

Income Study

January 2020



How high dividends can trap investors

Income-seeking investors should be wary of high dividend payments because they may not be sustainable. How can a secure income stream be maintained from stock market investment?

In the current low interest rate environment, many investors who prefer to take income have been tempted to switch from cash deposits and fixed income holdings into equity funds. They could have been attracted by the dividend yield obtainable from funds invested in FTSE 100 stocks, which exceeds 4%, compared with around 0.8% from gilts or typically 2.4% from sterling-denominated corporate bond funds.

As they can provide a steady income stream, together with potential for growth, equity income funds have become core holdings for many who are prepared to accept the risk associated with the stock market.

Portfolios prioritising income are often biased towards the UK. British businesses have a long history of paying generous dividends to shareholders. Yields of around 4% are available from the broader UK market as well as the FTSE 100.

As a comparison, the global stock market yields under 2.5% (MSCI World Index). The UK therefore offers one of the highest levels of income in the world. Adding to their attraction, stock market valuations of companies listed in the UK are currently considered by many to be modest compared with those in overseas markets and this view is likely to support their stock prices.

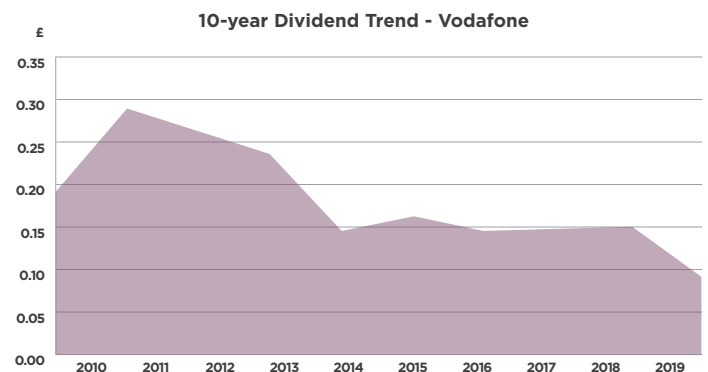
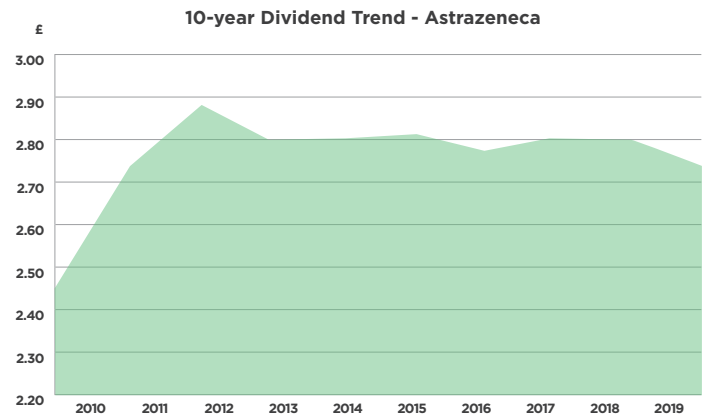
Whilst companies often maintain dividend payments while the underlying value of their shares fluctuates, yields are not guaranteed. Successful fund managers screen companies to avoid 'dividend traps' – companies paying high dividend payments that they are unlikely to be able to maintain. Instead of selecting the highest dividends, opting for more modest payments can result in better overall value – less can mean more in stock selection!

Quality companies are consistent payers

Some companies have outstanding records of dividend payments and are therefore favoured in income-focussed strategies. For example, Unilever has paid increasing dividends since 1995 and has not cut its payment since 1966. An appropriate strategy for many income fund managers is to identify companies with stable dividend pay-outs, as these are often a sign of resilience that rewards investors over the long term.

Richard Colwell, who manages income funds at Threadneedle, has for many years acclaimed the benefit of holding companies with consistent dividend-paying records. This is reflected in the top ten holdings of his funds in which, for example, AstraZeneca represents over 9% of the value of the Threadneedle UK Equity Income Fund.

The charts compare the steady income stream provided by AstraZeneca over the past 10 years with the gently declining dividend payment history of Vodafone. The stronger underlying profitability of AstraZeneca has enabled it to provide a more reliable dividend stream – a buying signal for a UK Equity Income Fund manager.



Source: Bloomberg

Reasons to be cautious

As investors have tended to abandon cash deposits and fixed income investments in favour of the higher yields available from riskier stock market holdings, some have encountered another reason to be cautious. The risk highlighted last year by the demise of Neil Woodford's popular income funds was exposure to unquoted stocks which are generally unsuitable for income generation. Companies issuing stocks outside of the main markets are normally at an early development stage and do not have surplus cash for dividend payments; indeed, they are more likely to make calls to shareholders for additional cash than to pay it out. Furthermore, their lack of liquidity renders their prices unstable because trading is dependent on the largely subjective valuations of a limited number of buyers and sellers. This makes unquoted stocks particularly vulnerable in times of market stress.

A further note of caution arises from the concentration of the UK equity market, coupled with the increase in the number of dividend payments from companies with dividend cover below one, meaning that total dividend payments are not fully covered by profits. In these cases, dividends are effectively being taken from capital reserves. Despite the relatively low number of income paying companies, fund managers strive to diversify income streams to avoid becoming reliant on those with balance sheets that are under pressure.

Rewards of caution

Although caution is needed, equity income funds maintain their popularity, particularly with investors seeking a regular income stream. We believe that investors in the White List selection of funds who have held their investments over the long term have been well rewarded. However, investors should be aware that past performance cannot be relied on as a guide to the future and cautious investors therefore may retain some cash deposits, and perhaps fixed income holdings, to reduce the overall risk of their portfolios and to use as a source of funds that may be needed at short notice.

Carefully selected income funds can offer an increasing income stream as well as capital appreciation over the long term. The Income Study analysis identifies funds that have met these criteria over the last five years and highlights them in the White List.

Notes:

(a) Funds are ranked using seven different criteria based on performance, volatility and the income distributed, with the most recent period of performance receiving a greater weighting.

(b) All funds are in the IA UK Equity Income sector.

(c) Performance data is provided by Morningstar on a bid-to-bid basis with income reinvested. Volatility is annualised.

(d) Yields sourced from Morningstar, FT and fund providers and represent the estimated annual payout.

(e) Funds with a value of less than £20m are excluded.

Important Information

All performance figures used in this document are provided by Morningstar and are quoted on a bid price to bid price basis (mid-to-mid for OEICs) ie ignoring initial charges, with income (dividends) reinvested. **Past performance is not a reliable indicator of future results.** All the views expressed are those of Sanlam Private Investments (UK) Ltd.

The value of unit trusts/OEICs, and the income from them, can go down as well as up. You may not get back all that you originally invested, particularly in the case of early withdrawal. Investors may be subject to an initial charge.

Any tax reliefs referred to are those currently available. Their value depends on the individual circumstances of the investor. Levels and bases of, and reliefs from, taxation may change. The value of investments may also rise and fall purely as a result of exchange rate changes.

In accordance with Financial Conduct Authority rule requirements, we have published a policy which sets out how we manage conflicts of interest. This policy is available on request from our Head of Compliance, or may be viewed on the Conditions section of our website: sanlam.co.uk.

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Remember, the Income Study is not personal advice based on your circumstances or a recommendation. If you are unsure about the suitability of an investment for your circumstances please contact an FCA authorised financial adviser.

The White List: specials

After a long period in which each new White List included a significant number of movements, the funds in our latest list are relatively unchanged, although some appear with new names. A few funds have returned to their previous glory; others have retained their successful status. The top four funds are existing White List constituents.

The **Aviva Investors UK Listed Equity Income Fund**, previously known as the Aviva Investors UK Equity Income Fund, is placed at the top of the January 2020 Study of the 61 eligible funds from the UK Equity Income sector. This fund has continued to deliver strong and consistent performance, which has resulted in an uplift of four places. While not ranking number one under any of our metrics, it is securely placed in the first and second quartile across our volatility, income and performance criteria, resulting in its first-place position.

Taking the second spot is the **Santander Enhanced Income Fund**, which many will recognise from previous Studies, as it appears regularly in the White List. After a tough period in 2016, the managers, Graham Ashby and Duncan Green, have recently proved their worth again. In 2019, the fund returned 26%, ranking seventh out of the funds in our universe. The **Man GLG UK Income Fund** is another frequently appearing fund; it has achieved third place this time. This fund has dropped just one place, having distributed slightly less income than the Santander fund over the review period.

The previous fourth place holder, the **Santander Equity Income Fund**, which entered the White List a year ago, has fallen by four

places to joint eighth position. However, as highlighted in the previous Study, performance, and the amount of dividend income distributed, have been strong. It is pleasing to see the fund maintain its White List positioning after its Black List placing in January 2017.

The fund house Premier Asset Management has performed more strongly than in recent Studies. Both the **Premier Monthly Income Fund** and **Premier Income Fund** have jumped substantially. These funds have recovered from a disappointing two years, having fallen out of the mid-2018 White List and dropped down the rankings. However, for the latest period, the funds have improved by 40 and 35 places respectively. Performance has been the key driver of this resurgence coupled with excellent income distribution. Premier has recently merged with Miton, although such success cannot be attributed to the **LF Miton UK Multi Cap Income Fund**, which has fallen 17 places into the Grey List, from third to twentieth.

Another notably successful fund is the **Allianz UK Equity Income Fund**. It has improved by 30 places, having returned 28.3% in 2019, ranking third for performance out of the 61 funds assessed.

Funds which have retained their White List status include the **NFU Mutual UK Equity Income Fund**, the **Lazard Multicap UK Income Fund** and the **Troy Trojan Income Fund**. Others have entered from the top of the Grey List, including the **Royal London UK Equity Income Fund**, the **Franklin UK Equity Income Fund**, and the **Artemis Income Fund**.

The White List Top fourteen funds by overall merit	Dividend yield 31/12/2019	Income 5 years to 31/12/19 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/01/2019 to 31/12/2019	01/01/2018 to 31/12/2018	01/01/2017 to 31/12/2017	01/01/2016 to 31/12/2016	01/01/2015 to 31/12/2015	01/01/2015 to 31/12/2019
Fund	%	£	%	%	%	%	%	
Aviva Investors UK Listed Equity Income	4.3	21.0	23.5	-10.3	12.8	11.1	7.6	9.8
Santander Enhanced Income	5.0	28.2	26.0	-11.1	13.2	4.7	10.2	10.4
Man GLG UK Income	5.3	23.6	20.9	-8.1	26.8	5.0	12.4	11.0
NFU Mutual UK Equity Income	4.6	21.5	19.3	-7.2	10.2	12.9	7.7	9.1
Allianz UK Equity Income	4.6	22.6	28.3	-10.0	14.6	7.5	3.6	10.1
Royal London UK Equity Income	4.4	20.8	23.1	-10.3	12.1	10.3	5.3	9.7
Premier Monthly Income	4.9	25.6	27.2	-15.7	12.0	8.6	10.1	11.0
Franklin UK Equity Income	4.5	21.0	22.4	-9.8	10.9	14.3	5.2	9.8
Santander Equity Income	5.1	24.7	25.9	-11.0	11.0	4.9	13.1	10.8
Lazard Multicap UK Income	4.6	21.7	19.3	-11.8	13.0	11.9	5.7	9.3
Premier Income	4.9	25.5	27.4	-15.4	11.7	8.3	10.6	10.9
Trojan Income	3.7	17.4	20.5	-7.1	6.3	10.5	11.2	8.6
MI Chelverton UK Equity Income	4.7	23.9	24.6	-14.2	24.3	4.9	17.5	12.6
Artemis Income	4.4	20.6	22.1	-10.5	11.8	9.7	4.9	9.5
White List Average	4.6	22.7	23.6	-10.9	13.6	8.9	8.9	10.2

Past performance is not a reliable indicator of future results.

The Grey List

As expected from the rise of some Grey List funds into the White List, there has been similar movement from the White List into the Grey List. Funds including the **BMO Responsible UK Income Fund**, the **AXA Framlington Monthly Income Fund**, and the **Schroder Income Maximiser Fund** are all in lower positions.

One of the most disappointing moves is the **Liontrust Income Fund**, formally known as the Neptune Income Fund, which now

ranks nineteenth after achieving first place in the last Study. Nearterm performance is the main reason for this decline and it will be interesting to see how the fund evolves following the team's acquisition by Liontrust Asset Management.

Premier appears again in a positive light with the **Premier Optimum Income Fund** moving up by 27 places from near the bottom to near the top of the Grey List (position 44 to position 17).

As with the other funds within the Premier offering, performance in 2019 has significantly improved and the fund's income distribution has been remarkably high, the yield being 6.6%.

Most funds in the Grey List have retained their status, with some slight shuffling of positions. For example, the **Kames UK Equity Income Fund** and the **Janus Henderson UK Responsible Income Fund** have each moved up three places and the **BNY Mellon UK Income Fund** and **Slater Income Fund** have improved by four and five places, respectively.

That said, several funds have fallen quite dramatically within the Grey List. **BNY Mellon Equity Income** and **Rathbone Income** have fallen, by 20 and 27 places respectively. Performance has

predominantly caused these shifts; however, the **Rathbone Income Fund** has also ranked quite poorly on the amount of income distributed over the period analysed.

One fund has made quite an astounding move, considering it has been languishing in the Black List for quite some time. The **Unicorn UK Income Fund** has struggled versus peers in our rankings for several Studies. However, in the current review, it improved by 27 places. While the fund volatility is poor over the period assessed, performance has been excellent and it now ranks first, with a return of 31.7% in 2019. The fund's small-cap exposure worked exceptionally well in 2019 when its style suited market conditions.

The Grey List	Dividend yield 31/12/2019	Income 5 years to 31/12/19 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/01/2019 to 31/12/2019	01/01/2018 to 31/12/2018	01/01/2017 to 31/12/2017	01/01/2016 to 31/12/2016	01/01/2015 to 31/12/2015	01/01/2015 to 31/12/2019
Fund	%	£	%	%	%	%	%	%
Kames UK Equity Income	4.5	20.8	21.6	-12.5	11.8	8.9	10.8	9.8
BMO Responsible UK Income	3.8	17.9	20.3	-8.9	13.5	3.5	10.9	8.9
Premier Optimum Income	6.6	41.6	25.7	-16.1	13.0	8.5	8.7	11.4
Fidelity MoneyBuilder Dividend	4.8	24.2	20.1	-9.9	4.5	6.7	7.6	9.3
Liontrust Income	5.5	21.3	15.5	-3.8	11.2	14.2	6.5	10.1
LF Miton UK Multi Cap Income	4.6	19.2	13.1	-7.7	15.7	3.1	19.4	8.4
Janus Henderson UK Responsible Income	4.0	19.3	28.4	-10.7	11.1	5.3	9.8	10.2
Slater Income	4.6	24.3	21.3	-12.9	12.1	-1.2	14.5	10.8
BMO UK Equity Income	4.7	21.4	26.7	-12.4	9.8	13.2	2.7	10.2
BNY Mellon UK Income	4.4	19.9	19.4	-7.5	9.7	8.5	6.4	9.5
Unicorn UK Income	4.3	20.4	31.7	-15.3	21.4	0.6	14.6	11.8
Marlborough Multi Cap Income	4.4	21.2	25.8	-14.2	18.0	-3.7	13.9	11.3
Schroder UK Alpha Income	4.6	24.1	22.2	-15.7	12.5	7.8	5.6	10.4
Castlefield BEST Sustainable Income General	4.1	22.2	21.7	-11.9	4.0	3.5	7.8	8.6
ES R&M UK Equity Income	4.7	21.5	14.8	-10.8	12.7	12.1	5.0	9.5
AXA Framlington Monthly Income	4.1	18.7	17.1	-10.2	16.0	9.8	4.4	8.8
Schroder Income Maximiser	7.4	32.1	8.7	-2.4	7.8	19.9	-6.2	9.6
ASI UK Income Equity	3.7	17.9	25.8	-9.1	7.5	13.6	-3.1	9.7
BNY Mellon Equity Income Booster	7.7	41.8	13.4	-12.0	10.9	14.6	-0.6	9.5
JOHCM UK Equity Income	5.0	22.4	20.0	-13.2	18.1	16.9	1.5	11.6
Threadneedle UK Equity Alpha Income	4.5	23.3	19.0	-5.5	2.9	13.9	3.1	10.0
Threadneedle UK Monthly Income	4.8	23.5	20.1	-10.9	3.5	6.8	7.4	9.5
BlackRock UK Income	3.6	19.6	19.2	-10.2	10.7	9.0	10.3	10.0
Threadneedle UK Equity Income	4.0	20.6	19.5	-7.2	6.6	12.9	4.1	9.9
Fidelity Enhanced Income	6.4	31.4	18.1	-9.5	4.3	3.4	5.6	8.7
Invesco Income & Growth UK	3.8	19.2	21.3	-9.2	7.5	6.2	5.6	9.4
FP Miton Income	3.9	21.0	16.7	-11.0	9.7	7.2	11.4	9.6
Rathbone Income	4.2	19.7	17.7	-9.2	7.4	7.6	9.0	8.9
BNY Mellon Equity Income	5.0	22.1	14.7	-9.4	10.8	14.2	0.2	10.0
JPM UK Higher Income	4.7	21.1	18.8	-14.0	14.7	5.7	6.6	9.8
AXA Framlington UK Equity Income	3.7	18.0	22.5	-12.2	7.9	9.1	5.1	9.8
SVS Albion Olim UK Equity Income	4.3	18.9	19.4	-12.9	14.6	8.5	7.4	10.4
LF Canlife UK Equity Income	4.7	20.6	19.0	-10.5	7.8	5.2	11.2	9.7
Grey List Average	4.7	22.8	20.0	-10.6	10.6	8.3	6.9	9.8

Past performance is not a reliable indicator of future results.

The Black List

The Black List shows the same relative consistency as featured in the White and Grey lists. While a few funds that have dropped into it, the list largely contains the usual disappointments. The **LF Majedie UK Income Fund** has just fallen into the Black List and is now ranked 48 out of 61, having dropped 17 positions. Volatility has been particularly high at just over 11% and near-term performance has been disappointing in a market which was exceptionally strong in 2019.

A particularly severe drop has been suffered by the **Liontrust Macro Equity Income Fund**. It has fallen 21 places, mainly attributable to only average performance over the evaluated timeframe and poor third quartile volatility. The fund hovered around the bottom of the Grey List for some time but has not quite held on to its improved status which it achieved in the previous Study.

The third and fourth additions to the Black List are the **Schroder Income Fund** and the **M&G Dividend Fund**, ranking 57 and 58

respectively. Each of the funds has fallen by over 15 places since the July 2019 Study. The **Schroder Income Fund** has continued its decline over the past year, while the **M&G Dividend Fund** has returned to its previous Black List ranking. Both funds have provided a dearth of distributed income compared with their peers and the inconsistency in long-term performance has had a large impact on their rankings.

Laggards that consistently appear in the Black List include the **HSBC Income Fund**, the **UBS UK Equity Income Fund**, and the **Janus Henderson UK Equity Income and Growth**.

The final funds worth mentioning in the Black List are the two **Standard Life funds**, now known as **AberdeenStandard (ASI) funds**, the **ASI UK Equity Income Unconstrained Fund** and **ASI UK High Income Equity Fund**. Neither fund has evaded their Black List status after tumbling down the rankings in the previous Study.

The Black List	Dividend yield 31/12/2019	Income 5 years to 31/12/19 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/01/2019 to 31/12/2019	01/01/2018 to 31/12/2018	01/01/2017 to 31/12/2017	01/01/2016 to 31/12/2016	01/01/2015 to 31/12/2015	01/01/2015 to 31/12/2019
Fund	%	£	%	%	%	%	%	%
LF Majedie UK Income	4.6	21.7	15.6	-8.2	11.9	6.6	5.7	11.0
Liontrust Macro Equity Income	5.3	24.1	20.8	-12.7	9.1	6.3	5.4	10.7
Merian UK Equity Income	4.8	23.7	20.8	-14.8	11.6	5.5	3.9	10.3
L&G UK Equity Income	4.7	21.8	21.2	-16.1	10.7	8.0	6.8	11.5
MI Downing Monthly Income	4.2	23.7	18.3	-18.4	17.0	7.8	1.3	10.6
Jupiter Income Trust	4.3	19.4	11.9	-8.3	9.3	18.9	2.1	10.0
Scottish Widows UK Equity Income	4.8	20.1	12.1	-8.7	11.0	13.3	1.5	10.8
HSBC Income Retail Income	4.1	21.1	18.0	-12.3	7.9	7.5	2.2	9.6
ASI UK High Income Equity	5.0	23.8	13.5	-15.3	13.8	1.3	8.7	11.8
Schroder Income	4.3	17.4	7.5	-1.7	8.5	24.4	-7.0	10.6
M&G Dividend	3.2	17.3	19.5	-14.9	9.0	7.6	7.8	10.6
Janus Henderson UK Equity Income	4.7	20.9	12.1	-12.8	8.8	9.6	3.5	9.9
ASI UK Income Unconstrained	4.6	20.1	10.8	-13.6	18.3	-3.9	13.3	12.7
UBS UK Equity Income	4.9	19.9	14.0	-13.7	11.7	35.2	-3.9	11.9
Black List Average	4.5	21.1	15.4	-12.3	11.3	10.6	3.7	10.8

Past performance is not a reliable indicator of future results.

Don't forget your ISA!

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For the current 2019-20 tax year, all investors can subscribe up to £20,000 in a stocks and shares ISA.

Dividend income within an ISA is tax-free.

The upper rate of capital gains remains at 20%, but investments held within an ISA wrapper remain exempt. An added benefit is the freedom to switch the funds held in your ISA at any time, which gives you the opportunity to follow future Income Study analysis.

Investing in the White list

Investing in the White List Portfolio ISA is the simplest way to invest in the White List funds. This portfolio, which is actively managed by SPW, holds a selection of the best UK equity income funds which have featured in the White List. Once you have filled in the application form there is no more paperwork to complete. We collect all the dividends for you and can pay them to your bank account.

However, many of our clients prefer to use the Income Study to assist in the selection of their own funds.

So, if you want to take out an ISA or invest in an individual fund, please call us on 01225 460010.

We offer a personal service and do not have a call centre.

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