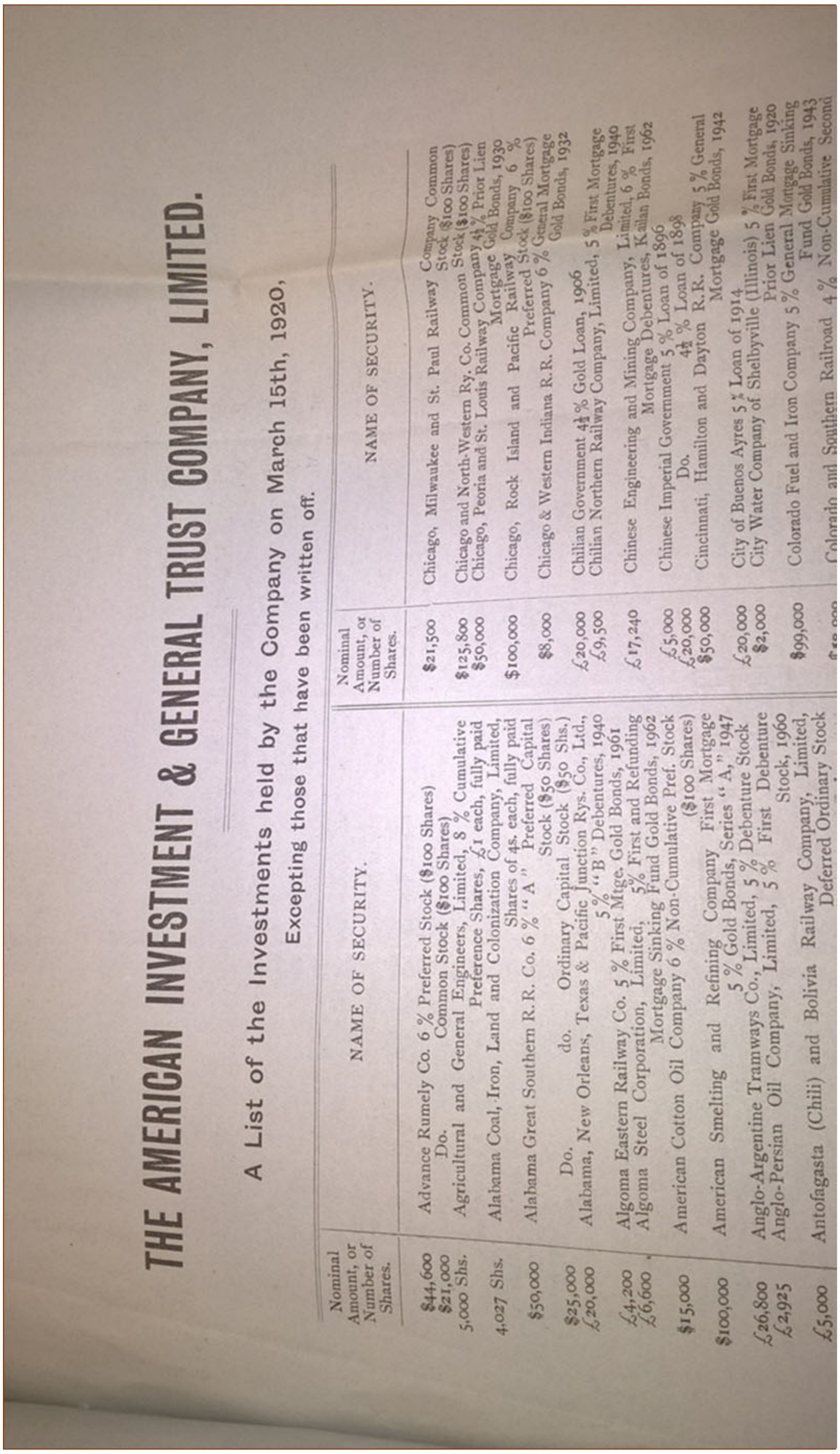
II

To answer my questions, I have constructed an appropriate data base using the portfolios of the British ITCs[5], following Sotiropoulos et al. (2020). Many of the ITCs have published the lists of their investments together with their annual financial statements, which can be found in *Guildhall Library,* London. A typical ITC's portfolio is presented in **Figure 1.** In these lists, details for every holding

[1] This was the British name for closed end funds.
[2] See Burton and Corner (1968) and Cassis (1990) for the newer approaches. For archives of that area, see Robinson (1923, 1930); Campbell (1924); Sturgis (1924); le Maistre (1926); Parkinson (1932).
[3] In this category belong the works of Chambers and Esteves (2004) and Hutson (2005).
[4] See indicatively Rutterford and Sotiropoulos (2016), and Sotiropoulos et al. (2020).
[5] To classify the companies as ITCs I have used Glasgow (1935).

emerge, such as: a) its name (its issuer), b) its nominal value, c) its currency, d) its security type, e) its maturity, and f) its yield (coupon or dividend).[6] Through the appropriate digitalization process, a data set of 30 companies and 40,000 observations has emerged.

Figure 1. A sample from a securities' list. The American Investment and General Trust Co. Ltd. 1920



THE AMERICAN INVESTMENT & GENERAL TRUST COMPANY, LIMITED.

A List of the Investments held by the Company on March 15th, 1920,
Excepting those that have been written off.

Nominal Amount, or Number of Shares.	NAME OF SECURITY.	Nominal Amount, or Number of Shares.	NAME OF SECURITY.
$44,600	Advance Rumely Co. 6 % Preferred Stock ($100 Shares)	$21,500	Chicago, Milwaukee and St. Paul Railway Company Common Stock ($100 Shares)
$21,000	Do. Common Stock ($100 Shares)	$125,800	Chicago and North-Western Ry. Co. Common Stock ($100 Shares)
5,000 Shs.	Agricultural and General Engineers, Limited, 8 % Cumulative Preference Shares, £1 each, fully paid	$50,000	Chicago, Peoria and St. Louis Railway Company 4½ % Prior Lien Mortgage Gold Bonds, 1930
4,027 Shs.	Alabama Coal, Iron, Land and Colonization Company, Limited, Shares of 4s. each, fully paid	$100,000	Chicago, Rock Island and Pacific Railway Company 6 % Preferred Stock ($100 Shares)
$50,000	Alabama Great Southern R. R. Co. 6 % "A" Preferred Capital Stock ($50 Shares)	$8,000	Chicago & Western Indiana R. R. Company 6 % General Mortgage Gold Bonds, 1932
$25,000	Do. do. Ordinary Capital Stock ($50 Shs.)	£20,000	Chilian Government 4½ % Gold Loan, 1906
£20,000	Alabama, New Orleans, Texas & Pacific Junction Rys. Co., Ltd., 5 % "B" Debentures, 1940	£9,500	Chilian Northern Railway Company, Limited, 5 % First Mortgage Debentures, 1940
£4,200	Algoma Eastern Railway Co. 5 % First Mtge. Gold Bonds, 1961	£17,240	Chinese Engineering and Mining Company, Limited, 6 % First Mortgage Debentures, Kailan Bonds, 1962
£6,600	Algoma Steel Corporation, Limited, 5% First and Refunding Mortgage Sinking Fund Gold Bonds, 1962	£5,000	Chinese Imperial Government 5 % Loan of 1896
$15,000	American Cotton Oil Company 6 % Non-Cumulative Pref. Stock ($100 Shares)	£20,000	Do. 4½ % Loan of 1898
$100,000	American Smelting and Refining Company First Mortgage 5 % Gold Bonds, Series "A," 1947	$50,000	Cincinnati, Hamilton and Dayton R.R. Company 5 % General Mortgage Gold Bonds, 1942
£26,800	Anglo-Argentine Tramways Co., Limited, 5 % Debenture Stock	£20,000	City of Buenos Ayres 5½ % Loan of 1914
£2,925	Anglo-Persian Oil Company, Limited, 5 % First Debenture Stock, 1960	$2,000	City Water Company of Shelbyville (Illinois) 5 % First Mortgage Prior Lien Gold Bonds, 1920
£5,000	Antofagasta (Chili) and Bolivia Railway Company, Limited, Deferred Ordinary Stock	$99,000	Colorado Fuel and Iron Company 5 % General Mortgage Sinking Fund Gold Bonds, 1943
		[illegible]	Colorado and Southern Railroad 4 % Non-Cumulative Second

Source: Guildhall Library, Stock Exchange Co., Annual Report.

During the 1920s, the ITCs have continued to function as dynamic institutions, with a highly diversified portfolio; besides, their managers have continued implementing active portfolio management strategies. The average Trust was an institution with a well spread portfolio bearing a

[6] All the values of my database referred to nominal values.

wide variety of securities divided in a) various types, b) regions and c) sectors; this will be developed below. The average portfolio holding weighed only 0.29 per cent of portfolio value, an evidence for diversification.

Some basic descriptive statistics from this database are presented in **Table 1,** which encapsulates the time dimension. The main findings are the following: the number of holdings of the ITCs have increased from 330-340 holdings, reaching 383; a clear proof of the completely diversified portfolios. Then, the size of the average ITC portfolio follows; here we observe that these companies have remained quite stable; about 2 million £. for the examined period. However, this does not mean stagnation, or lack of profitability. New companies have established, as the ITCs' number has increased. Additionally, their diversification strategy does not seem to change, as the individual security's value declares, with an average 6,000 £ for the whole period; even the top 10 per cent valued at 13,000 £ (weighed at 0.65 per cent of the total portfolio value). Finally, portions of the three types of asset allocation is depicted in the lower subset of **Table 1**. The debentures' rate, although it remains dominant for the whole period, has gradually subsided to 52 per cent in 1928 (58 per cent in 1914). The other two types have slightly grown to 25 per cent for the ordinary shares and to 23 per cent for the preferred ones.

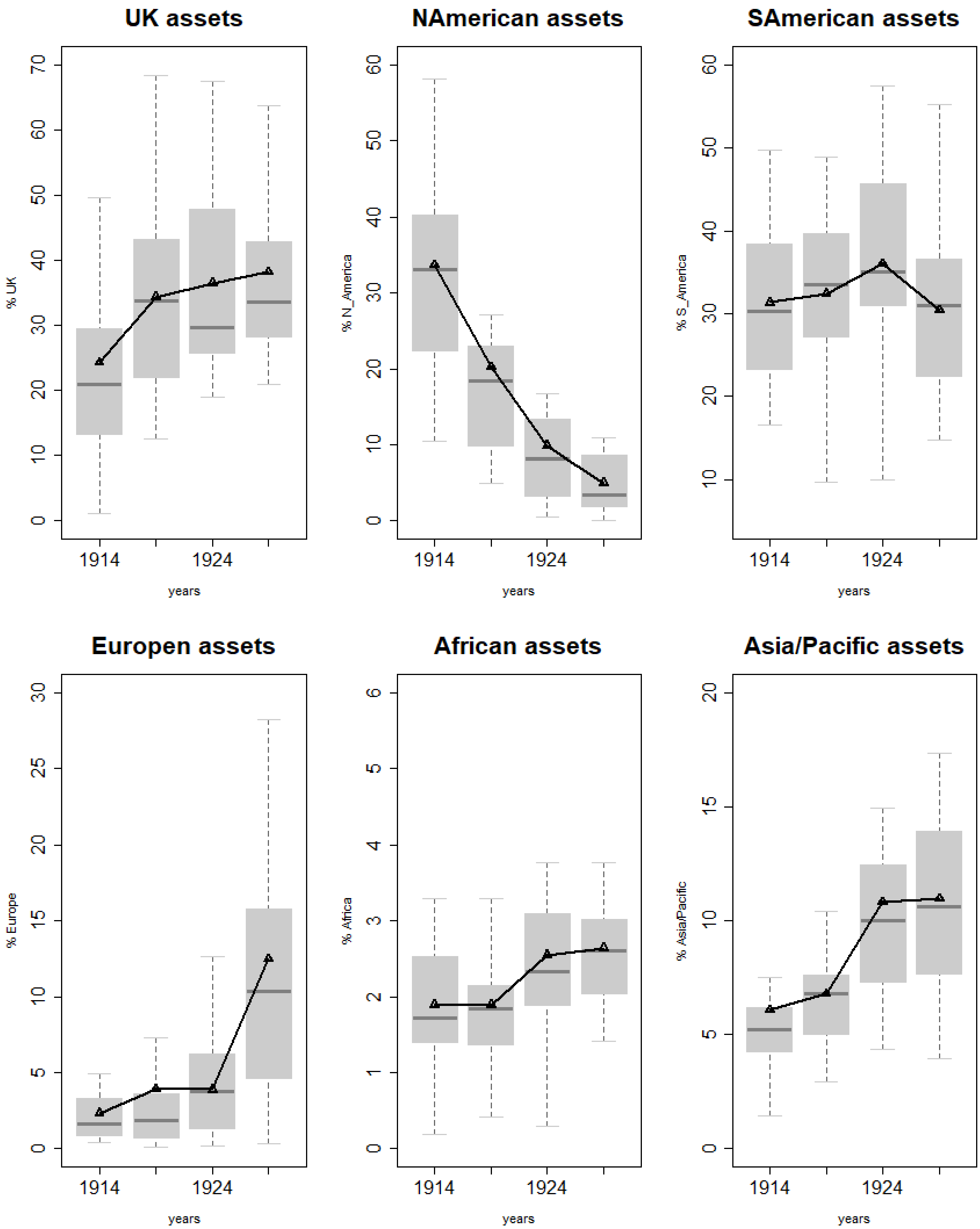
Table 1. Investment Trusts' portfolios by sample year (Average)

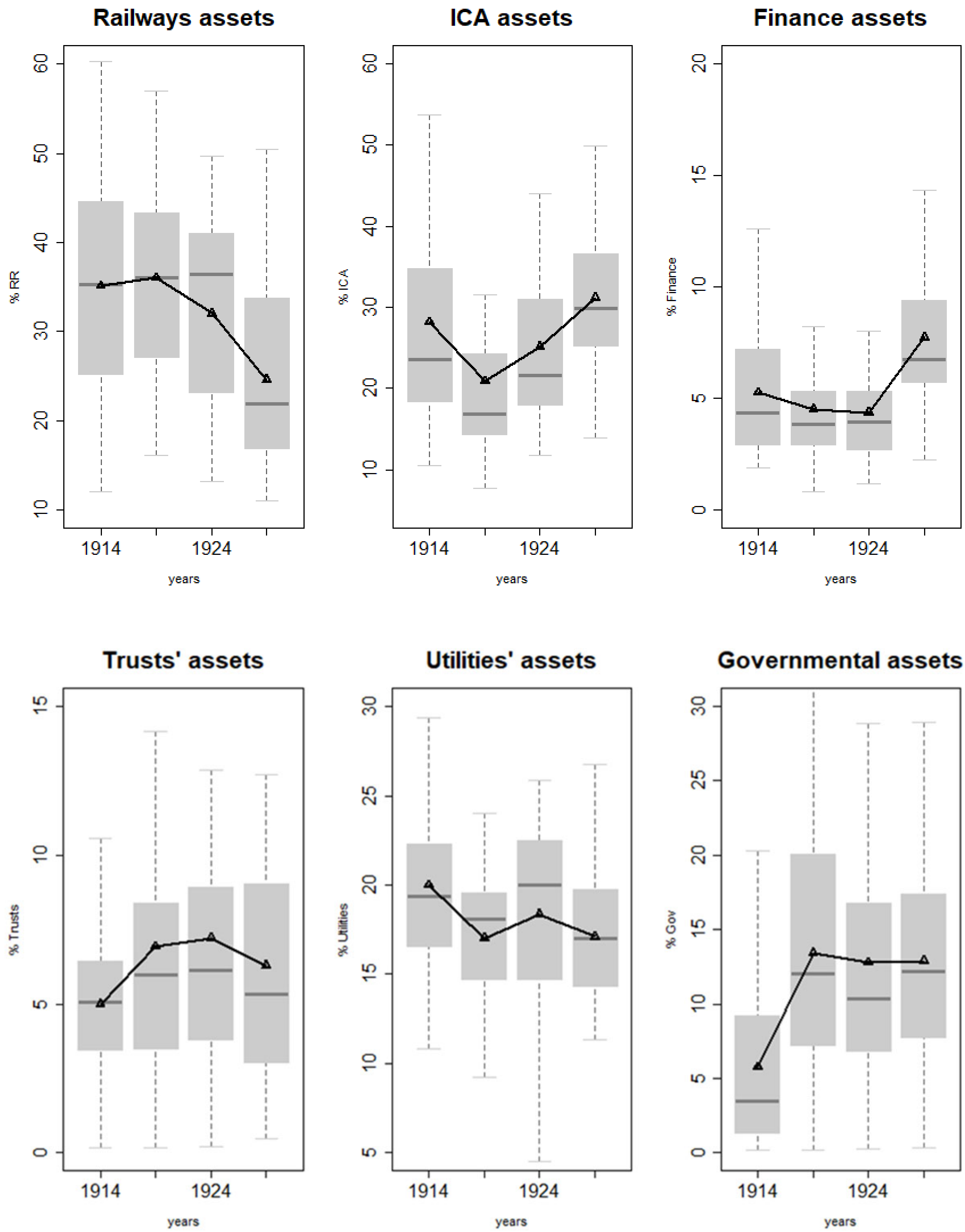
	1914	**1920**	**1924**	**1928**
Number of holdings per portfolio	337	330	342	383
Portfolio value (£ million)	2.05	2.29	2.20	2.06
Number of Trusts	24	30	30	33
Number of securities	8,088	9,885	10,252	12,650
Value of the individual security (in £)	5,758.93	7,346.11	6,304.17	4,760.38
Fixed interest (%)	58.48	55.32	26.88	52.31
Preference shares (%)	18.96	20.52	18.79	22.84
Ordinary shares (%)	22.57	24.15	24.33	24.85

Notes: The variables of the upper dataset have been aggregated at the level of the portfolios before the descriptive statistics calculations.
Source: For the 1914 I have used the data of Sotiropoulos et al. (2020). The rest belongs to my dataset.

After data processing, I have categorized the ITCs' securities in geographical and sectoral groups. The results are delineated in **Figure 2**.

Figure 2. ITCs geographical and sectoral allocation (% portfolio nominal value)





Notes: For the regional allocation *NA & SA assets* represent the Northern (USA, Canada) and South American (all the others) assets respectively. For the sectoral one, *ICA* refers to Industry, Commerce and Agriculture; *Trusts* refer to ITCs*; Utilities* are all the social overhead enterprises, except Railways.
Source: For the 1914 I have used the basis of Sotiropoulos et.al. (2020). The rest belongs to my dataset.

III

The picture of the average ITC's asset allocation in the burst of the First world war is described thereupon. Its biggest part has consisted of USA securities; the one-third of the sample. Second in ranking was Latin America with a 30 per cent of the total. So, six out of 10 £ have been invested in American territory. Of these, prevalent was the Railways sector, attracting the half of the total investments in the region (30 per cent of the whole sample). This, together with the rest of the *social overhead enterprises* (Edelstein 1982) and the national debts of the Latin American states have aggregated the total of the investments in the American continents. Despite the preference of the foreign assets, a significant rate of 25 per cent of the total sample has remained inside the United Kingdom, where holdings of the industrial sector have been gathered. Finally, the half of the world was mainly underrepresented; namely, the ITCs has held only a tiny 2.3 per cent of European securities; as for the mammoth Asian colonies, they have absorbed one out of 15 £; at the end the African continent had a negligible 1.8 per cent. As for the latter case (Asia - Africa), the lack of institutions, their low income, and the different financial organization have created an aversion to ITCs participation. As for the former, the total exposure of the neighbouring European investments (mainly French) had left no room for the British investors.

The First World War has been indeed a catalyst for the whole world, the UK included. The pre-war dominant position of London has expired (Morgan 1952; Eichengreen 2004). The abandonment of the Gold Standard, the huge fiscal and trade imbalances, the funding of the war issuing huge amounts of debt, the desperate need for foreign currencies, mainly dollars for the necessary raw materials; all these have led to the shrinkage of the British financial supremacy. The unprecedented intervention of the British State resulted in the mandatory exchange of the US dollars denominated assets with mainly British gilts (Atkin 1995). This gilts' deluge is translated also in **Table 1** as a value increment of the average holding (5,800 £ in 1914 vs 7,300 £ in 1920).

The next observation (1920) is characteristic. In the aftermath of the war, the Northern American holdings had been reduced by 40 per cent. As a result, the investments have automatically been transferred to the UK economy *en masse* (36 per cent in 1920, bringing the UK in the first position, see **Figure 2**). The investments of Latin America have remained stable (32 per cent). Finally, a slight increment in the holdings of Europe and Asia has been observed; Africa has remained stable.

Four years later, in 1924, the USA had lost the 50 per cent of its previous result, reaching a one-digit rate in the total sample. The British ITCs seemed unwilling to reinvest in their old lucrative dollar-based holdings; the reasons beyond the then recent state intervention, were mainly monetary (pound depreciation) and, also, in terms of yield (overvalued assets with low interest). Since 1920, the UK have become the leader of the destinations of the ITCs investments, mainly because of the high concentration of Victory bonds. However, a structural change was in progress. A *rationalization* movement which had already started, modified the British enterprises creating bigger, more stable and under more sophisticated management companies (Hannah 1983). The ITCs have risen to the challenge of adding new holdings in their portfolios; they have gradually changed older fixed income holdings with newer ordinary shares, selecting carefully among an abundance of newly founded consumer durables, and following a tendency of the augmentation of the lower class' consumption in both durable and consumable goods which have been produced in a more rational way, reducing their prices and becoming affordable (Scott 2017). Nevertheless, they haven't forgotten looking abroad; their new investment opportunities have emerged in the vast British Empire. Asia's share has increased by 60 per cent and Africa's by 44 per cent (see **Figure 2**). The pre-war lack of portfolio investments has now been substituted by a) restrictions in capital markets, b) the technological progress, c) the security offered by the British metropolis and mainly, d) the lack of alternatives; all these have shifted the ITCs management towards these safer (under the British supremacy) destinations.

Moving to the last year (1928), the last alternative, which has emerged in the middle of the decade, was Europe. European economies, which from the beginning were outside of the British investing target, had been extensively damaged during the war. In the aftermath, severe problems have appeared as: a) intense hyperinflation, b) huge fiscal fluctuations, and, c) trade collapse. New states have been founded bringing new challenges. Besides, Russia had established a new socio-economic system, which, for the first time, has practically abolished any type of private investments. Investors gradually understood that they had lost their investments in this country. Similar attempts had failed in various other European countries; however, they created a new alternative for the labour class in all over the world, starting from Europe.

For the ITCs to invest in Europe, two main problems should be solved: namely, political stability and economic prosperity (see Feinstein et al. 1995). Through financial support mainly from the USA (Daws Plans) and the establishment of international organizations (League of Nations, LON hereafter), the latter had been surpassed. As for the former, any political regime which could pledge to implement fiscal, monetary and social discipline would be accepted. Countries like Germany, Italy or France have participated in the sample offering strong arguments in favour of the stabilization process and the political sensitivity of the investors. Interesting reactions are to be found in the high participation of peripheral countries like Greece, Hungary, Czechoslovakia among others. These countries were under the *aegis* of the LON which had implemented strict fiscal and monetary stabilization programmes. Moreover, it seems that the majority of these countries had already pegged their currencies to the Gold exchange Standard scheme in an early stage; finally, they had developed national Stock Exchanges which had connections with London and of course with the directors of the ITCs. All these had as a result the tremendous raise of the British ITCs investments in European holdings by 220% from 1924 to 1928! A sophisticated and prudent management could not be untouched by such a great opportunity.

Apparently, the only stable investment for the all period was the Latin American holdings. Latin America was a continent with significant British investments (Rippy 1977). The growth pattern of the continent was complicated, the inequalities high and the infrastructure primitive; nevertheless, a significant growth rate was present since the beginning of the century attracting numerous migration flows for Europe. The generous state guarantee on the yield of the Railways companies was enough to attract the British investors to the region, offering a plethora of opportunities. Despite the economic penetration of two competitors, namely Germany and the USA, the gradual state intervention and the first industrial actions, ITCs seem to stabilize their lucrative investments in the region.

IV

In this paper I have presented the asset management of the ITCs for the period 1914-28. ITCs seems to maintain their basic characteristics like the: sophisticated management, diversification process, extensive geographical and sectoral allocation. Despite the drastic state intervention during the war and the different post-war environment, they have continued to search for new markets and promising securities, pledging a stable income to their investors and preserving their principles. One question remains unanswered: their reaction to the 1929 economic crisis and the collapse of many of their securities. This remains open for future research.

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