SHINING A LIGHT ON……
SCHRODER INCOME FUND

Update….

In a market awash with UK Income Funds how does an investor search out something that is a little different and has the potential to outperform over the long term. Naturally investors will gravitate to the big names like Artemis, Invesco and Woodford but these tend to focus on similar stocks which some argue are overvalued and offer very little in growth opportunities moving forward. (These managers would of course argue differently).

We have highlighted some alternatives and the Schroder Income Fund is another option to consider. Performance over the last five years hasn't necessarily been something to shout about but long term it has a good track record. Providing some background to the fund the co-fund manager Nick Kirrage explained that they manage a number of strategies from income to growth with a focus on the UK and globally but in all cases the philosophy is the same with a focus on value.

The argument is that the lower the P/E ratio the greater the chance of higher returns in the future, i.e. what you pay, not the growth you get, is the biggest driver of future returns. The challenge is that investors don't want to invest when the price is low and prefer to invest when everything seems to be going well. Effectively it is a lonely world investing where this fund goes but it is their belief, and through evidence of past investing, this is where the best returns will come from.

So the scary, cheap unloved areas include basic resources, food and drug retail, insurance, and utilities whereas expensive includes chemicals, financial services, food and beverage, tobacco, homebuilders and technology. The later are seen as stable but many are the most expensive they have been for 40 years and this is where most income funds are focused. Nick believes to some extent these are "Value" traps as there really is nowhere for them to go.

Whereas focusing on low valuations you have companies and opportunities. You can find companies prepared to evolve and not sit, wait and die and it is these that he wants to add to the fund. He added that the value sectors are offering more opportunities at the moment than growth. If you take the expensive sectors like tobacco and staples there is nothing that is cheap, everything is expensive. On the other side with cheap stocks everything is cheap in say commodities and this is where opportunities will be found.

Digging deep Nick added that the FTSE 100 yield average is 3.5% and currently we are sat around this average but in early 2000 about 70% of the market delivered this, this is now about 25% which means a few very big companies are effectively propping up the market. Some of these have started to cut dividends and therefore the number of companies that managers can turn to is shrinking creating greater concentration risk. He added that some of these income companies are seeing more money pour in via these big income funds and it comes back to the "value" trap whereby this flow of money could be propping up the share price.

A great hunting ground for Nick and his team is when the market starts to downgrade the share price because it believes the dividend is going to be cut. Evidence shows that these stocks tend to do well over the preceding two years and were dividends have been cut to zero or in half it is easier for them to grow this in the future. The fund doesn't like to hold zero producing ex dividend stocks but will have some exposure.

To further illustrate Nick explained that the income paid out on the fund has increased by 6% p.a. over the last 28 years. The divided was cut in 2010 but has compounded by 10% p.a. since then but he expects that to slow to closer to the average moving forward.

In the recent volatility he has added to Barclays, BP, Lloyds, Home Retail and Staples and reduced weightings to the likes of BT and BAE. He has also reduced weightings to Anglo American which they purchased at £3 and has now gone to over £8. They have taken some of the profits because of the rapid correction in the share price and if it falls back they can buy more.

The fund will not work at all times and Nick added that investors need to have a patient long-term investment approach. Due to the nature of the holdings it can be more volatile than some other funds as these stocks can fall out of favour more often as they build their road to recovery. Over a five to ten-year period Nick believes investors will be rewarded for this style of investment.

In summary, for investors who are patient and prepared to wait then this is certainly a fund to consider. However, the periods of underperformance will test investors and this an important consideration when investing in this fund. It can act as a standalone investment or a blend.

Fund performance

Performance from 2011 to 28 April 2016:

	2011	**2012**	**2013**	**2014**	**2015**	**2016**
Schroder Income Fund	-7.96%	25.83%	33.05%	4.52%	-6.95%	7.77%
iShares UK Dividend ETF	-6.62%	17.46%	24.15%	6.54%	0.95%	1.58%

Performance over 12 months, 3 years, 5 years and 10 years

	12 months	3 years	5 Years	10 Years
Schroder Income Fund	-6.78%	21.97%	53.32%	128.85%
iShares UK Dividend ETF	-8.66%	21.12%	44.31%	47.89%

You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

The source of information in this note has been provided by Schroder and is correct as at April 2016. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision.