EDISON

Standard Life Equity Income Trust

Unconstrained investment in UK equities

Investment trusts

Standard Life Equity Income Trust (SLET) aims to generate above-average income and real growth in capital and income from a portfolio of UK equities across the capitalisation spectrum. At end-December 2016, more than 55% of the portfolio was invested outside of the FTSE 100 index. While the last year has seen a tough period of relative investment performance as a result of outperformance of large-cap companies with overseas earnings, which were not held, SLET continues to have a good long-term track record; it has outperformed the benchmark FTSE All-Share index over both five and 10 years. With the exception of one year of static dividends, SLET's annual dividend has increased every year since launch.

12 months ending	Share price (%)	NAV (%)	FTSE All-Share (%)	FTSE 100 (%)	FTSE 250 (%)
31/12/12	26.3	19.2	12.3	10.0	26.1
31/12/13	33.1	32.8	20.8	18.7	32.3
31/12/14	5.1	5.2	1.2	0.7	3.7
31/12/15	15.5	13.3	1.0	(1.3)	11.2
31/12/16	(10.9)	(3.4)	16.8	19.1	6.7

Source: Thomson Datastream. Note: All % on a total return basis in GBP.

Investment strategy: Unconstrained vs benchmark

Manager Thomas Moore is able to draw on the wide resources of Standard Life Investments' UK equity team. He employs the firm's Focus on Change philosophy, a proprietary screening matrix and thorough fundamental research to construct a relatively concentrated portfolio of 50-70 companies that are trading at a discount to their intrinsic value. Moore's unconstrained approach means that stock and sector weightings vary significantly from the benchmark; at end-December 2016, more than one-third of the fund was invested in financial stocks. Gearing is permitted in a range of 5% net cash to 15% net gearing – net gearing is typically c 10%.

Market outlook: Better outlook for smaller-caps

UK equities have rallied strongly since the post-Brexit sell-off – the FTSE 100 index has hit a series of new highs. Smaller companies have more attractive P/E valuations than mega-caps and, while their dividend yields in aggregate are lower, their income can be more sustainable. The dividend cover for smaller companies is much more attractive than for the mega-caps in general and studies show that companies which start paying or grow their dividends, outperform over the long term. Investors seeking income from investment in UK equities may be interested in a fund that offers significant exposure to smaller UK companies.

Valuation: Scope for discount to narrow

SLET's current 7.4% share price discount to cum-income NAV is wider than the averages of the last one, three, five and 10 years (range of 2.3% to 4.0%). This offers potential for the discount to narrow if near-term relative performance improves. SLET's board aims to grow the dividend in real terms – over the last five years, annual dividends have compounded at an average rate of 4.4% pa. Its current dividend yield of 3.9% is above the peer group average.

30 January 2017

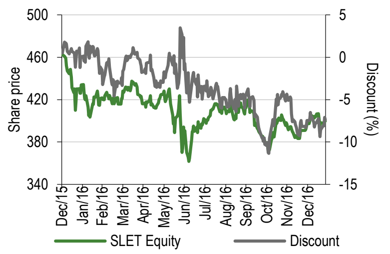
Price	**399.8p**
Market cap	**£197m**
AUM	**£235m**

NAV*	428.0p
Discount to NAV	6.6%
NAV**	431.6p
Discount to NAV	7.4%

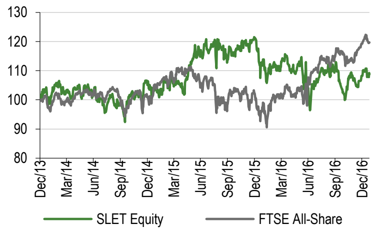
*Excluding income. **Including income. As at 25 January 2017.

Yield	3.9%
Ordinary shares in issue	49.2m
Code	SLET
Primary exchange	LSE
AIC sector	UK Equity Income
Benchmark	FTSE All-Share

Share price/discount performance



Three-year performance vs index



52-week high/low	437.5p	361.5p
NAV** high/low	440.3p	360.4p

**Including income.

Gearing

Gross*	12.7%
Net*	9.7%

*As at 31 December 2016.

Analysts

Mel Jenner +44 (0)20 3077 5720

Sarah Godfrey +44 (0)20 3681 2519

investmenttrusts@edisongroup.com

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.

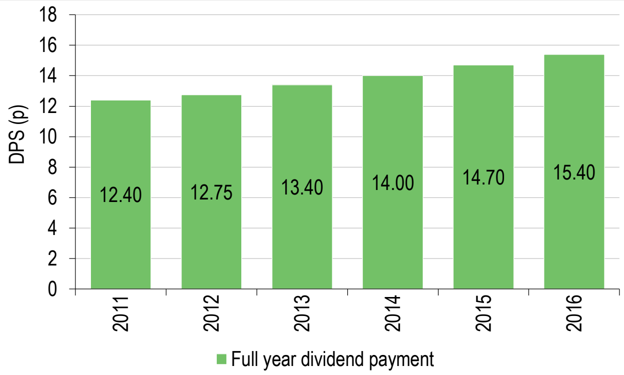
Recent developments

- 13 January 2016: Applied for admission of 3.9m new shares following the exercise of subscription rights.
- 30 December 2016: Final date for conversion of subscription shares. Subscription share listing suspended 3 January 2017.
- 15 December 2016: Retirement of director Keith Percy at AGM, replaced by Caroline Hitch, effective 1 January 2017.
- 16 November 2016: Final results for 12 months ending 30 September 2016. NAV TR of +0.9% versus benchmark TR +16.8%. Share price TR -2.7%.

Forthcoming		Capital structure		Fund details	
AGM	January 2018	Ongoing charges	0.96%	Group	Standard Life Investments
Interim results	May 2017	Net gearing	9.7%	Manager	Thomas Moore
Year end	30 September	Annual mgmt fee	0.65% to £250m, then 0.55%	Address	1 George Street, Edinburgh, EH2 2LL
Dividend paid	Quarterly	Performance fee	None		
Launch date	14 November 1991	Trust life	Indefinite	Phone	+44 (0)345 600 2268
Continuation vote	Five yearly, next 2021	Loan facilities	£30m with Scotiabank	Website	www.standardlifeinvestments.com

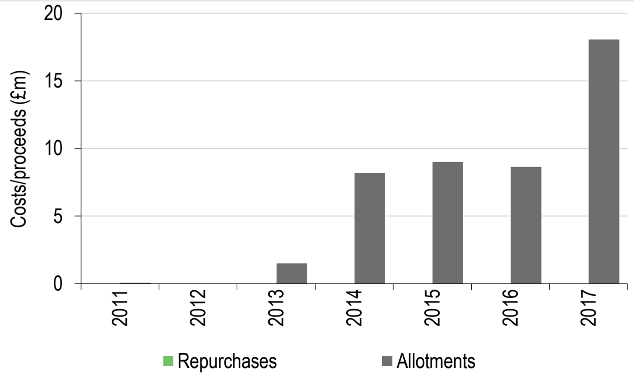
Dividend policy and history (financial years shown)

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.

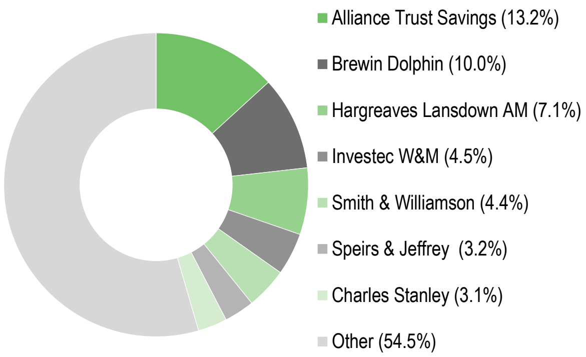


Share buyback policy and history (financial years shown)

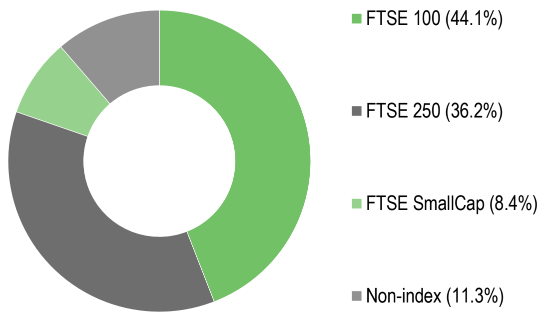
SLET may buy back up to 14.99% or allot up to 10% of ordinary shares annually to manage a discount or a premium. Figures include shares issued as a result of subscription share exercise.



Shareholder base (as at 18 January 2017)



Portfolio exposure by market cap (as at 31 December 2016)



Top 10 holdings (as at 31 December 2016)

		Portfolio weight %	
Company	**Sector**	**31 December 2016**	**31 December 2015****
Rio Tinto	Mining	3.7	N/A
Aviva	Life insurance	3.6	3.4
BT	Fixed line telecom	3.5	4.4
Sage	Software & computer services	3.0	3.3
Imperial Brands*	Tobacco	2.8	N/A
Micro Focus	Software & computer services	2.7	N/A
Vodafone	Mobile telecom	2.6	2.7
Legal & General	Life insurance	2.5	2.6
Close Brothers	Banks	2.4	2.2
Prudential	Life insurance	2.4	N/A
Top 10 (% of portfolio)		**29.2**	**27.7**

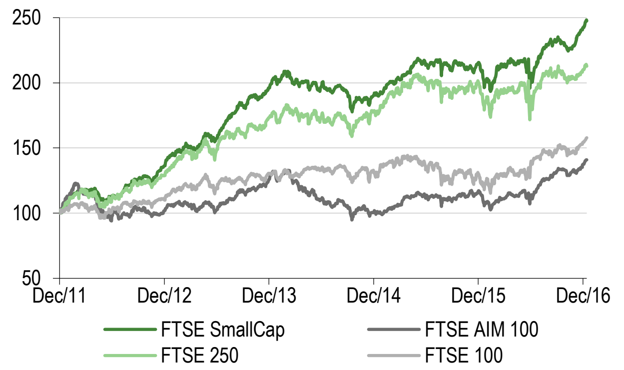
Source: Standard Life Equity Income Trust, Edison Investment Research, Morningstar, Bloomberg. Note: *Formerly Imperial Tobacco. **N/A where not in December 2015 top 20.

Market outlook: Smaller-caps relatively attractive

As shown in Exhibit 2 (left-hand side), the FTSE 250 and SmallCap indices have significantly outperformed the FTSE 100 and AIM 100 indices over the last five years (although underperformed in 2016). The valuations of UK indices are shown in Exhibit 2 (right-hand side); while P/E multiples are at or close to the high end of their historical ranges, the valuations of smaller-cap companies look relatively attractive versus larger-cap companies. While they have lower average dividend yields, their income can be more sustainable. Between 2014 and 2016 there has been a succession of FTSE 100 companies cutting dividends, including selected resource stocks and supermarkets. As a result of low earnings growth, dividend cover of the FTSE 100 index is below 1x. This compares to the FTSE 250 index, where dividend cover is closer to 2x; in addition, it has a superior dividend growth track record versus the FTSE 100 index and studies from Goldman Sachs show that companies that grow or initiate dividends outperform in total return terms over the long term. In a continued low interest rate environment, for investors seeking exposure to UK equities, a fund with a focused income bias, broad exposure across the capitalisation spectrum and a good long-term performance track record may be of interest.

Exhibit 2: UK stock market performance and valuation

UK indices over five years (total return)



Valuation metrics of UK indices

	P/E* (x)	P/B (x)	EV/sales (x)	ROE (%)	Div yield (%)
FTSE All-Share	24.7	1.9	1.7	4.3	3.8
FTSE 100	27.6	1.9	1.7	3.7	4.0
FTSE 250	16.9	2.2	1.6	9.6	3.0
FTSE 350	25.2	1.9	1.7	4.5	3.8
FTSE SmallCap	13.7	1.4	1.0	-3.9	2.9

Source: Thomson Datastream, Edison Investment Research. Note: *P/E is current, based on cash earnings.

Fund profile: Focused equity income investment

SLET was launched in 1991 and originally managed by Morgan Grenfell, which was acquired by Deutsche Bank. Standard Life Investments (SLI) took over management of SLET in November 2005 following Deutsche Bank's decision to exit the UK retail funds market. Since November 2011, SLET has been managed by Thomas Moore, who aims to provide above-average income and real growth in capital and income. He has an unconstrained investment style with a higher exposure to mid- and small-cap equities than the benchmark FTSE All-Share index. The portfolio normally comprises 50-70 positions – SLET's top 10 holdings may not exceed 50% of net assets and no single holding will exceed 10%. Portfolio turnover is typically between 20% and 35% pa. The board has delegated gearing responsibility to the manager; a range of 5% net cash to 15% net gearing is permitted although, in practice, net gearing is generally c 10%.

The fund manager: Thomas Moore

The manager's view: More macro surprises in 2017?

The manager suggests that 2016 was a year of "unexpected changes in the macro drivers", such as the result of the UK's referendum, the outcome of the US election and a significant recovery in the oil price, and that macro surprises could continue in 2017. Brexit had a negative effect on SLET's performance as c 50% of its portfolio companies' revenues are generated in the UK. Following Donald Trump's election in the US, there has been a shift from monetary to fiscal stimulus, which has been mirrored in the UK; Moore expects this trend to continue. SLET's largest sector exposure is financials, which typically benefit from a steepening of the yield curve. The trust tends to own more financial and cyclical stocks and fewer bond proxies than its peers, and so the manager suggests its relative performance should improve in an environment of accelerating growth and higher interest rates.

The manager is open-minded about the potential impacts of Brexit on the UK economy; so far, UK companies have generally been upbeat in their commentary. There is a perception among economists that UK consumption growth will slow, but so far this is not being backed up by economic or corporate data. However, there are some companies (not held by SLET) that are being affected by industry-specific factors, such as Foxtons, which is seeing lower sales volumes as a result of higher stamp duty, and easyJet, which the manager suggests is suffering from too much European short-haul capacity. Moore comments that there is a wide valuation disparity between companies generating profits domestically and those generating profits overseas. He adds that this has only occurred two other times in the last 13 years – during the global financial crisis and around the time of the Scottish referendum. When domestic-earning companies have become this cheap on a relative basis, their stocks have subsequently rallied. More generally, there are signs that sentiment towards the UK is improving on the back of more robust economic data, as evidenced by the FTSE 100 hitting new all-time highs.

Asset allocation

Investment process: Focus on change

The manager and the well-resourced UK Equity team at SLI employ the firm's Focus on Change philosophy, which recognises that at different times in the economic cycle there are different factors that drive individual stocks and markets. When analysing a company for potential inclusion in the portfolio, the following five questions are considered:

- What are the key drivers and issues for this stock?
- What is changing?
- What is assumed in the price?
- What will make the market change its mind about this stock?
- What specific triggers are there?

The wide potential investment universe of c 1,500 stocks is screened using SLI's proprietary stock-screening matrix; factors include earnings growth and revisions, stock price momentum, valuation and dividend yield. Stocks that pass the screen are subject to rigorous fundamental analysis, which includes an evaluation of a company's dividend policy and its corporate governance track record. The resulting portfolio contains 50-70 high-conviction positions and, while the manager is unconstrained by the stock and sector weightings of the FTSE All-Share benchmark, risk is monitored using SLI's sophisticated risk modelling system.

Current portfolio positioning

At end-December 2016, the top 10 positions accounted for 29.2% of the portfolio; this is modestly higher than end-December 2015. Excluding cash, 44.1% was in FTSE 100, 36.2% in FTSE 250, 8.4% in FTSE SmallCap and 11.3% in non-index companies. By way of comparison, the benchmark FTSE All-Share index is split approximately 80% FTSE 100, 15% FTSE 250 and 5% in FTSE SmallCap. SLET has a much larger percentage in smaller stocks than the benchmark; these stocks generally have higher potential for sustainable dividend growth than mega-cap stocks.

As shown in Exhibit 3, more than one-third of the portfolio is invested in financial companies. Over the last 12 months to end-December 2016, the largest increases in exposure are in basic materials (+5.7pp) and financials (+2.8pp), and the largest decreases are in industrials (-6.7pp) and consumer services (-4.3pp). SLET is heavily overweight the financial sector, which detracted from performance in 2016, and reflecting the manager's unconstrained investment approach, has zero exposure to the healthcare sector, which comprises c 10% of the benchmark. The manager suggests that the research and development pipelines at pharmaceutical companies such as AstraZeneca and GlaxoSmithKline remain disappointing in spite of heavy investment spend. Within the oil & gas sector, the manager has recently become more positive – the oil price has rallied and both OPEC and non-OPEC producers have agreed to reduce production. He has recently (December 2016) initiated a small position in BP, which has been actively cutting costs since the 2010 Deepwater Horizon oil spill, suggesting a better outlook for dividend growth and cover.

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

	Portfolio end-December 2016	Portfolio end-December 2015	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Financials	36.7	33.9	2.8	25.7	11.0	1.4
Consumer services	16.2	20.5	-4.3	11.7	4.5	1.4
Industrials	14.5	21.3	-6.7	10.7	3.9	1.4
Consumer goods	8.9	7.6	1.2	14.4	-5.5	0.6
Telecommunications	8.6	8.6	0.0	4.0	4.6	2.1
Technology	5.9	6.3	-0.4	0.8	5.0	7.0
Basic materials	5.7	0.0	5.7	6.9	-1.2	0.8
Utilities	2.6	1.8	0.7	3.6	-1.0	0.7
Oil & gas	1.0	0.0	1.0	13.3	-12.2	0.1
Healthcare	0.0	0.0	0.0	9.1	-9.1	0.0
	100.0	**100.0**		**100.0**		

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

One of the recent additions to the portfolio is Premier Asset Management, which had its initial public offering in October 2016; SLET participated and received a reasonable allocation. It is a retail asset management group across a range of strategies including multi-asset, equity and absolute return funds. It is benefiting from the trend of IFAs spending more of their time on financial planning and less time on selecting funds, which they are outsourcing to multi-managers such as Premier. The company has had 15 consecutive quarters of positive net inflows, is growing earnings at a double-digit rate and trading on a forward P/E multiple of c 13x.

Classified within the consumer goods sector are holdings in housebuilders Bovis, Galliford Try and Persimmon. They are trading on attractive dividend yields and the manager suggests that a lot of bad news is already priced into the stocks, despite the companies issuing positive trading statements. Outside London, housing activity is brisk, so this is an example of good news stories that are being ignored by the wider investment community.

Other cyclical stocks in the portfolio with overseas earnings and strong market positions that have lagged the broader market despite continued solid trading include the following:

- Inchcape – an automotive distributor and retailer, where the manager suggests that investors are underestimating the company's ability to grow revenues across multiple geographies. The company has a strong balance sheet and a high free cash flow yield.
- Carnival – a cruise ship operator, which the manager believes can rapidly increase its dividend. Share price weakness on the back of a rising oil price and concerns about the Zika virus provided an attractive investment entry point.

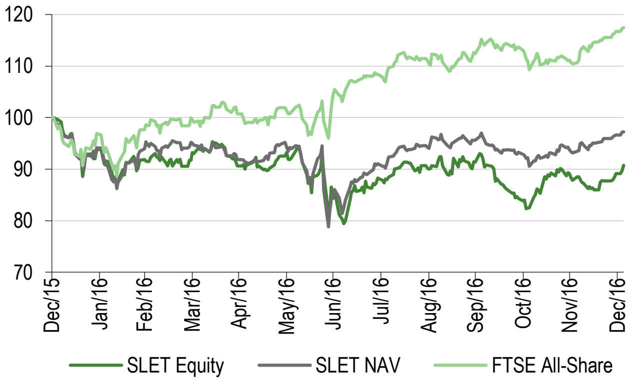
Performance: Tough one-year performance

The manager comments that he aims to provide above-average returns with real growth in capital and income by investing on an unconstrained and index-agnostic basis. For FY16 ending 30

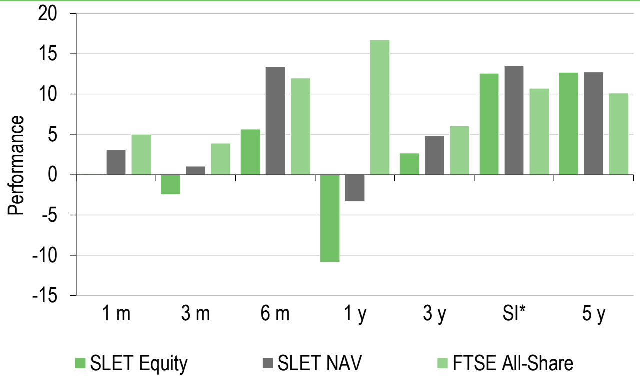
September, SLET's NAV and share price total returns of +0.9% and -2.7% respectively trailed the benchmark's +16.8% total return. FY16 relative performance was affected by limited exposure to large-cap companies with overseas earnings, which significantly outperformed small-and mid-cap companies with domestic operations both before and after the UK's EU referendum and the underperformance of some of SLET's large-cap holdings, such as BT, even before the announcement from its Italian subsidiary. In periods of market stress, stock market leadership can be particularly narrow – for example, SLET's relative performance in FY16 was affected by not holding BP or Royal Dutch Shell, both mega-cap companies that rallied strongly in a rising oil price environment. The largest positive contributors to relative performance in FY16 were holdings in Micro Focus International (1.1pp), Sage (0.7pp) and Barclays (0.7pp). The largest detractors to performance were a holding in Staffline (-1.3pp) and not holding Royal Dutch Shell (-0.9pp), BP and British American Tobacco (both -0.7pp).

Exhibit 4: Investment trust performance to 31 December 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.

A tough period of relative performance over the last 12 months has affected SLET's positive three-year performance record. However, its NAV and share price total returns remain ahead of the benchmark over both five and 10 years.

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	(4.7)	(6.1)	(5.6)	(23.7)	(9.3)	12.4	5.1
NAV relative to FTSE All-Share	(1.8)	(2.7)	1.2	(17.2)	(3.4)	12.6	6.0
Price relative to FTSE 100	(5.0)	(6.5)	(5.4)	(25.2)	(8.6)	17.7	8.3
NAV relative to FTSE 100	(2.1)	(3.1)	1.5	(18.8)	(2.7)	18.0	9.3
Price relative to FTSE 250	(3.1)	(4.1)	(6.1)	(16.4)	(12.0)	(11.3)	(15.4)
NAV relative to FTSE 250	(0.2)	(0.6)	0.7	(9.4)	(6.3)	(11.1)	(14.7)

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

Exhibit 6: NAV total return performance relative to benchmark over three years

Source: Thomson Datastream, Edison Investment Research

Discount: Wider than historical averages

SLET's 7.4% share price discount to cum-income NAV is wider than the 3.5% average of the last 12 months. Over the past year the range has been a from 3.5% premium to an 11.3% discount – the widest discount occurred on 3 November 2016, a period of heightened investor risk aversion ahead of the US presidential election. The current discount is also wider than the averages of the last three, five and 10 years (2.3%, 3.0% and 4.0% respectively).

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

Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

Issued in December 2010, SLET had a line of subscription shares, the last exercise date for which was 30 December 2016 at 320p; their listing was suspended on 3 January 2017. For shareholders not electing to exercise their rights, the final subscription trustee exercised the outstanding rights to 2.14m shares; those shareholders received 70.6p per share (the difference between the prevailing market price and the exercise price, minus costs). As a result, SLET now has a single line of shares; there are currently 49.2m ordinary shares in issue. The trust has a £30m lending facility with Scotiabank; the average cost of borrowing in FY16 was 1.5%. At end-December 2016, net gearing was 9.7%. Standard Life Investments receives an annual management charge, which is charged 30% to revenue and 70% to capital. The fee is calculated as 0.65% on the first £250m and 0.55% on assets above £250m, (prior to October 2016 it was 0.65% of gross assets). FY16 ongoing charges were 0.96%, a 2bp increase versus the previous year.

Dividend policy and record

Dividends are paid quarterly in March, June, September and December. The FY16 dividend of 15.4p was a 4.8% increase versus the prior year; it was 1.16x covered by revenue. Over the last five years the annual dividend has compounded at an average rate of 4.4% per year, which is above the level of annual UK inflation. Based on the current share price, SLET's dividend yield is 3.9%, which is higher than the weighted average of the UK Equity Income peer group.

Peer group comparison

SLET is a member of the AIC's UK Equity Income sector, which comprises 23 funds. Exhibit 8 shows the largest 15, which have a market capitalisation higher than £175m. SLET's NAV total returns are behind the whole peer group average over one, three and five years, ranking 22nd, 18th and 12th over one, three and five years respectively, its weaker performance over one year having affected the longer-term track record. At the time of our last report in June 2016, SLET ranked eighth, sixth and ninth out of 23 funds over one, three, and five years respectively. The weaker near-term performance has had an impact on SLET's risk-adjusted returns, as measured by the Sharpe ratio, which now lag the weighted averages over one and three years. SLET's ongoing charge is above average, but no performance fee is payable. Its discount is modestly wider than average, its net gearing is broadly in line, but it has a higher than average dividend yield, ranking 10th out of 23 funds in the sector.

Exhibit 8: AIC UK Equity Income investment trusts above £175m as at 26 January 2017

% unless stated	Market cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	Ongoing charge	Perf. fee	Discount (ex-par)	Net gearing	Dividend yield (%)	Sharpe 1y (NAV)	Sharpe 3y (NAV)
Standard Life Equity Income	197.4	4.6	17.1	75.5	1.0	No	(6.1)	108	3.8	(0.4)	(0.2)
City of London	1,356.0	16.3	22.1	71.9	0.4	No	1.5	107	3.9	0.1	(0.2)
Diverse Income Trust	355.3	5.3	22.2	121.5	1.2	No	3.7	100	3.0	(0.6)	(0.3)
Dunedin Income Growth	370.5	24.8	15.9	53.6	0.6	No	(9.7)	115	4.7	0.5	(0.2)
Edinburgh Investment	1,367.7	10.7	34.4	85.4	0.6	No	(4.0)	116	3.5	(0.2)	0.1
F&C Capital & Income	283.6	23.6	23.6	64.6	0.7	No	1.9	108	3.6	0.3	(0.1)
Finsbury Growth & Income	973.0	18.5	36.0	119.2	0.7	No	0.8	103	2.0	0.1	0.0
JPMorgan Claverhouse	341.0	21.3	23.2	79.4	0.8	No	(9.9)	114	3.4	0.2	(0.1)
Lowland	376.6	26.8	19.9	97.0	0.6	Yes	(8.2)	109	3.3	0.3	(0.3)
Merchants Trust	502.9	21.6	11.9	57.6	0.6	No	(6.2)	119	5.2	0.3	(0.2)
Murray Income Trust	487.6	22.3	17.8	57.8	0.8	No	(8.7)	107	4.5	0.4	(0.2)
Perpetual Income & Growth	876.4	6.3	19.2	86.2	0.7	Yes	(8.0)	117	3.5	(0.4)	(0.2)
Schroder Income Growth	187.3	19.1	24.2	77.1	1.0	No	(7.0)	109	3.9	0.2	(0.1)
Temple Bar	823.3	30.2	19.0	76.6	0.5	No	(5.7)	103	3.3	0.6	(0.2)
Troy Income & Growth	215.3	11.8	33.3	69.9	1.0	No	1.5	100	3.3	(0.2)	0.0
Sector weighted avg (23 funds)		**17.0**	**23.8**	**81.6**	**0.7**		**(3.9)**	**110**	**3.6**	**0.1**	**(0.1)**
SLET rank out of (23 funds)	**14**	**22**	**18**	**12**	**10**		**12**	**11**	**10**	**20**	**17**

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 (100 = ungeared).

The board

There are five directors on the board at SLET; all are non-executive and independent of the manager. Chairman, Richard Burns, was appointed as a director in 2006 and assumed his current role in December 2014. Josephine Dixon was appointed in 2011, Mark White in 2013 and Jeremy Tigue in 2014. The newest member of the board is Caroline Hitch, who has a background in investment management. She was appointed on 1 January 2017 to replace Keith Percy, who retired after 25 years as a director of the trust.

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