

# Standard Life Equity Income Trust

## Multi-cap portfolio building a strong record

Standard Life Equity Income Trust (SLET) follows an unconstrained approach to seeking above-average income with real capital and income growth potential. Manager Thomas Moore selects a portfolio of 50-70 UK stocks where dividend growth is backed by earnings growth, strong balance sheets and sensible valuations. Since taking on the fund in late 2011, Moore has changed SLET's focus from a predominantly large-cap fund to a portfolio tilted to mid-sized and smaller companies, with exposure to AIM stocks as a further differentiating factor from most UK equity income peers. The trust has maintained or grown its dividend every year since launch and ranks second of 21 funds for risk-adjusted NAV total return performance over one and three years. SLET may use gearing of up to 15% and is currently c 11% geared.

12 months ending	Total share price return (%)	Total NAV return (%)	FTSE All Share index (%)	FTSE 100 index (%)	FTSE 250 index (%)
31/08/11	4.0	6.3	7.3	6.7	10.1
31/08/12	9.3	12.0	10.2	10.0	11.7
31/08/13	41.1	30.6	18.9	16.6	31.7
31/08/14	10.0	13.1	10.3	10.1	11.5
31/08/15	19.6	13.3	(2.3)	(5.0)	10.6

Note: 12-month rolling discrete total return performance.

## Investment strategy: Unconstrained approach

Moore makes use of Standard Life Investments' well-resourced UK equity team, 'Focus on Change' investment philosophy and quantitative stock matrix to build a fairly concentrated portfolio of 50-70 stocks with attractive yields and the potential for real growth in capital and income. Although SLET uses the FTSE All-Share index as a benchmark, its unconstrained mandate means that both portfolio weightings and performance are likely to differ markedly from the index; as well as being very underweight the largest companies, at 31 August the Trust had 14% of its portfolio outside the benchmark, principally in AIM stocks.

## Market outlook: Global factors weigh on sentiment

A sharp sell-off in late summer has seen the blue-chip FTSE 100 index falling by more than 16% from the all-time high achieved earlier this year. Market turmoil sparked by growth concerns in China, fears over the impact of interest rate normalisation in the UK and US, and broader geopolitical concerns are all weighing on investor sentiment. However, with the UK economy continuing to improve, domestically-focused stocks could prove more resilient in the near term.

## Valuation: Close to par after two-way spike

At 30 September SLET's shares were trading at a 1.1% premium to cum-income net asset value. Having touched a three-year widest discount of 10% as election jitters dented appetite for trusts with smaller company exposure, a sharp re-rating saw the shares reach a 4.2% premium in late August, a record level under Standard Life Investments' management.

## Investment companies

1 October 2015

**Price** 439.0p  
**Market cap** £188.7m  
**AUM** £215.8m

NAV\* 428.3p  
 Premium to NAV 25.5%  
 NAV\*\* 434.4p  
 Premium to NAV 1.1%

\*Excluding income. \*\*Including income. Data at 30 September.

Yield 3.2%  
 Ordinary shares in issue 42.98m  
 Code SLET

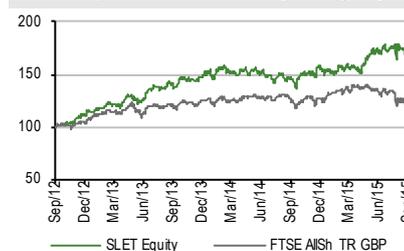
Primary exchange LSE

AIC sector UK Equity Income

## Share price/discount performance



## Three-year cumulative perf. graph



52-week high/low 469.0p 368.0p  
 NAV\*\* high/low 469.1p 374.5p

\*\*Including income.

## Gearing

Gross\* 15.4%  
 Net\* 11.3%

\*As at 31 August 2015.

## Analysts

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### Exhibit 1: Trust at a glance

#### Investment objective and fund background

Standard Life Equity Income Trust (SLET) aims to provide shareholders with an above-average income from their equity investment while also providing real growth in capital and income. It seeks to achieve this through a diversified portfolio of between 50 and 70 equity holdings. The benchmark is the FTSE All-Share index.

#### Recent developments

- 24 August 2015: Third quarterly dividend of 3.4p declared, payable on 25 September.
- 14 May 2015: Half-year results for the six months ended 31 March. NAV TR of +12.8% for the period, compared with +5.3% for benchmark FTSE All-Share index. Share price TR of +5.7%.

#### Forthcoming

AGM	December 2015
Final results	November
Year end	30 September
Dividend paid	Quarterly
Launch date	14 November 1991
Continuation vote	Five-yearly, next 2016

#### Capital structure

Ongoing charges	0.98%
Net gearing	11.3%
Annual mgmt fee	0.65% of gross assets
Performance fee	None
Company life	Indefinite
Loan facilities	£30m with Scotiabank

#### Fund details

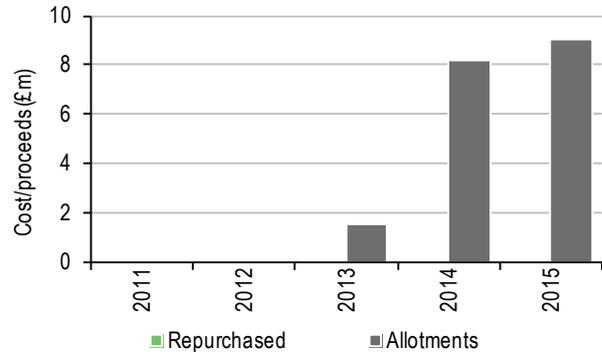
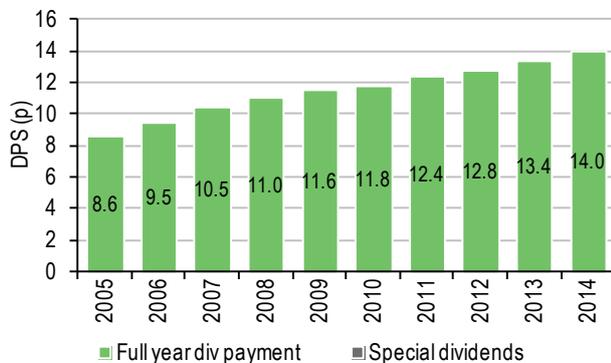
Group	Standard Life Investments
Inv manager	Thomas Moore
Address	1 George Street, Edinburgh, EH2 2LL
Phone	+44 845 60 24 247
Website	<a href="http://www.standardlifeinvestments.com">www.standardlifeinvestments.com</a>

#### Dividend policy and history

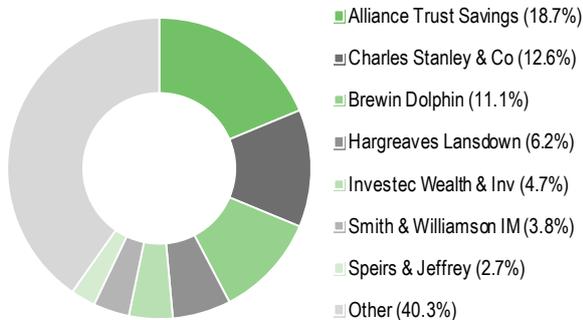
Dividends are paid quarterly, in March, June, September and December. It is the board's intention that SLET should achieve long-term real (ie above inflation) growth in its dividend.

#### Share buyback policy and history

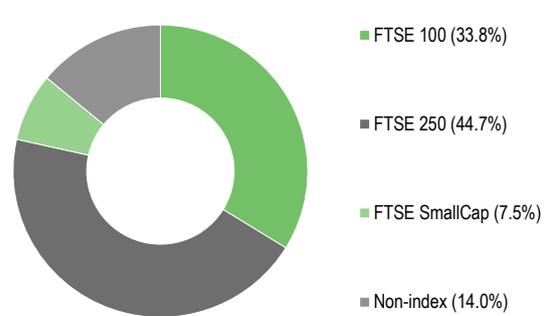
SLET may buy back up to 14.99% or allot up to 10% of ordinary shares annually to manage a discount or a premium. Figures shown below are for financial years to end September and include shares issued as a result of subscription share exercise.



#### Shareholder base (as at 31 August 2015)



#### Distribution of portfolio (as at 31 August 2015)



#### Top 10 holdings (as at 31 August 2015)

Company	Industry	Portfolio weight %	
		31 August 2015	28 February 2015*
BT	Fixed Line Telecom	3.8	4.1
DS Smith	General Industrials	3.1	3.0
Aviva	Insurance	2.7	N/A
Vodafone	Mobile Telecom	2.6	2.5
Legal & General	Life Insurance/Assurance	2.5	2.9
Close Brothers	Financial Services	2.2	2.4
RELX	Media	2.1	1.7**
Rightmove	Financial Services	2.1	2.0
Staffline	Support Services	2.0	N/A
Prudential	Life Insurance/Assurance	2.0	1.8
<b>Top 10 (% of portfolio)</b>		<b>25.1</b>	<b>25.7</b>

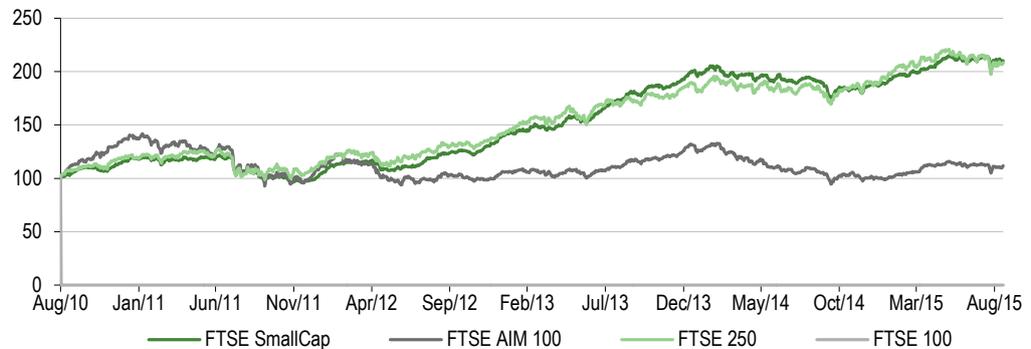
Source: Standard Life Equity Income Trust, Edison Investment Research, Morningstar, Bloomberg. Note: \*N/A where not in February 2015 top 20. \*\*RELX was formerly known as Reed Elsevier.

## Outlook: Flexible focus could offset market jitters

While 2015 might have looked like a shining advertisement for the hit-and-miss stock market adage of ‘Sell in May and go away, come back on St Leger day’ (FTSE All-Share index down 9.6% in total return terms from 1 May to 11 September), the fact that markets have continued to struggle since the last classic flat race of the season (FTSE All-Share down another 2.4% from 14 to 22 September) points to underlying uncertainty in the market. A combination of worries about the pace and timing of US and UK interest rate rises and concerns over growth in China have weighed on global indices, with UK large-caps hit harder than smaller companies perhaps owing to their greater international exposure: from 1 May to 22 September the total return on the FTSE 100 was -13.7%, while for the FTSE SmallCap it was +1.4%.

Over longer periods (Exhibit 2 shows total return performance over five years) small and mid caps have also outperformed, although the junior AIM index (here measured by the largest 100 stocks) has lagged the blue-chips, largely owing to a poor 2014.

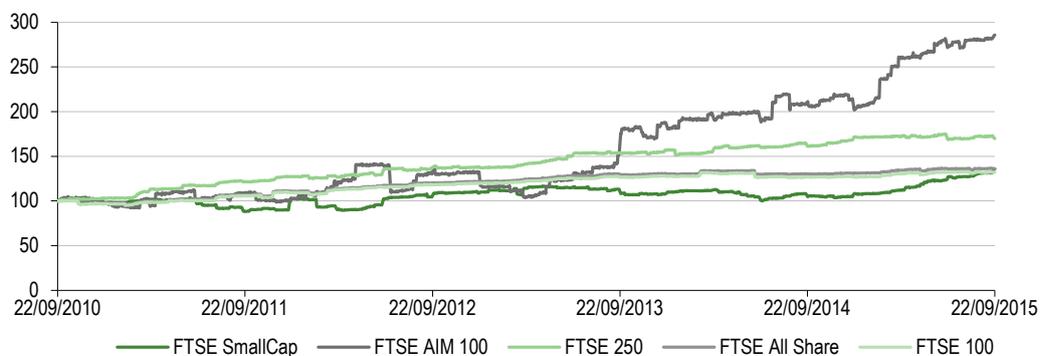
**Exhibit 2: Total return performance from UK indices over five years**



Source: Thomson Datastream, Edison Investment Research. Note: Indices rebased to 100.

Investors seeking income may be of the view that the FTSE 100 index – made up as it is of well-established household names – is the place to go for dividends. On one level they would be correct – the blue-chip index has the highest yield of all the indices shown in Exhibit 3 (4.08% at 22 September). However, the growth in dividends from most other areas of the market – particularly the low-yielding AIM stocks, as well as the second-tier FTSE 250 – has been superior over the past five years, suggesting that for investors who wish to achieve attractive total returns over time, it may be wise to cast their net wider.

**Exhibit 3: Indicative dividend growth from UK indices over five years, rebased to 100**



Source: Thomson Datastream, Edison Investment Research. Note: Calculated as a multiple of index level and dividend yield, rebased to 100.

The future path of UK market performance will depend, as ever, on a combination of factors. Concerns about valuations, which were prevalent earlier in the year as the FTSE 100 index breached 7,000 points for the first time, may seem less pressing with the index some 1,000 points lower. As shown in Exhibit 4 below, smaller stocks and mid-caps in particular look more expensive than large-caps (which also dominate the FTSE 350 and All-Share) on a number of measures, although investors may feel they are willing to pay for the faster growth potential demonstrated by small and mid-sized companies in Exhibit 2.

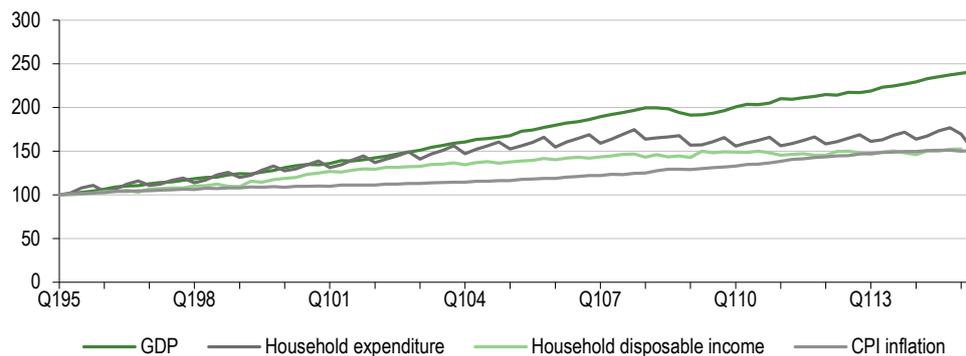
**Exhibit 4: UK index valuation metrics**

	P/E* (x)	Price/book (x)	Price/sales (x)	Rtn on equity (%)	Div yld (%)
FTSE All-Share	15.5	1.8	1.1	10.8	3.6
FTSE 100	14.9	1.8	1.0	10.7	3.9
FTSE 250	18.1	2.0	1.4	12.6	2.5
FTSE 350	15.4	1.9	1.1	11.0	3.6
FTSE SmallCap	20.6	1.3	1.4	7.4	2.7

Source: FTSE All-Share monthly review, 31 August 2015. \*Note: P/E is ratio of current price to cash earnings.

The largest UK companies include global names such as HSBC and Unilever – which have benefited in the past from their exposure to emerging markets, but may struggle in the near term as fears grow about the impact of slowing growth in China on its neighbours – while many of the second-tier and smaller stocks have a more domestic focus. This means they are better placed to benefit from the economic pick-up in the UK (see Exhibit 5), which, combined with the falling oil price (another headwind for many large UK stocks in the resources and materials sectors), is buoying consumer demand.

**Exhibit 5: Key UK economic data since 1995**



Source: Office for National Statistics, Edison Investment Research. Quarterly data, rebased to 100.

However, with lingering worries over the size of the UK budget deficit and its impact on the domestic economy, together with broader geopolitical concerns, markets are likely to remain volatile for the immediate future. In such a situation, a flexible investment strategy that is not constrained by benchmark weightings or market capitalisation could stand investors in good stead.

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## Fund profile: Seeking growth and growing income

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Standard Life Equity Income Trust is a relatively concentrated (50-70 holdings) portfolio of UK stocks chosen for their potential to produce above-average income along with real capital and income growth. Launched in 1991 by Morgan Grenfell and later coming under the Deutsche Bank umbrella, its management transferred to Standard Life Investments (SLI) in November 2005 following a 'beauty parade' sparked by Deutsche's decision to leave the UK retail funds market. SLET is managed from Edinburgh by Thomas Moore (first as co-manager with Karen Robertson from November 2011 and in sole charge from May 2012), who also runs the Standard Life UK Equity Income Unconstrained OEIC, with over £1bn of assets under management. SLET follows the same unconstrained investment style, with a multi-cap portfolio that has a much larger weighting in mid-sized and smaller companies than the benchmark FTSE All-Share index. SLET is a member of the Association of Investment Companies' UK Equity Income sector, a large and competitive peer group containing a number of well-known funds with high-profile managers. Over one, three and five years to 21 September, SLET's NAV total return performance ranks it in the top five of the sector.

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## The fund manager: Thomas Moore

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### The manager's view: Investing away from the herd

Moore sees the depth of Standard Life Investments' UK equity team as a key differentiating factor in a market in which sell-side analyst cover is diminishing, with a team of 13 providing full coverage of the FTSE 350, plus five small-cap specialists and two quantitative analysts. The manager can also draw on the macro insights of SLI's multi-asset team (which runs the £26bn Global Absolute Return Strategies fund), although he says such views tend to be expressed at the stock level – for instance there is currently very little exposure to emerging markets in the portfolio – rather than through increasing or reducing the level of gearing, which is stable at c 10%.

As an equity income fund, earnings growth and momentum are key factors in stock selection. Moore uses SLI's quantitative matrix (see Investment process, below) to screen portfolio holdings weekly, and says he is ruthless in jettisoning stocks with poor earnings momentum: "In a concentrated portfolio an earnings downgrade is an indicator that your original thesis is in question," he explains. Moore says the ideal stocks for the SLET portfolio are those with strong balance sheets, favourable valuations and good earnings and dividend growth.

Currently, consumer discretionary stocks are providing the most positive earnings surprises, buoyed by lower oil prices and better employment and wage figures in the UK, while oil and gas and basic materials are seeing the most downgrades. Moore says consumer staples, which are trading on high valuations because of their perceived defensive qualities, are vulnerable to negative sentiment on emerging markets and the impact of expected interest rate rises on both sides of the Atlantic. The dominance of staples and resource and materials stocks in the FTSE 100 is one of the factors underlying his current tilt towards medium-sized and smaller companies.

Moore's unconstrained approach means he does not have to take a position in any stock, however large. This leads to a lack of commonality with other funds that may have a more index-relative approach. The manager points to this as beneficial in income terms: in the first quarter of 2015, according to the Capita Dividend Monitor, the top five dividend payers in the FTSE 100 accounted for 50% of total dividends for the index, with the top 15 paying out 80% of total dividends. This level of income concentration can leave funds vulnerable to dividend cuts, as seen among the banks in 2008/9 or BP in 2010 following the Deepwater Horizon accident. Of the 10 most widely held stocks by UK equity income funds at 31 July, SLET held only BT, Vodafone and Legal & General. Moore

points out that many of the largest and most widely held income stocks are growing their dividends ahead of their earnings – a situation that may prove unsustainable in the long run.

A stock that exemplifies Moore's approach is Close Brothers, a financial services company active in areas such as private banking and wealth management. Moore says the stock has seen a prolonged period of double-digit loan growth and year-on-year increases in its tangible net asset value (TNAV). It has a high return on equity at c 20% and did not cut its dividend even at the height of the financial crisis. It is building dividend cover by growing its dividend at a slightly slower pace than its earnings, in contrast to a big bank like HSBC, where dividend cover is becoming stretched under the pressure to keep up payouts in spite of headwinds from its emerging markets exposure.

## Asset allocation

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### Investment process: Unconstrained equity income investing

SLET manager Thomas Moore is part of the large UK equity team at Standard Life Investments. Moore and his 12 colleagues on the UK large-cap desk provide full coverage of the FTSE 350 index, and the manager is also able to draw on the expertise of the five-strong UK smaller companies team, as well as two quantitative analysts, a large GSRI (governance, stewardship and responsible investment) team and risk management specialists. Company meetings are a key source of ideas, and equity managers also gain insights into the wider investment picture from SLI's credit, real estate, strategy and multi-asset teams.

Like SLI's other mandates, SLET is managed in accordance with the firm's 'Focus on Change' investment philosophy. Managers ask five key questions regarding any candidate for inclusion in portfolios:

1. What are the key drivers and issues for this stock?
2. What is changing?
3. What is assumed in the price?
4. What will make the market change its mind about this stock?
5. What specific triggers are there?

While there is a valuation tilt to the process, with question three focusing on whether current valuations factor in expected improvements, Moore stresses that it is not a 'value' style as such; a company may be trading at a valuation higher than that of comparable peers or relative to its own history, but SLI managers are more concerned with the potential further upside, which could make today's 'expensive' valuation look very favourable in hindsight.

To sift the large universe of potential investments (350 large and mid-cap stocks and a further c 1,200 encompassing the FTSE SmallCap and Fledgling indices and the UK companies listed on AIM), Moore makes use of Standard Life's proprietary stock screening matrix. This looks at a range of measures including the following:

- earnings per share and EBITDA revisions;
- Starmine estimates (indication of estimate stability and dispersion);
- director dealing (used with reference to price momentum);
- price momentum;
- earnings per share growth;
- P/E ratio and yield; and
- Altman Z-scores (financial strength/quality indicator)<sup>1</sup>.

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<sup>1</sup> The original Altman Z-score is a weighted combination of five ratios: working capital/ total assets, retained earnings/total assets, earnings before interest and tax/total assets, market value of equity/total liabilities and sales/total assets. A score of below 1.8 is seen as a warning sign while 3.0 and above is a positive indicator.

The matrix helps in flagging up potential investment ideas for the team, and for existing investments, acts as a discipline to re-examine the investment case if the score deteriorates. Moore says that SLET has a bias to cheaper versus more expensive stocks, strong earnings growth and dividend growth (rather than necessarily a high dividend yield), and a strong Z score to underpin sales and earnings expectations.

As SLET is an unconstrained fund, Moore's approach is 'index agnostic'; although the portfolio is tilted to mid-sized and smaller companies, the proportion in FTSE 100 stocks could rise from its current one-third if the manager saw better opportunities in larger companies. However, he says it is unlikely to go back to the previous c 75% weighting owing to the statistical improbability of finding three-quarters of his best ideas in such a small segment of his overall universe.

Stocks are given 'buy', 'hold' or 'sell' ratings by SLI's analysts, and there is a 'winners list' of 20 top UK stock picks, 13 of which were in the SLET portfolio at the time of writing. (As an income fund, not all the UK 'winners' are likely to be suitable.) Moore says his high-conviction approach could lead him to reassess a stock that was downgraded from 'buy' to 'hold', although he would not necessarily sell; a downgrade to 'sell' would almost inevitably trigger an exit, however. Other reasons for exiting a position would include a dividend freeze or cut – particularly an unexpected one, as this is often the precursor to more bad news. A deterioration in a company's matrix score would prompt Moore to investigate whether there is real cause for concern or if it is a 'false' signal, such as a temporary and reversible foreign exchange issue.

Risk is monitored across the portfolio, both in terms of divergence from index position (measured across stocks, sectors and valuation metrics) and in absolute terms. SLI's sophisticated factor risk tools allow the manager to gauge what adding a particular stock would do to the overall portfolio risk; Moore says this allows him to maintain conviction in his positioning, rather than holding more stocks to diversify. Potential volatility is broadly in line with the wider market in spite of the trust being markedly different in make-up, with 90.5% active share (the amount by which the portfolio differs from benchmark weightings) at 30 June.

## **Current portfolio positioning**

At the end of August SLET had 72 holdings, at the top of its c 50-70 stock range, although the manager says this stems more from having a lot of high-conviction ideas, rather than targeting lower stock-specific risk through greater diversification. The top 20 holdings made up 44.1% of the portfolio, with the top 10 accounting for 25.1%, below the 32.3% average for the UK Equity Income peer group. Under Thomas Moore's management the proportion of the portfolio invested in large FTSE 100 companies has fallen from c 75% in late 2011 to c 33% today, while mid-cap and particularly smaller company holdings have risen, to 44.7% and 21.5% respectively at the end of August. Within the small-cap segment, 14.0% of the portfolio is held outside the FTSE All-Share index, mainly in AIM stocks. While the mandate allows for investment in hybrid or fixed income securities such as convertible bonds or preference shares, the portfolio is currently 100% in equities (or 111.3% including gearing), and all the companies held are UK-based.

From a sector perspective (Exhibit 6) SLET is most overweight industrial and consumer services stocks; the overweight to financials reflects positions in speciality financial and life assurance stocks rather than the major banks. There are currently no holdings in oil & gas, where earnings momentum and dividend growth prospects are poor because of the recent falls in the oil price, and also no holdings in healthcare.

**Exhibit 6: Sector exposure**

%	31 Aug 2015	Change from Feb 2015	Active weight vs FTSE All-Share
Financials	35.4	(2.1)	9.1
Industrials	26.3	(5.4)	15.9
Consumer Services	24.0	4.6	11.5
Consumer Goods	9.6	1.8	(5.6)
Telecommunications	8.8	(0.2)	3.6
Technology	3.7	0.0	2.1
Utilities	2.2	0.3	(1.5)
Basic Materials	1.3	0.1	(4.2)
Health care	0.0	0.0	(8.6)
Oil & gas	0.0	(1.0)	(11.0)
Gearing	(11.3)	1.9	N/A
<b>Total</b>	<b>100.0</b>	<b>0.0</b>	<b>11.3</b>

Source: Standard Life Equity Income Trust. Note: Portfolio exposures shown including gearing.

Recent purchases include small positions in Rio Tinto, Burberry and Sage, as well as larger stakes in Vodafone, SuperGroup (the company behind Superdry branded apparel) and Real Estate Investors (REI). Rio is a high-yielding stock (not normally a principal consideration for Moore) that is well positioned to benefit from any pick-up in the resource cycle because of its low cost of production. SuperGroup and Burberry have both seen share price weakness but have the potential to surprise the market through operational improvements. Vodafone's position in 4G data services means it is well placed to benefit from what Moore sees as an inflection point in mobile telecommunications, with consumer spending on data picking up, while Sage has a new CEO who the manager believes can accelerate growth without affecting margins. REI is a Midlands-based real estate investor, benefiting from its ability to secure good properties at attractive yields by focusing away from the hotspots of London and the South East.

Turnover has been fairly consistent at c 30-35% a year under Moore's management, implying a three-year holding period. The manager is willing to hold stocks longer than this, however, particularly where there has been significant management action that may take time to take effect.

Exhibit 7 below shows various portfolio metrics for the trust and the benchmark. While SLET holdings are on slightly higher P/E valuations and lower dividend yields than the FTSE All-Share average, they show markedly superior sales and earnings growth compared with the index at large.

**Exhibit 7: Portfolio characteristics vs benchmark**

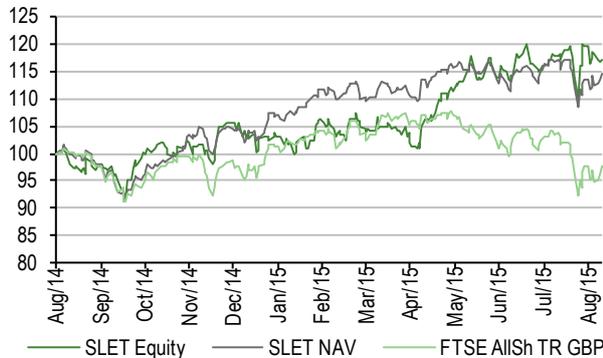
Metric (weighted averages)	SLET portfolio	FTSE All-Share	Difference (%)
Market capitalisation	£8,765m	£36,873m	(76)
Dividend yield (%)	2.82	3.47	(19)
Price/earnings (x)	17.06	15.57	10
Price/cash flow (x)	9.98	9.89	1
Price/book value (x)	2.48	1.70	46
Price/sales (x)	1.00	1.10	(9)
Historical 3y sales growth (%)	8.54	3.04	181
Historical 3y EPS growth (%)	20.67	1.95	962
Return on equity (%)	16.53	16.42	1
Operating margin (%)	15.73	18.14	(13)

Source: Standard Life Equity Income Trust. Note: At 30 June 2015.

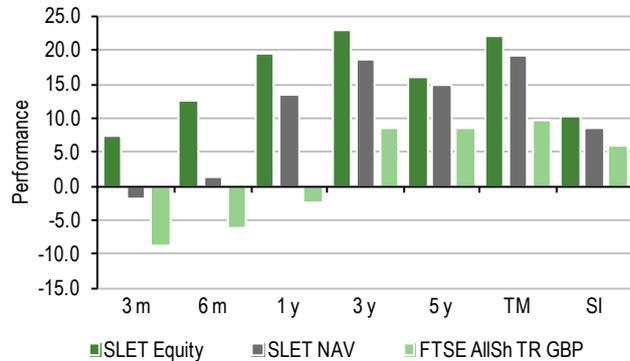
## Performance: Strong record under current manager

**Exhibit 8: Investment trust performance to 31 August 2015**

Price, NAV and index total return performance, one year rebased



Price, NAV and index total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Index performance is sterling adjusted. Performance figures annualised over periods of three years and longer. TM – since managed by Thomas Moore (14 May 2012). SI – since managed by Standard Life Investments (25 November 2005).

**Exhibit 9: Share price and NAV total return performance, relative to indices**

	Three months	Six months	One year	Three years	Five years	TM*	SI**
Price relative to FTSE All-Share	17.6	20.0	22.4	44.8	39.3	42.2	48.4
NAV relative to FTSE All-Share	7.3	8.1	16.1	30.7	31.6	31.2	27.9
Price relative to FTSE 100	18.8	22.2	25.9	52.2	47.2	49.5	59.5
NAV relative to FTSE 100	8.4	10.1	19.3	37.3	39.1	38.0	37.5
Price relative to FTSE 250	13.3	11.9	8.1	14.3	5.6	11.5	(4.0)
NAV relative to FTSE 250	3.4	0.7	2.5	3.1	(0.2)	2.9	(17.2)

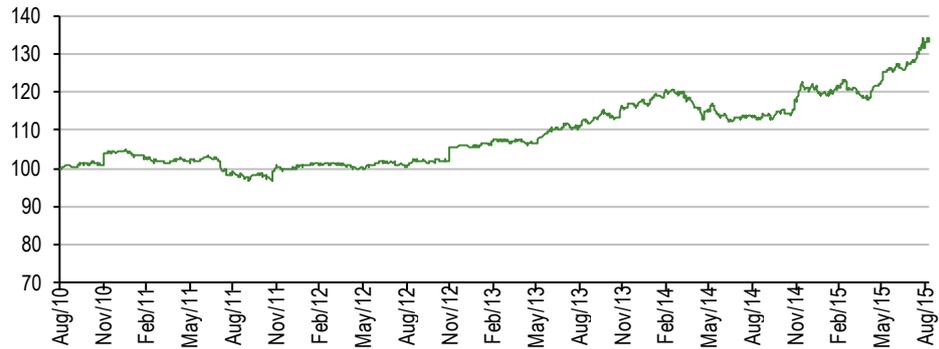
Source: Thomson Datastream, Edison Investment Research. Note: Data to end-August 2015. Geometric calculation. \*TM – since managed by Thomas Moore (14 May 2012). \*\*SI – since managed by Standard Life Investments (25 November 2005).

SLET has outperformed its FTSE All-Share benchmark in both share price and NAV terms over three and six months, one, three and five years, and since Thomas Moore took sole charge of the portfolio on 14 May 2012, as well as over the near 10-year period under SLI's management (Exhibit 8). Differentiated performance versus the benchmark is a natural consequence of the Trust's focus on mid-cap and smaller companies, which make up 66.2% of the portfolio, compared with 20.6% of the FTSE All-Share index. Outperformance has been particularly notable on a share price basis since early May, owing to the Trust's move from a 10% discount to a small premium to NAV.

On a discrete basis, NAV total return performance has been positive both in absolute terms and versus the FTSE All-Share in each of the last four 12-month periods ending 31 August (see table, page 1). The fact that the trust has also kept pace with or outperformed the mid-cap FTSE 250 index over these four discrete periods and the majority of cumulative periods shown in Exhibit 9, suggests that positive performance versus the All-Share is based on favourable stock selection and not just on the decision to focus attention away from the largest UK stocks.

The chart in Exhibit 10 tracks the Trust's net asset value performance relative to the FTSE All-Share over five years. It shows a steady although not unbroken record of outperformance; slight reverses such as those in early 2014 and mid-2015 have tended to coincide with periods when large-cap stocks were more in favour, and the trust has outperformed strongly during this summer's sell-off, albeit NAV performance was slightly negative in absolute terms over three months to the end of August.

**Exhibit 10: Five-year NAV performance relative to FTSE All-Share**



Source: Thomson Datastream, Edison Investment Research. Data to end-August 2015.

## Discount: Back above par after election jitters

At 21 September SLET's shares traded at a 0.3% premium to cum-income net asset value. This was lower than the 4.2% premium (a 10-year high) seen towards the end of August, but above the one-, three- and five-year average discounts of 2.9%, 2.1% and 3.4%, respectively.

The early part of 2015 was characterised by a widening of investment trust discounts generally, and particularly for the lower-yielding, more growth-focused UK equity income trusts, many of which had traded at or above par for some time. SLET's discount reached its widest point in three years, at 10.0%, on 7 May as the UK went to the polls in the general election. There was a sharp re-rating for many trusts – especially those with a tilt towards smaller companies – in the post-election period, as the result was seen as positive for British business. Since early June SLET's shares have largely traded in a range from a 2% discount to a 2% premium to NAV.

SLET may buy back or issue shares to manage a discount or a premium. No shares have been bought back since June 2007. In the past 12 months 850,000 ordinary shares (not including shares issued as a result of subscription share exercise) have been issued, raising £3.8m.

**Exhibit 11: Share price discount to NAV (including income) over three years (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

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SLET is a conventional investment trust, with 42.98m ordinary shares in issue at 21 September. The trust has the authority to allot up to 10% or buy back up to 14.99% of shares annually to manage a discount or a premium. On 16 September 2015 the trust made a blocklisting application for a further 3.45m shares to be issued as demand arises.

In 2010 SLET made a bonus issue of 7.45m subscription shares, with one subscription share allotted for each five ordinary shares held. The 'sub shares' may be converted into ordinary shares by paying a subscription price of 320p on the last business day of June or December. The final exercise date is 30 December 2016. With the ordinary shares trading at 447.5p at 21 September, the subscription shares are comfortably 'in the money', and have been so on the last five exercise dates. So far 2.23m subscription shares have been exercised, or about one-third of the total.

The trust has a £30m three-year revolving credit facility with Scotiabank, at a fixed interest rate of 1.66%. At the 31 March half-year end (and at the 30 September year-end) £23m of the loan was drawn, with net gearing having ranged between 10% and 13% over the six-month period depending on market and cash levels. The manager drew down a further £2m during the late summer sell-off. The board has set a gearing range of 5% net cash to 15% net geared, and at 31 August net gearing stood at 11.3%.

Standard Life Investments is paid an annual management fee of 0.65% of total assets, charged 30% to revenue and 70% to capital, with no performance fee. Maven Capital Partners is engaged under a separate agreement with SLI to provide company secretarial and administrative services, paid for out of the management fee. Ongoing charges were 0.98% per year at the half-year end.

## Dividend policy and record

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Dividends are paid quarterly, in March, June, September and December. SLET aims to achieve real growth in both income and capital, as well as paying an above-average income. The manager has a marked preference for stocks with good dividend cover and steady dividend growth, rather than high-yielding stocks where future dividends could be under pressure. This is mirrored in SLET's own record: from 2009 to 2014 dividends grew at a compound annual rate of 3.9%, compared with compound annual CPI inflation of 2.9% over the same period. Dividends have been more than covered by net income for four of the last five financial years (the exception was FY10), and the trust has a large revenue reserve: c 14.5p per share at FY14, or more than enough to cover last year's total dividend of 14.0p. Based on the FY14 dividend and the 30 September share price of 439p, SLET yields 3.2%. Three of the four dividends for FY15 have been declared, amounting to 10.0p. This is an increase of 4.2% on the first three dividends of FY14, pointing to the potential for the c 4% level of annual dividend growth to be maintained for the year ending 30 September 2015.

## Peer group comparison

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SLET is a member of the AIC's UK Equity Income sector, a large and diverse peer group with 21 constituents (see Exhibit 12; excludes packaged units of split-capital trusts). Its performance in recent years has been strong, with the trust ranking second in the peer group for NAV total return performance over one year, fourth over three years, and fifth over five years. For risk-adjusted performance as measured by the Sharpe ratio, it is ranked second over both one and three years.

Given the ongoing appetite for income-generating investments, several trusts in the sector are trading at a premium to NAV; SLET's 1.1% premium at 21 September (according to Morningstar

figures) ranks it fifth in the group. Gearing is slightly below average, while ongoing charges are slightly above. SLET's 3.2% yield is towards the lower end of the range (18th of 21) though it is only a little below the weighted average of 3.8%. In common with most of the peer group, SLET does not charge a performance fee.

**Exhibit 12: UK Equity income investment trusts**

% unless stated	Market cap £m	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	Discount(-) /premium	Net gearing	Yield	Sharpe NAV 1 yr	Sharpe NAV 3 yrs
<b>Standard Life Equity Income</b>	<b>187.0</b>	<b>12.4</b>	<b>59.7</b>	<b>84.4</b>	<b>1.0</b>	<b>No</b>	<b>1.1</b>	<b>110.0</b>	<b>3.2</b>	<b>1.2</b>	<b>1.7</b>
BlackRock Income and Growth	46.4	5.6	34.4	47.1	1.2	No	0.4	100.0	3.3	0.6	1.0
City of London	1158.3	1.8	36.2	68.6	0.4	No	2.0	109.0	4.1	0.3	1.0
Diverse Income Trust	343.2	19.0	84.4	--	1.3	No	0.9	100.0	2.8	2.1	2.8
Dunedin Income Growth	341.3	-9.5	15.4	41.5	0.6	No	-5.9	110.0	5.0	-0.5	0.5
Edinburgh Investment	1322.9	9.5	51.5	93.9	0.6	No	2.0	115.0	3.4	0.9	1.3
F&C Capital & Income	242.3	1.0	25.7	45.4	0.7	No	2.5	108.0	3.9	0.2	0.9
Finsbury Growth & Income	650.9	10.2	59.8	112.0	0.8	No	0.6	103.0	2.2	0.7	1.3
Invesco Income Growth	159.2	2.0	39.7	76.2	0.9	No	-5.8	110.0	3.8	0.4	1.2
The Investment Company	17.6	4.7	22.5	57.1	2.5	No	-2.8	99.0	6.4	0.6	0.8
JPMorgan Claverhouse	309.2	-0.5	42.0	55.6	0.7	Yes	-5.2	122.0	3.7	0.1	1.1
JPMorgan Elect Managed	49.4	0.8	35.5	59.8	0.7	No	-4.0	99.0	3.7	0.2	1.1
Lowland	353.5	-1.2	42.8	104.5	0.6	Yes	-1.2	117.0	3.1	0.0	1.3
Merchants Trust	454.5	-7.6	22.5	47.7	0.6	No	-2.6	121.0	5.8	-0.2	0.7
Murray Income Trust	444.2	-6.9	19.9	45.1	0.7	No	-7.2	107.0	4.9	-0.5	0.7
Perpetual Income & Growth	942.2	6.5	59.8	98.6	0.7	Yes	1.5	119.0	3.5	0.7	1.6
Schroder Income Growth	176.9	-0.3	41.1	63.7	0.9	No	-1.5	108.0	3.9	0.3	1.1
Shires Income	66.2	-2.2	35.4	65.7	1.0	No	-2.8	128.0	5.5	0.0	1.0
Temple Bar	691.7	-8.0	26.5	60.9	0.5	No	-3.0	101.0	3.8	-0.3	1.0
Troy Income & Growth	175.5	8.1	34.5	69.2	1.0	No	1.1	96.0	3.3	0.6	1.0
Value & Income	105.7	-1.8	26.6	51.9	1.4	Yes	-18.2	127.0	4.1	0.1	1.1
<b>Sector weighted average</b>		<b>2.7</b>	<b>42.6</b>	<b>76.0</b>	<b>0.7</b>	<b>0.0</b>	<b>-0.7</b>	<b>111.0</b>	<b>3.8</b>	<b>0.4</b>	<b>1.2</b>
<b>SLET rank in sector</b>	<b>13</b>	<b>2</b>	<b>4</b>	<b>5</b>	<b>7</b>		<b>5</b>	<b>8</b>	<b>18</b>	<b>2</b>	<b>2</b>

Source: Morningstar, 21 September 2015. Notes: TR = total return. TER = total expense ratio or last ongoing charge. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds (100 = ungeared).

## The board

SLET has five independent non-executive directors. Richard Burns joined the board in 2006 and became chairman at the December 2014 AGM following the retirement of Charles Wood. Keith Percy has served on the board since launch in 1991. Josephine Dixon was appointed in 2011, Mark White in 2013 and the newest director, Jeremy Tigue, in October 2014. The directors all have backgrounds in investment management, with the exception of Ms Dixon, who is a chartered accountant.

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