

Income Study

June 2020



Are dividend payments in permanent decline?

Our mid-year review highlights the impact of the current pandemic on the main feature of the UK Equity Income sector: the payment of dividends.

Many UK investors are attracted by dividends, whether drawn as income or reinvested. Their appeal is illustrated by the performance of the FTSE 100 index over the five-year period to 2019. Investors who reinvested their dividends enjoyed average annual growth of around 4% but returns were flat over the same period if dividends are excluded. The impact is even more striking over the 20-year period to December 2019 when the FTSE 100 hardly changed but reinvestment of dividends would have provided a total return of 112%, according to Bloomberg.

Long-term dividend growth has certainly benefitted income investors over the past 10 years. Dividends totalled £54 billion in 2009 and had more than doubled to £110.5 billion a decade later in 2019. This figure would have been only £73 billion, according to Bank of England data, if dividends had grown only in line with inflation over the same period.

Most of the UK's largest companies pay dividends, although a disproportionate volume are from just a handful of major industries. Prior to the pandemic, £102bn of cash was expected to be returned to shareholders as dividends in 2020, which would have been the second-highest year on record, after the bumper returns of 2019. This forecast has now been obliterated as pressure on cash flows has forced companies to slash payouts – in some cases, for the first time ever. And, in many instances, dividend cuts have been accompanied by share price collapses, adding to the pain.

Which income funds have been most challenged?

Within the Equity Income sector, enhanced income funds could face the most pressure from scrapped dividends. In the current period of high market volatility, the 'covered-call' strategies used to increase yield could prove problematic. The risk is that, when volatility is very high, the price of these options is likely to be considerably higher than in the past few years.

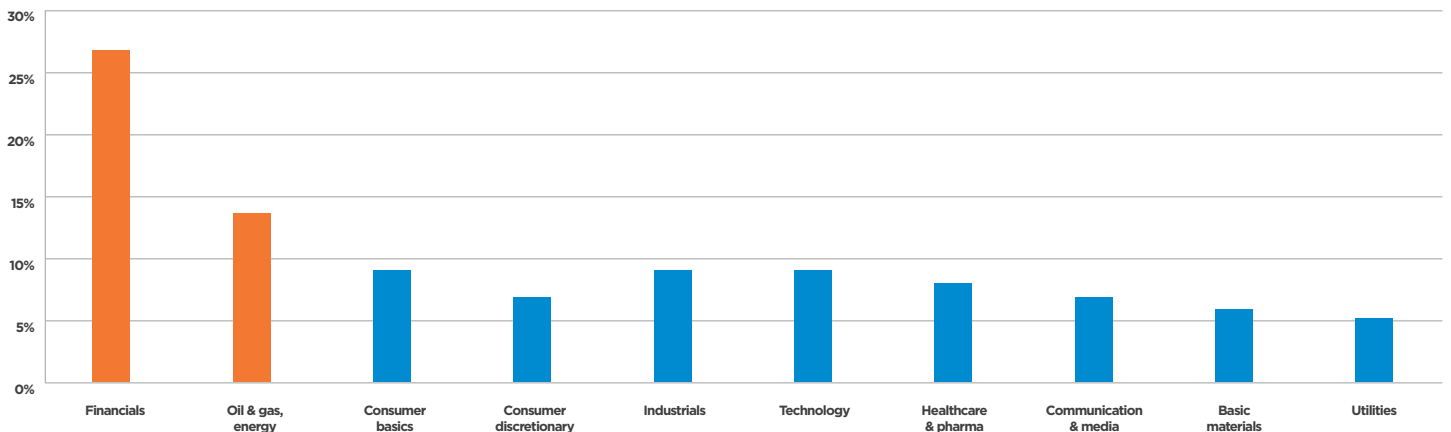
Small-cap companies have generally faced the greatest challenge within the UK Equity Income sector. Compared with their large-cap counterparts, small-caps generally have lower access to capital, have a domestic bias, and have more narrowly focused business models. Consequently, they have been at the forefront of underperformance as consumers have stayed indoors and economic activity has generally slowed.

Conservatively managed funds, particularly those with an emphasis on dividend sustainability, have tended to perform well, in some cases falling by far less than the FTSE All-Share index, over the recent crisis period.

Concentration of dividends by sectors

The freezing of banks' dividends highlights the concentration risk of dividends in the UK stock market. The only sector that has traditionally contributed more than banks to market yield is 'Big Oil'. This may not currently offer much comfort.

2019 dividends industry and sectors



Source: Janus Henderson, Global Dividend Report Q1 2020

With the price of oil reaching negative territory in April 2020, these UK oil and gas businesses are likely to be loss-making this year. Maintaining their dividends could only be achieved through funding from increased debt so the dividend cut announced by Royal Dutch Shell – its first since World War 2 – was not really a surprise. Without the dividends of financials and energy stocks (which together made up 39% of the UK market yield) the UK market yields a modest 4%, rather than the more enticing headline historic yield of approaching 6%.

However, the view from the UK Income Team at Artemis was more comforting when we spoke with them following the initial announcement of dividend cuts at the beginning of Q2 2020: “Furthermore, it should be realised that some of the cuts and cancellations announced represent a dividend ‘sabbatical’, reflecting prudence or due regard to the hardship of customers and it is highly likely that these dividends will return from sabbatical, albeit not back to the levels from which they departed. Others will be gone or retired for longer, reflecting a long road back to being able to sustain a dividend.”

For investors focused on maintaining UK dividend funds in their portfolio, it is important to consider funds that source income from outside the FTSE 100. Such a strategy provides diversification and reduces vulnerability to the risks associated with the concentration of dividend payments from a shrinking pool of heavyweights.

Although the current crisis will inevitably have long-term structural economic effects, its impact on the stock market is likely to be brutal, but relatively short-lived. Whilst dividend streams are now being challenged, the crisis may provide an opportunity for skilled active fund managers who are prepared to search beyond the largest and usual sources of income to differentiate themselves, both in terms of income and overall return.

Carefully selected income funds can offer an income stream as well as capital appreciation over the long term. The Income Study analysis identifies the funds that have been the most successful in meeting 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.

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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

Navigating the dividend environment in the disruption caused by the present crisis is challenging. The Investment Association has responded by temporarily suspending dividend yield targets for funds in the IA UK Equity Income sector. As a result, yields from some funds may be substantially reduced this year as managers focus on rebuilding portfolios for 2021. Our Income Study analysis puts the current situation into context by providing insight over a five-year period. Market uncertainty this year, however, highlights the fact that past performance cannot be used as an indicator of the future.

In this mid-year Study, six out of the first eight funds are new entrants in the White List, and we report several big moves across the rankings, driven by this recent volatility.

The **Liontrust Income Fund**, run by Robin Geffen (the ex-CEO of Neptune Investment Management) is placed at the top, the same position as in the July 2019 Study. Its mid-year top spot has been restored since year-end by an upward move of 18 places in the list of 59 eligible funds from the whole UK Equity Income sector. This fund has delivered solid performance over several years, and has fared well during the recent volatile period. Key to its success has been its overall consistency across the Study's criteria, which are volatility, income and performance.

The **Santander Enhanced Income Fund**, in second place, will be recognised from previous regular appearances in the White List. After a tough period in 2016, the managers, Graham Ashby and Duncan Green, have proved their worth recently, their fund now ranking eighth out of the funds in the universe, in part by paying a good dividend when compared to peers.

Another fund frequently seen in the White List is the **LF Miton UK Multi Cap Income Fund** which has secured third place this time, after dropping into the Grey List at the previous review. The fund has delivered the top performance versus peers for the period considered, ended June 2020, and jumped 17 places and out of the Grey List. Whilst distribution is not the strongest element of its strategy, with a 4.1% yield, volatility management over five years has been a strong attribute.

The **Blackrock UK Income Fund** and the **ES R&M UK Equity Income Fund** are two first-time entrants, having jumped 33 and 24 places respectively since the previous Study. First quartile volatility outcomes over five years versus peers and good performance during the volatility of 2020 have helped to secure White List placings for these two funds.

The **Fidelity Enhanced Income Fund** re-entered the White List after a few recent Grey List slots. The defensive profile of the fund, as well as the high dividend paid through the option overlay and its consistency of volatility management, contributed to its rise of 32 places since January.

Funds retaining their White List status, with some repositioning, include the **NFU Mutual UK Equity Income Fund**, the **Aviva UK Listed Equity Income Fund**, the **UK Artemis Income Fund**, the **Franklin UK Equity Income Fund**, the **Troy Trojan Income Fund**, the **Santander Equity Income Fund** and the **Man GLG Income Fund**. Others have moved from the top of the Grey List, including the **Fidelity MoneyBuilder Dividend Fund**, its improved ranking resulting mainly from lower volatility against peers and good more recent performance.

The White List Top fourteen funds by overall merit	Dividend yield 30/06/2020	Income 5 years to 30/06/2020 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/07/2019 to 30/06/2020	01/07/2018 to 30/06/2019	01/07/2017 to 30/06/2018	01/07/2016 to 30/06/2017	01/07/2015 to 30/06/2016	01/07/2015 to 30/06/2020
			%	%	%	%	%	%
Liontrust Income	5.3	25.3	-13.2	6.1	9.2	21.9	-0.1	13.1
Santander Enhanced Income	5.2	30.7	-6.0	0.3	7.6	17.9	-1.1	13.5
LF Miton UK Multi Cap Income	4.1	19.4	-1.5	-6.1	9.1	24.4	-1.8	11.9
BlackRock UK Income	4.8	23.6	-6.7	0.3	5.1	20.5	-0.5	12.5
ES River & Mercantile UK Equity Income	5.0	23.1	-3.7	-5.0	8.1	22.4	-4.3	12.1
NFU Mutual UK Equity Income	5.9	27.0	-15.0	-0.4	8.0	16.7	4.8	12.6
Fidelity Enhanced Income	7.8	37.9	-8.4	-1.7	-2.5	10.7	2.3	11.1
Fidelity MoneyBuilder Dividend	5.8	28.3	-7.6	-1.6	-2.1	12.5	5.3	11.7
Aviva Investors UK Listed Equity Income	4.9	24.3	-10.7	0.6	7.2	19.8	2.0	14.4
Artemis Income	4.6	24.0	-11.4	-2.2	8.2	19.3	-0.6	12.5
Franklin UK Equity Income	5.4	25.3	-12.1	1.7	5.5	16.5	6.2	13.3
Trojan Income	4.0	19.0	-5.6	4.2	1.4	11.4	10.1	10.5
Santander Equity Income	5.5	27.8	-8.6	0.7	7.2	17.5	-2.3	15.2
Man GLG Income Retail	6.7	31.8	-16.3	-1.1	12.8	32.0	-6.6	15.7
White List Average	5.4	26.2	-9.0	-0.3	6.1	18.8	1.0	12.9

Past performance is not a reliable indicator of future results.

The Grey List

Funds rising from the Grey to the White List have been replaced by others moving in the opposite direction. These include the **Lazard MultiCap UK Income Fund**, the **Royal London UK Equity Income Fund** and the **Allianz UK Equity Income Fund**, all lower in the rankings.

The **ASI UK Equity Income Fund** and the **Threadneedle UK Equity Income Fund** both appear near the top of the Grey List after jumping 16 and 21 places respectively. Near-term performance and managed volatility over the period under review are the main reasons for these improvements.

Most funds in the Grey List have retained their status, with some shuffling. For example, the **Axa Framlington UK Monthly Income Fund**, the **BNY Mellon Equity Income Booster Fund** and **Threadneedle UK Monthly Income Fund** have moved upwards by 3, 4 and 6 places respectively, and the **Schroder Income Maximiser Fund** remains in the same position (31 out of the 59 funds).

Several funds within the Grey List have fallen quite dramatically. The **Royal London UK Equity Income Fund** and **Allianz UK Equity Income Fund** have fallen by 17 and 19 places respectively. A mixture of recent performance, income return and volatility has caused these shifts. The **Unicorn UK Income Fund** has also suffered the same fate and fallen by 18 places this time around.

The **MI Chelverton UK Equity Income Fund** has surprised on the downside, having dropped 31 places after delivering a poor return in

the near-term period under review, and being ranked at the bottom of the list in the volatility measure over the most recent period.

The **UBS UK Equity Income Fund** is a particularly strong performer, rising from the bottom of the list, having struggled in recent rankings. Despite relatively poor volatility, and less than average performance, a good income payment and some decent historic performance has edged it into the Grey List, after a long gap.

Just avoiding a fall into the Black List, The **Premier Monthly Income Fund** has dropped 38 places and now ranks at number 45. Volatility has been high, at just over 17%, and some periods of lacklustre and disappointing performance, outweigh the high dividend income that the fund generates.

The Grey List	Dividend yield 30/06/2020	Income 5 years to 30/06/2020 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/07/2019 to 30/06/2020	01/07/2018 to 30/06/2019	01/07/2017 to 30/06/2018	01/07/2016 to 30/06/2017	01/07/2015 to 30/06/2016	01/07/2015 to 30/06/2020
			%	%	%	%	%	%
BNY Mellon UK Income	5.4	24.1	-11.4	3.3	4.5	7.9	12.4	12.5
ASI UK Income Equity Income	4.5	19.2	-4.8	4.1	0.6	17.2	-1.0	12.4
Threadneedle UK Equity Income	4.9	25.2	-5.0	-5.2	4.0	17.7	1.0	13.1
Lazard Multicap UK Income	5.4	27.0	-15.7	-1.4	8.0	20.7	-2.5	13.7
Threadneedle UK Equity Alpha Income	4.0	22.4	-8.9	-4.2	4.9	19.5	2.7	13.1
Janus Henderson UK Responsible Income	4.8	21.8	-7.1	2.7	5.1	16.7	-1.1	13.5
BMO Responsible UK Income	3.7	20.3	-9.8	1.0	5.2	18.3	-2.8	12.8
Kames UK Equity Income	4.6	23.1	-11.4	-1.5	4.1	18.6	3.9	13.2
Royal London UK Equity Income	4.9	24.9	-15.0	-0.7	6.1	18.8	2.7	14.0
Allianz UK Equity Income	5.9	26.7	-10.3	-4.4	13.3	20.7	-7.8	15.4
AXA Framlington UK Equity Income	4.3	20.5	-5.7	0.2	4.2	16.7	-2.6	12.7
Rathbone Income	5.3	24.2	-13.8	0.2	0.4	19.3	0.9	12.6
AXA Framlington Monthly Income	5.7	25.2	-15.4	-2.8	7.1	24.5	-3.0	14.1
BMO UK Equity Income	5.0	24.9	-9.7	-3.9	6.2	17.2	2.4	15.2
BNY Mellon Equity Income Booster	6.2	29.1	-19.5	-3.5	7.2	21.7	-3.5	13.8
Threadneedle UK Monthly Income	5.1	27.6	-12.1	-2.5	1.1	13.8	0.8	13.0
Schroder Income Maximiser	8.6	40.7	-21.4	-3.8	10.7	19.2	-5.4	13.5
Castlefield BEST Sustainable Income	4.1	24.1	-7.9	-0.2	-3.4	17.0	-5.7	11.7
BNY Mellon Equity Income	9.7	54.8	-20.2	-5.4	4.4	21.3	-2.5	13.4
Schroder UK Alpha Income	6.0	29.6	-13.2	-3.9	2.2	20.0	-3.4	14.1
LF Canlife UK Equity Income	5.5	24.9	-13.5	-3.2	5.7	15.4	0.8	13.4
FP Premier Miton Income	5.8	24.1	-10.4	-6.1	6.0	15.1	1.5	13.4
Scottish Widows UK Equity Income	6.1	25.4	-17.3	-2.2	8.1	19.7	-2.8	14.5
Jupiter Income Trust	6.3	27.0	-21.3	-5.5	6.8	19.1	5.9	13.9
Marlborough Multi Cap Income	5.9	25.6	-14.6	-2.2	8.9	20.3	-9.8	16.4
Invesco Income & Growth UK	4.7	23.1	-12.1	-1.8	2.9	14.5	0.7	13.0
UBS UK Equity Income	6.9	28.1	-26.3	-9.0	8.7	32.3	-0.5	16.8
LF Majedie UK Income	5.9	26.9	-17.4	-5.9	12.8	20.9	-8.0	14.2
Unicorn UK Income	5.7	25.3	-15.3	-0.1	3.7	30.7	-9.1	17.3
MI Chelverton UK Equity Income	5.9	30.6	-20.2	-9.2	13.8	35.5	-9.7	19.6
Premier Monthly Income	6.0	31.8	-16.8	-7.5	5.1	22.2	-3.7	17.1
Grey List Average	5.6	26.7	-13.7	-2.7	5.8	19.8	-1.6	14.1

Past performance is not a reliable indicator of future results.

The Black List

Like the White and Grey Lists, the Black List has remained relatively consistent. A few funds have entered, but familiar constituents dominate.

The **Slater Income Fund** is a surprising entry, having fallen 25 places, mainly attributable to poor performance in the last couple of years and its fourth-quartile measure of volatility, versus peers. Over the last few Studies, the fund has slowly sunk from the White List into the Grey List, and now the Black List, as its style and small- to mid-cap bias have hampered any recovery in the recently challenging market.

Premier Asset Management (now renamed Premier Miton Investors) has also been unable to match previous successes in

this Study. Both the **Premier Income Fund** and **Premier Optimum Income Fund** have dropped substantially, continuing their fall since their White List presence in mid-2018. Falls of 35 and 34 places respectively reflect weak performance and volatility indicators.

Some familiar names continue to languish in the Black List. They include **Liontrust Macro Equity Income, HSBC Income, ASI UK High Income Equity, Merian UK Equity Income, M&G Dividend, L&G UK Equity Income, MI Downing Monthly Income, Janus Henderson UK Equity Income and Growth** and **ASI UK Income Unconstrained**.

The Black List	Dividend yield 30/06/2020	Income 5 years to 30/06/2020 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/07/2019 to 30/06/2020	01/07/2018 to 30/06/2019	01/07/2017 to 30/06/2018	01/07/2016 to 30/06/2017	01/07/2015 to 30/06/2016	01/07/2015 to 30/06/2020
			%	%	%	%	%	%
Premier Income	6.0	31.5	-15.9	-7.5	5.1	22.1	-3.7	17.3
Slater Income	5.2	30.1	-17.0	-6.5	6.0	22.7	-8.5	15.8
Schroder Income	6.8	25.2	-23.2	-5.4	14.3	21.4	-5.2	14.6
JOHCM UK Equity Income	7.7	30.0	-21.1	-9.4	13.0	30.3	-8.9	17.5
Liontrust Macro Equity Income	5.7	29.2	-17.2	2.6	2.5	16.9	-7.0	14.7
Premier Optimum Income	7.8	51.1	-16.8	-8.1	3.7	24.5	-6.0	18.3
ASI UK High Income Equity	6.0	30.3	-16.5	-9.2	9.6	19.1	-10.7	15.9
HSBC Income Retail	5.3	27.2	-19.3	-1.5	2.2	14.7	-1.4	13.6
Merian UK Equity Income	5.2	28.7	-16.8	-5.4	6.7	16.6	-6.5	15.3
M&G Dividend	5.7	21.6	-15.6	-2.8	-1.1	19.4	-1.9	14.4
L&G UK Equity Income	5.8	27.9	-20.9	-6.2	5.3	18.7	-2.1	15.6
MI Downing Monthly Income	5.4	27.9	-15.3	-8.7	2.6	24.2	-10.3	16.1
Janus Henderson UK Eq Income & Growth	5.5	27.5	-22.1	-8.0	3.3	23.2	-7.9	15.3
ASI UK Income Unconstrained	5.0	26.0	-22.1	-7.2	7.7	21.2	-10.8	17.5
Black List Average	5.9	29.6	-18.6	-6.0	5.8	21.1	-6.5	15.8

Past performance is not a reliable indicator of future results.

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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 rebalanced 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 460 010.

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

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