

Ian Williams on UK Income



(IA) UK Equity Income: Over three years

	3yr % chg	Rank	Vol monthly	Fund size (£m)	Morningstar rating™
Top 5					
BlackRock UK Income	37.95	1	2.75	383.65	★★★★
Troy Trojan Income	37.92	2	2.39	3,344.71	★★★★★
Franklin UK Equity Income	37.79	3	2.52	373.88	★★★★
Rathbone Income	35.85	4	2.40	1,403.26	★★★★
Jupiter Income Trust	35.37	5	2.57	2,347.88	★★★★
Bottom 5					
Vanguard FTSE UK Eq Inc	18.57	71	2.74	1,021.79	★★
Allianz UK Equity Income	18.25	72	2.54	67.35	★★
Neptune Quarterly Income	18.07	73	2.97	13.00	★★
Aberdeen UK Equity Income	17.95	74	2.81	180.45	★★
HSBC Income Accumulation	17.90	75	2.41	206.09	★★
SECTOR AVERAGE	27.62		2.65	775.57	

Performances calculated bid to bid, net income re-invested, GBP to 16/04/17. Source: © 2017 Morningstar.

As the UK economic cycle turns from deflation to inflation, yield-hungry investors face some challenging decisions to generate above-average income while protecting, let alone growing, their capital.

Their first big hurdle is global interest rates, led by the US, are on the rise again after a decade of declines. With the UK likely to be the next major economy to increase rates, all fixed income securities, and counter intuitive as it might sound in a rising inflation environment, index-linked gilts, are now at risk of incurring significant capital loss.

In contrast, blue-chip equities, with stable and growing dividends, offer a better solution for income investors. Yet many UK income funds appear indistinguishable from each other because they have crowded into similar equities and sectors en masse.

Such portfolios seem to be dominated by a relatively small group of familiar and often consumer-facing companies that have already had a great run but are unlikely to set the pace for further outperformance.

Exposure to cyclical sectors, in particular mining companies, remains relatively low even as a multi-year bull market gathers momentum in base and precious metals such as copper, iron ore and silver. The exception is likely to be energy as US shale producers increase output and productivity.

Bull Points

Rising inflation and higher interest rate expectations reduce attractions of fixed income securities

Dividend-paying cyclicals – such as miners and housebuilders – will outperform defensive and consumer stocks

Bear Points

Slower-than-expected economic growth and low inflation could dampen investor appetite for equities

A strong rally by sterling could take the shine off UK companies with high overseas earnings

Faced with new trends, income investors need to adopt more differentiated strategies to outperform.

Our long-cycle analysis suggests the best returns will come from overweighting cyclical sectors, including a high exposure to global miners, who stand to benefit from rising commodity prices, lower energy costs (a big component of their operating expenses), and the positive impact of industry rationalisation during the 2011-2016 downturn. As a result, mining sector cashflows are expected to soar and could fuel bumper shareholder returns.

Ian Williams is chairman and chief investment officer of Charteris Treasury Portfolio Managers