The North American Income Trust

Quality portfolio focused on income and growth

Investment trusts

The North American Income Trust (NAIT) adopted an active strategy in 2012, aiming to generate above-average income and long-term capital growth primarily from investment in US and selected Canadian equities. NAIT's performance has been particularly strong over the last 12 months in absolute terms and relative to its S&P 500 index benchmark and its NAV total return is ahead of the peer group average over one, three, five and 10 years. NAIT has a progressive dividend policy – annual dividends have compounded by 19.2% pa over the last three years and during this time there have been regular additions to revenue reserves.

12 months ending	Share price (%)	NAV (%)	Primary benchmark (%)	Secondary benchmark (%)	FTSE All-Share (%)
30/09/12	22.7	19.4	25.6	26.3	17.2
30/09/13	22.2	14.5	19.0	22.0	18.9
30/09/14	5.1	14.3	19.6	18.8	6.1
30/09/15	(7.0)	(2.0)	6.4	2.3	(2.3)
30/09/16	48.8	44.1	34.6	35.5	16.8

Note: Twelve-month rolling discrete £-adjusted total return performance.

Investment strategy: Bottom-up stock selection

NAIT's bottom-up stock selection process aims to provide above-average income and long-term capital growth from a concentrated portfolio of primarily US equities. Initial screens of the potential investment universe are used to highlight stocks worthy of further analysis. Valuation is a key consideration and meeting with company management prior to purchase is an important part of the investment process. The dividend yield on the portfolio is approximately 1.5x the benchmark's. Income is enhanced by selected investment in bonds and writing options, which are used primarily to buy and sell stocks at target price levels.

Market outlook: Focus on quality companies

US equities have performed strongly relative to other developed markets and the weakness in sterling since Brexit has enhanced returns for sterling-based investors. As a result, some US market valuation metrics, such as forward P/E and price-to-book multiples are looking full. However, return on equity is still meaningfully below its 10-year average, suggesting potential for US companies to improve profitability. For income-seeking investors, looking to gain exposure to the US market, a fund investing in high-quality companies and generating above-average yield may be appealing.

Valuation: Near-term narrowing of discount

Since the market turmoil following the UK's EU referendum, NAIT's share price discount to cum-income NAV has narrowed below its 12-month average of 10.7%. However, its current discount of 9.2% is wider than the averages of the last three, five and 10 years of 7.3%, 6.1% and 5.5% respectively. NAIT has a progressive dividend policy; following the investment mandate change in 2012, annual dividends have compounded at an annual rate of 19.2%. The current dividend yield of 3.1% compares favourably with the peer group.

11 October 2016

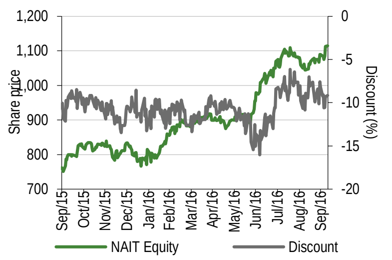
Price	**1,115.0p**
Market cap	**£320m**
AUM	**£403m**

NAV*	1,207.9p
Discount to NAV	7.7%
NAV**	1,227.3p
Discount to NAV	9.2%

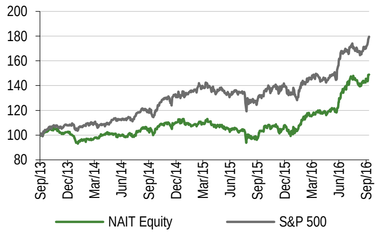
*Excluding income. **Including income.

Yield	3.1%
Ordinary shares in issue	28.7m
Code	NAIT
Primary exchange	LSE
AIC sector	North America
Benchmarks	Primary: S&P500 Secondary: Russell 1000 Value

Share price/discount performance



Three-year performance vs index



52-week high/low	1,115.0p	766.0p
NAV* high/low	1,227.3p	867.4p

*Including income.

Gearing

Net*	11.9%
Net* (ex. cash held against options)	13.0%

*As at 31 August 2016.

Analysts

Mel Jenner	+44 (0)20 3077 5720
Gavin Wood	+44 (0)20 3681 2503

investmenttrusts@edisongroup.com

Edison profile page

The North American Income Trust is a research client of Edison Investment Research Limited

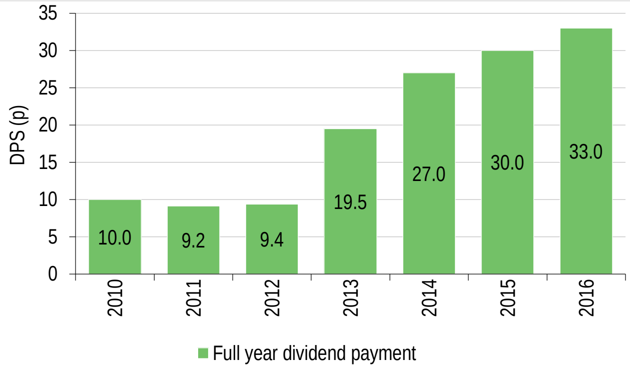
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
The North American Income Trust's objective is to provide investors with above-average dividend income and long-term capital growth through active management of a portfolio consisting predominantly of equities in the benchmark S&P 500 Index. The board also benchmarks the trust against the Russell 1000 Value Index. The investment objective was changed on 29 May 2012 from being an index fund tracking the capital and income of the S&P 500 Index.	■ 3 October 2016: Half-year results for six months to 31 July 2016. NAV TR 28.0% vs S&P 500 TR 21.0%. Share price TR 34.1%. Announcement of second interim dividend of 7.0p. ■ 5 July 2016: Announcement of first interim dividend of 7.0p. ■ 24 March 2016: Annual results for 12 months to 31 January 2016. NAV TR +3.2% vs benchmark TR 5.2%. Share price TR -2.0%.

Forthcoming		Capital structure		Fund details	
AGM	May 2017	Ongoing charges	1.03%	Group	Aberdeen Asset Managers
Annual results	March 2017	Net gearing	13.0%	Manager	Fran Radano
Year end	31 January	Annual mgmt fee	0.8%	Address	Bows Bells House, 1 Bread Street, London, EC4M 9HH
Dividend paid	Aug, Nov, Feb, May	Performance fee	None		
Launch date	November 1902	Trust life	Indefinite	Phone	0500 00 00 40
Continuation vote	Every three years, next at 2018 AGM	Loan facilities	£45m (see page 7)	Website	www.northamericanincome.co.uk

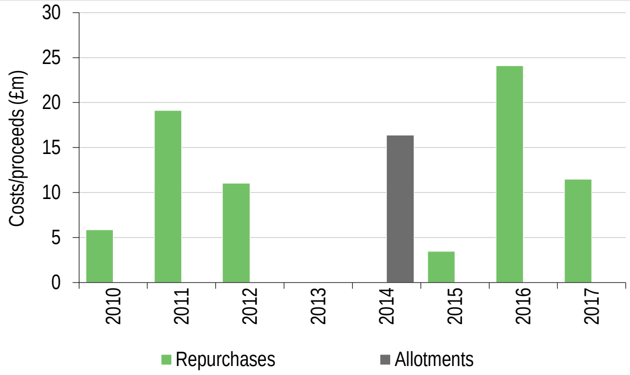
Dividend policy and history

NAIT has a progressive dividend policy. Dividends are paid four times a year in August, November, February and May.

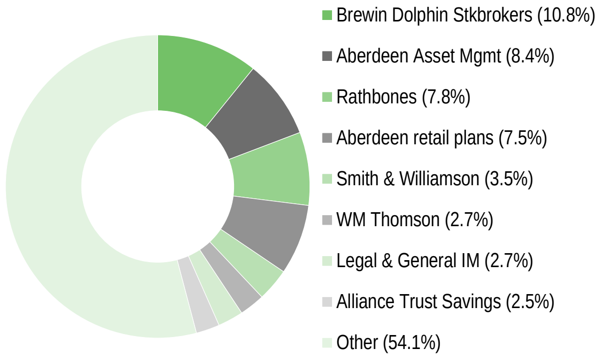


Share buyback policy and history

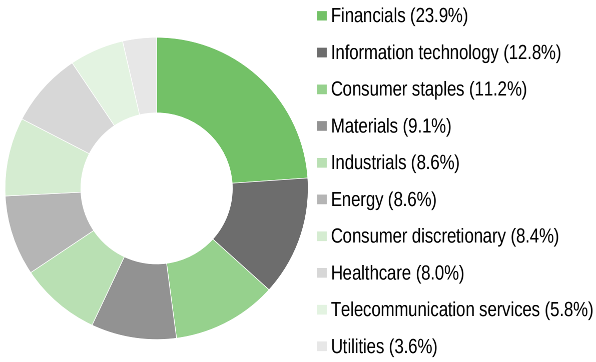
There is an annually renewed authority to buy back up to 14.99% and allot up to 10% of issued share capital. Financial years shown.



Shareholder base (as at 7 October 2016)



Portfolio exposure by sector (as at 31 August 2016)



Top 10 holdings (as at 31 August 2016)

			Portfolio weight %	
Company	Country	Sector	31 August 2016	31 August 2015*
Wells Fargo & Co	US	Financials	4.2	N/A
CME	US	Financials	3.8	3.1
Dow Chemical	US	Materials	3.8	3.8
Pfizer	US	Healthcare	3.6	N/A
Microsoft	US	Information technology	3.6	3.3
Molson Coors Brewing	US	Consumer staples	3.3	3.1
Chevron	US	Energy	3.1	N/A
Rockwell Automation	US	Industrials	3.0	N/A
Johnson & Johnson	US	Healthcare	2.7	N/A
Verizon Communications	US	Telecommunication Services	2.7	3.7
Top 10			33.8	32.0

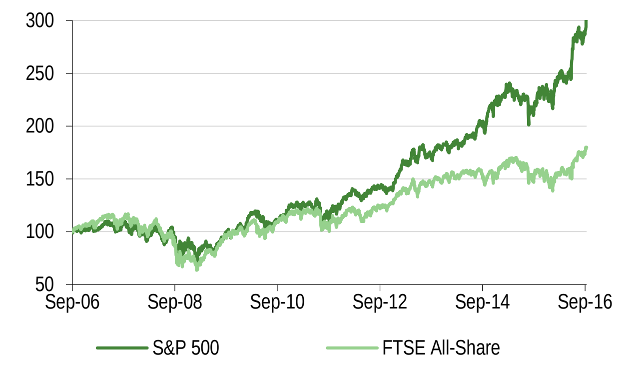
Source: The North American Income Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in August 2015 top 10.

Market outlook: Fundamentals and income are key

Exhibit 2 (left-hand side) shows the strong performance of the S&P 500 index over the last 10 years. It has significantly outperformed the FTSE All-Share index, which has been affected by its higher exposure to resource stocks and has lower exposure to high-growth companies such as US-based large-cap companies Amazon and Apple. Sterling weakness following the UK's European referendum has added to the recent performance of overseas indices in sterling terms. Looking at the US market, represented by the US Datastream index some valuation measures are looking extended (Exhibit 2, right-hand side). The 12-months forward P/E and price-to-book multiples are near the top end of their ranges and c 20% above their 10-year averages. However, the dividend yield is roughly in line and there appears scope for US companies to improve profitability, given the return on equity is c 25% below the 10-year average. In an environment where there are question marks over the level of global economic growth and uncertainties that include the outcome of the US election, a fund generating an above-average yield and investing in high-quality companies trading at reasonable valuations, may hold appeal.

Exhibit 2: Market performance and valuation

Performance of indices (in sterling terms)



Valuation of US Datastream Index

	Last	High	Low	10-year average	Last as % of average
P/E 12 months forward (x)	17.3	17.7	9.4	14.4	120
Price to book (x)	3.0	3.1	1.3	2.4	124
Dividend yield (%)	2.1	3.5	1.6	2.0	102
Return on equity (%)	11.3	17.8	4.1	13.0	86

Source: Thomson Datastream, Edison Investment Research. Note: As at 10 October 2016.

Fund profile: Dividend and long-term capital growth

Launched in 1902, NAIT is a well-established trust. Its mandate was changed in 2012 from tracking the S&P 500 index, to providing above-average dividend income and long-term capital growth. Its benchmark remains the S&P 500 index, but in 2015, the Russell 1000 Value index was added as an additional reference as it better reflects NAIT's mandate. NAIT is managed by Fran Radano, who is able to draw on the experience of the other members of Aberdeen's North American equity team. Companies are selected for their solid fundamentals and potential for sustainable dividend growth. The resulting portfolio will typically contain 35-45 equity positions and 10-15 bond holdings. Gearing of up to 20% of net assets is permitted and up to 20% of the portfolio may be covered by derivatives. No single position may exceed 10% of the portfolio at the time of purchase and there are no limits on market capitalisation or sector exposure.

The fund manager: Fran Radano

The manager's view: More positive view on banks

Having been structurally underweight banks for the last four years, the manager now has a more positive view on these stocks, which are trading below 15x forward earnings on arguably depressed earnings. Current low interest rates are compressing returns in spread businesses, but other operations such as wealth management and leasing have healthy, predictable earnings. Also, balance sheets are now seen as overcapitalised due to tougher regulation. The manager suggests there is potential for both higher earnings and higher multiples in the banking sector. He opines that for bond yields to move higher, there needs to be evidence of more robust economic growth, and not just in the US. Since adopting an active strategy, among the large commercial banks NAIT has preferred to invest in Wells Fargo. However, this position has recently been reduced due to near-term governance concerns. Sale proceeds have been used to increase the position in BB&T, a high quality, regional bank, with an above-average level of fee income, which is also well positioned if interest rates normalise. BB&T is currently digesting recent acquisitions, which the manager expects will lead to a higher return on assets.

Regarding the economy, the manager notes that since the bottom of the recession in 2009, there has been steady growth in non-farm payrolls, which provides a solid underpinning. The effect of wage inflation has been limited as although headline rates are rising, this tends to be for lower-paid workers; in the bulk of the economy, older, higher-paid workers are being replaced by younger, cheaper employees. Growth in capex has generally been subdued, with disproportionate investment in automation and technology. Energy companies have been significantly affected by low commodity prices and banks are being selective in making loans to this industry, which will constrain capex growth going forward. The manager comments that the US M&A environment remains robust, given that higher-quality corporations with strong balance sheets are able to borrow money at low interest rates with interest charges being tax deductible, which means they can afford to pay high acquisition multiples. With regards to tax, the manager suggests that the US tax system may be reformed. The country has the highest corporate tax rate of the major developed nations; increased scrutiny by the EU of US companies such as Apple and Starbucks who are paying lower tax overseas, may provide a catalyst for change.

Asset allocation

Investment process: Quality, valuation and income

NAIT follows the Aberdeen investment process, which is bottom-up, focusing on quality, valuation and income, aiming to generate above-average income and long-term capital growth, from a portfolio of primarily US equities. The universe is screened, looking for companies with a sustainable business strategy, high-quality management, strong financial performance including cash flow generation and a robust corporate governance policy. For companies that pass the screen, valuations are reviewed; measures considered include price-to-earnings, price-to-book and price-to cash flow multiples. Meeting with company managements is a fundamental element of the Aberdeen investment process; the manager will not invest in any company where he or a member of the team has not met management. The resulting portfolio is concentrated (typically 40 stocks and 10 bonds) and is diversified by sector. The manager is benchmark aware, but not driven by its composition. Portfolio income is typically 1.5x the underlying benchmark. Historically, equity holdings in the portfolio have in aggregate generated high-single digit growth in annual dividends. Dividend growth is now more in line with companies' earnings growth, after higher-than average growth following the global financial crisis. 75% of income is generated from equities, with the balance from options and bonds. Options are generally used to buy and sell an equity position at a desired price, rather than being used purely as a source of income.

Current portfolio positioning

As shown in Exhibit 3, the majority of NAIT's portfolio comprises US equities. There have only been modest changes to the composition of the portfolio over the last 12 months. At end-August 2016, the top 10 positions accounted for 33.8%, a modest increase in concentration versus 32.0% at end-August 2015. Five of the top 10 holdings were common to both periods, one of which is CME, which the manager considers a particularly high-conviction investment as exchanges have high barriers to entry and pricing power and are benefiting from increased regulation. CME is also beginning to monetise its trade data, which should provide a long-term tailwind to earnings growth.

Exhibit 3: Portfolio breakdown by geography, asset class and option positions

	End-August 2016	End-August 2015	Change (pts)
US (%)	86.5	87.9	-1.4
Canada (%)	8.8	9.2	-0.4
Cash for investment (%)	3.4	1.9	1.5
Cash held against options (%)	1.3	1.0	0.3
	100.0	100.0	
Equities (%)	96.2	94.9	1.3
Fixed income (%)	3.8	5.1	-1.3
	100.0	100.0	
Number of option positions	9	2	7
Equity sleeve optionised (%)	6.68	2.01	4.67

Source: The North American Income Trust, Edison Investment Research

Exhibit 4 shows how NAIT's portfolio is well diversified by sector. Traditional income funds may favour higher yielding sectors: REITs, telecoms and utilities, but NAIT holds just two companies in each. Telecom and utility companies often have high dividend yields but low growth and the manager considers REITs expensive; he sees better investment opportunities in other sectors.

Exhibit 4: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-August 2016	Portfolio end-August 2015	Change (pts)	Index weight	Active weight vs index (pts)	Trust weight/ index weight (x)
Financials	23.9	20.5	3.4	16.3	7.6	1.5
Information technology	12.8	8.2	4.6	21.0	-8.2	0.6
Consumer staples	11.2	18.3	-7.1	10.1	1.1	1.1
Materials	9.1	9.4	-0.3	2.9	6.2	3.1
Industrials	8.6	11.0	-2.4	9.9	-1.3	0.9
Energy	8.6	9.2	-0.6	7.0	1.6	1.2
Consumer discretionary	8.4	7.1	1.3	12.2	-3.8	0.7
Healthcare	8.0	3.8	4.2	14.6	-6.6	0.5
Telecommunication services	5.8	7.4	-1.6	2.7	3.1	2.1
Utilities	3.6	5.1	-1.5	3.2	0.4	1.1
	100.0	100.0		100.0		

Source: The North American Income Trust, Edison Investment Research

Over the last 12 months, the largest increases in exposure have been in IT, healthcare and financials, while the largest decrease was in consumer staples, where the position in Kraft was sold on valuation grounds. While the company benefited from the merger with Heinz, which had seen significant margin expansion while in private equity ownership, the manager considered that the stock became too expensive, selling at a high-twenties forward earnings multiple for low-single digit revenue growth. Profits have been taken in other consumer staples companies such as Philip Morris, again on valuation grounds and PepsiCo, where the manager sees earnings risk if a soda tax becomes more widely adopted.

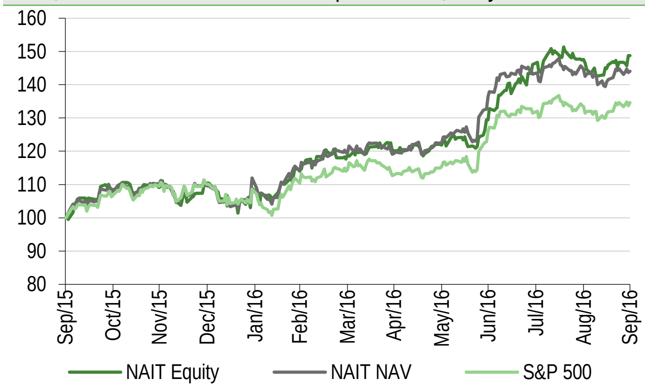
In recent months, two new consumer discretionary names have been added to the portfolio: Coach and Tiffany. Coach (accessories) is a global aspirational brand, which is working through a series of issues, including problems with distribution. A new management team is in place, which has invested heavily in the business over the last two years and has a greater focus on pricing and profitability. Operating margins have more than halved since FY13, but the manager suggests that not a lot of 'heavy lifting' is required for them to improve materially. As Coach is a turnaround situation, the initial holding was a modest 1.5% of the portfolio. The manager views Tiffany (jewellery) as a well-managed, best-in-class operator, whose business has been affected by a lower numbers of tourists visiting the US due to the strength of the dollar. The company has recently increased its quarterly dividend by 12.5% and the stock was purchased at a trough valuation, however, given the cyclicality of luxury businesses, Tiffany is unlikely to become a top 10 position in the portfolio.

Performance: Near-term results continue to improve

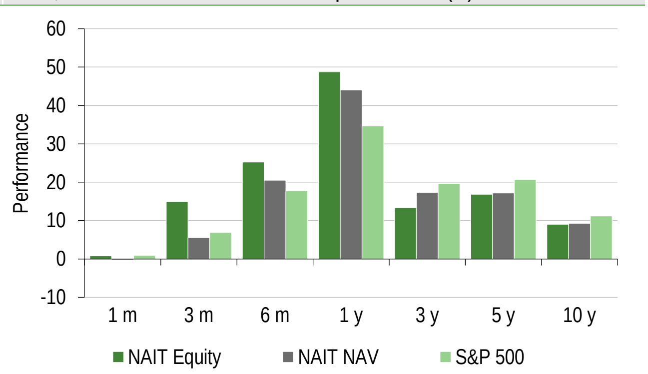
For the half year to 31 July 2016, NAIT's share price and NAV total returns of 34.1% and 28.0% respectively were ahead of the S&P 500 and Russell 1000 Value indices' total return in sterling terms of 21.0% and 23.2% respectively.

Exhibit 5: Investment trust performance to 30 September 2016

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 5 (right-hand side) shows NAIT's high absolute returns over the last 12 months; its share price and NAV total returns are 48.8% and 44.1% respectively. Contributing factors include the outperformance of US versus some other developed market equities and weakness in sterling as a result of Brexit, which has added to the relative performance of overseas equities for sterling-based investors.

Exhibit 6: Share price and NAV total return performance, relative to index (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to primary benchmark	(0.0)	7.5	6.4	10.5	(15.0)	(14.8)	(17.9)
NAV relative to primary benchmark	(1.2)	(1.2)	2.4	7.0	(5.7)	(13.8)	(15.8)
Price relative to secondary benchmark	0.2	7.9	4.6	9.8	(11.6)	(14.0)	(6.5)
NAV relative to secondary benchmark	(1.0)	(0.9)	0.7	6.3	(1.9)	(13.0)	(4.1)
Price relative to FTSE All-Share	(0.9)	6.6	11.0	27.4	20.1	29.1	35.3
NAV relative to FTSE All-Share	(2.1)	(2.1)	6.8	23.3	33.3	30.7	38.8

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-September 2016. Geometric calculation.

Looking at relative returns in Exhibit 6, NAIT's share price and NAV total returns have outperformed both the benchmark S&P 500 and the Russell 1000 Value indices over six months and one year. As a reference to UK investors, NAIT's share price and NAV total returns have also outperformed the FTSE All-Share index over these periods as well as over three, five and 10 years.

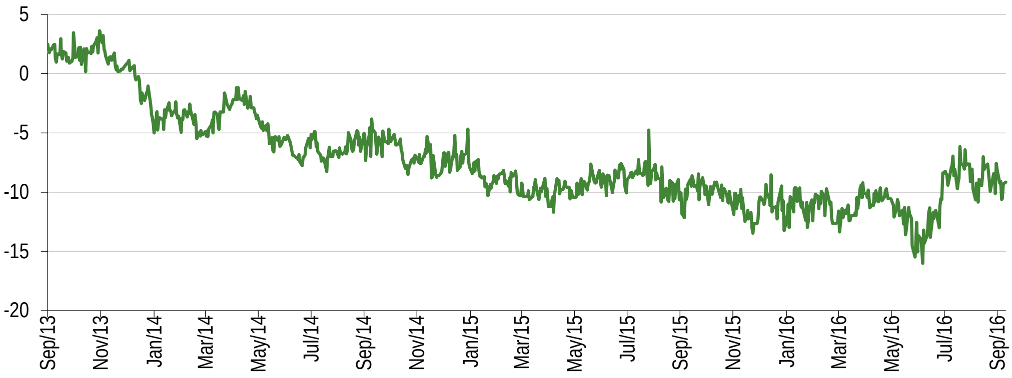
Exhibit 7: NAV performance relative to S&P 500 index over three years

Source: Thomson Datastream, Edison Investment Research

Discount: Narrower following outcome of referendum

Having been in a widening trend for most of the last three years, NAIT's share price discount to cum-income NAV has narrowed in the period since the market turmoil following the UK's vote to exit the EU. The current discount of 9.2% is narrower than its average 10.7% over the last 12 months (range of 6.1% to 16.0% on 6 July 2016), but wider than its averages over the last three, five and 10 years of 7.3%, 6.1% and 5.5% respectively. This leaves scope for NAIT's discount to narrow further if it continues to outperform its benchmark, or if there is higher investor appetite for North American equities. There is no formal discount control policy, but the board has been actively buying back shares since 2015. In the current financial year to end-September, 1.29m shares (4.3% of issued capital) have been repurchased at an average cost of 889.2p.

Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

NAIT is a conventional investment trust with one class of share in issue; there are currently 28.7m ordinary shares outstanding. It has a £45m borrowing facility with State Street. £30m was fixed in July 2014 (equivalent to $51m at the time) at an all-in rate of 2.18% and was fully drawn down. The balance of £15m revolving credit has a rate of 0.9% over Libor and at the end of H117, approximately half was drawn down. At end-August, net gearing excluding cash held against option positions was 13.0% compared to 10.6% at the end of H117.

The annual management fee is 0.8% and there is no performance fee. In FY16 the ongoing charge of 1.03% was in line with the prior year.

Dividend policy and record

NAIT has a progressive dividend policy; dividends are paid quarterly in August, November, February and May. Since the change in investment strategy in 2012, the quarterly dividend has been raised in Q3 and a final special dividend has been paid in each year. Over this period annual dividends have compounded at a rate of 19.2% pa. The 33p annual dividend in FY16 was a 10% increase versus the prior year and there was another addition to revenue reserves. In NAIT's H117 results, a second interim dividend of 7p was announced. The first-half dividend of 14p is a 7.7% increase versus the prior year. At the current share price, NAIT has a dividend yield of 3.1%.

EDISON

Peer group comparison

NAIT is a member of the AIC North America sector, a small sector, which contains some funds investing primarily in Canadian equities and trusts with/without an income mandate. NAIT's NAV total return has outperformed the peer-group average over all periods shown, ranking first out of six funds over one year, and second over three, five and 10 years out of five, four and four funds respectively. In terms of risk-adjusted returns as measured by the Sharpe ratio, NAIT ranks first over one and three years. The trusts in the sector trade at a wide range of discounts; NAIT ranks third out of six. Its ongoing charge is below average, and no performance fee is payable. NAIT's dividend is above the peer-group average, while its level of gearing is broadly in line.

Exhibit 9: AIC North America sector peer group as at 10 October 2016

% unless stated	Market cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
North American Income Trust	319.1	43.9	64.9	120.8	150.9	1.3	0.8	(8.8)	1.0	No	111	3.1
BlackRock North American	103.1	36.4	59.1			0.8	0.7	(3.1)	1.2	No	100	2.8
Canadian General Investments	379.7	27.9	27.9	60.7	80.6	0.3	0.1	(31.4)	1.6	No	118	3.5
Gabelli Value Plus+ Trust	113.7	29.7				0.5	0.1	(9.2)	1.0	No	100	0.3
JPMorgan American	900.6	32.4	68.1	138.3	188.6	0.5	0.8	(3.7)	0.6	Yes	110	1.2
Middlefield Canadian Income	105.2	34.2	24.5	57.6	133.2	0.6	(0.0)	(12.3)	1.1	No	122	5.1
Sector average	320.2	34.1	48.9	94.3	138.3	0.7	0.4	(11.4)	1.1		110	2.7
NAIT rank in sector	3	1	2	2	2	1	1	3	4		3	3

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown 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 total assets less cash and equivalents as a percentage of net assets.

The board

NAIT has four directors on the board; all are non-executive and independent of the manager. Chairman James Ferguson was appointed in March 2002 and senior independent director Guy Crawford was appointed in March 2004. The other two board members and their dates of appointment are Archie Hunter (September 2003) and Susan Rice (March 2015).

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place,
88 Phillip Street, Sydney
NSW 2000, Australia

Wellington +64 (0)4 8948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand