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# The strong case for UK equity income

Low interest rates and an expected rise in inflation make UK equity income an important sector

UK equity income, this one-time darling of those charged with constructing portfolios for private investors, took quite a tumble in the wake of the 2008 financial crisis as banks cut dividends and BP suspended dividend payments in the wake of the Gulf of Mexico disaster. More recently the sector has returned to favour, not surprising, given the poor income prospects from government securities and cash. But a glance at the tables shows that managers have had a tough time in dealing with the changing environment for income-focused portfolios.

Some of the best known fund managers in the UK have been involved in this sector. Neil Woodford, Bill Mott, Tony Nutt and the late John MacClure – all have been well regarded and enjoyed spells at the top of tables. Only one – Woodford – continues running money in the UK Equity Income sector and his performance, in the relatively short period his Woodford Equity Income fund has been running, has seen the fund staying in the bottom half of the tables.

Despite this blip, the arguments for favouring this sector remain strong. Essentially, shares able to maintain a high payout ratio arguably fall into the value side of the equity market. At the very least investors are being paid to stay with these shares, regardless of what might be happening to the capital value. I recall an advertisement for the M&G Dividend fund, one of the very earliest of the UK equity income breed, back in 1988 when investors were still reeling from Black Monday in October of the previous year.

The then marketing director of M&G, Tim Miller, came up with the idea of highlighting that £1,000 invested in the fund on its launch a quarter of a century earlier would be gener-

## The numbers

**69**

Number of UK equity income funds in the sector over one year

**18%**

Rise of top-performing fund in the six months to the end of September

**58**

Number of UK equity income funds in the sector over five years

**8%**

Rise of the average fund in the six months to the end of September

## IA UK Equity Income

## 6 MONTHS

1	UBS UK Equity Income	+17.7%
2	Elite Charteris Premium Income	+13.0%
3	F&C UK Equity Income	+12.9%
4	Aberdeen UK Equity Income	+12.8%
5	Franklin UK Equity Income	+12.6%
70 funds, average performance		+7.7%

## 1 YEAR

1	UBS UK Equity Income	+22.4%
2	Old Mutual Newton UK Income	+22.2%
3	Newton UK Income Institutional	+21.9%
4	Jupiter Income Trust	+21.7%
5	Elite Charteris Premium Income	+20.0%
69 funds, average performance		+11.3%

## 3 YEARS

1	Trojan Income	+40.2%
2	CF Miton UK Multi Cap Income	+39.1%
3	MGTS Ardevora UK Income	+38.8%
4	Newton UK Income Institutional	+38.0%
5	Franklin UK Equity Income	+36.9%
63 funds, average performance		+23.6%

## 5 YEARS

1	MI Chelverton UK Equity Income	+122.4%
2	Ardevora UK Income	+115.8%
3	Royal London UK Equity Income	+114.7%
4	Montanaro UK Income Sterling Seed	+109.5%
5	Standard Life Inv UK Equity Inc Unconstrained	+106.7%
58 funds, average performance		+75.0%

Data to 30/09/16

Source: Lipper, a Thomson Reuters company, offer to offer, net income reinvested

ating £1,500 plus in income. In other words, forget the fall in capital value that had taken place the previous year, just celebrate the rise in income distribution.

This fund remains a giant in this sector. Managed by Phil Cliff, it has a current worth of more than £1.2bn, is actively managed and sits pretty much in the middle of the tables.

Of course, the 1970s had seen high inflation, which flattered dividend growth. This was the golden period for this sector, as asset prices were driven higher by persistent inflation and profits buoyed by the steady rise in the cost of living. Then the competition from bonds for income investors was more intense, with double digit returns available for much of the decade. And while the focus on value investing was less intense, total returns – the combination of the capital growth and the income generated – tended to put the better performing of these funds ahead in the overall performance tables.

Still, aside from the varying fortunes of the managers of these funds, there are some issues to take on board before determining that this is a one-stop-sector for investors in the UK. Paramount among these is the growing pension deficits that exist in much of corporate Britain. The fundamental choice appears to be between paying shareholders or plugging the funding gap for those entitled to pension benefits. Much of this is a consequence of a prolonged period of low interest

rates, which has driven the cost of annuities ever higher. Perversely, this is what makes this sector so appealing at present.

The performance tables provide little in the way of clues as to which horse to back in a popular, but not overcrowded sector. Some names do feature regularly, but they are generally a different crowd to that which might have been at the peak several years ago. Some managers have clearly struggled recently. Unicorn, which remains a creditable seventh over five years, is in the fourth quartile for six months and one and three years.

Other longer-term good performers have also suffered in the shorter-term tables. While the Royal London and Ardevora funds have maintained top-quartile status over all four timeframes reviewed, Chelverton, Montanaro and Standard Life have all seen their funds relegated to fourth quartile in shorter periods. Columbia Threadneedle is worthy of a mention, though. While it has not featured in the top five at all, its UK Equity Income fund was sixth over five years and the lowest position came over six months when, ranked 19, it returned a respectable 10 per cent plus.

This is an important sector that will feature in many advisers' choices. It has become a trickier call to make, though. But with interest rates low and likely to move lower, plus the expectation that inflation may well pick up, the case for considering this sector seems as strong as ever.



UK Equity Income is a naturally appealing sector to those for whom investment is primarily a means of generating spending money. With the yield gap between government securities and shares now properly re-established, equities do have an important role to play in income generation, but this has become a trickier and more volatile sector than in the past, so it no longer enjoys the safe haven status it once commanded.