Standard Life Equity Income Trust

Unconstrained approach to income and growth

Investment trusts

Standard Life Equity Income Trust (SLET) is a multi-cap UK portfolio made up of manager Thomas Moore's 50-70 best ideas for achieving a high and growing income with the potential for capital appreciation. The manager seeks attractively valued stocks with strong earnings and dividend growth potential that may not have been fully appreciated by the market. He currently sees better fundamentals in stocks outside the blue-chip FTSE 100 Index, and the trust has a large weighting (60%+) to smaller and mid-cap stocks as a result. Recent performance has been affected by poor sentiment towards UK domestic stocks in the run-up to the EU referendum; there is potential for this to reverse if, as widely expected, Britain votes to remain in the EU, although a Brexit vote could have the opposite effect.

12 months ending	Share price (%)	NAV (%)	FTSE All-Share (%)	FTSE 100 (%)	FTSE 250 (%)
31/05/12	(10.4)	(9.4)	(8.0)	(7.7)	(9.7)
31/05/13	38.7	38.4	30.1	28.4	39.8
31/05/14	23.0	17.8	8.9	7.8	14.4
31/05/15	7.1	14.4	7.5	5.7	16.5
31/05/16	0.8	(3.3)	(6.3)	(7.2)	(2.8)

Source: Thomson Datastream. Note: Total returns in sterling.

Investment strategy: Multi-cap 'best ideas' portfolio

SLET manager Thomas Moore uses Standard Life Investments' Focus on Change philosophy and proprietary quantitative stock matrix to help narrow down the universe of c 1,500 UK stocks to his best 50-70 ideas. While the trust uses the FTSE All-Share Index as a performance benchmark, the manager is unconstrained by index weightings and tends to have a larger proportion in small and mid-cap stocks. Moore seeks stocks with attractive yields and the potential for real growth in both capital and income. The portfolio is constructed bottom-up and company meetings are a key part of the process.

Market outlook: Volatility may persist in the near term

Global equity markets have been troubled in recent months, hit by uncertainty over global economic growth and US interest rate policy. An added factor for UK stocks is the referendum on EU membership, although a vote to remain may provide a fillip to performance in the short term. The summer months have a tendency to be volatile, given lower trading volumes, but outside the FTSE 100 a more favourable earnings outlook could boost prices and dividends on small and mid-cap stocks.

Valuation: Currently at a small discount

At 2 June SLET's shares traded at a 2.4% discount to cum-income net asset value. While broadly in line with the five-year average, it is wider than the one- and three-year averages of 0.4% and 1.2% respectively. Over the long term the shares have tended to trade in a range from a 4% discount to a 2% premium, with share issuance used to meet demand when the shares are trading above par. The recent slight widening in the discount may reflect investor nerves ahead of the EU referendum, and there is thus scope for it to narrow should the UK vote to remain.

6 June 2016

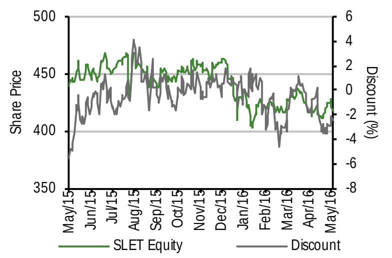
Price	**418.3p**
Market cap	**£187.0m**
AUM	**£219.8m**

NAV*	423.7p
Discount to NAV	1.3%
NAV**	428.6p
Discount to NAV	2.4%

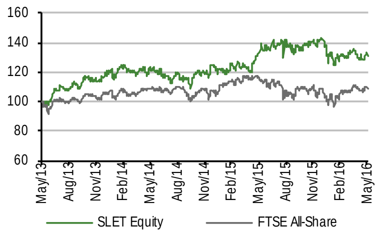
*Excluding income. **Including income. Data at 2 June 2016.

Yield	3.6%
Ordinary shares in issue	44.7m
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	403.5p
NAV* high/low	469.1p	398.3p

*Including income.

Gearing

Gross*	13.2%
Net*	13.2%

*As at 30 April 2016.

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Edison profile page

Standard Life Equity Income Trust is a research client of Edison Investment Research Limited

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.

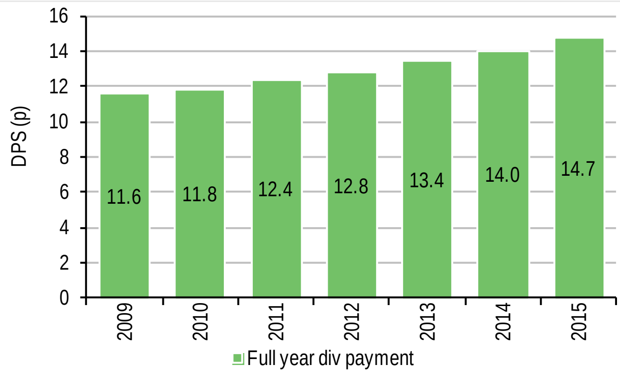
Recent developments

- 26 May 2016: Half-year results to 31 March. NAV TR of +0.7% compared with +3.5% for FTSE All-Share benchmark. Share price TR of -0.7%.
- 20 May 2016: Second quarterly dividend of 3.4p declared, payable on 24 June.
- 12 February 2016: Dividend timetable published for the year.

Forthcoming		Capital structure		Fund details	
AGM	December 2016	Ongoing charges	0.94% (at 31 March)	Group	Standard Life Investments
Final results	November	Net gearing	13.2%	Manager	Thomas Moore
Year end	30 September	Annual mgmt fee	0.65% of gross assets	Address	1 George Street, Edinburgh, EH2 2LL
Dividend paid	Quarterly	Performance fee	None		
Launch date	14 November 1991	Trust life	Indefinite	Phone	+44 (0) 845 60 24 247
Continuation vote	Five-yearly, next 2016	Loan facilities	£30m with Scotiabank	Website	www.standardlifeinvestments.com

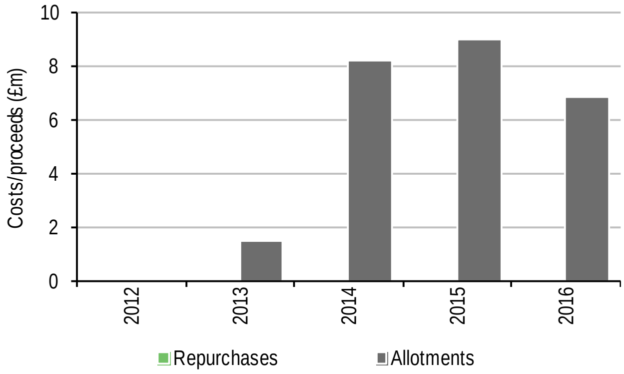
Dividend policy and history

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.

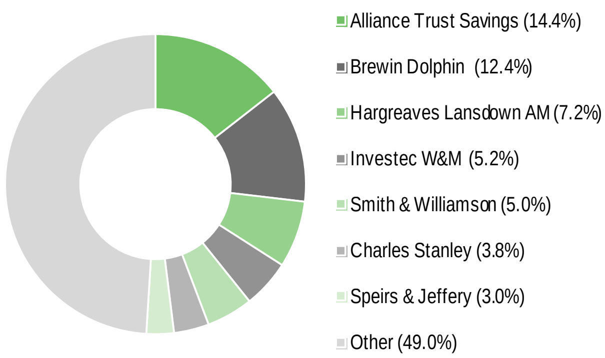


Share buyback policy and history

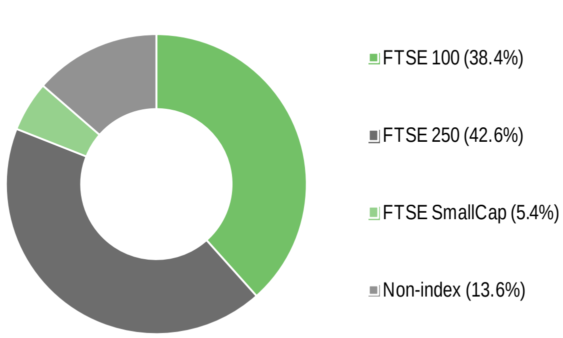
SLET may buy back up to 14.99% or allot up to 10% of ordinary shares annually to manage a discount or a premium. Figures shown below are for financial years to end September and include shares issued as a result of subscription share exercise.



Shareholder base (as at 20 May 2016)



Portfolio exposure by market cap (as at 30 April 2016)



Top 10 holdings (as at 30 April 2016)

		Portfolio weight %	
Company	Sector	30 April 2016	30 April 2015*
BT	Fixed line telecom	4.3	4.2
Sage	Software & computer services	3.4	1.9
Aviva	Life insurance	2.9	2.9
Vodafone	Mobile telecom	2.8	2.6
RELX	Media	2.5	N/A
Legal & General	Life insurance	2.3	2.7
Britvic	Beverages	2.2	2.0
River & Mercantile	Financial services	2.2	N/A
Rightmove	Media	2.2	2.1
Imperial Brands	Tobacco	2.1	N/A
Top 10 (% of portfolio)		26.9	25.8

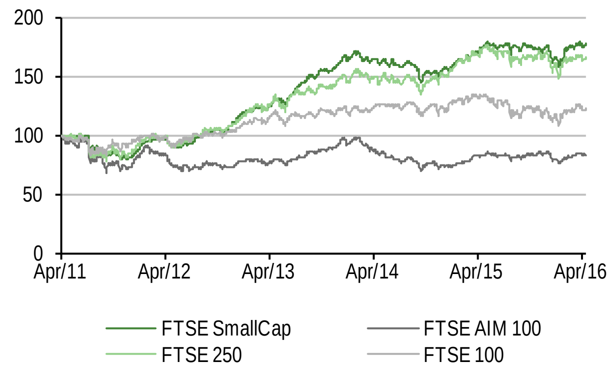
Source: Standard Life Equity Income Trust, Edison Investment Research, Morningstar, Thomson. Note: *N/A where not in April 2015 top 10.

Market outlook: Near-term volatility likely

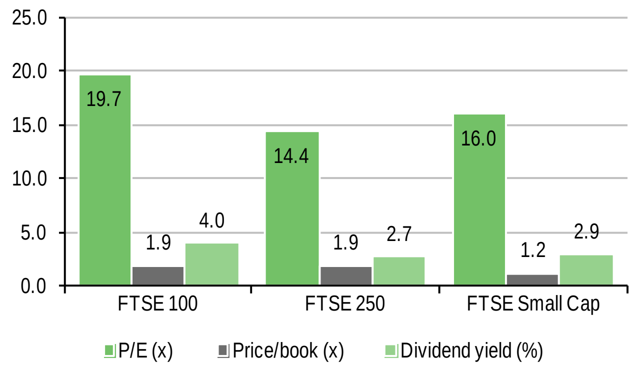
After three years of broadly positive performance, UK stocks have struggled to advance in recent months, hit by fears over the global economy, US interest rate policy, growth in China and, closer to home, the looming referendum over Britain's membership of the EU. As we enter the summer, when trading volumes tend to be low, volatility may persist, although a leg up in share prices may occur if, as widely expected, the UK votes to remain. As shown in Exhibit 2 (left-hand chart) below, small- and mid-caps have outperformed over the past five years, with the exception of those in the AIM Index. However, nervous investors have shown a preference for large-caps, given their greater perceived security, and valuations on the FTSE 100 Index (right-hand chart) are higher as a result. The high yield on the FTSE 100 comes with a caveat, however: dividend cover is historically low (see The manager's view) and smaller stocks may offer more sustainable yields.

Exhibit 2: Market valuation and performance

UK indices over five years (total return)



Valuation metrics for FTSE All-Share components



Source: Thomson Datastream, Edison Investment Research, FTSE Russell. Note: All data to 30 April 2016.

Fund profile: Unconstrained equity income specialist

Standard Life Equity Income Trust (SLET) was launched in 1991 by Morgan Grenfell (later Deutsche Bank); the mandate was won by Standard Life in 2005 following Deutsche's decision to exit the UK funds market. Originally managed at Standard Life Investments by Karen Robertson, it has been run by Thomas Moore (initially as co-manager until May 2012) since November 2011. Moore also manages the open-ended Standard Life UK Equity Income Unconstrained fund. Both funds follow an unconstrained investment style, with a higher weighting in mid-sized and smaller companies than the FTSE All-Share Index benchmark. The trust aims to achieve an above-average dividend yield as well as capital and income growth. It is a member of the Association of Investment Companies' UK Equity Income sector, a large and competitive peer group, in which the trust ranks in the first or second quartile for NAV total return performance over one, three, five and 10 years.

The fund manager: Thomas Moore

The manager's view: Seeking sustainable dividends

As a manager with a focus on growing dividends, Thomas Moore remains concerned by the level of dividend cover on some large UK stocks. Several FTSE 100 companies have cut their dividends in recent months, starting with food retailers such as Tesco and Sainsbury, some of the utilities, all of the major mining stocks and the banks Standard Chartered and Barclays. Management change at GlaxoSmithKline, credit rating fears at BP and Shell and caveats by HSBC in its last results make the dividends on these four stocks (all on dividend cover of c 1x), which together make up c 18% of the blue-chip index, look vulnerable, argues Moore.

He points out that SLET's unconstrained, multi-cap approach allows him to look beyond the big names to find dividend growth potential that has not been priced in. While in aggregate dividend cover on the FTSE All-Share is as low as it was in the bear markets of 2002 and 2009, cover on the FTSE 250 is relatively healthy, with revenues at more than 2x the cost of dividends, and Moore notes that many FTSE 250 and smaller companies are still growing their earnings, making future dividends more sustainable. At present the FTSE 250 is the largest weighting in the SLET portfolio (42.6%); this is because of a combination of more sustainable dividends and also some companies 'growing up': having previously been a non-index position, for instance, DFS (which recently paid a special dividend) is now in the mid-cap index.

As well as avoiding stocks that are vulnerable to dividend cuts, Moore's approach allows him to respond after dividend cuts have taken place. Share prices of companies where the dividend outlook is poor tend to fall well in advance of a cut, but may stabilise once it has taken place. An example of this is Rio Tinto, which Moore bought back in February after it cut its dividend by 50%. He says the company has incorporated the weaker fundamental outlook into its dividend policy, showing it was facing up to reality, and it now has a higher yield than peers in the mining sector.

Looking ahead, Moore says the EU referendum is weighing on sentiment towards UK domestic stocks, but underlying prospects remain strong for companies in the portfolio, where dividend cover and growth are better than average. The manager argues that prices should move back in line with fundamentals once the Brexit uncertainty is out of the way (particularly if the UK votes to remain), and while capital values may fluctuate in the short term, dividend and earnings momentum are good.

Asset allocation

Investment process: 'Best ideas' portfolio with focus on change

SLET manager Thomas Moore is a member of Standard Life Investments' well-resourced UK equity team and runs the trust using the firm's Focus on Change investment process. Moore sits within the UK large-cap team, which provides full research coverage of the FTSE 350, and can also draw on the insights of the UK smaller companies team. SLI's wider resource also includes quantitative analysts, risk management specialists and a large GSRI (governance, stewardship and responsible investment) team, as well as credit, real estate, multi-asset and strategy teams with whom Moore can discuss the macroeconomic backdrop. The trust's portfolio is built from the bottom up, with company meetings forming a key part of the process.

SLI's Focus on Change philosophy is centred on five key questions:

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 not strictly a 'value' style, the aim is to buy stocks where the market has not appreciated the company's potential, leading to the possibility of share price upside.

SLET has a large investment universe, encompassing not just the 350 largest UK stocks but also a further c 1,200 from the FTSE Small Cap, FTSE Fledgling and AIM indices. To narrow down the field, Moore uses SLI's proprietary stock screening matrix, which looks at a range of measures including earnings revisions, EPS growth, director dealings, price momentum, valuation and yield. The trust portfolio has a bias to stocks with cheaper valuations and strong earnings and dividend growth. As well as using the matrix to generate investment ideas, Moore also applies it to the portfolio, with a deterioration in scores acting as a trigger to re-examine existing holdings.

The investment approach is unconstrained by FTSE All-Share Index weightings, although there is a 20% limit on non-index (broadly FTSE Fledgling and AIM) stocks. Moore aims to include only his best ideas in the portfolio of 50-70 stocks. Risk is monitored across the portfolio using SLI's sophisticated factor risk tools, which measure risk both on an absolute level and in terms of divergence from the index position at the stock, sector and valuation level. SLI's analysts give all stocks a 'buy', 'hold' or 'sell' rating. A downgrade to a 'sell' rating would usually cause Moore to exit a position; if a stock moves from a 'buy' to a 'hold' he will reassess the position. Given SLET's aim to provide an above-average and growing income, a dividend freeze or cut would almost certainly be a trigger to sell a holding.

Current portfolio positioning

At 30 April 2016 there were 65 stocks in the SLET portfolio, with the top 10 making up 26.9% of the total. Seven of the top 10 stocks were also in the top 20 a year earlier, underlining the relatively low level of turnover (typically 30-35%, implying an average holding period of three years). Gearing was 13.2%; it is used to increase conviction in individual stocks rather than broadly across the portfolio.

The portfolio is broadly spread by market capitalisation, with 38.4% of assets in FTSE 100 companies, 42.6% in the FTSE 250, 5.4% in the FTSE Small Cap and 13.6% in non-index (FTSE Fledgling and AIM) stocks at 30 April. In sector terms the largest weighting is in financials, mainly insurance, real estate and asset managers, but with the recent addition of Lloyds Bank. The biggest change in sector weightings over the past year is an 8.6pp reduction in industrials, partly as a result of a reduction in the holding in packaging firm DS Smith, where manager Moore says the story is now well understood by the wider market. The largest underweights are to consumer goods, which Moore feels are expensive, and oil & gas, where dividends are under pressure as the oil price remains low. Financials, industrials and consumer services are the largest overweights.

The biggest overweight positions at 30 April were in software firm Sage (where Moore says the market has yet to appreciate the improvement potential given a new management team), BT, asset manager River & Mercantile (held mainly for its fiduciary services/institutional business) and Aviva.

Recent purchases include Lloyds Bank (the biggest net purchase of the past six months), Sage (topping up an existing holding), Investec, John Laing Group, International Airlines, ventilation specialist Volution Group (owner of the Vent-Axia brand) and Majestic Wines, recently the subject of a reverse takeover by Naked Wines, whose CEO Moore says is very highly regarded. Sales include BHP Billiton (following the Samarco dam disaster), Playtech (an online gaming company that announced a shift in strategy from B2B to B2C, where it has less experience), Barclays Bank (following a downgrade to guidance) and Cineworld. Moore sold out of Rio Tinto in late 2015 before it cut its dividend, and bought it back in February at a more favourable valuation.

Exhibit 3: Portfolio sector exposure vs benchmark (% unless stated)

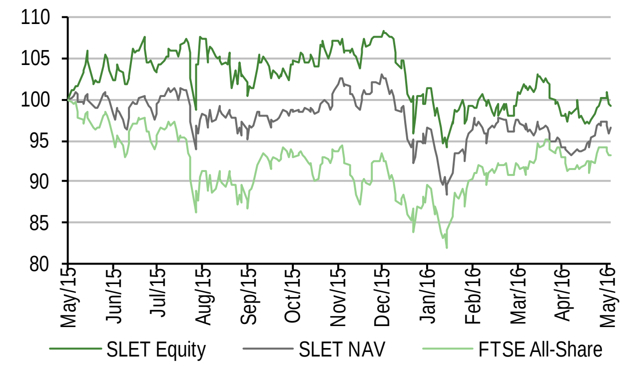
	Portfolio end April 2016	Portfolio end April 2015	Change (% pts)	FTSE All-Share weight	Active weight vs index (% pts)	Trust weight/ index weight (x)
Financials	36.3	32.0	4.3	24.1	12.2	1.5
Consumer services	19.8	19.3	0.5	12.3	7.5	1.6
Industrials	17.7	26.3	-8.6	10.5	7.2	1.7
Telecommunications	8.6	8.2	0.4	5.2	3.4	1.7
Consumer goods	7.4	7.6	-0.2	17.2	-9.7	0.4
Technology	5.3	3.6	1.7	1.5	3.8	3.6
Basic materials	2.6	1.2	1.4	5.5	-3.0	0.5
Utilities	2.4	1.9	0.5	4.0	-1.6	0.6
Oil & gas	0.0	0.0	0.0	11.2	-11.2	0.0
Healthcare	0.0	0.0	0.0	8.6	-8.6	0.0
	100.0	100.0		100.0		

Source: Standard Life Equity Income Trust, Edison Investment Research. Note: Adjusted for gearing.

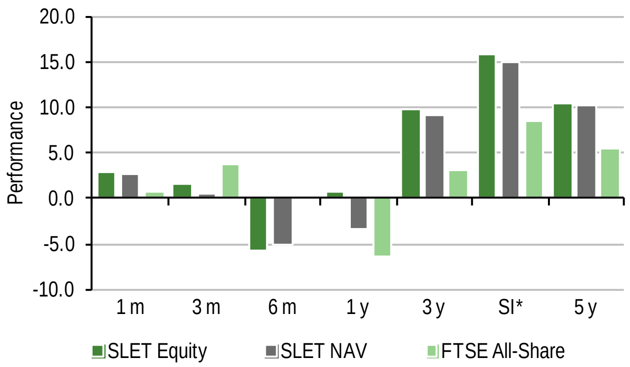
Performance: Solid long-term record hit by macro fears

Exhibit 4: Investment trust performance to 31 May 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 and five-year and since inception performance figures annualised. *Since inception (SI) refers to tenure of Thomas Moore, appointed 14 May 2012.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-Share	2.2	(2.2)	(5.9)	7.6	21.1	25.8	32.9
NAV relative to FTSE All-Share	2.1	(3.2)	(5.2)	3.2	18.9	24.6	23.2
Price relative to FTSE 100	2.6	(1.9)	(5.8)	8.7	25.6	31.8	41.3
NAV relative to FTSE 100	2.5	(2.9)	(5.2)	4.2	23.3	30.5	31.0
Price relative to FTSE 250	0.3	(2.9)	(5.8)	3.7	2.5	0.9	(8.6)
NAV relative to FTSE 250	0.2	(3.9)	(5.2)	(0.5)	0.6	(0.0)	(15.3)

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

SLET has a strong long-term record of outperforming the benchmark FTSE All-Share Index, as shown in Exhibits 4, 5 and 6, both under current manager Thomas Moore and his predecessor Karen Robertson. Positive share price returns over 12 months to 31 May (Exhibit 4), compared with a slightly negative NAV and benchmark total return, reflect the re-rating of investment trusts with UK smaller companies exposure in the aftermath of the May 2015 general election.

The manager describes the first half of SLET's 2016 financial year (1 October to 31 March) as a period of two halves, with strong performance in the first three months turning negative from the start of the new calendar year. In relative terms, the continued outperformance of defensive consumer staples stocks and the resurgence in resources, both areas to which the trust is largely unexposed, have detracted. In absolute terms, the impact of Brexit fears on UK domestic stocks, to which the trust is heavily weighted, has also been negative. However, good individual stock performance has come from holdings such as Sage, Micro Focus and Rightmove.

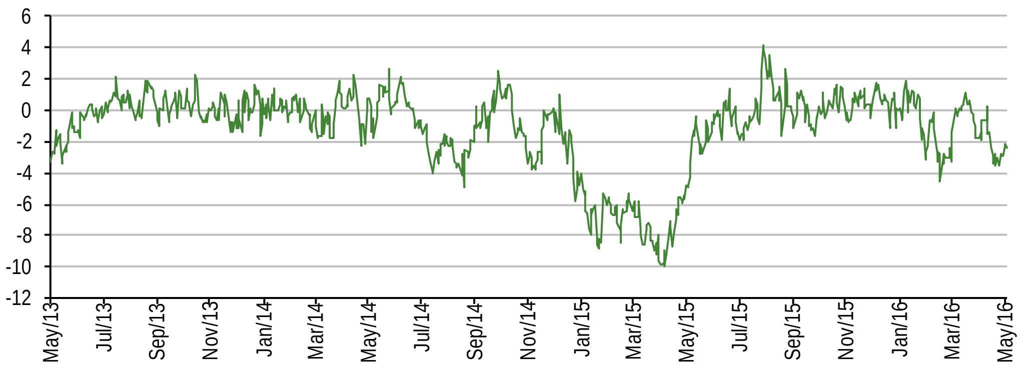
Exhibit 6: NAV performance relative to FTSE All-Share over three years

Source: Thomson Datastream, Edison Investment Research

Discount: Back in long-term range, close to par

Having widened significantly in the run-up to the May 2015 UK general election, when sentiment towards smaller companies (a significant weighting in the trust) was poor, SLET's discount quickly reverted to its long-term range, broadly between a 4% discount and a 2% premium. At 2 June the shares stood at a 2.4% discount to cum-income NAV; this is wider than the one- and three-year averages (0.4% and 1.2% respectively) but broadly in line with the five-year average. SLET has the authority to buy back up to 14.99% or allot up to 10% of shares annually to manage a discount or a premium. In the past five-and-a-half financial years, 6.78m shares have been allotted (including those issued on the exercise of subscription shares) and no shares have been bought back.

Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

SLET is a conventional investment trust. It currently has two classes of share: ordinary shares (44.7m in issue) and subscription shares (4.47m outstanding at H116), which have a final exercise date of 30 December 2016 and can be converted into ordinary shares at 320p on the last business day of June and December. In H116, 728,215 subscription shares were exercised, and a further 1m shares were issued at a premium in response to investor demand. The trust has a £30m bank lending facility with Scotiabank, implying a maximum potential gearing level of c 15%. On average £25m of the facility was drawn during H116, and at 30 April SLET had net gearing of 13.2%.

Standard Life Investments receives an annual management fee of 0.65% of total assets, charged 30% to revenue and 70% to capital. There is no performance fee, and at H116 ongoing charges stood at 0.94%.

Dividend policy and record

SLET pays dividends quarterly, in March, June, September and December. Since 2016 it has published a dividend timetable giving investors visibility on payment dates. The trust aims to achieve real growth in both capital and income and has increased its annual dividend at a compound rate of 3.7% over the past five years compared with a compound annual CPI inflation rate of 1.9% over the same period. The FY15 dividend of 14.7p was 5.0% up on the prior year and was again fully covered by income. Two dividends have so far been declared for FY16, amounting to 6.8p (historically the fourth dividend has been set at a higher level than the first three). Based on the 2 June share price of 418.3p and the last four dividends, SLET currently yields 3.6%.

Peer group comparison

SLET is a member of the AIC's UK Equity Income peer group. This is a large sector of 23 funds; Exhibit 8 shows the 14 with a market capitalisation above £175m. SLET is the smallest of this group. In NAV total return terms the trust is broadly average over one, three and five years and is also close to the average for risk-adjusted returns as measured by the Sharpe ratio over one and three years. Gearing and dividend yield are also broadly in line with averages. In a sector where several trusts are trading at a premium, SLET has one of the smallest discounts to NAV. Charges are a little above the sector average but SLET does not charge a performance fee.

Exhibit 8: UK Equity Income investment trusts above £175m as at 27 May 2016

% unless stated	Market cap £m	TR 1 Year	TR 3 Year	TR 5 Year	Ongoing Charge	Perf. fee	Discount (ex-par)	Net Gearing	Dividend yield (%)	Sharpe 1y (NAV)	Sharpe 3y (NAV)
Standard Life Equity Income	189.9	(1.7)	29.5	57.0	0.9	No	(1.1)	111.0	3.5	(0.4)	0.6
City of London	1,242.7	(3.2)	21.7	55.0	0.4	No	1.3	110.0	4.0	(0.4)	0.4
Diverse Income Trust	358.1	10.9	54.9	111.1	1.3	No	5.0	100.0	2.8	0.5	1.5
Dunedin Income Growth	325.3	(9.9)	3.4	25.9	0.6	No	(11.2)	115.0	5.2	(0.7)	0.0
Edinburgh Investment	1,363.8	1.4	33.3	79.7	0.6	No	(0.8)	113.0	3.5	(0.2)	0.6
F&C Capital & Income	253.5	(0.5)	15.4	37.2	0.7	No	2.3	109.0	3.8	(0.3)	0.3
Finsbury Growth & Income	802.0	2.4	37.1	94.6	0.8	No	1.1	104.0	2.0	(0.1)	0.7
JPMorgan Claverhouse	305.8	(4.7)	21.4	40.4	0.7	Yes	(9.9)	118.0	3.8	(0.4)	0.4
Lowland	343.6	(3.9)	22.2	66.3	0.6	Yes	(4.1)	117.0	3.2	(0.4)	0.4
Merchants Trust	436.0	(10.3)	7.9	34.5	0.6	No	(9.9)	123.0	6.0	(0.7)	0.1
Murray Income Trust	444.0	(7.3)	7.0	33.8	0.7	No	(6.8)	108.0	4.8	(0.6)	0.1
Perpetual Income & Growth	918.5	(2.7)	30.6	77.8	0.7	Yes	(3.7)	117.0	3.8	(0.5)	0.6
Temple Bar	715.5	(6.1)	11.1	46.9	0.5	No	(6.0)	103.0	4.4	(0.6)	0.2
Troy Income & Growth	197.9	3.3	28.8	61.0	1.0	No	1.2	100.0	3.2	(0.1)	0.6
Sector weighted average (23 fds)		(2.3)	24.5	62.9	0.7		(2.8)	111.1	3.8	(0.4)	0.5
SLET rank out of 23	14	8	6	9	10		9	11	17	9	7

Source: Morningstar, Edison Investment Research. Note: TR=NAV 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 (100 = ungeared).

The board

SLET has five directors. Richard Burns (chairman since December 2014) joined the board in 2006. Josephine Dixon was appointed in 2011 and Mark White became a director in 2013. Jeremy Tigue joined the board in October 2014. Keith Percy, the longest-serving director (on the board since launch in 1991), will retire at the December 2016 AGM, and the board is currently seeking a replacement. The directors have backgrounds in investment management and accountancy.

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