

Income Study

July 2019 Mid-year review



UK equity income: a rightly neglected asset class or a hidden store of value?

The UK stock market has fallen out of favour since the Brexit referendum, but when compared with other international markets, London stock valuations could appear attractive.

The political crisis caused by the decision to leave the European Union has hurt the UK economy because companies have delayed investment and spending decisions amid the uncertainty of Brexit preparations. An important point for investors, however, is that the UK stock market is not closely linked with the UK economy. According to the UK Income Team at Schroders, companies listed in London generated just 27% of their revenues from the UK last year.

At the end of June 2019, the FTSE All-Share yielded 4.6%, down from 4.8% at the start of the year. This drop in average income has been caused by the 10% rebound in the index, year to date, which makes up for most of last year's fall. However, the current yield is still significantly higher than its 3.5% average of the past 30 years, which shows the degree to which UK shares have failed to keep pace with rising corporate profits. (Ironically, Brexit has boosted companies' overseas earnings in the past two and a half years as they are worth more when converted into the weak pound.) As a result, over 30% of medium-sized and large FTSE companies yield over 5%, providing a large pool of potential investments for UK equity income funds targeting capital growth and a rising income for investors.

Risks of a disorderly Brexit

Given that most active UK equity funds are overweight in UK revenue exposure, relative to the FTSE All Share, we would expect the average fund to face performance headwinds relative to the index in the event of a disorderly Brexit. Of course, the opposite effect will be likely from an outcome that is more favourable to UK businesses. However, many factors affect active UK equity funds. For example, a disorderly Brexit may prompt a significant fiscal stimulus to boost the UK economy. The complex interplay of economic and political market influences make it hard to predict the consequences of the possible Brexit outcomes.

However the Brexit crisis is resolved, interest rates remain close to historic lows and are unlikely to rise significantly in the short term. So, the prospect of regular dividends from some of the UK's most successful companies is likely to remain attractive to

investors. Dividends can be as important for investors wanting capital growth as for those who prefer to use the payments as a source of income. Accumulating dividends, rather than withdrawing them as cash, is an effective way of increasing the value of a holding in a fund or company – dividend payments are likely to increase in proportion to the increasing value of the underlying investment. Equity income funds can therefore provide a foundation for a portfolio to suit various investment goals.

Funds appearing in the Sanlam White List are run by experienced fund managers whose funds have overcome some severe fluctuations in market levels and provided long-term rewards. Because equity investments are likely to fluctuate in value, they are not considered to be suitable as an investment option for cash that may be required within an investment timeframe of less than five years.

Finding value in UK businesses

Brexit will continue to command headlines and is likely to cause periods of stock market volatility. However, underlying company fundamentals remain broadly strong and valuations appear moderate, so from a medium to long-term perspective, a case can be made for buying UK equities.

Although the shares of UK companies have been shunned by international investors, at a corporate level the low valuations have been recognised and 2018 was a record year for UK company acquisitions, overseas buyers having paid the equivalent of an estimated 700 billion US dollars for UK enterprises. (Citi Research)

With the three-year anniversary of the referendum having passed, and the next Brexit deadline delayed until the end of October, investors continue to enjoy a good income from the UK equity market, despite the political and economic uncertainty. Committing further funds to a market at a time when it is out of favour has often been shown to be a profitable strategy.

UK Equities rank as least favoured choice of global fund managers

Long and short positions relative to history (z-scores)



The above chart shows the extent to which global fund managers are more positive or negative about traditional investment areas, compared with their average historical expectations.

Managers of funds appearing in the White List have produced the leading performances in our analysis which is based on measurements of income, growth and volatility over a 5 year period.

Because of sector concentration, traditional equity income funds, which have tended to allocate disproportionately to sectors with the highest dividend yields, may contain a hidden risk for investors. Most of the managers of funds appearing in the White List have

the ability to vary the size of their underlying positions according to where they see the best opportunities. This flexible approach enables the managers to respond to the prevailing market conditions over the short to medium term.

By selecting funds from the White List, investors are able to enjoy a high level of dividend income as well as the satisfaction of investing in funds that have demonstrated superiority over the past five years in our six-monthly analysis.

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

Global stock markets have been particularly volatile over the past year. The substantial fall in the UK market late in 2018 was followed by a strong recovery. This had a major impact on the funds covered in our Income Study which uses volatility as a key rating measure. The number of changes in the White List has been greater than usual, half of the funds in the previous Study having been replaced.

The **Neptune Income Fund**, run by Neptune's CEO Robin Geffen, is placed at the top of this July 2019 Study. Moving up 25 places in the list of 62 eligible funds from the whole UK Equity Income sector, this fund has outperformed all its peers over the recent volatile period. It returned 5.6% over the year to 30 June 2019, when most funds have struggled to achieve positive results.

The **Man GLG UK Income Fund** is in second place, having risen from seventh. While it displays volatile tendencies, its overall performance and income yield have strengthened its position in the White List. Yet again, the **Miton UK Multi Cap Income Fund** appears in third place, having retained its long run in the top three funds. Run by Gervais Williams and Martin Turner, the fund boasts strong long-term performance and exceptionally low volatility, despite being invested in the small and mid-cap space.

In fourth place, the **Santander Equity Income Fund**, which entered the White List in our previous Study, has risen five places. As previously highlighted, performance has continued to improve and a good level of dividend income has helped the fund maintain a strong position. As recently as January 2017, this fund appeared in the Black List. Its sister fund, the **Santander Enhanced Income Fund**, a version of the Equity Income Fund that places a greater emphasis on yield, retained its White List presence, moving up three places.

The **Troy Trojan Income Fund**, previously in first place, dropped 11 places to number 12. This fund has moved up and down the list many times and, whilst performance over the past year has been strong, total income distributed to investors has disappointed over the longer term.

Despite its low long-term volatility, the **AXA Framlington Monthly Income Fund**, run by George Luckraft, has dropped by 7 places from its previous ranking as the second placed fund in the White List. While performing well over the long run, its recent yield and performance have weakened in comparison to its peers. However, the management style may hold the fund in good stead in the event of a repetition of last December's sharp downturn.

New entrants to the White List include the **Schroder Income Maximiser Fund** and the **BMO Responsible UK Income Fund** which have finally broken into the list after hovering at the top of the Grey List in the previous study. Although very different funds, the low volatility of both has played a key role in their improvement by 10 and 4 places respectively.

Several funds from the White List have dropped into the Grey List, including the **Franklin UK Equity Income Fund**. Although showing a positive performance for the year, this fund was adversely affected by a combination of income, long-term performance and volatility measures.

Artemis Income, FP Miton Income, Fidelity Enhanced Income and Fidelity MoneyBuilder Dividend also drop into the Grey List. While the severity of the falls varied between 13 and 22 places, each of the falls is attributable to recent performance during the particularly volatile period that started in the fourth quarter of 2018. Several funds with strong performance records have struggled in the current market environment and this has contributed to the high degree of movements within our lists.

The White List Top fourteen funds by overall merit	Dividend yield 30/06/2019	Income 5 years to 30/06/19 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			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	01/07/2014 to 30/06/2015	01/07/2014 to 30/06/2019
Fund	%	£	%	%	%	%	%	
Neptune Income	4.4	20.6	5.6	8.7	21.3	-0.6	7.2	10.1
Man GLG UK Income	5.4	22.6	-1.1	12.8	32.0	-6.6	10.7	10.5
LF Miton UK Multi Cap Income	4.8	20.9	-6.8	8.3	23.4	-2.5	12.1	8.0
Santander Equity Income	5.0	23.2	0.7	7.2	17.5	-2.3	11.9	10.4
Aviva Investors UK Equity Income	4.4	20.8	-0.1	6.4	19.0	1.3	8.0	9.7
Schroder Income Maximiser	8.0	40.1	-3.7	10.6	19.2	-5.4	6.4	9.1
Santander Enhanced Income	5.3	28.1	0.1	7.2	17.4	-2.0	5.6	9.9
Lazard Multicap UK Income	4.8	21.3	-1.9	7.5	20.0	-3.1	6.8	9.0
AXA Framlington Monthly Income	4.4	22.2	-2.8	7.1	24.6	-3.0	4.7	8.2
NFU Mutual UK Equity Income	4.6	20.5	-0.4	8.0	16.7	4.8	4.4	9.1
BMO Responsible UK Income	4.3	18.9	1.0	5.1	18.3	-2.8	11.4	8.6
Troy Trojan Income	4.2	19.3	3.7	0.9	10.8	9.5	9.4	8.6
BNY Mellon Equity Income Booster	8.0	42.6	-4.9	4.9	21.9	-2.1	5.3	9.2
Rathbone Income	4.1	19.0	0.2	0.4	19.3	0.9	8.8	8.7
White List Average	5.1	24.3	-0.8	6.8	20.1	-1.0	8.0	9.2

Past performance is not a reliable indicator of future results.

The Grey List

There were some positive movers within the Grey List, including the **Kames UK Equity Income Fund**, run by Ian Wells and Douglas Scott, the **Ardevora UK Income Fund**, and the **Liontrust Macro Equity Income Fund**. These funds improved by 16, 32, and 11 places respectively. Ardevora's particularly strong rise can be attributed to much stronger performance in recent periods than historically. For example, in the period July 2016 to June 2017 the fund ranked second to last (61 out of 62) versus peers for performance, whereas in subsequent periods it has appeared in the first and second quartile, a noteworthy improvement.

For this Study, three new entrants have positioned themselves firmly in the Grey List. The first is the recently renamed **Janus Henderson UK Responsible Fund**, which has now been added to

the IA UK Equity Income Sector. It ranks 24th overall, mainly due to performance, as its yield and dividend income paid out to investors ranks last among its peers. The **LF Canlife UK Equity Income Fund** and the **SVS Albion Olim UK Equity Fund** have finally qualified for inclusion in the Study due to growth in their assets under management. They have not shown in previous studies because they have failed to meet our liquidity criteria.

Despite the **Schroder Income Maximiser Fund** qualifying for the White List, Kevin Murphy and Nick Kirrage's **Schroder Income Fund** has dropped another 10 positions in the Grey List, after falling 24 places in January's Study. The disparity between the funds arises both from performance and the amount of dividend income generated.

The Grey List	Dividend yield 30/06/2019	Income 5 years to 30/06/19 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			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	01/07/2014 to 30/06/2015	01/07/2014 to 30/06/2019
Fund	%	£	%	%	%	%	%	%
Franklin UK Equity Income	4.6	20.3	1.7	5.5	16.5	6.2	5.9	9.6
Royal London UK Equity Income	4.4	19.9	-0.7	6.1	18.8	2.7	7.0	9.6
BlackRock UK Income	4.5	19.8	-0.4	4.3	19.5	-1.2	11.8	9.9
Artemis Income	4.4	20.1	-2.2	8.2	19.3	-0.6	6.2	9.3
Kames UK Equity Income	4.9	22.8	-2.4	3.2	17.6	3.1	8.1	9.6
Ardevora UK Income	4.6	19.8	-1.4	10.2	8.0	1.6	10.5	9.8
Marlborough Multi Cap Income	4.7	23.0	-2.2	8.9	20.3	-9.9	13.6	10.9
FP Miton Income	5.3	24.0	-6.1	6.0	15.1	1.5	10.9	9.4
BNY Mellon Equity Income	4.8	21.0	-2.9	7.9	22.6	-3.0	6.3	9.7
Janus Henderson UK Responsible Income	3.9	18.5	2.7	5.1	16.7	-1.1	15.0	10.2
Castlefield BEST. Sustainable Income General	4.4	22.3	-0.5	-3.6	16.8	-5.9	9.4	8.6
Fidelity Enhanced Income	7.7	40.6	-1.8	-2.5	10.7	2.5	3.4	8.4
Slater Income	4.9	24.1	-6.5	6.0	22.7	-8.5	12.3	10.1
BNY Mellon UK Income	4.2	19.7	3.3	4.5	7.9	12.4	4.4	9.5
Liontrust Macro Equity Income	5.5	26.3	2.6	2.5	17.0	-6.9	8.0	10.2
Fidelity MoneyBuilder Dividend	5.1	23.7	-1.6	-2.1	12.5	5.3	4.4	9.1
JPM UK Higher Income	5.1	22.8	-4.1	8.7	15.7	-2.0	5.8	9.3
LF Majedie UK Income	5.2	21.3	-5.9	12.8	21.0	-7.9	15.3	10.5
Threadneedle UK Monthly Income	4.9	23.1	-2.5	1.1	13.8	0.8	7.8	9.3
LF Canlife UK Equity Income	3.9	19.8	-3.2	5.7	15.4	0.8	9.9	9.5
Allianz UK Equity Income	4.9	21.9	-4.4	13.3	20.7	-7.8	4.0	9.6
River & Mercantile UK Equity Income	4.6	20.8	-5.8	7.3	21.5	-5.0	6.8	9.5
MI Chelverton UK Equity Income	5.1	23.4	-9.9	13.0	34.6	-11.9	11.3	12.3
M&G Dividend	4.8	23.7	-2.7	-1.1	19.4	-1.9	8.3	10.5
Merian UK Equity Income	5.0	23.1	-5.4	6.7	16.6	-6.5	11.4	9.9
AXA Framlington Blue Chip Equity Income	4.0	20.6	0.2	4.2	16.7	-2.5	6.4	9.7
JOHCM UK Equity income	5.7	24.4	-11.7	12.6	29.9	-9.5	7.4	10.8
BMO UK Equity Income	5.0	21.0	-3.9	6.2	17.2	2.4	2.3	9.6
Schroder Income	4.3	19.0	-5.4	14.3	21.4	-5.2	6.9	10.1
Premier Optimum Income	6.7	41.0	-9.1	3.7	24.5	-6.0	10.1	10.7
SVS Albion Olim UK Equity Income	4.0	19.5	-1.2	5.3	20.0	0.5	4.2	10.2
Premier Income	5.5	25.3	-8.1	4.3	21.2	-4.4	9.4	10.3
Premier Monthly Income	5.3	25.3	-8.4	4.3	21.2	-4.4	8.9	10.3
Scottish Widows UK Equity Income	4.8	21.2	-2.1	8.1	19.7	-2.9	2.8	10.6
Grey List Average	4.9	23.0	-3.3	5.9	18.6	-2.2	8.1	9.9

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The Black List

The Black List is showing more consistency than the other sections of the Study. Although several funds make new appearances, the majority are familiar names, including the **Unicorn UK Income Fund**, the **HSBC Income Fund** and the **Aberdeen UK Equity Income Fund**. The poorest overall performers, using our measures, are **UBS UK Equity Income**, **L&G Equity Income** and **Janus Henderson UK Equity Income and Growth**, which are placed right at the bottom of the Black List.

The fund showing the largest movement is the **Threadneedle UK Equity Alpha Fund** which has fallen 43 places. Performance has been consistently weak over all but one period reviewed. Moreover, the fund house itself has struggled; the **Threadneedle**

UK Equity Income Fund has tumbled, this fund by 23 places into the Black List. Again, performance is the main factor determining its poor positioning. The third Threadneedle fund, **Threadneedle UK Monthly Income**, remains in the Grey List having dropped six places.

The two Standard Life funds, **SLI UK Equity Income Unconstrained** and **SLI UK Equity High Income**, now appear in the Black List. Both were placed near the bottom of the Grey List in the January 2019 Study but have fallen by 15 and 11 places respectively. They have both ranked poorly on volatility and their performance has also struggled versus peers in the recent disorderly market

The Black List	Dividend yield 30/06/2019	Income 5 years to 30/06/19 (Based on £100 investment)	Total return – capital growth and income reinvested					Volatility
			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	01/07/2014 to 30/06/2015	01/07/2014 to 30/06/2019
Fund	%	£	%	%	%	%	%	%
Threadneedle UK Equity Income	4.2	20.2	-4.2	4.9	19.5	2.7	5.2	10.0
Invesco Income & Growth	3.9	18.9	-1.8	2.9	14.5	0.7	6.9	9.2
Aberdeen UK Equity Income	4.0	19.5	4.1	0.6	17.2	-1.0	-1.6	9.7
Unicorn UK Income	3.9	20.2	-0.8	2.9	29.7	-9.8	7.8	11.4
Schroder UK Alpha Income	5.0	24.3	-4.6	1.5	19.0	-4.1	7.7	10.1
HSBC Income Retail Income	4.2	21.3	-1.5	2.2	14.7	-1.4	3.6	9.3
Jupiter Income Trust	4.3	19.3	-5.5	6.8	19.1	5.9	3.6	9.8
MI Downing Monthly Income	4.9	25.9	-8.7	2.6	24.2	-10.3	8.8	10.2
SLI UK Equity Income Unconstrained	5.0	22.0	-7.8	7.0	20.5	-11.6	13.5	12.3
SLI UK Equity High Income	5.4	23.3	-9.2	9.6	19.1	-10.7	11.4	11.9
Threadneedle UK Equity Alpha Income	4.6	22.9	-5.7	3.4	17.0	0.4	5.5	10.0
UBS UK Equity Income	4.8	20.8	-9.2	8.5	31.9	-1.2	1.2	11.4
L&G UK Equity Income	5.2	23.3	-6.1	5.3	18.7	-2.1	5.3	10.8
Janus Henderson UK Equity Income	4.3	19.9	-8.0	3.3	23.2	-7.9	5.6	9.6
Black List Average	4.5	21.5	-4.9	4.4	20.6	-3.6	6.0	10.4

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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.

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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 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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