



TOP PERFORMING EQUITY INCOME FUNDS: SPOT THE DIFFERENCE

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The 'hunt for income' has been a theme institutional investors have been battling with since record low interest rates have seen the continued erosion of lucrative yields.

As investors struggle to find sustainable sources of income, some are turning to the obvious choices of "income funds" and "high yield" strategies. Many asset managers have tried to capitalise on this approach by launching a growing number of these types of investments across multiple asset classes. In fact, over 880 different equity income-oriented funds now exist across the globe, making up assets of over £600bn (source: Lipper as at 31 March 2018).

Investors, however, need to be sure when choosing a "high income" or "high yield" strategy that promised income is inherent in a fund's exposure due to genuine style positioning, rather than a result of mere marketing or a promising fund name. It is imperative that investors obtain the complete story behind what they are buying so as to differentiate between real substance and insignificant noise.

ANALYSING THE PEER GROUP OF EUROPEAN INCOME FUNDS

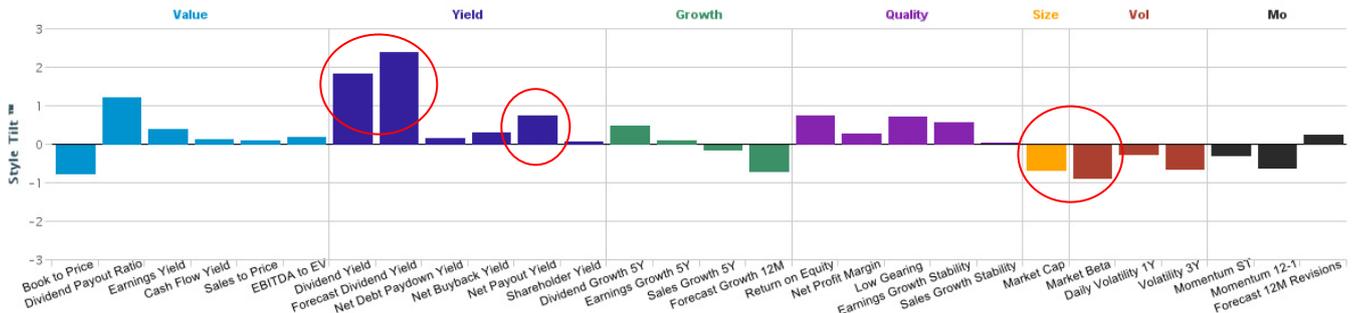
By using Style Analytics Peer Insights™, a holdings-based factor analysis software, we can understand not only the style exposures of an entire universe of peer funds but, crucially, also select individual funds and compare them to each other, alongside the desired peer group. This kind of comparison uses objective, factor-based analysis to achieve genuine transparency and unbiased insights into different strategies of a desired universe.

For the purposes of this paper we used Peer Insights™ to analyse Morningstar’s European Income Funds peer group, which comprises 74 funds (as at end December 2017). We were then able to examine some of the top performing European Equity Income funds over 12 months ending December 2017.

By viewing this data through a “factor lens”, we revealed the median factor exposures of this peer universe versus the FTSE All World Europe Index (Figure 1). This showed a strong peer group bias towards higher dividend yield (both current and forecast), a higher net pay-out yield, and lower market size and beta.

FIGURE 1

STYLE SKYLINE™ MEDIAN CASA*



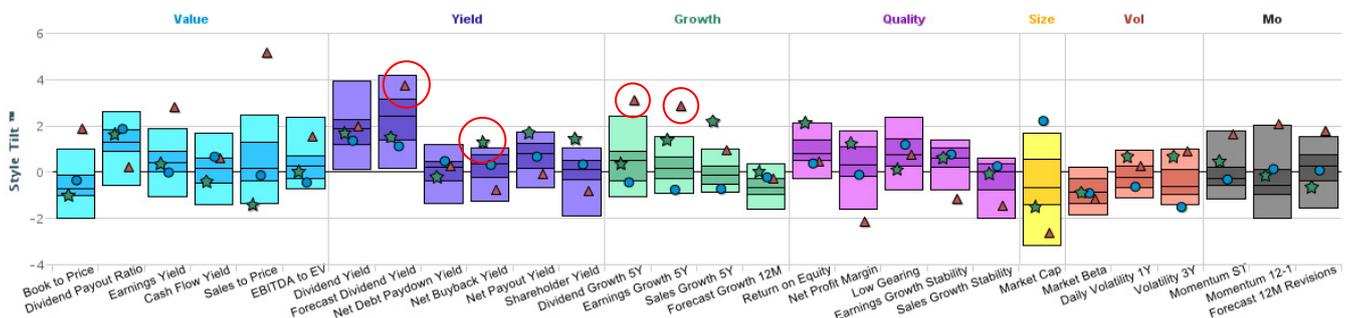
Peer Group: EU – Europe – Equity Income (74)
 Benchmark: FTSE All World Europe
 Analysis Date: 31/Dec/2017

“This revealing analysis raises new questions when it comes to making the right choice to fit with your investment objectives.”

A closer analysis of the peer group (Figure 2) showed differences across the range of various factor exposures, particularly in the yield factor category. Funds in the peer group had a bias towards stocks that already had an attractive dividend yield and forecasted dividend yield - as one might have expected. Other exposures revealed that most of the funds in the peer group lean towards smaller market cap holdings and had little bias towards high quality stocks, which might come as a surprise since quality and yield often go hand in hand.

FIGURE 2

PEER STYLE SKYLINE™ CASA*



- ▲ *Hi-DividendenPlus Europa-Fonds*
- *CS MACS European Dividend Value*
- ★ *M&G Pan European Dividend Fund*

Peer Group: EU – Europe – Equity Income (74)
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We then drilled down further into the data and examined some of the top performing income funds within this universe, including **Helaba Invest-DividendenPlus Europa-Fonds**, **M&G Pan European Dividend Fund** and **Credit Suisse European Dividend Value fund**.

Examining the style positioning of these top-performing funds, it was interesting to note that the exposures to yield were completely different. The **Helaba Invest-DividendenPlus Europa-Fonds** stood out with a significant positive bias towards holdings with a high forecasted dividend yield. Meanwhile, the **M&G Pan European Dividend Fund** showed a strong peer-group average bias to stocks with high net buyback yield, net pay-out yield and shareholder yield, whereas the Helaba fund had little exposure (circled in Figure 2). Concurrently, the Credit Suisse fund was relatively neutral versus peers on all yield factors.

“Investors need to obtain the complete story behind the fund they are buying so as to differentiate between real substance and insignificant noise.”

In conclusion, although these funds belong to the same Equity Income peer group, they had markedly different exposures not only in the yield category, but also across other commonly considered factor styles. For example when looking at the growth category, the Helaba Invest fund had strong positive biases to stocks with certain factor exposures (dividend growth and earnings growth,- circled in Figure 2), whilst the M&G fund was closer to the peer average, and the Credit Suisse fund displayed a negative skew away from these same exposures. This can also be observed when looking at value and quality factors; where one fund might have a neutral position, the others could be skewed negatively or positively to the same factor.

It is useful to be aware of these exposures when choosing an income fund, as although it may be tempting to go for a top-performing fund in a vast peer group, these different levels of factor exposures can have a significant impact on risk and performance - an important consideration when trying to achieve certain investment objectives.

What we were also able to see was the long-term historic exposure to certain desirable factors, which can help demonstrate consistency of the fund’s investment style. Analysing the M&G fund (Figure 2), we can see that it was quite negatively skewed towards value, but favoured several growth and quality factors. It had a top quartile position in 5-year growth for both earnings and sales, as well as return on equity and net profit margin. In order to demonstrate this had been consistent over time, Peer Insights™ revealed a historic tilt towards net profit margin and 5-year growth in earnings for the three years to end December 2017 (Figures 3 and 4), which indeed suggests an increase towards these quality and growth factors over a certain period of time.

FIGURE 3

NET PROFIT MARGIN CASA*

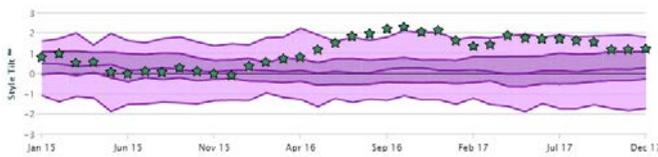
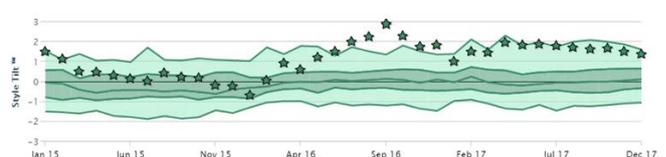


FIGURE 4

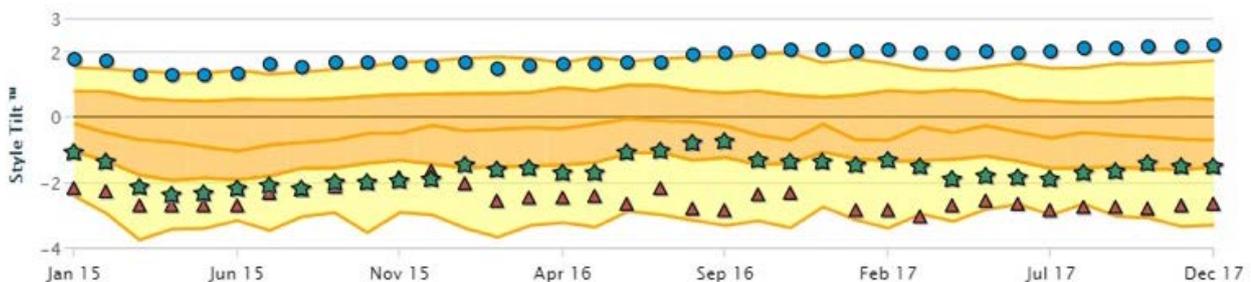
EARNINGS GROWTH 5Y CASA*



By looking at the market cap exposure, we can likewise observe that the Credit Suisse fund had the strongest bias towards large cap stocks of the three top performing funds, whereas this same fund was neutral on most other factors including value, growth and quality. We can view the differences in market cap exposures over time, showing us that the other two funds were consistently in the bottom quartile of the peer group based on market capitalisation, particularly the Helaba fund (Figure 5).

FIGURE 5

MARKET CAP CASA*

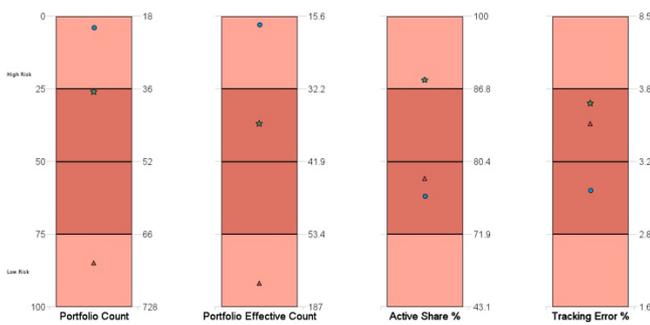


BEYOND FACTORS

So far we have focused on analysing and comparing style factors. However, with Peer Insights™ we are also able to analyse the risk profiles of each fund (Figures 6 and 7) and begin to determine significant differences in terms of portfolio stock concentration and active share, whilst showing close to peer-average predicted tracking errors. Although the Credit Suisse fund had the highest stock concentration, its predicted tracking error was typical for this peer group. The M&G fund had high active share and the highest predicted risk versus the other two funds. In addition, the three funds exhibited differences in terms of their sector biases. For example, Helaba was overweight in Consumer Services and Financials, which corresponds to the two sectors where Credit Suisse came in underweight.

FIGURE 6

PORTFOLIO RISK RANK

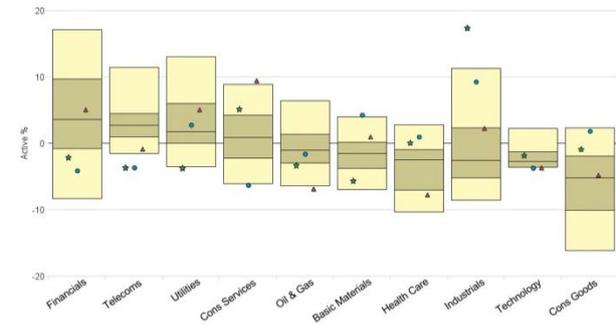


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FIGURE 7

PEER SECTOR DISTRIBUTION ACTIVE WEIGHT



- ▲ Hi-DividendenPlus Europa-Fonds
- CS MACS European Dividend Value
- ★ M&G Pan European Dividend Fund

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ONE PEER GROUP. THREE VERY DIFFERENT FUNDS.

What we learnt by conducting an independent, factor-based analysis of Morningstar's European Income Funds peer group using Style Analytics Peer Insights™, was that there were significant differences in factor exposures that could be bought into, in addition to either high income or yield. Having looked at the top three performing funds, which all had exposure to yield, we also noted that each had a different overall exposure to some of the most commonly recognised industry factor styles.

This revealing analysis raises new questions when it comes to making the right choice to fit with your investment objectives. In addition to yield, are you willing to take on a fund with exposures to other factors that had the potential to significantly impact your objectives? Does it matter where the yield is coming from, whether quality, growth, value or size?

Using detailed factor analysis to examine and compare individual funds, one can begin to see a clear comparison between similar types of funds and larger peer groups. This helps investors gain a true understanding of what exposures they might be buying, without the biases that might come from asset managers' tools used to analyse performance and exposures.

Given the sheer range and volume of product options in today's investment universe, as well as the confusing, competing product messages and data that institutional investors must interpret, undergoing a factor analysis should entail a fundamental step in fund selection. To uncover potential blind spots, investors need the ability to assess funds via a factor-based framework allowing them to focus on the substance, rather than the noise.

NOTES

**CASA: Country and Sector Adjusted measures help understand whether there are genuine style orientations or whether tilts are mostly due to sector or country characteristics.*

**Style tilts: The Style Research Portfolio Style Skyline™ shows a portfolio's exposure to investment factor styles relative to a benchmark. The larger the difference versus the benchmark 0 line, the more significant the exposure. In addition to revealing differences in exposures to fundamental investment factors, these style tilts are also designed to provide direct comparisons of benchmark-relative style orientation between portfolios.*

DISCLAIMER

The content of this whitepaper is not intended as investment advice and does not constitute recommendations or endorsements of any issuer or security. The information provided is to be used as an illustration for knowledge purposes. All facts and data shared are accurate to the best of our knowledge. Unless otherwise stated, all data is at 31 December 2017. Past performance is not a guide to future results.

ABOUT STYLE ANALYTICS

Style Analytics is an independent, global software provider for investment professionals. We enable asset owners, consultant and asset managers to build objective and comprehensive factor analysis on markets, portfolios and peer groups.

By creating transparency through factor exposures - the systematic drivers of portfolio risk and return - we help investment professionals validate and make strong investment decisions.

Previously known as Style Research, Style Analytics has over 20 years' experience in factor analysis and serves over 280 investment institutions across 30 countries. Our breadth and depth of industry knowledge and expertise continues to bring superior tools and innovations to support our clients.

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