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Investment
Top performers

Fund Focus

"We are prepared to go against the grain"

Robin Hepworth, manager of the Ecclesiastical Higher Income fund, tells ***Maria Merricks*** where he is finding the holy grail of undervalued income opportunities

1 What has driven the fund's outperformance over five years?

We take a long-term view and seek out companies with sound financials, good management, growth prospects and the potential to generate a strong and consistent cash flow. Often, we find this calls for a contrarian approach and are prepared to go against the grain when it comes to investment decisions.

Getting the allocation right between equities and fixed income has been crucial for this fund. For example, within fixed income, our higher allocation to corporates over government bonds has worked particularly well over the last few years.

Our consistent and robust investment process is the driving force behind our strong track record and the main factor that supports our ideas generation.

The fund's investment process and objectives have been reflected by its move from the UK Equity and Bond Income sector to the Mixed Investment 40-85% Shares sector in January 2013.

This move was designed to support the continuing strong performance and growth of the fund, and to take further advantage of increased equity yields overseas, particularly in the Far East and Europe.

2 Does this mean you are currently finding better equity income opportunities abroad?

The increased exposure to overseas markets allows us to diversify away from the UK economy but we are significantly underweight US equities, which we believe to be very overvalued right now.

In my experience, there are equity income opportunities both at home and abroad and we are actively pursuing these. Specifically, however, we think Asian equity markets are very undervalued and there are opportunities for all investors, including ones with income mandates. Asian equities have de-rated over the past three years but the region's fundamentals remain sound and valuations are compelling.

66%
Proportion of the fund currently allocated to equities

3 Where else are you finding good value income opportunities?

We also like UK building society permanent interest bearing shares (PIBS) as we think there is value and attractive yield here for investors.

Another area we are seeing value at the moment is in property and we have been financing a move into this sector over the past few months. This has been achieved through exiting our small- and mid-cap holdings, including Dixons, John Menzies and a number of overseas holdings, such as Singapore company SIA Engineering.

4 Financials make up over half of the fund's equity exposure. How are you positioned there?

Financials is our largest equity sector weighting, with exposure split fairly evenly between banks, insurers, REITs and investment trusts. What differentiates us from our peers is that we are less exposed to Western banks, preferring to hold their better capitalised Asian counterparts, which we believe have stronger growth outlooks.

5 What is your outlook for UK dividend growth over the next 12 months?

Overall, we maintain a positive outlook for UK dividend growth over the next 12 months of around a 3% to 4% rise. The fund itself is on course to see its income distribution grow by an estimated 7% to 8% in 2014, compared with the previous year's distribution.

In terms of positioning, we remain comfortable in holding PIBS and preference shares, as they have done well over the last six months, with many still offering a yield of 5% or 6%. We are also preparing the portfolio for a potential rise in interest rates by gradually increasing our equity exposure.

6 What are the key criteria you look for in an investment?

Companies with solid long-term track records over more than one business cycle have the ability to survive and prosper amid economic upheaval. They are also often candidates for sustainable dividend growth.

Alongside this, an important part of our analysis is of a company's ESG factors, as these help us to assess the long-term risks it might be facing. We are increasingly seeing companies able to monetise the return on ESG initiatives. For example, reducing the carbon footprint through energy efficiency or renewable energy can reflect in a positive impact on their bottom line.

An example of a recent purchase by us is the Picton Property trust, which invests in real estate assets across the UK. Picton's portfolio is very well diversified both geographically and by sector. The outlook for the sector is positive and valuations are attractive. Vacancy levels are falling, due to a limited supply of new developments, and, despite rental values falling sharply following the crisis, a pick-up in demand has seen them return to positive growth. Picton offered a 5% yield at the time of the placing and the valuation remains attractive relative to sector peers.

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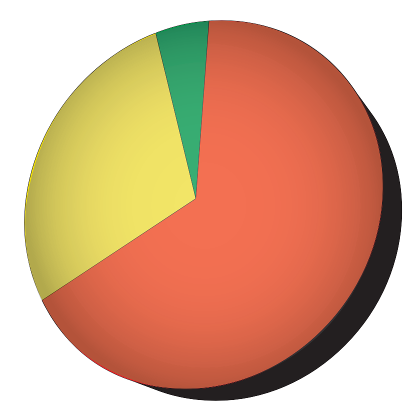
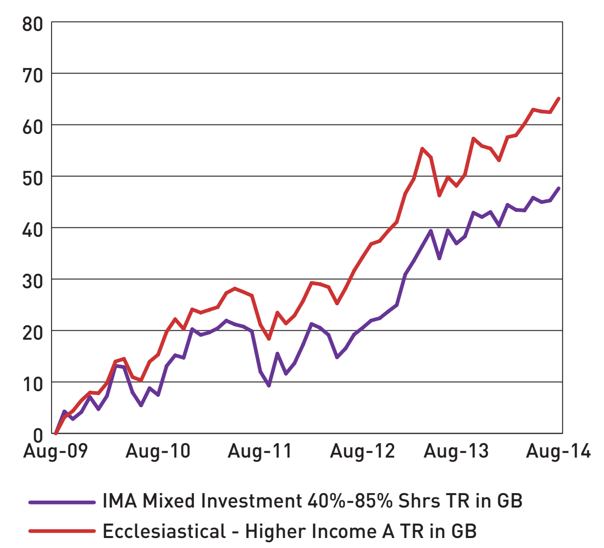
Fund facts: Ecclesiastical Higher Income

Fund size: £276.1m
Launch date: November 1994
IMA sector: Mixed Investment 40-85% Shares
Min initial investment: £200; additional: £200
Initial charge: 5%
Annual charge: 1.25%



Percentage growth return over five years



Source: FE Analytics

The CV: Robin Hepworth


Robin Hepworth

Robin Hepworth joined Ecclesiastical as general investment analyst in 1988. He was appointed manager of the Pension fund in 1990 and the Higher Income fund in 1994. He has managed the Amity International fund since its launch in 1999 and also co-manages the Amity Sterling Bond fund with Chris Hiorns.

Ecclesiastical

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