For Professional Advisers Only

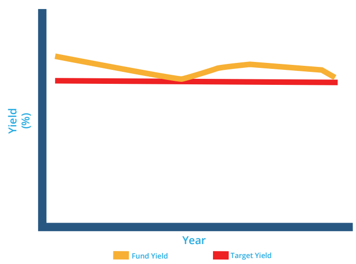
A Spotlight On:
Global Equity Income

February | 2019

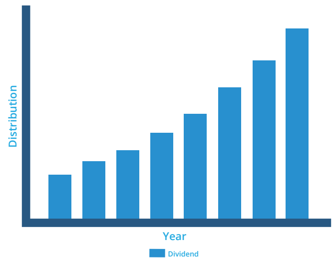
Introduction to Sector

As at the end of December 2018, the IA Global Equity Income sector comprised of 56 funds with combined assets in excess of £19bn. To meet the IA's sector requirements, funds must achieve a yield premium to that of the MSCI World index and allocate at least 80% of their assets to global equities. In practice, the sector includes funds which seek to deliver multiple outcomes, and is one that we would further categorise into three sub-groups; funds that seek to provide a yield in excess of the index (including enhanced income strategies), funds that seek to grow their dividend distributions over time and those which seek to provide a level of total return, when income is reinvested.

Yield in Excess of Index



Dividend Distribution



Total Returns

Sector Nuance

We would highlight that there are funds which, in our opinion, get misclassified and therefore should fall in/out of the sector. For example, one of the characteristics that Stuart Rhodes, manager of the M&G Global Dividend fund, looks for is companies with 10 years of consecutive dividend growth. However, the fund does not meet the IA Global Income sector's yield criteria, and therefore falls into the IA Global sector. Conversely, a number of infrastructure funds, for example, are included within the sector and investors need to be aware that such funds may be investing in niche areas of the market.

One must also be mindful that many of the managers in the sector are reliant on some form of quantitative screen within their processes to help narrow down the universe of companies. The global equity universe consists of a substantial number of stocks and how a fund manager attempts to cover such a universe is crucial to understanding how they intend to deliver their objectives. It does not follow that larger levels of resource, headcount for example, translate into superior returns. In addition, in-depth qualitative assessments are also often required to assess many of the non-numerical factors that could impact upon a company's ability to pay a dividend. Thus, active management is generally a preference within the sector, which is reflected by the low demand for and lack of availability of lower cost, higher yielding passive solutions.

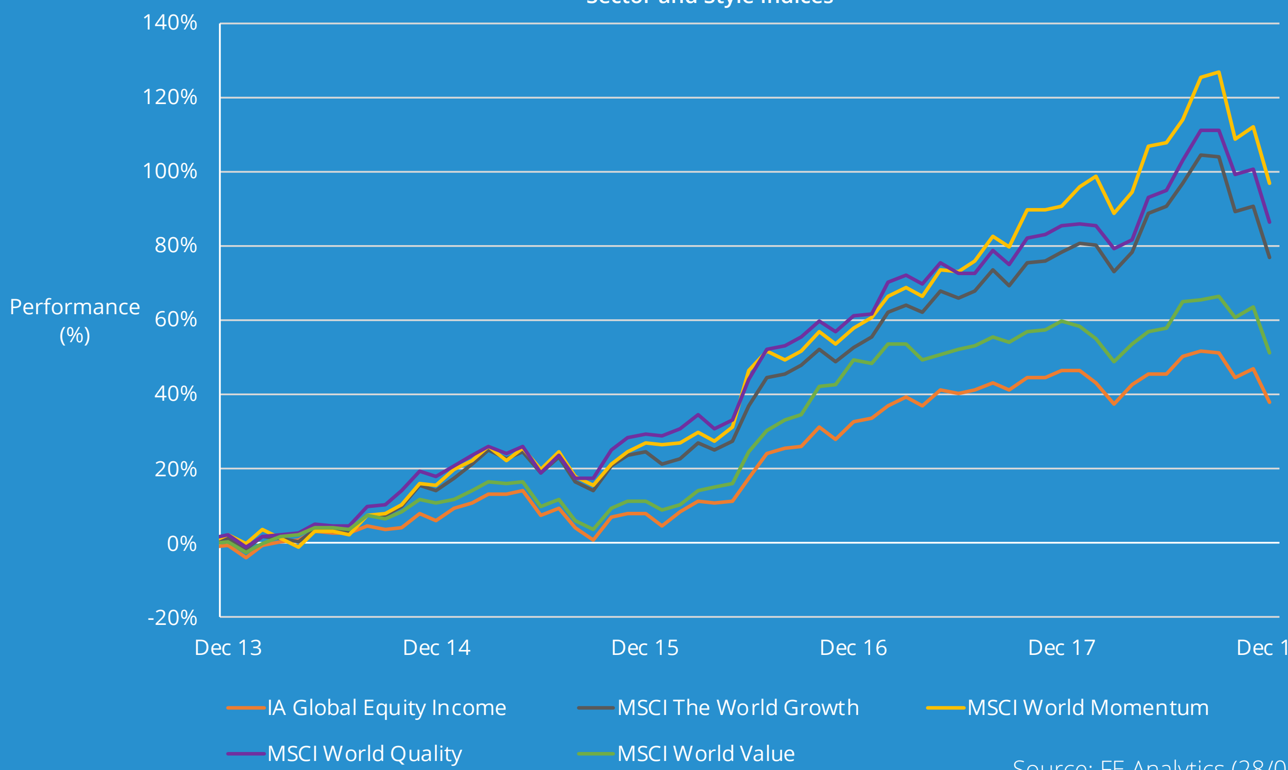
Recent Sector Performance

Broadly speaking, momentum, quality and growth investment styles have led global equity markets in recent years and more specifically, certain market sectors, for example the technology sector has dominated returns, where many of the underlying companies do not pay a dividend. Therefore, global equity income strategies, given the yield requirement, have lagged as they tend to be more "value" orientated by their very nature.

Although someway further up the risk-curve, the sector has also temporarily played host to bond investors in recent years, as yields available from fixed income markets have fallen shy of investor requirements. Companies with more predictable earnings streams and lucrative dividend policies have therefore benefited from this trend.

Outside of this specific instance, global equity income funds generally tend to come good in periods of market distress where they have historically offered both a superior level of downside protection and a reduced level of volatility, versus the mainstream Global Equity sector. For example, over the five year period ending 31st December 2018, the Global Equity Income sector had a maximum drawdown of -14.4% versus -17.1% of the IA Global sector.

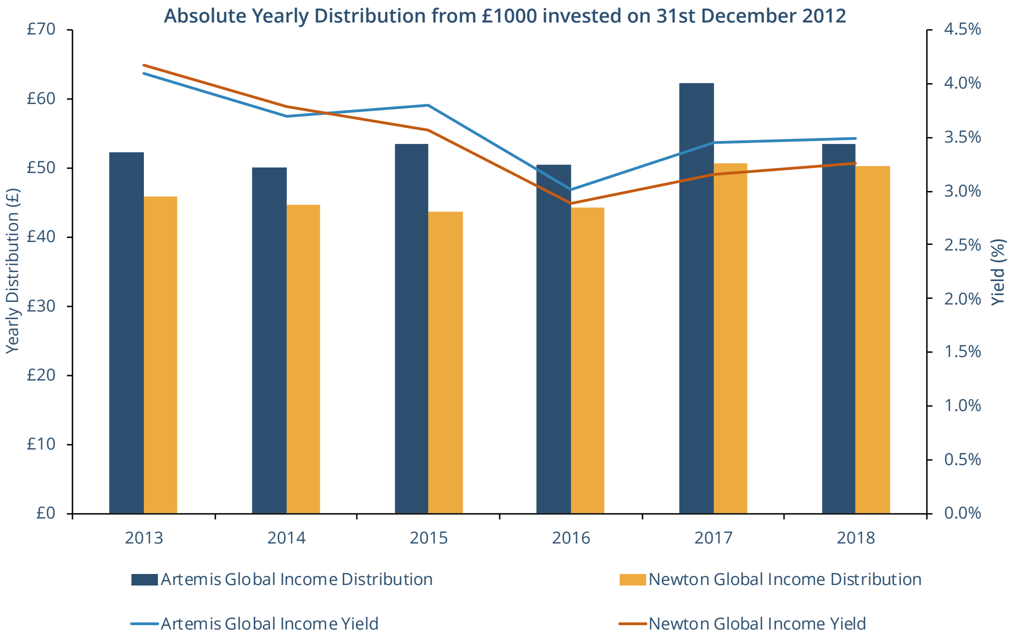
5 Year Cumliative Performance to 31st December 2018 for the IA Global Equity Income. Sector and Style Indices



Source: FE Analytics (28/01/19)

Funds in Focus

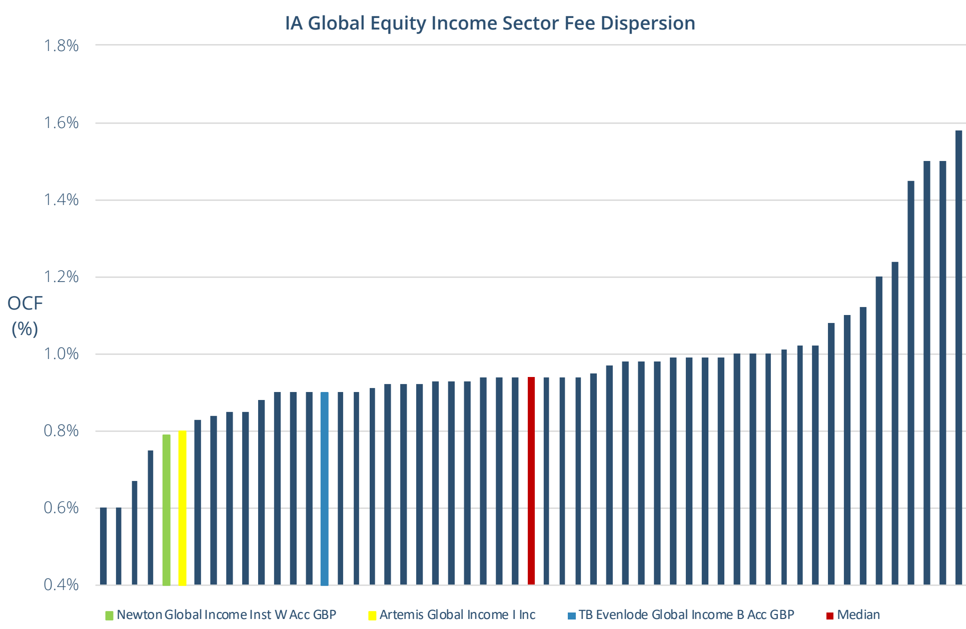
Although it is a fairly diverse sector, nearly half of its assets sit within two funds. Both, in our opinion, are run by credible managers who we hold in high regard. The largest is the Newton Global Income fund, which holds solid, blue chip companies with strong records of paying dividends. It benefits from Newton's thematic investment approach and draws upon ideas from the broader group. The fund can take meaningful positions away from its FTSE World benchmark and as a consequence, performance over shorter timeframes can be variable but we would expect this strategy to deliver attractive risk adjusted returns over the longer term.



Source: FE Analytics (28/01/19)

The second largest is the Artemis Global Income fund, which has a clear objective; to achieve around 5% dividend growth per annum and to outperform the MSCI AC World index on a total return basis, over the long term. The managers aim to achieve this by picking financially sound and attractively valued businesses within the context of the broader economic backdrop. The resultant portfolio offers a blend of well-known, traditionally high yielding stocks with those further down the market cap scale.

In contrast, a newer entrant into the market, but one that we believe has a promising future, is the TB Evenlode Global Income fund. It seeks to deliver mid-to-high single digit absolute returns over the long term, whilst also growing its annual dividend distribution in real terms. In order to achieve this, the managers invest in companies that can deliver sustainable growth with limited need for capital re-investment, and can therefore return cash back to shareholders by way of dividends.



Source: FE Analytics (28/01/19)

The ongoing charge figure (OCF) in the sector ranges from 0.6% to 1.6%. We would highlight that at the more expensive end of the range there are funds that invest in specialist areas, such as infrastructure, and so a premium fee may be warranted. In addition, investors seeking yield should be mindful that fees could be taken from income which would result in a reduced level of distribution.

Sector Outlook

In addition to the idiosyncratic risks that funds in this sector undertake, the current middle to late cycle macroeconomic backdrop is one where the most obvious and imminent risk to global equities is the impact of rising interest rates, particularly in the US where the Federal Reserve continues its gradual tightening programme. Companies with significant levels of debt may struggle in such an environment especially if they are unable to cope with increasing debt repayments. This is undoubtedly a period where actively managed strategies may add value in their assessment of future cash flows.

Other areas for concern include further trade tariffs in the US and the uncertainty of Brexit; both are largely in the hands of politicians and may have a significant impact on currencies. For example, a strengthening US dollar has historically been a natural headwind for emerging markets and a weak sterling would see the value of overseas investments increase for a UK based investor.

Global equities generally offer a limited amount of protection in market turmoil, but, an allocation to global equity income funds may be a more appropriate way to participate in markets for the more risk averse investor. In addition, the compounding effect of reinvesting dividends can be powerful and is one that has served investors well over the long term.

SQUARE MILE
INVESTMENT CONSULTING & RESEARCH