

# Ian Williams on UK Income



## (IA) UK Equity Income: Over three years

	3yr % chg	Rank	Vol monthly	Fund size (£m)	Morningstar rating™
<b>Top 5</b>					
MI Chelverton UK Equity Income	44.95	1	3.61	590.23	★★★★★
Man GLG UK Income Professional	44.08	2	3.04	352.84	★★★★
LF Miton UK Multi Cap Inc	39.14	3	2.27	1,034.49	★★★★★
UBS UK Equity Income	35.75	4	3.20	28.12	★★★
Unicorn UK Income	32.99	5	3.30	668.60	★★★★★
<b>Bottom 5</b>					
Rathbone Blue Chip Income And Gr	12.24	73	2.88	74.82	★★★
Threadneedle UK Equity Alpha Inc	12.14	74	2.62	751.53	★★★
LF Woodford Equity Income	10.97	75	2.81	7,579.33	★★
Fidelity Enhanced Income	8.24	76	2.33	442.78	★
Castlefield B.E.S.T. Sust Inc Instl	8.00	77	2.40	25.63	★
SECTOR AVERAGE	22.12		2.64	720.95	

Performances calculated bid to bid, net income re-invested, GBP to 04/02/18. Source: © 2018 Morningstar.

Last spring, I highlighted that UK equity income investors would require a differentiated strategy with a high exposure to cyclical sectors (in particular, blue-chip mining shares) to achieve sustainable returns while protecting their capital. As interest rates and inflation expectations continue to harden, this strategy still has much merit.

Since then, the UK equity income sector has experienced a number of shocks as several of the traditional safe haven stocks – such as Capita, GlaxoSmithKline, BT, Provident Financial, plus all the utility stocks – suffered significant losses that has cratered the performance of some well-known funds. The explanation for this is quite simple: all markets are cyclical in nature.

The key, therefore, is to attempt to determine where we are in respect of underlying primary market cycles. Our analysis shows that one of the most relevant cycles is the 10-year equity/commodity cycle, which is currently flagging up extreme cheapness in commodity-linked assets despite the strong rally in raw materials prices over the past year.

In contrast, traditional equity sectors favoured by many institutional investors have become expensive, with technology shares at the extreme end of overvaluation.

As markets react to this valuation gap, mining shares have topped the UK leaderboard over the past year or so. These trends have much further to run and as a result, investors should look to commodity-based investments for continued

## Bull Points

UK equity income sector remains attractive due to a significant yield premium over gilts

Well-capitalised cyclical stocks will outperform defensive and consumer stocks due to stronger growth prospects

## Bear Points

10-year equity market cycle shows stockmarket as being vulnerable to a correction

Slower than expected economic growth could make equities a less attractive asset class

outperformance. Furthermore, prospective dividend yields on stocks such as Rio Tinto and BHP Billiton are still high, and these companies have the ability to massively increase dividends should the price of their products (such as copper or zinc) continue to rise. For example, copper is already in a structural supply deficit that will be exacerbated by growing demand for electric cars, which consume four times more copper than traditional vehicles.

However, UK blue chips still enjoy a significant yield premium over gilts. Until gilt yields hit about 4%, investors should look to companies offering strong cashflows and rising dividends.

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