Murray Income Trust

Initiation of coverage

Positioned to perform in challenging conditions

Investment trusts

Murray Income Trust (MUT) seeks to provide investors with a high and growing income, as well as capital growth, by investing mainly in UK equities. Lead manager Charles Luke and deputy manager Iain Pyle run a relatively focused portfolio of 30–70 companies chosen for their attractive yields and dividend and capital growth prospects. They seek good-quality businesses with strong balance sheets and competitive positions, and may invest up to 20% of the portfolio overseas in order to diversify sources of income, and access opportunities unavailable in the UK. Following the merger of Aberdeen Asset Management and Standard Life, MUT has access to a significantly expanded UK equity team, with in-depth coverage of large, medium-sized and smaller companies, and has increased its exposure to higher-growth mid and small caps as a result. MUT has a 45-year record of dividend growth and currently offers a yield of 4.5%, above the average for its AIC UK Equity Income peer group.

12 months ending	Share price (%)	NAV (%)	FTSE All-Share (%)	FTSE 350 HY (%)	MSCI AC World (%)
31/12/14	0.0	0.5	1.2	0.5	11.2
31/12/15	(7.0)	(0.3)	1.0	(5.5)	3.8
31/12/16	12.8	16.4	16.8	25.2	29.4
31/12/17	14.9	11.6	13.1	10.4	13.8
31/12/18	(4.6)	(7.4)	(9.5)	(9.2)	(3.3)

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

Investment strategy: Income fund with quality focus

MUT has benefited from the amalgamation of Aberdeen Asset Management and Standard Life Investments (SLI), with the SLI side having had a much larger UK equity team, offering in-depth, sector-based research coverage of the whole FTSE 350 Index, as well as access to Harry Nimmo's UK small-cap team. However, MUT Manager Charles Luke's approach remains largely unchanged: seeking quality businesses at reasonable prices, with attractive yields and dividend growth prospects. The 30–70 stock portfolio is diversified by sector, geography and company size.

Market outlook: Not out of the woods yet

Following the broad-based market sell-off in the second half of 2018, markets have begun 2019 in a more optimistic vein. However, the factors underpinning last year's volatility – such as slowing global growth, trade tensions and Brexit uncertainty – persist, meaning investors should not become complacent. A more reasonable level of P/E valuations, supported by continued earnings growth, provides a measure of comfort, and dividends should prove an important component of total returns.

Valuation: Tighter-than-average discount; 4.5% yield

At 30 January, MUT's shares traded at a 5.9% discount to cum-income net asset value. This was narrower than the average discount of 8.3% over one year, following share price outperformance of the NAV during the market volatility in 2018. MUT has an active discount management policy and, while there is no publicly stated level at which it will repurchase shares, it has tended to buy back at discounts exceeding c 9%. MUT currently offers a 4.5% dividend yield.

31 January 2019

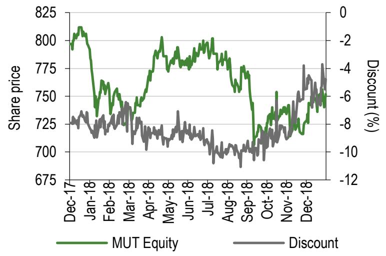
Price	**752.0p**
Market cap	**£497.2m**
AUM	**£571.0m**

NAV*	793.4p
Discount to NAV	5.2%
NAV**	799.0p
Discount to NAV	5.9%

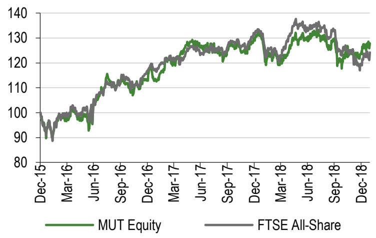
*Excluding income. **Including income. As at 30 January 2019.

Yield	4.5%
Ordinary shares in issue	66.1m
Code	MUT
Primary exchange	LSE
AIC sector	UK Equity Income
Benchmark	FTSE All-Share index

Share price/discount performance



Three-year performance vs index



52-week high/low	803.0p	700.0p
NAV* high/low	883.6p	752.6p

*Including income.

Gearing

Gross*	9.1%
Net*	7.3%

*As at 31 December 2018.

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Edison profile page

Murray Income Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

Murray Income Trust (MUT) aims for a high and growing income combined with capital growth through investment in a portfolio principally of UK equities. Its investment policy is to invest in companies that have potential for real earnings and dividend growth, while also providing an above-average portfolio yield. The emphasis is on the management of risk and on the absolute return from the portfolio. MUT measures its performance versus the FTSE All-Share Index.

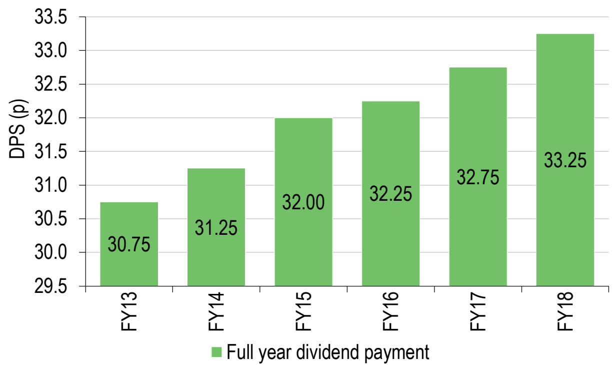
Recent developments

- 4 December 2018: First three interim dividends of 8.0p per share declared for the year ending 30 June 2019, to be paid in January, March and June.
- 5 November 2018: All resolutions passed at AGM.
- 20 September 2018: Annual results for the year ended 30 June 2018. NAV TR +3.9% and share price TR +3.3% versus +9.0% for FTSE All-Share Index. Final dividend of 9.25p brings total for year to 33.25p, the 45th consecutive annual increase.

Forthcoming		Capital structure		Fund details	
AGM	November 2019	Ongoing charges	0.69%	Group	Aberdeen Standard Investments
Interim results	February 2019	Net gearing	7.3%	Managers	Charles Luke, Iain Pyle
Year end	30 June	Annual mgmt fee	Tiered (see page 10)	Address	Seventh floor, 40 Princes Street, Edinburgh, EH2 2BY
Dividend paid	Quarterly	Performance fee	None		
Launch date	1923	Trust life	Indefinite	Phone	0808 500 0040 (retail)/0131 222 1863
Continuation vote	No	Loan facilities	£40m loan notes/£20m bank loan	Website	www.murray-income.co.uk

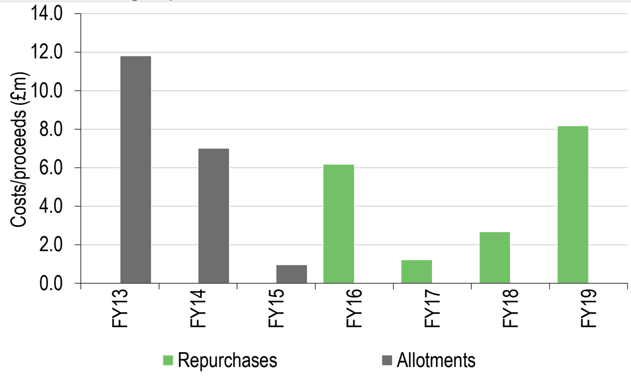
Dividend policy and history (financial years)

MUT's board aims to increase the total dividend each year. Three interim dividends are normally paid, in January, March, and June, with a final dividend declared in the annual results and paid after approval at the AGM in November.

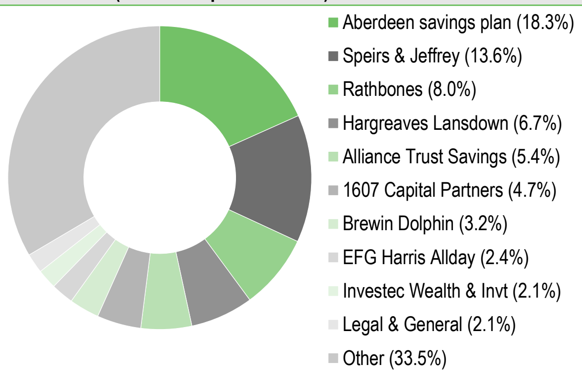


Share buyback policy and history (financial years)

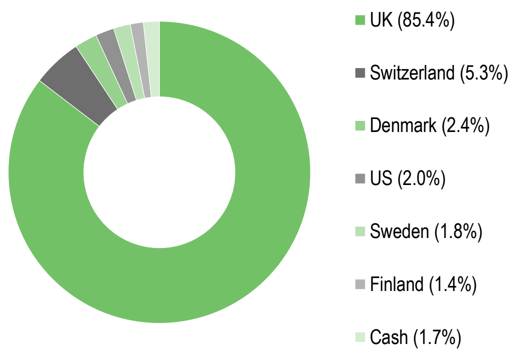
Renewed annually, MUT's board has the authority to allot shares up to the equivalent of 5% of the share capital, and to repurchase up to 14.99% of shares, in order to manage a premium or a discount.



Shareholder base (as at 29 September 2018)



Portfolio exposure by geography (as at 31 December 2018)



Top 10 holdings (as at 31 December 2018)

			Portfolio weight %	
Company	**Country**	**Sector**	**31 December 2018**	**31 December 2017***
Unilever	UK	Consumer goods	4.1	4.4
AstraZeneca	UK	Healthcare	3.7	4.0
BHP Group	UK	Basic materials	3.5	2.9
Diageo	UK	Consumer goods	3.5	2.4
BP	UK	Oil & gas	3.3	3.3
Royal Dutch Shell 'B'	UK	Oil & gas	3.3	3.4
Prudential	UK	Insurance	3.0	3.9
Roche	Switzerland	Healthcare	2.8	3.2
RELX	UK	Media	2.7	N/A
HSBC	UK	Banks	2.6	3.5
Top 10 (% of holdings)			**32.5**	**36.0**

Source: Murray Income Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-December 2017 top 20.

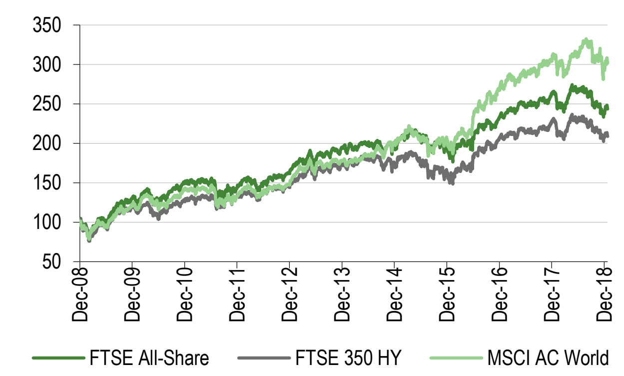
Market outlook: Valuations reasonable after sell-off

Having enjoyed a period of more or less sustained growth since their low point in March 2009 following the global financial crisis, world stock markets suffered a significant setback in the second half of 2018, with many posting their worst annual total return performance in years. As shown in Exhibit 2 (left-hand chart), the global market has outperformed the UK in sterling terms over the past decade, assisted by the weakness of sterling since the UK's vote to leave the European Union in the June 2016 referendum. High-yielding UK stocks (as measured by the FTSE 350 Higher Yield Index) have produced a lower total return over the period than the broad UK index (up 106.9% versus 138.3% for the FTSE All-Share), although much of this can be attributed to a divergence early in the period; over five years, total returns from the two indices are 19.2% and 22.1%, respectively.

So what comes next? The early part of 2019 has so far seen markets mount something of a recovery, although many of the economic and political factors that surrounded the volatility in late 2018 remain: slowing global growth (with China a particular worry), the risk of a monetary policy misstep in the US, trade tensions, and the ongoing Brexit saga. What has changed as a result of the sell-off is that equity valuations – which had reached quite extreme levels earlier in 2018 – now look more reasonable (right-hand table). In the UK, the forward P/E multiple of 11.9x for the Datastream UK Index is 5% below the 10-year average, and with corporate earnings growth forecasts remaining positive, this could point to a favourable entry point for investors. While many commentators argue that we are in the closing stages of the decade-long bull run, few yet predict recession or a market collapse in the near term. However, with volatility likely to remain a feature, the UK's world-beating 4.3% dividend yield could help to support total returns.

Exhibit 2: Market performance and valuation

Performance of UK and global indices over 10 years (£)



12m forward P/E mutliples for global equity markets (x unless stated)

	Last	High	Low	10-year average	Last as % of average	Dividend yield (%)
UK	11.9	15.7	8.5	12.5	95	4.3
World	13.8	16.3	9.8	13.5	102	2.7
US	15.8	19.0	11.1	15.1	104	2.1
Europe	12.2	15.6	7.6	12.2	100	3.6
Japan	12.5	23.6	10.5	14.4	86	2.3
Asia ex-Japan	12.5	14.3	9.9	12.3	102	2.6

Source: Thomson Datastream, Edison Investment Research. Valuation data based on Datastream indices, as at 29 January 2019.

Fund profile: Seeking a high income with growth

Murray Income Trust (MUT) began life in 1923 as the Caledonian Trust Company, a Glasgow-based investment trust with a focus on fixed income securities in the UK and overseas. It began investing more heavily in equities following the stock market crash of the 1930s, gradually transforming into a generalist equity investment trust. In order to differentiate itself in a crowded market, in 1979 the trust adopted a narrower focus on income growth, and changed its name to Murray Caledonian Investment Trust. In 1984 it became Murray Income Trust, a name it retained following the takeover of its investment manager, Murray Johnstone, by Aberdeen Asset Management (AAM) in 2000. AAM merged with Standard Life in 2017, and its fund management arm is now known as Aberdeen Standard Investments (ASI).

MUT seeks to achieve a high and growing income, as well as capital growth, by investing mainly in UK equities, although up to 20% of its portfolio may be invested overseas. It has been managed since 2006 by Charles Luke, with deputy manager Iain Pyle joining in 2018.

The trust is a member of the Association of Investment Companies' UK Equity Income sector, and uses the FTSE All-Share Index as a benchmark for performance measurement, although the portfolio is constructed without reference to the index. MUT's managers invest in a relatively focused (30–70 stocks) portfolio of companies that have potential for real earnings and dividend growth, while also providing an above-average portfolio yield. The trust is geared via £40m of fixed-rate debt and a £20m flexible multicurrency facility, providing available gearing of c 12% of NAV versus a limit of 25%. Given its focus on achieving a high income, MUT targets a dividend yield above that of the FTSE All-Share Index.

The fund manager: Charles Luke

The manager's view: Focus on quality and diversity

MUT's Lead Manager Charles Luke argues that dividends are a touchstone in terms of corporate strength, and encourage a disciplined, long-term stewardship approach in company managements. He says the trust's bias towards quality companies is key to ensuring a sustainable and growing dividend for its investors. Businesses need to grow their earnings in order to increase their dividends sustainably, and are best able to increase their earnings when they exhibit quality factors such as a strong competitive position in an attractive industry, low operational leverage, a strong balance sheet and the ability to perform throughout the business cycle.

The manager points out that dividends (and their reinvestment) have accounted for the bulk of long-term equity market returns. However, simply focusing on the highest-yielding stocks runs the risk of being faced with dividend cuts, so the key is to identify those companies where dividend yields are both attractive and sustainable.

Luke says the UK currently has a higher prospective dividend yield than any other region, and for most of the period since the global financial crisis, equity yields have exceeded those on government bonds. Because the biggest UK firms derive a large proportion of their earnings from overseas, UK companies' dividend growth has also been boosted by the weakness of sterling since the Brexit referendum in 2016. On average, MUT's holdings generate 20% of their income in the UK, compared to an average for the FTSE All-Share of c 30%. Luke points out that globalisation is nothing new for these companies; Unilever, MUT's largest holding, has been selling soap in India since the 1880s, and generates less than 4% of its revenues in the UK, with 53% coming from Asia and other emerging markets.

In terms of the macroeconomic outlook, Luke says that while a sustained period of ultra-low interest rates and quantitative easing in developed markets has helped to push up asset values, there are now signs of a return to more conventional monetary policy. With the flow of cheap money reducing for investors and businesses alike, the manager says MUT's focus on good-quality companies with strong balance sheets, that are capable of growing their earnings and dividends over the long term, is more important than ever. Following the market weakness in 2018, valuations are now also more attractive in absolute terms.

Luke's recent purchases for the MUT portfolio generally have better dividend growth prospects than the stocks he has sold. He points to examples such as support services firm Rentokil Initial (which is not a high-yielding stock but has grown its dividend by 14.4% pa over the past three years), and Holiday Inn operator Intercontinental Hotels Group (IHG), with 15.6% pa dividend growth over the past three years. Other new holdings offer attractive yields backed up by strong balance sheets, such as retail distribution warehouse specialist London Metric Property (LMP), utility aggregator Telecom Plus, and over-50s travel and insurance group Saga.

In general, says Luke, it is hard to be very optimistic on UK consumer companies as a whole, because of weak consumer confidence and continued uncertainty over the terms and timing of the UK's exit from the European Union. However, there are structural factors underpinning the growth prospects of selected consumer stocks the manager has recently purchased – such as IHG's international focus, LMP's exposure to e-commerce, and the fact that Saga's target customer group owns 75% of the UK's household wealth – that should enable them to work through any short-term volatility.

Luke is cognisant of the risks to the global outlook: the possibility of an overheating economy in the US, trade tensions, volatility in emerging markets, Brexit uncertainty and the tightening of monetary policy. However, he says he takes comfort from MUT's quality perspective: companies with pricing power can combat risks from rising inflation; balance sheet strength is important if interest rates rise; and UK companies benefit from good intellectual property, global brands, an educated workforce, strong corporate governance and a robust legal framework. Furthermore, the increasing numbers of non-fundamentally focused market participants, such as index-tracking funds and momentum strategies, provide an opportunity for fundamental investors to pick up shares in good-quality companies cheaply during periods of volatility. However, Luke concludes, in volatile markets it is more important than ever to maintain a diversified portfolio in terms of both capital and income potential.

Asset allocation

Investment process: Enhanced approach to income investing

MUT has been managed since 2006 by Charles Luke, who was joined during FY18 by Deputy Manager Iain Pyle. The trust comes under the umbrella of Aberdeen Standard Investments (ASI), which was formed following the merger of Aberdeen Asset Management and Standard Life in 2017. Under the new structure, the four UK fund managers from Aberdeen's pan-European equities team (of which Luke was a member) have joined with the larger UK equity team from Standard Life Investments, of which Pyle was a member. There are 16 investors in the expanded ASI team, with Luke and Pyle making up two of the five-strong UK income product group.

Luke explains that prior to the merger, the AAM UK equity managers were all generalists, whereas the SLI managers each undertook research coverage of specific industry sectors. The new ASI team follows the specialist model, with full sector-based coverage of all FTSE 350 companies spread across the 16 team members, who can also draw on Harry Nimmo's UK smaller companies team for small-cap ideas. ASI has c 150 investors covering equity markets globally, giving Luke and Pyle access to overseas stock picks in addition to their core UK portfolio.

The new team blends elements of both its predecessors' approaches. AAM's style is to use in-house fundamental research and regular meetings with management to target high-quality companies, which it aims to hold for the long term with very low portfolio turnover. SLI has greater coverage of the whole UK equity market, assisted by its larger team, sector specialist focus and the use of external research. AAM's approach is to find quality companies first, and then gauge if they are attractively valued, while Luke describes SLI's Focus on Change process as a lens to find undervalued companies, which are then assessed on quality factors. The ASI UK equity team gives all the companies it covers a buy, hold or sell rating, and has a 'Winners List' made up of the top 20 highest-conviction ideas, all of which must be buy-rated.

Luke stresses that much of the MUT approach remains unchanged as a result of the merger and team expansion: he and Pyle use fundamental research and corporate access to identify attractively valued, quality companies; take an active approach to engaging on environmental, social and governance (ESG) factors; and aim to hold for the long term. However, the new structure, as well as ASI's investments in people and technology, have improved market coverage and sector expertise, enabled earlier recognition of any change in the quality factors of companies, and facilitated faster decision-making.

MUT's threefold investment objective is stated in order of priority: to achieve a **high** and **growing income**, combined with **capital growth**. While it invests mainly in UK companies, up to 20% may be held overseas, helping the managers to diversify risk and gain access to opportunities where there may be no attractive UK equivalent. Around 30% of the portfolio is held in small and mid-cap companies (broadly, those outside the FTSE 100), meaning MUT has greater size diversification than the FTSE All-Share, where the largest 100 companies account for c 80% of the total market capitalisation. The portfolio typically has between 30 and 70 holdings (currently 58), with the top five holdings limited to 40% of total assets (currently 18.1%). The top three sectors (using the ICB definition of 'sector', which is the third level of classification, beneath industry and supersector) may not exceed 50% of the portfolio. Derivative instruments may be used to enhance income; the managers write put and call options in concert with the investment process, allowing them to generate option premium income on holdings they would be happy to top-slice (via the sale of call options) or top up (via the sale of put options).

In order to achieve the investment objective, the managers seek companies with above-average dividend yields, dividend growth and dividend security. They aim to build a portfolio of quality companies (based on both qualitative and quantitative assessments) that offer diversification of income, capital and sector. As shown in Exhibit 3, MUT's portfolio at end-FY18 had a higher return on equity, operating margin, and forecast earnings and dividend growth than the FTSE All-Share Index, and significantly lower net debt.

Exhibit 3: MUT quantitative quality characteristics

	MUT (%)	FTSE All-Share (%)
Return on equity	16.2	14.2
Operating margin	19.3	15.9
Net debt (ex-financials)	37.8	61.5
EPS growth 3y forward	8.1	7.4
DPS growth 3y forward	5.6	4.8

Source: Murray Income Trust, Edison Investment Research. Note: Calculated as weighted medians, as at 30 June 2018.

MUT's manager describes the trust's approach to stewardship and engagement with its holdings as "active not activist", founded in patience and persistence, and based on frequent and varied contact with companies and a willingness to behave as part-owners of the business, rather than investors keen to make a quick profit. Examples of engagement include productive discussions on executive remuneration, cybersecurity, and approaches to managing geopolitical and environmental risk.

The trust has structural gearing, with an official limit of 25%, although current borrowing facilities limit achievable gearing to c 12%. Luke comments that with MUT's fixed-rate borrowing carrying an interest rate of 2.51%, it makes sense to use gearing to invest in stocks with yields of more than 4% as well as the potential for capital growth. Gearing is deployed across the whole portfolio, with the multicurrency bank loan used to defray some of the foreign exchange risk from overseas holdings.

Luke has a broadly buy-and-hold approach, explaining that "ideally I would hold things forever", although he is happy to top-slice holdings that have done well, and recycle the proceeds into favoured stocks on price weakness. However, he could look to sell if the fundamental outlook for a company became less attractive, or its dividend looked insecure, or there was a better idea elsewhere. The expanded team meets every morning to discuss company newsflow, and any downgrades are flagged immediately, which Luke says has improved the sell discipline and led to an uptick in MUT's performance as a result of prompt action being taken.

The trust's patient, long-term approach means portfolio turnover is very low. While it was somewhat higher at 23.9% in FY18, reflecting a degree of rebalancing in the portfolio as a result of enhancements to the investment process, the average turnover for the previous five financial years was 9.7%, implying a holding period of more than 10 years.

Current portfolio positioning

At 31 December 2018, there were 58 holdings in the MUT portfolio, compared with 51 a year earlier. The top 10 holdings accounted for roughly one-third (32.5%) of the portfolio, compared with 36.0% at 31 December 2017, with concentration in the top 20 stocks falling from 62.0% to 53.8% over the period. While only 12 out of the top 20 stocks were common to both periods, all of the 20 largest positions at end-H119 (31 December 2018) were held in the portfolio at end-H118 – in many cases at weightings that would have seen them included in the H119 top 20 – illustrating the relatively low turnover of the strategy. However, enhancements to the investment process as a result of the new team structure did result in a higher level of portfolio activity than usual during the period, with nine positions exited and 16 added between end-H118 and end-H119.

Luke says that concentration in the largest holdings (which are well-known, good-quality companies) has fallen somewhat as a result of finding more ideas among mid-cap stocks, and trying to back these with conviction. Very few of MUT's positions are less than 1% of the total portfolio.

MUT may invest up to 20% of its assets outside the UK, and at 31 December 2018, overseas holdings made up c 13% of the portfolio, compared with c 15% a year earlier (Exhibit 4). The principal purpose of the overseas holdings is to diversify exposure to sectors where UK dividends are concentrated in a small number of stocks (such as pharmaceuticals), and to gain access to areas such as technology, that are underrepresented in the UK. The technology sector accounts for less than 1% of FTSE All-Share market capitalisation, compared with c 15% of the MSCI AC World Index. The majority of MUT's non-UK holdings are in Europe (particularly Switzerland and Scandinavia). There is no direct exposure to Asia, and the only US holding is Microsoft. New overseas holdings over the past 12 months include Finnish lift maker KONE, and Swiss vacuum valve specialist VAT Group. Luke says that one of the benefits of having an enlarged team with greater coverage is that there are more UK stock ideas, and consequently less need to invest overseas, leading to a drop in MUT's non-UK exposure from an average of 14–17% over the past five years. The manager also points out that many of the large UK-listed holdings generate a significant proportion of their earnings overseas: the top five holdings at 31 December 2018 (see Exhibit 1) all derive at least 94% of their revenues from outside the UK.

Exhibit 4: MUT's overseas holdings as at 31 December 2018

			% of portfolio	
Company	**Country**	**Sector**	**31 December 2018**	**31 December 2017**
Roche Holdings	Switzerland	Pharmaceuticals & biotechnology	2.8	3.2
Microsoft	USA	Software & computer services	2.0	2.6
Nordea Bank	Sweden	Banks	1.8	2.6
Nestlé	Switzerland	Food producers	1.7	1.2
Novo-Nordisk	Denmark	Pharmaceuticals & biotechnology	1.7	2.2
KONE	Finland	Industrial engineering	1.4	N/A
Scandinavian Tobacco	Denmark	Tobacco	0.8	1.0
VAT Group	Switzerland	Industrial engineering	0.7	N/A
Total non-UK exposure			**12.8**	**15.2**

Source: Murray Income Trust, Edison Investment Research

From an industry perspective (Exhibit 5), MUT has few large overweights or underweights versus the benchmark. Most weightings are within c 2pp above or below those of the FTSE All-Share; the exceptions are oil & gas (a 7.7pp underweight) and technology (a 3.1pp overweight, although as noted above, the All-Share technology weighting is extremely small). The largest change in industry exposure over the past 12 months is a 5.3pp increase in consumer services, more than doubling the weighting at 31 December 2017. Purchases in this area during FY18 include media companies

RELX (now in the top 10) and Euromoney Institutional Investor, as well as travel & leisure stocks Intercontinental Hotels Group and Hostelworld. The weighting in basic materials increased by 2.6pp (aided by additions to the holding in chemical company Croda), while technology exposure fell by 2.6pp, mostly as a result of the exit from accountancy software firm Sage, although the managers also took some profits in Microsoft.

Exhibit 5: Portfolio industry exposure vs FTSE All-Share Index (% unless stated)

	Portfolio end-December 2018	Portfolio end-December 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Financials	25.8	26.8	(1.0)	26.2	(0.4)	1.0
Consumer goods	16.0	16.8	(0.8)	13.9	2.1	1.1
Industrials	11.9	11.1	0.8	10.9	1.0	1.1
Healthcare	10.4	12.4	(2.0)	8.5	1.9	1.2
Consumer services	9.4	4.1	5.3	11.5	(2.1)	0.8
Basic materials	7.8	5.2	2.6	7.8	0.0	1.0
Oil & gas	6.6	7.8	(1.2)	14.3	(7.7)	0.5
Technology	4.1	6.7	(2.6)	1.0	3.1	4.1
Telecommunications	3.6	4.4	(0.8)	3.1	0.5	1.2
Utilities	2.2	0.8	1.4	2.8	(0.6)	0.8
Cash	2.2	3.9	(1.7)	0.0	2.2	N/A
	100.0	**100.0**		**100.0**		

Source: Murray Income Trust, Edison Investment Research

Holding a broad spread of sectors means MUT is not overexposed to any one area in terms of income generation. While some industry groups – such as financials and consumer goods – are expected to contribute to portfolio income in line with their weightings (for example, ASI forecasts that 26.6% of MUT's FY19 income will come from financials, which made up 25.8% of the portfolio at 31 December 2018), others make a greater or lesser contribution. Oil & gas, for instance, makes up 6.6% of the portfolio but is expected to provide 12.2% of the income; conversely, industrials are 11.9% of the portfolio but are forecast to supply only 6.9% of the income. These stocks may, however, grow their dividends more quickly than the big oil companies such as Shell and BP.

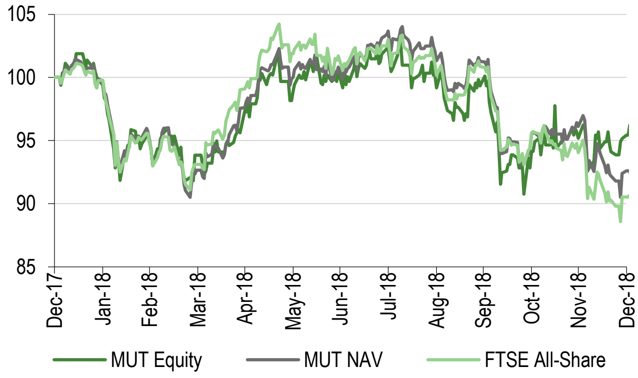
Looking at portfolio activity over the past 12 months, of the nine holdings sold, three were FTSE 100 companies, three were mid-cap FTSE 250 companies, and three were overseas holdings. Of the 16 new holdings, four were in the FTSE 100 Index, eight in the FTSE 250, and two each in the FTSE Small Cap and overseas. There was also a change in one of the two smaller company investment trust holdings, with Standard Life UK Smaller Companies coming into the portfolio after it merged with Dunedin Smaller Companies. Among the more recent new purchases are emerging markets focused investment manager Ashmore Group, paving specialist Marshalls, and UK housebuilder Countryside Properties. Recent sales included engineering firm Rotork and aerospace company Rolls-Royce.

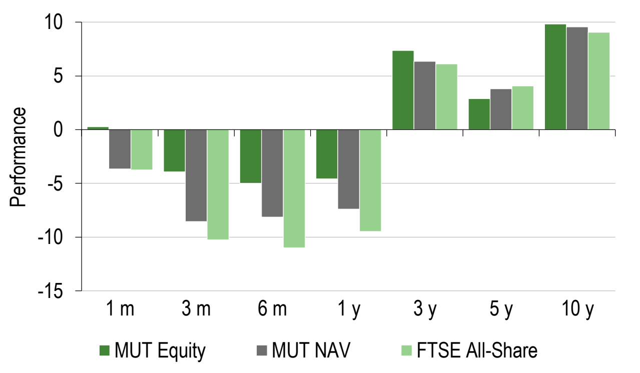
At 31 December 2018, there were seven call options (enabling MUT to sell a stock at a predetermined price) and two put options (enabling the trust to buy at a certain price) written over portfolio holdings. The manager uses these as a means of trimming or topping up holdings after a period of share price strength or weakness, as well as to enhance the revenue account via option premium income.

Performance: Outperforming in recent market volatility

Exhibit 6: Investment trust performance to 31 December 2018

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.

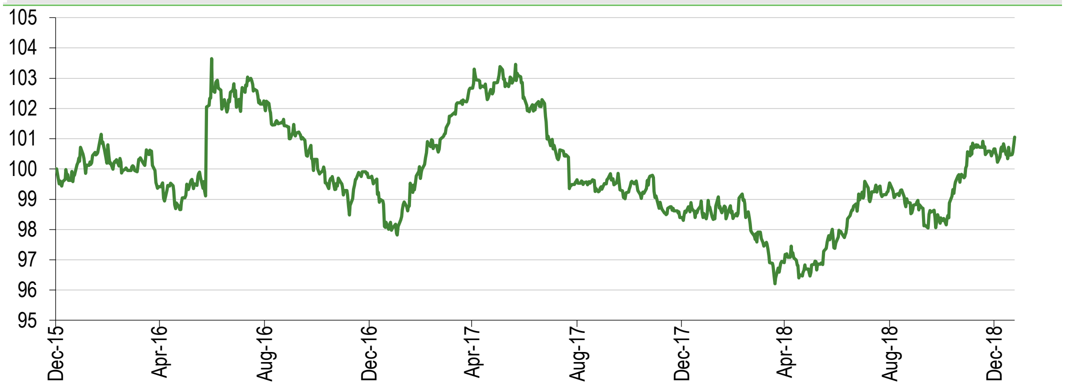
Exhibit 7: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-Share	4.2	7.1	6.7	5.4	3.6	(5.6)	7.2
NAV relative to FTSE All-Share	0.1	1.9	3.2	2.3	0.7	(1.3)	4.7
Price relative to FTSE 350 HY	4.1	6.1	5.9	5.1	(1.3)	(3.3)	23.5
NAV relative to FTSE 350 HY	0.0	0.9	2.3	2.0	(4.1)	1.1	20.6
Price relative to MSCI AC World	7.6	7.4	0.5	(1.3)	(13.1)	(30.0)	(13.1)
NAV relative to MSCI AC World	3.4	2.2	(2.8)	(4.3)	(15.6)	(26.7)	(15.1)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-December 2018. Geometric calculation.

MUT's NAV and share price total returns declined in absolute terms during the year to 31 December 2018, although it has outperformed the benchmark FTSE All-Share Index over one, three, six and 12 months, as well as three and 10 years (Exhibits 6 and 7). MUT underperformed the index in FY18 (ended 30 June), owing to a combination of stock-specific factors. These included holding Provident Financial, whose share price collapsed in August 2017; being underweight Royal Dutch Shell, which performed strongly; and the off-benchmark top 10 position in Swiss pharmaceutical company Roche, whose shares drifted lower throughout the year. With Roche's shares rebounding by c 14% in the second half of 2018, however, this position helped the trust to outperform as the All-Share Index fell sharply in the latter part of the year. As shown in Exhibit 7, MUT has also performed in line with or better than the high-yield FTSE 350 HY index over periods of one year and less, and, over the most recent periods, has also exceeded the total returns on the MSCI AC World Index. Factors contributing to this outperformance may include the trust's focus on relatively defensive, good-quality companies, whose high dividend yields form an important part of total returns in periods of declining share prices.

Exhibit 8: NAV total return performance relative to FTSE All-Share Index over three years



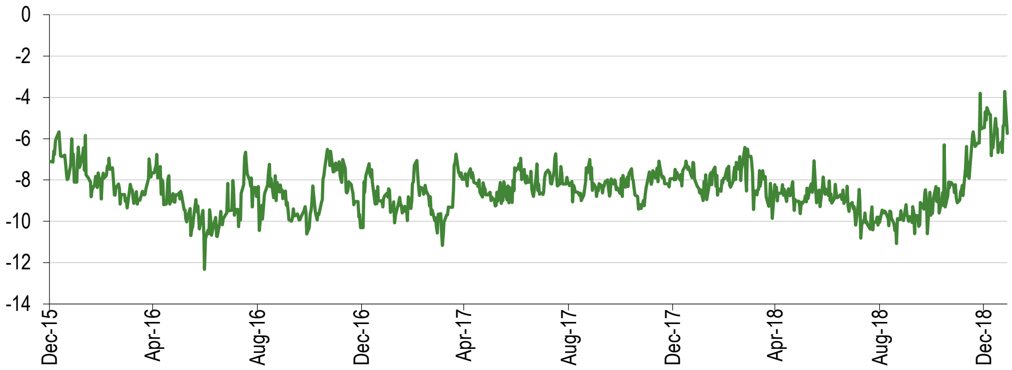
Source: Thomson Datastream, Edison Investment Research

Discount: Narrower than recent averages

At 30 January 2019, MUT's shares traded at a 5.9% discount to cum-income NAV (with debt at fair or market value). This was narrower than the one- and three-year average discounts of 8.3% and 8.4%, respectively, having contracted in the last quarter of 2018 as the trust's share price outperformed its NAV. The average discount has historically been narrower (6.5% and 3.9% over five and 10 years, respectively), and the shares broadly traded at a premium to NAV for most of the period between 2010 and 2014, before derating during a period of poor performance in 2015.

The board may allot or repurchase shares to manage a discount or premium. It uses its buyback powers relatively sparingly and tends not to repurchase shares at less than a c 9% discount to NAV. There were no buybacks during calendar 2017 – a period of historically low stock market volatility – but 2018 saw the highest level of repurchases of the last four years.

Exhibit 9: Share price discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

MUT is a conventional investment trust with one class of share. At 30 January 2019, there were 66.1m ordinary shares in issue, with a further 2.5m held in treasury. The trust's board has the authority to repurchase up to 14.99% of the shares, or allot shares up to 5.00% of the share capital, in order to manage a discount or a premium. During 2018, 912,045 shares (1.4% of the share base) were bought back at a cost of £10.8m.

Gearing is available via £40m of 10-year loan notes at a fixed rate of 2.51%, and a £20m multicurrency revolving bank loan. These were both arranged in November 2017 and replaced a previous £80m revolving multicurrency bank loan. At 31 December 2018, c £6.5m of the bank loan was drawn, and together with the loan notes this represented gross gearing of 9.1%, compared with maximum available gearing of 11.8%. The manager uses the multicurrency facility to match the currency exposure of the overseas holdings.

Aberdeen Standard Fund Managers (MUT's alternative investment fund manager, or AIFM) is paid an annual management fee of 0.55% of the trust's net assets up to £350m, 0.45% between £350m and £450m, and 0.25% above £450m. This split has been in place since 1 January 2018; previously, the percentages were the same, but were tiered at assets up to £400m, between £400m and £550m, and above £550m. As noted below, the management fee is now charged 70% to the capital account and 30% to the revenue account (previously 50/50). For FY18, ongoing charges were 0.69% (FY17: 0.72%). Had the new fee tiers been in place for the whole of FY18, ongoing charges would have been c 0.67%. MUT's ongoing charges are below the average for its peer group and are very competitive compared with the average of 1.25% for the AIC investment company universe.

Dividend policy and record

MUT pays dividends quarterly, with interim payments in January, March and June, and a final dividend in November. With effect from FY18, the trust has rebalanced its dividend payments to give a more even spread of income through the year, resulting in higher interim dividends (8.00p a quarter versus 7.00p in FY17) and a lower final dividend (9.25p versus 11.75p in FY17). Total dividends for FY18 were 33.25p, up from 32.75p in FY17 (+1.5%), representing a 45th consecutive year of dividend growth. Compound annual growth in the dividend has been relatively muted, at 1.6% pa over the past five years. The manager points out that this is partly a function of MUT's focus on companies with above-market yields, as a high starting yield may point to a lower level of dividend growth. Dividends have been fully covered by income in four of the last six financial years (1.01x cover in FY18), and MUT has a healthy revenue reserve, amounting to 25.9p per share (c 0.8x the total FY18 dividend) after accounting for the final dividend.

A change in the allocation of management fees and financing costs (charged 30% to revenue and 70% to capital with effect from 1 July 2018, compared with the previous 50/50 split) will boost MUT's revenue account from FY19 onwards. The revenue return per share for FY18 would have been c 3.6% higher under the new policy. MUT has announced it will pay three interim dividends of 8.0p each in respect of FY19, the same as in FY18. Based on the FY18 dividends and the current share price, MUT has a dividend yield of 4.5%.

Peer group comparison

Exhibit 10: AIC UK Equity Income sector as at 29 January 2019*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
Murray Income Trust	**493.2**	**(6.5)**	**28.2**	**26.2**	**168.8**	**0.7**	**No**	**(5.3)**	**107**	**4.5**
Aberdeen Standard Equity Income	203.8	(11.8)	10.6	23.1	171.2	0.9	No	(2.4)	112	4.6
BlackRock Income and Growth	44.8	(10.6)	15.6	32.0	148.4	1.1	No	(1.2)	108	3.7
BMO Capital & Income	304.8	(7.8)	33.7	36.8	160.6	0.6	No	0.4	104	3.7
BMO UK High Income	111.2	(14.7)	14.2	16.5	120.4	0.3	No	(9.3)	103	4.2
Chelverton UK Dividend Trust	39.0	(19.9)	9.5	33.4	496.7	2.0	No	(7.1)	159	4.7
City of London	1,416.1	(8.0)	19.1	28.4	178.2	0.4	No	1.9	113	4.7
Diverse Income Trust	354.6	(6.5)	16.1	34.9	--	1.1	No	(2.5)	100	3.7
Dunedin Income Growth	360.4	(8.1)	27.5	21.2	158.8	0.6	No	(7.6)	114	5.5
Edinburgh Investment Trust	1,237.4	(8.8)	8.8	33.2	171.7	0.6	No	(7.2)	108	4.3
Finsbury Growth & Income	1,382.4	1.9	41.2	64.9	427.8	0.7	No	0.6	103	2.0
Invesco Income Growth	150.5	(6.2)	13.9	21.9	175.2	0.8	No	(13.9)	103	4.4
Investment Company	14.2	(5.9)	7.6	14.3	392.7	2.6	No	(9.9)	100	6.5
JPMorgan Claverhouse	391.3	(12.9)	22.2	25.2	172.6	0.8	No	2.6	111	4.0
JPMorgan Elect Managed Inc	70.8	(11.5)	14.5	21.4	147.9	0.7	No	(2.5)	103	4.5
Lowland	372.9	(13.2)	25.7	20.2	338.7	0.6	Yes	(1.6)	113	3.9
Merchants Trust	515.4	(11.6)	22.2	16.6	153.2	0.6	No	1.7	120	5.5
Perpetual Income & Growth	792.5	(10.1)	3.7	16.7	169.1	0.7	No	(9.2)	113	4.3
Schroder Income Growth	182.4	(9.7)	20.0	27.3	154.1	0.9	No	(5.4)	109	4.4
Shires Income	75.2	(12.3)	29.6	29.9	237.9	1.0	No	1.5	150	5.2
Temple Bar	830.6	(7.0)	31.4	23.3	224.8	0.5	No	(2.9)	100	3.5
Troy Income & Growth	209.0	(5.3)	14.9	39.6	201.0	0.9	No	0.8	100	3.7
Value And Income	117.3	(7.8)	14.8	15.0	133.8	1.5	No	(14.2)	131	4.6
Sector average	**420.4**	**(9.3)**	**19.3**	**27.0**	**213.8**	**0.9**		**(4.0)**	**112**	**4.4**
MUT rank in sector (23 funds)	**7**	**6**	**5**	**11**	**14**	**12**		**14**	**14**	**9=**

Source: Morningstar, Edison Investment Research. Note: *Performance to 28 January 2019. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

MUT is a member of the Association of Investment Companies' UK Equity Income peer group, one of the largest equity sectors, with 23 constituents. Unlike the open-ended equivalent IA UK Equity Income sector, there is no requirement for funds in the peer group to target a higher dividend yield than the FTSE All-Share, although MUT is one of those that does have such a target. The trust's NAV total returns are above the sector average over one and three years (ranking sixth and fifth, respectively), broadly in line over five years, and below average over 10 years. Ongoing charges are below average, and MUT does not have a performance fee. The discount to NAV is currently a little wider than average, although it has narrowed significantly over the past three months, and the level of gearing is below average. MUT's dividend yield of 4.5% is currently in line with the All-Share dividend yield, and is slightly above the sector average, ranking equal ninth.

The board

There are currently five directors on the board of MUT, all non-executive and independent of the manager. Neil Rogan joined the board in 2013, and has been chairman since November 2017, following the retirement of Neil Honebon. Jean Park was appointed in 2012, and became senior independent director in November 2018 following the retirement of David Woods. Donald Cameron MSP has served on the board for six years, and two new directors were appointed during FY18 – Peter Tait (in November 2017) and Stephanie Eastment (in August 2018). Eastment is now chairman of the audit committee, a role previously undertaken by Park. Mike Balfour also stepped down from the board in FY18. Historically, MUT has had six directors, and a search is currently under way for a new board member. The directors have backgrounds in investment management, insurance, accountancy and law.

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