

JULY 2018

Income Study

Mid-year review

How is continuing economic uncertainty affecting the UK Equity Income fund sector?

In this mid-year review we explore the performance of the funds in our latest analysis and we address current investor concerns.

Increasing outflows from the UK Equity Income sector suggest that the mood of investors is changing. In January 2018 the value of investments in the sector fell at a faster rate than those in any other sector. However, even after recent outflows, the sector remains one of the largest, with assets of more than £60 billion under management, accounting for roughly ten percent of all assets invested in UK-domiciled open-ended funds.

Two concerns are often raised by investors: the sustainability of dividend payments and the concentration of dividend income from a small number of high-yielding company shares.

Dividends are an incentive to own the shares of companies and many investors rely on the steady income they provide. However, the payment of dividends could indicate that a company has decided to distribute profit as dividends because it can no longer benefit from reinvesting cash to grow its business. Even the most stable companies must constantly assess their ability to make dividend payments in the ever-changing, and currently uncertain, economic environment.

Decisions to cut dividends are made for several reasons. For example, a company may see an opportunity to reinvest in its business – perhaps through an acquisition – rather than pay a dividend. More often, it is a decline in profits that leads to an inevitable dividend reduction. If profits fall, companies often maintain dividends for a time, but if decline continues, then eventually the capacity to make payments at a consistent level is constrained and a cut is announced.

News of a dividend cut may prompt income-seeking investors to sell shares, causing downward pressure on their price. Such movements in a company's share price will naturally affect the price of funds holding the share. If fund managers are generally relying on a similar selection of high-yielding FTSE 100 stocks to maintain income, then the misfortune of a single company could impact the entire sector adversely. To avoid this concentration of income sourcing, managers have shown an increasing tendency in recent years to widen their search for income and many have found good, reliable sources of income from mid and smaller capitalised companies.

Fund managers scrutinise dividend cover – the proportion of a company's net profit that is allocated to dividend payments – in their assessment of a company's scope to maintain and increase payments to shareholders. Ideally, dividend cover should be around 2X, meaning that profits should be twice the amount paid out in dividends. Recently, though, the average for FTSE 100 companies has been 1.63X. Investors are therefore asking whether there is sufficient margin of safety to resist a sudden, unexpected trading downturn in a specific company, or indeed in the UK and global economies as a whole.

The following table shows the ten FTSE 100 companies forecast to have the lowest dividend cover as at the end of April 2018.

Company	Dividend Yield 2018 (%)	Dividend Cover 2018
BT	6.2	1.73x
Lloyds	6.8	1.62x
Legal & General	6.2	1.52x
Barratt Developments	7.1	1.49x
Taylor Wimpey	7.6	1.41x
GSK	6.2	1.35x
SSE	7.2	1.26x
Centrica	8.0	1.24x
Direct Line	7.7	1.12x
BP	6.1	0.99x

*Source: AJ Bell Dividend Dashboard

Dividend payments from FTSE 100 companies in 2018 are expected to total £87.5 billion which equates to a yield of 4.4% – a far higher return than is available from cash savings and bonds. Are these high yields sustainable? The recent rise in dividend yield of several companies is attributable to sharp falls in their share prices, leading investors to question whether the high payments can be maintained.

One way for investors in funds to mitigate the risk from FTSE 100 dividend concentration is to consider funds that contain the shares of a higher proportion of small and medium sized companies, several of which feature in our White List. The Chelverton UK Equity Income fund, the Milton UK Multi Cap fund and the Marlborough Multi Cap fund are examples of such funds. Although smaller companies lack the scale and breadth of operations that

characterise many of the largest enterprises, they offer investors an opportunity to avoid over-exposure to the risk of dividend cuts by a small number of top-payers.

Fund managers whose funds appear in the White List are adept at taking advantage of a volatile corporate and economic climate. Even a dividend cut can be seen as an opportunity to buy into a company suffering a drop in its share price, especially if the business is being put on a

more sustainable footing that will enable it to eventually restore both its dividend and its share price. When already invested in a company that has cut its dividend, it can make sense to continue holding the shares; the dividend cut may be in the best long-term interests of the company, and therefore its shareholders.

Looking ahead, markets will accommodate both the Brexit outcome and, over the longer term, the expected interest rate rises in the coming

years. In the meantime, UK equity income funds are likely to remain a favoured source of income at a level unavailable elsewhere.

Long-term White List investors have been comforted by some positive economic statistics and have continued to enjoy a pleasing return from their fund holdings by diversification within individual funds and by picking from the full range of funds that we highlight in our *Income Study*.

THE WHITE LIST: specials

The White List has remained relatively stable in our mid-year analysis. The majority of the highest ranking funds have remained, with six of the lower ranking funds moving out of the White List.

The **Slater Income Fund**, run by Mark Slater, has now reached the top of the Study having performed strongly since first appearing in January 2017. Its high-ranking dividend yield versus peers, consistent performance and moderate volatility have brought the fund into the first position that was previously held by the **Miton UK Multi Cap Income Fund**, which now ranks third.

There has been a slight shuffle in the top few funds with a new joiner and the addition of five new funds moving into the White List following strong performance.

It is worth mentioning Adrian Frost's **Artemis Income Fund** which had quite a big fall in 2017. It was placed in 30th position a year ago versus all

peers for the period. Since then, the fund has delivered on its mandate and, despite not paying the highest dividend income, it has managed to perform consistently in all the other years reviewed, in particular over the last two Studies. The fund is now in 4th position in the White List, having moved up 15 places.

Of the six new entrants to the White List (including Artemis Income mentioned above) the **Schroder Income Maximiser Fund** was a constituent of the White List as recently as January 2017. For the following two Studies, the fund was in the middle of the Grey List before moving up 18 places this time, helped by the dividend income element which has been stronger versus peers over the period reviewed.

Other new entrants include the **Schroder Income Fund**. This fund, managed by Kevin Murphy and Nick Kirrage, has moved up 38 places in the review

and ranks first in performance versus peers, with a respectable yield of 3.4%. It has therefore risen significantly to secure a position in the White List.

The **Aviva Investors UK Equity Income Fund** and the **FP Miton Income Fund** are also new additions to the White List, having been close to the top of the Grey List in the previous Study. Finally, the **Insight Equity Income Booster Fund** has made an impressive appearance at the bottom of the White List for its first review following its recent five-year anniversary. The fund, managed by Tim Rees, benefited from decent returns, a high dividend income paid over the period under review and a lower standard deviation compared to peers.

THE GREY LIST

The **Royal London UK Equity Income Fund**, managed by Martin Cholwell, has moved out of the White List. The fund has had a poor two-year period in terms of calendar performance, ranking 22 out of the peers within the study. Thomas Moore manages the **SLI UK Equity Income Unconstrained Fund** which also moved out of the White List, due to a higher volatility than peers driving the fund lower.

The **Premier Monthly Income Fund** dropped into the Grey List for similar reasons. This pattern of under- and out-performance is consistent over previous years too, and has resulted in some of these funds producing a high standard deviation figure versus peers. It is this volatility which is to blame for the **Premier Monthly Income Fund** and the **SLI UK Equity Income Unconstrained Fund** falling 18 and 17 places respectively.

The **Threadneedle UK Equity Income Fund**'s positioning also worsened over the period under review. The fund, run by Richard Colwell, dropped another eight places into the Grey List and, unlike some of its peers, this is predominantly due to disappointing performance over the last period reviewed, which has led to it ranking 42 out of the 61 funds.

Other large movers were the **Franklin UK Equity Income Fund**, managed by Ben Russon, Colin Morton and Mark Hall. The fund dropped 20 positions due to poor numbers in the most recent period. The situation was similar for Chris White, the manager of the **Premier Income Fund** which also had poor numbers combined with a higher volatility than peers over the period covered.

The strongest positive mover is the **Ardevora UK Income Fund**, which has climbed 31 places from the Black List to the top of the Grey List. The fund has tended to deliver consistently on a calendar year versus peers.

In contrast, Francis Brooke's **Troy Income Fund** has made a significant negative move. Whilst producing a respectable level of income in January 2018's Study, and a low volatility during the 5-year period, this fund has struggled due to stock-specific issues over the last two calendar periods. The fund, which was in the White List a couple of Studies ago, is now ranked 38, at the bottom of the Grey List.

THE BLACK LIST

There has not been a wide divergence among the bottom ranks. The Black List continues to have the same constituents, with the exception of three funds.

The first is the **Unicorn UK Income Fund** which has dropped from the Grey List to the Black List after being in the White List in July 17. The fund, managed by Fraser Mackersie and Simon Moon, suffered from stock-specific issues which have affected the most

recent calendar numbers, leaving the fund at the bottom of the peer group over the period reviewed.

The second new constituent is the **Schroder UK Alpha Income Fund** which has dropped into the Black List, continuing its recent fall in the rankings. Performance was the key driver for the 12-position fall, as both 2016 and 2017 have been challenging versus peers. The third fund to fall into the black list

is the **Fidelity Enhanced Income Fund** which has delivered disappointing performance numbers versus peers over the period reviewed.

Laggards that continue to find themselves near the bottom of the Black List include the **Invesco Perpetual Income & Growth Fund**, the **M&G Dividend Fund**, the **HSBC Income Fund** and the **Aberdeen UK Equity Income Fund**.

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.

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: www.whitelist.co.uk. This newsletter is based on information that we believe to be reliable, but is not guaranteed as to accuracy and completeness by Sanlam Private Investments (UK) Ltd.

Information on individual funds is given without taking into account readers' specific circumstances and requirements and does not constitute investment advice under the Financial Services and Markets Act.

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

Top fourteen funds by overall merit

Fund	Gross yield 30/06/18	Income 5 years to 30/06/18 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/07/2017 to 30/06/18	01/07/2016 to 30/06/2017	01/07/2015 to 30/06/2016	01/07/2014 to 30/06/2015	01/07/2013 to 30/06/2014	01/07/2013 to 30/06/2018
Slater Income	4.4	32.4	4.1	22.7	-8.5	14.9	22.1	9.6
AXA Framlington Monthly Income	4.3	21.8	4.4	24.6	-3.0	7.6	25.3	8.0
LF Miton UK Multi Cap Income	3.9	19.6	5.5	23.4	-2.5	9.8	28.2	7.7
Artemis Income	4.0	26.8	7.1	19.3	-0.6	10.9	10.6	9.0
Marlborough Multi Cap Income	4.3	33.1	4.5	20.3	-9.9	13.1	26.1	10.2
Man GLG UK Income Retail	5.2	20.3	12.6	32.0	-6.6	13.9	14.0	10.7
Schroder Income Maximiser	6.9	42.9	10.0	19.2	-5.4	9.4	11.0	9.0
Schroder Income	3.4	26.8	13.5	21.4	-5.2	10.7	12.9	10.4
Majedie UK Income	4.4	20.7	11.1	20.0	-8.6	20.7	20.2	10.6
MI Chelverton UK Equity Income	4.3	21.6	10.4	34.6	-11.9	12.3	22.9	11.5
FP Miton Income	4.5	29.5	3.1	15.1	1.5	15.6	9.3	9.0
Aviva Investors UK Equity Income	4.2	26.9	4.1	18.3	0.7	10.9	11.2	9.2
JOHCM UK Equity Income	4.2	20.4	12.3	29.9	-9.5	11.2	14.3	10.3
Insight Equity Income Booster	7.7	41.2	2.7	21.3	-2.5	9.3	11.1	8.9
White List Average	4.7	27.4	7.5	23.0	-5.1	12.2	17.1	9.6

Notes:

- 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.
- All funds are in the IA UK Equity Income sector.

- Performance data is provided by Morningstar on a bid-to-bid basis with income reinvested. Volatility is annualised.
- Yields sourced from Morningstar, FT and fund providers and represent the estimated annual payout.
- Funds with a value of less than £20m are excluded.

THE GREY LIST

Fund	Gross yield 30/06/18	Income 5 years to 30/06/18 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/07/2017 to 30/06/18	01/07/2016 to 30/06/2017	01/07/2015 to 30/06/2016	01/07/2014 to 30/06/2015	01/07/2013 to 30/06/2014	01/07/2013 to 30/06/2018
	%	£	%	%	%	%	%	
Rathbone Income	3.8	25.2	-2.0	19.3	0.9	12.7	11.0	8.8
RBS Equity Income	4.1	20.8	4.2	18.4	1.1	10.3	11.3	9.1
Lazard Multicap UK Income	4.1	20.1	5.5	20.0	-3.2	10.4	12.9	9.3
Neptune Income	3.8	21.4	8.4	21.3	-0.6	12.0	4.8	10.3
Ardevora UK Income	3.5	20.2	5.2	7.2	3.2	14.2	14.7	10.5
Old Mutual UK Equity Income	4.1	22.4	5.0	16.6	-6.5	14.9	12.9	10.0
Santander Equity Income	5.1	22.7	4.2	17.5	-2.3	16.8	10.3	9.9
Royal London UK Equity Income	3.8	19.2	3.0	18.8	2.7	11.7	18.7	9.6
SLI UK Equity Income Unconstrained	4.1	20.0	7.6	20.5	-11.6	14.0	20.5	11.8
Allianz UK Equity Income	4.0	20.7	11.0	20.7	-7.8	9.1	10.3	9.2
F&C Responsible UK Income	3.7	14.2	4.3	18.3	-2.8	14.1	10.6	8.8
MI Downing Monthly Income	4.9	24.5	1.4	24.2	-10.3	12.3	15.3	10.3
Premier Monthly Income	4.4	24.1	0.8	21.2	-4.4	12.1	14.0	10.3
Insight Equity Income	4.2	19.7	5.4	21.7	-3.5	10.3	11.7	10.1
Liontrust Macro Equity Income	5.2	30.9	2.3	17.0	-6.9	12.4	12.9	9.8
River & Mercantile UK Equity Income	3.6	19.5	4.4	21.5	-5.0	10.4	12.7	9.6
Premier Income	4.4	23.7	0.8	21.2	-4.4	12.7	14.0	10.4
Santander Enhanced Income	5.6	30.6	4.3	17.4	-2.0	9.0	10.1	9.3
Threadneedle UK Monthly Income	4.4	22.4	-1.3	13.8	0.8	12.1	15.2	9.2
Kames UK Equity Income	4.4	22.0	2.4	17.6	3.1	12.3	8.6	9.6
Franklin UK Equity Income	4.2	19.6	3.3	16.5	6.2	11.2	12.2	9.5
Threadneedle UK Equity Income	3.8	19.1	1.7	19.5	2.7	10.0	17.0	9.6
JPM UK Higher Income	4.2	21.1	7.2	15.7	-2.0	10.4	9.8	9.3
Troy Trojan Income	4.1	20.3	-3.3	10.8	9.5	14.7	10.6	8.9
UBS UK Equity Income	3.8	18.4	7.3	31.9	-1.2	4.4	11.5	10.8
NFU Mutual UK Equity Income	4.2	20.2	3.9	15.3	3.5	6.0	11.5	9.4
LF Canlife UK Equity Income	3.7	19.7	3.6	15.4	0.8	12.7	8.1	9.3
SLI UK Equity High Income	3.9	20.2	8.0	19.1	-10.7	14.1	10.9	11.5
Janus Henderson UK Equity Income	3.7	17.9	1.5	23.2	-7.9	8.4	22.3	9.1
L&G UK Equity Income	4.7	27.5	2.7	18.7	-2.1	9.2	10.4	10.1
Fidelity MoneyBuilder Dividend	4.6	23.9	-4.9	12.5	5.3	9.9	10.9	9.1
Threadneedle UK Equity Alpha Income	4.1	22.8	-0.8	17.0	0.4	8.7	19.5	10.1
Grey List Average	4.2	21.7	3.4	18.4	-1.7	11.4	12.7	9.8

THE BLACK LIST

Fund	Gross yield 30/06/18	Income 5 years to 30/06/18 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			01/07/2017 to 30/06/18	01/07/2016 to 30/06/2017	01/07/2015 to 30/06/2016	01/07/2014 to 30/06/2015	01/07/2013 to 30/06/2014	01/07/2013 to 30/06/2018
	%	£	%	%	%	%	%	
BlackRock UK Income	4.0	17.5	1.8	19.5	-1.2	16.7	9.2	10.2
AXA Framlington Blue Chip Equity Income	4.0	21.6	1.8	16.7	-2.5	11.2	12.1	10.0
Castlefield BEST Income General	3.9	23.4	-5.2	16.8	-5.9	12.8	10.1	8.8
Fidelity Enhanced Income	7.0	40.4	-5.2	10.7	2.5	8.7	9.8	8.2
Schroder UK Alpha Income	4.7	22.8	-0.5	19.0	-4.1	12.1	11.4	10.2
Premier Optimum Income	7.3	10.4	0.0	24.5	-6.0	12.3	17.1	10.7
Scottish Widows UK Equity Income	4.1	20.0	8.1	19.7	-2.8	7.5	7.3	10.3
F&C UK Equity Income	4.0	14.4	4.3	17.2	2.4	6.7	4.5	9.1
Rathbone Blue Chip Income and Growth	4.1	24.6	-11.6	19.1	2.4	10.9	9.7	10.4
Newton UK Income	3.9	20.5	2.2	7.9	12.4	10.0	8.4	9.8
Invesco Perpetual Income & Growth	3.8	18.4	-1.5	14.5	0.7	10.7	13.4	9.5
M&G Dividend	4.7	22.4	-3.5	19.4	-1.9	11.2	7.1	10.3
Unicorn UK Income	4.1	20.0	-0.9	29.7	-9.8	6.1	24.0	10.7
Aberdeen UK Equity Income	3.9	20.7	-3.5	17.2	-1.0	3.7	8.2	10.2
HSBC Income	4.2	13.7	0.1	14.7	-1.4	8.1	8.7	9.5
Black List Average	4.5	20.7	-0.9	17.8	-1.1	9.9	10.7	9.8

Past performance is not a reliable indicator of future results.

Don't forget your ISA!

As opportunities to reduce your tax bill become increasingly scarce, it becomes ever more important to utilise your ISA allowance each year.

For the current 2018-19 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. If you would like details of any of our preferred funds, please get in touch.

So, if you want to make a new investment, take out an ISA or switch from an underperforming fund, dealing through SPW is simple: call us on **01225 460010**.

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

Past performance is not a reliable indicator of future results.

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.

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