SHINING A LIGHT ON……
SLI UK EQUITY INCOME UNCONSTRAINED FUND

At a glance

There are over 400 UK Equity Growth and Income Funds; providing investors with access to many different investment styles. So choosing the right fund depends upon understanding their methods and aims.

Performance is part of the equation but equally the management team is crucial. We have met a number of talented Fund Managers, the likes of Standard Life Investments, Neptune, Schroders, Legal and General, Threadneedle and Liontrust (not all of these are in our portfolios).

One fund we have used, and followed the manager for some time, is the SLI UK Equity Unconstrained Fund. There are a plethora of UK Equity Income Funds and many have similar holdings and in reality have done no better than a fund that tracks the index over the last three years (although they have started to pull away over a 5 year time frame).

For us we wanted to find a manager who didn't follow the crowd and offered something different but equally we wanted someone that was risk aware and didn't take outsized bets to achieve returns.

The SLI Fund is one of the funds we found which we like. The manager has been at the helm for 6 years and has delivered significant outperformance (191.86% vs the Index of 119.51% since assuming stewardship of the fund on the 1 January 2009*). In this update we wanted to share his approach to investing.

**Note: Past performance is no guarantee to future performance and investments can fall as well as rise.*

Who are the team behind the fund?

Thomas Moore has managed the fund for six years and has a string of awards and is well respected in the industry. Since his appointment he has outperformed the peer group 69% of the time with the majority of his outperformance coming in a rising market.

Although this is his fund, Standard Life have an approach where the team is as important as the manager and he has input across the company including 11 UK large company specialists and 5 UK smaller company specialists.

In addition to managing this fund he also manages the Standard Life Equity Income Trust and is the main analysis for Banks and the Financial Services Sector.

Fund highlights?

It is worth highlighting that the fund may differ from some more cautiously managed funds. Some of the key differences are:

1. Nearly 60% of the portfolio is currently invested in small and mid-cap stocks
2. Volatility is currently around 14.81% (to compare the Rathbones Income Fund has volatility around 9.04%)

Balancing this is that the performance is significantly above the index and the yield is currently 3.54% p.a.

This fund can work in two ways for investors either a growth fund (where income is reinvested) or as an income fund perhaps against a less volatile income fund.

The two areas of focus for Tom are improving earnings and multiples but key to this is total return rather than focusing just on dividend yield. This is made up of three factors; dividend yield, dividend growth and capital growth. How he looks to maximise growth is through conviction, multi cap investing and diversification.

Tom went onto to explain using two stocks, GlaxoSmithKline (which he doesn't hold) and BT (which he does). The dividend yield between the two since he purchased BT has been about the same but the key difference is the share price which is flat with Glaxo and BT up over 100%. The point is that many large caps have weak underlying fundamentals and it is these companies he looks to avoid but equally there are strong ones like BT (which he will focus on).

Most UK Income Funds will hold AstraZeneca, Royal Dutch Shell, GlaxoSmithKline, HSBC, BP, Imperial Tobacco, BT, Vodafone, BAE Systems and BAT. This fund only has exposure to four of these stocks. Taking it further the index tends to have an 81% weighting to the FTSE100 this fund has around 40% exposure, with 44.9% in the FTSE250 compare to the index which is 15%. Tom explained that this is important because the dividends between the two is different where the average from the FTSE100 is around 4.6% whereas the FTSE250 is higher at 6.7%.

One area that Tom believes that the fund benefits from is the focus on the UK. He believes as the UK consumer spending improves companies with a domestic focus will benefit. Currently 48% of the fund is UK Focused.

Sectors he likes are support services (the likes is WS Atkins) and Financials (the likes of Close Brothers). Areas he remains underweight are Oil and Gas, Pharmaceuticals and BioTech, Banks, Mining and Tobacco. The highest weighting in the fund is BT at 4.3%.

Of the top ten main FTSE 100 dividend payers the fund has just 11% exposure to these holdings – as a comparison the new Woodford Fund has nearly 40% exposure to these holdings and Invesco Income Fund nearly 30%.

In summary this is a well-managed fund with an excellent track record. Unconstrained doesn't mean it is risky but it means that the manager doesn't conform to the benchmark meaning this is a multi-cap fund seeking opportunities for income and growth. Because the holdings tend to focus away from the key holdings of many income funds this could act as a blend to other funds or it could act as a blend with UK growth funds. It is more volatile than some income funds and this may deter investors looking for income to using it as there only UK income exposure.

Fund performance

Performance over the previous five years is shown below (comparing to IP Income Fund, Rathbone Income Fund and iShares UK Dividend ETF).

	2009	2010	2011	2012	2013	2014	Yield	5 years
Rathbone Income Fund	24.18%	19.28%	0.33%	15.48%	24.45%	6.98%	3.60%	89.97%
IP Income Fund	11.08%	10.78%	9.07%	8.14%	26.75%	10.48%	3.39%	89.97%
SLI UK Equity Income Unconstrained Fund	43.18%	24.00%	-9.45%	24.16%	37.83%	6.09%	3.54%	108.02%
iShares UK Dividend	32.63%	13.24%	-6.62%	17.46%	24.15%	7.24%	4.30%	73.59%

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. Returns are based on the US share class.

Conclusion

Since assuming management of the fund Thomas has delivered strong outperformance based on his unconstrained approach to investing. Its portfolio make up is likely to differ from many UK income funds but it will also be more volatile. It may not appeal as a standalone fund but it could act as a blend either with another income fund or a pure growth fund.

The source of information in this note has been provided by SLI and is correct as at December 2014. 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. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well rise.