Peter Elston: Investment Letter

Issue 25: June 2017

This document is intended for professional investors only

Data as at 31.05.2017

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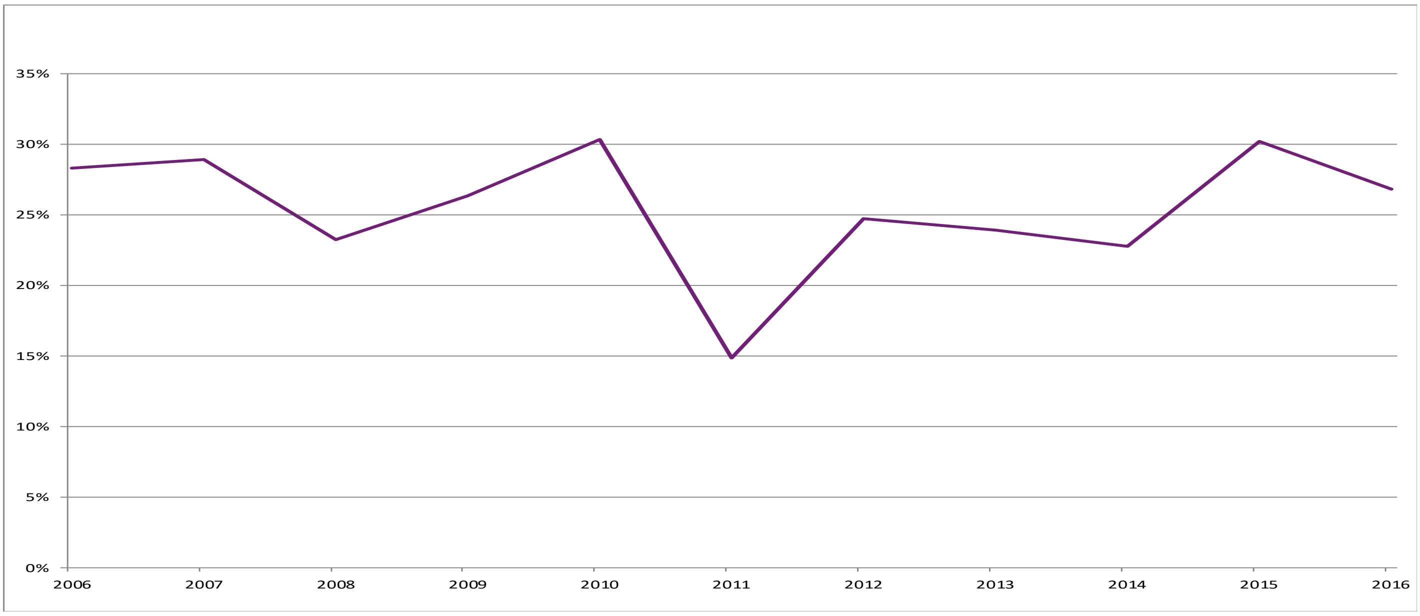
Beware dividend concentration among UK large caps

Much has been written about dividend concentration among UK large caps of late. According to a recent article[1] in Investment Week, more than half of the 79 funds in the Investment Association's UK Equity Income sector derived over 40% of their income from their largest ten holdings. Furthermore, according to an article in Money Observer,[2] half of FTSE 100 dividends this year will come from just seven companies. These figures reflect extreme concentration risk and should be a concern for investors in UK large cap income funds.

That said, although dividend concentration may have increased somewhat in recent years, it is not particularly out of line with history. According to our analysis, dividend concentration was lower in 2016 than in 2006, 2007 and 2010. This can be seen in the chart below.

Chart 1: % Decrease in yield when top 10 dividend payers taken out of top 100



1 https://www.investmentweek.co.uk/investment-week/analysis/3007907/how-concerned-should-investors-be-about-dividend-concentration-risk
2 http://www.moneyobserver.com/our-analysis/half-ftse-100-dividends-to-come-just-seven-companies-2017

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Multi-Asset Value Investing

But fear not, help is close at hand. Venture into the mid cap space, and you can find plenty of decent yielding stocks. According to an April article in Investors Chronicle[1], "Analysis of the FTSE 350 reveals 117 companies with a trailing yield over 3.5 per cent, and even if we tighten up our selection criteria to those with strong cover of at least two times and PE below 13, we are left with 35 companies that pay a healthy dividend."

In the UK equity segment of our multi-asset funds, we have a focus on mid caps. This is principally because over time mid caps tend to perform better than large caps, both in terms of returns as well as volatility-adjusted returns (since 1998, the FTSE 250 index has beaten the FTSE 100 index by 5%pts per annum).

But this is not the only reason. Mid caps are under-researched, so stock picking opportunities abound. Furthermore, as mentioned, you can find decent yields in the mid cap sector.

Our UK stocks, most of which are mid caps, on average yield 4.3% compared with 3.0% for mid caps in general. You may think we are sacrificing dividend cover but this is not the case. Average coverage for our stocks on a forward looking basis is 1.9 times compared with 2.1 times for the mid cap universe (and with 1.6 times for large caps!) Nor are we sacrificing quality: our return on equity is 21.4% on average compared with 13.8%.

According to Trustnet, the median fund yield in the IA UK Equity Income sector at the end of May was 3.9%. Furthermore, the median FE Risk Score for the sector was 85 (this means that on average, the volatility of funds in the sector was equivalent to 85% that of the FTSE 100 index). Finally, the median two-year fund performance was 13.8%.

A search for income does not need to be confined to the UK Equity Income sector though. Comparing these numbers with those of our CF Seneca Diversified Income Fund reveals some interesting results. Our fund yields 4.7% versus the median income yield of 3.9% for the IA UK equity income sector. Ah, but that's because it is sacrificing total return, I hear you say. Not true. Two year total return has been 16.6% versus 13.8%. In that case it must be because the fund is more volatile. Again, no. The fund's FE Risk Score is 43 half that of the UK Equity Income sector average!

The merits of a multi-asset approach in general and of our fund in particular are, we think, obvious.

1 http://www.investorschronicle.co.uk/2011/09/09/the-best-dividend-payers-OC7nBGwijAvjAVCwzyQNbL/article.html

Current fund targets

The target weights in the table below are where funds should be positioned currently. Actual positions may deviate slightly from these target weights as a result of market movements or ongoing trades for example.

Table 1: Current fund tactical asset allocation (TAA) target weights as of 31 May 2017 (prior issued letter's targets in brackets)

TAA target Weights (%) (prior month's targets in brackets)		OEICs		Investment Trust
		CF Seneca Diversified Income Fund	CF Seneca Diversified Growth Fund	Seneca Global Income & Growth Trust plc
Equities	UK	25.5 (25.5)	23.0 (23.0)	33.0 (33.0)
	North America	0.0 (0.0)	4.0 (4.0)	1.5 (1.5)
	Europe ex UK	6.0 (6.0)	9.0 (9.0)	8.0 (8.0)
	Japan	1.0 (1.0)	8.0 (8.0)	4.5 (4.5)
	Asia Pacific ex Japan	5.5 (5.5)	10.5 (10.5)	9.5 (9.5)
	Emerging Markets	1.0 (1.0)	4.5 (4.5)	3.0 (3.0)
	Global Funds	2.0 (2.0)	2.0 (2.0)	1.5 (1.5)
	Equities Subtotal	**41.0 (41.0)**	**61.0 (61.0)**	**61.0 (61.0)**
Fixed income	DM Government	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)
	EM Debt	5.0 (5.0)	2.0 (2.0)	1.9 (1.9)
	Corporate	26.2 (26.2)	8.0 (8.0)	6.3 (6.3)
	Fixed income Subtotal	**31.2 (31.2)**	**10.0 (10.0)**	**8.2 (8.2)**
Specialist assets*	Property	**6.7** (5.5)	**6.7** (5.5)	**7.0** (5.8)
	Private equity	4.0 (4.0)	4.5 (4.5)	5.4 (5.4)
	Specialist financial	**10.2** (9.3)	**9.0** (8.1)	**10.1**(10.2)
	Infrastructure	**5.3** (5.0)	**5.0** (4.7)	**5.7** (5.4)
	Specialist Subtotal	**26.2 (23.8)**	**25.2 (22.8)**	**29.2 (26.8)**
Cash		**1.6**(4.0)	**3.8** (6.2)	**1.6** (4.0)
Total		100.0	100.0	100.0

Source: Seneca Investment Managers, 31 May 2017

* Target weights for the specialist assets subsectors are the aggregate of holding level targets as top down driven asset allocation targets are not applied to this sector.

Increased *Decreased*

General

- Specialist Assets was increased by 1.2%pts to accommodate new holding (see below). This increase came out of cash.
- Sterling fell as opinion polls showed the gap between Conservatives and Labour narrowing
- It was broadly a good month for equities, though in the UK mid caps lagged large caps, reversing April's gains
- Employment and inflation data across the world in general continued to improve
- Very good results from Intermediate Capital, which included a 17% increase in the total ordinary dividend.
- Increased prospect of a special dividend from Victrex, following very strong cash generation in the first half of the company's financial year.
- A review of the CouplandCardiff Japan Income & Growth Trust during the month highlighted the attractions of the portfolio, with its bias towards smaller companies and focus on dividend growth.
- European Assets Trust performed well, driven by its large exposure to the industrial sector.
- We invested in PRS REIT which launched with a successful IPO. The REIT will build a portfolio of newly built private rental properties and benefit from significant economies of scale.
- We participated in the additional equity raise of International Public Partnerships, the listed infrastructure vehicle. The team have a proven track record, high quality operational assets and inflation protected income.

SDIF

- Small additional investment in Muzinich Short Duration High Yield Bond Fund

SIGT

- Additions were made to the Cullen North American High Dividend Value Equity Fund, Invesco Perpetual European Equity Income Fund and Magna Emerging Markets Dividend Fund.
- European Assets Trust was reduced, in order to bring position to target weight.
- Small increase in Royal London Short Duration Global High Yield Bond Fund
- We added to the holding of RM Secured Direct Lending as the team has constructed a good quality secured loan portfolio with solid asset backing.